

bae urban economics

City of Bloomington, Minnesota
Affordable Housing Nexus Study and Feasibility Analysis
November 9, 2019



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Dear Mr. Johnson:

We are pleased to present the Affordable Housing Nexus Study and Feasibility Analysis report. It has been a pleasure working with you and your staff on this project.

Sincerely,



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INTRODUCTION

This report documents the quantitative nexus, or relationship, between new market rate rental housing development and the need for additional affordable housing in the City of Bloomington. This is done using the industry standard approach of estimating the new employment generated by the new development due to new household spending, then by estimating the likely combined household incomes associated with new worker households. This study also evaluates the cost of providing new affordable housing units and translates those costs to represent the maximum per square foot fee that would need to be assessed on new residential development to adequately offset induced demand for affordable housing. Based on this nexus, the study evaluates the impact of these “maximum justifiable” fees on the financial feasibility of new development. The report concludes with recommendations for development of an inclusionary housing policy and fee schedule that are intended to ensure that the ordinance is justifiable and legally defensible and 2) that impact fees (also known as in-lieu fees) are set at levels that adequately account for the cost of providing affordable housing and encourage on-site production of affordable housing units, while not creating undue constraints to the financial viability of new market rate housing developments.

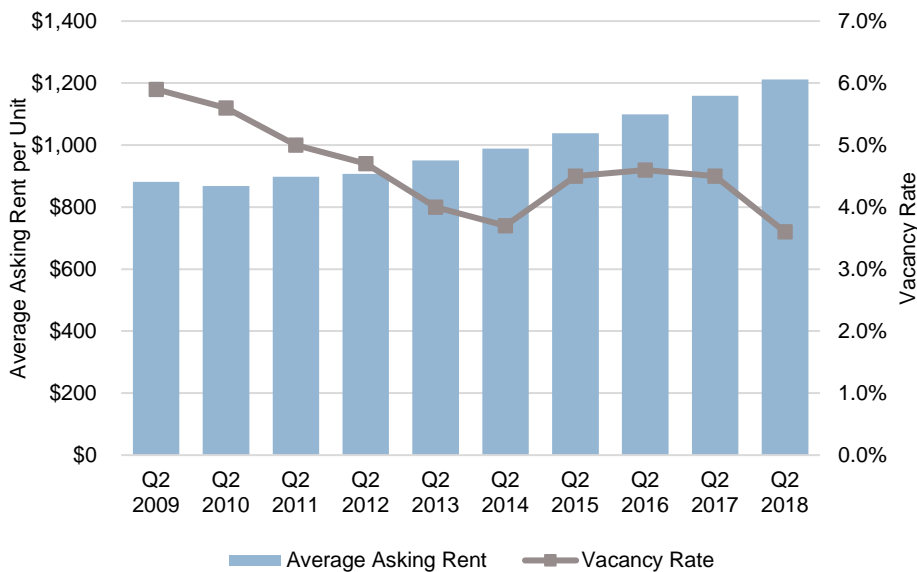
HOUSING NEEDS ASSESSMENT

For the purposes of this research, BAE conducted an abbreviated affordable housing needs assessment intended to provide the City with some insight into the minimum household income that is required to comfortably afford an average market rate rental housing unit. The City also completed a Comprehensive Housing Needs Analysis in May 2018, which provides additional in-depth analysis and is available on the City’s website.¹

Rental Housing Market Overview

Following the onset of the Great Recession in 2008, the average rental rate for multifamily housing in Bloomington remained relatively stable, until roughly 2012 when rates began to increase at an average rate of around five percent per year. As illustrated in Figure 1, average vacancy in Bloomington decreased steadily from 2009 through 2014, before stabilizing, with some fluctuation, at around 4.5 percent between 2014 and 2017. As of the second quarter of 2018, vacancy rates again dropped below four percent.

Figure 1: Multifamily Rental Rate and Vacancy Trends, City of Bloomington, Q2 2009 to Q2 2018



Sources: CoStar, 2018; BAE, 2018.

¹ Maxfield Research & Consulting. (May 2018). *Comprehensive Housing Needs Analysis for the City of Bloomington, Minnesota*. Bloomington, MN: Bloomington Housing and Redevelopment Agency. Available at: https://www.bloomingtonmn.gov/sites/default/files/media/1854-01%20Bloomington%20Housing%20Needs%20Analysis_05_05_2017%20%28002%29_0.pdf

Based on data from CoStar, which tracks rental housing properties with 50 units or more, the majority of the larger multifamily rental complexes in Bloomington include mostly one- and two-bedroom apartments, with studio and three-bedroom units accounting for only 10 percent of the total stock. Vacancy among all unit types is relatively low at 5.5 percent or below. Average market rate rents across all larger complexes range from \$935 for a studio to \$1,529 for a three bedroom, with one- and two-bedroom units priced in between at \$1,100 and \$1,351, respectively. The average rental rate for larger complexes increased by 4.6 percent since the second quarter of 2017. The average rental rate for one-bedroom units increased the most at 5.8 percent, while rate increases among other unit sizes were below four percent. For additional details on current rental housing market conditions, please refer to Table 1, below.

Table 1: Multifamily Rental Housing Market Overview, City of Bloomington, Q2 2017 and Q2 2018

City of Bloomington	Studio	1-Bedroom	2-Bedroom	3-Bedroom	All Sizes (a)
Inventory, Q2 2018 (units)	542	4,302	3,798	348	9,173
Percent of Units (b)	6.0%	47.9%	42.2%	3.9%	100%
Occupied Units	520	4,142	3,661	342	8,842
Vacant Units	22	160	137	6	331
Vacancy Rate	5.4%	4.4%	4.1%	4.5%	4.3%
Avg. Asking Rents, Q2 2017 - Q2 2018					
Avg. Asking Rent, Q2 2017	\$906	\$1,040	\$1,302	\$1,473	\$1,159
Avg. Asking Rent, Q2 2018	\$935	\$1,100	\$1,351	\$1,529	\$1,212
% Change Q2 2017 - Q2 2018	3.2%	5.8%	3.8%	3.8%	4.6%
Under Construction, Q2 2018 (units)	32	16	16	0	64
Deliveries, Q1 2010 - Q2 2018 (units)	1,341	763	439	28	2,571

Notes:

(a) The totals for each unit size do not sum to the total for all units because some units in the CoStar database lack classification by number of bedrooms.

(b) Percent of units for which the number of bedrooms is known.

Sources: CoStar, 2018; BAE, 2018.

To identify current average rental rates for newly built rental housing, BAE contacted a selection of newly developed properties that were recommended by City staff. These include Luxembourg, IndiGo Apartments, The Covington, Genesee Apartments and Townhomes, and One Southdale Place. The Preserve at Normandale Lake was also identified but indicated by Staff to be targeted toward the very top of the market and, thus, is not representative of most of the new housing expected to be built in Bloomington in the near future. Table 2, below, reports the average rental rate and square footage by unit type at these properties. Note that the weighted average rents at these new complexes are notably higher than the market-wide average at nearly \$1,800 per month, compared to roughly \$1,200 per month.

Table 2: Multifamily Rental Housing Market Overview, Selected New Construction, City of Bloomington, August 2018

Unit Type	Total Units	Per Unit		Rent Per Sq. Ft.
		Sq. Ft.	Rent	
Studio	85	575	\$1,400	\$2.43
1-Bedroom	806	830	\$1,629	\$1.96
2-Bedroom	457	1,176	\$2,086	\$1.77
3-Bedroom	20	1,391	\$2,233	\$1.60
All Units	1,368	938	\$1,776	\$1.89

Note:

(a) Based on a survey of the following projects:

- The Preserve at Normandale Lake
- Luxembourg
- IndiGO Apartments
- The Covington
- Genesee Apartments & Townhomes
- One Southdale Place

Sources: Apartment Complex Owners and Managers, 2018; BAE, 2018.

Rental Housing Affordability

To assess the relative affordability of rental housing in Bloomington, BAE calculated what households at different income levels could afford to pay. This analysis assumes that households may reasonably dedicate up to 30 percent of their income to housing without becoming overly cost burdened. This is consistent with applicable local, state, and federal standards. The analysis also accounts for a reasonable utility allowance using data published by HousingLink.org for the Bloomington Housing and Redevelopment Agency (HRA).²

Special Note on Income Limits

There are a wide variety of income limits published by various state and federal agencies. The most common source for data on the maximum income for households within the commonly accepted income categories (i.e., extremely low-, very low-, low-, moderate-, and above moderate-income) is the U.S. Department of Housing and Urban Development (HUD). HUD publishes income limits annually for two of its largest funding programs, the Home Investment Partnerships Program (HOME) and the Community Development Block Grant (CDBG) Program. HUD uses a simple formula to calculate the maximum household income within each income category by household size, but also makes adjustments to the income limits based on a variety of factors, including accounting for high-cost markets. The income categories are defined as a percentage of the HUD Adjusted Median Family Income (HAMFI). HUD publishes income limits for the extremely low- (30 percent of HAMFI), very low- (50 percent of HAMFI), and low-income (80 percent of HAMFI) categories, as well as a fourth breakout for households earning 60 percent of HAMFI. HUD does not typically report the median income by household size, except for four-person households. The use of various adjustments, as well as the lack of

² Available at: <https://www.housinglink.org/SubsidizedHousing/HousingAuthorityWaitingList/bloomington-hra>

published median income data, makes it difficult to use the HUD income limits for analyses that do not rely on the standard income categories provided in the dataset.

For this analysis, the City of Bloomington wanted to evaluate what an ideal income threshold would be for use in an inclusionary housing ordinance (IHO). This required BAE to calculate income limits for non-standard income categories as a percentage of the area median income (AMI), such as moderate-income (120 percent of AMI). With the City's approval, BAE chose to use income limits for Hennepin County that are published by Minnesota Housing, the state's housing finance agency.³ The income limits used are effective as of April 1, 2018 and are for projects placed in services on or after that date (Table K).

Affordable Rental Rates

Using the income limits from Minnesota Housing and the Bloomington HRA utility allowances, BAE calculated the maximum rental rate that could be considered affordable to households within an array of income categories by unit size. The analysis assumes that households of different sizes can occupy different sized units, assuming either one person per bedroom or one person per bedroom plus one additional resident (e.g., two parents and one child). Based on a comparison between the affordable rental rates reported in Table 3 and the average rental rates reported in Table 1, BAE determined that households at 60 percent of AMI and below would struggle to afford an average priced housing unit, regardless of unit size, without incurring an undue housing cost burden or living in overcrowded conditions.⁴ This means that households earning 60 percent of AMI or below are likely to struggle to locate and secure market rate rental housing in Bloomington that is reasonably affordable, either in newly developed or existing properties. The data indicate that households earning the median income could likely afford the current weighted average rent for newly constructed studio or one-bedroom units, while two- and three-bedroom units are not affordable at median incomes, but area affordable to moderate-income households (120 percent of AMI) and above.

³ Available at: <http://www.mnhousing.gov/wcs/Satellite?cid=1362997094928&pagename=External%2FPage%2FEXTStandardLayout>

⁴ Households face an undue cost burden when housing costs, including cash rent and utilities, exceed 30 percent of income. Overcrowding is often defined in two different ways. The definition used here specifies that a household is overcrowded if the number of persons living in the unit exceeds one person per bedroom, plus one.

Table 3: Estimated Affordable Rental Rates, Hennepin County, 2018 (Page 1 of 2)

Income Category (a)	Income Limits/Household Size				
	1 Person	2 Person	3 Person	4 Person	5 Person
Median Family Income: \$94,300					
Extremely Low (30% AMI)	\$19,830	\$22,650	\$25,470	\$28,290	\$30,570
Very Low (50% AMI)	\$33,050	\$37,750	\$42,450	\$47,150	\$50,950
60% AMI	\$39,660	\$45,300	\$50,940	\$56,580	\$61,140
Low (80% AMI)	\$52,880	\$60,400	\$67,920	\$75,440	\$81,520
Median (100% AMI)	\$66,100	\$75,500	\$84,900	\$94,300	\$101,900
Moderate (120% AMI)	\$79,320	\$90,600	\$101,880	\$113,160	\$122,280

Affordable Rents (b)	Unit Size				
	Studio	1-Bedroom	2-Bedroom	3-Bedroom	4-Bedroom
Utility Allowance (c)	\$76	\$86	\$106	\$114	\$131
Extremely Low (30% AMI)					
1-Person	\$420	\$410			
2-Person		\$480	\$460		
3-Person			\$531	\$523	
4-Person				\$593	\$576
5-Person					\$633
Very Low (50% AMI)					
1-Person	\$750	\$740			
2-Person		\$858	\$838		
3-Person			\$955	\$947	
4-Person				\$1,065	\$1,048
5-Person					\$1,143
60% AMI					
1-Person	\$916	\$906			
2-Person		\$1,047	\$1,027		
3-Person			\$1,168	\$1,160	
4-Person				\$1,301	\$1,284
5-Person					\$1,398
Low (80% AMI)					
1-Person	\$1,246	\$1,236			
2-Person		\$1,424	\$1,404		
3-Person			\$1,592	\$1,584	
4-Person				\$1,772	\$1,755
5-Person					\$1,907
Median (100% AMI)					
1-Person	\$1,577	\$1,567			
2-Person		\$1,802	\$1,782		
3-Person			\$2,017	\$2,009	
4-Person				\$2,244	\$2,227
5-Person					\$2,417
Moderate (120% AMI)					
1-Person	\$1,907	\$1,897			
2-Person		\$2,179	\$2,159		
3-Person			\$2,441	\$2,433	
4-Person				\$2,715	\$2,698
5-Person					\$2,926

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Sources: Minnesota Housing, Multifamily Tax Subsidy Projects, Table K, 2018; HousingLink.org, Bloomington Housing and Redevelopment Authority, Utility Allowance, 2018; Apartment Owners and Managers, 2018; BAE, 2018.

Table 3: Estimated Affordable Rental Rates, Hennepin County, 2018 (Page 2 of 2)

Notes:

(a) Based on the Minnesota Housing Finance Agency Housing Tax Credits and Tax Exempt Bond Income and Rent Limits for 2018.

(b) Affordable rents equal up to 30 percent of gross monthly income, minus a utility allowance.

(c) Based on the utility allowance published by HousingLink.org for the Bloomington Housing and Redevelopment Agency (HRA).

Includes all electric utilities, except for natural gas heat and water heating, with water, sewer, and trash collection included in the monthly rental rate.

Sources: Minnesota Housing, Multifamily Tax Subsidy Projects, Table K, 2018; HousingLink.org, Bloomington Housing and Redevelopment Authority, Utility Allowance, 2018; Apartment Owners and Managers, 2018; BAE, 2018.

NEXUS ANALYSIS FOR NEW HOUSING

This following chapter quantifies the link between new rental residential development and changes in demand for additional below market rate (BMR) housing. The resultant demand for BMR housing, as well as the estimated cost of providing BMR units, are used to estimate the per square foot fee that could be levied, allowing the City of Bloomington to subsidize new BMR housing development, thus offsetting the new induced affordable housing demand.

The Nexus Methodology

The current industry standard methodology for conducting residential nexus analysis is typically broken down into the following five steps:

1. Identify the number of new housing units included in the new market rate development and to identify the target pricing (i.e., average rental rate).
2. Estimate the minimum income associated with new resident households based on standard affordability criteria (i.e., 30 percent of income to housing, including rent and a reasonable utility allowance).
3. Identify how new household spending associated with occupant households will contribute to local job growth, particularly in the retail and service sectors.
4. Convert jobs to worker households, identifying the number of new worker households by income level, which is synonymous with new housing demand.
5. Calculate the maximum justifiable fee based on the estimated financing gap per affordable housing unit demanded by new worker households per market rate unit.⁵

Estimated New Housing Demand

As noted above, the first step in this analysis is to determine the affordable housing need generated by new rental housing development. To do this, BAE uses the weighted average rental rate among selected new rental housing developments as a benchmark for the current market rate rents that can be supported within newly constructed apartment projects.

Assuming that each household spends no more than 30 percent of their income on housing, BAE then estimates the household income associated with newly occupied units. BAE then uses the Impacts Analysis for Planning (IMPLAN) software package to identify the number of new jobs by industry that would be created due to new household spending. BAE then uses

⁵ The affordable housing financing gap is the difference between the cost of developing a given unit, minus the value that the unit can support when occupied at below market rates. The financing gap for a rental unit is equal to the difference between the cost of development, minus the value of the permanent loan that could be supported based on the net operating income of the unit (i.e., gross rental receipts, minus operating expenses).

the U.S. Census Bureau’s Public Use Microdata Sample (PUMS) dataset to identify the combined household incomes (i.e., for households with multiple wage earners) associated with households containing workers employed in the impacted industry sectors, to identify the portion of new workforce housing demand that would require below market rate housing.

Estimated Household Incomes in New Market Rate Housing Developments

Expenditures made by households who occupy newly constructed market rate housing units are the first in a chain of actions that lead to additional induced demand for new affordable housing for workforce households that cannot afford to rent market rate housing. Household expenditures on goods and services are correlated to household income levels, and the cost of housing dictates the income necessary to afford that housing without overpayment.

Table 4 presents the annual household income required to rent a newly constructed multifamily apartment unit in Bloomington. Assuming that households spend no more than 30 percent of their income on housing costs, including rent and utilities, the income required to rent a newly constructed two-bedroom multifamily unit in Bloomington is \$75,842 per year.

Table 4: Household Income Required to Rent New Housing

Average Monthly Rent (a)	\$1,800
Utility Cost (b)	\$96
Monthly Housing Costs for New Unit	\$1,896
Annual Housing Costs	\$22,752
Household Income Required (c)	\$75,840
Number of Households in Development (d)	100
Aggregate Household Income (Millions)	\$7,584,000

- Notes:
- (a) Based on the weighted average rental rate at a selection of newly constructed projects identified by City staff as likely to be representative of future development projects in the City of Bloomington.
 - (b) Based on the utility allowance published by HousingLink.org for the Bloomington Housing and Redevelopment Agency (HRA). The figure used here represents the mid-point between the reported utility allowance for one- and two-bedroom apartment units. Includes all electric utilities, except for natural gas heat and water heating, with water, sewer, and trash collection included in the monthly rental rate.
 - (c) Assumes that housing costs do not exceed: 30% of income
 - (d) This analysis assumes that the hypothetical development project contains a total of 100 units. This assumption provides for ease of analysis and does not impact the results of the analysis.

Sources: HousingLink.org, Bloomington Housing and Redevelopment Authority, Utility Allowance, 2018; BAE, 2018.

Estimate Impacts on Industries and Employment

Having estimated the household incomes associated with the rental of new market rate housing in Bloomington, the next step is to identify how the household expenditures of those new households translate to new demand for goods and services. That new spending consequently supports new jobs in goods and service-producing industries. To estimate the effect of new household spending on employment generation, this nexus study uses IMPLAN, a widely-accepted and utilized input-output economic impact modeling software and data package. At the heart of the model is an input-output dollar flow table. For a specified region,

the input-output table accounts for all dollar flows between different sectors of the economy, including households, businesses, and the government. Using this information, the IMPLAN software models the way income injected into the economy is spent and re-spent across all sectors, generating waves of economic activity, or so-called “economic multiplier” effects. Appendix A provides a summary of the IMPLAN economic impact software and data package.

The IMPLAN model measures economic activity using a number of different metrics, including jobs, and is able to estimate the number of jobs generated by a given economic “event.” For the purpose of this analysis, the economic “event” is household spending by occupants of new residential units in Bloomington. For example, by expanding the local demand for grocery store products, these household expenditures generate additional jobs for cashiers and courtesy clerks at grocery stores patronized by the households. The process initiated by household expenditures continues as these workers and the businesses they work for spend money in subsequent transactions, supporting employment at places other than the initial point of sale, such as wholesalers supplying retail stores, or truck drivers delivering goods to those stores. In turn, these businesses and workers spend money to generate additional activity in the local economy. These are all parts of the impacts linked to the household expenditures that IMPLAN tracks through the economy of the specified region; in this case, Hennepin County.

The IMPLAN model is customized to reflect the economic characteristics of a specified region. The nexus analysis considers regional employment generation, rather than jobs generated in Bloomington exclusively, because household spending in Bloomington creates jobs throughout the region. If the analysis solely considered workers living in Bloomington, it would effectively discount the needs of worker households that do not have incomes necessary to live in Bloomington. In other words, the analysis examines employment effects in Bloomington and beyond its borders linked to housing development in the City in order to address the City’s “fair share” of regional housing need. Housing need is based on the number of households rather than the number of jobs. As such, jobs are translated into households by dividing the number of jobs in each income category by the average number of workers per worker household in Hennepin County.⁶

Estimate of Household Incomes of Workers in Affected Industries

Worker households often have more than one person who contributes to household income.⁷ In some instances, economists estimate household income for workers by simply multiplying worker earnings, by industry, by the average number of workers per worker household. This methodology relies on the unsatisfactory assumption that, on average, each employed household member generates the same amount of income as other workers in his or her

⁶ Average workers per worker household from American Community Survey (ACS), 2012-2016.

⁷ A worker household is defined as a household with one or more employed persons. They may be wage and salary workers, or self-employed/sole proprietors.

household. Given the diversity of household composition, this assumption is not appropriate. For example, a household may include a teacher and a doctor, with significantly different individual earnings.

To address this issue, this analysis makes use of a detailed data set published by the U.S. Census Bureau called the Public Use Microdata Sample (PUMS). The dataset is derived from a five percent sample of all households published as part of the American Community Survey (ACS). This data source allows cross-tabulation of variables, such as industry of employment and household income. This analysis uses the most recent available PUMS data for Hennepin County, based on the 2012 through 2016 five-year ACS survey period.

BAE queried the PUMS data to identify the number of households, by income category (controlling for household size), by industry. This generated a household income distribution by industry, constructed based on income categories, as defined by Minnesota Housing, benchmarked against AMI, and adjusted based on household size and percentage of that AMI. The resulting household income distribution by industry is shown below, in Table 5.

Housing Demand Generated by Household Expenditures by Income Level

As mentioned above, new worker housing demand is a function of the level of household spending associated with households that occupy new market rate housing units. Table 6 applies the income distribution by industry to the number of jobs generated in each industry as a result of spending by households residing in new rental housing units. As shown, the new household spending associated with a new 100-unit apartment complex supports a total of 35 new worker households across various income groups, with approximately nine of those households earning incomes of 60 percent of AMI or below.

Table 5: Household Income Level by Industry

NAICS Code	Industry	Estimated Household Income as a Percent of AMI (a)						Total
		Extremely Low (30% AMI)	Very Low (50% AMI)	(60% AMI)	Low (80% AMI)	Moderate (120% AMI)	Above Moderate (>120% AMI)	
Private Sector								
11, 21	Agriculture & Natural Resources	3.8%	1.1%	6.3%	8.5%	22.0%	58.3%	100%
23	Construction	5.1%	6.9%	3.8%	10.5%	25.9%	47.7%	100%
31-33	Manufacturing	3.0%	5.5%	4.0%	7.8%	21.2%	58.4%	100%
42	Wholesale Trade	3.6%	2.9%	3.3%	9.1%	21.7%	59.4%	100%
44-45	Retail Trade	5.5%	9.6%	5.7%	10.2%	23.1%	45.9%	100%
48-49, 22	Transportation, Warehousing, & Utilities	4.3%	10.4%	5.9%	8.7%	25.1%	45.5%	100%
51	Information	2.2%	3.8%	6.2%	9.0%	23.3%	55.4%	100%
52-53	Finance, Insurance, & Real Estate	1.9%	3.8%	2.9%	8.7%	18.1%	64.6%	100%
54-55	Professional, Scientific, & Technical Services, & Mgmt of Companies	2.1%	2.9%	2.3%	6.1%	17.8%	68.8%	100%
56	Admin, Support, & Waste Mgmt Srvcs	10.6%	13.1%	4.8%	15.1%	20.6%	35.8%	100%
61	Educational Services	6.9%	9.2%	3.3%	9.6%	20.8%	50.2%	100%
62	Health Care & Social Assistance	6.1%	8.6%	6.5%	10.5%	19.7%	48.5%	100%
71-72	Leisure & Hospitality	10.5%	14.2%	7.4%	13.8%	22.3%	31.8%	100%
81	Other Services Except Public Admin	6.2%	12.1%	3.9%	14.3%	22.2%	41.3%	100%
All Government	Government	3.8%	4.7%	3.3%	8.5%	24.7%	55.0%	100%

Note:

(a) Based on a cross tabulation of Public Use Microdata Samples (PUMS) from the 2012-2016 American Community Survey. These incomes were compared to household income limits published by the Minnesota Housing Finance Agency for 2016 and as calculated by BAE to determine the percentage of households falling into each income category. The analysis controlled for household size, to address the varying HUD income limits for each household size.

Sources: American Community Survey, 2012-2016 Public Use Microdata Sample, 2018; Minnesota Housing Finance Agency, 2018; IMPLAN, 2018; BAE, 2018.

Table 6: Employment Generation by Income Level from New Rental Housing Project with 100 Units

NAICS Code	Industry	Total Jobs (b)	Estimated Jobs by Percent of AMI (a)					Above Moderate (>120% AMI)
			Extremely Low (30% AMI)	Very Low (50% AMI)	(60% AMI)	Low (80% AMI)	Moderate (120% AMI)	
Private Sector								
11, 21	Agriculture & Natural Resources	0.01	0.00	0.00	0.00	0.00	0.00	0.01
23	Construction	0.47	0.02	0.03	0.02	0.05	0.12	0.23
31-33	Manufacturing	0.23	0.01	0.01	0.01	0.02	0.05	0.14
42	Wholesale Trade	1.40	0.05	0.04	0.05	0.13	0.30	0.83
44-45	Retail Trade	8.64	0.47	0.83	0.49	0.88	2.00	3.96
	Transportation, Warehousing, & Utilities	1.53	0.07	0.16	0.09	0.13		0.70
48-49, 22	Utilities						0.38	
51	Information	0.92	0.02	0.03	0.06	0.08	0.21	0.51
52-53	Finance, Insurance, & Real Estate	7.83	0.15	0.30	0.22	0.68	1.42	5.06
54-55	Professional, Scientific, & Technical Services, & Mgmt of Companies	2.79	0.06	0.08	0.06	0.17		1.92
56	Admin, Support, & Waste Mgmt Svcs	2.82	0.30	0.37	0.13	0.43	0.58	1.01
61	Educational Services	1.97	0.14	0.18	0.06	0.19	0.41	0.99
62	Health Care & Social Assistance	12.58	0.77	1.08	0.82	1.33	2.48	6.11
71-72	Leisure & Hospitality	9.14	0.96	1.30	0.68	1.26	2.04	2.91
81	Other Services Except Public Admin	6.72	0.42	0.81	0.27	0.96	1.49	2.77
All Government Employment		0.19	0.01	0.01	0.01	0.02	0.05	0.10
Total Jobs		57.26	3.44	5.25	2.97	6.32	12.04	27.24
Workers per Households (c)		1.65	1.23	1.38	1.43	1.45	1.69	1.88
Number of Households		34.66	2.80	3.79	2.08	4.34	7.12	14.53
Percent of Base Project (d)			2.8%	3.8%	2.1%	4.3%	7.1%	14.5%
<i>Cumulative</i>			<i>2.8%</i>	<i>6.6%</i>	<i>8.7%</i>	<i>13.0%</i>	<i>27.3%</i>	<i>34.7%</i>

Notes:

(a) Based on 2016 Tax Credit Income Limits; 80% to 120% limits calculated by BAE.

(b) Job estimates are the output of the IMPLAN model, and show s employment generated by household spending. Columns to right may not sum to Total Jobs due to independent rounding.

(c) Average number of w orkers per w orker household by income category calculated based on American Community Survey PUMS Analysis, 2012-2016.

(d) Represents induced w orkforce housing demand w ithin each income bracket as a percentage of the original project (i.e., 100 market rate units).

Sources: American Community Survey, 2012-2016 Public Use Microdata Sample, 2018; Minnesota Housing Finance Agency, 2018; IMPLAN, 2018; BAE, 2018.

Cost to Provide Affordable Workforce Housing

This section describes the methodology used to estimate subsidies needed to provide affordable housing, in the form of below market rate rental apartments. As discussed earlier in this report, there are standard criteria for estimating the maximum monthly rent that a household at a given income level can reasonably afford without incurring excessive costs. The accepted methodology for calculating rental housing subsidies is to compare the estimate cost to develop a given housing unit with the maximum permanent loan amount that can be supported based on the rent that households at the target income level can afford to pay. The remaining gap is then assumed to be equal to the subsidy that would need to be secured by a developer in order to construct the unit.

Cost to Provide Affordable Rental Units

Table 3, provided earlier in this report, calculates the maximum affordable monthly rent that households at each income level can afford to pay based on standard affordability criteria, which calls for renters to spend no more than 30 percent of their household income on monthly rent and utilities. The resulting figures represent the range of maximum monthly rents that an affordable housing operator could charge tenants at each income level.

Table 7 documents a series of calculations that estimate the net operating income that an affordable housing developer would earn, when renting apartments at the restricted rent levels, for households at each income level. The net operating income (NOI) is equal to total scheduled rents, less a vacancy allowance and operating expense charge. NOI ranges from negative \$119 per month (i.e., operating subsidy required from other sources) to \$1,460 per month, for units rented to extremely low- and moderate-income households, respectively.

The net operating income determines the amount of money that an affordable housing developer can borrow in order to secure funding to develop affordable housing. This amount is a function of the loan underwriting terms for the developer's permanent mortgage. Table 7 assumes prevailing bank lending terms, including a 1.15 debt service coverage ratio, a 30-year loan term, and a fixed interest rate of 4.75 percent per year. A debt service coverage ratio of 1.15 means that the project's monthly net operating income must equal 1.15 times the monthly required loan payment. Table 7 shows that the monthly supportable debt service per unit ranges from \$0 for an extremely low-income unit to \$1,270 for a moderate-income unit. Based on the estimated monthly debt service amounts and the loan term and interest rate, Table 7 reports that the maximum supportable loan amounts for apartment units range from \$0 for the extremely low-income unit to \$243,513 for the moderate-income unit.

Next, Table 7 presents an estimated development cost of \$259,784 per workforce apartment unit, based on *2019 Housing Tax Credit Cost Containment Thresholds* published by Minnesota Housing. Then, the bottom line of Table 7 presents the results from subtracting the supportable loan amounts for each household income level from the estimated apartment

construction cost, yielding financing gaps that range from \$259,784 per unit for extremely low-income units, to \$16,271 for moderate-income units.

Table 7: Financing Gap, Rental Housing

	Income Level				
	Extremely Low	Very Low		Low	Moderate
	(30% AMI)	(50% AMI)	(60% AMI)	(80% AMI)	(120% AMI)
Household Income Limit (a)	\$22,650	\$37,750	\$45,300	\$60,400	\$90,600
Maximum Affordable Monthly Rent Per Unit (b)	\$480	\$858	\$1,047	\$1,424	\$2,179
Monthly Operating Expenses (c)	\$566	\$566	\$566	\$566	\$566
Vacancy (d)	7%	7%	7%	7%	7%
Net Operating Income Per Unit (e)	(\$119)	\$232	\$407	\$758	\$1,460
Net Operating Subsidy from Other Sources (f)	\$119	\$0	\$0	\$0	\$0
Monthly Supportable Debt Service Per Unit (g)	\$0	\$201	\$354	\$659	\$1,270
Loan Amount (h)	\$0	\$38,618	\$67,793	\$126,238	\$243,513
Affordable Unit Development Cost (i)	\$259,784	\$259,784	\$259,784	\$259,784	\$259,784
Financing Gap Per Affordable Unit (j)	\$259,784	\$221,166	\$191,991	\$133,546	\$16,271

Notes:

- (a) Based on the Minnesota Housing Finance Agency Housing Tax Credits and Tax Exempt Bond Income and Rent Limits for 2018 assuming an average two-person household.
- (b) Affordable rents equal up to 30 percent of gross monthly income, minus a utility allowance based on the utility allowance published by HousingLink.org for the Bloomington Housing and Redevelopment Agency (HRA). Includes all electric utilities, except for natural gas heat and water heating, with water, sewer, and trash collection included in the monthly rental rate.
- (c) Based on an average expense ratio of 35 percent for units rented at the moderate income level.
- (d) Based on the standard underwriting criteria for tax credit affordable housing as reported by Minnesota Housing.
- (e) Affordable monthly rent minus operating expenses and vacancy.
- (f) Operating subsidy is necessary for units that generate a negative net operating income based on the restricted rent level.
- (g) Net operating income plus operating subsidy, divided by the debt coverage ratio: 1.15
- (h) Assumes the following financing terms:

Interest Rate 4.75%
Term of Loan 30 years

- (i) Based on the 2019 Housing Tax Credit Cost Containment Thresholds, as published by Minnesota Housing.
- (j) Total development cost per unit minus the per unit supportable loan amount.

Sources: Minnesota Housing, Multifamily Tax Subsidy Projects, Table K, 2018; HousingLink.org, Bloomington Housing and Redevelopment Authority, Utility Allowance, 2018; BAE, 2018.

Maximum Justifiable Fees

Table 8 8 synthesizes information from Table 3 through Table 7, to calculate the maximum justifiable housing impact, or in-lieu, fees that could be charged to market rate housing developers to offset the costs associated with of satisfying new induced housing demand. The upper part of the table summarizes the estimated new induced housing demand, by income level, resulting from construction and occupancy of 100 new market rate rental housing units. Note that these values are cumulative. For example, to identify the estimated induced demand for housing among households earning 60 percent of AMI or less, sum the reported values for the three income categories ranging from 30 percent to 60 percent of AMI. The second section reports the estimated average financing gap per affordable unit, by income

level. The third section shows the total dollar value associated needed to close the financing gap for the newly demanded housing units. The fourth section calculates the relative fee that could be charged per market rate housing unit by dividing the total financing gap by 100. BAE also estimated the per square foot equivalent, assuming an average unit size of 938 square feet for new market rate construction. Note, again, that the maximum justifiable fee estimates are cumulative. Thus, if the inclusionary housing policy is ultimately designed to offset the costs associated with providing housing to households earning 60 percent of AMI or less, recognizing that households earning more than 60 percent of AMI can likely secure market rate housing, it would be appropriate to sum the maximum justifiable fee estimates associated with the income levels equal to 60 percent of AMI or less. In this example, the maximum justifiable fee would equal approximately \$19,663 per market rate unit, or \$20.97 per leasable square foot within the market rate component of a project.

Table 8: Maximum Affordable Housing Impact/In-Lieu Fee Calculation

New Employee Households (a)		
Extremely Low (30% AMI)		2.80
Very Low (50% AMI)		3.79
(60% AMI)		2.08
Low (80% AMI)		4.34
Moderate (120% AMI)		7.12
Total, Affordable Housing Need		20.14
Financing Gap Per Unit		
Extremely Low (30% AMI)		\$259,784
Very Low (50% AMI)		\$221,166
(60% AMI)		\$191,991
Low (80% AMI)		\$133,546
Moderate (120% AMI)		\$16,271
Affordability/Financing Gap (a)(b)		
Extremely Low (30% AMI)		\$728,374
Very Low (50% AMI)		\$838,638
(60% AMI)		\$399,265
Low (80% AMI)		\$580,100
Moderate (120% AMI)		\$115,837
Total, Affordability/Financing Gap		\$2,662,214
Max. Justifiable Fee (c)	Per Market Rate Unit	Per Market Rate Sq. Ft. (d)
Extremely Low (30% AMI)	\$7,284	\$7.77
Very Low (50% AMI)	\$8,386	\$8.94
(60% AMI)	\$3,993	\$4.26
Low (80% AMI)	\$5,801	\$6.19
Moderate (120% AMI)	\$1,158	\$1.24

Notes:

- (a) Per 100 market rate housing units.
- (b) Calculated by multiplying the number of worker households at each income level by the financing gap per unit at each affordability level.
- (c) To identify the fee sufficient to address demand across a range of incomes, sum the values for each target income category.
- (d) Assumes an average market rate unit size, across all unit types, of approximately 938 square feet.

Sources: BAE, 2018.

FINANCIAL FEASIBILITY ANALYSIS

This chapter presents the results of preliminary feasibility analysis for prototype projects completed by BAE, and then discusses commentary received from the development community regarding the methodology and findings from the preliminary analysis.

Methodology and Analysis

The following financial feasibility analysis uses static pro-forma financial modeling techniques, which involve estimating the developer's costs to undertake the project and the value of the completed projects, in order to calculate the estimated profit accruing to the developer.

At the direction of City staff, BAE conducted this analysis using three different rental housing prototype projects. These include a “low-rise” prototype on 3.44 acres at 25 dwelling units per acre (du/a), a “mid-rise” prototype on 4.59 acres at 60 du/a, and a “high-rise” prototype on 2.75 acres at a density of 90 du/a. The low-rise prototype is intended to represent the type of rental apartment housing that Bloomington has typically seen built during prior cycles, while the mid-rise prototype represents the type of multifamily housing that is more commonly being built within the current market. The high-rise prototype is intended to represent a type of multifamily development that the City would like to see more of in the near future, as the market dictates. The purpose of these three prototypes is to help the City better understand how an inclusionary housing requirement may reasonably impact profitability, making sure that the policy requirements do not unduly burden developers while encouraging the production of the required below market-rate housing.

Assuming that rental housing prices and consumer preferences regarding unit size and finish quality are dictated by consumers and the market et. al, this analysis uses the same basic distribution of units by size and price for each of the three prototypes. The unit size distribution and pricing are based on the characteristics of the newly constructed apartment projects summarized in Table 2. Parking requirements are as estimated by the City. The City of Bloomington currently offers a variety of “flexibility measures” with regard to parking requirements. The total off-street parking requirements applied here account for a typical package of flexibility measures and a typical average number of spaces per unit based on a review of recently approved projects. Development and financing cost information for each prototype was collected through interviews with developers from throughout the Minneapolis-St. Paul region. Wherever possible, BAE uses cost estimates specific to developments in Bloomington, though for some line items, regional estimates were considered adequate, due to the presence of a regional market for construction labor and materials, for example.

As reported in Table 9, the low-rise development prototype is currently the most profitable with a yield on cost (YOC) of 6.53 percent.⁸ This is just over the minimum hurdle rate of return necessary for a regional developer to consider moving forward with the project of 6.25 percent. By comparison, the mid-rise prototype provides a YOC of 4.55 percent, while the high-rise prototype provides the lowest overall YOC of 3.98 percent. These results generally highlight that the current returns to multifamily rental housing development are relatively small. Nonetheless, BAE estimates that under baseline conditions, the low-rise rental housing project that is subject to the inclusionary housing policy could reasonably absorb up to an additional \$9,000 of cost, per market rate unit, in the form of an affordable housing impact, or in-lieu, fee charge. At this level, the YOC for the low-rise development would be reduced to the minimum acceptable level of 6.25 percent.

Please note, however, that there are mid-rise development projects that were recently constructed, or are under development, in Bloomington. There are a number of possible explanations for why the pro-forma modeling exercise differs from real life experience. For example, the unit size distribution for at least one of the known mid-rise projects skews more toward studio and one-bedroom units, compared to the unit size distribution used for this analysis, though the assumptions used here are based on a review of recently developed projects. Assuming sufficient market demand for such units, smaller sized units tend to be less costly to build per unit (even though the per square foot cost is typically higher) and more revenue efficient (i.e., higher rent per square foot). Also, a number of the projects identified in this research also received additional incentives and financial support from local governments, including regulatory relief and subsidy by-way of tax increment financing (TIF). Also, depending on when the developer of the property acquired their land, the land costs associated with the pro-forma financial modeling exercise may overstate such costs, as the model uses an estimate of the current average market rate land price per housing unit.

⁸ Yield on Cost (YOC) is defined as net operating income (NOI) divided by total development cost.

Table 9: Static Proforma Feasibility Analysis for Low-, Mid-, and High-Rise Rental Housing (Page 1 of 2)

Development Program (a)				Major Assumptions				Major Assumptions			
Development Assumptions	Low Rise	Mid Rise	High Rise	Development Cost Factors	Low Rise	Mid Rise	High Rise	Development Costs	Low Rise	Mid Rise	High Rise
Site Size (Acres)	3.44	4.59	2.75	Land Acquisition (Per Unit)(d)	\$31,400	\$31,400	\$31,400	Land Acquisition	\$2,700,400	\$8,635,000	\$7,755,800
Density (Units/Acre)	25	60	90	Site Preparation (Per Site Sq. Ft.)	\$10	\$8	\$6	Site Preparation	\$1,498,464	\$1,599,523	\$720,000
Number of Units	86	275	247	Parking (Per Space)	\$7,000	\$20,000	\$20,000	Parking	\$1,055,880	\$9,074,600	\$7,664,000
Studio	5	17	15	Hard Cost (Per Leasable Sq. Ft.)	\$122	\$190	\$210	Hard Cost	\$9,784,400	\$48,412,000	\$48,006,000
1-Bedroom	51	164	148	Permit & Fees (Per Unit)	\$7,415	\$7,915	\$8,415	Permit & Fees	\$637,690	\$2,176,625	\$2,078,505
2-Bedroom	28	91	82	Housing Impact Fee (Per Unit)	\$0	\$0	\$0	Housing Impact Fee	\$0	\$0	\$0
3-Bedroom	2	3	2	CitySAC Fee (Per Unit)(e)	\$1,415	\$1,415	\$1,415	CitySAC Fee	\$121,690	\$389,125	\$349,505
Average Rental Rate	\$1,762	\$1,756	\$1,755	All Other Fees (Per Unit)(f)	\$6,000	\$6,500	\$7,000	All Other Fees	\$516,000	\$1,787,500	\$1,729,000
Studio	\$1,460	\$1,460	\$1,460	Soft Costs (% of Hard Costs)	20%	20%	20%	Soft Costs	\$1,956,880	\$9,682,400	\$9,601,200
1-Bedroom	\$1,570	\$1,570	\$1,570	Financing Costs (% of Const. Cost)	2.2%	3.2%	4.2%	Construction Costs	\$14,933,314	\$70,945,148	\$68,069,705
2-Bedroom	\$2,130	\$2,130	\$2,130	Project Pricing				Interest Expense	\$283,920	\$2,023,267	\$2,604,943
3-Bedroom	\$2,250	\$2,250	\$2,250	Rental Rate (Per Sq. Ft./Month)	\$1.89	\$1.89	\$1.89	Loan Fees	\$47,320	\$224,807	\$260,494
Average Unit Size	933	927	926	Vacancy Rate	5%	5%	5%	Financing Costs	\$331,240	\$2,248,074	\$2,865,437
Studio	600	600	600	Collections Loss	3%	3%	3%	Total Development Cost	\$17,964,954	\$81,828,223	\$78,690,942
1-Bedroom	800	800	800	Operating Expense	30%	30%	35%	Cost Per Unit Built	\$208,895	\$297,557	\$318,587
2-Bedroom	1,200	1,200	1,200	Profitability Metrics				Project Revenue			
3-Bedroom	1,400	1,400	1,400	Capitalization Rate (CAP)	5.5%	5.5%	5.5%	Gross Scheduled Rents	\$1,821,316	\$5,786,426	\$5,191,432
Leasable Area (Sq. Ft.)	80,200	254,800	228,600	Yield on Cost (YOC)	6.25%	6.25%	6.25%	Less Vacancy/Collections	\$145,705	\$462,914	\$415,315
Common Area Adjustment	30%	30%	30%	Construction Financing				Adjusted Annual Rents	\$1,675,611	\$5,323,512	\$4,776,118
Gross Area (Sq. Ft.)	104,260	331,240	297,180	Annual Interest Rate	4.5%	4.5%	4.5%	Less Operating Expenses	\$502,683	\$1,597,054	\$1,647,761
Off-Street Parking Standards (b)	168	534	479	Loan Fees (% of Loan Amount)	0.75%	0.75%	0.75%	Net Operating Income (NOI)	\$1,172,928	\$3,726,458	\$3,128,357
Studio (1.8 per unit)	9	30.6	27	Loan Term (Months)	12	18	20	Yield on Cost (YOC)	6.53%	4.55%	3.98%
1-Bedroom (1.8 per unit)	91.8	295.2	266.4	Loan to Cost Ratio	65%	65%	79%				
2-Bedroom (2.2 per unit)	61.6	200.2	180.4	Draw down Factor	65%	65%	65%				
3-Bedroom (2.6 per unit)	5.2	7.8	5.2	Permanent Financing							
Average Approved Reduction (c)	10%	15%	20%	Debt Service Coverage (DSC)	1.25	1.25	1.25				
Required Off-Street Parking	151	454	383	Annual Interest Rate	4.75%	4.75%	4.75%				
Spaces Per Unit	1.75	1.65	1.55	Loan Term (Years)	10	10	10				
				Amortization (Years)	30	30	30				

- Notes on Following Page -

Sources: Local Developers and Contractors; City of Bloomington; BAE, 2018.

Table 25: Static Proforma Feasibility Analysis for Low-, Mid-, and High-Rise Rental Housing (Page 2 of 2)

Notes:

- (a) All development assumptions are as specified by the City of Bloomington, with the exception of pricing, unit size, and the common area adjustment, which were defined by BAE. Pricing and unit size assumptions are based on a comparison between six comparable projects (two for each prototype) identified by the City of Bloomington.
- (b) The number of parking spaces is based on minimum off-street parking standards currently in use by the City of Bloomington.
- (c) The City of Bloomington offers several flexibility measures (transit reduction, TDM reduction, shared parking reduction, on-street parking reduction, and proof of parking) that are commonly used for multifamily residential project. The reductions applied here are based on a review of the flexibility measures associated with past approvals conducted by the City of Bloomington.
- (d) The average land cost per newly built residential unit is a weighted average based on a review of comparable land sales in the greater Bloomington area in 2015 and 2016, which was provided to BAE by the City of Bloomington.
- (e) Includes a new fee for sanitary sewer expansion needed to accommodate increased densities.
- (f) Includes all other municipal fees including building permits, inspection fees, certificate of occupancy, plan review fees, utility permits, application fees, impact fees, and other miscellaneous municipal charges.
- (g) Based on project net operating income (NOI) divided by the target developer yield on cost (YOC). This analysis uses YOC, since most developer interviewed for this research anticipate holding the property following completion. An alternative is to use the exit capitalization rate (CAP) that better reflects the ratio of NOI to market sales value.

Sources: Local Developers and Contractors; City of Bloomington; BAE, 2018.

PUBLIC OUTREACH AND ENGAGEMENT

For the purposes of this research, BAE partnered with Daedalus Advisory Services,⁹ which are working under a related contract on behalf of the City of Bloomington, to facilitate to public outreach sessions and one City Council study session regarding the inclusionary housing policy and related nexus and feasibility analyses.

Overview of the Public Outreach Sessions

The two public outreach sessions were held on September 27th, 2018. To encourage diverse participation, one of the outreach session was held in the morning, with another session held in the evening. Both sessions covered the same material. Both sessions included a diverse range of participants, including both for-profit and non-profit housing developers, affordable housing advocates, and members of the general public (both tenants and home owners). The sessions began with presentations from the consultant teams, including BAE and Daedalus. The material covered included a summary of the goals and intended purpose of the inclusionary housing ordinance, a review of pertinent background data regarding affordable housing need in Bloomington, a review of the residential nexus methodology and data, and a discussion regarding preliminary findings, including the maximum justifiable inclusionary housing percentage and in-lieu fee amount, as identified through the nexus study, as well as the preliminary results of the development feasibility analysis. Attendees were provided an opportunity to review the preliminary development assumptions used as part of the static pro-forma development feasibility analysis. Attendees were also afforded ample opportunities to ask questions. For more details on the information presented, please refer to Appendix B.

Comments and Observations

Attendees at both of the public outreach sessions were quite respectful of one another, regardless of differences in viewpoint. A good faith effort was made to identify common ground approaches that appealed to all sides. Attendees generally indicated that they were pleased that the City is pursuing a “balanced approach” toward addressing a diversity of housing needs while respecting the realities of contemporary real estate development. Attendees expressed a hopefulness that the consultant team’s recommendations can encourage adoption of an inclusionary housing policy that can drive new affordable housing development (i.e., create new units) without curbing market rate residential unit production.

The developers in attendance generally did not express concerns regarding the nexus and feasibility analysis research findings. They did, however, add that it is important that all stakeholders understand the meaning and differences between the different profit metrics reported as part of the research being conducted by BAE and Daedalus. They also identified a

⁹ <https://www.daedaluservices.com/>

brief assortment of incentives and/or concessions that would be useful to them in offsetting the burden imposed by the inclusionary housing ordinance requirements. These included reductions to parking requirements, reduced or waived storage requirements, reductions and/or deferral of City imposed impact and processing fees, and the relaxation of requirements regarding materials and finishes. Housing advocates, by comparison, were most concerned about ensuring that the ordinance provides tools that can help the City meet the needs of the most vulnerable populations and highlighted that the total need for affordable housing in the community is even greater than was presented by the consultants.

Overview of the Council Study Session

The City Council study session was held on October 29th, 2018 at 6:00 pm in the Haeg Conference Room at the Bloomington Civic Plaza. While the session was open to public observers, the focus was on providing the City Council with information and receiving their questions. No public comment period was provided. Similar to the public outreach sessions, the City Council study session began with presentations from the consultant teams, including BAE and Daedalus. The material covered included a summary of the goals and intended purpose of the inclusionary housing ordinance, a review of pertinent background data regarding affordable housing need in Bloomington, a review of the residential nexus methodology and data, and a discussion regarding preliminary findings, including the maximum justifiable inclusionary housing percentage and in-lieu fee amount, as identified through the nexus study, as well as the preliminary results of the development feasibility analysis. The presentation also included a set of preliminary recommendations and outlined an array of policy options that the City may want to consider when developing the policy. For more details on the information presented, please refer to Appendix C.

Comments and Observations

Members of the Bloomington City Council expressed a diversity of opinions regarding the information presented, including strong support from Mayor Winstead and other Council members. Council Member Baloga expressed some doubt regarding whether the nexus study accounts for all economic factors contributing to induced demand, including asking whether changes in labor productivity were factored into the analysis. The Council Member also asked whether the consultant team had spoken with individuals cited in a recently published article regarding the proposed inclusionary housing policy in Minneapolis. Other Council Members expressed concern regarding the loss of existing naturally occurring affordable housing units. Additional concern was expressed regarding the likelihood that adoption of an inclusionary housing policy might impact the willingness of property owners to maintain their properties and discourage the creation of urban “slum” housing. Another Council Member asked about the ability to incorporate “green incentives” for water and energy improvements. Council Members made a wide variety of other comments and asked many insightful questions. The Council subsequently provided direction for Staff to work with the consultant team and to return to the Council with a policy for their review and consideration.

RECOMMENDED POLICY UPDATES

The preceding analyses identified the maximum inclusionary housing percentages that could be justified for use as part of a new inclusionary housing ordinance, based on the induced demand for housing generate as a result of new development. Based on the maximum justifiable inclusionary percentage, the preceding section then calculated the maximum affordable housing impact fee that could be justifiably charged to new development as an alternative to requiring construction of inclusionary housing units.

The feasibility analysis indicates market rate development is currently only marginally feasible, but that in some cases could support payment of a reduced impact, or in-lieu, fee. Recognizing that static pro-forma models represent a simplified, point-in-time, perspective on development feasibility, and that such models cannot be fully representative of all development applications that the City may encounter, BAE recommends the use of caution when considering potential impact fee amounts and inclusionary policy provisions.

The recommendations provided below incorporate the input collected during the developer and community outreach processes and City Council study session. This includes consideration of developer and community perspectives regarding who should bear the burden of funding affordable housing, the relationship between impact fee levels and potential project feasibility, as well as opinions and preferences regarding potential alternative methods for complying with the inclusionary housing requirements. The recommendations also recognize the potential for the City to leverage other local, state, and federal funding sources using housing trust fund dollars, which may allow the City to establish an impact fee amount that is lower than the maximum that would otherwise be justifiable, thereby facilitating project feasibility, while still generating funds sufficient to build much needed affordable housing.

Policy Options and Preliminary Recommendations

When establishing or updating inclusionary housing policies, most jurisdictions generally strive to achieve a balance between community benefit and project feasibility. The goals are often to 1) ensure that the inclusionary housing percentage and impact fee levels adequately mitigate for the impacts of new home construction; 2) that the imposition of such requirements does not overly discourage new development; 3) that the inclusionary policy provides incentives for developing the required inclusionary housing units; and 4) that the fee is high enough to generate sufficient funds to subsidize construction of the units that otherwise would have been built. To these ends, BAE recommends that the City consider the policy options:

Setting the Inclusionary Percentage

Based on the analysis presented earlier in this report, BAE recommends targeting the inclusionary housing ordinance to offset induced housing demand among households earning 60 percent of AMI or less. This is because households with incomes above this level are likely

able to afford housing at current market rates and are thus more readily served by the open market. Meanwhile, households with incomes of 60 percent of AMI or less are much less likely to be able to afford market rate rental housing and, thus, require assistance. As demonstrated by the nexus analysis, this new demand for housing is a direct result of new household spending generated as a result of new development; thus, imposition of an inclusionary housing requirement internalizes the impacts associated with induced housing demand that are not otherwise being readily addressed by the market.

BAE also recommends providing developers with the option of building units at any level at or below 60 percent of AMI. For this purpose, BAE developed a rough equivalency table designed to ensure that a developer would provide roughly the same value to the community, regardless of which income level is targeted. The table is based on the estimated financing gap associated with meeting the induced housing demand at incomes of 60 percent of AMI and below of \$1.97 million. The equivalency table divides this total cumulative financing gap amount by the relative financing gap associated with providing housing at each income level. For example, to identify the total number of units to be provided if targeted at 60 percent of AMI, divide \$1.97 million by the per unit financing gap of \$191,991. This generates a total requirement of 10.24 units. Similarly, if the developer preferred to target households with incomes of 30 percent of AMI or below, divide \$1.97 by the per unit financing gap of \$259,784. This generates a total requirement of 7.57 units. BAE then recommends rounding down to the nearest whole number and allowing developers to account for the remaining fractional unit through a prorated in-lieu fee payment.

Table 10: Inclusionary Housing Requirement Equivalency by Income Level

Cumulative Financing Gap (@ 60% of AMI and Below)		
	\$1,966,276	
	Financing Gap Per Inc. Unit	Total Req. (BMR Units)
Extremely Low (30% AMI)	\$259,784	7.57
(40% AMI)	\$250,456	7.85
Very Low (50% AMI)	\$221,166	8.89
(60% AMI)	\$191,991	10.24

Source: BAE, 2018

Setting the Impact or In-Lieu fee

Due to concerns regarding the impact of fees on project feasibility, and recognizing that affordable housing developers often leverage other funding sources as well, BAE recommends setting the baseline impact fee at around \$9.60 per market rate leasable square foot (including market rate units only for calculation purposes). This would generally produce approximately \$9,000 per market rate housing unit developed, which is about the maximum that BAE estimates can be supported by the market. It would similarly generate around \$100,000 per affordable housing unit required under the inclusionary housing policy, which is roughly comparable to the in-lieu fee charged in other surrounding communities. Charging the

fee on a per square foot basis reduces the disincentive to develop smaller housing units, which are often more affordable compared to larger units. BAE also recommends including a provision in the inclusionary housing policy that makes the in-lieu fee option available to developers only in cases where they can demonstrate that it is not feasible to develop the required units while taking advantage of the available incentive options (to be discussed later).

The recommended affordable housing impact fee amount and structure seeks to balance the various policy objectives articulated above. The proposed fee level represents a substantial reduction from the justifiable maximum, recognizing current challenges to development feasibility; the typical funding structure for affordable housing projects; and the desire to reduce the incentive for developers to pay the in-lieu fee instead of building inclusionary units.

Alternative Compliance Options

Recognizing the preference of the community that inclusionary housing units be incorporated within market rate housing projects, the City may wish to consider requiring on-site construction of inclusionary housing units within market rate housing projects, and offering the impact fee and other alternative compliance methods as options only in those cases where the developer can demonstrate a clear need or community benefit. Note, however, that this creates additional uncertainty for developers and may function as a disincentive to develop in Bloomington, compared to surrounding jurisdictions. Also, such a requirement can create an administrative burden to the City by requiring that City staff review and accept financial documents provided by the developer that demonstrate the need for an in-lieu fee option. This would add additional time and expense to the process to allow for review and negotiation.

The City may also want to consider offering any of a number of alternative compliance options that may suit the circumstances and the needs of the City and the Developer. These may include, but are not limited to:

- Development the required housing units off-site;
- Purchase and deed restriction of existing units (e.g., NOAH);
- Payment of the inclusionary housing impact/in-lieu fee;
- Donation of suitable land of equal or greater value;
- Partner with non-profit developer to construct required units;
- Other options as proposed by the developer and deemed appropriate by the City Council to meet the objectives of the inclusionary housing ordinance.

The City may also want to consider incorporating a provision authorizing the reduction of inclusionary housing requirements on a case-by-case basis as necessary to encourage feasibility, provided that the project in question meets other community development objectives. One example of a project that meets community development objectives is one that includes housing designed to be affordable to low- or moderate-income households at market rates by providing smaller units (i.e., affordable by design).

Incentives and Concessions

The City should consider including provisions as part of the inclusionary housing ordinance that authorize the use of incentives and other concessions to offset the costs of providing required inclusionary housing on-site as part of mixed-income developments while simultaneously promoting project feasibility. BAE recommends considering different types of regulatory relief and expedited review, such as parking reductions, setback reductions, open space reductions, fee waivers or deferrals, ministerial approval (i.e., does not require a hearing), etc. Some of these incentives may be made available to any developer interested in building required inclusionary housing units on-site, such as parking reductions or fee deferrals. Other incentives, such as the use of Tax Increment Financing (TIF) may be reserved and scaled for use by developers who commit to providing additional affordable housing or deeper levels of affordability, such as restricting units to 30 percent of AMI, versus 60 percent.

Housing Trust Fund

The City should consider establishing parameters to direct the ways in which housing trust fund dollars may be spent. For example, the City may restrict the use of funds to construction of new deed restricted housing units. However, the City may also want to consider allowing use of trust fund dollars to buy down additional affordability (i.e., pay a developer a reasonable cost to deed restrict housing units to levels that are affordable to households below the level required under the inclusionary housing ordinance). The City may also want to consider allowing the use of trust fund dollars to purchase and/or rehabilitate existing housing units, including naturally occurring affordable housing (NOAH), in exchange for establishment of new deed restrictions requiring a desired level of affordability. A similar provision may also allow the use of funds for the purchase and/or preservation deed restricted affordable housing that may otherwise be at risk of conversion to market rate.

APPENDIX A: ECONOMIC IMPACTS ANALYSIS FOR PLANNING (IMPLAN) OVERVIEW

Economists use regional and national input-output models as a tool to understand the complex interactions among the various parts of an economy. The economic model used in this analysis, IMPLAN (“IMPact analysis for PLANning”), is a computer software package that automates the process of developing input-output models for regions within the United States. The IMPLAN model is well respected as the industry standard for projecting economic impacts resulting from current or future economic activities often called “events.” In this study, the increase in household expenditures of the residents of newly-constructed housing projects in Windsor make up the “events” that the analysis uses as the IMPLAN model’s inputs.

At the heart of the IMPLAN model is a county-level trade flow called the Social Accounting Matrix (SAM) constructed from the production functions of 536 industries, using data from a variety of sources including the Bureau of Economic Analysis, Bureau of Labor Statistics, and US Census. The SAM uses each county’s observed economic relationships between government, industry, and household sectors, allowing IMPLAN to model payments between industries, between households and industries, between government and industries, and between government and households. Thus, for a specified region, the input-output table estimates the dollar flows between the different sectors within the economy. IMPLAN then applies county-level price and wage data, as well as considering the availability of goods within the analysis region, to estimate the impacts specific to this area, which for this analysis defined as Sonoma County.

Once the selected economic events have been entered into the model, IMPLAN reports the following types of impacts:

- **Direct Impacts.** Direct impacts refer to the set of producer or consumer expenditures applied to the predictive model for impact analysis. It is the amount of spending available to flow through the local economy. IMPLAN then displays how the local economy will then respond to these initial changes. The direct impacts may equal up to the amount of spending input into the model, depending on a variety of factors.
- **Indirect Impacts.** The indirect impacts refer to the impact of local industries buying goods and services from other local industries. The cycle of spending works its way backward through the supply chain until all money leaks from the local economy, either through imports or by payments to income and taxes. For capital projects this would include payments for construction inputs such as wood, steel, office supplies, and any other non-labor payments that a construction firm would purchase in the building process.
- **Induced Impacts.** The induced impacts refer to an economy’s response to an initial

change (direct impact) that occurs through re-spending of income according to household spending patterns. When households earn income, they spend part of that income on goods and services locally, such as food and healthcare. IMPLAN models households' disposable income spending patterns and distributes them through the local economy.

For the analysis of the potential impacts of new housing in Bloomington using the IMPLAN model, BAE determined the household income required to rent or purchase market rate housing. For multifamily rental housing, condominiums, and single-family houses, BAE assumed a 100-unit project as a benchmark; the income associated with a single residence would not be enough to generate job impacts in the IMPLAN model.

The 100-unit project incomes were then entered into IMPLAN as a change in household income; since the "event" consists solely of this income change, all the impacts per IMPLAN are induced incomes linked to the expenditures of the new households.

The impacts of concern for this analysis are the jobs generated by that income. The detailed output provides jobs by each of the 536 IMPLAN sectors. For this analysis, BAE has collapsed those sectors into major industry sectors by NAICS code. The distribution by income generated by the PUMS analysis is then applied to this total number of jobs by industry.

APPENDIX B: STAKEHOLDER ENGAGEMENT WORKSHOP PRESENTATION

Bloomington City Hall
Council Chambers
September 27, 2018

****AGENDA****

8 am - Team meeting at Bloomington City Hall Auditorium

9:00 - 9:15 AM

- Eric Johnson, MPA, PhD, Introduction and Overview of Program - Nexus Study and Modeling Effort in Support of an Inclusionary Housing Ordinance for Bloomington
- Eric Johnson – Purpose of today's meeting

9:15 – 10:00 AM

- BAE Presentation on the Bloomington Nexus Study
- Daedalus Advisory Services' Presentation on the IHO and Competitiveness
- Questions and answers on the presentation

10:00 – 10:55 AM

- Stakeholder input - open discussion around these topics
 -
 - Opportunities and impediments to developing affordable housing
 - Incentives and costs of developing affordable housing
 - Inclusionary housing policy options
 - Affordable housing needs in Bloomington not already covered
 - Other issues not otherwise addressed

10:55 to 11:00 AM

- Next Steps and Meeting Wrap-Up

11:00 - 1:00 PM Lunch

1:00-1:15 PM

- Eric Johnson, MPA, PhD, Introduction and Overview of Program - Nexus Study and Modeling Effort in Support of an Inclusionary Housing Ordinance for Bloomington
- Eric Johnson – Purpose of today's meeting

1:15 – 2:00 PM


- BAE Presentation on the Bloomington Nexus Study
- Daedalus Advisory Services' Presentation on the IHO and Competitiveness
- Questions and answers on the presentation

2:00 – 2:55 PM

- Stakeholder input - open discussion around these topics
 - Opportunities and impediments to developing affordable housing
 - Incentives and costs of developing affordable housing
 - Inclusionary housing policy options
 - Affordable housing needs in Bloomington not already covered
 - Other issues not otherwise addressed

2:55 to 3:00 PM

- Next Steps and Meeting Wrap-Up



AFFORDABLE HOUSING NEXUS STUDY | City of Bloomington

Community Outreach Session: September 27, 2018

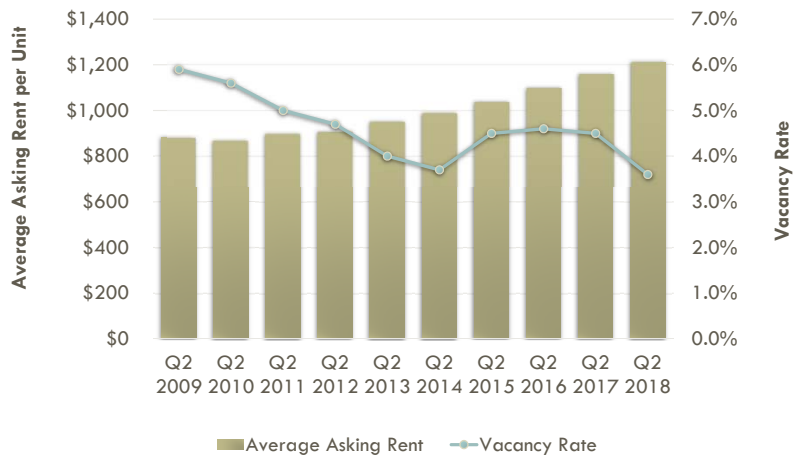
INCLUSIONARY HOUSING POLICY

- Bloomington is developing an inclusionary housing policy
 - Other nearby cities (e.g., Edina) have similar policies
 - Sometimes, more of a political than analytical process
- Bloomington engaged BAE Urban Economics to conduct an affordable housing nexus and fee study
 - Provide a quantifiable justification for setting the inclusionary percentage and in-lieu fee amount

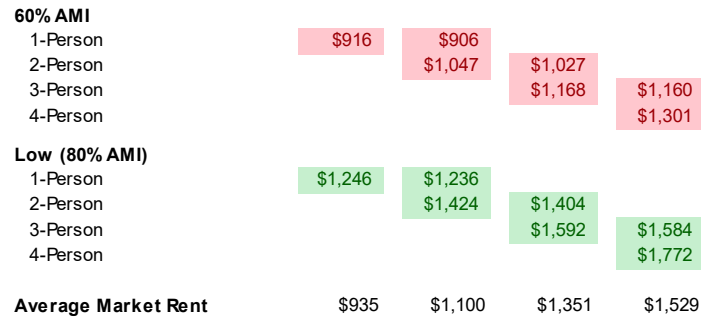
HOUSING NEXUS & FEE STUDY

- ❑ Industry standard methodology for establishing nexus
 - ❑ Step 1 – Identify income necessary to rent new units
 - ❑ Step 2 – Estimate new employment supported by new units
 - ❑ Step 3 – Estimate proportion at each income level
 - ❑ Step 4 – Calculate Financing Gap for Inclusionary Units
 - ❑ Step 5 – Calculate Maximum Justifiable Fee

RENTS & VACANCY RATES



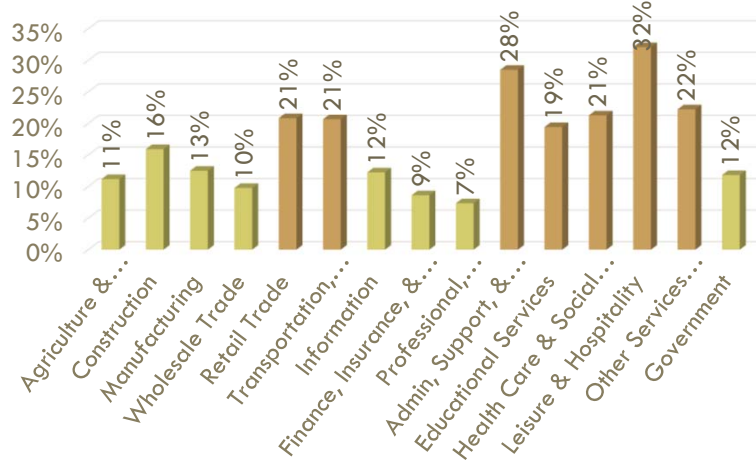
AFFORDABLE RENTAL RATES AND AVERAGE MARKET RATE RENTS



HOUSEHOLD INCOME CATEGORIES

Income Category	Income Limits/Household Size			
	1 Person	2 Person	3 Person	4 Person
Median Family Income: \$94,300				
Extremely Low (30% AMI)	\$19,830	\$22,650	\$25,470	\$28,290
Very Low (50% AMI)	\$33,050	\$37,750	\$42,450	\$47,150
60% AMI	\$39,660	\$45,300	\$50,940	\$56,580
Low (80% AMI)	\$52,880	\$60,400	\$67,920	\$75,440
Median (100% AMI)	\$66,100	\$75,500	\$84,900	\$94,300
Moderate (120% AMI)	\$79,320	\$90,600	\$101,880	\$113,160

WORKFORCE HOUSEHOLDS EARNING 60% AMI OR LESS



NEW APARTMENT RENTAL RATES

Unit Type	Total Units	Per Unit		Rent Per Sq. Ft.
		Sq. Ft.	Rent	
Studio	85	575	\$1,400	\$2.43
1-Bedroom	806	830	\$1,629	\$1.96
2-Bedroom	457	1,176	\$2,086	\$1.77
3-Bedroom	20	1,391	\$2,233	\$1.60
All Units	1,368	938	\$1,776	\$1.89

Note:

(a) Based on a survey of the following projects:

- Luxembourg
- IndiGO Apartments
- The Covington
- Genesee Apartments & Townhomes
- One Southdale Place

INCOME NEEDED TO AFFORD MARKET RATE APARTMENTS

Average Monthly Rent (a)	\$1,800
Utility Cost (b)	\$96
Monthly Housing Costs for New Unit	\$1,896
Annual Housing Costs	\$22,752
Household Income Required (c)	\$75,840

MARKET RATE AND AFFORDABLE NEXUS

- Use the IMPLAN 3.0 software package to estimate new jobs supported by new household spending
- Use the Public Use Microdata Sample (PUMS) to identify:
 - Average number of workers per household by industry of employment
 - Average household income by industry of employment
- Identify the number of workforce households supported by new resident spending by income category

WORKFORCE HOUSING DEMAND INDUCED FROM MARKET RATE DEVELOPMENT

Industry	Total Jobs (b)	Estimated Jobs by Percent of AMI (a)					
		Extremely Low (30% AMI)	Very Low (50% AMI)	Low (60% AMI)	Low (80% AMI)	Moderate (120% AMI)	Above Moderate (>120% AMI)
Total Jobs	57.26	3.44	5.25	2.97	6.32	12.04	27.24
Workers per Households (c)	1.65	1.23	1.38	1.43	1.45	1.69	1.88
Number of Households	34.66	2.80	3.79	2.08	4.34	7.12	14.53
Percent of Base Project (d)		2.8%	3.8%	2.1%	4.3%	7.1%	14.5%
<i>Cumulative</i>		2.8%	6.6%	8.7%	13.0%	27.3%	34.7%

COST TO DEVELOP AN AFFORDABLE HOUSING UNIT

- Reviewed information on tax credit projects from Minnesota Housing
 - 2017 Cost Containment Report
 - 2019 Thresholds for Cost Containment

Region	Activity Type	Building Type	Applicable Cost Threshold
Minneapolis Metro	New Construction	Singles	\$223,952
Minneapolis Metro	New Construction	Families/Mixed	\$259,784
Minneapolis Metro	New Construction	Large Families	\$273,457

Sources: Minnesota Housing; BAE, 2018.

MAXIMUM JUSTIFIABLE FEES

- ❑ Calculate the financing gap for below market rate units
 - ❑ Rental units: Based on cost to build the unit, minus the value of the permanent loan that can be supported by projected rents.
- ❑ The maximum justifiable fee equals the financing gap, times induced new housing demand

MAXIMUM JUSTIFIABLE FEES

	Income Level				
	Extremely Low (30% AMI)	Very Low (50% AMI)	(60% AMI)	Low (80% AMI)	Moderate (120% AMI)
Household Income Limit	\$22,650	\$37,750	\$45,300	\$60,400	\$90,600
Maximum Affordable Monthly Rent Per Unit	\$480	\$858	\$1,047	\$1,424	\$2,179
Monthly Operating Expenses	\$566	\$566	\$566	\$566	\$566
Vacancy	7%	7%	7%	7%	7%
Net Operating Income Per Unit	(\$119)	\$232	\$407	\$758	\$1,460
Net Operating Subsidy from Other Sources	\$119	\$0	\$0	\$0	\$0
Monthly Supportable Debt Service Per Unit	\$0	\$201	\$354	\$659	\$1,270
Loan Amount	\$0	\$38,618	\$67,793	\$126,238	\$243,513
Affordable Unit Development Cost	\$259,784	\$259,784	\$259,784	\$259,784	\$259,784
Financing Gap Per Affordable Unit	\$259,784	\$221,166	\$191,991	\$133,546	\$16,271

MAXIMUM JUSTIFIABLE FEES

<u>New Employee Households</u>		<u>Affordability Gap (Per BMR Unit)</u>	
Extremely Low (30% AMI)	2.80	Extremely Low (30% AMI)	\$259,784
Very Low (50% AMI)	3.79	Very Low (50% AMI)	\$221,166
(60% AMI)	2.08	(60% AMI)	\$191,991
Low (80% AMI)	4.34	Low (80% AMI)	\$133,546
Moderate (120 AMI)	7.12	Moderate (120 AMI)	\$16,271
Total, Affordable Housing Need	20.14		
<u>Affordability/Financing Gap</u>		<u>Max. Fee (Per Market Rate Unit)</u>	
Extremely Low (30% AMI)	\$728,374	Extremely Low (30% AMI)	\$7,284
Very Low (50% AMI)	\$838,638	Very Low (50% AMI)	\$8,386
(60% AMI)	\$399,265	(60% AMI)	\$3,993
Low (80% AMI)	\$580,100	Low (80% AMI)	\$5,801
Moderate (120 AMI)	\$115,837	Moderate (120 AMI)	\$1,158
Total, Affordability/Financing Gap	\$2,662,214		

IMPACTS ON DEVELOPMENT FEASIBILITY

- Used pro-forma financial models to assess the impact of the maximum fee on development feasibility
- Considered three rental housing prototypes
 - “Low-Rise” – Wood frame construction at 25 du/a
 - “Mid-Rise” – Wood frame w/ concrete podium at 60 du/a
 - “High-Rise” – Concrete construction at 90 du/a
- See handout for details on the pro-forma models

PRELIMINARY IN-LIEU FEE FINDINGS

- ❑ Maximum feasible fee appears to be approximately \$10,000 per market rate unit
- ❑ This represents approximately 1/2 of the maximum justifiable fee
- ❑ The equivalent in-kind contribution would be approximately 9 additional units affordable to households at 60% of AMI for every 100 new market rate rental units

QUESTION AND ANSWER



INPUT ON DEVELOPMENT FEASIBILITY ASSUMPTIONS

Land costs

Hard construction costs – per square foot

Soft costs

Financing costs

Market rate rents

Apartment operating costs

Profit requirements (Yield on Cost)

Other

WHAT KINDS OF ASSISTANCE WOULD HELP FEASIBILITY?

- Parking reductions?
- Density bonuses?
- Other modifications to development standards?
- Funding to assist in achieving deeper affordability/increased inclusionary percentages?
- Other types of assistance or incentives?

INPUT ON POLICY OPTIONS

- To what projects should inclusionary policy apply?
 - All new housing development
 - Rental housing projects only
 - Projects over a certain size (e.g., 5+ units)
 - New development only (excludes remodels)
 - Other options of interest?**

INPUT ON POLICY OPTIONS

- How to comply with the inclusionary requirements?
 - Build required housing units on-site
 - Build required housing units off-site
 - Pay a fee in-lieu of building units
 - Dedicate land of equal value
 - Deed restrict existing housing units
 - Other options of interest?**

INPUT ON POLICY OPTIONS

- Other important considerations:
 - Impact of fees on development feasibility?
 - Adopt the maximum fee or something less? Why?
 - Should changes be phased in, or apply to current pipeline?
 - Are compliance options disincentives to build units?
 - Are developers prepared to build/manage inclusionary units?
 - Are there other options or partnerships that could add value?

WRAP-UP AND NEXT STEPS



ADDITIONAL COMMENTS/QUESTIONS?

BAE Urban Economics

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Davis, CA

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Matt Kowta, Principal

mkowta@bae1.com

Aaron Nousaine, Vice President

aaronnousaine@bae1.com

APPENDIX C: CITY COUNCIL WORKSHOP PRESENTATION

Request for Council Action

Originator Community Development	Item Affordable Ordinance Development
Agenda Section Study Item	Date Monday, October 29, 2018

Requested Action

Staff is seeking feedback and direction from the City Council on the research findings and preliminary policy recommendations for the creation of an affordable housing ordinance. Daedalus Advisory and BAE Urban Economics will present the findings of the affordable housing ordinance research work taken place over the past several months.

Item created by: Eric Anthony Johnson (CD Director)

Presenter: Eric Anthony Johnson (CD Director) and Daedalus Advisory and BAE Urban Economics

Description

With rising housing costs and extremely low vacancy rates, concerns about the lack of affordable housing across Bloomington and the Twin Cities metro region have been growing. The challenges include but not limited to:

- Tight demand and supply, and rising rents have intensified the affordable housing challenge in Bloomington
- Affordable units comprise 12% of the total rental unit stock, with 0% vacancy.
- Many buildings have closed wait lists
- Market rate units show a tight demand-supply situation - <2% vacancy
- Average monthly rent for a two bedroom apartment is \$1,896 including utilities
- Annual housing costs for a new unit is \$22,752 with a required annual income of \$76,000 needed to afford.
- The greatest housing need is for individuals and families making between 30-60% of area median income.


The City Council has prioritized the creation of an affordable housing ordinance as part of a series of strategies to support addressing the issue. At the study session, City Staff in concert with Daedalus Advisory and BAE Urban Economics will present key research findings and policy recommendations related to creating a comprehensive affordable housing ordinance rooted in economic analysis, stakeholder engagement, nexus study and best practices.

Attachments:

10/29/2018 Powerpoint Presentation

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ADVISORY SERVICES

bae urban economics



Analysis supporting a proposed Inclusionary Housing Ordinance for Bloomington
October 2018

1

DAEDALUS
ADVISORY SERVICES

bae urban economics

Agenda

- Introduction & background
- Policy options
- Research findings
- Preliminary recommendations
- Next steps
- Comments & questions

2

What is an Inclusionary Housing Ordinance (IHO)?

Inclusionary housing refers to a range of local policies that tap the economic gains from rising real estate values to create affordable housing—tying the creation of homes for low-or moderate-income households to the construction of market-rate residential or commercial development.

(Source: Adapted from Inclusionary Housing, Creating and Maintaining Equitable Communities, 2015 Lincoln institute of Land Policy, Cambridge, Mass. 2015.)

- The primary objective of an IHO is to **increase the supply of and preserve affordable housing units**, and promote localized economic and community integration
- Difficult to estimate the affordable units created using IHO's but **one estimate ranges between 100,000 to 150,000 nationwide** since the late 1980s across 27 states and Washington DC

3

Agenda

- Introduction & background
- Policy options
- Research findings
- Preliminary recommendations
- Next steps
- Comments & questions

4

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Bloomington's affordable housing ordinance is being developed around a structured approach and including provisions that cover a range of issues

- Approach: Nexus study, development testing, best practices, lesson learned and stakeholder engagement as the foundation of the work
- AMI focus: 60% of AMI and below (i.e., identified need)
- Comprehensive approach with flexibility as a foundation
- Percent affordable units on all new developments and substantial rehabilitation
- Creation of a payment in-lieu of on-site units
- Creation of an affordable housing trust fund
- Development fee deferral initiative
- Introduction of regulatory incentives tools (geared toward developments that focus on addressing the identified need) Bundling of resources to support reaching the greatest need (60-30% AMI as a collective).
- Introduction of substantial rehabilitation
- ADU's
- Affordable housing plan
- Transition period
- Right of first refusal

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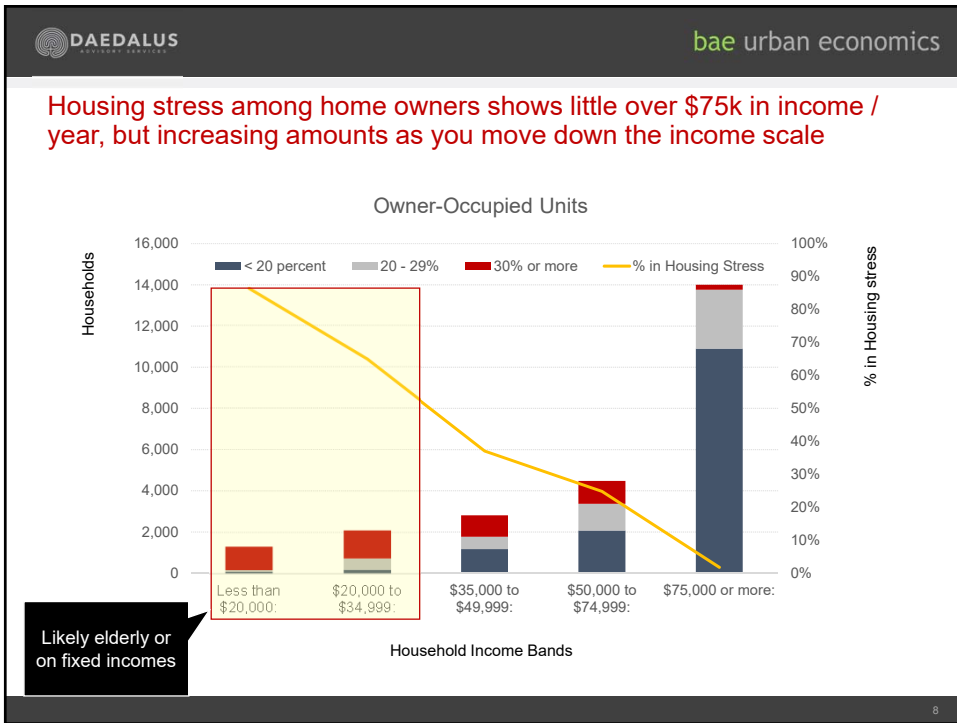
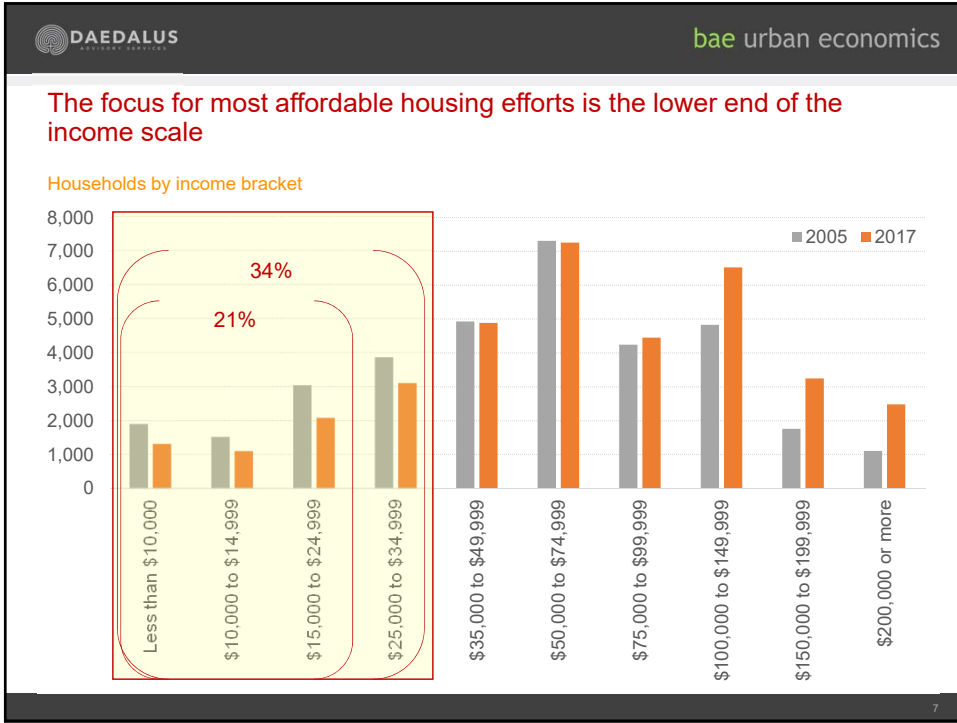
DAEDALUS
CITY PLANNING

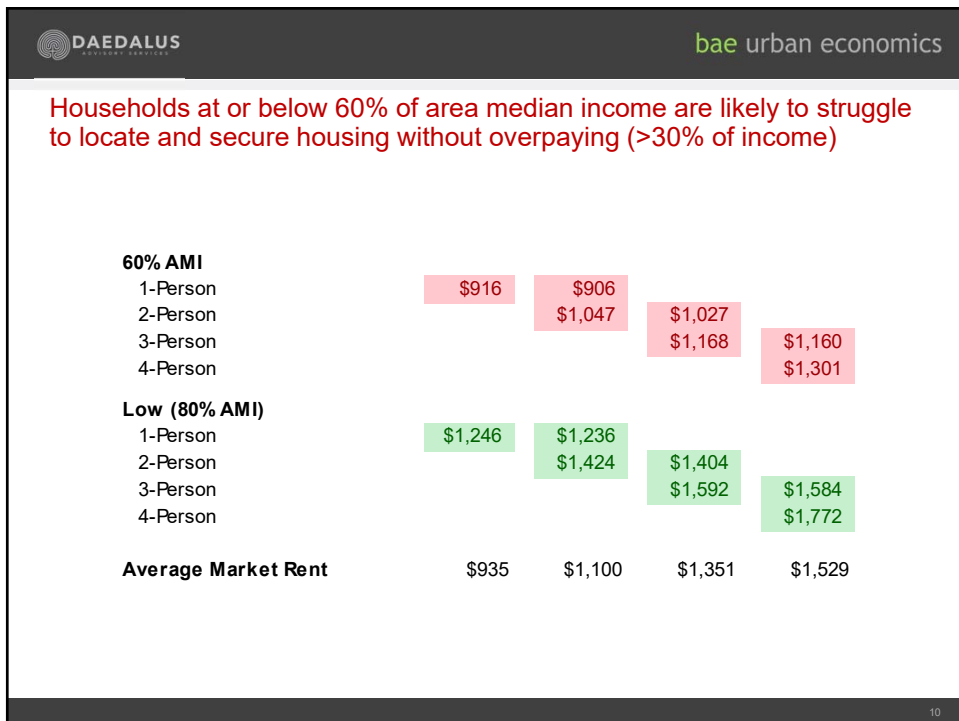
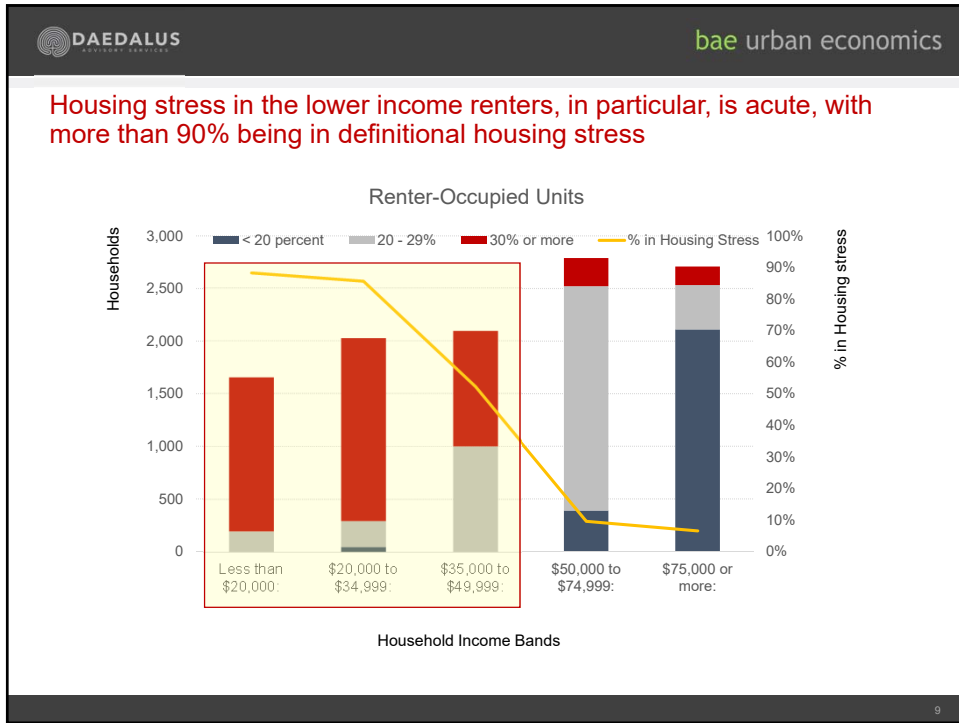
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Agenda

- Introduction & background
- Policy options
- Research findings
 - Need for affordable housing
 - Key definitions
 - Nexus study
 - Lessons learned from IHOs
 - Stakeholder responses
 - Incentives analysis
- Preliminary recommendations
- Next steps
- Comments & questions

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To better understand the IHO and nexus process, it may be helpful to review some key definitions

- Affordable Housing – Where the cost to own or rent the housing unit does not exceed 30 percent of income
- Induced Demand – New demand for housing created as a result of new household spending
- Housing Nexus – A clearly defined relationship between new housing development and resulting induced demand for housing
- Inclusionary Housing – The percent of a new housing project required to be affordable at a given income level
- Financing Gap – The difference between the cost to create a housing unit and the revenue it generates
- In-Lieu Fee – A payment made by a developer in exchange for being released from the requirement to build inclusionary housing
- Area Median Income (AMI) – The median income of households in Hennepin County

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Nexus studies typically follow an industry standard methodology that defines the relationship between development and housing demand.

- Industry standard methodology for establishing nexus and informing inclusionary housing policies
 - Step 1 – Identify income necessary to rent new units
 - Step 2 – Estimate new employment supported by new units
 - Step 3 – Estimate proportion at each income level
 - Step 4 – Calculate Financing Gap for Inclusionary Units
 - Step 5 – Calculate Maximum Justifiable Fee

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The first step is to identify pricing for newly built project. BAE reviewed a selection of new projects, which all had a similar unit mix and pricing.

Unit Type	Total Units	Per Unit		Rent Per Sq. Ft.
		Sq. Ft.	Rent	
Studio	85	575	\$1,400	\$2.43
1-Bedroom	806	830	\$1,629	\$1.96
2-Bedroom	457	1,176	\$2,086	\$1.77
3-Bedroom	20	1,391	\$2,233	\$1.60
All Units	1,368	938	\$1,776	\$1.89

Note:
 (a) Based on a survey of the following projects:

- Luxembourg
- IndiGO Apartments
- The Covington
- Genesee Apartments & Tow nhomes
- One Southdale Place

Sources: Apartment Managers, 2018; BAE, 2018.

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Step two in the nexus process is to identify the minimum income required to afford market rate rents in newly built multifamily housing project.

Average Monthly Rent	\$1,800
Utility Cost	\$96
Monthly Housing Costs for New Unit	\$1,896
Annual Housing Costs	\$22,752
Household Income Required	\$75,840

Sources: Apartment Managers, 2018; BAE, 2018.

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The next step is to use an input-output economic model to estimate the number of jobs by industry that are supported by new household spending.

- Use the IMPLAN 3.0 software package to estimate new jobs supported by new household spending
- Use the Public Use Microdata Sample (PUMS) to identify:
 - Average number of workers per household by industry of employment
 - Average household income by industry of employment
- Identify the number of workforce households supported by new resident spending by income category

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Then, BAE uses Census data to convert jobs by industry to worker households by income level, accounting for multiple wage earners

Industry	Total Jobs (b)	Estimated Jobs by Percent of AMI (a)					
		Extremely Low (30% AMI)	Very Low (50% AMI)	(60% AMI)	Low (80% AMI)	Moderate (120% AMI)	Above Moderate (>120% AMI)
Total Jobs	57.26	3.44	5.25	2.97	6.32	12.04	27.24
Workers per Households (c)	1.65	1.23	1.38	1.43	1.45	1.69	1.88
Number of Households	34.66	2.80	3.79	2.08	4.34	7.12	14.53
Percent of Base Project (d)		2.8%	3.8%	2.1%	4.3%	7.1%	14.5%
<i>Cumulative</i>		2.8%	6.6%	8.7%	13.0%	27.3%	34.7%

Sources: U.S. Census Bureau, Public Use Microdata Sample, 2018; BAE, 2018.

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The first step in identifying a justifiable fee is estimating the average cost to build an affordable housing unit.

- Reviewed information on tax credit projects from Minnesota Housing
 - 2017 Cost Containment Report
 - 2019 Thresholds for Cost Containment

Region	Activity Type	Building Type	Applicable Cost Threshold
Minneapolis Metro	New Construction	Singles	\$223,952
Minneapolis Metro	New Construction	Families/Mixed	\$259,784
Minneapolis Metro	New Construction	Large Families	\$273,457

Sources: Minnesota Housing; BAE, 2018.

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The next step is to calculate the difference between the permanent loan that BMR rents can support and the cost of building housing.

- Calculate the financing gap for below market rate units
 - Rental units: Based on cost to build the unit, minus the value of the permanent loan that can be supported by projected rents.
- The maximum justifiable fee equals the financing gap, times induced new housing demand

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The maximum justifiable fee is calculated by multiplying the induced demand by the financing gap, then dividing by the number of units.

Income Level	New Employee Households	Financing Gap Per Afford. Unit	Cumulative Gap (Per 100 mrkt. Units)	Maximum Justifiable Fee	
				Per Mrkt. Unit	Per Mrkt. Sq. Ft.
Extremely Low (30% AMI)	2.80	\$259,784	\$728,374	\$7,284	\$7.77
Very Low (50% AMI)	3.79	\$221,166	\$838,638	\$8,386	\$8.94
(60% AMI)	2.08	\$191,991	\$399,265	\$3,993	\$4.26
Induced Housing Need	8.68		\$1,966,276	\$19,663	\$20.97

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The next step is to test whether new development can support an impact/in-lieu fee, and if so, how much?

- Used pro-forma financial models to assess the impact of the maximum fee on development feasibility
- Considered three rental housing prototypes
 - “Low-Rise” – Wood frame construction at 25 du/a
 - “Mid-Rise” – Wood frame w/ concrete podium at 60 du/a
 - “High-Rise” – Concrete construction at 90 du/a
- Pro-forma models based on developer input and current development cost and revenue data
- Indicates an average project could support up to a \$9,000 in-lieu fee
- Also considered how incentives can offset the cost of providing the required inclusionary units (presented later by Daedalus)

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We have interviewed four peer jurisdictions to understand Lessons Learned about their implemented IHOs

Montgomery County, MD	Evanston, IL	Denver, CO	Carlsbad, CA
<ul style="list-style-type: none"> • pioneer in implementing IHO, • 12,000+ units delivered since inception, • In-lieu fees as last resort • refined mix of incentives, but flexible, • highly integrated approach 	<ul style="list-style-type: none"> • since 2016, bring in isolated groups, • 10%, 20% (if public funds), 5-10 units • \$75-100K in-lieu (to be moved up) • targeted areas, e.g., TOD • Alternative compliance possible 	<ul style="list-style-type: none"> • new program • unit production oriented • wide range of incentives, but flexible • strong developer input/outreach • clear processes 	<ul style="list-style-type: none"> • since 1990's with several iterations • 15%, >7 units • 2,000+ units delivered since 1993 • Alternate compliance possible

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Balancing market trends and IHO compliance is emerging as a key theme to successfully designed and implemented IHOs



- **Variation in approaches** by cities and jurisdictions with economic integration and unit production seen often as main driver
- **Local market conditions and balancing the economic impacts** of a policy against the desire to create affordable housing are important
- **Segmenting the market** so as to properly target housing unit objectives, e.g., size, locations, types can help
- **Incentives to developers** are common and are key to stimulate production, but need to be designed to minimize impacts on city finances and be relevant to investors
- **Implementation issues** are not be under-estimated, e.g., stakeholder outreach, interconnected policy, legal and process issues, staffing, reviews, compliance and monitoring
- **Clarity in implementation** is important for developer buy-in

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A wide range of incentives can be used singly or jointly for policy successes

DIRECT		INDIRECT		OTHER	
Development Fee Waivers / Reductions	Cash grants	Density bonus	In-Lieu payment	Off site location	Housing type choice
		Expedited review	Exemptions	Mixed-use options (zoning)	Other waivers
		Geographic focus	Zoning variances	Parking options	Interior variances

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Stakeholder workshop feedback on initial approach was largely positive

- **A broad range of interests:** for profit and non-profit developers, housing advocates, tenants and home owners
- **Respectful,** common ground approaches from all sides
- Generally happy that we chose **a balanced approach** towards housing needs and the realities of developing property
- Were hopeful that our recommendations could **create new affordable units without curbing overall unit production**

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Stakeholder workshop feedback on initial approach was largely positive

- Developers **generally did not express concerns** nexus findings or feasibility findings
- Developers noted that it is important that all stakeholders understand the meaning and **differences between various profit metrics**
- Developers indicated the following types of incentives/concessions would be useful in conjunction with inclusionary requirements:
 - Reduced parking requirements
 - Reduced/waived storage requirements
 - Fee deferrals/reductions
 - Relaxed requirements for materials/finishes
- Housing advocates were concerned about **reaching the most vulnerable populations** and thought the need was even greater than we presented

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We evaluated incentive impacts using an actual project. Results give an idea of IHO impacts without incentives

Financial return estimates for example 174 unit building			
	20% @ 60% AMI	All Market	20% @ 30% AMI
Unleveraged (no debt)			
IRR	4.8%	5.9%	4.3%
NPV (10%)	(\$24M)	(\$21M)	(\$26M)
Leveraged (incl. debt)			
IRR	5.9%	8.3%	4.6%
NPV (10%)	(\$11M)	(\$8M)	(\$13M)

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Incentives offset the IHO's cost and revenue impacts on development projects. Not all incentives are valued similarly.

Financial return estimates with incentives for 20% at 30 AMI case

	Parking reduction	Density bonus	TIF	Fee deferral	All incentives
	<i>No city money</i>	<i>No city money + 42 units</i>	<i>City money</i>	<i>Delayed fees for permit, parks and dev</i>	
Unleveraged (no debt)					
IRR	4.7%	5.7%	6.3%	4.3%	7.7%
NPV (10%)	(\$24M)	(\$21M)	(\$18M)	(\$26M)	(\$12M)
Leveraged (incl. debt)					
IRR	5.6%	8.7%	9.5%	4.3%	13.8%
NPV (10%)	(\$11M)	(\$7.6M)	(\$7.9)	(\$14M)	(\$1.7M)

Market limitations on parking reductions

Market limitations on additional units

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Agenda

- Introduction & background
- Policy options
- Research findings
- Preliminary recommendations
- Next steps
- Comments & questions

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Preliminary Recommendations

- Based on this analysis, BAE/Daedalus recommend:
 - Structuring the IHO to incentivize housing construction
 - Set inclusionary percentage at ~9% to account for induced demand created at 60% of AMI and below
 - Set the in-lieu fee at ~\$9.60 per leasable square foot of market rate residential area
 - Does not penalize developers for smaller units
 - Based on a supportable fee of ~\$9,000 per market rate unit
 - Would generate ~\$100,000 per inclusionary unit needed
 - Allow developers to request payment of in-lieu fee, if justified
 - Create a set of incentives to encourage construction and to offset the cost of providing inclusionary units

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In-lieu fee of roughly ~\$9.60 square foot on market rate units can raise ~\$100,000 per inclusionary housing unit needed

In-lieu Fee (Per Mrkt. Sq. Ft.)	# of Mrkt. Rate Units	Ave. Unit Size	Total In-Lieu Fee Payment	Incl. Units Required	Trust Fund Contribution Per Incl. Unit
~\$9.60	100	938	~\$900,000	9	~\$100,000

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The policy options for Bloomington involve a number of considerations

- Apply the IHO to
 - All new rental housing development
 - Projects over 20 units
 - New development and major renovations (exclude minor remodels)
 - All areas of the city
 - All at once after public notice, but allowing existing permitted and in process projects to be grandfathered in

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Compliance issues also require evaluating a range of potential options

- Allow developers flexibility in meeting the requirements
 - Give preference to building required housing units on-site, but allow off-site options under specific conditions
 - Allow the payment of a fee in-lieu of building units
 - Allow Dedication of land of equal or greater value
 - Deed restrict existing housing units

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Housing, population and economic trends shift constantly. Policy should reflect consideration of those factors as well

- Other important considerations that require additional policy discussions
 - Faster permit processing and development fee deferral options?
 - Adopt the maximum fee or something less?
 - Are compliance options disincentives to build units?
 - Are developers prepared to build/manage inclusionary units?
 - Should the City use other resources to encourage (i.e., buy) deeper affordability, such as provide TIF subsidy?
 - Is the policy prepared to withstand economic change?
 - How flexible should it be to accommodate unique circumstances?
 - Are there other options or partnerships that could add value?

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Agenda

- Introduction & background
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- Comments & questions

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Next Steps

- Finalize Nexus study results
- Finalize investor impact model
- Get input from other affordable market players, as needed
- Finalize draft set of incentives
- Get input on regulatory options and incentives
- Advance IHO draft

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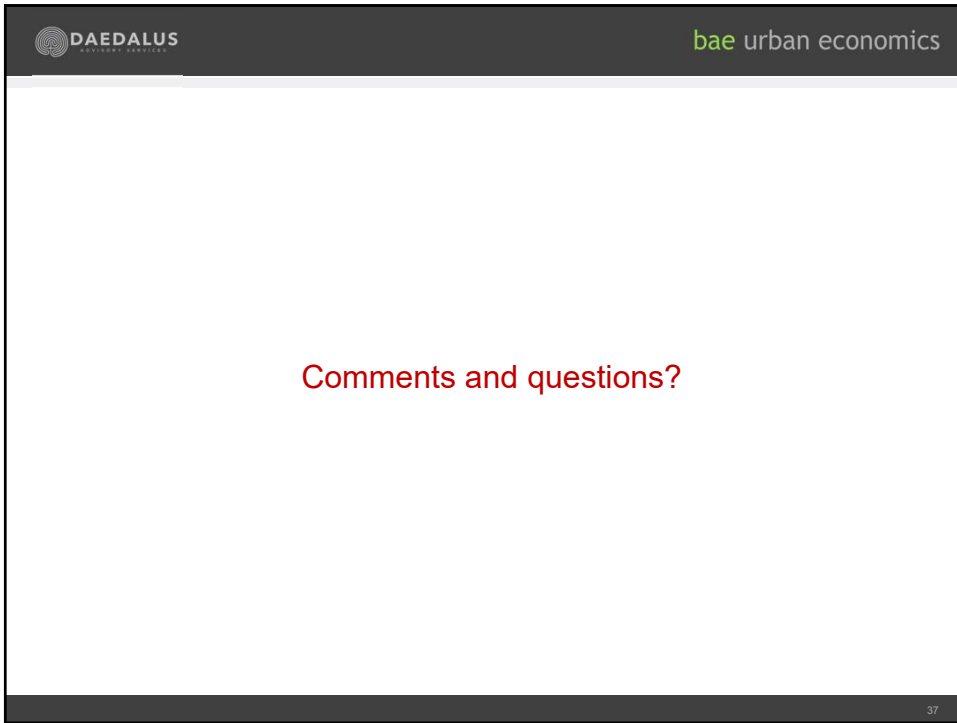
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Comments and questions?

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This is a presentation slide. At the top left, there is a logo for 'DAEDALUS SUSTAINABLE DEVELOPMENT'. At the top right, the text 'bae urban economics' is displayed. The main body of the slide is white and contains the text 'Comments and questions?' in red. At the bottom right corner of the slide, the number '37' is visible.

Homebuilders concerned about proposed Minneapolis "inclusionary zoning" rule

Resistance is building to a proposed Minneapolis requirement that developers reserve 10% to 20% of new rental units for affordable housing.

OCTOBER 28, 2018 — 3:20PM

NEAL ST. ANTHONY @STANTHONYSTRIB

Resistance is building among housing developers and business community allies to a proposed Minneapolis requirement that developers reserve 10 to 20 percent of new rental units for affordable housing.

Kelly Doran, a developer and Minneapolis resident who has been one of the city's most prolific builders of market-rate apartment housing since 2009, warned Mayor Jacob Frey and the City Council in a letter this month that builders and investors would pull out in response to a blanket policy.

"I know that is my company's position," Doran wrote.

Doran is part of a coalition formed this year of for-profit and nonprofit developers focused on affordable as well as overall housing supply in housing-pressed Minneapolis.

Building Minneapolis Together, led by Downtown Council President Steve Cramer, the former CEO of affordable housing developer-manager Project for Pride in Living, has joined with Doran and other developers to argue the unintended consequence of an "inclusionary zoning" ordinance of 10 percent or more affordable units could kill a lot of planned housing.

"I keep telling council members that you can require whatever you want, but it's a matter of math," Cramer said.

In a position paper, the coalition embraces the "vast majority" of credible housing experts who contend the expansion of housing supply should be the primary goal, and policies that would "constrain new supply directly results in higher rents across the entire market ... thus exacerbating housing affordability."

Council President Lisa Bender, guided by populist sentiment and a city consultant that recommended inclusionary zoning, said it's the best way to create thousands more affordable units without additional cost to the city.

Frey, who has proposed a record \$40 million in subsidies toward low-income housing from a variety of sources next year, is holding his fire on the proposed ordinance.

"The ordinance should complement other efforts so that it doesn't stymie our work to address [the overall] housing shortage amid low vacancy rates," Frey said in an interview. "I'm committed to working with council colleagues to make sure this is done thoughtfully."

In an interview, Doran said requiring 10 percent of units go to low-income renters in the Expo, a \$100 million 368-unit apartment complex he is building with co-developer Gary Holmes of CSM Corp. on a former parking lot near St. Anthony Main would drive up the cost by \$8 or \$9 million and require raising base rents on unsubsidized units by \$100 or more, starting with \$1,000-a-month units.

"There's unanimity that there's an affordable housing problem," Doran said last week. "There are more thoughtful ways to a solution."

Basically, the business lobby says the blanket requirement will wound or kill the housing business in town, particularly in what's likely the late stages of a long economic recovery that is being threatened by higher interest rates. That's compounded by rising construction and labor costs.

The building coalition said to meet demand the city must add "7,500 new housing units today plus 5,000 new housing units every year to reach equilibrium, representing a capital need of \$3.1 billion [this year] and \$1.25 billion every year thereafter."

That would get the vacancy rate to about 5 percent.

Cramer and others argue that institutional investors, insurance companies, pension funds and other investors will balk over a restrictive ordinance. The group wants to work with the city on raising subsidy money available for affordable housing, possibly by millions through dedicating the tax increment from new developments to a housing fund, or other means. They also recommend more affordable-housing construction on vacant, city-owned land.

Alan Arthur, longtime CEO of nonprofit developer-manager Aeon said inclusionary zoning has shown limited success in some cities.

"However, it is not the [solution] and avoids the real challenge," Arthur said. "We are heading toward the greatest housing problems for low-income people since the Great Depression. It will cost billions in private and public dollars. We just can't argue policy tweaks."

In short, Arthur notes that wages have eroded for working people, a third of Minnesota's new jobs pay less than \$15 an hour and rents are up.

"The federal government has backed away from funding affordable housing [in real-dollar terms] since the 1980s," he said. "We're headed toward being short up to 200,000 units of affordable housing [in Minnesota]."

CEO Deidre Schmidt, of CommonBond, the area's largest affordable housing developer-owner, is concerned an ordinance could "disrupt the market" and that not all for-profit developers can handle a mix of tenants, including support services that nonprofit managers often provide.

"Regardless of what occurs in Minneapolis, I hope the city continues to invest local resources in construction, rehabilitation and preservation," she said. "The level and dependability of such investments is critical for those of us who do this work because of our mission, not a mandate like inclusive zoning. The very low-income households cannot afford housing without rent subsidies. This isn't just a supply issue."

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