

Questions about the Potential for Increased Real Estate Speculation

As part of the conversation surrounding the proposed changes to the Family Definition in the zoning code, a number of questions have come up regarding the potential for increased real estate speculation in the single family home market. While Madison already has a number of investors that own and rent out single family homes (in the UW-Madison campus area and throughout the city), the proposed change would open up more areas of the city to be rented to a broader definition of family and to non-family households (groups of roommates) which will increase demand for single family rental units. There are a number of factors that will influence the effects of that demand on the Madison single family home market.

First, from the perspective of investors there is a difference in the demand for single family rental housing based on the profile of the investor. Since the Great Recession, there has been a rise in institutional investment in the single family home market (REITs, hedge funds, etc). Per the most recent CoreLogic Single Family Index Report and ATTOM Single-Family Rental Market Report, these investors are typically looking to deploy tens of millions of dollars in markets that are seeing strong demand growth, low acquisition cost (sub \$250,000), low holding costs (property taxes, maintenance), and the ability to scale. In general Madison does not meet this definition. These investments have largely focused on Sunbelt markets where they can achieve gross rent yields (annual rent divided by acquisition cost) of 12-18%, although yields have fallen in the last year.

In contrast, the majority of the single family rental investment market is comprised of small investors who have a more diverse set of investment criteria. Factors such as the ability to self-perform property management, familiarity with local market conditions, short vs long-term hold, availability of capital, and tax advantages specific to the investor may outweigh straightforward gross rent yield.

From the perspective of a renter, the decision to rent a single family home compared to an apartment in a multifamily building is also based on a variety of factors. Single family homes can offer advantages such as greater outdoor space, greater numbers of bedrooms, a wider variety of common spaces (dining rooms, basements, garages), and a wider variety of neighborhoods that are attractive to certain renters. However, for other renters the convenience of professional property management, underground parking, locations that can be closer to downtown and transit, and not having to worry about things like shoveling snow are more important factors. Moreover, it is unclear how large the market is for non-family households (groups of roommates) looking to live in a communal arrangement sharing a kitchen and bathrooms.

Additionally, providing a granular analysis of the potential for increased speculation across the city is difficult because even on the same block, it is possible to have home prices that vary by hundreds of thousands of dollars based on the size, quality, and amenities of individual houses. Similarly, per bedroom rents vary across the city. That being said, it can generally be assumed that areas of the city that have single family homes that are lower cost but can still command strong rents are at greater risk for real estate speculation.

1. What are current rental and ownership trends that we see?

Renter and Owner Households, 2010-2020

	2010-2018		2018-2020	
	Compound Annual Growth Rate	Total % Growth	Compound Annual Growth Rate	Total % Growth
Population	1.2%	10.0%	1.2%	2.5%
Households (total)	1.3%	10.5%	1.5%	3.0%
Renter Households	2.5%	22.3%	0.9%	1.8%
Owner Households	0.0%	-0.2%	2.1%	4.3%

American Community Survey 5-Year Estimates

Households by Annual Income, 2010-2020

	2010-2018		2018-2020	
	Compound Annual Growth Rate	Total % Growth	Compound Annual Growth Rate	Total % Growth
<\$25,000	-1.3%	-10.0%	-3.9%	-7.7%
\$25,001 - \$50,000	-0.2%	-1.8%	-2.0%	-4.0%
\$50,001 - \$75,000	0.3%	2.6%	1.5%	3.0%
\$75,001 - \$100,000	1.2%	10.3%	3.2%	6.4%
> \$100,000	5.9%	58.1%	6.7%	13.9%

American Community Survey 5-Year Estimates

From the 2022 Housing Snapshot:

There has been tremendous growth in the City of Madison since 2010, with most growth occurring in the highest income brackets. Population growth from 2018-2020 remained consistent with the growth experienced 2010-2018 (1.2% CAGR), though household growth has increased slightly in the last 3-year period measured (representing smaller average household sizes). One possibility to explain the dramatic decrease in the number of lower-income households could be upward mobility of Madison’s lowest-income residents. However this may not account for the full decrease in households in lower income groups. Alternative options to income growth include lower-income households being “priced out” of the City’s rental market - moving to other municipalities or counties, or general wage inflation. Since 2018, renter household growth has slowed, with most recent figures showing larger growth in ownership markets, likely due to the relatively larger increase in high-income households within the City.

While we have not yet received American Community Survey data for 2022, market reports show while 2021 and 2022 saw record numbers of new apartments open, there were also record levels of renters are seeking out apartments. It appears that the pandemic impacted leasing activity in 2020 and led to slowed lease-up periods for new developments, rental demand has been resurgent since 2021. Five of the past six quarters have seen demand outpace the rate of elevated new supply additions, bringing rental vacancies to less than 3%.

We don't currently have data about conversions of single family houses to multi-unit buildings or vice versa, but we could track it going forward. Buildings that add units are required to pay a Parks Impact Fee. Two-family dwellings that become single-family dwelling typically pull an Electrical Permit to remove one of the electric meters.

Converting a single-family dwelling to a three- or more-family building is nearly impossible because of the costs and requirements to convert a building to meet the commercial building code. Fire separation, sprinklers, and accessibility are just some of the requirements that need to be addressed.

While it's still relatively rare, a conversion from a single-family dwelling to a two-family dwelling or vice versa is more doable because both use the residential building code. We may have a few conversions each year.

2. What are the characteristics of a desirable area for outside real estate investment, and does Madison show those characteristics?

- a. Low property taxes (not a characteristic of Madison or upper Midwest)
- b. Low property maintenance costs (not a characteristic of Madison or upper Midwest)
- c. Concentration of available homes for purchase in a specific area, to optimize maintenance costs. Where outside real estate speculation occurs, the purchasers often look to develop or purchase portions of subdivisions or similar larger quantities of available homes to purchase, not generally available in the Madison area.

3. What are the current average/typical economics for second home ownership and management costs and revenue-generating potential?

Because of the uniqueness of the student housing market and the differences in the zoning code, the single family home rental market near the UW Madison campus operates very differently than the single family home rental market in the rest of the city. In general, rents for single family homes that have been converted into multiple (4+) bedroom rental property in the UW Madison campus area are rented by non-family households (groups of roommates). These units command rents that are less than what is charged for 1-2 bedroom units and new construction on a per bedroom basis. In contrast, single family homes rented further from campus are typically marketed towards families and compete with duplexes and large units in larger multifamily apartment complexes and there are fewer of them listed for rent.

Area	Price Range	Ownership Cost	Current Avail Rents
Greenbush	Low: \$275,000 Median: \$405,000 High: \$740,000	Low: \$1,900/mo High: \$5,000/mo	\$500-660/bedroom
Vilas	Low: \$413,000 Median: \$807,000 High: \$1,200,000	Low: \$2,800/mo High: \$8,000/mo	\$525-800/bedroom
Citywide	Median: \$425,000	\$4,000/mo	\$500-925/bedroom Median: \$712/bedroom

To bring more context to that question, below are a few scenarios using the current (Feb. 2023) second-home interest rates, tax and insurance rates, and maintenance costs, assuming a 20% down payment, and in the last two columns a 10% annual return on equity and maintenance costs of 1% of property value.

Making the assumption that houses can be converted to 5 bedrooms at a negligible cost and that property management costs are functionally zero, below is a comparison of the rent needed to cover the cost to purchase at various price points.

Price	Breakeven - Rent Needed/ Bed	Breakeven – Total Rent Needed	10% Return + 1% Maintenance - Rent Needed/Bed	10% Return + 1% Annual Maintenance – Total Rent Needed
\$200,000	\$350	\$1,750	\$380	\$1,900
\$300,000	\$400	\$2,000	\$560	\$2,800
\$400,000	\$675	\$3,375	\$750	\$3,750
\$500,000	\$850	\$4,250	\$925	\$4,625
\$600,000	\$1,000	\$5,000	\$1,100	\$5,500

Given current market rents in the neighborhoods near campus, it is possible that properties that are currently selling at the lower end of the market (sub-\$400,000) will face increased competition from investor/landlords looking to convert properties to student targeted rental housing. However, properties above that threshold would likely need to charge rents that put them in direct completion with new construction closer to campus.

For areas outside of the campus and near west site, there are far fewer single family homes for rent. Those that are listed for rent range from \$500-\$800 per bedroom (with outliers for properties on the lakes or in rural settings. For context the median sales price for a single family home in Madison in 2022 was approximately \$425,000, which would require rental rate of approximately \$4,000 to deliver a 10% return in the scenario above.

Three+ bedroom rentals in multifamily buildings rent at rates anywhere from \$450-\$700 per bedroom. Opening the single family rental market to a broader definition of families as well as non-family households (groups of roommates) would increase the potential pool of renters, but it is unclear how much demand there is for individuals looking for a relatively large group of roommates.

4. What was happening in Madison in the 1960s and 1970s when this restriction was added to the zoning code?

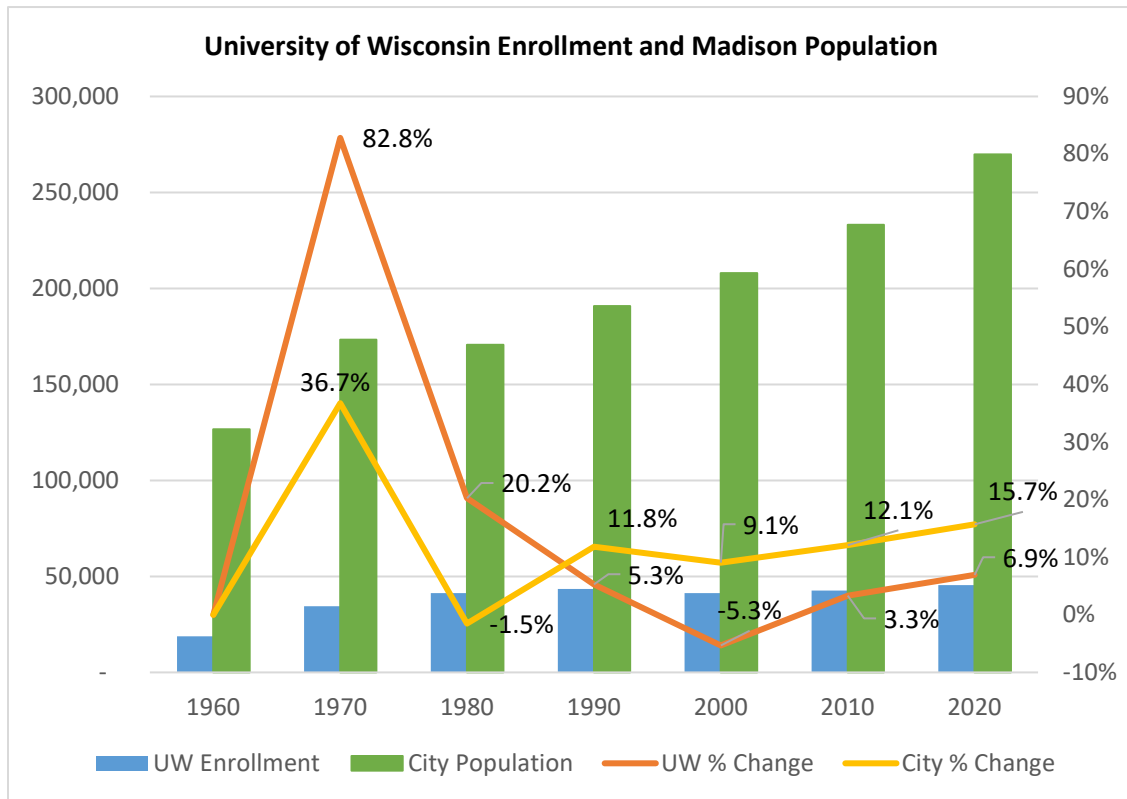
Defining family by blood and marriage and adding a limit of five unrelated people appears to have been added to Madison's zoning code in 1966, at the same time as a major rewrite of our code. Zoning occupancy restrictions based on family relationships were a common addition to zoning codes during this time, particularly in communities with colleges and universities. The City does not have documentation about the specific local reasons this was added to the code. However, based on reviewing case law from the time, restrictions like these were typically added to zoning codes in response to increasing college student enrollment and interest among younger adults of living in more communal, unrelated households.

In 1969, Madison's family definition was revised to set lower occupancy limits for renters in lower density residential districts throughout the city. The intent of this change in the family definition appears to be to give priority to homebuyers so they would not have competition for housing in these areas from a household of more than two unrelated renters.

Family. A 'family' is an individual, or two or more persons related by blood, marriage or legal adoption living together as a single housekeeping unit in a dwelling unit, including foster children, domestic servants and not more than four roomers, except that the term 'family' shall not, in R1, R2 and R3 Residence Districts, include more than one roomer except where such dwelling unit is owner occupied.

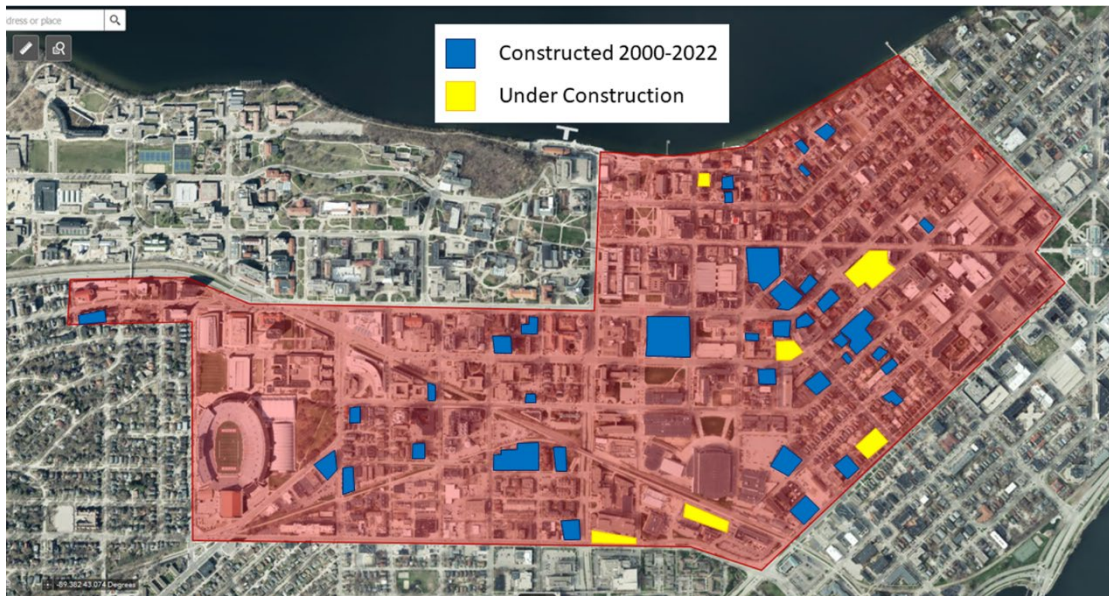
(MGO 28.03, 1969)

Between 1960 and 1970, University of Wisconsin enrollment increased by 82.8%, an increase of 15,577 students, while Madison's overall population increased by 36.7%. This occurred at a time when downtown was less densely developed, and there were fewer off-campus apartments to accommodate the additional enrollment at the time.



No ten year period following has had an increase near that scale. In comparison, enrollment from 2010 to 2020 increased 6.9%, or by 2,945 students. The density and types of available housing options in the campus area today also look much different than in the 1960s. Today, more college student-oriented housing options have been built and the pace of overall City population growth exceeds UW enrollment growth.

College Student-Oriented Housing, 2000 - 2022



College Student-Oriented Housing, 2000 - 2022

Address	Name of Development	Year Constructed	Number of Dwelling Units	Zoning District
110 N Brooks St	Campus Village Apartments	2000	64	PD
505 University Ave	The Embassy	2001	126	PD
920 Spring St	920 Spring St	2001	34	PD
45 N Randall Ave	Park Terrace West	2002	57	PD
535 W Johnson St	Palisade Apartments	2002	93	PD
210 Lakelawn Pl	210 Lakelawn Place	2002	19	PD
437 W Gorham St	Aberdeen	2004	77	PD
420 W Gorham St	420 West	2004	80	PD
1040 Spring St	Campus Village Apartments	2005	19	PD
409 W Gorham St	Equinox	2006	115	PD
202 N Charter St	210 N Charter	2006	25	PD
417 W Dayton St	The Lurican	2008	21	PD
777 University Ave	Lucky Apartments	2008	359	PD
1022 W Johnson St	Grand Central	2009	155	PD
4 N Park St	Park & Regent	2010	65	PD
1216 Spring St	Humbucker Apartments	2010	75	PD
621 Mendota Ct	621 Mendota Ct	2011	27	PD

424 W Mifflin St	The Sheelin	2012	44	PD	
1815 University Ave	Brownlofts Apartments	2012	64	PD	
229 W Lakelawn Pl	229 at Lakelawn Apartments	2012	14	PD	
1001 University Ave	X01 Apartments	2013	79	PD	
1323 W Dayton St	Vantage Point	2013	65	PD	
210 N Bassett St	Park Place	2014	75	PD	
311 N Frances St	City View Place	2014	40	PD	
202 N Brooks St	Brooks House	2014	14	PD	
633 N Henry St	Waterfront Apartments	2014	71	PD	
1423 Monroe St	Lark at Randall	2014	72	TSS	
409 W Johnson St	The Domain	2014	326	UMX	
142 W Johnson St	Lumen House Apartments	2014	19	DC	
437 N Frances St	The Hub	2015	313	DC	
110 N Bedford St	Lark at Kohl	2015	179	UMX	
431 W Mifflin St	Mifflander	2016	46	DR2	
433 W Johnson St	The Lux	2016	160	UMX	
432 W Gorham St	The James	2016	348	UMX	
623 N Lake St	Alpha Chi Sigma	Under Construction	28	DR2	
740 Regent St	Trinitas Madison	Under Construction	341	PD	
1313 Regent St	Lucky's 1313	Under Construction	47	TSS	
339 W Gorham St	Oliv Madison	Under Construction	386	UMX	
506 W Johnson St	Verve	Under Construction	142	UMX	
826 Regent St	Chapter at Madison	Under Construction	178	UMX	
		Average Year	Total Dwelling Units	Most Common Zoning District	
		2010	4,462	PD	27
		Mode Year	Units Already Constructed	UMX	7
		2014	3,340	TSS	2
		Median Year	Units Under Construction or Approved	DR2	2
		2012	1,122	DC	2

These 3,340 constructed units and 1,122 units in the pipeline represent more bedrooms and beds targeted at the college student market. Most of these dwelling units have multiple bedrooms. However, we know we continue to need additional housing of all kinds, including more housing intended for the college student market.

Plan Commission Housing Approvals, 2016 – 2022

	2016	2017	2018	2019	2020	2021	2022
Single family lots	383	525	1,338	334	195	143	152
Multi-family units	2,968	1,643	1,010	2,358	4,772	2,827	4,342

Building Permits for Housing, 2016-2022

	Single-Family Houses	Buildings with 2-4 Dwelling Units	Buildings with 5+ Dwelling Units	Manufactured Homes	Total Dwelling Units
2022	243	48	2,026	33	2,350
2021	289	64	3,273	7	3,633
2020	355	76	1,737	35	2,203
2019	378	74	1,190	40	1,682
2018	359	50	1,147	27	1,583
2017	361	33	1,640	25	2,059
2016	342	48	1,842	15	2,247

5. **Have other cities that have similarities to Madison changed their zoning occupancy limits? Have they seen many owner-occupied houses become renter-occupied? Have out-of-state investors bought more houses to be rental properties? Has there been an increase in complaints/issues related to junk, trash, and debris, noise/loud parties, property maintenance, or other nuisance-type issues? Have rents or property values increased, seemingly caused by change?**

Of 17 Big Ten communities, only one of them has a limit as low as Madison’s limit of 2 unrelated individuals. Seven of the 17 communities had a limit of 5 or more or no limit on the number of unrelated individuals. The full summary can be found [here](#).

We contacted Minneapolis, St. Paul, Ames, and Iowa City to ask questions about their experiences after zoning occupancy limits were increased.

Minneapolis, MN

In Minneapolis, the zoning code was amended in 2021 to remove limits on occupancy based on blood and marriage relationships and instead use the safety-based limits in their housing code. Minneapolis Planning staff and Housing staff shared that they are not tracking this kind of

information. Anecdotally, they haven't noticed any of these changes, which would come to Housing's attention through 311 complaints. Even before the ordinance change, Minneapolis didn't give out many citations for over-occupancy and the occupancy would likely be noticeable in only a subsegment of larger properties.

Minneapolis does have a requirement that applies near the University that limits the number of bedrooms in dwellings with 1-3 units and cluster developments to nine bedrooms in any principal structure. The purpose of the University provision is related to vehicle parking. It took effect after Minneapolis eliminated minimum vehicle parking requirements citywide.

Saint Paul, MN

In 2021, St. Paul's zoning occupancy limit was changed to six unrelated adults and any number of minor children in their care. Staff prefaced our discussion with the fact that they hadn't done any studies about this specifically, so they could only provide anecdotal experience. Since the code change two years ago, there has not been much negative feedback or any discussion of a change back to how things were. They did not believe the amount of nuisance complaints has increased, and much of the feedback they have received has been positive. St. Paul has a lot of older, larger housing with sometimes six or more bedrooms, and under the previous occupancy rules there was no way to legally use the entire house, even though it was being taxed based on all the square footage.

Areas where college students tend to live are those near the University of St. Thomas and Macalester College. St. Thomas has made an effort to build more on-campus housing, but they are an urban campus with limited space, so there is spillover into surrounding neighborhoods. Even though there is a portion of the University of Minnesota campus in St Paul, staff said the houses adjacent to it are quite upscale and expensive and haven't made economic sense to be used as student rentals.

Some tools that St Paul uses to regulate housing include "non-owner-occupied certificates of occupancy" which are issued to a property (not the owner). These are required in all cases where a house is not occupied by its listed owner, including all cases in which the house is owned by a corporation. This process includes systematic inspections, which vary in frequency depending on the number of violations found on the previous inspection. They can be done every 1-6 years, and include checking for fire safety, property maintenance, and occupancy concerns.

Overall, he said there has not been much impact. Property values have continued to increase as they have across the region. Any complaints they receive that involve occupancy typically include other issues that are the true reason for the complaint.

Ames, IA

The Iowa State Legislature preempted cities from imposing limits on the number of unrelated individuals in a dwelling unit in 2018. Ames then first limited the number of rental units that were allowed within a neighborhood, but the state preempted that. Now, generally, one more adult than the number of bedrooms is allowed, up to five adults. Children are not counted in this limit. Ames Planning staff and Building Inspection staff said they are not tracking

information about conversions to rental or negative impacts of the change. Their sense is that rentals are increasing in certain neighborhoods near the Iowa State campus.

The State requires communities of a certain size to license rentals so they are able to use that tool to address issues with rental properties. However, the State pre-empted their ability to regulate short-term rentals differently than long-term rentals so short-term rentals continue to be a problem. Local governments may not prohibit, require a license or permit, charge any fee, or adopt any other regulations specific to short-term rentals.

Iowa City, IA

Iowa City staff shared that when the change went into effect, there were significant concerns about the effect the change could have, and they hired additional staff to perform field observations of nuisance and property maintenance issues. However, they have since looked at the data, and nuisance violations have not changed since before 2018. There has not been an increase in illegal parking or property maintenance issues like junk, trash, and debris.

Staff felt that there was already large-scale noncompliance with the previous occupancy limits and removing the limits just made previously illegal occupancies legal; it hasn't changed the actual use. Staff stated that property values have continued to increase at a similar rate to before the change, although they have somewhat plateaued recently with higher interest rates, just as they have across the country. Staff said that the rate of owner-occupancy in the city has not changed. Overall, staff stated there has been no real impact.

Iowa City has a rental licensing program, and they do systematic inspections annually. They have the authority to suspend rental licenses after repeated nuisance violations. After three violations, licenses are put on a sort of probation, and if another violation occurs, the license is suspended for six months. Staff shared that in 20 years they only know of one license that was suspended. Usually just the threat of suspension is enough to compel compliance.

Another rule that Iowa City has is that no more than 35% of residential floor area can be bedrooms. Staff shared this is a typical percentage, and they have not had compliance issues with this. They have parking maximums and open space requirements that sound similar to Madison's parking maximums, usable open space, and maximum lot coverage.

6. Will parents be more interested in purchasing a house for their student child to live in with roommates through their college years?

This is already possible without a change to the zoning code. We have seen a few properties where college student is the titled owner, resulting in an owner-occupied home, which allows the higher occupancy. It's also already allowed in zoning districts which allow a higher occupancy, regardless of ownership.

7. Do we have any tools to address mass real estate speculation?

We are not aware of any way that we as a city, via an ordinance, could limit or restrict who the owner of properties is, or use some other method to limit ownership in a certain geographic area or using some other factor.

All properties, regardless of ownership, are required to meet certain minimum property maintenance standards.

A tool the city has for dealing with problem properties is our Chronic Nuisance Premises Ordinance. This is used for a few properties each year. The nuisance activities listed in the ordinance are generally associated with quality of life issues. Examples of nuisance activities include: harassment, disorderly conduct, battery, indecent exposure, damage to property, disturbing the peace, discharge of a firearm, trespass, obstructing a street or sidewalk, theft, arson, depositing rubbish, prostitution, open alcohol, selling alcohol without a license, possession, manufacture, delivery and/or distribution of a controlled substance, maintaining a drug dwelling, illegal gambling, keeping a dangerous animal, and violations of the minimum housing code

The first step in using the chronic nuisance ordinance is typically a meeting between the property owner, police, the City Attorney's Office and others. Many times that meeting is all that is needed to turn around a property. If the meeting isn't sufficient, the ordinance can be used to pursue a case in court. The City Attorney's Office has found the ordinance to be effective and doesn't see a need for changes to the law.