



August 15, 2019

MEMORANDUM

TO: Ms. Chloe McGuire Brigl
City Planner
City of Ramsey

FROM: Mr. Matt Mullins
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RE: Twin Cities Housing Trends: For-sale, Rental, and Senior Housing Markets

Introduction

This memorandum provides an overview of housing trends in the Twin Cities Metro Area for the general-occupancy apartment market, senior housing market, and the for-sale market. Please note all trends and data is reflective of market performance as of July and August 2019 and is subject to change based on economic conditions, market performance, submarket locations, etc.

Rental Housing Market

- Multifamily apartments have been the leading real estate product types for nearly a decade and the Twin Cities is one of the top apartment markets in the country. For the third year in a row, Twin Cities apartment deliveries have shattered the previous year's peak. This year, Maxfield Research estimates more than 8,000 new units are anticipated to be delivered in 2019 surpassing last year's peak by +40%. Minneapolis is leading city for new construction as over 2,800 units are expected to deliver in 2019. Combined with suburban Hennepin County, an estimated 70% of all new apartments in the Metro Area will be in Hennepin County.
- The Twin Cities market will continue to be a top apartment market in the country with strong market fundamentals: low unemployment rate & rising wages, strong demographics, low vacancy rates, and capital pouring into the multifamily sector. Furthermore, the apartment market has benefited from the lack of supply in the for-sale market as buyers remain on the sidelines due to the lack of homes for-sale.

- The Twin Cities has one of the lowest vacancy rates in the nation (sub 3% since 2011) which has been driving the demand for new construction. Although other major markets have been experiencing slower growth in 2019, the Twin Cities has attracted national interest and out-of-town investors are chasing apartment deals that have healthier returns than other larger urban areas. As a result, there has been capital investing into “value-add” older apartments as investors improve properties and increase the returns through higher rents.
- New construction throughout the Twin Cities tends to be wood-frame construction with three to five stories above a podium of parking and/or ground floor retail. Stick-based construction in a mid-rise building is substantially less financially to develop than steel or concrete and labor is more economical and available. Most densities in suburban communities in the Metro Area exceed about 25 to 30 units per acre and parking requirements are being decreased. New apartments are in an “amenities war” as each new property attempts to surpass the competition with the newest amenities that will lure tenants.
- New construction has skewed to smaller unit sizes to address affordability and smaller household sizes. Many new apartment communities offer mostly studio and one-bedroom apartments and offer fewer larger units due to high costs and fewer larger households seeking rental housing. Larger units have appealed to families who are building new homes and need rental housing during construction; however, this market segment is low. Micro-apartments are also being developed in the core cities and near transit stops. These units are popular among Millennials who desire amenitized buildings but smaller unit sizes and more affordable rents.
- Affordability continues to be a major obstacle as development has catered to the move-up and luxury sectors while demand is strong for the middle-market. As a result, most of the “affordable” rental housing is located in older, existing market rate buildings (Naturally Occurring Affordable Housing or NOAH) that has not been updated and rents are modest. In fact, about 70% of all affordable housing in the U.S. receives no government subsidies and is older market rate housing stock. However, there is a strong interest in retaining affordability in the older housing stock to keep rents in check with wage growth and inflation. Many cities are looking for funding solutions that allow these units to remain affordable.
- The recent Tax Cuts and Jobs Act is the most significant tax law change in the U.S in over 30 years (since the Tax Reform of 1986). The tax reform negatively affected the for-sale housing market for high-priced homes, second or vacation homes, and homes in high-tax states as the bill reduced tax benefits of owner-occupied homes. However, the reform was positive for the rental real estate industry as landlords benefit from tax savings and modify the way “pass-through income” is taxed and renters benefit from the increased standard deduction thereby increasing take-home pay. In addition, the tax cut fueled economic growth initially and has prolonged the current real estate cycle as more entities pour money into real estate assets. The bill also preserved the 1031 tax-deferred exchanges and maintains its status quo for low income tax credit housing.

Senior Housing

- Similar to general-occupancy apartment housing, senior housing in the Twin Cities has also had a banner year for new deliveries. In 2018 over 2,300 new senior housing units were completed breaking the previous record of just over 2,000 units in 2017. Historically, the Twin Cities has averaged about 1,400 new senior units annually since the year 2000. The Twin Cities is now a top ten market in the U.S. for new senior housing construction.
- New senior product has recently shifted and targeted active adult and independent product types that have comprised nearly 75% of all new units developed this past year. In addition, affordable senior housing accounted for 41% of all new production as local developer Dominion has been actively developing the Legends housing projects throughout the Twin Cities. Finally, for-profit developers have been the most active and now comprise about 85% of all new units in the pipeline. Previously, non-for-profit developers had a significantly higher market share.
- Although rising home prices should be a sign for older adults and seniors to “right size,” many seniors are not selling their homes. Over the past few years the 65+ demographic has had lower turnover rates than previous generations. Many seniors are not selling due to a lack of maintenance-free product and rising housing costs. Because older adults 55+ own most of real estate in the U.S., the housing market has been held back and has contributed to the housing shortage. At the same time, demand is strong for active maintenance-free living products as senior cooperatives, twinhomes, detached townhomes, rambblers, and condominiums. Because there is a lack of new product; many seniors have also sought-out traditional general-occupancy apartments as the next step.
- The long-term demand for senior housing is exceptionally strong due to future growth in the senior population over the next few decades (+110% senior growth by 2030). Demand will continue to be strongest for active-adult and independent living products in the short-term as assisted living and memory care are experiencing vacancy rates above equilibrium. Maxfield Research finds active adult and independent living vacancies averaging 2.4%, compared to 8.5% for assisted living and memory care housing. For the remainder of 2019, we expect modest rent growth and a competitive leasing environment for service-intensive senior housing.

For-Sale Market

- After a lengthy recovery resulting from the Great Recession and the trough of last decade; home prices are at peak values in 2019. Median home prices are at an all-time high of \$280,000 (July 2019), up 4% since year-end 2018. The market has been strong due to ongoing job growth, economic growth, increased consumer confidence, and low mortgage interest rates. Sellers are receiving 99% of list price and days on market continues to slide to less than 30 days. The market continues to suffer from a lack of inventory, especially for entry-level homes priced under \$300,000 where demand is strongest.
- The Twin Cities has one of the highest price spreads in the U.S. between new construction and existing homes. New construction has a median sales price of about \$400,000 (\$ 173 PSF) compared to \$265,000 (\$ 143 PSF) for an existing home. Builders are unable to deliver affordable homes due to a number of headwinds including building codes, regulatory issues, and increased land, labor, and material costs. As a result, most new construction targets the move-up and executive buyer with most new single-family homes coming in over \$500,000.
- New attached housing units such as townhomes, twinhomes, detached townhomes, and condominiums have increased production as buyers seek more affordable housing options in denser locations. However, housing costs for attached townhomes still exceed \$275,000 and more while new condominium product targets the luxury home buyer with prices above \$600,000. Production of attached housing products has not recovered since the recession and still represents a small proportion of new for-sale housing products.
- Because of the lack of supply and low mortgage rates of existing homeowners, many homeowners are staying put and are not selling their homes. This has contributed to the lack of homes for sale and kept many first-time home buyers on the sidelines due to lack of availability for entry-level homes.
- Mortgage rates have continued to fall in 2019 and are now at the lowest level since 2016 (about 3.6% on a 30-year fixed mortgage). Low interest rates have led to a refinancing boom and have assisted the housing market in 2019; however, interest rates have not nudged many first-time home buyers off the fence as they are concerned about housing affordability.
- New construction demand has moved outside the Twin Cities core as buyers seek affordability. Technology and the Amazon effect allow outer-ring and tertiary locations to grow as more and more households are able to telecommute and are less dependent on proximity to their place of employment.