Toyer Strategic Consulting

FALL 2018

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December 10, 2018

Dear Community Representative:

Thank you for taking time to complete our company's survey on Iowa's housing incentives.

Housing is an obvious economic development challenge in many Midwest communities and the continued announcement of housing and relocation incentive programs nationwide (even in communities as big as Tulsa, OK) are likely to solidify housing's place as the next big differentiator between successful and unsuccessful economic development opportunities.

Through your participation (and the participation of 25 other communities) we were able to identify a range of incentives and future housing opportunities in your community. Additionally, your information was valuable in our determining some recommendations we believe can help communities like yours adequately address development costs and other factors that may be dissuading housing creation.

We believe our firm's experience working with communities and builders may be a unique opportunity where we can assist communities in planning and marketing housing opportunities, as well as assist small to medium size regional builders/developers in locating emerging housing markets.

As promised in return for your participation in our survey, we are making results available for your review[1]. In presenting these results in the form of a report, we hope to highlight how traditional and non-traditional housing incentives (and policies) impact the costs and feasibility of creating housing.

Should you want to analyze more data from the survey or take a deeper look at some of the examples we discuss in the report (codes, policies, etc.), please do not hesitate to contact me.

Thank you again for your participation.

Happy Holidays,

David Toyer
Owner

[1] This report focuses on single family housing, as survey responses contained more information overall, as well as more consistent and comparable data.

About Toyer Strategic Consulting

Toyer Strategic Consulting, LLC. has offices in Everett, Washington and Burlington, Iowa.

The Firm's Core Competencies

- Economic Development
- Land Use & Real Estate
- Communications & Marketing
- Government Relations

Public & Private Sector Clients

- Local Government (cities, towns and counties)
- Developers (residential, commercial and industrial)
- Economic Development Organizations (EDOs)
- Other Private Businesses & Organizations

Recent Public Sector Projects & Engagements

- Business Outreach Study & Program – City of Pacific, WA (completed)
- Economic Development Strategic Plan – Town of Skykomish, WA (completed)
- Economic Development Work Plan – Spencer, IA (current engagement)

Current Private Sector Projects & Engagements

- NP Hawks Prairie – a 1.9 million square foot multi-tenant industrial complex in Lacey, WA
- Labrador Rezone – a 1.89 acre single family to multiple family rezone in Auburn, WA
- Rhodora Annexation – annexation of 108 acres to the City of Lake Stevens, WA

Goal of this Report

Housing in Iowa is a significant economic development issue and our firm has worked with several Iowa communities over the last several years. At the same time, we've provided consulting services for developers and homebuilders (almost exclusively in the Pacific Northwest).

Our goal in producing this report was three-fold:

1. Gather a baseline of data, including:
    a. Availability and efficacy of incentives
    b. Identify municipal or EDO owned lots
    c. Collect housing needs studies (especially those that analyze potential market absorption)

2. Provide Iowa municipalities and EDOs with information, including:
    a. A summary of incentives currently offered statewide
    b. Information on supply and demand challenges that influence new housing development
    c. Examples of alternative incentives (financial and non-financial)

3. Evaluate potential client opportunities where we can assist with new housing in Iowa.

About Iowa's Housing Incentives

Most Iowa cities employ housing incentives, but the types of incentives vary widely from tax abatement to tax increment financing (TIF) rebates on infrastructure and from city construction of subdivisions to cash grants for homebuyers.

The effectiveness of such incentives can be difficult to gauge. Factors such as geographic location to a metro market (e.g. Des Moines, Ames, Davenport, Sioux City) can obviously influence the success of the incentives as there are more overall buyers and the ability to live in adjacent cities while maintaining a reasonable commute to a metro area job center.

Types of Incentives

Incentives in Iowa target either the demand or supply side of housing creation.

Demand side incentives (e.g. homebuyer grants, tax abatement, etc.) stimulate buyers while supply side incentives encourage developers/builders to create new homes, especially homes viewed as being likely to attract new workforce to a community. These supply side incentives include tax increment financing (TIF) rebates for infrastructure like roads, sewer, etc. But they may also include city offered lots or land at discounted lot prices created by TIF.

A few non-traditional supply side incentives that haven't gotten broader attention may also be worth considering individually or in conjunction with traditional incentives. We describe some of these later in this report.

Lastly, there are two significant trends that Iowa cities should follow.

The first involves the recent announcements by communities willing to offer relocating homebuyers cash incentives[2] (in places like Tulsa, OK and Polk County, IA) may be gaining in popularity. These incentives are likely to place additional pressures on smaller cities to "keep up" in order to compete for those buyers to enter (or stay) in their markets.

The second is the entry of DR Horton into the Des Moines metro housing market (through the announced acquisition of Classic Homes on December 4th). The fact that the nation's top homebuilder (by volume) is entering Des Moines signals that Iowa is finally on the radar of national builders, which employ a "production" vs. custom mentality to building homes. This is likely to have an impact on how existing regional builders look at future projects, product types, and which Iowa markets in which they should expand their operations.

Traditional Demand Side Incentives

The most popular demand side incentive is tax abatement – most likely because of (a) its low risk to the city as it is only available if the home is built and (b) the incentive foregoes future revenue as opposed to impacting cash balances in the general fund or reserves in a revenue/enterprise fund. By contrast, grants or "rebates" provided by cities to homebuyers upon purchase typically come from money earmarked out of the general funds, reserves or municipal utility funds. While still a low risk to the community (the house is built, and valuation added), this directly impacts municipal (or utility) cash flow.

[2] These programs are funded by private and/or public funds. For example, the Polk County incentive as announced on Sept. 6, 2018 relies on $4.7MM in funding from Wells Fargo for grants up to $15,000 to homebuyers in Polk County (comes with a 5-year occupancy commitment).

The different impact of each of these incentives is easily demonstrated. A tax abatement of 100% for 3 years can impact an unlimited number of new homes created (at least until the policy might be changed). But a $5,000 rebate can only create a limited number of units based on what a city (and its partners, if any) can afford. If a city set aside $150,000 for rebates at $5,000 per new home, then it could only incentivize (stimulate) the addition of 30 new homes. As such, this limitation may not incentivize sufficient new housing to account for both housing replacement and demand for new housing.

The downsides to demand side incentives are:

1. Homebuyers, beyond those looking to build a new house and move up, may not be attracted by abatement due to it's difficultly to understand and the lack of an immediate, more visible impact to their transaction.

2. While rebates or grants have a more immediate appeal to the buyer, they also have an immediate impact to the city limiting the number of new homes that can be stimulated.

Common abatement schedules identified were 100% for five years on the first $75,000 in valuation added or 100% for 3 years on the full valuation added. There were some examples of communities having a more aggressive tax abatement schedule. Communities offering abatement have added new housing, but it remains difficult to determine whether tax abatement was the determining factor. Note: we examine the value of abatement schedules and the number of housing units created later in this report (pages 12 and 13).

Cities interested in testing the waters of abatement may want to consider a temporary, aggressive tax abatement schedule to draw more immediate attention to their housing market needs. For example an abatement schedule available for only 4 years could include restrictions demanding occupancy of qualifying homes by the end of year 4.

Traditional Supply Side Incentives

The cost of infrastructure and construction (labor, materials) are significant challenges for the developer and homebuilder. Specifically, they place upward pressure on the cost of the finished product, which limits the number of qualified buyers in the market. In Iowa's smaller and more isolated housing markets, this increases the risk for the developer/builder. Thus, developers/builders in those markets tend to pursue pre-sales before deciding on a project – hoping to lower the risk in comparison to fully speculative construction.

The result is (a) less affordable housing, (b) slower development cycles and (c) low inventories of new homes.

To tackle these market challenges, jurisdictions can use supply side incentives. Primarily this consists of tax increment financing (TIF) rebates to pay for a portion of the cost of infrastructure. In these scenarios, the developer or build receives a rebate of the future property taxes paid by the homeowner for a fixed period. TIF rebates are often phased by the developer to ensure that their time clock on the fixed period does not run out before they've collected some of their rebate.

The risk of TIF rebates for a city are still low because the rebates are a form of foregoing future revenues, but the risk to the developer remains high and the structure of the deal is the most important factor to the developer/builder (how much rebate can they get over what period). Provisions in TIF rebates that limit the sales price of housing, restrict their collection to less than 10 years or reduce the percentage of the value add rebated make the rebates less attractive and increase the risk to the developer/builder.

The uncertainty for the developer and the bank regarding how much rebate will be achieved impacts the terms of the construction loan and potentially the developer's/builder's profit. They both look at how lower than expected rebates or

delays in collection impact the project's financing. Thus, the availability of TIF rebates are not guaranteed to attract new investment in housing.

Two other supply side incentives are where (a) the city agrees (before or after construction) to buy unsold lots from a local developer or (b) use TIF to construct its own subdivision with lots available for purchase (at or below price) from the city. These approaches increase the risk for the city, especially should lots not sell as quickly as anticipated (or at all).

The downsides to traditional supply side incentives include:

1. The developers/builders cost and risk is reduced, but the significance (positive or negative) of the TIF rebate determines whether the incentive is attractive enough to encourage additional housing creation by potential developers/builders

2. TIF rebates for infrastructure aren't seen by the buyer, nor do they stimulate buyer demand

3. City construction of subdivisions is a riskier proposition for cities, as it requires the expenditure of existing funds upfront and an unknown horizon for repayment

4. TIF abatement and TIF rebates can't be used together because they come from the same source

NON-TRADITIONAL SUPPLY SIDE INCENTIVES

There are a handful of alternative incentives that may help incentivize (stimulate) new housing supply. While some of these may have budget impacts (e.g. loss of fees paid), many of these alternatives do not financially impact city cash on hand. These alternatives include waiving permit and other fees, as well as looking at the city's regulatory requirements with an eye on reducing development costs.

Reducing the Cost of Development

Cities don't typically waive building fees on building permits, utility connections, etc. because the collection of those fees is generally used to off-set the cost of staffing their planning and inspection departments within a city. However, should a city waive such fees, it reduces the cost of developing housing (how much is unknown and depends on the value of the fees waived) and could help encourage projects on the edge of being feasible.

The other alternatives available address ways to reduce the per home cost of infrastructure and reduce the costs and risks developers/builders assume throughout development process.

Offsetting Infrastructure Costs with Density

The most significant way to reduce per lot infrastructure costs is to increase densities within subdivisions. Allowing higher densities through smaller lot sizes, reduced setbacks, allowed flag lots and adjusted "bulk and dimension" standards may not be what's traditionally permitted within a community, but these allows the developer/builder to spread infrastructure costs among more homes. This contributes to a more affordable range of housing prices that can appeal to a broader range of qualified home buyers.

The most common method of enabling this type of development is through adoption[3] either planned unit development or lot size averaging ordinances[1].

[3] Some communities may already have provisions resembling 'planned development' or 'planned residential development' ordinances in their zoning codes that could be revisited and amended.

Allowing 'Standard' Deviations

Another way to reduce the cost of the infrastructure is modifying the infrastructure requirements themselves. This can include reduced road widths, sidewalks on only one side of the street, etc. Often these are accomplished by jurisdictions granting formal "deviations" from their existing engineering, development and design standards (often requirements that are not codified) or through flexibilities permitted under planned development ordinances.

Addressing the Cost of Time (build-out) & Money (project financing)

Lastly, a city can consider regulatory and policy changes that reduce the cost of financing (aka carrying cost) and shorten the length of time it takes a developer/builder to complete permitting, site construction and build-out (sale of the last home in the project). In most cases, large developers/builders (regional and national builders) want to reach build-out in 24 to 36 months.

Two measures cities can adopt include:

1. Allow concurrent review of both the preliminary subdivision (plat) and construction plans so that upon preliminary plat approval the developer can immediately proceed with site construction.

2. Allow for the construction of homes within a subdivision before a final subdivision (final plat). In this scenario the city would grant a builder/developer temporary use permits or model homes permits to construct 2-6 homes (and in some cases a temporary sales trailer) in the subdivision as they are constructing the subdivision improvements (utilities, roads, etc.)[4]

   Because the construction season can be shorter in the Midwest due to weather related conditions, this allows the developer/builder starting a subdivision in spring to complete the improvements and have the first homes built before fall/winter.

   Having product available for buyers to view and contract for purchase (model homes can't be sold until final subdivision approval and recording) at this stage builds early sales momentum and can encourage buyers to enter the market outside the typical buying season (spring/summer) due to the "showroom" available in the form of one or more model house

EVALUATING TAX ABATEMENT

A survey was completed between August 16, 2018 and October 20, 2018 to understand the types of incentives available in Iowa. Responses were received from 31 communities of which 26[5] offer some form of tax abatement.

The following section of this report summarizes survey results specific to tax abatement.

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[4] Our firm has experience drafting ordinances for communities and we maintain examples of ordinances from communities. If you would like examples, please contact us.

[5] Respondents included: Knoxville, Van Meter, Coon Rapids, Panora, Rock Rapids, Orange City, Grinnell, Davenport, Nevada, Pleasant Hill, Winterset, Manning, Perry, Fort Dodge, Mason City, Ottumwa, Mount Pleasant, Spencer, Atlantic, Algona, Harlan, Milford, Storm Lake, Maquoketa, Newton, Charles City, Humboldt, Rock Valley, Marion, Decorah and Burlington

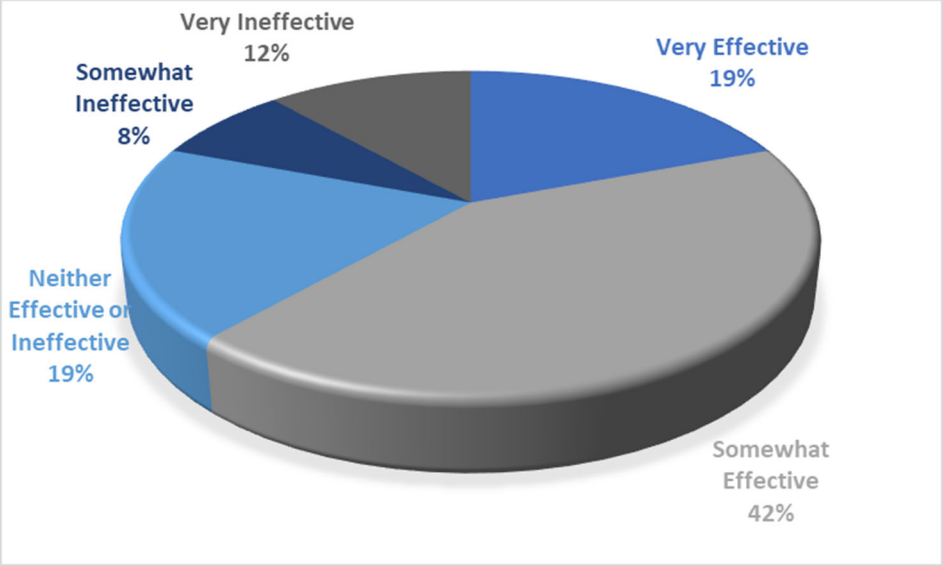
QUESTION: "In the last 3 years, how many new single-family units have been created as a result of this abatement incentive?"

Responses ranged from 3 (lowest) to 129 (highest). Based on these figures, tax abatement among respondent communities produced a "median" of 13 units and an "average" of 24 units.

QUESTION: "Rate the effectiveness of tax abatement in your community" 26 responses

Among the 26 respondents, 61% indicate that tax abatement has been either somewhat effective or very effective in creating new housing versus only 20% that say it has been somewhat ineffective or very ineffective (see Chart 1).

Chart 1: Effectiveness of Tax Abatement



QUESTION: "What metrics are used to evaluate the success of this incentive?" 18 responses

Residents surveyed to see if they would have moved to town without abatement
More interest in housing*
Urban infill
Base valuations
Number of New Homes Built/Started*
Continued Development
Increase in Permits*
Abatement Applications vs. Actual # of New Homes Constructed

**indicates multiple responses/similar responses*

Other Single-Family Incentives:

- 67% of respondents (20 cities) indicate they offer TIF (tax increment financing) for infrastructure, including rebates or upfront money
  - Among the 20 respondents, 15 communities saw housing created as a result of TIF
  - 55% of the respondent communities that offer TIF believe it has been very effective or somewhat effective (compared to only 10% that say it is somewhat ineffective or very ineffective)

- 35% of respondents (11 cities) have developed their own lots for sale by the community/city
    - An average of 46 lots created in the last 5 years among those respondents creating lots
    - On average respondents sold 61% of the lots they developed in the last 5 years
    - 50% of respondent communities that have developed lots indicate it is very effective or somewhat (compared to 22% that say it is somewhat ineffective or very ineffective)

COMPARING THE VALUE OF TAX ABATEMENT INCENTIVES

Comparing the value of tax abatement incentives across multiple communities is challenging due to the following:

- Home and land prices vary by community due to localized land prices, lot sizes and home finishes (include basement or slab construction)
- Valuations in different market areas appreciate differently over time based on their individual markets
- The tax levies in individual communities vary from year to year based on local budgetary conditions
- The residential "rollback" for property taxes fluctuates

Recognizing these challenges, the following 'static' assumptions were made to allow the value of incentives to be measured equally among all examples:

- A fixed valuation added by new construction of a house on a lot was fixed at $200,000 (this also ensured the minimum added valuation requirements in some communities was achieved)
- No market appreciation over time (as reflected in a home's assessed valuation) was included
- The residential "rollback" was fixed at 55.62090%
- A single property tax levy rate of $39 per $1000 in valuation was used

Figure 1 (page 10) shows the results comparing the "value" of tax abatement incentives by location. Table 1 (page 11) lists the tax abatement schedule by jurisdiction and Table 2 (page 11) details the formulas for those jurisdictions with "sliding-scale" abatements.

Figure 1 - Value of Tax Abatement Incentives by Iowa Jurisdiction

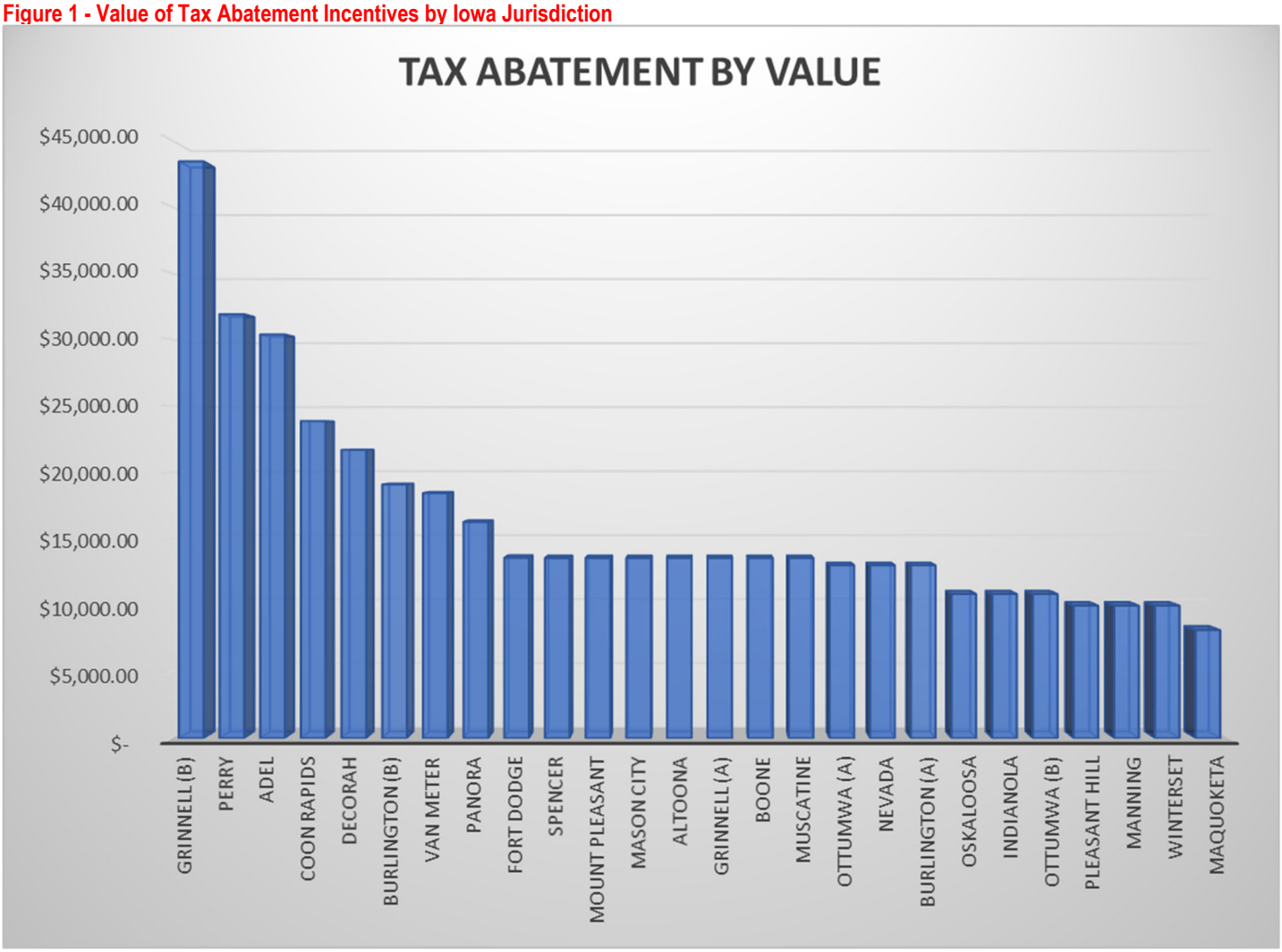


Table 1 - Tax Abatement Schedule

Community	Formula
Grinnell (B)	100% for 10 years
Perry	10 year sliding scale
Adel	100% for 7 years
Coon Rapids	10 year sliding scale
Decorah	100% for 5 years
Burlington (B)	10 year sliding scale
Van Meter	5 year sliding scale
Panora	5 year sliding scale
Fort Dodge	100% for 5 years on first $75,000
Spencer	100% for 5 years on first $75,000
Mount Pleasant	100% for 5 years on first $75,000
Mason City	100% for 5 years on first $75,000
Altoona	100% for 5 years on first $75,000
Grinnell (A)	100% for 5 years on first $75,000
Boone	100% for 5 years on first $75,000
Muscatine	100% for 5 years on first $75,000
Ottumwa (A)	100% for 3 years
Nevada	100% for 3 years
Burlington (A)	100% for 3 years
Oskaloosa	5 year sliding scale
Indianola	5 year sliding scale
Ottumwa (B)	5 year sliding scale
Pleasant Hill	5 year sliding scale
Manning	5 year sliding scale
Winterset	5 year sliding scale
Maquoketa	100% for 3 years on first $75,000

Table 2 - Tax Abatement Sliding Scales

Perry	Ottumwa Indianola Oskaloosa	Manning Winterset Pleasant Hill	Van Meter	Coon Rapids	Panora	Burlington (B)
100%	80%	75%	100%	100%	100%	80%
100%	65%	60%	100%	90%	100%	70%
100%	50%	45%	100%	80%	100%	60%
100%	35%	30%	75%	70%	50%	50%
100%	20%	15%	50%	60%	25%	40%
85%				50%		40%
60%				40%		30%
45%				30%		30%
30%				20%		20%
15%				10%		20%

RELATIONSHIP BETWEEN ABATEMENT VALUE & # OF NEW UNITS ADDED

It would be natural to assume there is some relationship between the value of the abatement offered and the number of new housing units achieved. However, as you can see in Figure 2 (page 13) the results do not identify a cause-and-effect relationship between abatement value and the number of new units among the respondent communities.

This lack of cause-and-effect relationship may be looked at by readers in several ways. Some may look at Figure 2 and find it evidence to dismiss the usefulness of abatement as an incentive. Yet others may view Figure 2 and conclude that housing is happening (or not happening) in respondent communities based on factors or patterns that can be explained by one or more of the following:

1. The size of the respondent community and its distance from a metropolitan or micropolitan statistical area (i.e. the "suburb" as opposed to the "rural" town) causes more housing because:

    a. Potential buyers are a spillover from adjacent more populated areas

    b. The proximity to larger labor markets and a larger number of new jobs being created

    c. A high concentration developers/builders, especially those willing to do speculative projects

2. The influence from other available incentives (e.g. cash to the buyer, etc.) or a combination of incentives

3. More local interest in housing creation and local investors willing to take risks to create new housing

<u>We strongly caution readers against reaching such conclusions</u>. Why?

First, this survey was open to any community willing to participate. Thus, participation did not account for geographical representation to accurately measure such things as proximity to metropolitan markets.

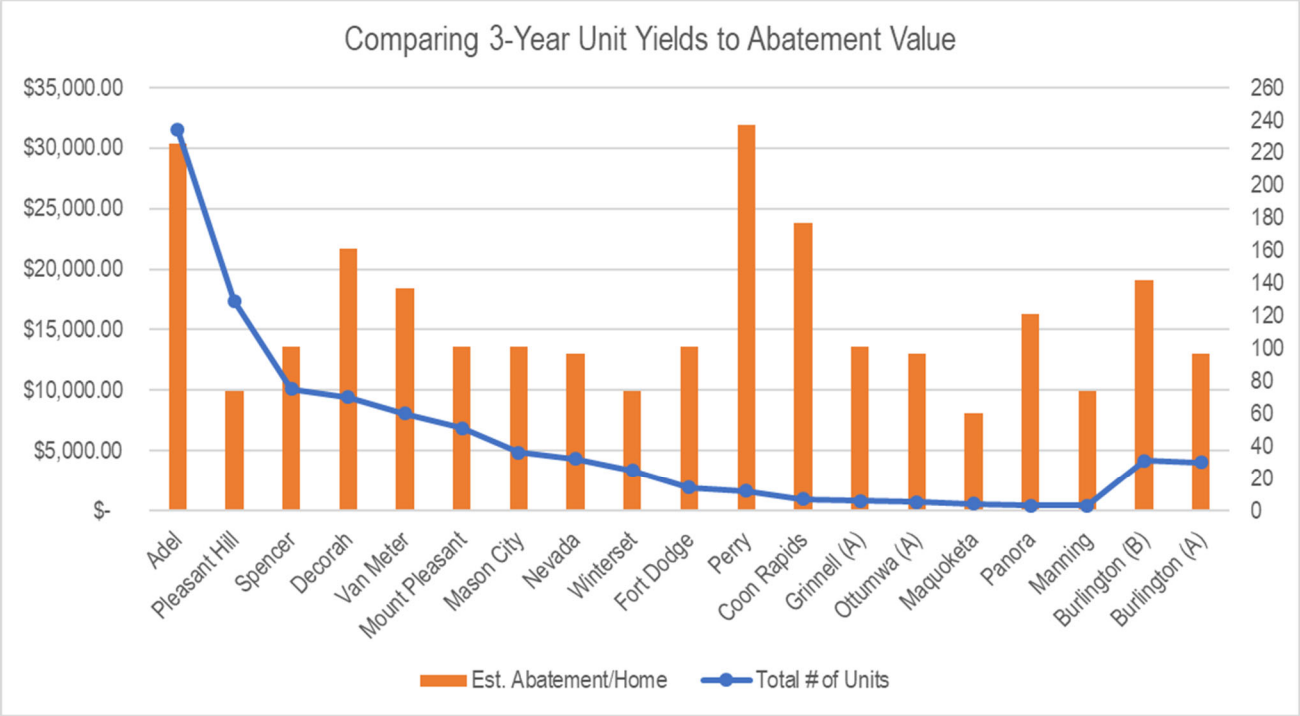
Second, the number of respondents represents a small sample size (26 out of 947 cities) and geographical differences aside it would take nearly ten times the number of respondent cities (274) to have a statistically valid sample at 95% confidence with a margin of error of +/- 5%. Therefore, the results in Figure 2 should be viewed as 'what you see is all there is' (WYSIATS).

Any patterns and conclusions drawn from the data in Figure 2 may appear to be logical and appropriate, but they are rooted in a common cognitive bias called the "illusion of validity[6]" – one of several common cognitive biases[7] that can cause information to be misinterpreted or misrepresented in these types of reports.

[6] The tendency for an individual to overestimate the ability to interpret and predict accurately the outcome when analyzing a set of data, in particular when the data analyzed show a consistent pattern or tell a coherent story. Daniel Kahneman, Amos Tversky

[7] Other cognitive biases that apply include the "insensitivity to sample size" – a tendency to underpredict the amount of variability likely to appear in a small sample of random or semi-random data.

Figure 2 – Tax Abatement & 3-Year Unit Yields



A Look at How Some Communities Package Incentives

Several communities in Iowa have put together "packages" to incentivize housing. These can include both demand and supply side programs.

Table 3 – Other Housing Incentives in Iowa

City	Incentive	# of Homes, Units or Lots
Boone	New construction in price range of $200,000 to $400,000 gets reimbursement of $10,000 at certificate of occupancy. If developer starts as spec home, developer & buyer split. ***Funded by city of Boone at $150,000 per year for two years using reserves*	Unknown Program just started in May 2018
Newton	**Homebuyer**: $10,000 cash plus $3,000 welcome package **Homebuilder**: waived permit and inspection fees, negotiated lot prices and subordination with landowners **Spec Homebuilder**: Payment for construction loan interest up to 1 year from issuance of building permit	Incentive available to first 40 homes that apply and are approved Home value must be >/= $160,000 net of land value
Spencer	Spencer Quality Housing Initiative Grant Program Up to $15,000 grant to buyers of newly constructed homes between $110,000 and $250,000 in value. ***Funded to date at $1.4 million by City, SMU and local banks*	75
Rock Valley	$3,000 per new home, plus $5,000 interest free loan	40
Coon Rapids	$10,000 per home (and 10-year sliding scale tax abatement)	7
Manning	City offering discounted lots ($15,000) with a $7,500 rebate if started in year 1 and finished in year 2	2 new homes with 18 incentivized lots available

About Our Work with Communities & EDOs

Our firm works with communities and economic development organizations (EDOs) on a broad range of projects and solutions. Our primary focus is helping smaller communities (less than 50,000 populations) excel at economic development, offering a range of services that include:

1. Strategic planning and implementation
2. Industrial park analysis and site certification support
3. Business retention and expansion (BRE) programs
4. Targeted industry analysis
5. Site due diligence and feasibility
6. Project management
7. Interim economic development staffing
8. Marketing and communications

Toyer Framework®
Strategic Planning Simplified

The **Toyer Framework®** is a strategic planning approach we created to help small communities avoid spending too many of their resources planning and not enough on implementation – an approach that focuses on creating fewer binders collecting dust on desks and shelves. The **Toyer Framework®** relies on a combination of unique surveys, interviews and facilitated strategy meetings to create an actionable strategic work plan.

Micgrowpolitan™
Smaller Markets. Bigger Opportunities.

Economic development services that are designed exclusively for the nation's 550 designated Micropolitan Statistical Areas (μSA) to maximize their immediate and long-term economic growth. Also offered is the opportunity for qualifying micropolitans to earn our firm's designation as a certified **Micgrowpolitan™** - an independent certification that can be used in marketing to confirm that micropolitan's strategic opportunities and readiness for growth.

More information on our firm and all our services can be found at **toyerstrategic.com**.