MARKET RATE RENTAL

PRIORITIES

For market rate rental housing, the primary goal is to ensure that there is sufficient quantity and diversity of supply to meet the needs of a growing market.

1. As housing preferences change and rental housing becomes a larger portion of our housing market, it is more important than ever that there is open communication and information sharing between rental housing providers and municipal government.
    a. **Create a quarterly Housing Data Report combining data on key market trends**
        i. Work with MG&E to improve their rental vacancy data (ex. reporting by Census tract)
        ii. Provide up-to-date City information on permits, development pipeline, year over year trends
        iii. Targeted towards policy makers, neighborhoods, developers to provide a common set of impartial data to inform decisions
    b. **Increase representation by rental housing providers on city committees** to foster greater communication and ensure that City policy is well informed of trends and concerns in the rental market
        i. Create dedicated seats in housing related committees (Community Development Authority, CDBG, Economic Development, Housing Strategy, and Tenant-Landlord) for rental housing providers

2. To meet the increased demand for rental housing, the City should take proactive steps to encourage rental housing development in locations that are suitably zoned, are well served by transportation infrastructure, and are in close proximity to amenities that renters demand.
    a. **Create a Housing Development Fund to finance land banking and pre-development costs to prepare sites and reduce barriers to rental housing development**
        i. Structured as a joint City/private equity fund with commitments from lenders for low-interest loans
        ii. Administered by the City, Community Development Authority, or a non-profit
        iii. Set clear parameters for acquisition targets and outcomes (Ex Require a portion of units be affordable, mixed-use, etc)
        iv. Target acquisitions/developments in Transportation Master Plan identified development zones
        v. Partner the fund with new Tax Incremental Financing Districts, zoning overlay and urban design districts to further support and guide development
        vi. Proactively advertise and market development zones to attract investment

CDA										
Common Council										
Community Development										
Economic Development										
Mayor's Office										
PCED										
Planning										

OVERVIEW

Knowing where growth is taking place is essential for projecting demand for infrastructure and public services. It can also be a window into what kinds of housing people prefer. Where people actually live depends on much more than what they say they want. Housing supply, energy prices, tax policy, and other factors all affect the availability and cost of housing and, as a result, where people end up living.

In recent years, pinpointing the true demand for housing has been complicated by the ownership housing bubble and the resulting housing crash and recession. The housing bubble fueled single family and condo construction and household growth on the city fringe and beyond, while the rental market actually shrunk. After the bubble burst, the number of renter households increased rapidly, though the construction market was slow to respond. As a result, 9 out of 10 new households added since 2007 have been renters. It is not clear if this is a market correction or a permanent shift toward more rental housing.

Since the beginning of the recession in 2007, the City of **Madison has experienced a continued rise in population and households that has outpaced its production of housing**. In response to this undersupply of residential rental housing, **the market has seen rents rise and vacancy rates fall**. These market conditions have lead to a boom in production to fill the market need. The thousands of units that have been constructed in recent years have largely been in the form of studio, one, and two bedroom units in low (3 stories or less) and midrise (4-7 stories) apartment buildings located …..

While the pace of multifamily residential development has been rapid, at this point there is little cause for concern about a bubble bursting comparable the recent single family housing bust because:

- Multifamily vacancy in Madison remains at 2-3%, meaning that 1,000 new units could be added tomorrow without pushing vacancy above 5%
- Lenders underwrite multifamily developments much more stringently than single family homes and require a greater level of equity participation, reducing the likelihood of foreclosure
- There are market mechanisms such as rent reduction, conversion to owner occupancy, and demolition/repurposing of obsolete stock to adjust for overbuilding

If preferences rapidly shift to owner occupancy or the market is overbuilt, the primary concern of the City should be the reduced incentive of property owners to manage and maintain buildings, particularly bank owned properties.

It is in the best of interest of the City of Madison to have a robust market for rental housing because it provides a housing option for households that:

- Are not ready to make a long-term commitment to a location (young professionals)
- Are not financially prepared to purchase
- Prefer the convenience of professional 3rd party management
- Prefer living in a location where the land economics favor multifamily housing (downtown)

Additionally rental housing attracts outside capital to invest in our real estate market, contributes to the property tax base, and offers an opportunity to increase density.

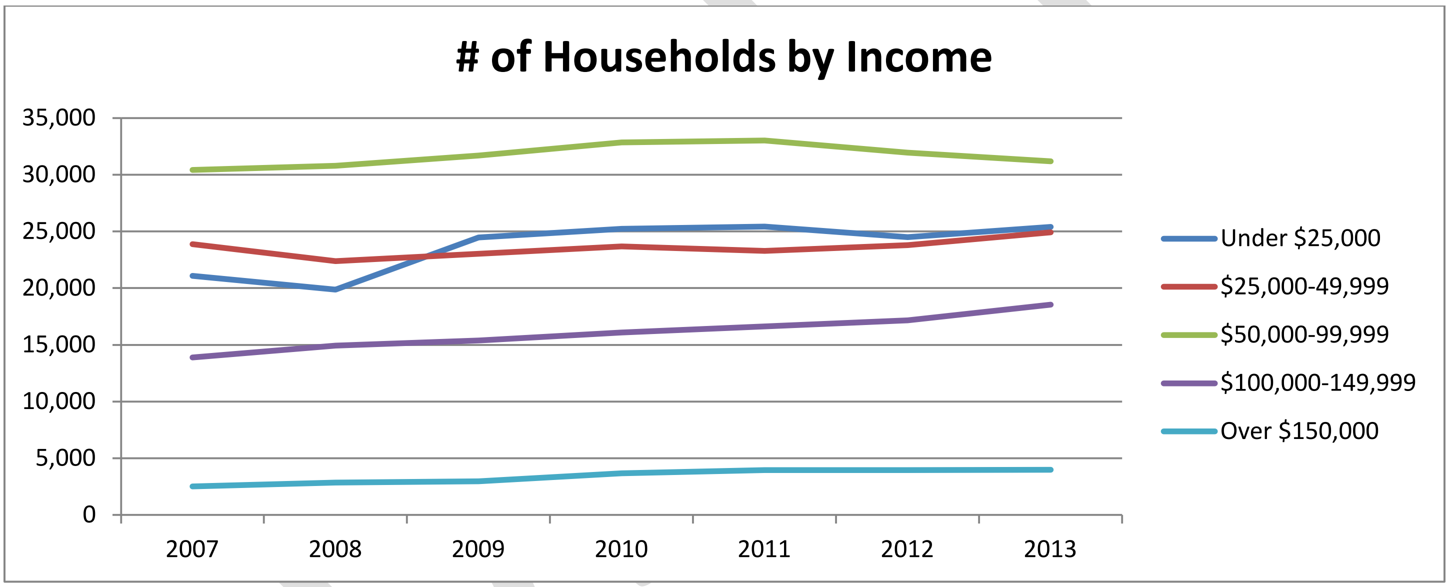
DEMAND

As an earlier chapter focused exclusively on low-income renters (those with household incomes below $50,000) this chapter will place particular emphasis on renter households with incomes greater than $50,000. Demand for rental housing by this population is likely driven by a preference for rental rather than ownership rather than strictly affordability factors. For this population, demand factors are also influenced by impediments to ownership including down payment and credit requirements.

DEMOGRAPHICS

Since 2007, the City of Madison has added approximately:

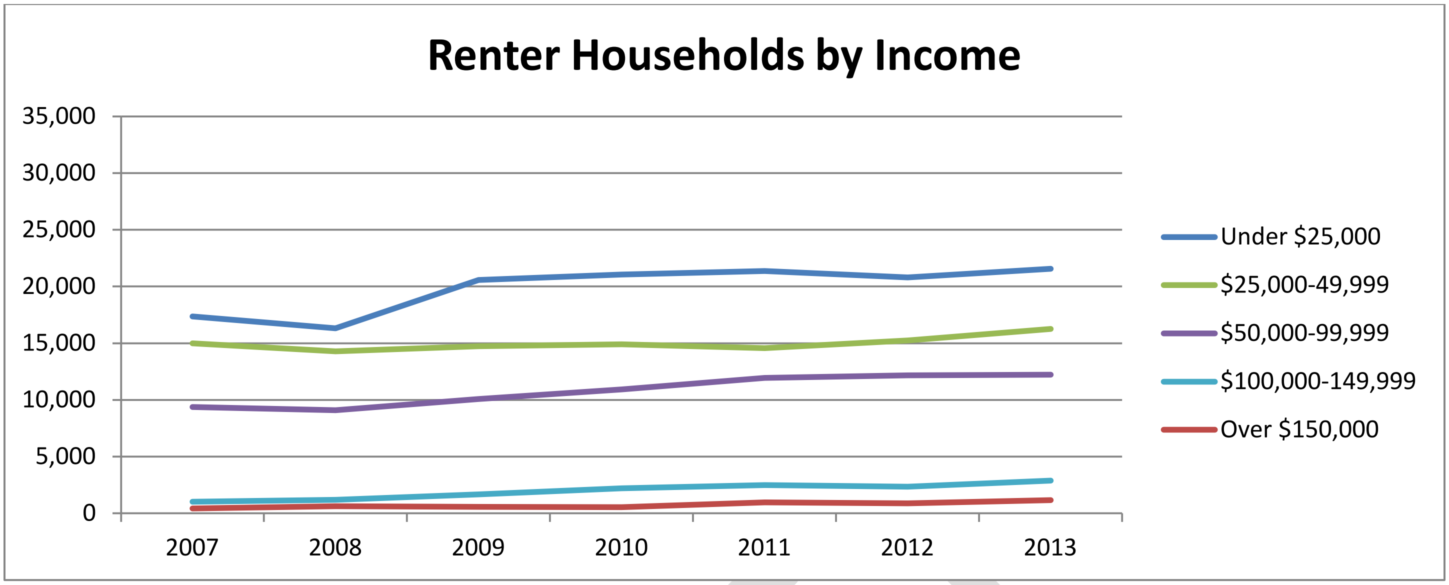
- 12,200 new households
- 4,300 households with incomes below $25,000 (~40% of Median Household Income)
- 1,000 households with incomes below $50,000 (~80% of Median Household Income)
- 800 households with incomes below $100,000 (~160% of Median Household Income)
- 2,700 households with incomes below $150,000 (~240% of Median Household Income)
- 3,400 households with incomes Above $150,000 (~240% of Median Household Income)



Source: 3-Year American Community Survey

Household Growth Rate 2007-2013

	Average Annual Growth Rate	Total
Total Population	2%	13%
Under $25,000	3%	20%
$25,000-49,999	1%	4%
$50,000-99,999	0.4%	3%
$100,000-149,999	4%	24%
Over $150,000	8%	61%



Source: 3-year American Community Survey

The income pattern of renter household in the City of Madison shows strong growth at all income levels.

Since 2007, the City of Madison has added approximately:

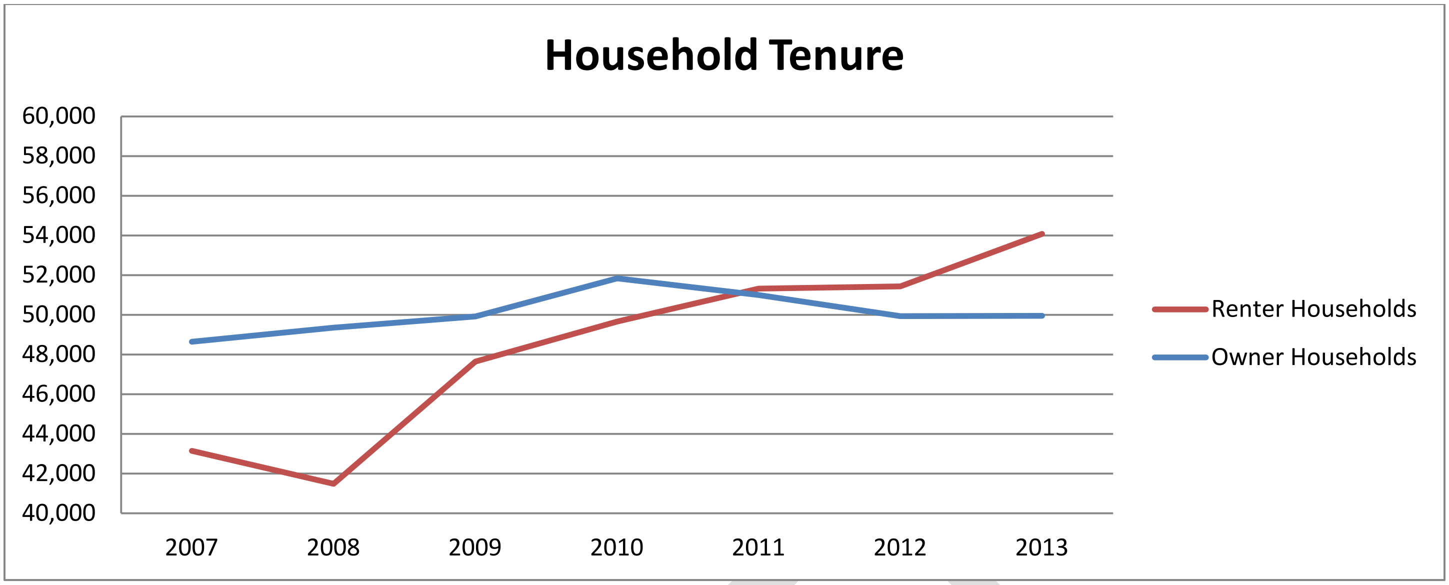
- 11,000 new renter households
- 4,200 households with incomes below $25,000 (~40% of Median Household Income)
- 1,300 households with incomes below $50,000 (~80% of Median Household Income)
- 2,900 households with incomes below $100,000 (~160% of Median Household Income)
- 1,900 households with incomes below $150,000 (~240% of Median Household Income)
- 700 households with incomes Above $150,000 (~240% of Median Household Income)

The rental market has absorbed almost 90% of households added to the city since 2007.

While in absolute numbers households with income under $25,000 grew more than any other category, the rate of growth was significantly higher among higher income households. This indicates that preferences for rental housing are quickly changing for higher income households.

Renter Growth Rate 2007-2013

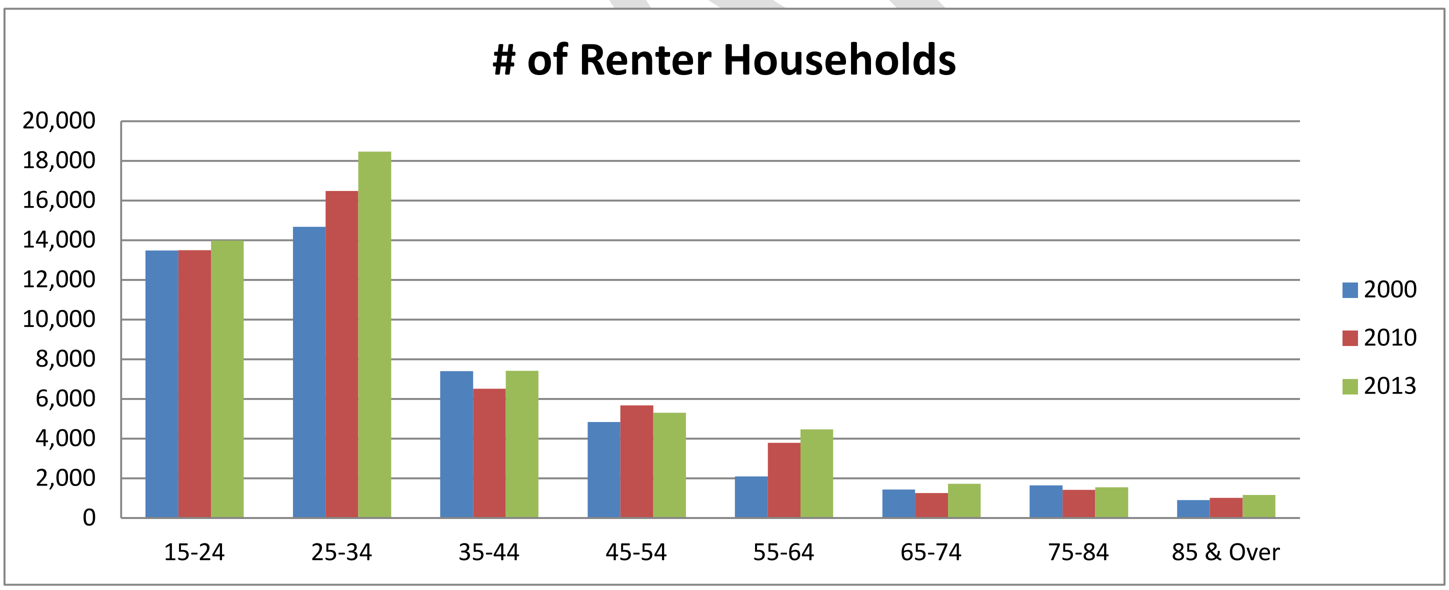
	Average Annual Growth Rate	Total Growth
Total Population	4%	25%
Under $25,000	4%	24%
$25,000-49,999	1%	8%
$50,000-99,999	4%	31%
$100,000-149,999	17%	185%
Over $150,000	16%	167%



Source: 3-year American Community Survey

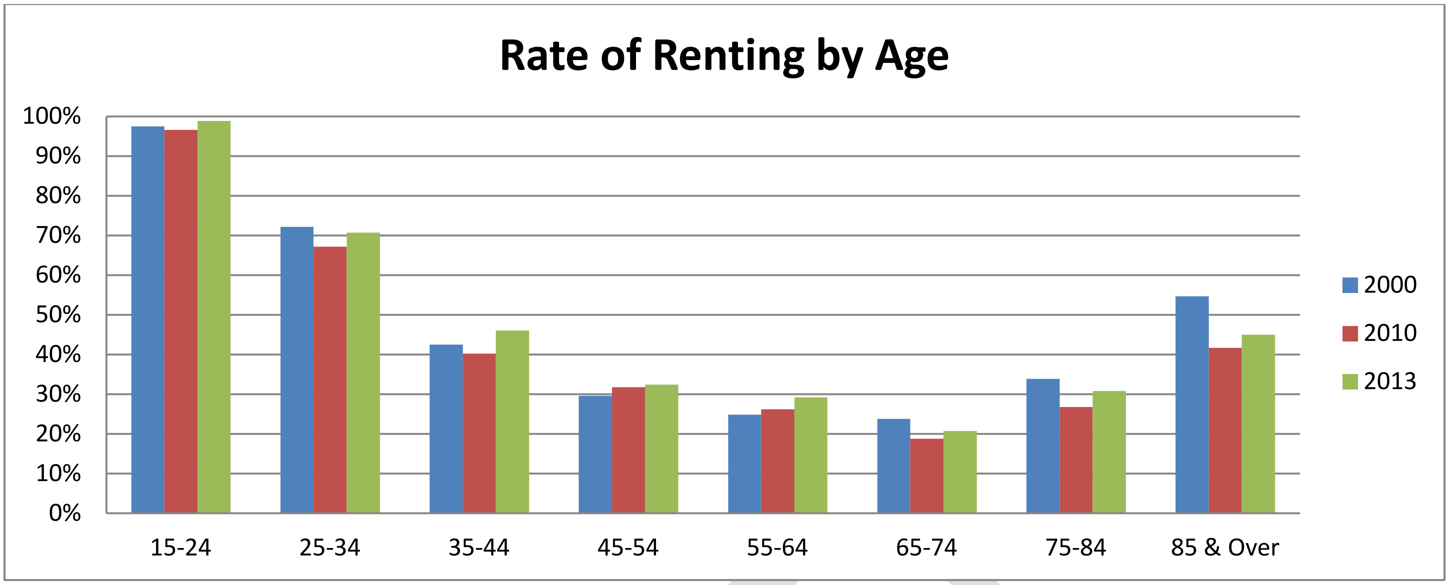
This growth in renters as a portion of our housing market is best illustrated with time series data, which show that **Madison became a majority renter community in 2011**.

PREFERENCES



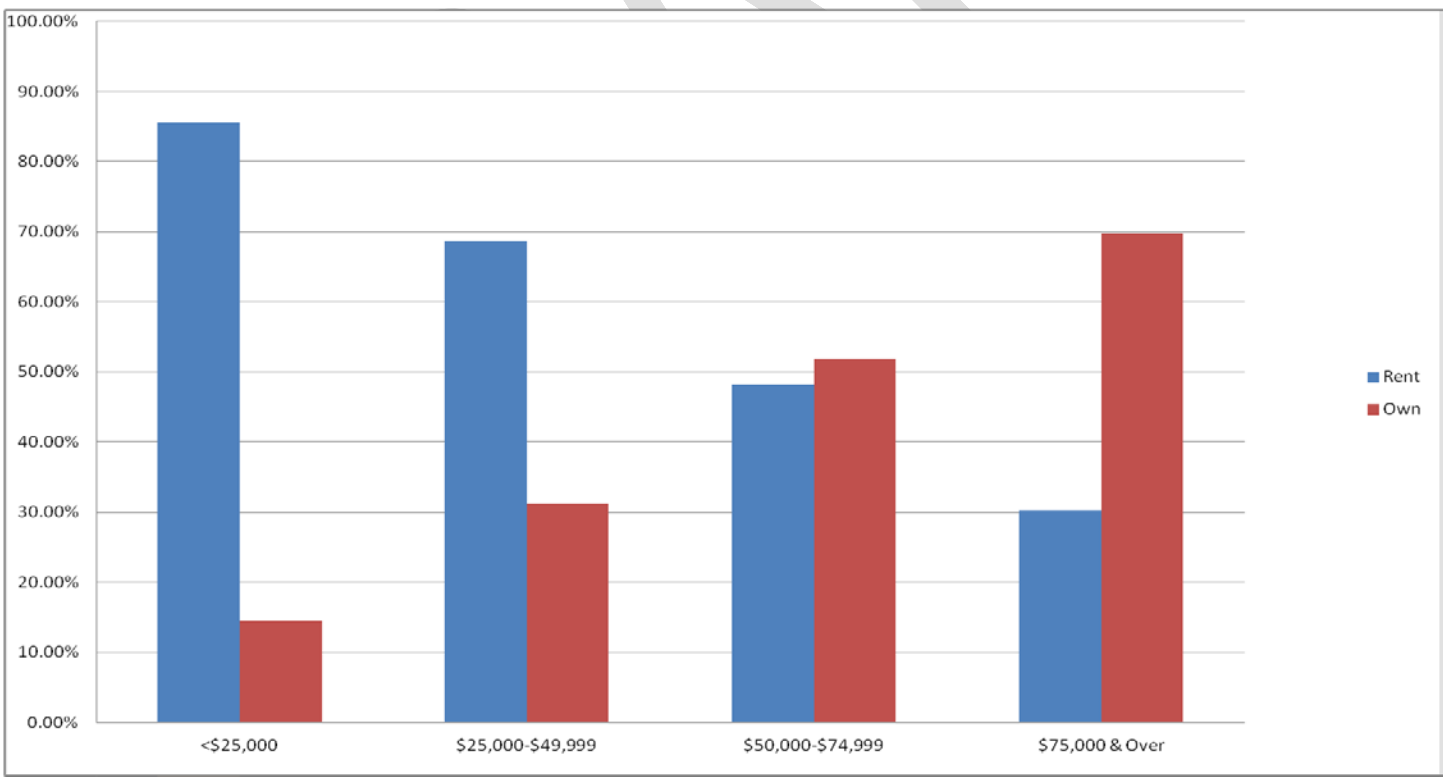
Source: 3-year American Community Survey

Over 80% of the growth in renters households since 2000 has almost occurred in two age brackets, 25-34 year olds and 55-64 year olds. This trend is likely explained by two factors, first is that general population growth was largely driven by these two groups (Millennial and Baby Boomers) and second that **households have returned to or are exceeding their historic ratio of renting to owning**.



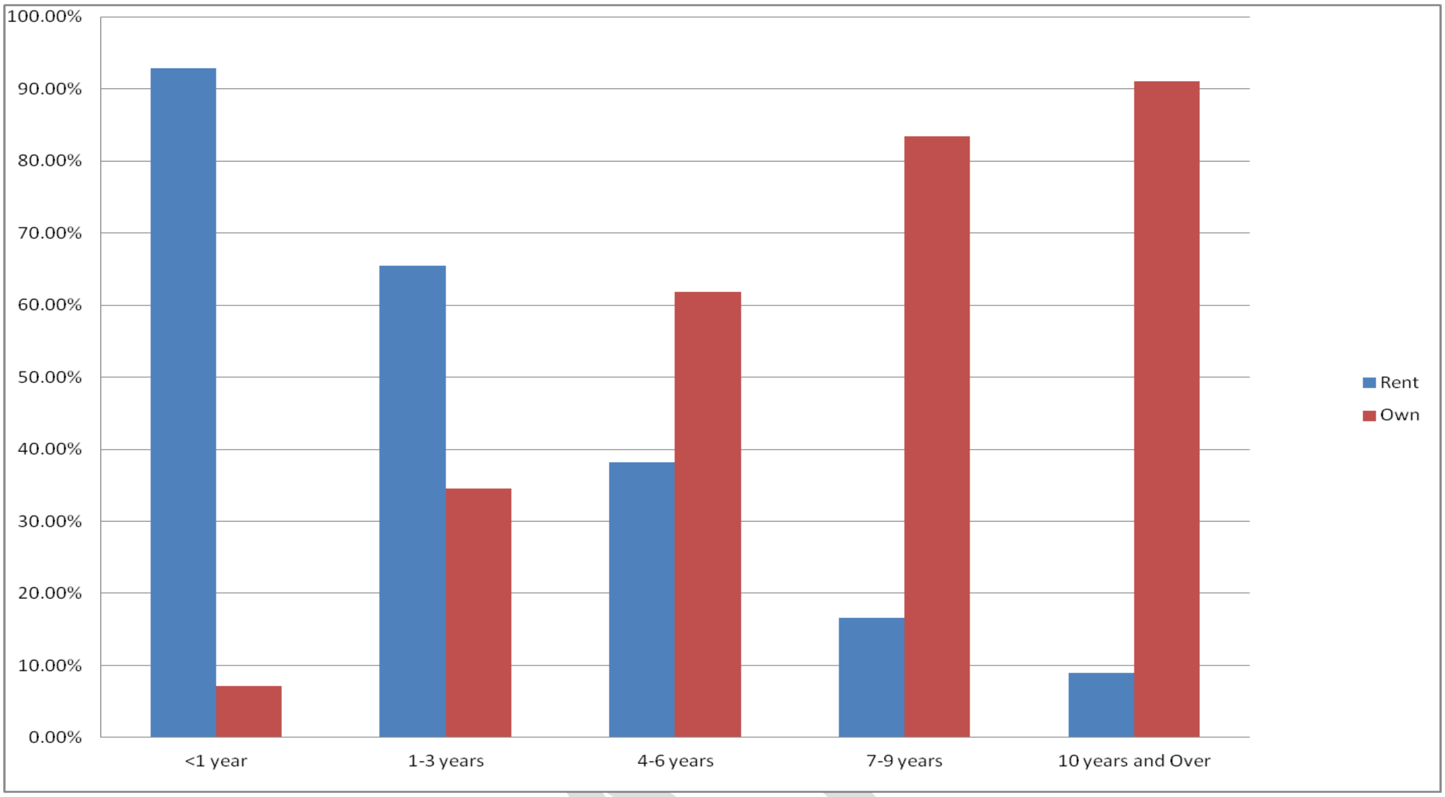
Source: 3-year American Community Survey

In particular, **the surge in demand from 25-34 year olds with above average incomes (young professionals) is driving the current boom in the rental market**. To better understand this demand, the City of Madison commissioned a survey on housing preferences from area employers including the City of Madison, Epic, and Madison College. These employers serve as a reasonable proxy for three of the primary employment sectors in Madison, government, technology, and higher education. From these data, a number of trends appear.



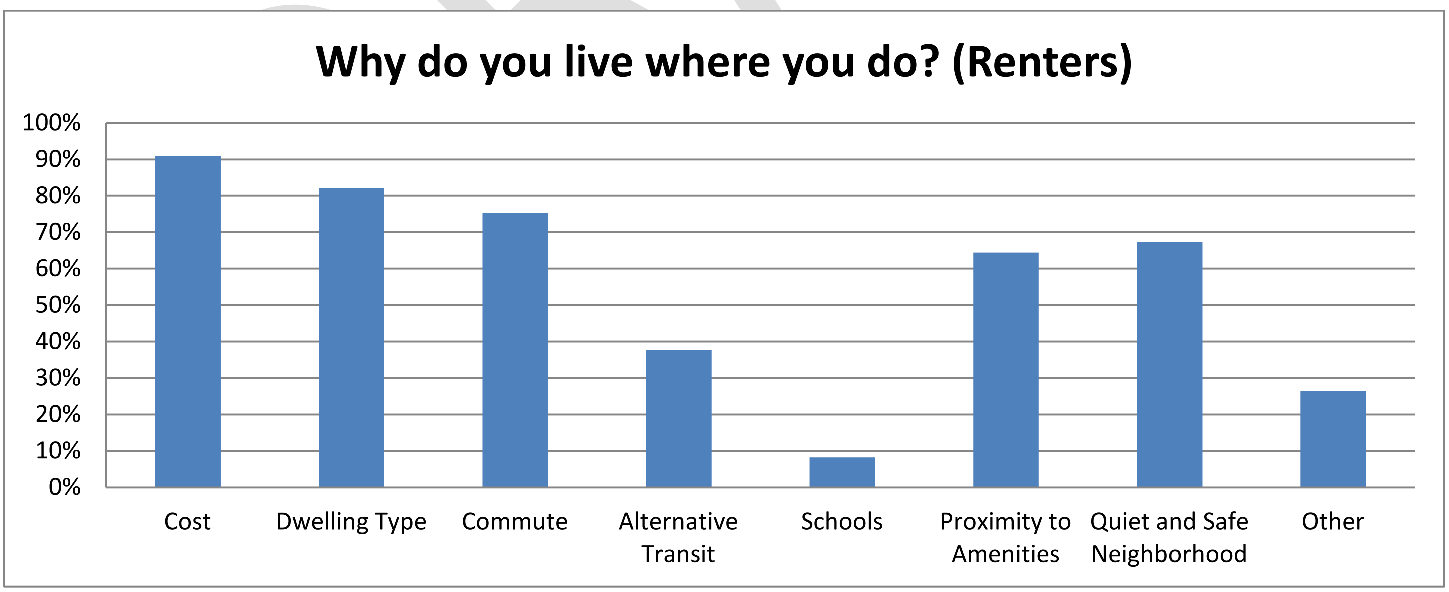
Source: 2014 City of Madison Housing Survey

First, just as in the Census data **a clear correlation exists between higher incomes and higher rates of homeownership.**



Source: 2014 City of Madison Housing Survey

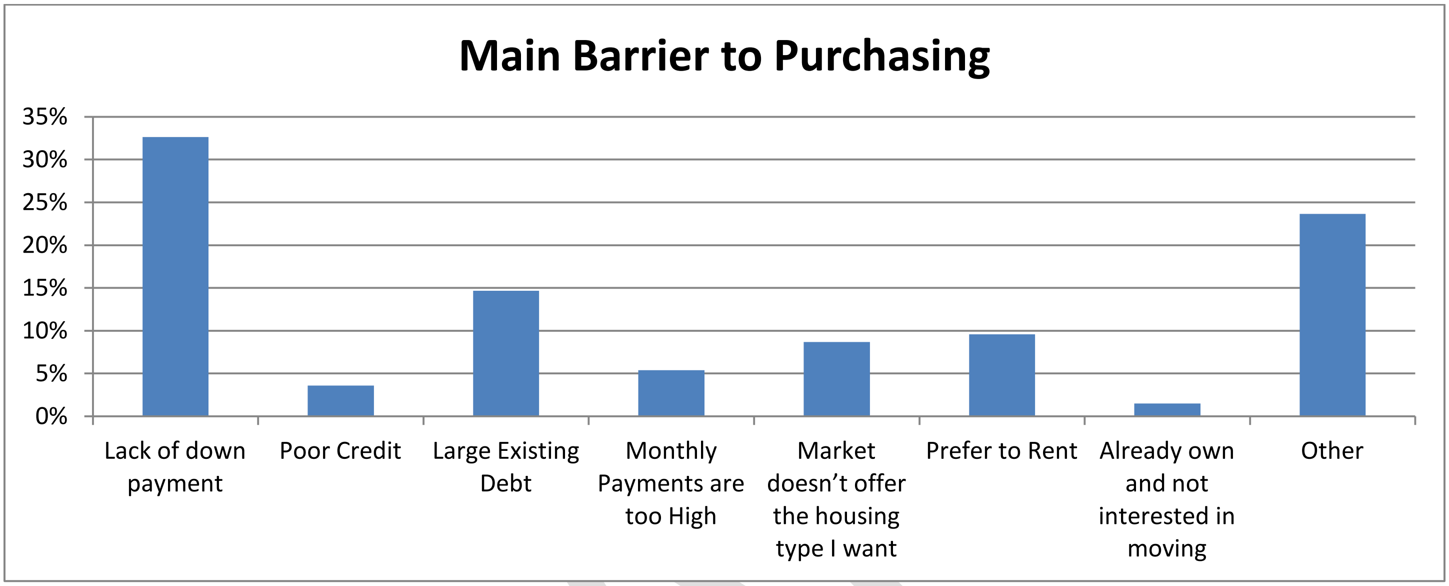
Second, **there is a very close correlation between the length of time an employee has worked for their current employer and their rate of homeownership**. This relationship holds across all income levels. This relationship indicates that while high growth firms with large numbers of new employees drives an increase in demand for rental housing, if those employees are retained it is likely that they will eventually become homeowners.



Source: 2014 City of Madison Housing Survey

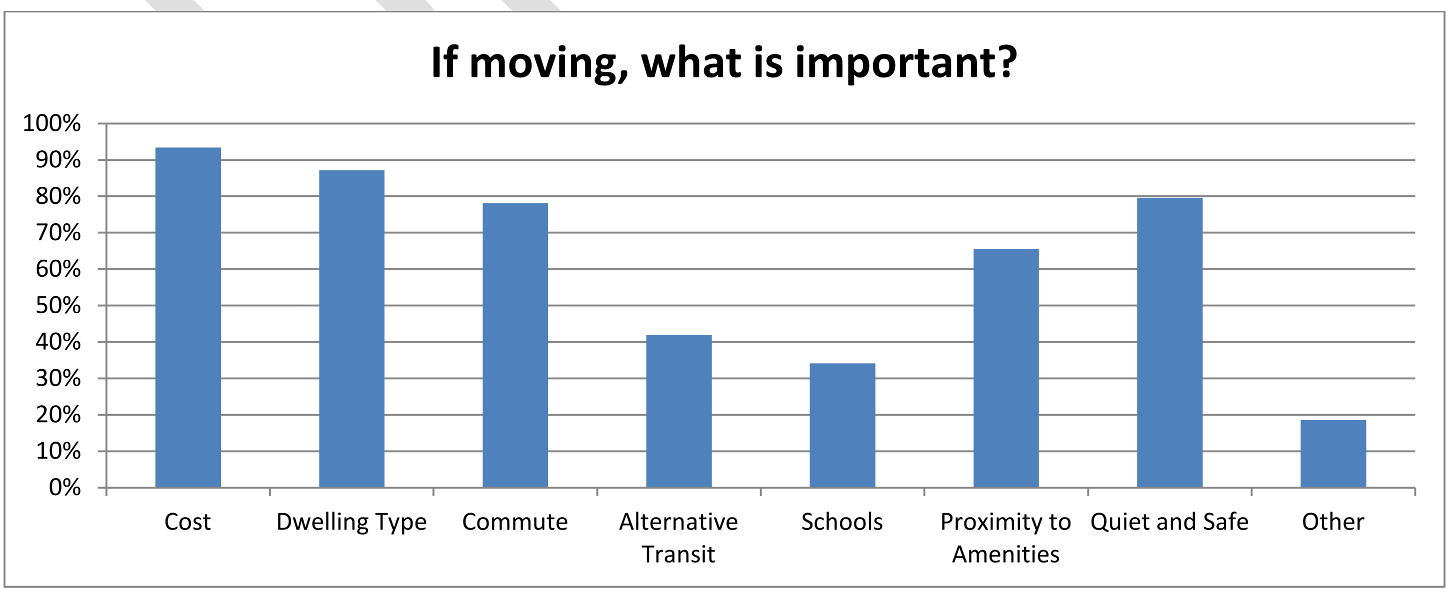
When asked why renters live where they do a few clear trends emerged:

- The unit itself was universally important as shown by questions the cost and type of unit
- Location is nearly as important as shown by commute, proximity to amenities, and quiet and safe neighborhood responses
- Proximity to amenities is particularly important to those who have worked for their employer for 6 years or less
- Quality of schools matters very little renters, and barely registers to renters without children
- The most common answer in the "Other" category was a desire to live in downtown Madison in an urban/dense setting



Renters, when asked if they planned to purchase a home in the next two years, 50% said no, while 25% said maybe and 25% said yes. For those in the yes and maybe categories, a few factors dominated:

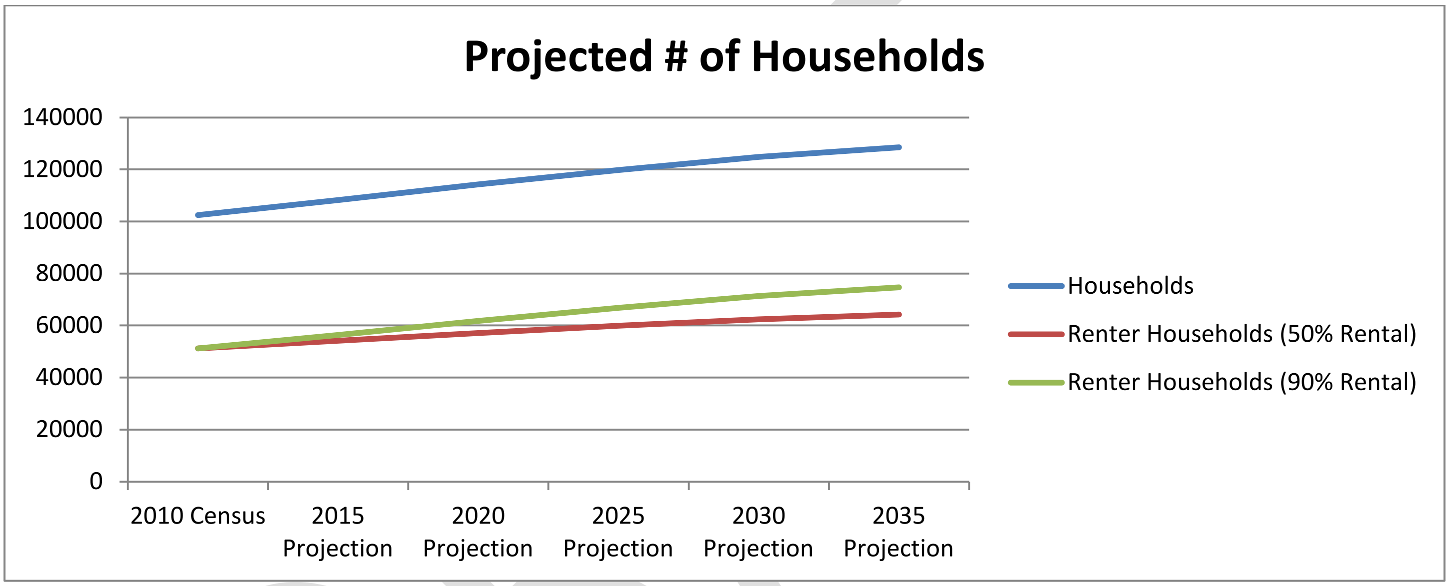
- The primary financial barrier was a lack of down payment with existing debt (presumably student debt) in second
- The actual monthly cost of ownership was seen as a very small barrier
- The largest non-financial barrier was "Prefer to Rent" and "Other" which largely consisted of comments regarding timing and uncertainty about commitment



When asked about moving in the future, the overwhelming response was that renters are happy with where they live and there was little that would make them move. **In particular, there was very little interest amongst downtown renters to move away from downtown.** The factors in deciding to move were virtually identical to the factors that determined where the currently live, with the exception that quality of schools became markedly more important.

FUTURE DEMAND

The Wisconsin Department of Administration estimates that **the City of Madison will add approximately 20,000 new households over the next twenty years (1,000 per year), and if the City's recent growth rate holds it could add twice that number**. If our market reverts to its traditional mix of 50% owner and 50% renter, we will need to add roughly 10,000 new rental units or about 500 per year. Instead, if recent trends hold and 90% of new households demand to rent, we would require 18,000 new rental units or 900 per year.



Source: WI Department of Administration

TRENDS

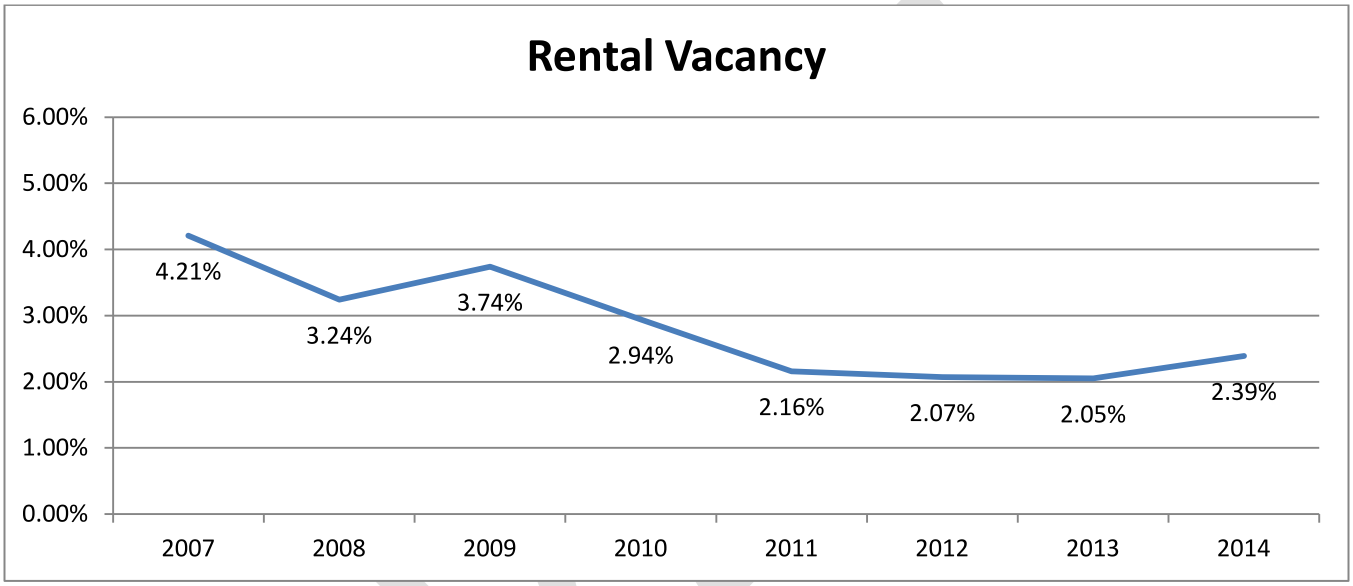
- Demand for rental housing is growing rapidly, outpacing homeownership
- Demand for rental housing is growing at all income levels
- Upper middle class households (Over $100,000) are the fastest growing population and they account for half of household growth
- Upper middle class households (Over $100,000) are the fastest growing group of renters and they account for ¼ of household growth
- Rental growth is driven by 25-34 year olds (Millenials) and 55-64 year olds (Baby Boomers)
- Renters who have been with their employer for 6 years or less (likely Millenials) place a very strong value on the location of their housing, particularly its proximity to amenities

SUPPLY

The supply of rental housing in the City of Madison has seen a sizable increase in recent years with much more in the pipeline, however it has not been sufficient to meet the demand from the market as shown by low vacancy rates and increasing rents.

VACANCY

Vacancy in the Madison rental market has been at or near historic lows for a number of years, implying that **the market is undersupplied.** In the United States, the typical rule of thumb is that a 5% vacancy rate is needed to maintain stable prices and housing choice.



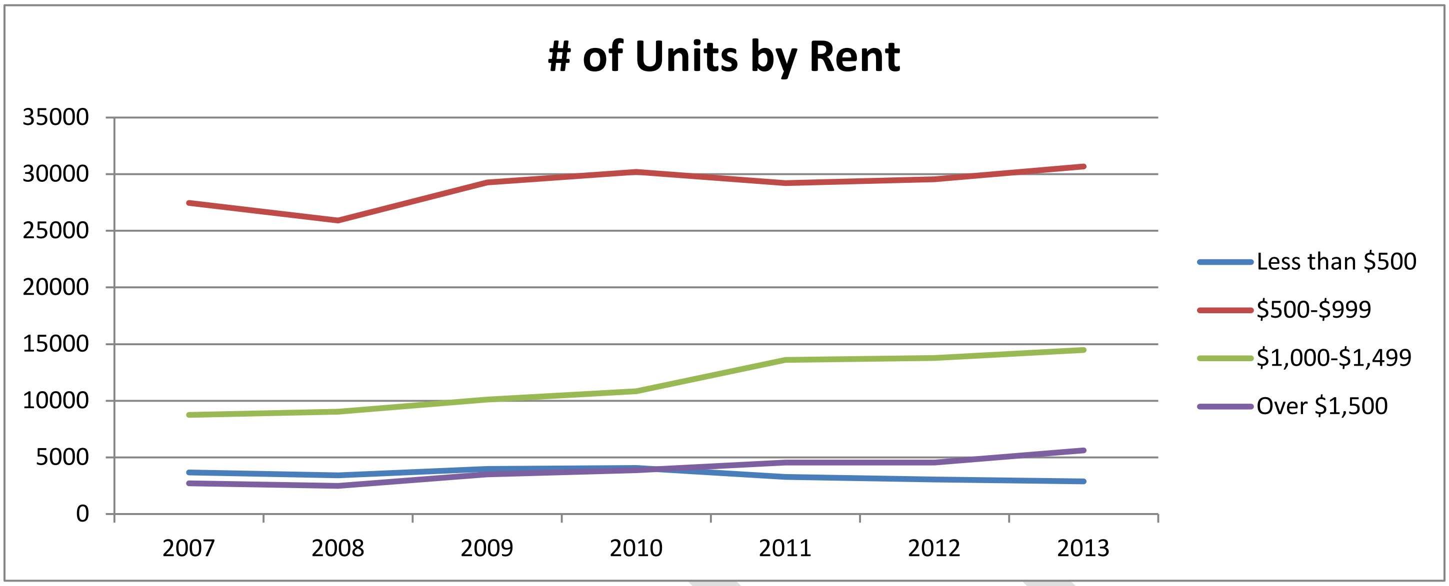
Vacancy is not evenly dispersed in the Madison market. The southwest, south, and east side have moderate vacancy of 3-4%. The west, far east, and downtown markets have vacancy rates as low as 1%.

Rental Vacancy Rates by ZIP Code

City	ZIP Code	Total Rental Units	Vacant Units	Vacancy Rate
Madison	53703	11,972	245	2.0%
Madison	53704	8,308	159	1.9%
Madison	53705	5,711	221	3.9%
Madison/Fitchburg	53711	6,281	121	1.9%
Madison	53713	6,569	213	3.2%
Madison	53714	2,046	83	4.1%
Madison	53715	3,021	120	4.0%
Madison/Monona	53716	1,754	59	3.4%
Madison	53717	1,091	17	1.6%
Madison	53718	1,771	4	0.2%
Madison	53719	1,390	34	2.4%
Madison	53726	1,363	13	1.0%
Total		51,277	1289	2.5%

Source: MGE Multifamily Vacancy

RENTS

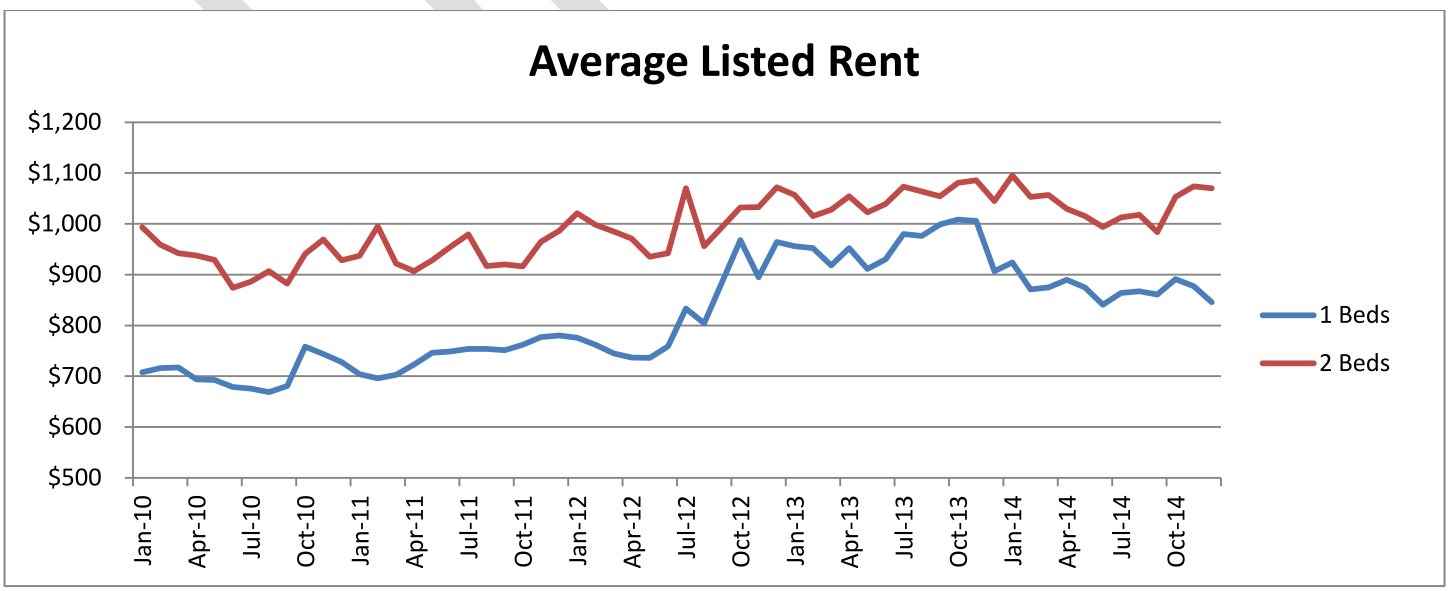


Source: 3 Year American Community Survey

Unit Growth Rate 2007-2013

	Average Annual Growth Rate	Total
Less than $500	-4%	-22%
$500-$999	2%	12%
$1,000-$1,499	8%	65%
Over $1,500	12%	108%

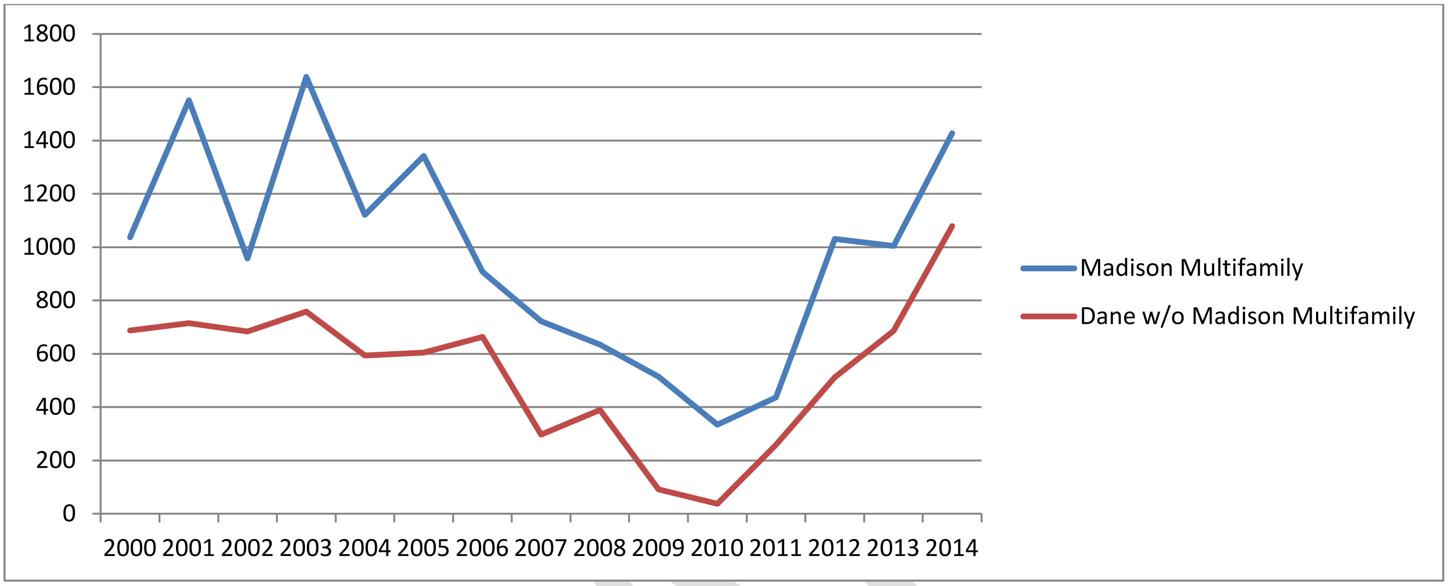
According to data from rentjungle.com, an aggregator of online rental listings, market rents for one and two bedroom apartments increased dramatically from mid-2012 through the end of 2013, but appear to have stabilized and dropped slightly in 2014. This increase and drop was especially apparent in the market for **one bedroom units, which saw a 30% increase in average list price from the beginning of 2012 through the end of 2013**.



Source: rentjungle.com

NEW SUPPLY

From 2007 to 2013, permits were pulled for only 4,675 multifamily units in Madison despite adding over 11,000 renter households in the same time period. This gap has been filled by a sharp reduction in vacancy, conversion of owner occupied housing to rental, and the completion of projects begun before 2007. The market has responded to the forces of rising rents and lower vacancy with a return to 2000-2005 levels of permits for multifamily units for both Madison and Dane County.



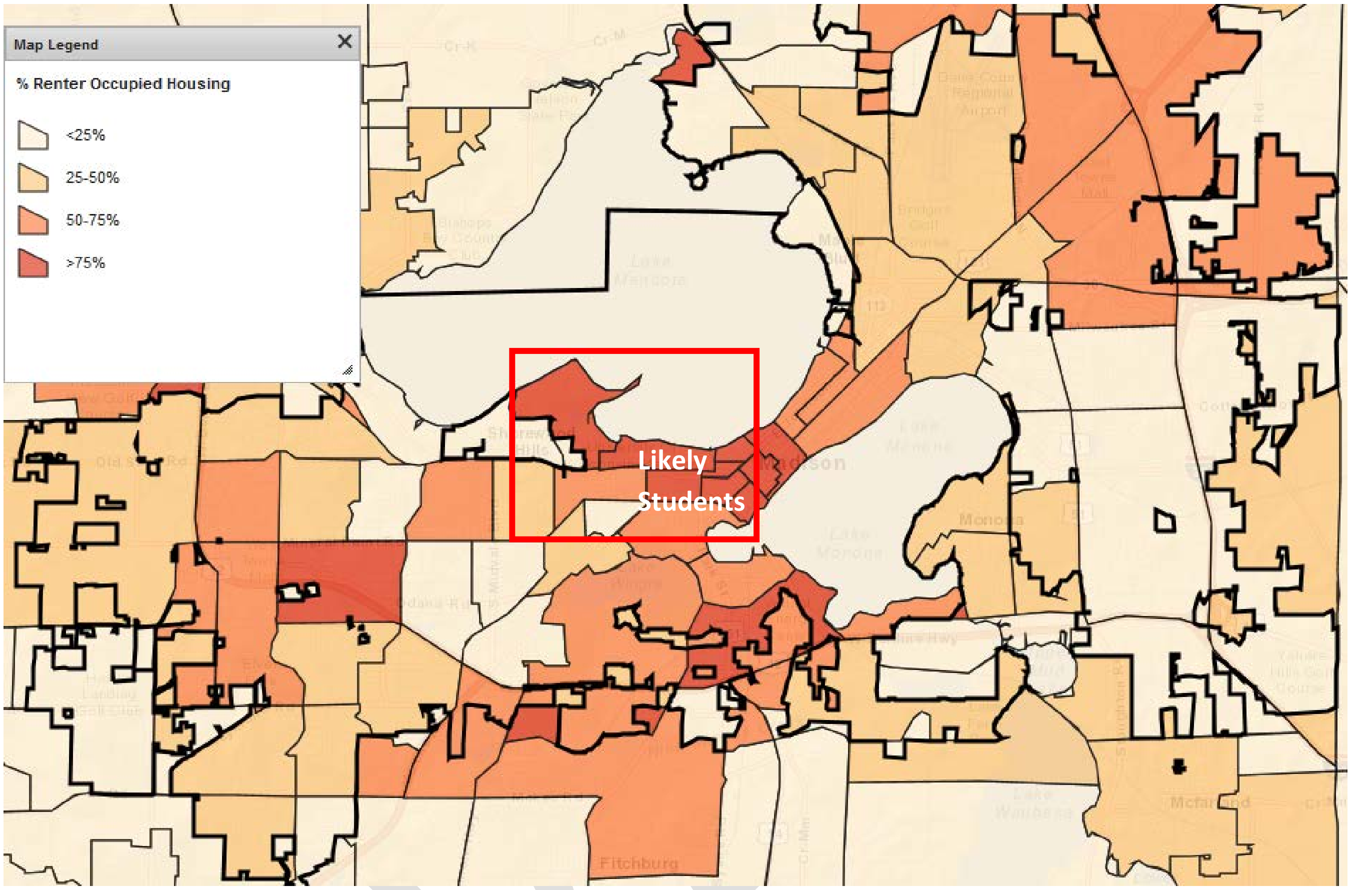
Source: Census Building Permits Survey

The City of Madison saw a significant increase in multifamily rental units in 2013 with:

- Projects Complete: 647 residential units
- Under Construction: 814 residential units
- Approved: 1287 residential units
- Major Pipeline Projects: 899 residential units
- TOTALS: 3,647 residential units

*Update data

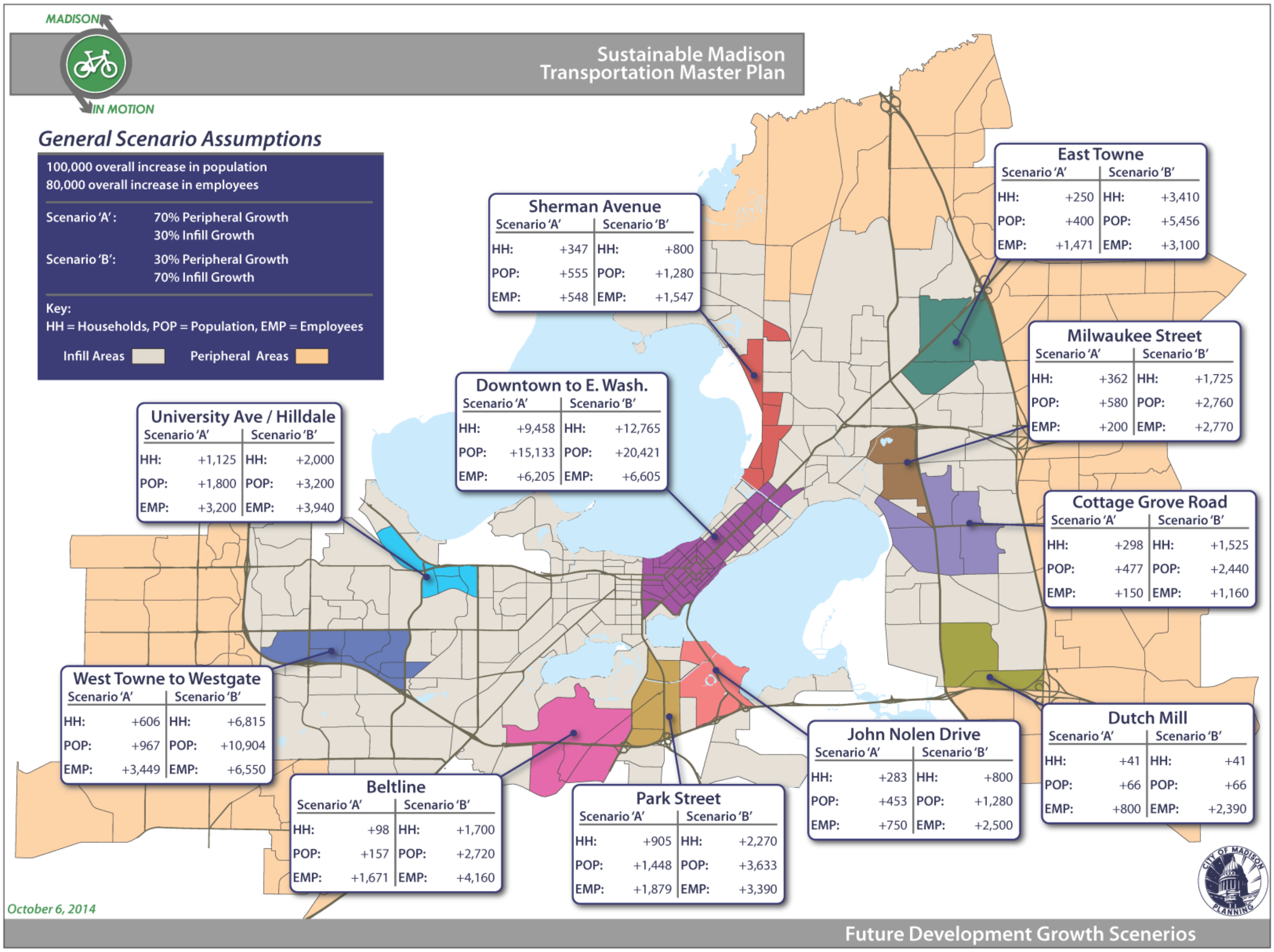
In the City of Madison, rental housing is currently concentrated in the downtown core, campus, south side, north east, and west sides of the city.



Source: HUD CPD Maps

Insert Map of new construction

Analysis of recent construction trends



Due to geographic constraints (lakes, adjacent municipalities), capacity of our transportation systems, and zoning restrictions there are limited locations available that can accommodate the new housing supply needed to meet projected future housing demand. The additional factor of strong demand preferences from young professional renters to be in locations close to amenities further narrows growth areas. The City Planning Division has undertaken a long-range transportation planning effort to map where this additional supply can be accommodated. They took the analysis a step further, calculating one scenario where development is focused on the periphery and another where development is focused on infill locations along transit corridors with greater access to amenities which is a better match the stated preferences of young professional renters. Assuming the infill focused scenario is a better match to future market demand, many of the shaded areas will need to adapt to accommodate a significant increase in rental housing units.

TRENDS

FINANCE/FUNDING

NATIONAL

The majority of funding for rental housing is in the form of traditional commercial mortgages and investor equity.

CONSTRUCTION/REHAB

- Freddie Mac
    - Offers securitized debt products to the multifamily market
    - Goal of reducing interest rates and increasing housing supply through providing stability and liquidity to the multifamily loan market
- Real Estate Investment Trusts (REIT)
    - A company that owns real estate or mortgages, and sells ownership shares on an exchange (similar to mutual funds)
    - Often large and well funded, allowing them to purchase entire real estate portfolios from landlords, finance improvements, weather market difficulties better than smaller private landlords
    - Provide market liquidity and an exit strategy for private developers and landlords
    - Often require larger properties and markets than exist in Madison

LOCAL SOURCES

- Tax Incremental Financing (TIF)
    - City of Madison funded program that uses projected future increases in the property taxes from a defined area (TID) to subsidize redevelopment in that TID
    - Project must be located in a TID with a “generator” property that is sufficient to increase the tax base
    - Project must prove that “but for” the subsidy the development would not occur
    - Affordable housing for renters under 80% AMI is an allowable use of funds
    - Can be used for capital costs but not for operating expenses
    - Project must pay property taxes
    - Recent changes in state law allow for the Tax Incremental Districts to be extended for one year for the purpose of use the funds for affordable housing within a municipality

CHALLENGES

The greatest challenge currently facing our rental housing market is that the supply of rental housing has been unable to keep up with demand. During the recession, very few new units were created despite growing demand. Despite the recent boom in construction, supply has yet to catch up with demand. This is demonstrated by the persistently low vacancy rates and rising rents. **If recent trends in population and household growth, demographic changes, and housing preferences persist, our market will need to continue to add a significant amount of new rental housing.** Over the medium to long term if demand growth remains strong, the ability of the market to adequately increase supply could be limited by:

PHYSICAL CAPACITY TO ADD SUPPLY

Adding large amounts of new rental housing supply will likely require adding additional housing density to existing concentrations of rental housing (downtown) as well in areas of the city zoned for multifamily housing and possess the infrastructure (transportation, retail, land) to support more intense use. **Acquiring sites, assembling property, and providing adequate onsite parking will pose a significant challenge to development in these locations**.

RISING CONSTRUCTION COSTS

During the recession and subsequent drop in construction activity, a significant percentage of the construction labor pool left the market. The resulting labor shortage has exacerbated the already rising costs that are a natural result of increased construction activity.

Insert updated construction cost numbers

SOLUTIONS

LOCAL

- Capital East District
  - The Capital East District located on Madison's near east side is the result of a concerted effort to encourage real estate development in a specific corridor by the City of Madison
  - Very specific goal of encouraging housing and employment opportunities along a major transit corridor
  - Removes barriers to development and reduces development costs through:
    - Land banking large and underutilized parcels to be remediated and sold through an RFP process
    - Creating a TIF district to subsidize development
    - Rebuilding transportation infrastructure to accommodate increased density
  - Applied an Urban Design District to the target area to allow for increased height and modified land use process
  - The City further encourages development through branding and marketing efforts to attract developers
  - Has resulted in the completion of one significant mixed use housing development, another under construction, and a strong pipeline of others on their way

The Constellation

NATIONAL MODELS

INFORMATION

- Developer Liaison
  - Dedicated staff to guiding real estate developers through the land use, permitting, and/or public financing process to facilitate development
  - Helps mitigate the complexity and high barriers to entry for new and non-local developers
  - Can be done by city staff or 3rd party organization such as a community development corporation contracted by the local government
  - Ex The City of Baltimore contracts the Baltimore Development Corporation to shepherd developers through the development process and facilitate site selection
- Economic Indicators
  - Release monthly or quarterly reports on key economic indicators that reflect supply and demand trends for the rental market (ex. building permits, job growth, vacancy rate)
  - Provides timely, objective, 3rd party data for City committees, policy makers, developers, and investors to make decisions
  - Most of the data is publicly available but is spread across multiple sources, released annually, or poorly formatted
  - Ex MetroDenver releases a monthly report of 18 key indicators for distribution to the business community displaying month to month and year over year trends

TARGETED DEVELOPMENT

- Expedited permitting or land use approval
  - Streamlining the process for building site permits and land use approvals can save developers substantial time and money
  - Lengthy approval processes cost developers money through land holding costs, added architect expenses, and opportunity costs
  - Can be tied to specific areas of the city, meeting 3rd party standards (ex green building), or uses (ex affordable housing)
  - Ex. Chicago's Green Permit Program reduces permit approval to under 30 days for projects that commit to LEED certification
- Reduce/Eliminate Parking Requirements
  - Reducing or eliminating parking minimums from multifamily rental developments to reduce the costs and land requirements for new development
  - Structured parking can cost tens of thousands of dollars, increasing rents or constraining development potential
  - Reduced requirements are often tied to location (density, proximity to transit)
  - Ex. The City of Madison Zoning Code has multiple designations with no parking minimum
  - Ex. Boston, New York and Vancouver are proposing to systematically reduce parking minimums for multifamily housing to encourage development and increase affordability
- Land Banking
  - Local governments or related entities purchase and manage underutilized property for later redevelopment
  - Often involves the purchase of foreclosed or difficult to develop parcels
  - Gives local government the ability to encourage or control the eventual development to a much greater degree than would be possible through zoning or subsidy
  - Ex. The City of Madison purchased the Union Corners out of foreclosure and later identified a buyer through an RFP process

- Development Zones
    - Designate clearly defined area of the city as development zones where a separate set of development rules apply to encourage development (Ex fast track land approvals, Tax incremental financing districts, height or density bonuses, or other public subsidy)
    - Often actively marketed and branded by communities
    - Ex. Madison's Capital East District combines TIF, land banking, and marketing by EDD staff

FINANCING

- Revenue and Housing Bonds
    - A special type of bond is repaid solely from lease revenues generated by a specified revenue-generating project, rather than from taxes
    - Can be used to finance housing or infrastructure
    - Exempt from state mandated borrowing caps on municipalities
    - Double tax exempt resulting in very low interest rates
    - Can be issued by the Community Development Authority (CDA)
- Municipal Real Estate Development Funds
    - Provides low interest financing through a revolving loan, loan loss reserve, or loan guarantee to fund land banking, site acquisition, and predevelopment costs for developments
    - Often a partnership between local governments who provide equity and lenders who agree to provide very low interest loans
    - Can be targeted to specific areas or types of development (affordable housing)
    - Can be administered by a community development authority or 3rd party non-profit
    - Ex. The $30 million Denver Transit Oriented Development Fund is funded by the City of Denver, Colorado Housing and Finance Authority, banks, and foundations to acquire property in transit corridors to preserve affordable housing or land bank for housing development
- Crowdfunding
    - A financing mechanism that allow small investors to invest in real estate developments
    - Allows neighbors to invest in projects in their community, giving them an opportunity to directly benefit from increased development and encourage the types of development that they want to see
    - Often managed through a website platform that matches investors with developers and handles transactions
    - Limited to SEC defined Accredited Investors with high income and net worth
    - Ex. In Oakland a grocery store raised $1.2 million in equity from neighbors who made $1,000 to $5,000 investments