FEBRUARY 2023

Itasca Project Housing Innovation Report

Recommended strategies to increase production and lower housing costs in Minnesota

ItascaProject™
The GREATER MSP Partnership

Acknowledgments

The Itasca Project would like to thank the Housing Innovation Working Group, Housing Affordability Task Team, advisors, and other contributors for their guidance and advice.

Itasca Housing Innovation Working Group

Collin Barr, Ryan Companies
Cecile Bedor, CommonBond Communities
Stephanie Brown, ULI Minnesota
Aarica Coleman, City of Bloomington
Kyle Hansen, Dominium
Tom Jasper, TCF Bank (Huntington Bank) (ret.)
Maureen Michalski, Ryan Companies
Anand Murali, MA Mortenson Companies
John Ohman, MA Mortenson Companies
John Patterson, Minnesota Housing
Deidre Schmidt, CommonBond Communities
Mary Tingerthal, Construction Revolution
Paul Williams, Project for Pride in Living
Charlie Zelle, Metropolitan Council

Itasca Housing Affordability Task Force

Collin Barr, Ryan Companies – *Chair*
Ron Feldman, Federal Reserve Bank of Minneapolis – *Chair*
Jennifer Ho, Minnesota Housing
Kenneth Holmen, CentraCare
Eric Jolly, St. Paul and Minnesota Community Foundation
Mike Maguire, City of Eagan
Jud Murchie, Wells Fargo
Karen Richard, Andersen Corporation
Susan Bass Roberts, Pohlad Foundation
Deidre Schmidt, CommonBond Communities
Kayla Schuchman, City of St. Paul
Nora Slawik, Metropolitan Council
Jaime Tincher, City of St. Paul
Paul Williams, Project for Pride in Living
Charlie Zelle, Metropolitan Council

Other Contributors

Jay Miller, IMAGEHAUS
Heidi Rathmann, CommonBond Communities
Julia Silvis, McKinsey & Company
Sarah Smith, Independent Contractor

About the Itasca Project

The Itasca Project is an employer-led alliance that seeks new and better ways to improve our future economic competitiveness and quality of life in the Twin Cities area. Its 80-plus participants include private-sector CEOs, public-sector leaders, and the leaders of major foundations based in the Twin Cities region. To learn more, please visit www.itascaproject.com

Executive summary

This report outlines the Itasca Project Housing Innovation Working Group's recommendations for how corporate, government, nonprofit and other leaders can use innovative practices to increase production and lower the cost of housing in the Minneapolis-St. Paul (MSP) region.

The MSP region has not built enough homes and, as a result, housing is now too expensive for many residents. For most of the past decade (2010-2020), the region's home production did not keep pace with job or population growth. Home production also lagged peer regions on a per capita basis, with the gap most acute for homes at modest price points. The increased housing costs threaten the overall prosperity of the region and worsen racial and economic gaps. Our region must act quickly if it hopes to increase and sustain a higher level of housing production.

In partnership with the Federal Reserve Bank of Minneapolis, the Itasca Project set an ambitious production target for the MSP region: producing 18,000 homes per year through 2030, or a total of 180,000 new homes. To meet this target, the region will need to employ new, innovative practices in housing production. To identify these practices, the Itasca Project assembled a small group of cross-sector housing leaders.

The Itasca Project Housing Innovation Working Group identified the most promising innovations for the MSP region and organized them into three 'innovation bundles.' They are at their most impactful when they are adopted together with complementary measures and implemented across the region and state:

- Reduce land costs: Assemble and prepare large parcels of land next to transit and transport corridors.
- Reduce development costs: Establish design standards that can be produced with modular or off-site methods and use faster approval processes as an incentive to motivate developers to use them.
- Reduce operating costs: Reduce commercial property taxes through the 4D property tax and focus this reduction on affordable units.

With these and other innovations, the MSP region can meet its production target of 18,000 homes per year. The working group emphasized that leaders in all sectors will need to approach housing production creatively if our region is to meet this ambitious goal year after year. Leaders must not only adopt the new and familiar innovations from this report and encourage others to do the same, but find new ways to collaborate with each other.

Learning to do things differently will be uncomfortable, but the payoff will be immense. Stable and affordable housing is the foundation for business and economic growth as well as a host of other positive individual and systemic outcomes. Increasing housing production and improving housing affordability will benefit families, firms, and the entire MSP region for generations to come.

Table of contents

The case for action

The MSP region has enjoyed decades of steady population and economic growth and is currently home to over 3.2 million residents and 15 Fortune 500 businesses. As the Itasca Project described in its September 2020 report, the relative affordability and availability of housing has been an important driver of these outcomes – but it is eroding quickly. At the core of this dynamic is a historical deficit in production, detailed further below, which will require sustained, elevated production to mitigate. In 2020 and 2021, MSP achieved target levels of production, but emerging issues related to supply chains, inflation, and interest rates threaten MSP's ability to maintain it.

MSP needs 18,000 new homes per year

In partnership with the Federal Reserve Bank of Minneapolis, the Itasca Project set an ambitious overall production target for the region: producing 18,000 homes per year through 2030, or a total of 180,000 new homes (Figure 1). This production level is approximately a 30% increase over the region's annual production from 2010 to 2020.

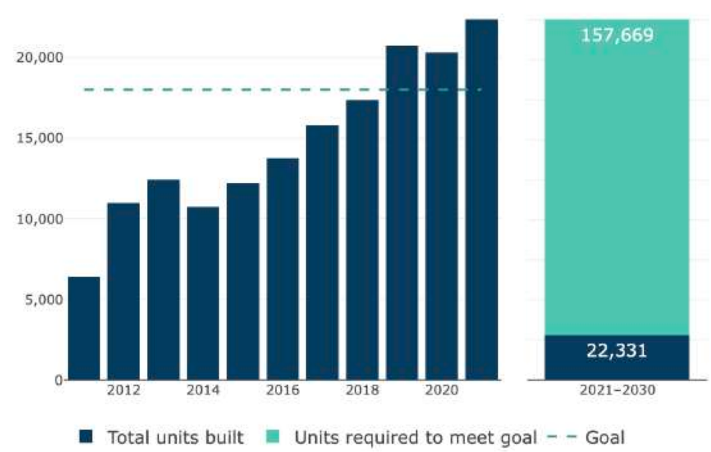
Why is such an increase needed? After the Great Recession, home production fell dramatically in the MSP region, as in many others. It continued to lag job and population growth during the next decade. As a result, the region accumulated a deficit of more than 15,000 units in the rental market and an additional deficit in the ownership market by the end of 2018.

To make up these deficits and keep pace with projected household growth (per Metropolitan Council forecasts), the Itasca Project and the Federal Reserve Bank of Minneapolis estimate that the region will need to build 18,000 units per year from 2020-2030. This production level will help balance the rental market at a vacancy rate of 5% and will likely moderate the region's rapidly increasing housing costs.

However, achieving it will require more than business as usual from actors in both the public and private sectors. They must adopt innovative practices if the MSP region is going to achieve and sustain the necessary level of housing production, especially given the current and expected macroeconomic challenges.

Figure 1: Number of housing units built in the seven-county Twin Cities area

From the Federal Reserve Bank of Minneapolis Housing Affordability Dashboard for the Twin Cities Region



Source: Metropolitan Council

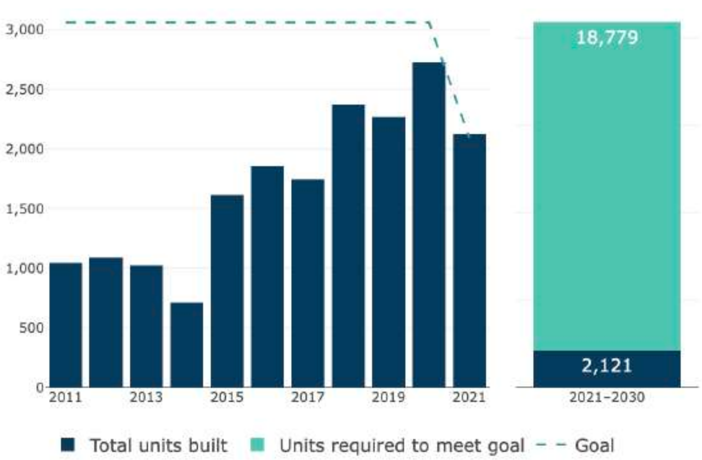
Affordable housing and housing equity are crucial

The share of new, affordable housing produced in the region is just as critical as the increase in home production overall.

Households with incomes at 30% of Area Median Income (AMI) and below are the ones most in need of such housing. For instance, 30% AMI for a family of four in 2021 was $35,200, while affordable rent for a 2-bedroom apartment at that income level was $792/month, according to the U.S. Department of Housing and Urban Development and the Metropolitan Council, respectively.

Our region has not been able to meet this need. The goals set by the Metropolitan Council for 2011-2020 indicated that the region should build at least 3,060 new units of affordable housing every year to meet the affordable housing goals. However, it peaked in 2020, building less than 2,750 new units. (Figure 2). Innovative practices that help increase the production of affordable housing will be required to sustain the Council's new more modest goal of 20,900 units over the 2021-2030 decade or 2,090 units per year.

Figure 2: Number of new affordable units in the seven-county Twin Cities area



Source: Metropolitan Council

Note: In the 2011–2020 period, the affordable housing production goal was 3,060 new affordable units per year. That estimate fell to 2,090 new affordable units per year for the 2021–2030 decade. For more information, see the About page of the Housing Affordability Dashboard.

The MSP region has some of the worst racial disparities in homeownership and housing affordability in the nation.

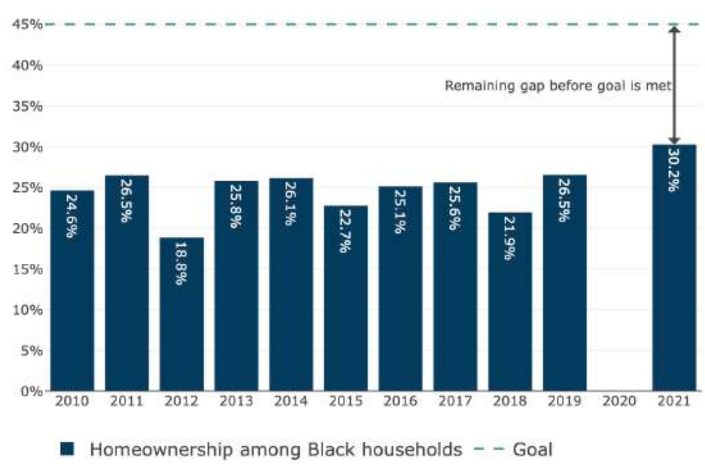
From the Federal Reserve Bank of Minneapolis Housing Affordability Dashboard for the Twin Cities Region

The Black homeownership rate was 30.2% in 2021, nearly 15% behind the national rate (Figure 3). MSP also has the worst disparity compared to 11 peer regions in the cost burden of housing for Black and white households; nearly 25% more Black households experience a housing cost burden (i.e., spend more than 30% of their income on housing) than white households.

It is clear that the MSP region will need to pair innovative practices to increase housing production and lower the cost of housing with intentional efforts to advance housing equity.

Figure 3: Homeownership among Black households in the seven-county Twin Cities area

From the Federal Reserve Bank of Minneapolis Housing Affordability Dashboard for the Twin Cities Region



Source: U.S. Census Bureau American Community Survey Public Use Microdata Sample and Housing Affordability Dashboard authors' calculations

Note: 2020 data are not available.

Without action, the MSP region risks going the way of peer regions which are experiencing extreme housing affordability crises. Congresswoman Pramila Jayapal (WA-7) offered her thoughts to the Itasca Project on the consequences of inaction for the Seattle region.

"Today, Seattle—like many other cities—is experiencing a crisis in affordability and a crisis in homelessness. Our rents have gone through the roof, as have housing prices. The median housing price in Seattle is now $1 million, and a two-bedroom apartment now rents for between $3,000-$4,000. Our yearly homelessness count continues to increase, including with young people experiencing homelessness."

Source: Office of Congresswoman Pramila Jayapal

"Without a common vision and commitment to that vision from non-profit and for-profit developers and landlords" she says, "profit has driven housing in our area."

This has led to such consequences as 'down-renting' by middle-income families that displaces lower-income families and high rates of people experiencing unsheltered homelessness.

Congresswoman Jayapal also detailed her perspective on actions she wishes leaders in the Seattle region would or could have taken 10 to 15 years ago. Among those actions, she emphasized the need for adjusting land use policies, preventing speculative investing, and more effectively utilizing both private and nonprofit developers:

"One of the most important areas of work we needed to invest in sooner was also bringing in more of the private developers to put forward a vision that they would buy into of producing enough housing units to meet the demand. Seattle has grown rapidly; any housing solutions will have to include both private and nonprofit developers."

Looking ahead, Congresswoman Jayapal advises leaders in the MSP region today to learn from these missed opportunities a decade ago in the Seattle region.

Congressional District 7

Source: Wikipedia

Our path forward: Focus on Innovation

Fortunately, our region still has a chance to avert such a crisis. It exceeded its 18,000 unit production goal in 2020 and 2021, building over 20,000 units each year (Figure 1). The region now needs to sustain this momentum in the face of emerging headwinds and ensure it also produces enough affordable housing.

The Itasca Project's September 2020 report recommended that the Itasca Housing Affordability Task Force pursue three recommendations, all of which it has since acted upon:

1. Use data to clarify how afford ability challenges are evolving in our region, how they will impact all residents, what gaps need to be closed, and how we should measure our progress against goals.

   The Itasca Project partnered with the Federal Reserve Bank of Minneapolis to create a Housing Affordability Dashboard for the Greater Twin Cities Region, which set ambitious goals and is referenced throughout this report.

2. Encourage employers to support their workforce with a housing-forward benefits package.

   The Itasca Project is currently seeking employers to partner with it on designing and piloting housing benefits packages for their employees.

3. **Identify new, innovative actions for private and public entities that will spur increased housing production**.

   The Itasca Project formed a small group of cross-sector leaders that has identified innovative practices in housing production.

This report highlights the Itasca Project Housing Innovation Working Group's efforts on the third recommendation. The working group, whose members are listed at the end of this report, addressed the following questions:

- What are the most impactful things the region could be doing to increase the amount and lower the cost of new housing?
- What role will various entities need to play (e.g., local government, private developers)?
- If successful, how many housing units could be built over the next 10 years using these approaches?

The biggest opportunity

The region's biggest opportunity to increase production and lower per unit costs lies in producing more and larger multi-family dwellings. It can meet its goal of producing 18,000 units per year for the next ten years by increasing the number of large multi-family projects by roughly 25%–approximately 25 to 30 more projects per year. Another significant portion of the additional units will need come from small single-family homes or 2-4 unit projects.

How to increase production

The region will need to enlist private sector developers to produce the vast majority of units required by this ambitious production target. According to data from the Minneapolis-St. Paul Business Journal, private developers accounted for approximately 98% of the residential square footage developed in the region from 2016-2021. Because cost and time drive their returns (Appendix A), innovative practices that lower costs and shorten timelines are critical if the region is going to activate them to increase housing production and reach its target.

Nonprofit developers are also crucial to meeting this goal, even though they account for a relatively smaller share of square footage production. The MSP region has one of the best nonprofit housing development ecosystems in the nation. It will play an especially important role in creating and preserving the desperately needed affordable housing units.

The importance of capital

Producing 18,000 units annually will be capital-intensive, requiring about $4 billion in annual investment, a figure which will only rise with inflation. Federal funding through the American Rescue Plan Act (ARPA) is providing a boost to city and county investments in housing. As of March 2022, GREATER MSP's research of Treasury State and Local Fiscal Recovery Fund allocations found that ~25% (or $193M) of ARPA allocations was committed to housing in the cities and counties of the Greater MSP region. To continue to close the gap, all sectors–private, public, and philanthropic–will need to work together to mobilize the necessary capital. Two promising venues for doing this already exist in our region.

GREATER MINNESOTA HOUSING FUND

The Greater Minnesota Housing Fund's $100 million Housing Impact Fund is aimed at offering new capital solutions to increase the production of affordable housing. Researched and in development, it seeks to use patient investments by private companies, healthcare institutions, and philanthropic institutions to develop new workforce housing at scale, bypassing public programs such as the Low-Income Housing Tax Credit. It also seeks to use these investments to preserve naturally-occurring affordable housing and test other promising models for affordable housing development.

GroundBreak Coalition

The recently-launched GroundBreak Coalition is a cross-sector partnership aimed at mobilizing at least $2 billion over ten years and changing how capital shows up in communities, making it more equitable and sustainable. GroundBreak itself is not a fund but instead seeks to make capital flow faster and differently by identifying a set of capital products and pathways and then brokering sufficient investment in them. It is about making capital available to people who have been excluded and limited from accessing it – specifically, people of color – and investing in a carbon-neutral future.

Leaders in all sectors need to approach housing development with a spirit of creativity. Such creativity is required if the region is going to generate the systemic change demanded for both producing more housing and closing racial gaps in homeownership and housing cost burden.

To identify the most promising innovations, the group first compiled a range of possible innovations (for a full list of innovations considered, see Appendix B).

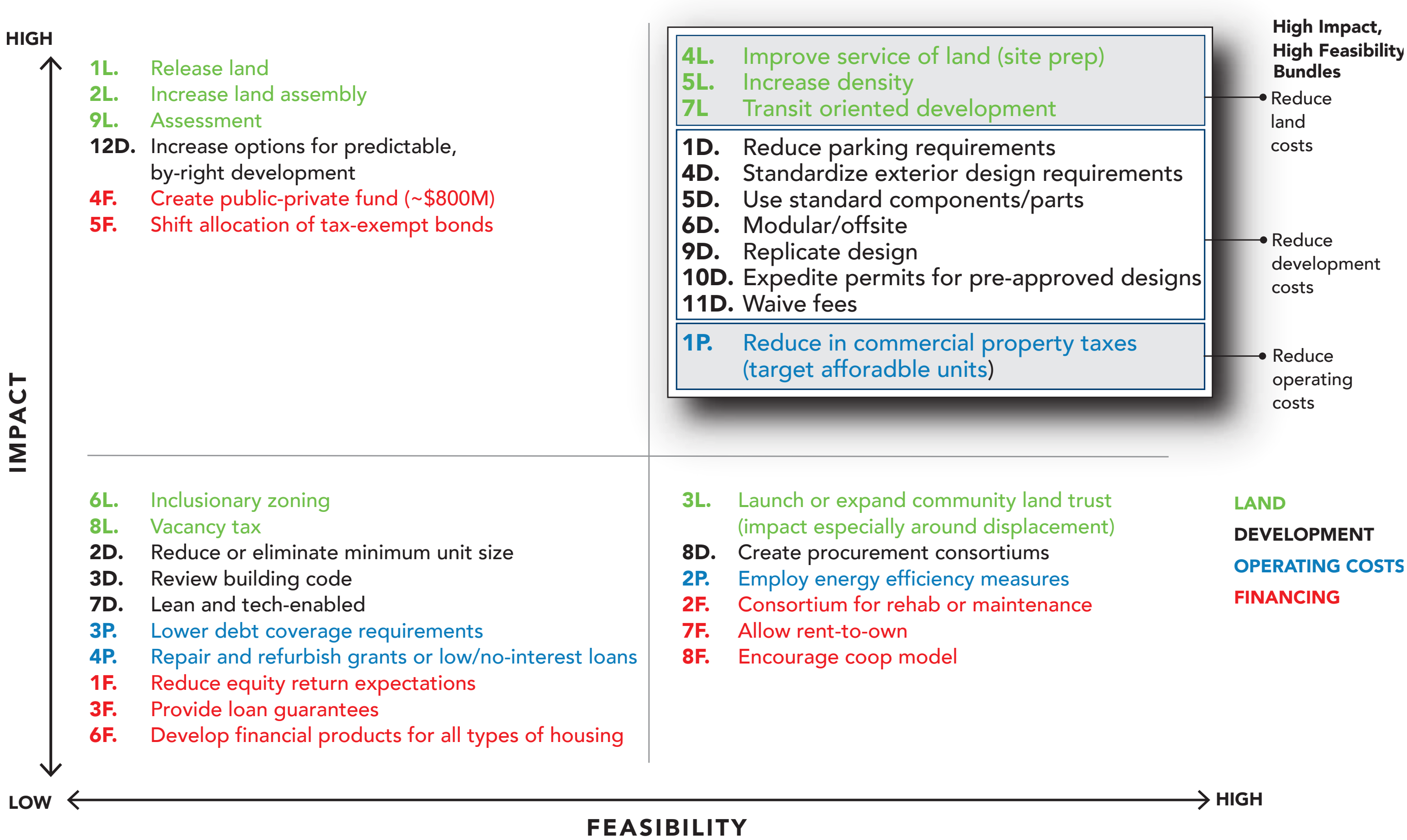
They then ranked these innovations on their impact and feasibility (Figure 5).

- **Impact**–an innovation's ability to increase the number of homes produced in the region and/or lower the costs of those homes
- **Feasibility**–an innovation's likelihood of success, including how difficult it is to implement and how certain the benefits are

The working group then created 'innovation bundles' of conceptually and practically related innovations. The most promising bundles of innovations are:

- **Reduce land costs:** Assemble and prepare large parcels next to transit and transportation corridors.
- **Reduce development costs:** Establish design standards that can be produced with modular or off-site methods and use faster city approval processes as an incentive to motivate developers to use them.
- **Reduce operating costs:** Reduce commercial property taxes through the 4D property tax and focus this reduction on affordable units.

Figure 5: Working group assessment of innovative practices, by impact and feasibility



These priority innovation bundles will be most powerful when adopted together with complementary measures (Appendix B) and implemented across the entire region. There are also additional actions that the private and public sectors can take, detailed in the next two subsections which would enable additional unit creation for the region.

The private sector can invest directly

If the private sector invests directly in housing, it can mobilize significant capital. This approach is gaining traction, especially in coastal regions with steep housing cost increases.

In Seattle, for example, Microsoft invested $750 million. Three years later, it has achieved the following:

- The $583 million already allocated has preserved or created 9,200 units of affordable housing at 120% AMI or less.
- A $100 million revolving land-acquisition fund has made long-term (i.e., 35 year) investments to maintain affordability.
- Seven suburban cities have partnered to increase their housing density.

The private sector can also actively support housing development (e.g., by speaking in favor of new housing development near owned locations, testifying at local government meetings, signing onto public letters, or organizing groups of employees) and partner with the Itasca Project or another entity to determine if their organization can better support employees through an innovative housing benefits package.

The public sector holds powerful levers

The public sector holds several powerful levers to increase housing production. It can:

- Provide land at low or no cost for developments that meet certain goals around affordability, density, and/or equity. As indicated by the priority innovation bundle around land costs, this provision can be especially powerful when paired with innovations like transit-oriented development. A Metropolitan Council analysis found that public entities own nearly 13,000 acres of land along existing or planned transit lines.
- Shorten and increase the certainty of the permit process, which will attract more residential development capital and activity.
- Use legislative action at the state level to dramatically impact housing production:
  - Housing Infrastructure Bond (HIB) funding offers a major opportunity to mobilize capital for affordable housing development, one that was missed in the most recent legislative session.
  - A more robust rental assistance program could enhance the feasibility of affordable housing projects by creating new income streams.

A call to action across sectors

We call upon all sectors – private, public, and nonprofit – and particularly developers, local elected officials, and state leaders, to take action. While some of these innovations are already in action in our region, we must accelerate and scale them if we are going to capture their impact and avert a housing crisis. We urge you to adopt the innovations in this report, encourage others to do the same, and find new ways to collaborate with each other.

Working Group members are taking action

Individual members of the Housing Innovation Working Group will jump-start this effort by doing the following over the next 12-18 months:

- Partner with cities to create guidelines/a model RFP to get the most benefit out of developments on city-owned land.
- Pilot streamlined regulations to speed development of projects with standard design characteristics.
- Explore opportunities to mobilize and attract capital for housing development through the GroundBreak Coalition, the Housing Impact Fund, and other venues.

While the challenge will be significant, we believe that the MSP region can continue to meet its production target of 18,000 homes per year. Stable and affordable housing will foster business and economic growth and provide better health, education, wealth-building, and racial equity, as well as a host of other positive outcomes. Increasing housing production and improving housing affordability will benefit families, firms, and the entire MSP region for generations to come.

Appendix A: Development costs and timelines

The group documented major cost categories of housing production, noting longer timelines for housing developed with subsidies than without (Figures A1 and A2 below). Of note:

- Land is the biggest single cost category and can be a lever for local governments: by offering land at low or no price to developers, they can influence the location, timing, and cost of development.
- Lengthy permitting processes may not add direct costs, but they delay returns, and therefore reduce return expectations.

The group specifically noted that creating affordable units at less than 30% area median income (AMI) often takes longer because:

- Subsidies are needed, often from many sources. If an application cycle is missed, development pauses.
- Local zoning approvals can be slowed by neighborhood objections.

Figure A1: Project viability formula, multi-family (simplified, non-exhaustive)

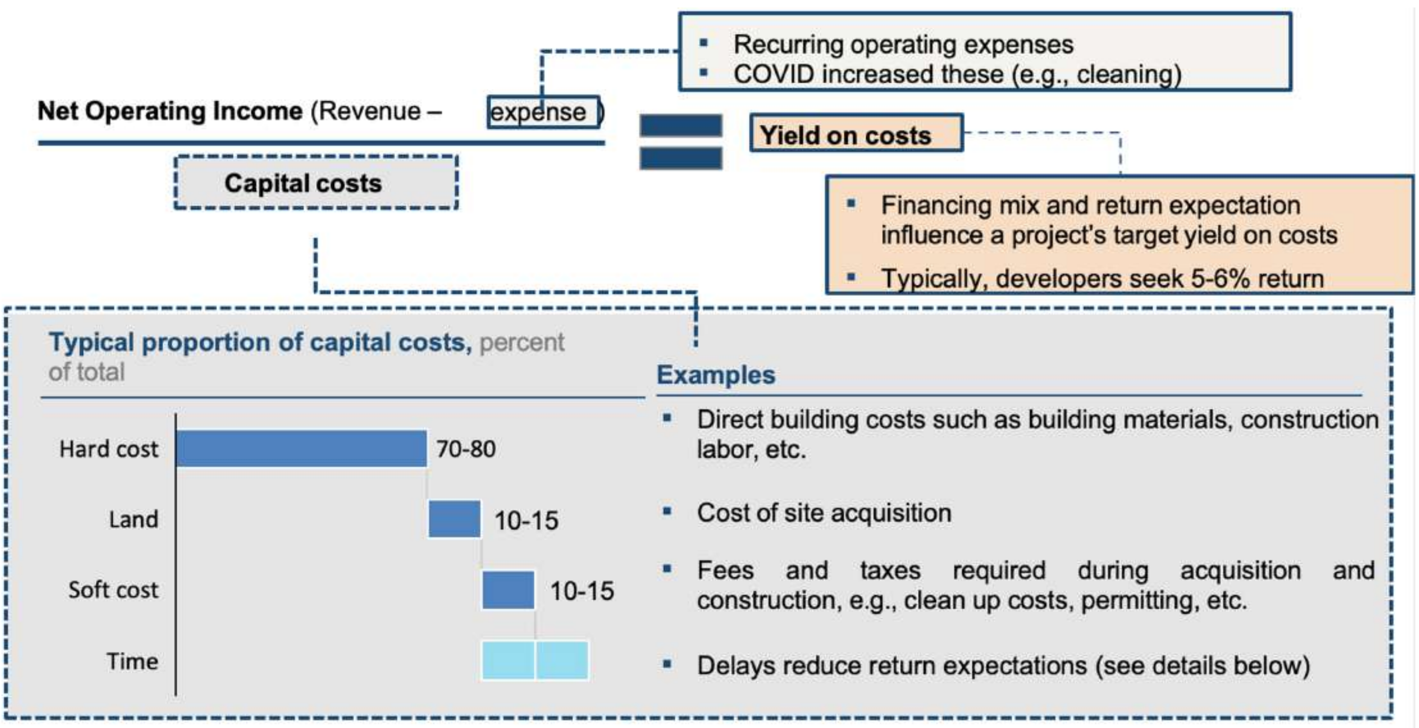
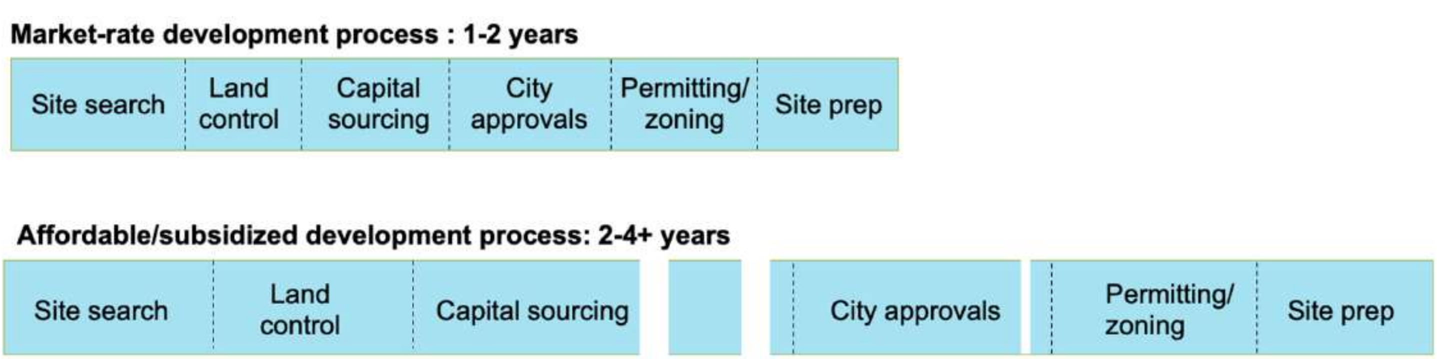


Figure A2: Many reasons elongate development timeline of affordable units; longer timelines reduce return expectations



Appendix B: Full list of innovations

The full list of innovations considered by the working group is included below for reference.

Land	
1L. Release land	Unlock land supply by selling or leasing strategically-located public or private land for affordable housing development
2L. Increase land assembly	Combine fragmented land ownership into single contiguous parcel
3L. Launch or expand	Ownership of land and structure are separated, and community land ownership used to ower unit costs
4L. Improve service of land (site preparation)	Improve infrastructure surrounding, and readiness of, undeveloped parcels
Land use	Increase number of units per parcel through:
5L. Increase density	Zoning changes to increase the allowable number of units per parcel
6L. Inclusionary zoning	Mandate inclusion of affordable housing as proportion of some new development
7L. Transit-oriented development	Concentrate and incentivize dense development around transit hubs
Increase use of vacant land	Utilize vacant land through:
8L. Vacancy Tax	Tax vacant land to incentivize productivity
9L. Assessment	Adjust property tax assessment to value land more than structure

Development — Hard Costs	
Change building requirements	Adjust local and state building requirements, such as:
1D. Reduce parking requirements	Reduce minimum parking requirements, mainly for multifamily housing projects
2D. Minimum unit size	Allow for smaller units by reducing or eliminating minimum unit size
3D. Review building code	Review building code to identify requirements that add cost to production - *any changes should be weighed against impacts on operating costs and other goals*
4D. Exterior design requirements	Review exterior design requirements to identify areas of added cost production (materials, landscaping, etc.)
Improve construction	Adjust construction approach through:
5D. Use standard components/parts	Reduce customization in design and construction
6D. Modular/offsite	Employ modular and offsite construction to simplify and expedite building
7D. Lean and tech-enabled	Utilize lean methodology and building information modeling

Appendix B: Full list of innovations (cont.)

Development — Soft Costs	
8D. Create procurement consortiums	Procure building materials by aggregating volume across developments and leverage scale to negotiate with suppliers
9D. Replicate design	Provide standardized design parameters across structure and finishing elements across projects to speed delivery of units
10D. Provide expedited permitting for pre-approved designs	Fast track permitting and approval process for pre-approved unit designs – projects can employ standard or modular construction
11D. Waive fees	Reduce or waive fees (e.g., park fees, SAC/WAC, etc.) – can be tied to affordability requirements
12D. Increase options for predictable, by-right development	Provide incentives, waivers, grants, bonuses, etc. to encourage developers to follow pre-defined designs
Operating Costs	
1P. Reduce in commercial property taxes	Reduce property taxes to lower the long-term operating costs of single and multifamily housing; target tax break to affordable units
2P. Employ energy efficiency measures	Develop standards for energy efficiency and provide support for capital investments to reduce long-term opex - to be weighed against impact on construction costs
3P. Lower debt coverage requirements	Provide debt with lower servicing costs and /or longer repayment schedule than market rate for given project
4P. Repair/refurbishment grants or low/no-interest loans	Establish structured programs to upgrade and refurbish existing homes
Financing — Developers	
1F. Reduce equity return expectations	Reduce return rate / lengthen payback period to reduce a project's cashflow requirements
2F. Consortium for rehab or maintenance	Pool resources at neighborhood level to better negotiate rehab or maintenance costs
3F. Provide loan guarantees	Provide loan guarantees for projects in "high risk" areas to encourage development and spur further investment
4F. Public-private fund	Create a fund and partner with local entities to deploy it (e.g., Microsoft in Seattle)
5F. Shift tax-exempt bond allocations	Consider shifting tax-exempt bond allocations to maximize access to Federal tax credits
Financing — Homeowners	
6F. Develop financial products for all types of housing	Develop and offer for all types of housings including income properties (e.g., duplex, triplex) and other non-standard units
7F. Allow rent-to-own	Change policies to allow "rent-to-own" agreements to encourage ownership
8F. Encourage coop model	Changes policies to allow and enable financing for cooperative housing models, as alternatives to standard ownership models

ITASCA project™

The GREATER MSP Partnership