Market Watch: Northland Region

Trends in the unsubsidized multifamily rental market

INTRODUCTION

Across the state, the growing ranks of renter households are facing an increasingly challenging housing market with rising rents and declining vacancy rates. Current owners of unsubsidized rental properties have few tools to preserve and improve aging properties to maintain homes for current and future tenants. In this research report, Minnesota Housing Partnership (MHP), in partnership with Greater Minnesota Housing Fund, tracks key trends in the unsubsidized multi-family rental markets of the Northland (Arrowhead) Region.

For the purposes of this report, naturally occurring affordable housing, or NOAH, refers to unsubsidized properties that have rents that are affordable to households with income at 60% area median income. Because these properties do not have subsidy, they are not required to keep rents affordable to any particular income; rents may change due to sale of property, improvements to property, change in market conditions, or other owner decisions.

KEY FINDINGS



Though the Northland region spans seven counties, NOAH Properties are largely clustered in Duluth and parts of the Iron Range.



Vacancies have dropped in eight out of ten cities with the most NOAH, thus constricting supply of available affordable rental homes.



Multifamily, market rate homes in the Northland region are some of the oldest in the state, with over one third older than 100 years. Aging housing is more vulnerable to repair concerns and may need significant reinvestment to be maintained as healthy, safe homes.



Renter income is lower than the state average in every county in the Northland.



Market-rate new construction in the region has been consistently minimal in the past twenty years, further compounding access to affordable housing.

DATA SOURCES



DATA SOURCE: Unless otherwise noted, data in this report comes from CoStar, a commercial real estate database that tracks multifamily properties with four or more units. This includes 228 market rate, existing multifamily properties in the Northland Region, for which data is directly sourced from property management by CoStar researchers. This report analyzes data for approximately 6,449 unsubsidized rental units in properties with 4 or more units in the Northland Region, excluding those that are currently under construction or renovation. Data for this report was accessed and downloaded the second week of February 2020.

RENT DATA: CoStar provides average, rather than median, rent data. Of the approximately 6,449 unsubsidized rental units in the Northland Region tracked by CoStar and included in this analysis, 48% include rent data. All rents in this report are adjusted for inflation.

BOUNDARIES: This report analyzes counties and cities by municipal boundary within the Northland Region. The seven counties in the Northland Region are as follows: Aitkin, Carlton, Cook, Itasca, Koochiching, Lake and St. Louis.

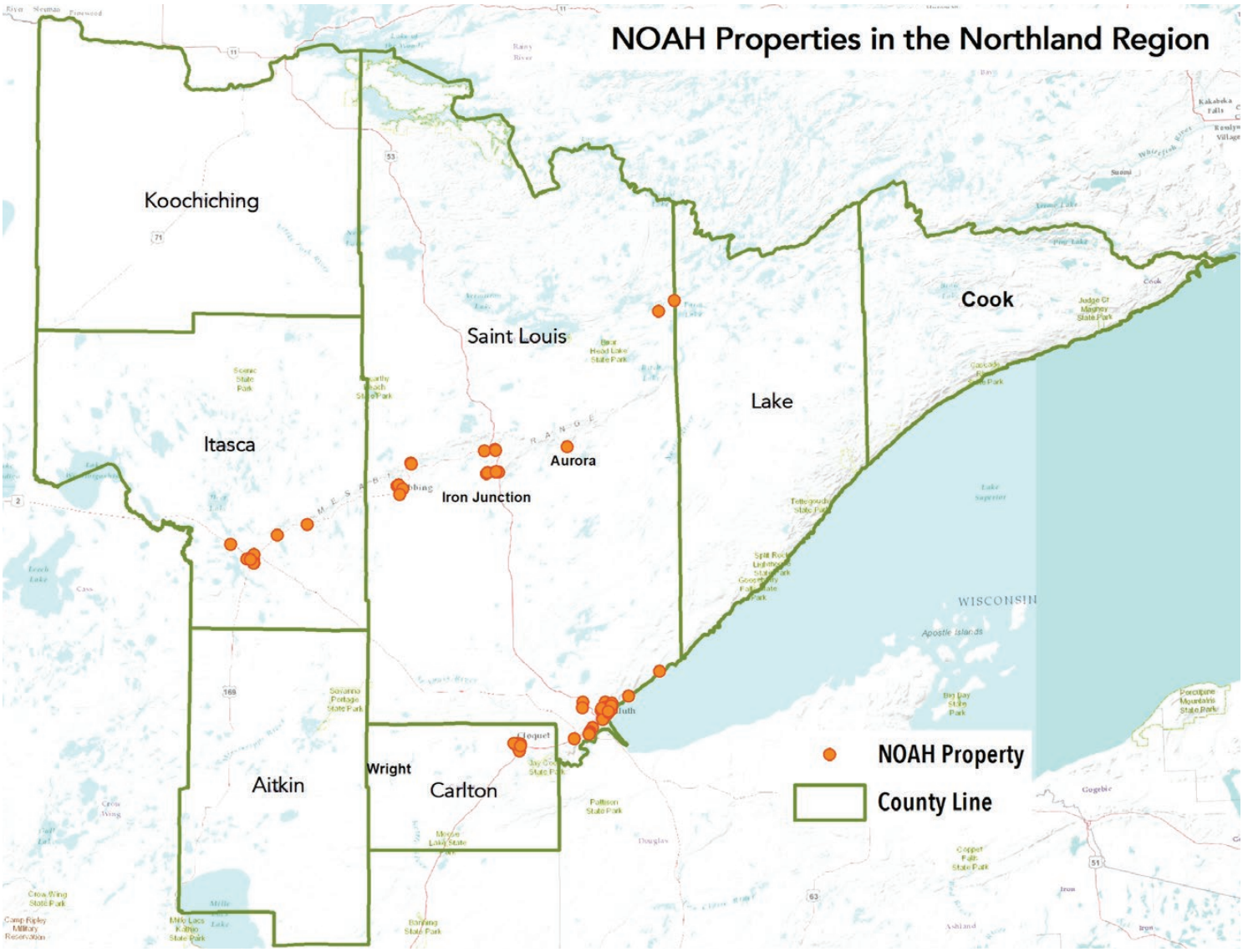
CLASSES: CoStar defines building class in the following way. CLASS A buildings represent current trends and standards in design and/or are of a timeless, perhaps historic quality. They include high quality finishes such as hardwood floors, granite countertops, and/or stainless steel appliances, as well as on-site shared facilities like clubhouse/party room, fitness center, business center, etc. CLASS B buildings are aesthetically average and contextually appropriate. They include average quality finishes and a few on-site shared facilities and spaces. CLASS C buildings are purely functional, often with below average finishes, small windows and likely no on-site facilities or shared spaces.

ACKNOWLEDGEMENTS

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Contributions to this report also provided by Adam Fulton, Interim Director, Planning & Economic Development, City of Duluth; Jason Hale, Senior Housing Developer, City of Duluth; Daryl Olson, Director of Programming, American Indian Community Housing Organization (AICHO); Dani Pieratos, Harvest Nation and Bois Forte Band of Chippewa; Pam Kramer, Executive Director, LISC Duluth; Jeff Corey, Executive Director, One Roof Community Housing; Jill Keppers, Executive Director, Duluth HRA.

GEOGRAPHY OF NORTHLAND NOAH



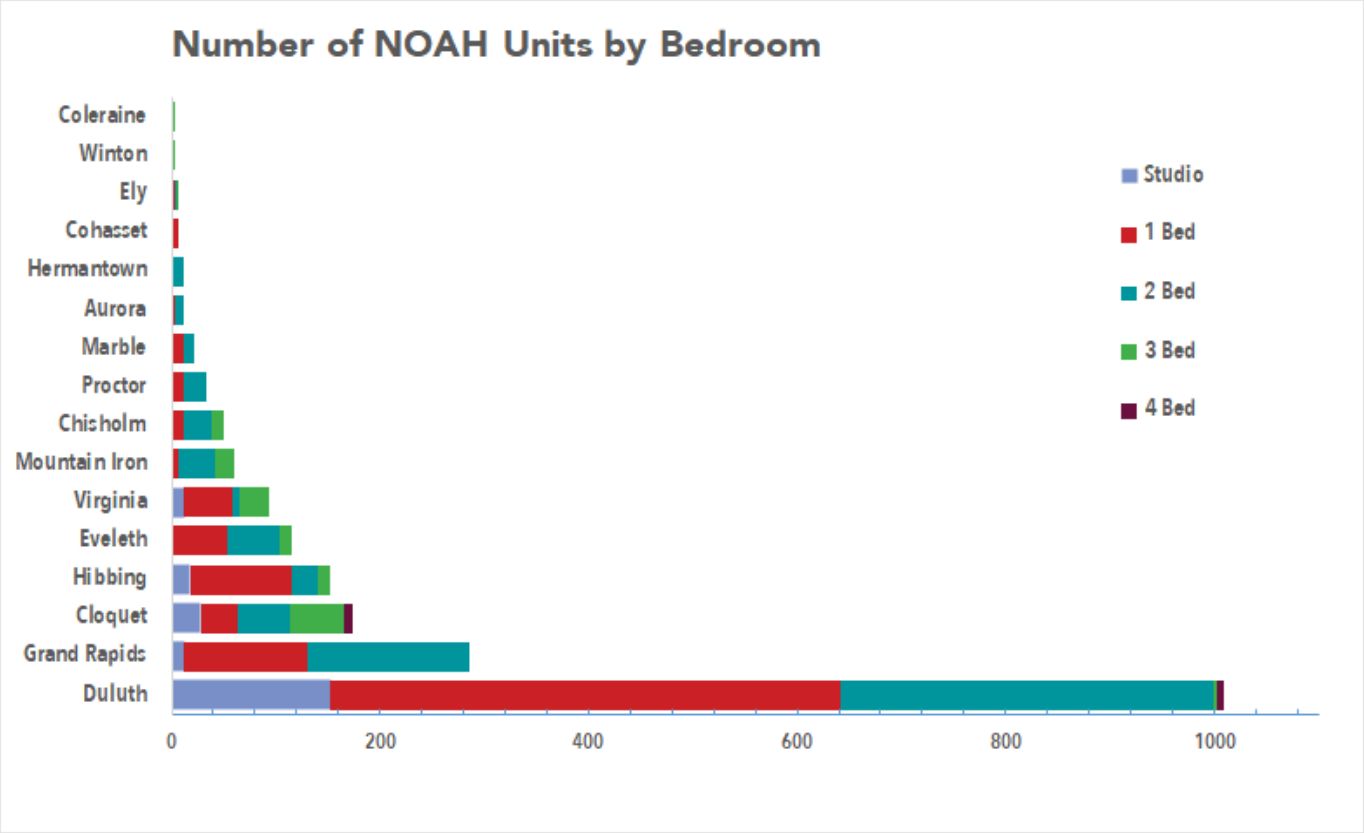
MARKET RATE AFFORDABLE UNITS IN THE NORTHLAND REGION

Thousands of households earning under 60% of the area median income (AMI) — for instance, a family of four earning under $50,400 annually — are able to call the Northland region home by renting in unsubsidized apartments in the private market. Unsubsidized units that are affordable to these residents are often referred to as naturally occurring affordable housing (NOAH).

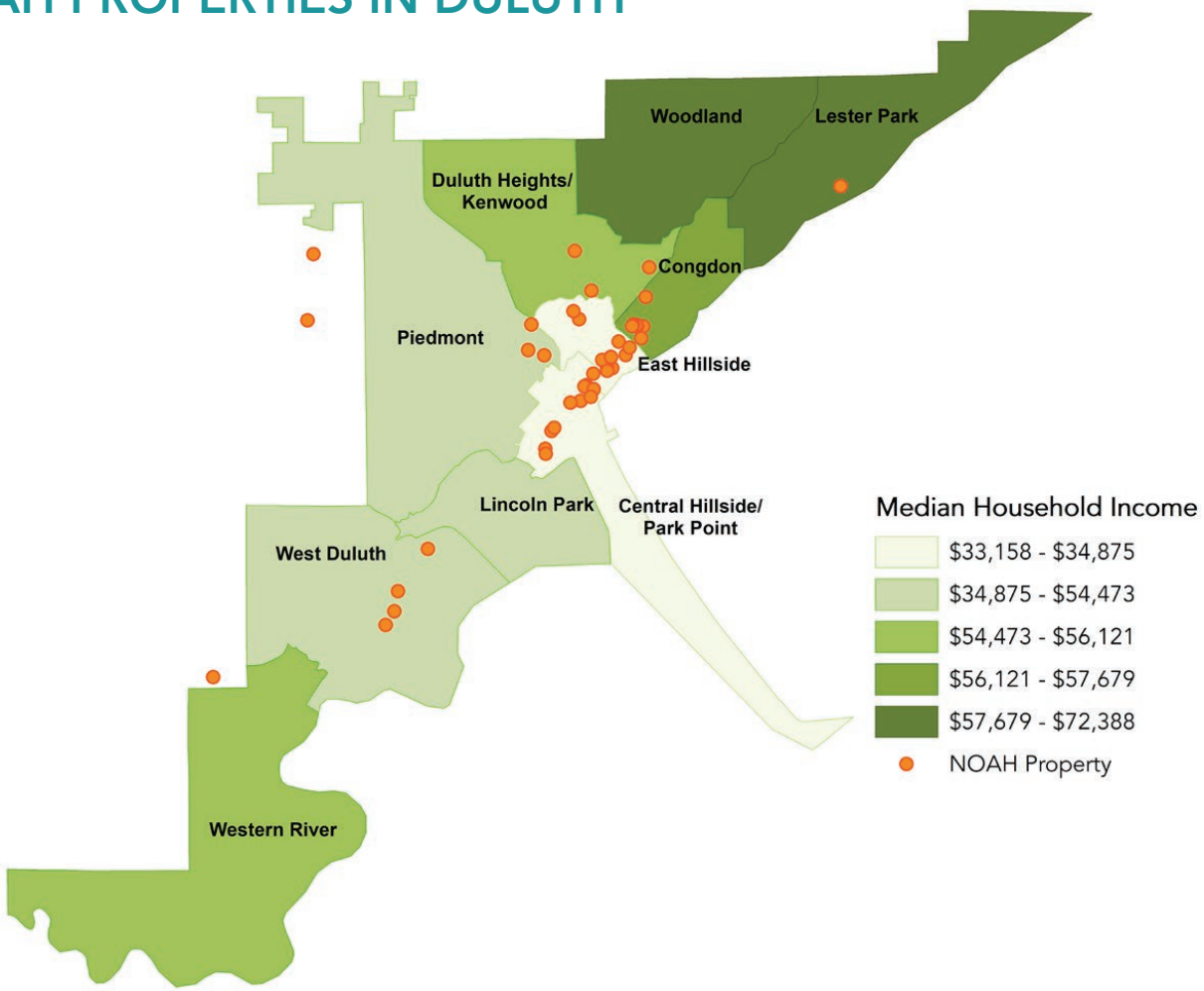
In total, 41% of units in our dataset contain apartments that are affordable to those earning under 60% of AMI. By number, Duluth, Grand Rapids and Cloquet contain the most units affordable to families earning less than 60% AMI in the region.

Ninety-two percent of NOAH buildings were built prior to 2000 in our data set, with 1953 the average year built. The average Northland NOAH building contains 36 units and are primarily smaller, Class C buildings.

The majority of NOAH units in the region are one (44%) and two-bedroom (37%). Affordable, larger units are far scarcer, with just 142 three-bedroom units in the region, or 7% of all NOAH units; affordable four-bedroom units are virtually nonexistent, with only 14 qualifying NOAH units in the Northland region.



NOAH PROPERTIES IN DULUTH

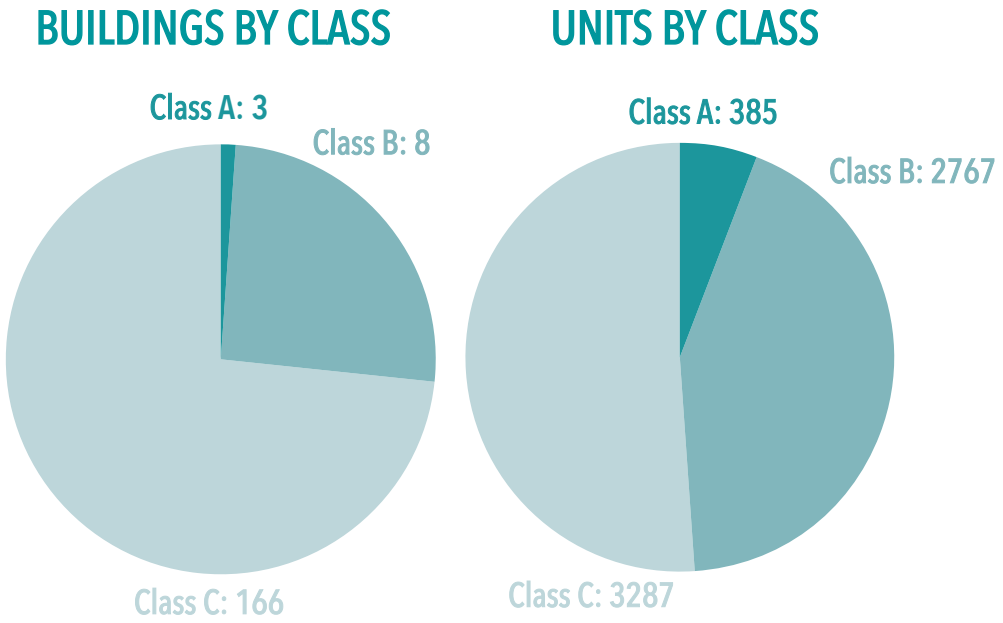


CHARACTERISTICS OF DULUTH RENTERS BY NEIGHBORHOOD

NEIGHBORHOOD	% RENTER HOUSEHOLDS	HOUSEHOLD SIZE	RENTERS OF COLOR	% RENTERS COST BURDENED
Central Hillside/ Park Point	65%	1.4	24%	52%
Congdon	47%	2.1	9%	52%
Duluth Heights/Kenwood	38%	2.1	9%	70%
East Hillside	58%	1.8	14%	58%
Lester Park	15%	2.0	5%	52%
Lincoln Park	50%	1.6	13%	47%
Piedmont	24%	1.7	8%	52%
West Duluth	25%	1.7	9%	41%
Western River Communities	31%	1.9	9%	40%
Woodland	13%	2	7%	31%

NORTHLAND PROPERTY CHARACTERISTICS

PROPERTY CLASS



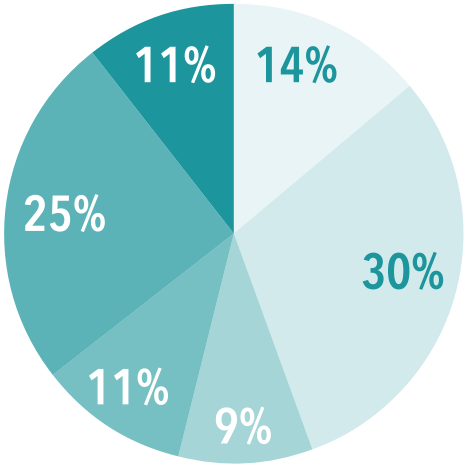
In the Northland Region, the majority of unsubsidized rental housing are Class C, or older properties that provide basic shelter without additional amenities; Class C properties account for 73% of all rental buildings. Because Class C buildings are typically smaller in size, they account for just 51% of all units in the region. Class B properties, which are slightly larger at 48 units on average, account for 25% of all properties and 43% of units in the region. Meanwhile, very little new construction has occurred in the region, resulting in just 1% of properties falling under Class A (and 6% of all units).

In 2019, the average rent for Class C buildings in the Northland region was $999. Overall, Class C rents are 13% lower than Class B rents in the region. If a Class C building is purchased and upscaled, the result could include a dramatic rise in rent. Potential rent gains from upscaling are particularly acute among studios and three bedroom units in the region where there is a 21% and 38% gap between Class B and Class C units, respectively. Vacancy rates in Class C buildings are extremely low, at just 2.7% in the first quarter of 2020.

There is a distinct difference in building size across classes in the Northland region, as is the case across the state. Class A buildings are typically larger at 128 units on average, while Class C buildings are much smaller with just 20 units on average.

PROPERTY AGE

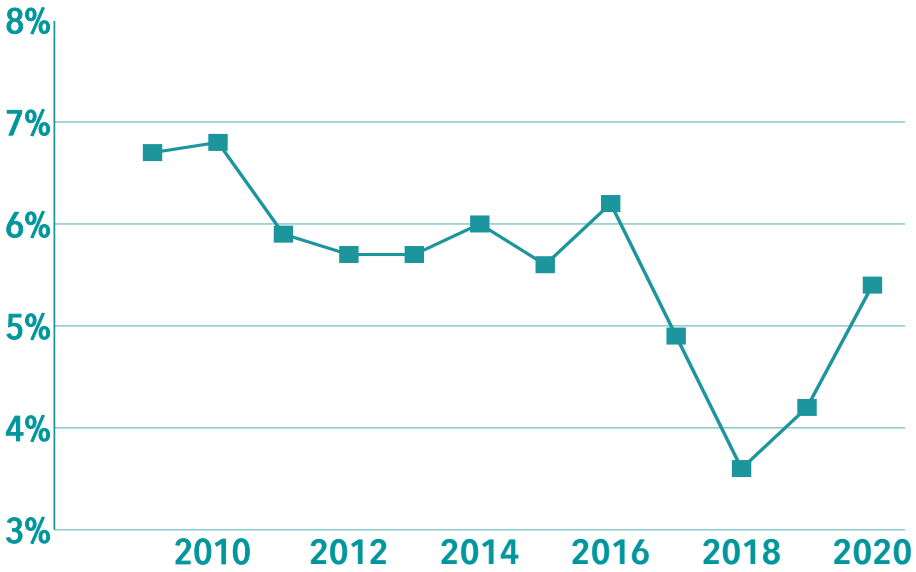
PROPERTIES BY AGE



total # of buildings	Building Age
19	126+ years
45	100-125 years
19	76-100 years
17	51-74 years
55	26-50 years
25	1-25 years

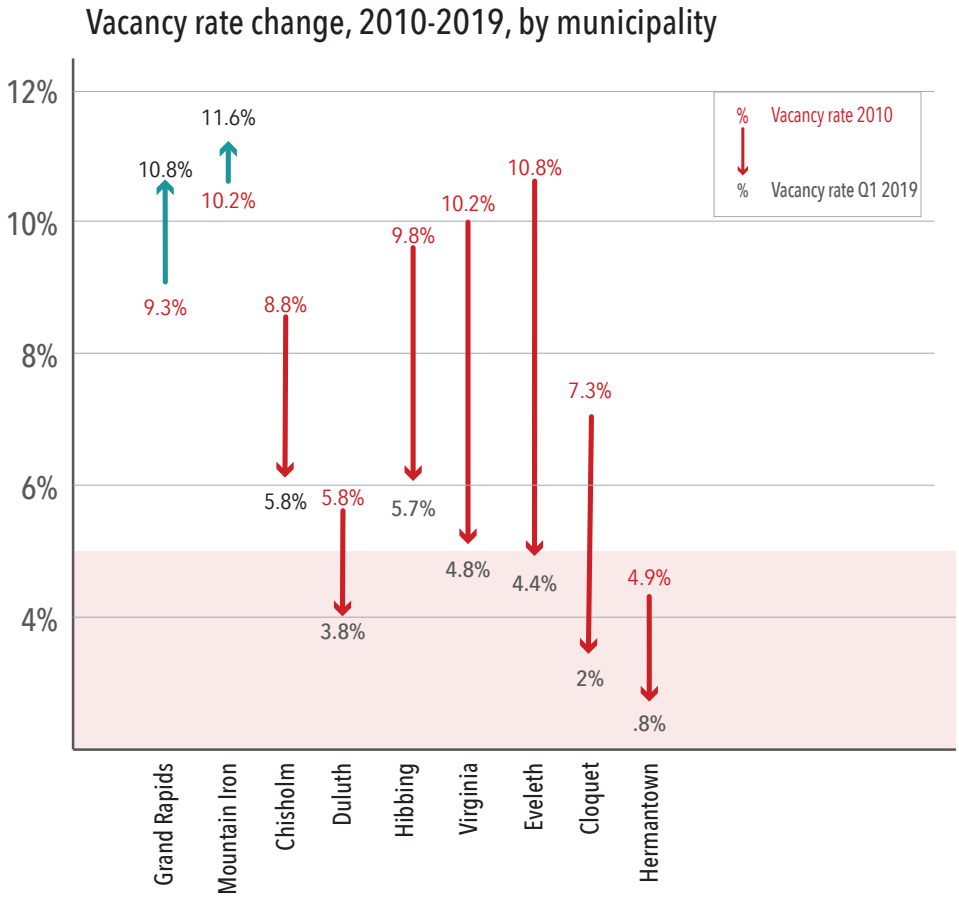
Properties in the Northland Region are aging. Fifty-six percent of multifamily, market rate properties are 50 years or older (built prior to 1970). Aging properties are most likely in need of rehabilitation and updating, in order to provide quality and safe housing for residents.

VACANCY RATES



When vacancy rates fall below 5%, renter households struggle to find affordable housing. Property owners can be more selective in tenant screening and potentially increase rent. In the Northland region, the vacancy rate is under 5%, reaching a 10-year low of 3.6% in 2018. Since 2018, the rate has slightly risen, on trend with vacancy rates across the state. In 2019, the vacancy rate in the region was 4.2%, a 38% decline from the 2010 rate of 6.8%.

VACANCY RATES



The cities of Hermantown, Cloquet, Duluth, Eveleth and Virginia have seen a 34%-84% drop in their vacancy rates since 2010. Vacancy trends in the Northland region vary from those in the state, where we commonly see higher vacancy rates in places with new construction. Mountain Iron and Grand Rapids currently have the highest vacancy rates, at 11.6% and 10.4% respectively; both cities have also seen increases in their overall vacancy rates since 2010.

VACANCY BY CLASS



Class A
3%

Class B
6.8%

Class C
2.7%

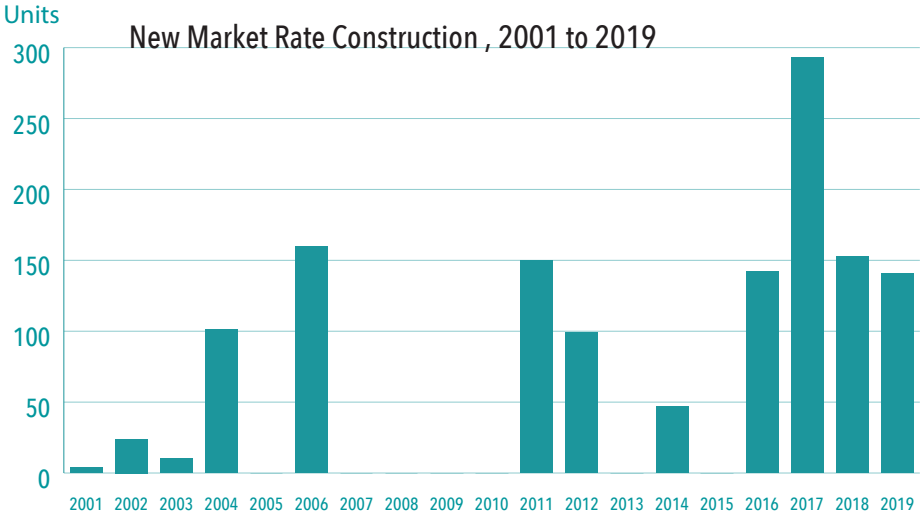
Unsubsidized affordable rental housing or NOAH is typically Class C: older properties that provide basic shelter without additional amenities. However, these buildings, on average, are far smaller than Class A and Class B buildings. Class C buildings often have lower rents that have seen minimal increases and have higher capital investment needs. Class C properties may be vulnerable to increased rents, due to new property owners making upgrades to reposition the units for higher income residents.

CONSTRUCTION AND SALES

NEW CONSTRUCTION

Compared to the rest of the state, the Northland region has seen very little new construction in the past ten years. We tracked a total of 15 multifamily properties that broke ground from 2010 to 2019; of those, just four were affordable. The majority of these properties were low-mid rise, with an average of 78 units.

For the twelve market rate properties built during this time, ten were constructed in the city of Duluth, with the remaining two in the city of Cloquet. These properties averaged a size of 85 units, with an overall average asking rent of $1,514. Within Duluth, most market rate construction occurred in the Duluth Heights/ Kenwood and Piedmont neighborhoods.



Of the four affordable properties constructed over this same time period (2010-2019), two were built in Duluth, one in Cloquet and one in Aurora. These properties are on average much smaller than their market rate counterparts, with average size of 56 units.

CONSTRUCTION CHALLENGES IN THE NORTHLAND

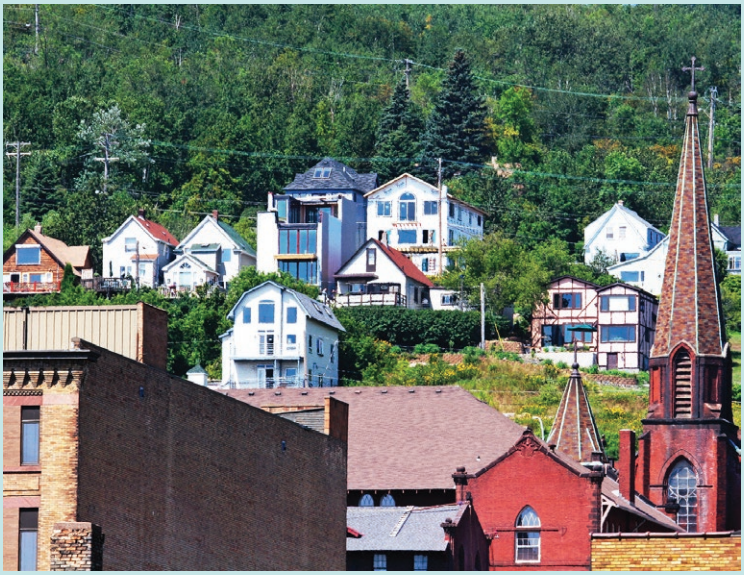
Duluth hasn't been spared from the housing crisis that has affected Minnesota and the nation. A range of factors make constructing new housing in Duluth a challenge.

"Like most of the nation, Duluth was struggling to construct affordable housing prior to COVID-19," says Jason Hale, Senior Housing Developer for the City of Duluth. "But unlike much of Minnesota, Duluth has unique barriers that make construction of new market rate housing and housing at prices affordable to median incomes difficult."

The geology of Duluth is a big factor. A lake shore means expansion southeast is impossible. Underlying bedrock close to the surface creates the need to blast rock to build.

"The terrain of the City provides beautiful vistas and the lake as a centerpiece and all the activity in the Port are what makes Duluth special," said Hale. "Yet, these become problematic when development requires blasting bedrock on the hill, avoiding and preserving wetlands where the terrain is flat, and constructing new housing near existing utilities."

Anyone who has visited Duluth in winter knows how beautiful the scenery can be but the city's unique weather also impacts construction. "While some projects operate in the winter months, most run against the seasonal clock, trying to complete building envelopes by October to avoid frost, snow and the cold," said Hale. "While all of Minnesota is cold in the winter, Duluth has to contend with November gales over the lake and Canadian cold fronts halting progress at any moment."



Duluth Hillside. Photo by Randen Pederson

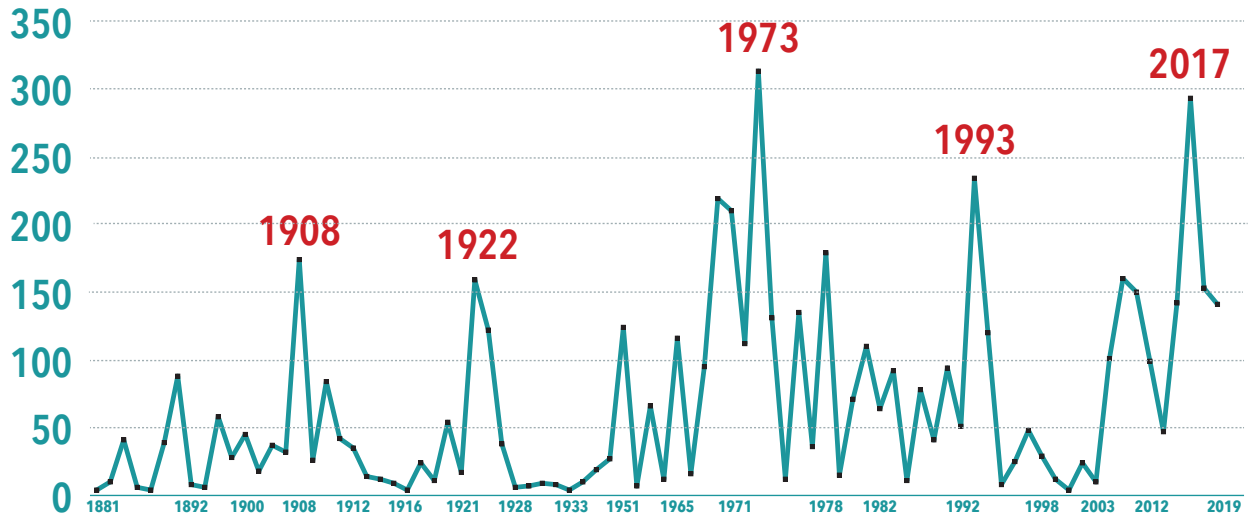
The region is also competing with the Twin Cities for skilled labor.

"We are fortunate to have major construction projects underway in our healthcare system, but this has caused additional stress on an already tight skilled-labor market," said Hale. "Contractors are busy, and many are turning down work or postponing jobs until next year. We suspected labor costs may decrease given the record unemployment claims since March, but we have seen little movement in that area."

"We are desperate for contractors," said Jill Keppers, Executive Director of the Housing and Redevelopment Authority of Duluth. "The Duluth HRA has started a construction training program, but we only have so much money. If there was funding for expanding this type of program to help low-income households learn skills to get them into living wage jobs as well as provide employees for local contractors or even create a new construction company specifically for training that could bid on rehab jobs in the city — that would be wonderful."

Hale notes that the most in-demand supportive and deeply affordable housing units are one-bedroom. And the City and Region will struggle to provide such housing so long as resources like Low-Income Housing Tax Credits and Housing Infrastructure Bonds are scarce and construction costs remain very high.

NOAH CONSTRUCTION BOOMS IN NORTHLAND REGION: 1881-2019



PROPERTY SALES

Top 10 Cities: Units Sold (2010-2019)

	City	Buildings	Units
1	Duluth	20	698
2	Grand Rapids	6	170
3	Hermantown	1	166
4	Cloquet	2	78
5	Eveleth	2	39
6	Hibbing	3	35
7	Moose Lake	2	27
8	Two Harbors	2	24
9	Virginia	1	19
10	Cohasset	1	18
	Total	42	1282

Overall the region has seen very little sales acquisition since 2010. Over 40 sales transactions occurred in the Northland region, from 2010 to 2019, with 2018 seeing the most activity at 9 sales that year. Most property sales occurred in Duluth, with 20 buildings and 698 units changing hands. Second to Duluth was Grand Rapids, which saw 6 buildings with a total of 170 units sell over the same time period.

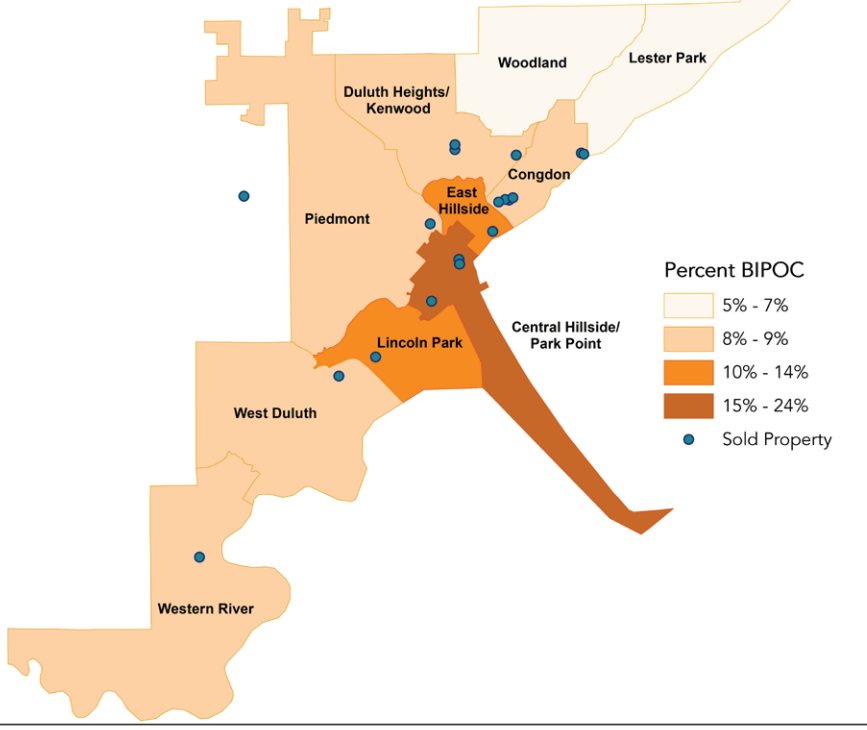
While the majority of sales were of Class C buildings (71%), Class B units accounted for the majority of unit sales (55%). Class B buildings represented 27% of sold properties. Only one Class A property sold over this time period, accounting for .02% of all sold multifamily buildings.

Over this time span, the average size of building that was sold contained 31 units in the Northland region-- significantly smaller than that of the overall 7-County metropolitan area, which had an average of 45 units per building sale. Seventy-nine percent of buildings sold had fewer than 50 units, with 58% containing fewer than 25 units.

Property sales in Duluth were more likely to occur in neighborhoods that are home to higher percentages of Black, Indigenous, and People of Color (BIPOC). This can indicate more displacement of renters of color.

Central Hillside/Park Point had the highest number of property sales followed by Congton. Central Hillside/Park Point also has the highest percent of people of color.

PROPERTY SALES, 2010-2019, BY NEIGHBORHOOD AND RACE



RENT IN THE NORTHLAND

RENTER TRENDS

In 2018, there were an estimated 35,746 renter households in the Northland region, accounting for just over a quarter of all households (26%). Various parts of the region saw fluctuations in renter population. In total, the region saw only a 3% increase in overall renter households since 2010. Of the seven counties in the Northland region, St. Louis was the only to see an increased renter population overall, gaining 5% new renter households. Many cities across the region saw more significant increases in renter households, including Hermantown (+51%), Two Harbors (+22%), Grand Rapids (+21%) and Virginia (+10%).

While most counties in the region have seen a recent increase in median renter income from 2010 to 2018, renter income is still significantly lower than that of the state average in all counties in the Northland region. With the statewide average renter household income of $37,686, renter households by counties in the region earn on average from 5% (or $36,000 in Lake County) to 80% (or $20,929 in Koochiching County) less than that. In the top five most populous cities in the Northland region, median renter income is 35% (in Duluth) to 91% (Grand Rapids) lower than that of the median renter income of the state.

Regionally, there are just over 4,300 black, indigenous, people of color (BIPOC) renters. While just 24% of white households are renters in the region, over half (53%) of BIPOC households occupy rental homes.

Geography	% Renter	% Change in renters	Proportionate change in renters	Population change
Eveleth	44%	5%	16%	-9.2%
Virginia	43%	10%	4%	5.4%
Grand Rapids	41%	21%	22%	-1.1%
Duluth	40%	-1%	0%	-1.2%
Two Harbors	39%	22%	17%	4.9%
International Falls	34%	-17%	-5%	-12%
Hermantown	30%	51%	36%	10.8%
Hibbing	29%	4%	15%	-10%
Cloquet	28%	-20%	-11%	-10.5%
Chisholm	27%	-13%	1%	-13.8%
Region	26%	3%	4%	-1%
State	28%	15%	10%	3%
Metro	32%	17%	10%	6%

The proportionate change of renter households indicates not only overall growth, but shifts in household trends. If the market sees an increase in proportionate renter households, people may be shifting from owning to renting a unit. And vice versa, if a market sees a decline in proportionate renter households, people may be opting to own a home in that market rather than rent.

TRENDS IN RENT

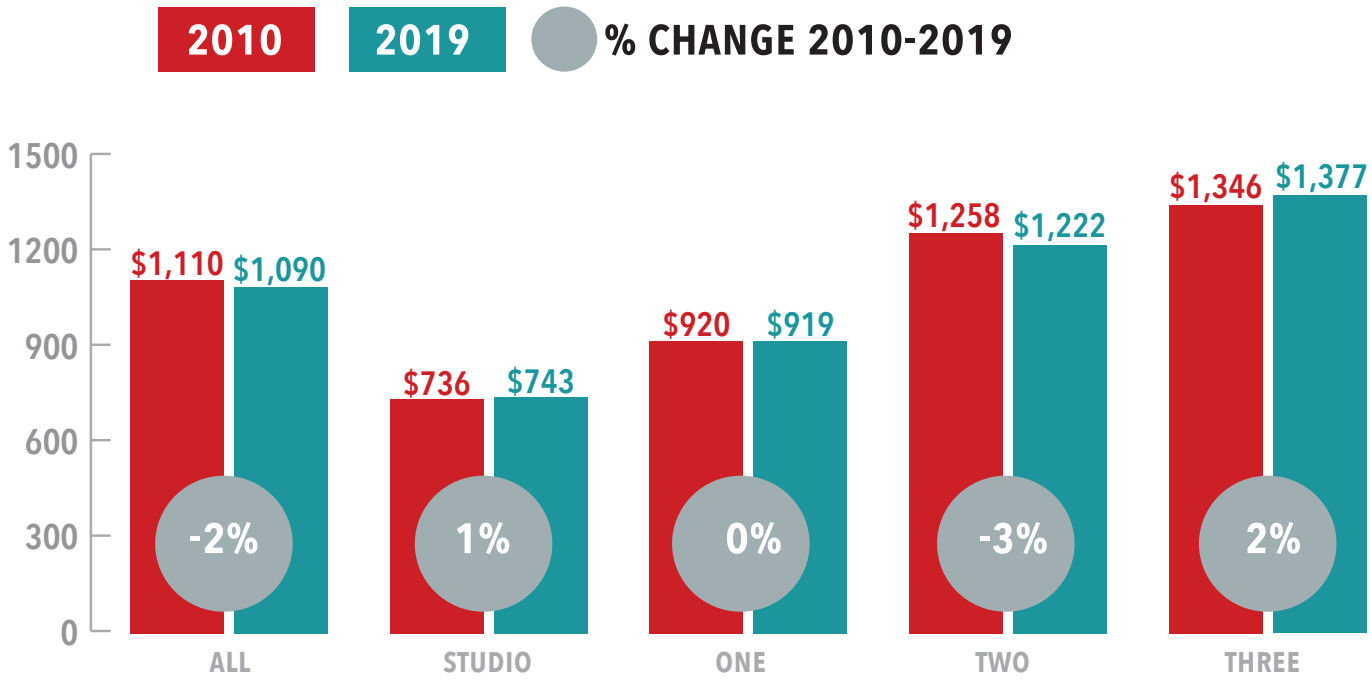
From 2010 to 2019 average rent fell 2% in the Northland region, declining slightly from $1,110 to $1,090. Studio units and three-bedroom apartments saw a 2% increase in gross rent, while one bedrooms saw 0% change in rent, and two-bedrooms saw a decline in rent by 3%.

For renters earning under 60% of area median income (AMI) and seeking affordable units without subsidy, average rent in the region is out of reach. As depicted in the chart below, the average one-bedroom in 2019 rented for $101 (13%) more per month than a household earning 60% AMI can afford and the average two-bedroom is $244 (25%) more per month than 60% AMI can afford.

Cities in the Northland region that saw the most significant gains in rent from 2010 to 2019 include Chisholm (7% increase), Cloquet (5% increase) and Eveleth (5% increase).

New units built since 2010 are commanding much higher rents. The average rent in properties that have come on the market since 2010 is $1,546 — 42% higher than that of the regional average.

CHANGE IN RENT BY UNIT SIZE, adjusted for inflation: 2010-2019



COST BURDEN IN THE NORTHLAND REGION

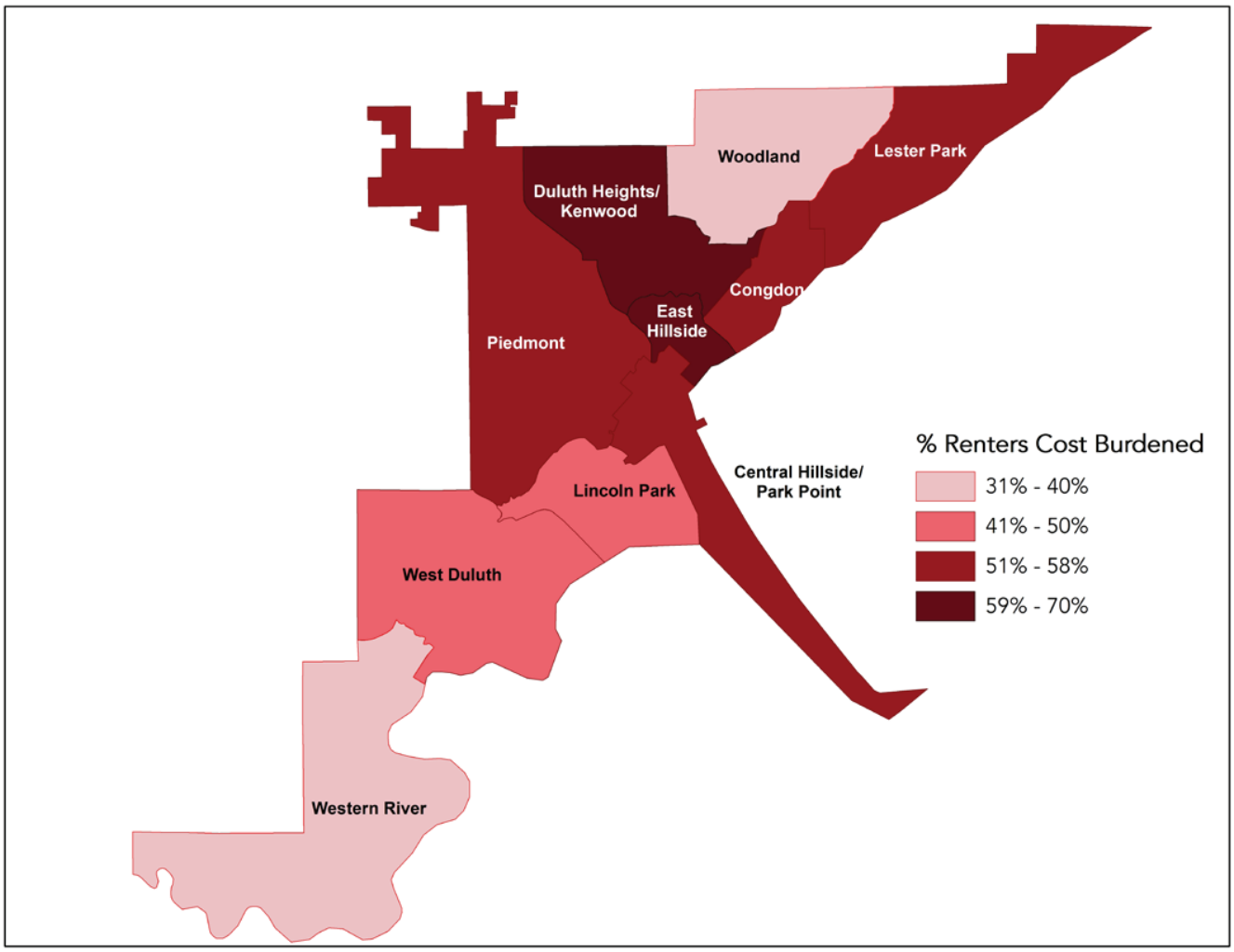


50% of renters pay more than 30% of their income on rent

In total, half of renter households (16,259) experience cost burden in the region, spending more than 30% or what they can afford on rental housing costs. Additionally, 69% of all renter households in the region earn under $50,000 annually.

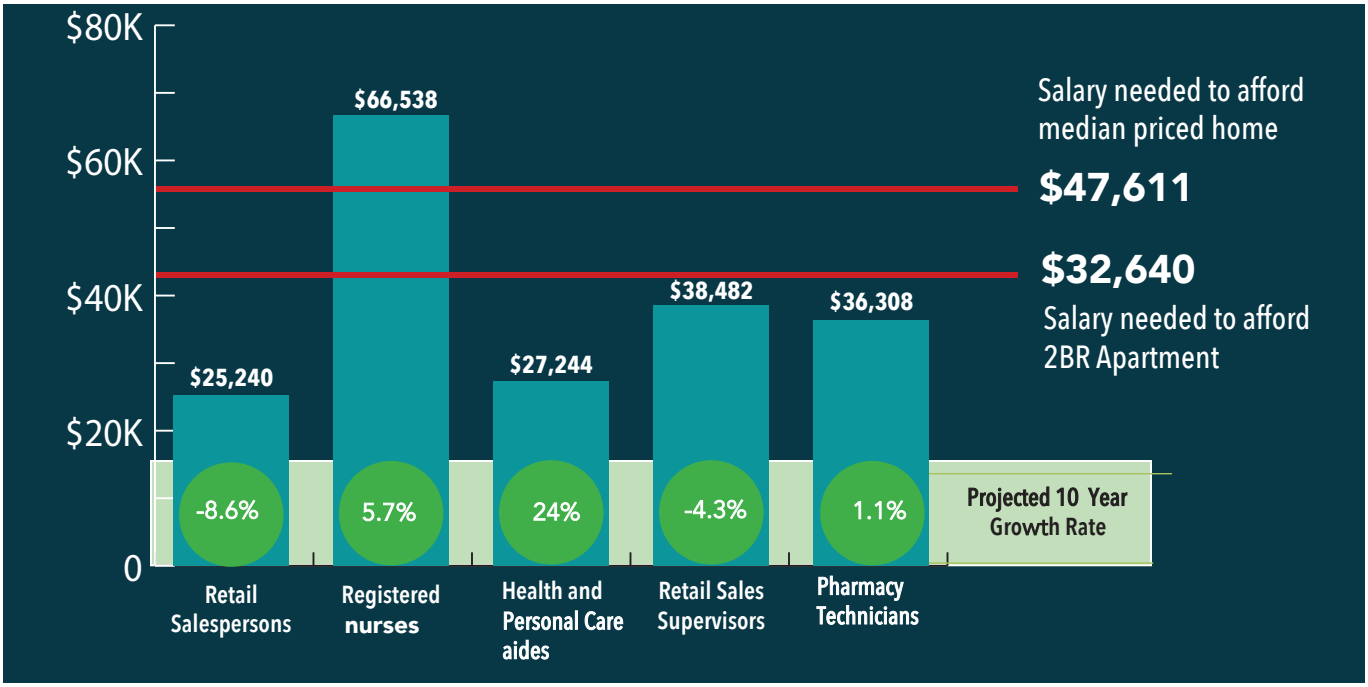
While Itasca and Koochiching Counties tie for the highest percentage of cost burdened renter households at 54%, St. Louis County contains the highest number of cost burdened renter households at 11,638, or 50% of all renter households paying more than they can afford on housing. Out of the top ten most populous cities in the region, Hermantown has the highest percentage of cost burdened renter households, with 70% paying more than 30% of their income towards rent, followed by Virginia (57%) and Grand Rapids (55%).

RENTER COST BURDEN IN DULUTH NEIGHBORHOODS

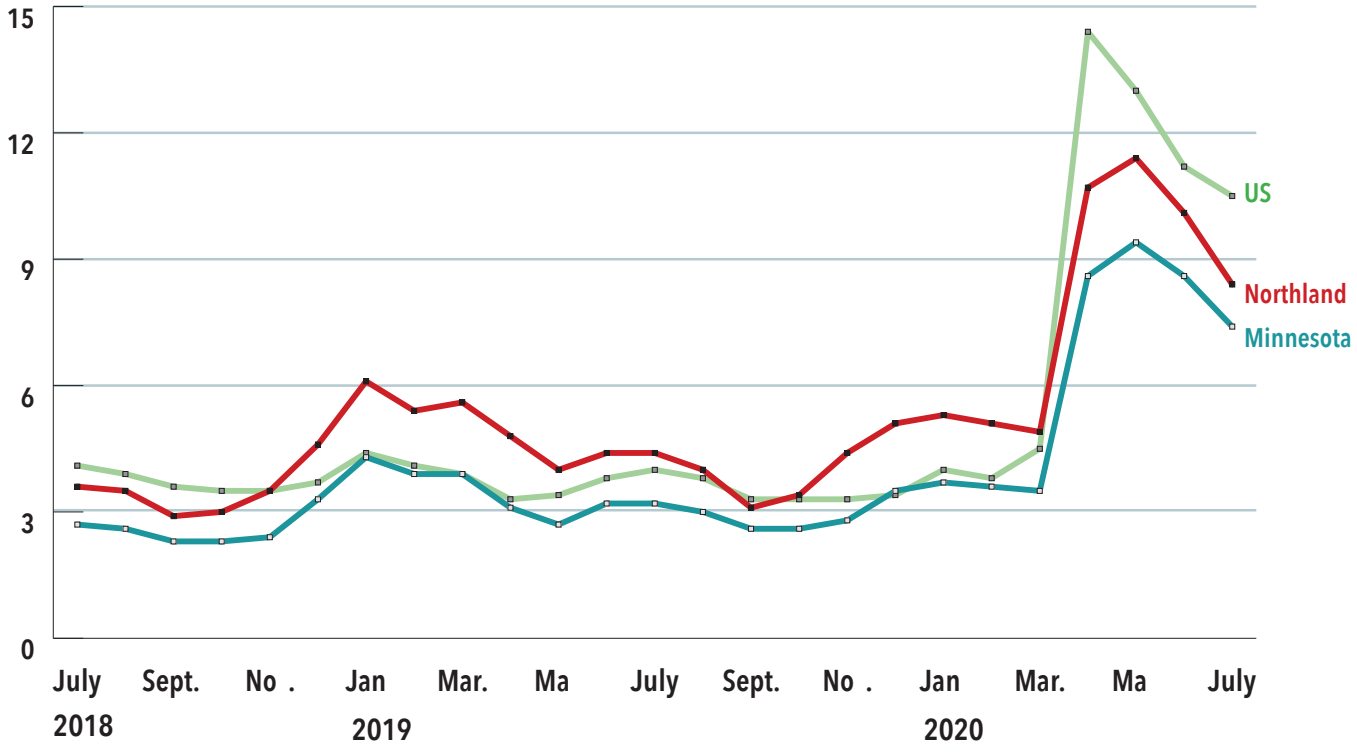


WAGES AND HOUSING AFFORDABILITY

Housing is out of reach for many of the current top in demand jobs in the Northland Region. As affordable housing options become increasingly scarce, workers may face a dilemma in where they are able to call home.



UNEMPLOYMENT



Even prior to COVID-19 impacts, the Northland region saw higher unemployment rates than Minnesota or the United States. Unemployment has increased during COVID19 and remains above the Minnesota rate, but it has fallen below the national rate.