Addressing the Critical Housing Shortage in Rural North Dakota

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
December 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
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Impediments to rural housing development identified

1. Typical rent in rural areas won't support enough debt to build new
2. The cost of construction is higher than in urban communities.
3. Generally, there is a shortage 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 achieved 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 making comparable properties for appraisals hard to find. 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 can require 50% equity investment or more to be financially feasible and maintain affordable rents
- Popular Federal programs for multi-family development work best for larger projects (24 to 42 units) that are often too big for rural areas.
- **Underfunded** - 2020 to 2022 Biennium, $9.5M appropriated for HIF, was overprescribed by $16M without consideration of smaller, rural projects.
- Urban projects have been further along in planning when HIF funds become available one time in each biennium, so more shovel ready, so more competitive. The sporadic availability of HIF funds has hindered rural projects.
- Highly flexible source of funding that can be used to meet unique rural challenges.

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%).
- Allow HIF to be used for homeownership in rural communities

LEGISLATIVE ACTION

- Increase biennial funding to no less than $50M for five biennia.
- Create stable, long-term funding source to enable planning and project development time for rural areas.
- Modify century Code to allow HIF to be used for homeownership activities in rural communities.

Rural Renewal Workforce Housing

This concept program would target workforce housing using displaced, blight and unsafe properties to promote 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 could be eligible. Businesses located in properties that were part of the program would 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 could 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 would be in-kind, in the form of property, city staff time to coordinate, and other related activities.

City population	# cities targeted	# properties per city / total statewide	Average cost per property	Housing study subsidy	Total cost	Estimated impact
Tier 1: up to 999 (307)	25	5 / 125	$25,000	n/a	$3.125M	$19.25M
Tier 2: 1,000 to 2,499 (32)	20	12 / 240	$35,000	$10,000	$8.6M	$61.62M
Tier 3: 2,500 to 20,000 (9)	6	20 / 120	$55,000	$15,000	$6.9M	$42.07M

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 website of available sites and community incentives

LEGISLATIVE ACTION

- Appropriate $18.625M for a two-biennia program
- Appropriate $736k 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 $225/sq ft development cost. 2-bedroom, 2-bath, garage.**

Scenario 1: No subsidies. $2,293/month rent which would require an annual household income of $99,700K ($48/hour for single-earner) to be "affordable" based on 30% standard. The owner investment required is $257K (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	$110,040 rental income	$863,260 max debt capacity (1.2 DCR)
$2,293 monthly rent	($18,000) operating expense ($4,500/unit - taxes, insurance, maintenance, property mgmt)	$722,500 max loan based on (75% LTV)
$200 monthly utilities	($11,004) 10% vacancy	$247,500 cost per unit
$99,700 min. household annual income for affordability ($48/hour)	($60,430) annual debt service	$1,030,000 total development cost (TDC) - inc. $40K land cost
	$20,606 annual profit/owner return	$257,500 owner equity (25% of TDC)
		$722,500 actual debt, 5%, 25 years (75%)
		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 $63K (6%) 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 rental income	$268,450 max debt capacity (1.2 DCR)
$1,000 monthly rent	($18,000) operating expense	$257,500 max loan based on 75% LTV
$200 monthly utilities	($4,800) 10% vacancy	$247,500 cost per unit
$48,000 min. household annual income for affordability	($20,143) annual debt service	$1,030,000 total development cost (TDC) - inc. $40K land cost
	$5,057 profit	$63,200 owner equity (6% of total TDC)
		$194,300 subsidized equity/grant/HIF (19% of TDC)
		$257,500 actual debt, 5%, 25 years (25% of TDC)
		$515,000 Gap (HIF) est. $115K/unit (50% of TDC)
		8% ROI

** All assumptions provided here are for discussion purposes only and do not reflect a specific development

MULTI-FAMILY - 8-Plex Scenarios

Scenario #3: No subsidies. Rental rate is $2,274/month which requires an annual household income of $99,960 ($48/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	$218,304 rental income	$1,709,493 max debt capacity based on 1.2 DCR
$2,274 monthly rent	($36,000) operating expense	$1,530,000 max loan based on 75% LTV
$200 monthly utilities	($21,830) 10% vacancy	$247,500 cost per unit
$99,960 min. household annual income for affordability	($40,787) debt service	$2,040,000 total development cost (TDC) - inc. $60K land cost
	$40,787 profit	$510,000 owner equity (25% of TDC)
		$1,530,000 actual debt, 5%, 25 years (75% of TDC)
		8% 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 rental income	$536,901 max debt capacity based on 1.2 DCR
$1,000 monthly rent	($36,000) operating expense	$510,000 max loan based on 75% LTV
$200 monthly utilities	($9,600) 10% vacancy	$247,500 cost per unit
$48,000 min. household annual income for affordability	($39,896) debt service	$2,040,000 total development cost (TDC) - inc. $60K land cost
	$10,8504 profit	$131,300 owner equity (6% of TDC)
		$378,700 subsidized equity/grant/HIF ((19% of TDC)
		$510,000 actual debt, 5%, 25 years (25% of TDC)
		$1,020,000 Gap (HIF) est. $113,750k/unit (50% of TDC)
		8% ROI

** All assumptions provide here are for discussion purposes only and do not reflect a specific development.

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 is required to reduce bank debt and achieve marketable rents - grant, not debt.
- A shared equity subsidy can increase ROI to make it a worthwhile investment. Again, grant, not debt, as there often 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

- What is a reasonable rent in rural communities? What are people willing or able to pay?
- Should the community have skin in the game?
- Should state investment be tied to economic development?
- Could a non-profit developer be an owner with lower ROI expectation?
- 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)?

EVERYONE CAN PLAY A PART

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?

Rural America is poised for a renaissance with more and more Americans recognizing the wonderful quality of life available in small towns. Technology is allowing workers to live where they choose. As this task force did research on the challenges and solutions we realized North Dakota is not alone, all of rural America has an opportunity.

The North Dakota legislature continues to invest in rural connectivity, making our small towns technology enabled. The state's workforce development efforts are starting to pay dividends. For many years, there has been very little investment in housing in many of our rural communities. **Now is the right time for our state to invest in rural places, to help meet the growing changing needs of our rural communities, to build on the momentum created by ongoing workforce development, and place making efforts.**

Rural communities are rolling up their sleeves and working to retain population and grow. Businesses want to grow, jobs are plentiful, people want to live here. **The Rural Housing Development Task Force concluded that a stable source of funding for the HIF program, and a long-term commitment to the program is the number one priority in helping rural communities meet their diverse housing needs.** HIF is a highly flexible funding source with a proven track record around the state.

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