MINUTES
Workforce Housing Study

Representative David Lust, Chair
Senator Ryan Maher, Vice Chair

First Meeting, 2017 Interim | **Room 413 – State Capitol**
Tuesday, June 13, 2017 | **Pierre, SD**

The first meeting of the Workforce Housing Interim Study was called to order by Representative Lust at 8:00 a.m. (CDT) on June 13, 2017, in Room 413 of the State Capitol, Pierre, South Dakota.

A quorum was determined with the following members answering the roll call: Senators Terri Haverly, Kevin Killer, and Jeff Monroe; Representatives Roger Chase, Jason Kettwig, Sean McPherson, Sue Peterson, Kyle Schoenfish, Jamie Smith, Charles Turbiville, and Susan Wismer; Senator Ryan Maher, Vice Chair; and Representative David Lust, Chair.

Staff members present included Clare Charlson, Principal Research Analyst; Emily Kerr, Legislative Attorney; Jeff Mehlhaff, Fiscal Analyst; and Rena Ortbahn, Legislative Secretary.

NOTE: For purpose of continuity, the following minutes are not necessarily in chronological order. Also, all referenced documents distributed at the meeting are attached to the original minutes on file in the Legislative Research Council office. This meeting was web cast live. The archived web cast is available at the LRC web site at http://sdlegislature.gov.

Opening Remarks

Representative David Lust welcomed the committee. He said the committee will probably meet three times this summer. This meeting is for information gathering on the issues. The second meeting should transition into possible solutions. Representative Lust views the underlying committee question to be “what role does the state have?”. He asked members to analyze the issue as to whether it is a local, federal, or state issue. He suggested that members not assume that the state has a role in the solution or presume there is a magic bullet solution.

Workforce Housing Issues Confronting SD Communities

Mayor Mike Levsen, Aberdeen, said from 1967 to 2004, the city’s population remained stable with no growth; however, from 2004 to 2017, the city’s population increased by 6,000 residents. Housing is limited. He said local developers have not been eager to build entry level homes.

Concerned citizens formed Homes Are Possible, Inc. (HAPI), a local non-profit organization to assist first-time homebuyers by looking for grants and home buying opportunities ***(Document #1)***. Mayor Levsen considers the formation of HAPI, Inc. to be one of the best things that has happened to Aberdeen. It works with people to access loans; if they stay in the housing for five years, per contract specifics, equity remains with them, but if they leave early, there are penalties. From 2008 to 2016, 667 single-family housing permits and 957 multi-family unit permits have been issued. He said the HAPI organization has been instrumental in making this happen.

Mayor Levsen described the current properties owned or managed by the Aberdeen Housing Authority ***(Document #2)***. He said the Housing Authority's biggest challenge is to find new land to build on. Aberdeen has run out of land on which to develop that is connected to city services. Apartment vacancies are low, and there are no major apartment projects currently underway.

In regards to the TIF projects, Mayor Lavsen said there are some classification issues. Most projects are classified as "other" in Aberdeen. If TIF loans had not been available, he thinks the projects may have been done, but they would not have been as large or done as quickly.

Representative Jason Kettwig, Milbank City Administrator, explained what has been done in Milbank in recent years to alleviate housing shortages ***(Document #3)***. He said Milbank, like many small communities, does not have the economies of scale or tax revenue that Aberdeen has; however, its population, unlike other small towns, is stable. He noted that businesses must expand to stay competitive. What is stopping that expansion is the lack of housing, and Milbank is subsequently losing workers to larger communities. He said 95 % of people leaving the county are of the child-rearing age, and this will negatively impact the school system. For them to come back, there needs to be adequate housing. He said 66% of Milbank's workforce lives elsewhere and commutes to work.

There have been no major developments in Milbank since the 1970's. Representative Kettwig is working to encourage development and promote laws that may lower development costs through cost sharing utility and street improvements. He said the community is trying to help itself through an extensive community involvement and planning process. He leads a group that is trying to generate home development. There have been stumbling blocks, but they are trying.

Representative Kettwig said for some older homes in Milbank, it is questionable whether they should stay or be demolished. The community, working with the South Dakota Housing Development Authority, purchased a foreclosed home at a reduced rate and worked with contractors and realtors to get it fixed at a rock bottom price. They sold the house after owning it for seven months. Presently, community leaders are working to generate interest in five similar properties.

Representative Kettwig responded to committee questions. He said the Home Address Plus planning program required a community investment. It forced them to prioritize, and was an eye-opening process. He said the housing rehabilitation project was funded mainly through the city and the South Dakota Economic Development Finance Authority.

Representative Charles Turbiville, Mayor of Deadwood, explained the unique housing issues of Deadwood. Founded in1876, the Black Hills town was built in a gulch. This now limits new housing; there is no new land to build on. Additionally, 55 years ago, Deadwood was designated as a national historic landmark; therefore, the city cannot tear down dilapidated housing. It must be rehabilitated. He told of a proposed development that would have to cross a creek, take out boulders, and go up a hill. He said to provide 60 to 100 homes, the infrastructure would cost $100 million.

Representative Turbiville said 94% of Deadwood workers and 84% of Lead workers commute from other communities. There is a need for workforce and family housing. The school system has seen a major drop in students in past years; there is a concern about being able to maintain the Deadwood grade school. Some gaming funds are available for elderly or low income owners to replace windows and doors. These funds are restrictive and limited. Another problem is some owners don't want to improve; others do not live in Deadwood**.**

Representative Turbiville said 43,000 square feet on the second and third floors of buildings on the main street potentially could be used for workforce and individual housing ***(Document #4)*****.** He said financing is the biggest hurdle. He presented a draft Deadwood city ordinance ***(Document # 5)***, which he said is to encourage construction of new housing or rehabilitation of vacant housing by providing a five-year rebate of municipal property taxes for such projects. The mill levy in Deadwood is low, so this would be a token, but he hopes it will be a beginning of incentives to rehabilitate second stories. He noted there is a problem getting control of properties. One property has an absent owner, and the water hasn't been turned on for 13 years. Another property is owned by a prisoner. He said property taxes are being paid, but homes are often not being adequately maintained.

Representative Turbiville said the TIF program can make a difference, and he hopes Deadwood can use it locally. He said Lead with a higher mill levy than Deadwood, may be able to utilize the Bulldoze, Build and Beautify Grant Program. He added that Lead and Deadwood perhaps should work together on their mutual housing problems**.**

Representative Kettwig observed with such differences among communities that local control is better. Representatives Kettwig and Turbiville and Mayor Levsen all said their communities are not actively pursuing tax deed sales.

Challenges in Creating and Sustaining Affordable Housing

Mr. Roger Jacobs, U.S. Department of Housing and Urban Development (HUD) Field Director, Sioux Falls, began the presentation on "Homes for South Dakota" ***(Document #6)***. It is a statewide coalition of non-profit, public and private entities created to address housing needs. He said the issues and housing needs identified are the result of over 30 housing studies. He said a big issue is the high cost of construction. In small communities, builders and contractors often must be brought in.

Ms. Lori Moen, Grow South Dakota, Sisseton, said there is a need for long-term planning and investment for communities to develop and maintain affordable housing, whether through rehabilitation, modification of existing housing, or new construction. It's important to maintain existing homes rather than to let them deteriorate, but there is a lack of reliable funding to do so. She said there needs to be sufficient housing to match income levels. She said the South Dakota Housing Opportunity Fund (HOF) process helps to bring communities together ***(Document #7)*****.**

Mr. Scott Engmann, Black Hills Habitat for Humanity, Rapid City, said the program spends hundreds of thousands of dollars across the state. Five hundred homes have been built statewide with 100 in the Black Hills area. Families must meet income guidelines and provide sweat equity ***(Document #8)***. He said the amount state and federal agencies put into Habitat projects is relatively small; 90% is private funding with lots of in-kind support.

Mr. Engmann stated families are earning less and there are fewer opportunities. Facing proposed federal budget cuts to all housing assistance programs, he thinks our state must do more. At the state level, he said HOF works, helping and housing families, but without HOF, the Habitat for Humanity program would have to make impossible choices. He said HOF leverages funds at a minimum of 6 to 1.

Mr. Engmann highlighted a few individuals who are benefiting from the Habitat for Humanity program, then spoke of the Garfield School Habitat project in Rapid City. The project involves renovating an old, empty elementary school into housing units and repairing existing homes. He said upon completion, it will generate $240,000 in new property taxes over ten years. The project is to receive $40,000 in HOF funds.

Ms. Joy McCracken, NeighborWorks Dakota Home Resources, Deadwood, said the housing in the Black Hills area is older, and there are lots of layers of money involved in workforce housing projects. She addressed the impact of HOF on five specific NeighborWorks projects.

Ms. McCracken pointed out with the high cost of housing and lower incomes, there is an affordability gap with families being priced out of ownership. She said NeighborWorks rehabilitates 25 to 30 homes per year.

She thinks commuting for work from one community in the Black Hills to another isn't a problem, but that all the Black Hills communities must work together to create housing and keep workers in the area and state.

HOF has funded studies that project the housing needs for several Black Hills communities over the next 5 years, broken down by both individual homeownership and rental units, market rate or affordable. There is a need for 225 affordable homeownership units and 1000 market rate units. She projects they may help with 100 of those.

Ms. McCracken said to meet the workforce housing needs will require collaboration of non-profit, for-profit, state, and federal programs. She hopes the HOF program is continued, as it provides flexibility to meet local challenges while federal programs such as HUD programs are restrictive.

Ms. Moen said Grow South Dakota started in 2012 through the help of community action and the South Dakota Economic Development Corporation. Ms. Moen noted building a house in a small rural community is expensive. Often a contractor may be able to build one house, but not five. The community may be missing a plumber or electrician. Then there is the overall question of who is responsible for housing. Flexible, reliable financing is needed. She said the solutions to housing issues all cost money and without grant programs, communities couldn't afford housing. Ms. Moen likes the flexibility of HOF funds. HOF can fund a variety of projects, all based on the individual project need. She said there is a waiting list of 250 people wanting HOF funds.

Ms. Moen wishes the SDHOF program would have more than one funding cycle; presently there's one cycle in August. With more funding and flexible financing, projects could be done at different times. At the sale of a house utilizing HOF funds, she would like to reinvest the profit back into the program, which could eliminate continually asking for new money. She said a $6 million state investment in the HOF program would be returned many times over. She said although $10 million was awarded in HOF monies in 2017, the actual need is twice that much.

Ms. Moen talked about the need to keep rental and multi-family units affordable and livable so that low-income residents can live in decent, safe housing. Vacant and abandoned housing needs to be addressed. She cited studies showing the housing needs in six communities, needs for repair and renovation, individual home ownership and rental housing, dilapidated and vacant housing, and asked, "who is responsible?". She said some cities are donating lots to those who want to build. Others are looking at discretionary property tax for new construction and possibly renovations.

Ms. Moen stated housing is economic development as a house will generate revenue year after year with utilities and taxes going back to the community.

Senator Kevin Killer foresees the need for housing will increase in the future, and he thinks more needs to be allocated to the HOF program.

Representative Sean McPherson asked how a landlord would apply for a HOF grant. Ms. Moen said a landlord would put cash down and obtain a forgivable loan. Then for five years the rental units must meet income restrictions. The house must be kept up to standards. If the landlord tries to sell and make a profit, funds can be recouped.

Representative Kettwig said with rentals in small communities, there is a rate structure that can't be broken. That's where this program helps to keep rent down.

Workforce Housing and the Rental Industry

Brian Majerus, President, and Denise Hanzlik, Executive Director, of the South Dakota Multi-Housing Association, Sioux Falls appeared before the committee ***(Document #9)*****.**

Mr. Majerus said it appears federal funding and policy are now encouraging states and local governments to address their local housing problems. The challenge is to meet local needs with less reliance on federal government financing, and he views this as an opportunity. He said the South Dakota Multi-Housing Association believes the current property tax rate is a problem and impedes the development of market-rate workforce housing. He said changing the property tax rate would be a win-win situation. If more apartment units are built, everything grows including the population, property tax, and employment. He stated the goal is not to shift the tax burden, but to grow the property and sales tax base. He sees housing, land, and construction costs as also being roadblocks. He pointed out there is a growing gap between the number of units needed and the number of units being built in many communities.

Ms. Denise Hanzlik said approximately 32% of South Dakotans rent their housing. For various reasons, there is an ongoing shift from home ownership to renting. Although the need for workforce housing varies, it is a statewide issue. There is a need to attract new business, and there needs to be sufficient housing for the workforce.

Ms. Hanzlik provided rental and vacancy rate statistics for six different sized cities in South Dakota. Mr. Majerus said if the vacancy rate is less than five percent, an aggressive landowner tends to raise rent. He said in these cases there is a need for more apartments to keep this from happening.

Ms. Hanzlik discussed barriers to workforce housing projects. Construction costs are doubling and tripling in a short amount of time. Real estate taxes are 30% higher for multi-family units than for owner-occupied homes. Land costs have increased dramatically. There are problems in obtaining capital for multi-family projects. Banks are not lending and, with possible budget cuts and program changes at the federal level, investors are not buying. There are problems in obtaining sufficient rent to pay for the construction costs.

Currently, South Dakota classifies property consisting of four units and higher as commercial property and 1 – 3 units as either owner-occupied property or non-owner occupied property. She suggested there be a new classification for all leased residential property and a reduction in the property tax rate spaced out over a ten-year period. Iowa enacted the property tax reduction program in 2013. Due to the extended 10-year progression of the rollback, there have been no tax shifts.

She pointed out that a tax abatement program has been successfully implemented in Sioux Falls. Taxes on the improved value are gradually increased to 100% over a five-year period. She cited a Sioux Falls developer who built workforce housing in Mitchell, Yankton, and Huron said that once he built, others have come in, and that tax increment financing is necessary.

Ms. Hanzlik said mixed-use housing development works well and that can spread costs. The federally funded programs are all excellent, except they are very restrictive and due to proposed federal budget cuts, investors are avoiding them. There are also programs that partner with the state. She said industry-built housing development has been successful. It allows industry to bring in structures for employees to live in.

Ms. Hanzlik sees potential in rehabilitating a larger structure into four and five bedroom rental units, especially in smaller communities where older homes are vacant.

Representative Roger Chase challenged the committee to study property taxes on rental units in South Dakota versus surrounding states. He thinks to attract developers to South Dakota that rental property taxes must be addressed. He said taxes for owner-occupied units are less than for the non-owner occupied units. That is a drawback for developers. **Representative Susan Wismer** agreed that the tax structure of neighboring states would be helpful information for the committee.

Mr. Majerus agreed with **Representative Kyle Schoenfish** that contractor's excise taxes and the cost of materials do add to a project's overall cost, especially for smaller projects. He said investors are holding back on the low-income tax credit programs.

Mr. Majerus said to get workforce housing into small communities, developers need encouragement to build four-unit and eight-unit housing projects. He thinks there is a need to hear from developers from around the state on what they are developing and what roadblocks exist.

Current Housing Programs

Ms. Lorraine Polak, South Dakota Housing Development Authority (SDHDA), Pierre, gave a brief overview of South Dakota Housing Development Authority Homeownership Programs ***(Document #10)***. She said most of the available programs are targeted to income levels. They partner with lenders throughout the state. These loan programs are highly regulated, have a limited target, and involve a long-term commitment. The loans are repaid. Annually, HUD publishes the area median income (AMI) per county and that is the basis for all programs. Funds typically used for rental programs provide 90% of the funding; if funding is at the 50 % level for rental housing, the other 50% can be at market rate.

SDHDA loan programs include First-time Homebuyers, Community Home Improvement Program (CHIP), Repeat Homebuyer Loan Program, Construction Loan Guarantee Program, and Housing Enhancement Loan Program. Other programs through the agency are: Mortgage Credit Certificate (MCC), Governor's House Program, and HERO Homebuyer Education.

Ms. Polak said the Housing Trust Fund is a new program targeted at South Dakotans earning 30% or below the area medium income ***(Document #11)***. SDHDA also administers the federal Housing Tax Credit program, receiving $2.7 million annually. Developers can utilize the tax credits for up to ten years. They use the tax credits to raise private equity capital to finance development costs while investors obtain a dollar-for-dollar tax reduction on their federal tax liability. Responding to questions, she said it is like a banking community reinvestment and the current dollar-to-dollar rate is between 85 to 95 cents on the dollar. Ms. Polak said the agency tries to encourage mixed rate financing.

She spoke of the HOF program as being attractive to developers in that it is diversified, can be used for homelessness or rehabilitation, and usually involves a forgivable loan. She provided the committee with the HOF annual report ***(Document #12)*** and Program Summary Report ***(Document #13)***.

To date the Community Housing Development Program has been used only once. It is for developers or owners to be invested in rental activities. Some units have reduced rent; others can be at market rate. Ms. Polak said it depends on the developer's intent. If the developers plan to develop and sell, they wouldn't be interested in such a loan.

She encouraged communities to participate in the Housing Needs Study Program. It has granted funds for 25 to 30 small South Dakota communities to conduct a community housing needs study.

Finally, Ms. Polak overviewed the SDHDA Housing Management Programs ***(Document #14)*** and responded to further committee questions.

Mortgage Lender Licensing

Mr. Bret Afdahl, Director, Division of Banking, South Dakota Department of Labor and Regulation, Pierre, provided an overview of the licensing structure for non-bank lenders as per SDCL chapter 54-14. He first listed those exempted from coverage and said for those exempt, there are no fees involved.

Non-residential lenders are regulated. They do not require a surety bond or need loan officers to be licensed. Residential lenders are more heavily regulated, requiring a surety bond, a company license, and individual licenses for loan originators and loan officers. They must be licensed through a nationwide loan system. Mr. Afdahl said they are very efficient if a company operates in multiple states.

Mr. Afdahl described the history and process of individual licensing. He said in total there are about 280 mortgage lenders and the state licenses approximately 2,700 loans yearly. The numbers ebb and flow.

Representative Lust said it is important for the committee to have the whole picture, including how to finance workforce housing projects.

Mr. Afdahl sees as housing issues the need for workforce housing versus inventory of houses, the cost to build compared to the market value, and the appraisal process. He said sometimes individual agencies have flexibility in changing the rules, and need to be persuaded to do so.

Workforce Housing and Mortgage Lending

Ms. Angela Beilke, First Premier Bank, Sioux Falls, manages the mortgage department. She has 15 years of experience in the secondary mortgage market and is knowledgeable as to how mortgage lenders work and the challenges they face in rural communities.

Ms. Beilke said the secondary market generally works with government sponsored entities (GSE) such as Freddie Mac. She said a bank generally sells the loans to these entities; none will buy a loan without a guarantee.

Ms. Beilke spoke of challenges she has observed in rural areas. Somebody will guarantee a loan but there may not be investors who will buy it, or an investor is willing to buy, but there is not a guarantee. In rural areas, the housing is older and needs repairs. The customer may qualify, but the house does not qualify for some programs. Then the challenge is to find a grant to get the houses into repair through programs such as HAPI. If one is using a program other than an SDHDA one, many grant programs can't be used, due to the different program requirements. The seller must put up money before a home closes, but can't get grant assistance until the home closes because they don't own the home. These are all challenges a lender faces helping individuals to purchase the home.

Ms. Bielke said government programs will require that a home be brought up to standards to get 100% funding. Home repair is maintenance and does not increase the appraised value of a home. She said just repairing the home to sell it may take it over cost. There are a lot of older homes in rural areas where this could be a problem.

She said appraisals take a long time, up to three months. Qualifying factors can change in three months, rates may change, and paperwork can expire. There is a lack of appraisers. Appraisers that are in the communities are getting older while younger ones are not coming in, and it is difficult to get in. There is much discussion as to whether appraisals are truly needed for everything or if something else would work. Perhaps the underwriting rules could be changed.

Representative Chase explained Huron has three appraisers all 55 to 70 years old. He said after the financial crisis, the requirements to become an appraiser increased. New appraisers must be college graduates and obtain 2000 hours of supervised service under a licensed appraiser. He said, until these federal regulations ease, there will be a limited number of people coming in. He added certain loans, such as VA loans, have different registration requirements for appraisers and not all appraisers qualify. Ms. Beilke said this problem cannot be addressed at the state level.

Senator Ryan Maher said in west river, appraisals often require a comparable sale in the past six months, and in a small town there may be only one comparable sale in a year. Ms. Beilke said if there is not a comparable, one may be able to directly deal with Fannie Mae or a federal home loan bank whose requirements do not include the comparable. Ms. Beilke said there is a difference between the underwriting guidelines and the regulations. It may depend on whether an investor allows you to delegate the underwriting. Banks need to be aware of investors that allow you to make the choice.

Representative Lust thinks it's important for the committee to get a sense of the regulatory environment for the lender, as all housing projects must be financed.

Ms. Beilke said there are many programs for the lower income first-time homebuyer, but not for the median income homebuyer. For the median income homebuyer, their closing costs are going up, and there isn't help available.

Representative Jamie Smith asked about rural development. Ms. Beilke said there are two sides to rural development, guaranteed loans with income qualifications and direct program loans. She has used the direct program for a client who didn't have a credit score. She pointed out a case of a person making payments over 20 years, at which time the person had negative equity in the home. She said the direct loan program is not meant for the borrower to remain in for the whole duration of the mortgage.

She said the guaranteed loan program is a very good program. It is probably used 80% of the time in rural areas. Under this program, one can include 100% of appraisal value, allowing the possibility of including home improvements in the loan.

Representative Kettwig agrees there is a gap in loan programs for the median incomes. There are good jobs available in rural communities; however, workforce is discouraged and driven away, as they are not able to qualify for a home loan due to their higher income.

Representative Kettwig thought perhaps a revolving loan program could help meet the gap at the local level. It would help homeowners who can't get loans because a home doesn't qualify due to necessary improvement costs.

Representative Wismer asked about banks selling home loans. Ms. Beilke said a bank can sell loans and still retain servicing rights, but the bank still must underwrite it to the investor's guidelines. She said Federal Home Bank is one program available that does have flexibility in underwriting rules, but it involves a shared risk.

Representative Lust encouraged Ms. Beilke to let the committee know if she thinks of something the state can do in easing lending regulations, especially in the residential area.

Issues Surrounding the Destruction and Removal of Old Buildings

Mr. Chad Babcock, Environmental Scientist, South Dakota Department of Environment and Natural Resources, Pierre, spoke on the disposal of debris from building demolitions ***(Document #15)***. He explained the difference between permitted solid waste disposal facilities and restricted use solid waste disposal facilities. He referred to maps within the document showing the location of regional landfills and the restricted use solid waste disposal facilities in South Dakota, and to tables providing further information on authorized waste permitted in the restricted use facilities. He said each site often has separate requirements, and the licensee may not accept everything it could. He explained that asbestos requirements do not apply to the demolition of individual homes.

Mr. Paul Merriman, State Fire Marshal, Pierre, provided written remarks identifying some of the potential issues and challenges faced by volunteer fire departments in South Dakota when dealing with the abatement of old, dilapidated homes and structures ***(Document #16)***.

Public Testimony

Mr. Curt Everson, South Dakota Bankers Association, Pierre observed that the committee exists partly because of tension in mortgage lending, especially in financing single homes. He said before the financial crisis, it was too easy for individuals to borrow money. With the housing crisis, Congress passed a bill that may have gone too far in tightening credit. The South Dakota Bankers Association will continue to work with Congress to undo some of the unintended consequences. He said today it is difficult for an individual to borrow for a qualified mortgage as it will include a maximum debt to income repayment threshold of 43%. The problem is people, such as farmers with an uneven income flow, often have difficulty qualifying for this type of mortgage. He said lenders are reluctant to make loans that don’t fit into the qualified mortgage bucket because of the risk down the road, which could contribute to the workforce housing issue. His association is committed to work with Congress to find bipartisan middle ground. He will speak to the members and try to bring some solutions to the committee.

Committee Discussion

Representative Lust had ideas for a preliminary agenda for the next meeting. The committee also discussed various ideas. These ideas included bringing developers in to speak of issues they face, exploring time limits on foreclosure, further examining how to get properties cleaned up, and perhaps hearing from a community that has rehabilitate an older home.

Representative Lust asked the committee to get their ideas to Clare Charlson, and she will get a draft agenda out to the members before the next meeting which will take place on August 1, 2017, in Pierre.

Adjourn

A MOTION WAS MADE BY REPRESENTATIVE KETTWIG AND SECONDED BY REPRESENTATIVE McPHERSON THAT THE WORKFORCE HOUSING INTERIM STUDY COMMITTEE MEETING BE ADJOURNED. The motion prevailed unanimously on a voice vote.

The committee adjourned at 3:25 pm