Addressing the Critical Housing Shortage in Rural North Dakota

DRAFT

Without new housing investment, rural communities are not able to grow or recruit workforce and newcomers.

Rural communities are beginning to see companies relocate to urban centers and other states.

ND Rural Housing
Development Task Force
Report and Recommendations
June 20, 2022

ND Rural Housing Development Task Force

The Task Force was initiated in early 2022 to:

- Establish a small task force that would review existing programs and identify gaps
- Identify specific policies that are current impediments in small communities and rural locations
- Identify the role nonprofit real estate developers could play as a catalyst for additional private sector development
- Develop programmatic and policy recommendations

- Dawn Mandt, Red River Regional Council, Chair
- Shawn Kessel and Rikki Roehrich, ND Dept of Commerce
- David Flohr and Jennifer Henderson, ND Housing Finance Agency
- Craig Hanson, Bank of North Dakota
- Brent Ekstrom, Community Works of ND
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Impediments to rural housing development identified

1. Rural projects require roughly 50% equity investment to be financially feasible and keep rents at an afforable level.
2. The cost of construction is higher than in urban communities.
3. Generally, there is a lack of trades professionals - builders, plumbers, electricians.
4. Lack of "ready to move" or modular home builders in North Dakota. Comparatively, Manitoba has numerous builders. Modular homes have production efficiencies and can convene skilled labor to a single location.
5. Urban centers have strong housing growth which is more profitable and less risky than rural communities. For-profit developers have ease of development and scalability in urban areas. Developers generally favor large-scale projects that are not viable in small towns.
6. A larger return on investment is more easily achived in urban communities due to large scale projects and the availability of contractors to mobilize.
7. Lack of variety of housing options to enable movement in the rural market such as single level, family, entry-level, or contemporary options such as micro-homes/villages. Stagnation in home improvements has left available housing stock aged and not appealing to newcomers or relocation.
8. Rural housing often has an "appraisal gap" - cost exceeds appraised value. Also lack of adequate number of appraisers.
9. Lack of housing development expertise and capacity in nonprofit or community levels.
10. Wage disparities between rural and urban communities decrease affordable rural rental rates and profitability.
11. "Cheap housing" has left housing market undervalued and lack of comparable properties for appraisals. This has also impacted the perception of what "affordable" is based on 30% of median income. There is a need for development to "prove up" the rural markets as viable construction areas.

Housing Incentive Fund (HIF)

The Housing Incentive Fund (HIF) is a state-funded gap financing program used with federal and private dollars to create affordable multi-family housing in urban and rural communities. The North Dakota Housing Finance Agency (NDHFA) administers the program on behalf of the state of North Dakota. Leveraged as an upfront, one-time investment, HIF ensures rental homes in the supported projects will be affordable for a minimum of 15 years.

The North Dakota Legislative Assembly created HIF in 2011 to address workforce housing needs in western North Dakota. The program has evolved over the past decade into a flexible funding resource to construct and rehabilitate multifamily housing in communities across the state. Funding is dependent upon legislative approval.

Currently, no HIF funding is available.

FINDINGS

- Rural projects require 50% equity investment to be financially feasible and maintain affordable rents
- Popular program for multi-family development usually doing sizable projects (24 to 42 units) that are not common rural areas. Rural needs are typically smaller projects such as four and eight plexes.
- **Underfunded** - 2021 to 2022, $9.5M appropriated, and was overprescribed by $16M without consideration of smaller, rural projects.
- Urban projects typically are most competitive because of the ability to finance and are shovel-ready. Rural projects can take more time to plan and prepare.
- Rural projects can take longer to lease up.

SUGGESTIONS

- Redefine "rural" as cities under 5,000.
- Create rural set aside for single and multi-family housing rehabilitation and new construction.
- Allow rural project to exceed existing 30% total development costs HIF investment.
- Modify underwriting standards to enable vacancy rate up to 15% (typically 7%).

LEGISLATIVE ACTION

- Increase biennial funding to no less than $40M for five biennia.
- Create stable, long-term funding source to enable planning and project development time for rural areas.

Homesteading Program (?)

This grant program targets workforce housing for the displaced, blight and unsafe properties and the effective re-use of existing infrastructure for in-fill housing development. The cost to construct is lower by eliminating lot acquisition and demolition costs and utilities are in place. Any housing type from tiny homes, single family homes to 8-plexes and mixed-use properties are eligible. Businesses located in properties that were part of the program will be eligible for an additional grant award of up to $10,000 if they are “workforce friendly”. Workforce-friendly businesses may include child care facilities and restaurants.

- Step One: The city, with grant assistance, conducts a housing study with a focus on workforce housing needs while identifying all blighted property and vacant lots in the community.
- Step Two: The city also must identify private sector partner(s) who are willing to build the properties.
- Step Three: City prioritizes the type of housing and prioritizes the properties on the blighted list that are best suited to build the prioritized housing or to best accommodate the identified need.
- Step Four: Grant funds acquire the property (if needed), remediate any hazards, remove the blighted structure, unless it has historical significance to the community. If there is historical significance, the adaptive reuse of the structure will be reviewed.
- Step Five: Land is gifted to the private sector partner to build housing prioritized by the city to sell/rent at a not-to-exceed price OR gifted to a person who does not currently live in ND and is willing to build a home and work full-time in the community or within 30 miles of the community.

Up to 10% of the properties on the blighted properties list can be razed to create a vacant lot to meet a community need such as a pocket park, veterans memorial or other community betterment need.

Community match is in-kind in the form of property, city staff time to coordinate, and other related activities.

City population	# cities targeted	# properties	Average cost per property	Housing study subsidy	Estimated impact
Tier 1: up to 999 (233)	20	5	$18,500		$15.5M
Tier 2: 1,000 to 2,499 (33)	15	12	$35,000	$10,000	$46.6M
Tier 3: 2,500 to 20,000 (12)	5	20	$55,000	$15,000	$35.6M

FINDINGS

- Rural communities have numerous slum and blighted properties that could be used for infill housing development.
- Infill would enable reuse of existing infrastructure and revitalize a community.

SUGGESTIONS

- Create a statewide "homesteading" website of available sites and community incentives

LEGISLATIVE ACTION

- Appropriate $13.87M for a two-biennia program
- Appropriate $603k for two temp FTEs to manage program for four years

Renaissance Zone

Income and property tax incentives are available to taxpayers for engaging in qualifying zone projects or for investing in a renaissance fund organization set up to provide financing to projects in a North Dakota renaissance zone. A zone project generally consists of a purchase, lease, or improvement to real estate located in the zone.

LEGISLATIVE ACTION

- Modify statute to enable tax credits to be set aside for developers or builders limited to rural communities to increase return on investment to market rates.

Housing Developers

There is a lack of housing developers willing and able to create new housing in rural areas. New development is needed to prove market potential. Nonprofit housing developers could fill this niche, yet there is a lack of capacity across the state.

SUGGESTIONS

- Provide start-up capital to launch new nonprofit development organizations.
- Support training and capacity building.

Community Recommendations

Communities have a number of ways to encourage housing development which include:

- Create an inventory of existing lots with dilapidated properties that could be cleaned up for housing.
- Create program information for contractor/developer conversations.
- Provide PACE matching funds for multi-family development (duplexes to apartments).
- Provide free or low-cost lots.
- Offer two-year tax abatement on new construction.
- Extend infrastructure.
- Access housing study matching funds through ND Housing Finance Agency to assess needs and develop a plan to address needs.

Advocacy

- Support ND Appraiser's Association changes to enable training of new appraisers to fill gaps.
- Develop messaging to address gaps in skill trades and entrepreneurship opportunities in partnership with Career and Technical Education, ND Workforce Development Council, Greater ND Chamber, Governor's Office.

BEFORE / AFTER CASE STUDIES

MULTI-FAMILY - 4-Plex Scenarios

The following case studies demonstrate the impact of the programmatic recommendations within this report. The multi-family scenario is an 4-plex, **1,100 sq ft per unit, and $200/sq ft development cost. 2-bedroom, 2-bath, garage.**

Scenario 1: No subsidies. $2,834/month rent which would require an annual household income of $121K ($58/hour for single-earner) to be "affordable" based on 30% standard. The owner investment required is $230K (25%) with an ROI of 8% (8-12% would be the range for-profit developers seek).

SCENARIO #1: 4-Plex - no subsidies		
Affordability	**Annual Operations**	**Development**
4 units, 1,100 sq ft	$136,032 rental income	$1,296,981 max debt capacity
$2,834 monthly rent	($12,000) operating expense ($3,000/unit - taxes, insurance, maintenance, property management)	$690,000 max loan based on 75% LTV
$200 monthly utilities	($13,603) 10% vacancy	$220,000 cost per unit
$121,360 min. household annual income for affordability ($58/hour)	($92,042) 1.2 DCR	$920,000 total development cost (inc. $40K land cost)
	$18,405 annual profit/owner return	$230,000 owner equity (25%)
		$690,000 actual debt, 5%, 25 years
		8% ROI

Scenario 2: with HIF subsidy. $1,000/month rent which would require an annual household income of $48K ($23/hour for a single earner) to be "affordable" based on 30% standard. Owner investment required is $65K (7%) with an ROI of 8% (8-12% would be the range for-profit developers seek).

SCENARIO 2: 4-Plex with HIF		
Affordability	**Annual Operations**	**Development**
4 units, 1,100 sq ft	$48,00 income	$366,443 max debt capacity
$1,000 monthly rent	($12,000) operating expense	$230,000 max loan based on 75% LTV
$200 monthly utilities	($4,800) 10% vacancy	$220,000 cost per unit
$48,000 min. household annual income for affordability	($26,000) 1.2 DCR	$920,000 total development cost (inc. $40K land cost)
	$5,200 profit	$65,000 owner equity (7%)
		$165,000 subsidized equity/grant (18%)
		$230,000 actual debt, 5%, 25 years
		$460,000 Gap (HIF) est. $115K/unit (50%)
		8% ROI

MULTI-FAMILY - 8-Plex Scenarios

Scenario #3: No subsidies. Rental rate is $2,688/month which requires an annual household income of $115,520 ($56/hour for single earner). Owner equity at 25%. ROI is 8%.

Scenario #3: 8-Plex, no subsidies, 25% owner equity		
Affordability	**Annual Operations**	**Development**
8 units, 1,100 sq ft	$258,048 income	$2,536,730 max debt capacity
$2,688 monthly rent	($24,000) operating expense	$1,365,000 max loan based on 75% LTV
$200 monthly utilities	($18,063) 7% vacancy	$220,000 cost per unit
$115,520 min. household annual income for affordability	($54,400) 1.2 DCR	$1,800,000 total development cost (inc. $60K land cost)
	$10,887 profit	$455,000 owner equity (25%)
		$1,350,000 actual debt, 5%, 25 years
		7.91% ROI

Scenario #4: with HIF subsidy. Rental rate is $1,000/month which requires an annual household income of $48,000 ($23/hour for single earner). Owner equity at 7%. HIF subsidy of $113,750/unit or $910,000 total (50%). ROI is 8%.

Scenario #4: 8-Plex with 50% HIF, 7% owner equity		
Affordability	**Annual Operations**	**Development**
8 units, 1,100 sq ft	$96,000 income	$766,711 max debt capacity
$1,000 monthly rent	($24,000) operating expense	$455,000 max loan based on 75% LTV
$200 monthly utilities	($6,720) 7% vacancy	$220,000 cost per unit
$48,000 min. household annual income for affordability	($54,400) 1.2 DCR	$1,820,000 total development cost (inc. $60K land cost)
	$10,880 profit	$136,000 owner equity (7%)
		$319,000 subsidized equity/grant (local) (18%)
		$455,000 actual debt, 5%, 25 years
		$910,000 Gap (HIF) est. $113,750k/unit (50%)
		8% ROI

BEFORE / AFTER CASE STUDIES

Conclusions

- Without a subsidy, such as HIF, rent is unaffordable in most rural communities on small projects such as a 4-or 8-plex.
- The return on investment (ROI) is too low without a subsidy to attract a for-profit developer. Generally, developers will seek an 8 to 12% ROI.
- Gap funding required to reduce bank debt and achieve marketable rents - grant, not debt.
- A shared equity subsidy (EDC, JDA or corporate partner(s)) can increase ROI to make it a worthwhile investment. Again, grant, not debt, as there is not adequate cash flow to support repayment.

Suggestions

- Soft financing could be serviced from available cash flow beyond an 8-10% ROI to the owner through the term of the loan and forgiven at maturity.
- Subsidized equity could stay with the project and get repaid upon the future sale of the property from sales proceeds.

The lack of available and variety of housing stock is limiting our ability to attract new residents and workforce. With a forecasted need of 1,000+ new employees in rural Region 4 in the next five years, this is a significant economic development issue.

Dawn Mandt, Executive Director
Red River Regional Council

Questions

- Is this a reasonable rent or could it be higher?
- Should the community have skin in the game?
- How will communities be selected given the deep subsidy required to make this work?
- Should it be tied to economic development?
- How much is too much subsidy?
- Could a non-profit developer be an owner with lower ROI expectation?
- How do non-profit developers get paid if not from cash flow? Typically, a developer's fee - which adds upfront cost.
- Is there workforce capacity in the trades to build the housing?
- Is there property management capacity in rural areas?
- Is there maintenance capacity in rural areas?
- What can the state do to increase workforce capacity?
- Can the state assist Section 3 eligible workers to start new businesses that can fill some of the workforce gaps in the state (both rural and urban)?

WHO COULD DO WHAT?

Potential Tools to Incentivize Rural Housing Development	Who
Interest rate buydown and subordinated debt for multifamily loans	BND
Builder/Developer tax incentives for new construction in rural communities	Legislature
Modify underwriting for rural rental projects - allow higher vacancy rates	BND, NDHFA, Local Banks
Guarantees for multi-family perm loans and single family construction loans in developing rural communities	BND, NDHFA
Travel incentives to travel to rural communities - flat fee payment upon completion of construction? tax credit?	NDHFA, Cities, Legislature
Low cost financing for cities to help with water/sewer/street extensions to lot lines	BND, RD

Other Opportunities - housing development is intertwined with:	Who
Economic Development	
What can employers in need of workers bring to the table? What is the labor shortage costing them? Can that be monetized and invested?	Employers
Workforce/Wages/Housing conversations - we can meet your workforce and housing needs if wages are right	Employers
Small scale off site single family home production - this is a business opportunity	Entrepreneurs
Renaissance Zone tax credits to incentivize new construction of workforce housing	BND, NDHFA
Education	
Promote education in the trades - construction, electrical, plumbing - scholarships	State, School District, NDHFA, BND, ND Career Builders
Encourage high school shop programs to teach trades, build a house, or tiny home to learn skills and increase interest - source start-up funding (curriculum, materials)	State, School District, NDHFA, BND
Community Development	
Would community benefit from a tiny/micro home village neighborhood - lots for owners	City, entrepreneur
Offer the two year tax incentive for newly constructed homes - you will come out ahead	City
Show the math - market reality check - many people can afford to pay the cost of new modern housing but they are conditioned to expect small towns should cost less	Economic developer, city, employers
Encourage local lenders to participate in NDHFA financing programs & FHLBDM membership to access resources to help buyers afford new construction	Economic developer, city, employers
Offer vacant city owned lots for development of new housing; assist with cost of demo for people purchasing dilapidated properties to redevelop for housing	City, state matching grant
Consider changing zoning and other local restrictions (setbacks, lot size, street widths in new development areas)" to allow all housing types (manufactured, modular, small homes on small lots, accessory dwelling units)	City
Evaluate taxable value increase from new development - what can be done to make it happen?	City

What's next?

- Solicit feedback on report and recommendations through August 2022
- Develop legislative strategy and advocacy plan for key points of HIF modifications and increase funding and Homesteading Program
- Who are the partners for advocacy?

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