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Analysis of the Rochester, Minnesota Housing Market

As of August 1, 2003

ECONOMIC RESEARCH

U.S. Department of Housing and Urban Development

Foreword

This analysis has been prepared for the assistance and guidance of the U.S. Department of Housing and Urban Development (HUD) in its operations. The factual information, findings, and conclusions may be useful also to builders, mortgagees, and others concerned with local housing conditions and trends. The analysis does not purport to make determinations with respect to the acceptability of any particular mortgage insurance proposals that may be under consideration in a particular locality or the housing market area.

The factual framework for this analysis follows the guidelines developed by HUD's Economic and Market Analysis Division. The analysis and findings are as thorough and current as possible based on information available on the "as-of" date from both local and national sources. As such, any findings or conclusions may be modified by subsequent developments. HUD wishes to express its appreciation to those industry sources and state and local government officials who provided data and information on local economic and housing market conditions.

This analysis takes into consideration changes in the economic, demographic, and housing inventory characteristics of the market area during three periods: 1990 to 2000, 2000 to the as-of date of the analysis (Current date), and from the Current date to a Forecast date. The analysis presents counts and estimates of employment, population, households, and housing inventory as of the 1990 Census, the 2000 Census, the Current date, and the Forecast date. For the purposes of this analysis the forecast period is 24 months.

The prospective demand expressed in the analysis should not be construed as a forecast of building activity; rather, it presents the prospective housing production that would maintain a reasonable balance in demand-supply relationship given the market's condition on the as-of date of the analysis. This analysis was prepared by Mr. Rodney Johnson, one of the Division's Field Economists in the Minneapolis Field Office, based on fieldwork conducted in September 2003. Questions regarding the findings and conclusions of the analysis may be addressed to Mr. Rodney Johnson at (612) 370-3000, ext. 2281, and at Rodney_Johnson@hud.gov.

Housing Market Area

The Rochester, Minnesota Housing Market Area (HMA) is defined as the Rochester metropolitan statistical area, consisting of Olmsted County. For purposes of this analysis, the HMA has been divided into two submarkets, the City of Rochester and the remainder of Olmsted County, referred to in this report as the Remainder.

Summary

During the latter half of the 1990s, rapid growth in employment, population, and households led to a substantial increase in housing demand. As a result conditions were extremely tight from 1998 through 2000.

Since 2001 the local economy has been relatively flat with little growth in employment. Local economic growth is expected to be modest over the forecast period ending July 2005, with the rate of growth increasing during the second year. Employment gains are forecast to total approximately 1,000 jobs during the 2 years.

The sales market has remained strong during the past 24 months, despite the slowdown in the local economy. The rental market, however, has moved from very tight in the late 1990s to much softer conditions, as large numbers of renters have opted for homeownership and few new households have taken their place in the rental market.

Demand for sales housing will remain strong, however, estimated at 900 units annually, during the forecast period, supported by continued shift of renter households to ownership, as well as ongoing strong growth in households.

The rental market is forecast to improve with continued household growth sufficient to generate limited demand for additional market rate rental housing. The substantial supply of excess vacant market rate rental units needs to be absorbed. Rental demand is forecast to total approximately 250 units during the 2-year forecast period, with most of the demand occurring toward the end of the period. Demand is expected to be almost exclusively for one- and two-bedroom units. While conditions in the market-rate segment of the rental market are soft, conditions in the affordable end of the market remain relatively tight. A very strong demand exists for rental units at “below-market rents.”

Economy of the Area

The HMA is located in southeastern Minnesota, about 70 miles south of the Minneapolis-St. Paul metropolitan area. Rochester is a major center of economic, social, and cultural activity for Southeastern Minnesota. Trends in labor force and total employment from 1992 to the Current date are presented in Table 1. The trends in nonagricultural employment for the same period are presented in Table 2.

Historically, economic growth in the HMA has tended to follow the employment trends at the area’s major employers: the Mayo Clinic, and since the 1950s, IBM. As a result there was a steady expansion for many years, with especially rapid job growth in the last half of the 1990s, accompanied by related increases in population and households.

Between 1992 and 2002, resident employment increased an average of 1,875 jobs annually, or 3.1 percent; nonfarm employment increased by an average of 1,970, or 2.9 percent a year. Over the most recent 24 months nonfarm employment has remained unchanged, at 87,400 jobs, but due to out-commutation, resident employment has increased by 550 in the past 12 months. It is estimated that more than 7,000 workers commute to jobs in the HMA from other areas.

The healthcare industry dominates the economy of the HMA, with education and health accounting for approximately 39 percent of the total nonfarm jobs in the HMA. Other significant industrial sectors include manufacturing, with more than 12 percent of the jobs in retail trade, government, and leisure and hospitality. The latter industry is tied closely to the healthcare segment, providing accommodations and services to patients receiving care at the Mayo complex and to relatives of patients.

The Mayo Clinic and its affiliated hospitals, headquartered in Rochester, have been the area's primary source of economic growth since its founding in the 19th century. The Clinic currently employs approximately 26,000 persons. Beginning in 1997 the Clinic initiated an expansion program scheduled to last 8 years. As a result, average annual employment in the education and healthcare sector increased by 7 percent a year, or 1,720 jobs annually, from 1997 to 2002. While the expansion program has not been completed, job growth in this sector slowed beginning in 2002 because international patient traffic declined following the attacks in September 2001.

Manufacturing employment in the HMA has been on a declining trend for the past 5 years. After reaching a peak of 12,900, employment has steadily declined. In the most recent 12 months ending July 2003, employment in this sector totaled 10,700, down by 1,000 from the previous 12 months. The declines are the result of layoffs at IBM and other firms, as well as plant closures. The plant closures since 1992 have meant the permanent loss of 1,000 high-paying jobs and the out-migration of population and households.

Given the recent indications of the beginning of a recovery in the HMA, resident employment is expected to increase by an average of 1,200 annually during the 2-year forecast period. The expected employment gains will support the growth of population and households, strengthening the already healthy sales market while helping to reduce the current surplus of market rate units in the rental market and setting the stage for demand for additional market rate rental units.

Household Incomes

The median family income in the Rochester HMA is estimated to be $69,200 in 2003, an 11.2 percent increase since the 2000 Census. The rate of increase is slightly below that for other areas in the state, and reflects the slowdown in the local economy and the loss of high-paying jobs in durable goods manufacturing.

Population

During the 1990s the population of the HMA increased by an annual average of 1,780 persons, or 1.7 percent, to a population of 124,277 as of 2000. The city grew by an average of 1,510, or 2.1 percent a year, to a 2000 population of 85,806. The rate of population growth has increased in the HMA since 2000. In the past 3-1/3 years, the population has increased an average of 2,620 persons annually, or 2.1 percent. The city of Rochester also continues to grow at a faster rate than the Remainder, with an average annual increase of 2,205, or 2.6 percent, compared with 1.1 percent for the Remainder. Detailed data on population trends from 1990 to the Forecast date are presented in Table 3.

Net natural increase accounted for 60 percent of the HMA population growth during the 1990s. But from 2000 to the Current date net in-migration has become the major factor in the population gains. Net in-migration in the HMA since the 2000 Census has averaged an estimated 1,470 annually and net natural increase has averaged 1,150 a year.

The nonhousehold portion of the population increased by an average of 59 persons annually from 1990 to 2000. Group homes and correctional facilities in Rochester made up the primary increase, more than offsetting a decline in nursing home residents. Since 2000 the nonhousehold population has changed little, and little change is anticipated during the 2-year forecast period. During the forecast period, the population is expected to increase an average of 2,000 persons annually.

Households

The change in households in the Rochester HMA since 1990 has paralleled the changes in the economy and the population. From 1990 to 2000 the number of households in the area increased an average of 775 a year, or a rate of 1.9 percent. Much of the growth occurred in the latter half of the decade when employment expanded rapidly. Since 2000 growth has averaged an estimated 1,215 households annually, or 2.5 percent, tracking the population and resident employment increases of the period. Approximately 80 percent of the growth from 1990 to the Current date has occurred in the City of Rochester. With the anticipated lower rates of increase in employment and population in-migration, household growth during the forecast period is estimated to be approximately 1,000 annually, or a rate of 1.9 percent. Detailed data on household trends are presented in Table 3.

Housing Inventory

Changes in the Rochester housing inventory, like changes in households, have followed the changes in the economy of the HMA. From 1990 to 2000, the housing inventory grew an average of 780 units a year. As of the 2000 Census a total of 49,422 housing units were in the HMA. From 2000 to the Current date, the housing inventory is estimated to have grown at an average of 1,465 units annually to 54,300. As of the Current date an estimated 51,850 occupied units are in the HMA. Of an estimated 2,450 vacant units, 1,450 are available for sale or for rent, and the remaining 1,000 units are held off the market for other reasons. Since 1990 homeowners have accounted for an increasing share of the households in the Rochester HMA. Owners have increased from 72.4 percent of households in 1990 to 75.9 percent in 2000 and 76.8 percent as of the Current date. It is estimated that a continuous shift of renters to homeownership has occurred since 1990, averaging approximately 150 annually. Trends in housing inventory, tenure of occupancy, and housing vacancy from 1990 to the Current date are presented in Table 4.

Housing production, especially home building, has followed the economic growth in the HMA. The trends in residential building permit activity in the HMA from 1992 through 2002 are presented in Table 5. With the exception of a 3-year period from 1994 through 1996, single-family building permit activity in the Rochester area has exhibited a relatively steady increase from 1990 through 1999, averaging some 740 homes annually. From 2000 to the Current date, in response to the substantial increase in households and demand, activity increased to an average of 1,115 homes annually. Multifamily building permit activity has followed a similar pattern but on a smaller scale. In the early part of the 1990s activity in the HMA averaged 300 units annually. After a significant cutback from 1993 through 1995, activity in the second half of the decade steadily increased to a peak of 473 units in 1999. With strong economic growth in 2000, activity picked up dramatically and then declined beginning in 2001 as the rental market softened due to much slower employment growth and the movement of a significant number of renters to homeownership.

Despite the increases in housing production in the HMA during the latter part of the 1990s, supply did not keep up with demand. This period of rapid growth in employment led to a shortage of housing, especially at rents affordable to lower-income workers. The shortage became serious enough to restrict employment growth as the supply of housing within a reasonable commuting distance declined to very low levels. In response, in 1999 a group of local and state public and private organizations created the First Homes program, with the intent of increasing construction of single-family starter homes and affordable rental housing in an area within a 30-mile radius of Rochester. The program was implemented that year with funding from local foundations, the Mayo Clinic, and a number of state and local public agencies. In its first phase, the program has a goal of 600 single-family homes and 275 rental units by 2004. As of the Current date, sales of 296 homes had been closed and 225 rental units had been completed.

Housing Vacancy

The vacancy rate for sales housing, which was 1.1 percent in 1990, declined to 0.7 percent in 2000 with the rapid increase in demand for homes in the latter half of the decade. Similarly, the rental vacancy rate decreased from 5 percent in 1990 to 3.9 percent in 2000. Housing production since 2000 has eased the shortage of sales units, while the number of units entering the rental market has exceeded demand. As a result, the current sales vacancy rate is estimated to be 0.9 percent, and the rental vacancy rate stands at 8.4 percent.

Sales Market Conditions

Even with the slowdown in the local economy, conditions in the Rochester sales market continue to be very strong for both new and existing homes. Much of the volume results from large numbers of renters taking advantage of low interest rates and the relatively affordable prices in the HMA to move to homeownership. In 2000, home sales in the City of Rochester, including both new and existing homes, totaled approximately 1,900, with an average price of $150,800, according to data from the Rochester Association of REALTORS®. The following year, sales increased to 2,164, at an average price of $156,200. In 2002 sales totaled 2,156 homes, at an average price of $170,080. For the 12 months ending June 2003, sales totaled 2,149 homes, at an average price of $173,478, or an increase of 7. 1 percent compared to the previous 12 months.

Local sources indicate that the strongest demand is for homes priced around $150,000 and below. Starter homes priced at $135,000 are being developed under the local First Homes program and demand runs very high. Strong demand also is reported for homes for move-up buyers at $250,000 and higher. Many of the new homes in this price range are being built in southwest and northwest Rochester and outside the city in Rochester Township.

Rental Market Conditions

Conditions in the rental market in the Rochester HMA became extremely tight in the last 3 years of the 1990s, especially in the lower rent ranges. Since 2000, however, conditions have become more balanced overall, but are highly competitive and somewhat soft in the upper rent ranges. Older, more affordable developments continue to report lower vacancy rates and tight conditions. With the decline in job growth and the movement of a substantial number of renters to homeownership, the number of vacant rental units in the HMA has increased significantly. Much of the current softness in the market is confined to newer developments—some in the northwestern part of the city with rents in the higher ranges. According to reports, some of these projects have had difficulty renting up and are offering concessions. Other projects with above-average rents, however, are experiencing satisfactory occupancy. For families with lower incomes, affordable housing remains an issue as conditions remain tight for both the local Section 8 Voucher program and developments financed by low-income tax credits.

Forecast Housing Demand

Demand for sales housing during the 2-year forecast period to August 1, 2005, is for 900 units annually, based on continued growth in population, households, labor force, and resident employment as well as an upturn in nonfarm employment numbers as the economy improves. Continued movement of renter households into homeownership also will drive demand for sales housing.

For rental housing, annual demand is forecast to average 125 units, with demand building over the forecast period. Annual demand is projected at 50 one-bedroom units with monthly gross rents starting at $625, 60 two-bedroom units with gross rents starting at $810, and 15 three-bedroom units with gross rents starting at $975. Efficiency units could satisfy, in part, the demand for one-bedroom units. Initially during the forecast period, demand will be expressed in reduction of excess vacancies. Detailed data on rental demand for the forecast period, by bedroom size and rent, are presented in Table 6.

Table 1

Labor Force and Total Employment

Rochester HMA

1992 to August 1, 2003

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Prior 12 Mos.	Current 12 Mos.
Labor Force	62,950	64,350	65,050	64,150	64,250	66,500	70,500	72,700	74,900	78,150	82,800	82,150	83,200
Total Employment	61,050	62,250	62,800	62,300	62,300	65,050	69,350	71,250	72,900	76,200	79,800	79,550	80,100
Unemployment	1,875	2,100	2,250	1,875	1,950	1,450	1,100	1,475	2,000	1,950	3,000	2,625	3,075
Rate (%)	3.0	3.3	3.4	2.9	3.0	2.2	1.6	2.0	2.7	2.5	3.6	3.2	3.7

Note: Numbers may not add to totals due to rounding.
Sources: Minnesota Department of Employment and Economic Development
U.S. Bureau of Labor Statistics

Table 2

Nonagricultural Employment, Rochester HMA

1992 to August 1, 2003

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Prior 12 Mos.	Current 12 Mos.
Total	67,700	69,100	68,100	68,700	70,200	73,700	78,200	81,500	85,000	87,400	87,400	87,400	87,400
Total Private	60,800	62,100	60,900	61,600	63,300	66,500	71,000	74,200	77,300	79,500	79,600	79,500	79,600
Goods-Producing	13,900	14,100	12,500	12,700	12,700	14,400	15,800	15,900	15,700	15,900	15,100	15,500	14,500
Nat. Res./Constr./Mining	2,300	2,300	2,200	2,400	2,500	2,800	2,900	3,100	3,400	3,700	3,800	3,800	3,800
Manufacturing	11,600	11,800	10,300	10,300	10,200	11,500	12,900	12,700	12,300	12,200	11,300	11,700	10,700
Service-Providing	53,800	55,000	55,500	56,000	57,500	59,300	62,300	65,600	69,200	71,500	72,300	71,900	72,900
Trade/Transport/Utilities	10,200	10,600	10,800	10,900	11,200	11,400	12,400	12,500	13,400	13,400	13,300	13,300	13,400
Wholesale Trade	1,300	1,200	1,300	1,300	1,400	1,300	1,500	1,500	1,400	1,400	1,400	1,400	1,400
Retail Trade	7,400	7,900	7,900	8,000	8,200	8,500	9,000	9,100	9,900	10,000	10,100	10,000	10,100
Transp./Wareh'sing/Utilities	1,400	1,400	1,600	1,400	1,500	1,500	1,800	1,900	2,000	2,000	1,900	1,900	1,900
Information	1,000	1,100	1,000	900	800	800	800	800	900	900	900	900	900
Financial Activities	2,100	2,200	2,300	2,300	2,400	2,100	2,100	2,200	2,300	2,400	2,300	2,300	2,300
Prof. & Business Services	2,800	2,900	3,000	3,400	3,700	4,200	4,700	5,400	5,300	5,300	4,700	4,800	4,700
Education & Health	21,800	22,200	21,800	22,400	23,500	24,500	25,700	27,700	29,600	31,500	33,100	32,600	33,700
Leisure & Hospitality	5,900	6,000	6,200	6,000	5,900	6,100	6,400	6,400	6,700	7,200	7,100	7,100	7,100
Other Services (Private)	2,700	2,700	2,700	2,700	2,800	2,700	2,800	2,900	3,000	2,900	3,000	2,900	2,900
Government	6,900	7,000	7,200	7,000	6,900	7,100	7,100	7,300	7,700	7,900	7,900	7,900	7,800
Federal	900	900	900	900	900	900	900	900	1,000	900	900	900	900
State	1,000	1,000	1,000	1,000	1,000	1,200	1,100	1,100	1,300	1,400	1,300	1,400	1,200
Local	4,900	5,000	5,200	5,100	4,900	5,000	5,100	5,200	5,400	5,600	5,700	5,600	5,700

Note: Numbers may not add to totals due to rounding.
Source: Minnesota Department of Employment and Economic Development; U.S. Bureau of Labor Statistics

Table 3

Population and Household Trends

Rochester HMA

April 1, 1990 to August 1, 2005

	April 1, 1990	April 1, 2000	August 1, 2003	August 1, 2005	Average Annual Change: 1990 to 2000 Number	1990 to 2000 Rate (%)	2000 to Current Number	2000 to Current Rate (%)	Current to Forecast Number	Current to Forecast Rate (%)
Population										
Rochester HMA	106,470	124,277	133,000	137,000	1,780	1.7	2,620	2.1	2,000	1.5
City of Rochester	70,729	85,806	93,150	96,400	1,510	2.1	2,205	2.6	1,625	1.7
Remainder of HMA	35,741	38,471	39,850	40,600	270	0.8	415	1.1	375	0.9
Households										
Rochester HMA	40,058	47,807	51,850	53,850	775	1.9	1,215	2.5	1,000	1.9
City of Rochester	27,913	34,116	37,350	38,950	620	2.2	970	2.8	800	2.1
Remainder of HMA	12,145	13,691	14,500	14,900	155	1.3	245	1.8	200	1.4

Sources: Sources: U.S. Census Bureau
Minnesota State Demographic Center
Minnesota Department of Health, Vital Statistics
Estimates by analyst

Table 4

Housing Inventory Tenure and Vacancy

Rochester HMA

1990 to August 1, 2003

	Rochester HMA			City of Rochester Submarket Area			Remainder of Rochester HMA Submarket Area		
	1990	2000	Current	1990	2000	Current	1990	2000	Current
Total Housing Inventory	41,603	49,422	54,300	28,961	35,346	39,400	12,642	14,076	14,900
Occupied Units	40,058	47,807	51,850	27,913	34,116	37,350	12,145	13,691	14,500
Owners	29,012	36,304	39,800	18,486	24,214	26,850	10,526	12,090	12,950
%	72.4	75.9	76.8	66.2	71.0	71.9	86.7	88.3	89.3
Renters	11,046	11,503	12,050	9,427	9,902	10,500	1,619	1,601	1,550
%	27.6	24.1	23.2	33.8	29.0	28.1	13.3	11.7	10.7
Vacant Units	1,545	1,615	2,450	1,048	1,230	2,050	497	385	400
Available Units	902	725	1,450	704	585	1,250	198	140	200
For Sale	317	258	350	230	175	270	87	83	80
Rate (%)	1.1	0.7	0.9	1.2	0.7	1.0	0.8	0.7	0.6
For Rent	585	467	1,100	474	410	980	111	57	120
Rate (%)	5.0	3.9	8.4	4.8	4.0	8.5	6.4	3.4	7.2
Other Vacant	643	890	1,000	344	645	800	299	245	200

Sources: Sources: U.S. Census Bureau
Local building inspectors
Estimates by analyst

Table 5

Residential Building Permit Activity

Rochester HMA

1992 to 2002

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Rochester HMA											
Total	1,013	640	488	478	764	878	1,133	1,334	1,814	1,514	1,570
Single-family	758	596	424	375	493	626	732	861	853	1,080	1,262
Multifamily	255	44	64	103	271	252	401	473	961	434	308
City of Rochester Submarket											
Total	789	455	363	358	595	678	933	1,118	1,634	1,089	1,253
Single-family	534	419	299	263	324	428	532	645	675	747	945
Multifamily	255	36	64	95	271	250	401	473	959	342	308
Remainder of Rochester HMA Submarket											
Total	224	185	125	120	169	200	200	216	180	425	317
Single-family	224	177	125	112	169	198	200	216	178	333	317
Multifamily	0	8	0	8	0	2	0	0	2	92	0

Sources: U.S. Census Bureau
Local building inspectors

Table 6

Estimated Qualitative Annual Demand for New Market-Rate Rental Housing

Rochester HMA

August 1, 2003 to August 1, 2005

One Bedroom		Two Bedrooms		Three Bedrooms	
Monthly Gross Rent ($)	**Units of Demand**	**Monthly Gross Rent ($)**	**Units of Demand**	**Monthly Gross Rent ($)**	**Units of Demand**
625	50	810	60	975	15
725	40	860	50	1,175	10
775	35	910	45	1,325	5
825	30	960	40		
875	25	1,010	30		
925	20	1,060	25		
1,025	15	1,110	20		
1,125	10	1,210	15		
		1,310	10		

Note: Distributions above are noncumulative. Demand of fewer than 10 units is shown as 0.
Source: Estimates by analyst