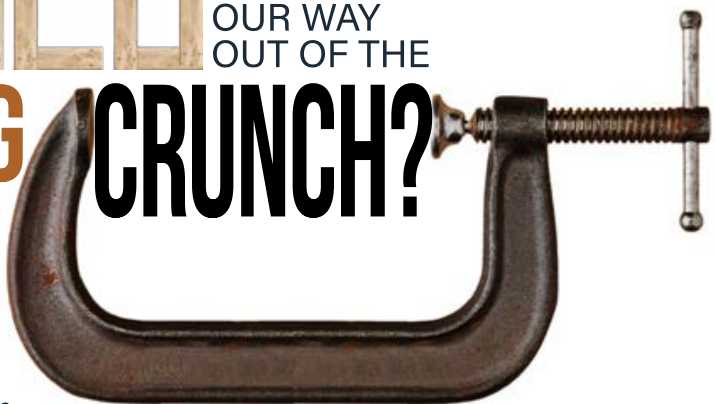
CAN WE BUILD OUR WAY OUT OF THE HOUSING CRUNCH?



Despite ambitious new government programs designed to get more buyers into homes, Minnesota's construction industry struggles to meet demand. High costs, labor shortages, and regulations have slowed home building to a crawl.

For thousands of aspiring homebuyers, Minnesota's chronic shortage of housing inventory is an unyielding obstacle. According to the Minnesota Housing Finance Agency, the current rate of new-home construction is far behind population growth in the state. Only a few years from now, Minnesota will face a shortfall of 40,000 affordable homes and apartments. And while this gap will hit lower-income, first-generation homebuyers the hardest, it will make purchasing a home more grueling, competitive, and costly for buyers across the income spectrum. Despite the Minnesota legislature's recent passage of a $1 billion omnibus housing finance bill, the housing shortage is unlikely to be reversed any time soon.

How did a state flush with so much money, talent, natural resources, and skilled labor come to be in such a quandary? In a little over a decade, Minnesota went from a historic glut of homes on the market to nearly bare shelves. To understand how we got here—and where we might be going—it's helpful to take a look back.

Welcome to the Boom

The mid-1990s were prosperous times for Minnesota. With its wide range of industries, the state was a regional powerhouse, attracting new residents from neighboring states and across the country with the promise of good jobs, vibrant culture, and pristine miles of lakeshore. Many Baby Boomers were still raising families, trading up from humble starter homes to larger single-family dwellings in the expanding suburbs. Despite the apocalyptic scare of a massive tech meltdown from Y2K, the good times rolled into a new millennium. Not even the Dot Com crash of 2000 dealt more than a glancing blow to Minnesota's diverse economy. Soon, tail-end Boomers and Gen Xers joined the housing gold rush, taking advantage of mortgage rates skimming just under 6%. At the boom's peak in 2003–2004, more than 23,000 new homes a year carpeted developments and subdivisions across the state.

Adding Fuel to the Fire

Highly motivated to stoke growing demand, mortgage lenders swept in under-qualified buyers with risky subprime loans. In a new financial innovation, these loans were bundled into bonds and sold to mammoth national investor banks that reaped enormous profits. An entire financial ecosystem was built on this quavering foundation, from loggers and lumber mills to Realtors®, mortgage companies, and titans of Wall Street. For a while, that big hot balloon of debt soared beyond anyone's wildest dreams.

Until it didn't.

By spring 2005, the first leaks were forming. Wages weren't keeping pace with the cost of living, and more families struggled paycheck to paycheck. Orders for new homes slowed. By summer, construction companies were laying off workers. In northern Minnesota, lumber mills were nearly idled, producing far fewer beams and boards. More workers lost their jobs. Loggers, who took on big debt for licenses to harvest trees on private lands, silenced their chainsaws. Many went out of business. Pyramids of felled timber sat stacked in stumpy clearings where forests once stood, monuments to short-sightedness, arrogance, and greed.

In 2006, the ground started shifting. As adjustable rates rose on subprime mortgages, many borrowers were unable to keep up with increased payments and defaulted on their loans. Investment banks grew nervous when investors accused them of selling bad bonds. Locally, Minnesota mortgage companies found the market for loan sales drying up, saddling them with many millions of dollars in loan debt. By the following year, there were 38,000 foreclosures in Minnesota alone, with many hundreds of thousands more rippling across the nation. Lenders began auctioning off foreclosed properties at deep losses. Some properties in north Minneapolis went for as little as $30,000.

The Great Recession, as it came to be known, gouged the entire U.S. economy, plunging the gross domestic product (GDP) by nearly 3% and spiking the unemployment rate to 10% at its height in 2009. During the slow, painful recovery, there were still tens of thousands of foreclosures a year until 2014 when the rate slipped under 5,000 for the first time since the crisis began. Most of these properties were scooped up by investors and turned into rentals, setting the stage for today's housing crunch.

Supply Wears Thin as Buyers Scramble for Homes

Although demand for single-family homes picked up from 2015 onward, supply lagged as a new generation entered the market. Millennials, those born between 1981 to 1996, comprised the largest U.S. population surge since the Baby Boom. The oldest of them were in their mid-20s to mid-30s, building careers, starting families, and aspiring to own homes. Unlike earlier generations, many were saddled with historically high levels of debt. Almost 44% owed up to $20,000 in student loans for college, according to the St. Louis Fed. Further, a 2021 report from the National Association of Realtors® (NAR) found that more than half of Millennials said student-loan debt was delaying their purchase of a home. Despite the barriers, thousands of them crowded into open houses, signed representation agreements, and competed for shrinking housing stock.

In 2020, the first year of the COVID-19 pandemic, the housing market exploded. Claustrophobic from lockdowns, and suddenly needing home-office space, once devoutly urban Millennials fanned out to the suburbs in pursuit of big yards and more square footage. By August of that year, 30-year fixed mortgage interest rates dipped below 3%. Bidding wars flared from the Twin Cities metro to the northern lake shores. By year's end, pending sales rose in the double digits for seven consecutive months. Homes for sale were down 46% over 2019 with 8,400 fewer homes for sale. Closed sales spiked 8.4% to almost 93,000 residential properties sold. But homes for sale were down 46% over 2019 with 8,400 fewer homes for sale.

If You Don't Build It, They Won't Come

In almost any previous decade, market conditions like these would have fueled explosive growth in construction. But the pandemic, international supply chain issues, rising materials and fuel costs, and a shrinking pool of skilled and unskilled workers idled buzz saws and hammers across the state. For the present, there is little hope Minnesota's lumber industry will revive. A 2022 case study by the Forest Resources Association found that two-thirds of the state's logging-business owners are over age 50. Discouraged by rising costs, labor and transportation issues, and falling profits, most are not encouraging their children or other family members to enter the industry. So, when the last of these loggers walk out of the forest, it is not clear who will take their place.

On the construction side, inflating land values, onerous zoning codes, regulations, and fees make it difficult—if not impossible—to produce the high volume of affordable homes that buyers so desperately want. The relatively few new houses that were being built in the pandemic and post-pandemic period were priced well above the threshold for affordability.

The Market Cools but Home Prices Run Hot

Despite chronically bare housing stocks—inventories rarely rose above 1.5 months' supply until 2023—the hot market boiled for two years. By June 2021, sellers were averaging 103.2% of their asking price, pushing the median sales price to $325,000, 18.9% above 2020. A year later, competitive bids still kept sales well above the asking price, pushing the median sales price to $345,000. By year's end, however, inflation and rising interest rates—which surpassed 7% in October 2022—were cooling the market, with closed sales down almost 40% compared to December 2021. The trend continued in 2023 and by the end of the second quarter buyers were staying home, and sellers were reluctant to put their properties on the market. Still, inventory crept up, with about two months' supply on the market by the end of June. Even though homes were taking longer to sell, competition for affordable, desirable homes remained heated, allowing many sellers to get over 100% of their asking price.

New Hope for First-Generation Homebuyers

While middle-class households push the limits of affordability to close on homes, lower-income families are virtually locked out. The situation is particularly difficult for first-generation homebuyers, of which a significant number are Black, indigenous, and People of Color. Of these groups, Black buyers suffer the greatest disadvantage, with only 25% of households owning homes in Minnesota. That grim statistic puts Minnesota in the top five states with disproportionately high racial homeownership gaps. Although the recently passed "First-Generation Homebuyers Down Payment Assistance Fund," targets the gap with a $100 million program, and will help thousands of households purchase homes, it does not push the needle on the supply side. (for more, see p.12, "New Pilot Program Targets Assistance for First-Generation Homebuyers in Minnesota").

Will $1 Billion Build More Houses?

In May, the Legislature passed the omnibus housing finance bill, appropriating $1.07 billion dollars for a wide range of programs, including first-generation homebuyer downpayment assistance. The funds include $90 million for a community-stabilization program designed to keep existing homes affordable through rehabilitation or outright acquisition. A $65 million program will prevent people from falling into homelessness. And many millions more will provide homeownership investment grants, workforce housing development, manufactured home lending grants, housing infrastructure grants, and numerous other programs.

Notably absent from the bill are policies that would stimulate new home construction by the private sector. Paul Eger, Minnesota Realtors® (MNR) senior vice president of Governmental Affairs commented on this during testimony on Rep. Steve Elkins' HF 2235 ("Legalizing Affordable Housing Act") in March 2023. "MNR's most recent data shows that while the market has cooled, the chronic lack of housing inventory poses a significant challenge to getting more Minnesotans into homeownership," Eger observed. He added that healthy, well balanced housing markets have at least 4–6 months' supply. By contrast, Minnesota's market is chronically under supplied, rarely exceeding 1.5 months of inventory.

"While it may be controversial," Eger continued, "the discussion around how to increase the supply of housing needs to include an examination of barriers such as restrictive planning and zoning codes, burdensome permitting processes, and cost drivers resulting from impact fees and other fees on new housing."

Minnesota's housing shortage is the result of a complex web of laws, regulations, building codes, fees, materials and land costs, and ongoing labor shortages. And there are no magic bullets. Even cities like Minneapolis and St. Paul that have overturned single-family zoning in many of their neighborhoods, are struggling to attract the affordable duplexes, triplexes, and small apartment buildings envisioned in their 2040 plans. Many residents who eagerly endorsed the zoning changes are resisting the construction of actual buildings in their neighborhoods. And developers say the affordable-price targets are unrealistic given land costs and construction expenses. For example, a 41-unit apartment building that was completed in Minneapolis in 2020 charges from $995 to $2,495 per month. Whether this is affordable depends entirely on the size of your paycheck. And for too many city residents it clearly is not.

In a more hopeful sign, homebuilding activity was increasing by May 2023. In the Twin Cities, 487 permits were issued for single-family homes, according to Housing First Minnesota, a homebuilders' trade association. And though this number was still 13% below permits issued the same time last year, it was a market improvement over the earlier months of 2023 when permits were down over 40%.

"Minnesotans want to own homes, but the current existing market is failing to meet them where they are," James Vagle, CEO of Housing First Minnesota stated in the June issue of the association's newsletter. "Minnesota's homebuilders are ready to fill that gap and provide safe and durable homes for our state."

Lessons from California

California might offer a model of a way forward for Minnesota. In 2022, Governor Newsome signed laws that will pour billions into tackling the state's chronic shortfall of affordable housing and widespread homelessness. And the need is mammoth. According to the state's housing plan, California will need more than 2.5 million housing units over the next decade. At least one million of these homes must be affordable for low-income residents. To achieve this, the state is experimenting with a number of approaches, including rezoning underutilized commercial sites for low-and-middle-income homes; and dramatically expanding the construction of accessory dwelling units (ADUs), so called "tiny homes" that can now be built in the backyards of existing properties. Since laws were passed in 2016 to make ADU construction easier, California has issued over 23,000 permits for ADUs, which is about one-fifth of all the state's building permits*. Recently, there has even been bi-partisan support for changing its strict environmental laws, making it easier and less costly to build homes.

Ultimately, solving Minnesota's affordable-home crisis will require cooperation, creativity, and innovation from state and local governments, and the private sector. Although there are few, if any, easy solutions, history shows that Minnesotans always rise to the challenge. After all, in the span of just 165 years, great cities, communities and cultures took root and prospered on frozen plains that few Americans believed could be tamed.

*Learn more about ADUs in Minnesota by reading MNR's blog from October 2022: "Honey, I Shrunk the House."