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The Importance of Moderately Priced Rental Housing to Continued Economic Growth

(Or, Portland's Rental Housing Plight)

by Erin MacLean

Currently, the Greater Portland area is experiencing a significant shortage in both subsidized rental housing and moderately priced, market-rate rental housing. According to Erin MacLean, the problem is that even with heightened demand, historically low interest rates, and historically high rents, developers are finding that new, market-rate housing is too expensive to build in Portland. The lack of moderately priced housing has affected local business owners as well, who report they are finding it difficult to hire workers in the $8 to $15 range. Their efforts to recruit and retain workers place an upward pressure on wages, which can act as a deterrent to economic growth. In this article, MacLean discusses the circumstances that have led to Portland's current shortage in rental housing and concludes with a discussion about reducing the costs of construction. She strongly urges local officials to help control costs, and suggests that communities with a clear vision and sensible permitting processes will be more successful in attracting the type of development they desire.

Although Southern Maine has slowly recovered from the recession of the late 1980s and early 1990s, and population has grown very slowly during that time, the rental housing market in the Greater Portland area[1] has been approaching 100% occupancy for three years. Virtually no new market-rate rental housing has been built in the area during the 1990s, resulting in a shortage of approximately two thousand housing units.[2] The City of Portland is currently experiencing a shortage of rental housing—both subsidized, affordable rental housing and moderately priced, market-rate rental housing. A shortage of rental housing will continue to drive up rents in the Portland area, which already have increased an average of 10% in the most expensive locations over the last year.[3]

Since Portland reached full occupancy in 1996,[4] increasing rental rates have put upward pressure on wages in the retail, restaurant, and building trades. Rick Holden of Project Staffing in Brunswick said that, because of the lack of rental housing, it has been difficult for his firm to fill jobs in Portland paying between $8 and $15 per hour. Holden said that for many workers in this pay range, the costs of commuting—extended daycare, gasoline, insurance—offset any increase in pay a job in the Portland area might offer. To fill those jobs, employers will be forced to increase wages in order to entice workers away from other jobs, offset the costs of commuting, or make it possible for workers from elsewhere to afford to live nearby.

Competition for housing, with its corresponding increase in rental rates, also puts downward pressure on those people with the fewest resources. According to Mark Adelson, Director of Housing and Neighborhood Services for the City of Portland, Portland's homeless shelters have been filling up with the "economic homeless," those who have been forced from the city's least expensive rental units due to steep competition for housing. Among other things, this puts additional strain on city services.

Clearly, the solution is construction of new rental housing. The problem is that even with heightened demand, historically low interest rates, and historically high rents, developers are finding that new, market-rate housing is still too expensive to build in Portland. This has implications for all of Maine's communities. If—at the peak of demand, in a climate of economic growth and attractive debt terms—the rents in Maine's most expensive housing market are not high enough to support the cost of new construction, where else in Maine is it economically feasible to build new, market-rate housing?

There is a lesson here for all of Maine's communities. The availability of moderately priced rental housing within the community should be viewed as an important component of any economic development strategy. Like the availability of good schools and quality jobs, proximity to transportation and shopping, community planners should consider future demand for moderately priced rental housing in their plans for economic growth. Planning ahead will also help to control the cost of building new housing when it becomes necessary. Planning ahead is a luxury available only to communities that do not yet have a shortage. After-the-fact solutions may be limited and costly. In particular, the circumstances that gave rise to Portland's rental housing shortage highlight the demographic factors that planners in other communities may want to watch, and provide context for discussion of the role policymakers can play in helping to control the cost of new construction. These circumstances and some thoughts about reducing the costs of new construction are offered below.

JOB GROWTH, POPULATION GROWTH AND NO NEW CONSTRUCTION DURING THE 1990s

Both the Portland-area economy and its population have grown since 1990. Between 1990 and mid-1998, the Portland Metropolitan Statistical Area (MSA) enjoyed a net gain of 8,680 jobs. Also in 1998, the Portland MSA and Cumberland County recorded the lowest unemployment rates of the decade, 2.6% and 2.8%, respectively.

During the first half of the decade, 1990 to 1996, the Greater Portland area enjoyed a total 1.87% rate of population growth, or 0.311% annual growth, according to estimates provided by the Greater Portland Council of Governments. In July of 1996, these estimates put the population at 158,560. Carrying forward the growth rate for the area at a constant annual rate of 0.311% would yield an area population of 159,548 in 1999 or a gain of 3,892 people since 1990.

	Greater Portland Area	Cumberland County
Apr-90	155,656	243,135
Jul-91	156,366	244,195
Jul-92	155,107	244,377
Jul-93	155,890	245,263
Jul-94	156,906	247,320
Jul-95	157,374	248,855
Jul-96	158,560	251,087
Overall Growth	1.87%	3.27%
Annual Growth	0.311%	0.545%

Source: GPCOG

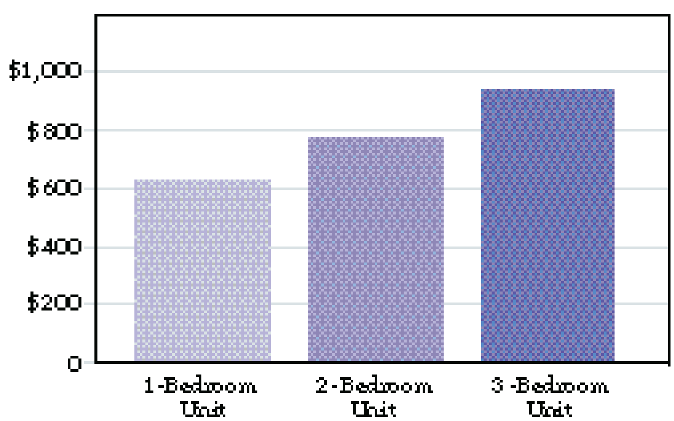
By contrast, only five hundred ninety-three new multi-family units were created in the Portland area during the same period. Of these, 65%, or three hundred eighty-seven units are reserved for elderly or low-income tenants. To date, there has been no new construction of market rate apartment buildings with more than twenty units during the 1990s. The most recent addition of market rate units to the rental pool came from the 1998 renovation of Holt Hall, a historic building located near Maine Medical Center in Portland, which created thirty-six new market rate units.

THE EXISTING RENTAL HOUSING STOCK IS OLD

The fact that no new units have been built is significant because Maine's housing stock is some of the oldest in the country, and Portland has the greatest concentration of old rental housing in the state. According to the 1990 census, the City of Portland had a total of 16,340 renter-occupied housing units. Assuming none of these units have been demolished since 1990, 68% are more than forty years old today, and 7% are between thirty and thirty-nine years old today, making a full 75% of the City's rental-housing units more than thirty years old today.

These figures may significantly understate the actual age of the buildings because the census data merely indicate that the oldest units were built before 1939. Some of these units are located in structures built many years before 1939. A significant number of the older units are approaching obsolescence, and a great many do not meet modern code requirements and cannot be renovated to modern standards, except at excessive cost, and in some cases, not at any cost.

Average Rental Rates (Heat Included)



Consequently, from 1990 to 1998, 8,680 new jobs attracted 3,892 more people to the Greater Portland area, yet only 206 new market rate rental units were made available. As a result, rental occupancy rates rose to 98% and, meanwhile, the existing housing stock continued to age.

SHRINKING HOUSEHOLD SIZE BOOSTS DEMAND

Between 1980 and 1990, when the City of Portland, the Greater Portland area, and Cumberland County were each experiencing population growth, the total number of households increased at roughly double the rate of population growth in each of those areas. This disproportionate increase resulted from a decrease in the number of persons per household in each of the three areas. Households were 6% to 6.6% smaller by the end of the decade.[5]

Decreasing household size was a nationwide trend between 1980 and 1990, fueled by the coming-of-age of the "baby boomers" who generally have stayed single longer, delayed childbirth, divorced more frequently, and lived alone longer than their parents. This trend has fueled a growth in the number of households, which, in turn, has increased the demand for housing. This trend is projected to continue through the end of this decade.[6]

By the year 2000, given the trend described above (and using total population, projected population in the number of households, and total number of renter households), there will be an estimated 17,152 renter households in the City of Portland—an increase of 812 renter households since 1990. Unless new rental units are built in Portland before the year 2000, the city will have added only 158 units of market-rate rental housing to its rental pool during the same period, and it's worth noting that in 1999, demand already exceeds supply.

RISING RENTAL RATES

A survey of rental properties conducted in June 1997, December 1997, and again in October 1998 revealed rising rental rates in the Greater Portland area.[7] The survey included all of the "high-end" market-rate properties with more than twenty units because these were the most likely to be professionally managed and offer the best amenities, therefore commanding the highest rents. A total of 2,503 units were included in the survey, which represents 9% of the total rental units available in the Greater Portland area.

While interest rates have recently gone down, thereby reducing financing costs, the cost of building materials and the cost of labor are still higher in New England than in other areas of the country.

In the survey sample, rental rates in October 1998 ranged from $380 to $1,100 per month for one-bedroom units (including studios). The rates for two-bedroom units ranged from $470 to $1,200 per month, and the rates for three-bedroom units ranged from $692 to $1,400 per month. Average rental rates (including an adjustment for heating costs) were $629 for one-bedroom units, $781 for two-bedroom units, and $948 for three-bedroom units, including heat.

Keep in mind that these figures represent the top 10% of market rents in the City of Portland. Many of the people who occupy these units are "lifestyle" renters, or "renters by choice," young professionals and others who can afford to own a home, but who choose to rent instead. In Maine, these "renters by choice" have become the target market for developers seeking to build new, market-rate housing. For those market-rate projects currently in development stages, pro forma rents are, for the most part, at or above the highest existing rents, and will be most affordable for the targeted "renter by choice."

THE COSTS OF NEW CONSTRUCTION

The variables that dictate the total development cost associated with building new housing include the "soft" costs of designing, planning, permitting, and financing the project as well as the "hard" costs of land, building materials, and labor. While interest rates have recently gone down, thereby reducing financing costs, the cost of building materials and the cost of labor are still higher in New England than in other areas of the country. At the same time, appropriately zoned land, with access to water, sewer, and utility lines has become scarce in many locations, thereby driving up acquisition, planning, and permitting costs. In addition, every development project must generate a reasonable return on investment. Despite the excesses of the 1980s, there is real risk (construction, lease-up, interest rate, etc.) associated with developing and owning rental housing, and real return on equity is required to induce developers to take that risk.

Development costs are typically discussed in terms of cost-per-square foot, or, for housing, cost-per-unit. Five of the apartment complexes in the survey cited earlier were sold during the last two years at a cost of approximately $50,000 per unit. Prior to those sales, apartment buildings in this market were selling for $30,000 to $40,000 per unit.[8] According to developers Ted Carman of Concord Square Development Company and James Whelan of Princeton Properties, the cost of constructing comparable new units exceeds $70,000 per unit. As long as the difference between market value and construction cost is so great, it will be a deterrent to new development. However, a prolonged shortage of rental housing will drive up both rents and property values.

Late in 1998, Carman's company completed the rehabilitation of Holt Hall in Portland (adding thirty-six market-rate units to the apartment market), and the company currently has a new construction project in development stages in Portland. The newest project, which would add seventy market-rate units to the rental pool, is the only Portland apartment project in the planning stage that could add units to the market by 2000. In order to be feasible, the project will need to command rents in excess of $1.10 to $1.20 per square foot. By comparison, the Portland market survey revealed average per-square-foot rents of $0.95 for one-bedroom units, $0.62 for two-bedroom units, and $0.71 for three-bedroom units in the top 10% of the market.

Carman expects that his development will achieve the highest rents in the market because it will offer something the market does not currently have—new, spacious units, ocean views, quality finishes, and a serious exercise facility, including indoor lap pool, weights, and a tennis court. Without offering something unique and appealing to "renters by choice," the project will not work.

Whelan's firm is the largest private owner of apartment units in Southern Maine and, recently, it made the decision not to pursue development of an adjacent parcel of land into new apartment units because the cost was too high. Although Princeton Properties would have had to purchase the adjacent parcel, the project would have had the benefit of sharing an existing leasing office, recreational amenities, and a curb cut. Even with these advantages, the per-unit development costs were too high for the project to be feasible.

Communities with a clear vision, established criteria, and a sensible permitting process will have more success attracting the type of development they desire.

BRINGING DEVELOPMENT COSTS DOWN

There are a number of factors that can be adjusted to bring down the cost of new development. The developer can accept a smaller profit margin, or make a larger equity contribution to reduce the amount of debt the rents must support. Keeping in mind that a knowledgeable and experienced developer will require a risk-adjusted, market return both on the investment and on the work before attempting the project, adjustments to these two factors alone are unlikely to produce new rental housing.

The cost of land, Carman suggests, can be reduced in communities that desire construction of new rental housing by making available adequate land, appropriately zoned for multi-family housing. For communities such as Portland, which have only a small amount of undeveloped land left, this will not be possible. However, for the surrounding communities of South Portland, Westbrook, Scarborough and Gorham, major tracts of land near job centers like the Maine Mall could be zoned for multi-family housing.

Designing a project that is attractive and compatible with surrounding uses, and working with neighbors in the initial planning stages, is politically necessary and will save time and expense in later development stages, according to Adelson. "At this point in Portland's development, the community demands that if a development of any kind is going to take the last space available, then it's going to be done well. That's why our approval process is so thorough."

The approval process is another variable that affects the cost of new development. Communities with a clear vision, established criteria, and a sensible permitting process will have more success attracting the type of development they desire. Too often, developers complain the approval process is slow, and can be drawn out or held hostage by one or two strong-willed individuals. This is the stage in the development process where the developer has had to advance substantial amounts of money to cover pre-development costs and cannot secure financing until all the necessary permits have been obtained. Delays at this stage cost the developer money and increase the overall cost of construction.

The regulatory environment certainly adds to the cost of new construction. The Clean Water Act, the Endangered Species Act, the Davis-Bacon Act, Occupational Safety and Health regulations, and growth controls are some of the many regulations that may affect the cost of development. For example, in complying with the Clean Water Act, the developer must consider and comply with the federal rules relating to wetlands, storm water, and non-point source discharges. The "wetlands" designation alone can cause long, expensive delays. Part of the problem is in the definition of "wetland." Sometimes the land is not wet, has no significant environmental function, and is not part of an aquatic ecosystem.

The National Association of Homebuilders cites state and federal regulations as a major cause of the increase in lumber costs. Lumber prices are 50% higher than in the 1980s, due in part to the legal maze created by conflicting laws controlling national forest management, including the Endangered Species Act, the National Forest Management Act, and the National Environmental Policy Act. Informed and helpful state and local officials can help developers negotiate the regulatory maze and comply with these laws in a timely fashion, helping to reduce the overall cost of new construction.

While state and federal programs subsidize the construction of low-income housing with low-cost loans or grants, tax credits, and operating assistance, there are few subsidies available for the construction of moderately priced, market-rate housing for middle-income renters. To make new construction of market-rate housing possible, state and local policymakers must understand the connection between availability of moderately priced rental housing and economic growth, and participate proactively in the development process.

Local officials should be encouraged to help control costs by fostering conversations among community leaders now to ensure a coherent and cohesive approach to building in their community. This should lead to a zoning policy that ensures the availability of properly zoned land, the existence of adequately detailed building codes and architectural guidelines, a streamlined permitting process, and an amicable and productive relationship with the development community. In this way, community planners can reduce the cost of new construction and influence both the timing and the type of new housing construction in their community, thus ensuring the possibility of future economic growth.

Erin Cooperrider MacLean has worked in real estate development and asset management since 1989. She has served as officer and board member of the Washington, D.C.-based Real Estate Capital Recovery Association, has advised the Federal Deposit Insurance Corporation on implementation of affordable housing policy, and has testified before the Thrift Depositor Protection Oversight Board. She currently works for The Signal Group—a Portland-based real estate advisory firm serving clients nationwide.

ENDNOTES:

1 The Greater Portland area includes the cities of Portland, South Portland, and Westbrook, and the towns of Cape Elizabeth, Cumberland, Falmouth, Freeport, Scarborough, Yarmouth and North Yarmouth.

2 The Signal Group prepared three feasibility studies for private developers seeking to build new apartments in the City of Portland between June 1997 and October 1998. This work included demographic research and projections, as well as market research. A summary of the research describing the methodology used to derive the projections discussed in this article is available from The Signal Group, 45 Exchange Street, Suite 200, Portland, ME 04101.

3 Ibid.

4 "Garden Apartment Market Survey, Greater Portland," by ILS Advisory Group, August 1996, p.2.

5 See note 2.

6 Ibid.

7 The survey was conducted by The Signal Group as part of the feasibility work described in note 2.

8 These figures were obtained through conversations with commercial real estate brokers at Malone Commercial Brokers, Major, O'Connor & Rich, and The Boulos Company.