

An Assessment of Demand for Housing In Downtown Duluth, Minnesota

Prepared For:

Greater Downtown Council In Partnership With:

Local Initiatives Support Corporation (LISC)

Wells Fargo Bank, N.A.

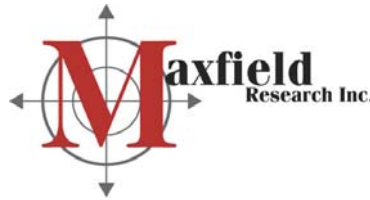
U.S. Bank, N.A.

Duluth, Minnesota

November 2002



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Minneapolis, MN 55413
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November 15, 2002

Ms. Kristi Stokes
President
Greater Downtown Council
5 West 1st Street
Suite 101
Duluth, Minnesota 55802

Dear Ms. Stokes:

Attached is our assessment of the potential demand for housing in Downtown Duluth. This study focuses on an analysis of demographic trends and current market conditions that support the development of residential units in the Downtown.

The study reviews growth trends and resident demographic characteristics, reviews current housing market conditions for for-sale and rental housing, pending housing developments and quantifies the number of housing units that could be supported in Downtown through 2010.

This report identifies demand for housing that would be generated by the draw area population in addition to demand for second residences that would come primarily from households residing outside of the Duluth area that would want to live in Duluth either year-round or seasonally.

Detailed findings are found in the body of the report.

We have enjoyed conducting this study for you and are available to answer any questions or provide additional information.

Sincerely,

MAXFIELD RESEARCH INC.

Mary C. Bujold
President

Attachment

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Purpose and Scope of Study

Maxfield Research Inc. was engaged by the Greater Downtown Council to assess the potential demand for additional housing in Downtown Duluth. For the purpose of this report, Downtown Duluth is defined roughly as an area bounded by Mesaba Avenue on the west, 6th Avenue East on the east, Canal Park and the Harbor area on the south and 2nd Street on the north. We acknowledge the connection of the Central and East Hillside neighborhoods to Downtown Duluth, but focus on the potential to add new housing in and/or in close proximity to the Downtown commercial core.

Key Findings of Study

The following paragraphs summarize the key points regarding the potential demand for additional housing in Downtown Duluth. The primary draw area (Study Area) used in this analysis includes the Cities of Duluth, Proctor and Hermantown in addition to the Townships of Canosia, Lakewood, Rice Lake and Midway. In addition, there is a proportion of demand for housing in the Downtown that will come from outside of this area, from other communities in Northern Minnesota and from households seeking housing for seasonal use (i.e. retirement housing, vacation homes, etc.)

Regional Setting

- Duluth's location on the southwestern tip of Lake Superior provides a unique amenity for housing. Lake Superior, the largest of the Great Lakes, is not only an economic engine for the community, but is perhaps even better treasured for its picturesque beauty. Minnesota, the Land of 10,000 Lakes has experienced a boom in tourist and recreation travel and the majority of it has been focused on the Twin Cities and on numerous lakes throughout the State. Water amenities, ranging from ponds to large bodies of water, generate premiums for housing development.
- The Duluth-Superior MSA is now considered to be a major Minnesota tourist location and events such as Grandma's Marathon have given the City national media attention. Duluth's summer tourist business increased substantially during the 1990s as many travelers began looking for vacation areas closer to their place of residence. The majority of visitors to Minnesota are from the immediate surrounding five-state region including Minnesota. The vast majority of this travel occurs between May and September.
- Duluth is also a regional health care and education center. The expansion of the hospital campuses and the strength of UMD, College of St. Scholastica, and other technical and community colleges, have brought a substantial number of jobs to the region in addition to an increased student presence in the community.
- Enrollment growth at the local colleges and universities combined with increased job growth overall in the community has reduced the availability of rental housing each year for the past

three years as students and workers have filled many of these units. In addition, the advanced age of much of the rental housing stock resulted in its acceptance by primarily price-sensitive market segments, with little market for move-up housing targeted to a “lifestyle renter.” New and rehabbed rental housing in the Duluth area has been primarily targeted to low- and moderate-income households. Very little new housing has been developed targeted to meet the needs of upper middle-income and upper-income professionals other than single-family homes located in areas where land is available for new development. New housing has been developed primarily above the bluff near Miller Hill Mall and in Hermantown or farther out on lakeshore property in the surrounding townships.

Area Growth Trends and Demographic Analysis

- Census 2000 data indicates that Duluth city and the surrounding Study Area added more people and households than were previously projected by almost 50%. The Census shows that the primary draw area gained nearly 2,700 people and 1,846 households during the 1990s. The majority of the growth in the draw area occurred in the City of Duluth, which added 1,425 people and 937 new households.
- The April 2000 Census should have resulted in a relatively full count for the City, not affected substantively by student households vacating as this does not typically occur in full until May and June of any year.
- Employment experienced a peak in November 2001 at 44,054, an unemployment rate of 3.5%. Employment dropped to a low of 42,346 in January 2002, but has risen since then to 44,631 as of October 2002, an unemployment rate of 3.1%. According to a recent report, the Northland businesses produced more goods and services, \$8.5 billion, during 2001, even as the economy lost jobs. The City of Duluth and the core metro area proved resilient, primarily as a result of tourism and health care industries. Total tourism tax collections in Duluth through June 2002 were up 5.4%, adjusted for inflation. Hotel employment was 5% higher in 2002 than in 2001. Increased convention bookings and increased local travel added to the advance in tourism dollars. After September 11th, long distance travel dropped with more local venues benefiting from leisure travelers staying closer to home. The study, by the U.S. Conference of Mayors, concluded that the Duluth-Superior Metropolitan Area’s economy grew 1.3 percent in 2001, even though employment declined by 2.0%.
- The Duluth area’s health care industry is also growing with 2.5% more jobs in 2002 than in 2001. Expansions planned by St. Mary’s Duluth Clinic (SMDC) and by St. Luke’s Hospital will bring not only more jobs, but also increased patients and visitors to Duluth, resulting in a need for more housing and more lodging in addition to other services.
- The projected increase in physicians and other highly skilled health care professionals will provide opportunities to attract a portion of these employees to housing in the Downtown that would be located in close proximity to these campuses.
- Duluth has continued to gain economically despite recent fluctuations in employment. This has been dissimilar to other communities in Minnesota that experienced a greater economic

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downturn due to the sluggish economy and the events of 9/11. The most recent figures from the MN Workforce Center (October 2002) show Duluth city's unemployment rate at 3.1%, a seasonally unadjusted rate. This rate is lower than for the State as a whole that was at 3.8%. At an unemployment rate of 3.1%, Duluth is again experiencing labor shortages in some industries, primarily in the health care industry, a major employer.

- Recent figures on covered employment (jobs by place of work) revealed that the education and health services sector continues to experience strong growth. The average weekly wage in Duluth increased from \$612 as of year-end 2001 to \$642 as of the end of 1st Quarter 2002. This equates to an annual gross income of approximately \$33,400. This is a per worker income. Most households today have more than one worker.
- Incomes are projected to increase, albeit somewhat more slowly in the short-term than previously projected. According to Claritas, Inc., income movement upward is projected through the various categories, indicating that more households are moving up the distribution scale. Census data released in September 2002 revealed that younger households, those between the ages of 25 and 34 had higher household incomes than was previously estimated.

Housing Market Conditions

- The for-sale housing market in Duluth remains tight, with strong demand in the mid-price ranges and very little housing available. According to recent figures released by the Duluth Association of Realtors, the median home price in Duluth as of 2001 was \$98,500, up from \$89,000 in 2000, an increase of 10.7%. Low mortgage interest rates have allowed more households into the for-sale market. As a result, the prices of the limited supply are being bid up. According to the 2001 Housing Market Indicators report, compiled for Duluth, a total of 800 new housing units will be needed over the next decade to support projected demand, including demand from new household growth and replacement needs. Currently, the City has been producing roughly 58 units per year, insufficient to meet the demand.
- Housing construction has been constrained by a number of factors, some unique to Duluth. These factors include:
 - Limited land availability in the central city for new construction;
 - Difficult topography in many areas of the City restrict the number of sites suitable for new construction;
 - Soil conditions (bedrock) limiting developable sites;
 - Constrained by westward growth (Lake Superior forms eastern barrier);
- There are more than 1,500 housing units located in and on the periphery of the Downtown, but most are targeted to serving households with low- and low-moderate incomes. Some older buildings with deferred maintenance have de facto become low-income housing. There are some properties that have been developed specifically to meet the needs of households that require additional lifestyle assistance. Many of these households are located in the

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Downtown to be in close proximity to service providers (health care, retail), public transportation and other services.

- There is a very limited amount of new housing in the Downtown (new construction or renovated) that is market rate. In part, this situation arose because of a mismatch between achievable market rents/sales prices, the high cost of developing residential units in small buildings and a lack of parking, among other factors. The limited amount of new housing that has been developed within the past few years has been positioned at the top of the market and is owner-occupied.
- Strong employment growth in the 1990s, a growing base of professionally employed workers, changing lifestyles and an aging population (growth in the baby boom cohort) has led to increased interest in multifamily housing options and in housing that would be located in the Downtown.
- There is currently a perception that housing in the Downtown is only for low-income households. In part, this perception is supported by the greater amount of this product that is located in the core of Downtown. Community and Federal financial incentives have traditionally focused on providing assistance for households that cannot otherwise afford “market rate” housing. A result of these incentives however, is that the middle-income groups, those who could afford to pay rents of between \$700 and \$900 per month for rental housing or those who could afford to purchase a condominium/townhome unit priced between \$150,000 and \$250,000 are excluded from the Downtown market because private sector developers on their own have not been able to produce this housing in sufficient quantities to make it economically viable.

Second Residences

- Strong economic growth in the 1990s, strong home appreciation and an increasing empty-nester demographic have all combined to shift the market toward multifamily ownership at a higher average price points and toward more luxurious units. We have seen this trend occur in major metropolitan areas as well as in seasonal and resort areas such as the Brainerd Lakes area and along the North Shore.
- A greater variety of housing in the Downtown (upper-income, middle-market) will enhance the vitality of Downtown’s after hours environment and in a sufficient amount, will spur increased retail development. Downtown residents are more likely to consider the Downtown as their neighborhood and spend money for entertainment, recreation and other retail goods and services in close proximity to where they live and work.

Demand for Primary Residences

- From now to 2010, we project demand for between 40 and 85 for-sale units at a variety of price points, between 21 and 32 units of market rate rental housing and between 55 and 75 units of middle-income rental housing in the Downtown. Housing on high-amenity sites (views, location) will command the highest prices, all other things being equal.

Demand for Secondary Residence

- In addition, we have calculated demand that would result from buyers seeking a second residence or a retirement residence that may be from outside of the Study Area. The rise in second home ownership in the United States and increased interest in vacation properties is expected to continue in the short-term. We estimate that through 2010, Downtown Duluth could support demand for 50 units of condominium housing, a portion of which may be rented out for vacations.

Downtown Housing and Revitalization

- The development of a critical mass of market rate housing in the Downtown is likely to require public/private partnership in order to achieve a broader range of housing types at varying price points. Housing has been a part of the Downtown since the City's inception. People living in close proximity to employment, entertainment and retail goods and services is not a new concept, but one that had been lost for a time until there was a renewed focus on a return to urban living.
- A greater variety of housing in the Downtown (upper-income, middle-market) will enhance the vitality of Downtown's after hours environment and in a sufficient amount, will spur increased retail development. Downtown residents are more likely to consider the Downtown as their neighborhood and spend money for entertainment, recreation and other retail goods and services in close proximity to where they live and work.
- The Downtown area would be attractive to a variety of market segments including students, working professionals, retirees, seasonal residents, and others. Housing can be developed to specifically meet the needs of one or more of these segments (i.e. student-specific housing, senior housing with services, housing for seasonal residents). The greatest constraint to developing this housing is finding buildings and sites that can accommodate housing with features and amenities that will meet the needs of these groups.

Next Steps

We recommend that the Greater Downtown Council in conjunction with LISC, the City and other local community organizations solicit interest from the private development community in developing housing in the Downtown. We suggest that further investigation of potential sites and buildings be completed to better determine their physical potential for renovation to housing.

We recommend that local organizations and the City work in cooperation to identify potential funding alternatives to traditional federal and state programs that limit the type of housing that can be developed. These other programs may include density credits, tax exempt bonds, and other types of loans, land acquisition, tax increment financing, tax abatement, among others.

We recommend that specific attention be given to long-range plans for incorporating housing in the Downtown and identification of potential housing sites in the core and on and near the waterfront. This could be included in the completion of the Comprehensive Plan.

Study Area Definition

This section of the report reviews factors related to the demand for rental housing located in the City of Duluth, Minnesota. Factors examined include population, household and employment trends, the age distribution of the population and household base, the propensity of households to rent/own their housing and incomes of households. This data was examined for an area defined as the primary draw area for housing in Duluth (herein referred to as the “Study Area”).

The Study Area consists of the Cities of Duluth, Proctor, Hermantown and the Townships of Canosia, Rice Lake, Midway and Lakewood. Maxfield Research Inc. identified this Study Area based on a review of traffic patterns, natural and man-made geographic boundaries, and our knowledge of the draw areas for rental housing. We include a map of the Study Area on the following page.

The majority of the demand for Downtown housing will come from within the defined Study Area. We acknowledge that a portion of the demand for housing will come from outside of the Study Area from households not currently residing in the Study Area, but who are drawn to the area for other reasons. Downtown housing is more likely to attract a higher proportion of households from outside of the traditional draw area due to its higher concentration of entertainment venues and recreational amenities. We also include data in the demographic tables for St. Louis County and for Minnesota as a whole as a comparison.

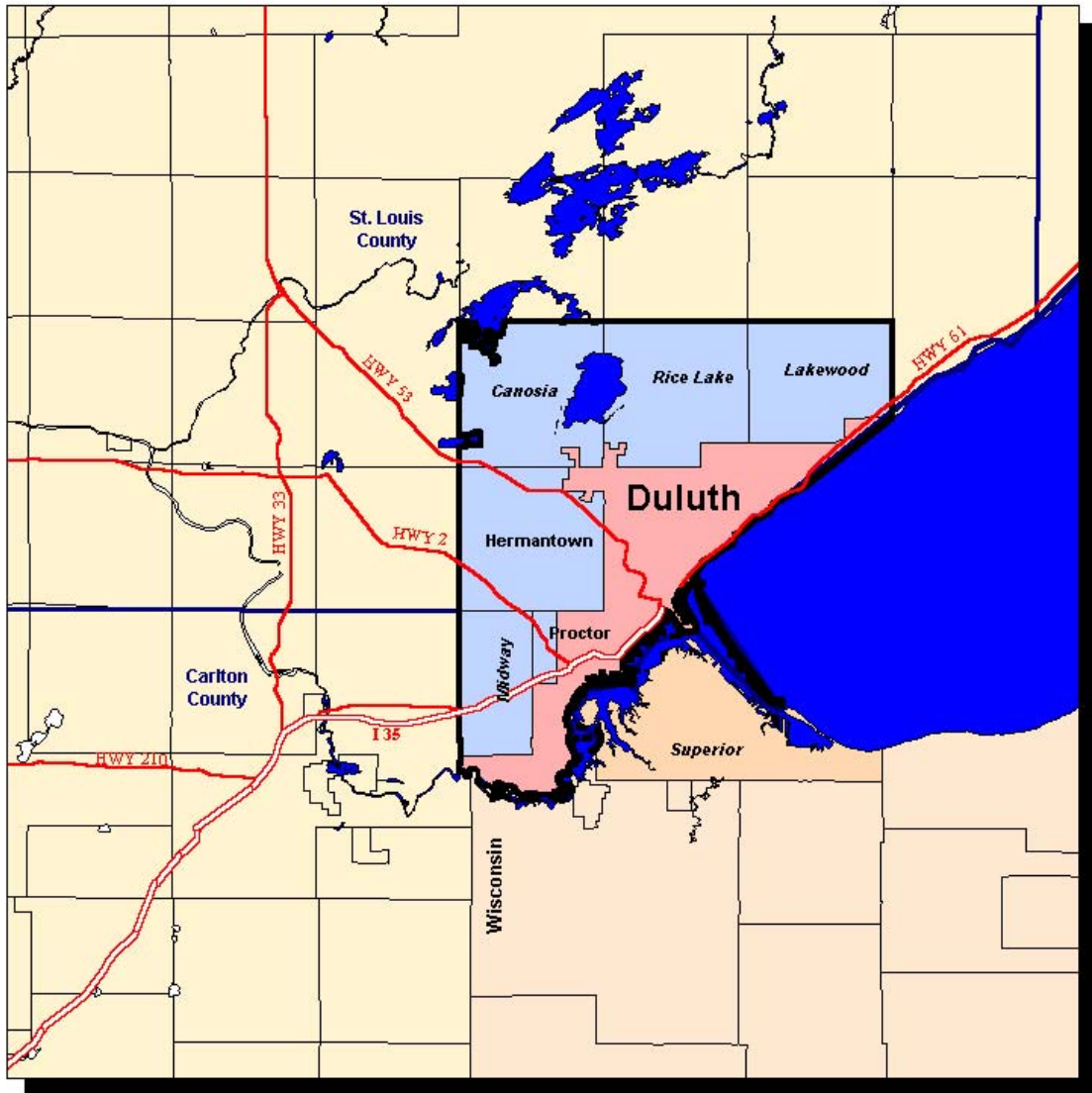
Population and Household Growth Trends and Projections

Tables 1 and 2 show data on population and the household base for the Study Area, St. Louis County and Minnesota from 1980 to 2010. These tables show 2000 Census population and household figures and incorporate updated projections for both population and households to 2010. The historic data is from the US Census Bureau while the updated forecasts for 2010 were developed by Maxfield Research Inc. using data gathered from the City of Duluth, Minnesota Planning (State Demographer) and Claritas, Inc., a national demographic forecasting company. The following paragraphs summarize the key points from the tables.

Population

- According to current 2000 Census population figures, the Duluth Study Area had 106,847 people in 2000, and remains at approximately 53 percent of St. Louis County’s total population base.
- During the 1980s, the City of Duluth lost –7,300 people, a decrease of nearly -8.0 percent. The 1990s however, brought a stabilization of the former decline, and Duluth gained 1,425 people or 1.7 percent during the last decade. St. Louis County, which also lost a significant number of people during the 1980s, also added 2,315 people during the 1990s, or 1.2 percent.

Duluth Study Area



Maxfield Research Inc.

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**TABLE 1
POPULATION GROWTH TRENDS
DULUTH STUDY AREA
1980 - 2010**

	U.S. Census			Forecast 2010	Change					
	1980	1990	2000		1980 - 1990		1990 - 2000		2000 - 2010	
					No.	Pct.	No.	Pct.	No.	Pct.
Duluth City	92,811	85,493	86,918	87,718	-7,318	-7.9	1,425	1.7	800	0.9
Remainder of Study Area										
Proctor	3,180	2,974	2,852	2,800	-206	-6.5	-122	-4.1	-52	-1.8
Hermantown	6,759	6,761	7,448	7,748	2	0.0	687	10.2	300	4.0
Midway Twp.	1,751	1,500	1,479	1,504	-251	-14.3	-21	-1.4	25	1.7
Canosia Twp.	1,562	1,743	1,998	2,098	181	11.6	255	14.6	100	5.0
Rice Lake Twp.	3,861	3,883	4,139	4,289	22	0.6	256	6.6	150	3.6
Lakewood Twp.	1,680	1,799	2,013	2,016	119	7.1	214	11.9	3	0.1
Subtotal	18,793	18,660	19,929	20,455	-133	-0.7	1,269	6.8	526	2.6
Study Area Total	111,604	104,153	106,847	108,173	-7,451	-6.7	2,694	2.6	1,326	1.2
St. Louis County	222,229	198,213	200,528	205,910	-24,016	-10.8	2,315	1.2	5,382	2.7
Minnesota	4,075,970	4,375,099	4,919,479	5,452,500	299,129	7.3	544,380	12.4	533,021	10.8
Sources: U.S. Census Bureau, MN Planning, Woods and Poole, Maxfield Research Inc.										

Both Proctor and Midway Township lost population during the 1980s and continued to lose population during the 1990s. However, the adjacent surrounding townships gained some people as growth continued to move outward from Duluth proper. The majority of the Study Area's population however, is concentrated in the City of Duluth.

- Within the Study Area, the rate of population growth is expected to decline again during the 2000s, a result of the aging of the baby boom generation coupled with a reduction in birth rates and the smaller size of the baby bust generation. This trend is similar to many other communities in the Upper Midwest. The Study Area population is expected to increase numerically, however by 1,326 people, an increase of 1.2 percent.
- The precipitous decline during the 1980s was largely a result of the recession of the early 1980s. The economy, despite a slowing during 2001, is expected to remain relatively stable for the foreseeable future and Duluth is expected to capitalize on technology and its growth industries (health care and tourism) over the next 20 years. Conversely, the remainder of St. Louis County is projected to lose a very small number of people during the 2000s, -54 over the ten-year period.
- During the 2000s, the Study Area's population is expected to experience some growth, occurring both in the City and in the adjacent townships outside of Duluth as households continue a modest outward movement to the more rural areas where land is in greater supply and new housing is being built. Most specifically, Duluth city's lack of available land for

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housing development has resulted in most of the new housing being built in Hermantown and several adjacent townships where land is more readily available.

It should be noted that there is significant housing demand within the City of Duluth. However, there is very little land available for development and the unique topography of the City (hills and rock) create significant challenges to substantial development to accommodate the demand for new housing.

Households

Household growth is a particularly reliable gauge of an area's housing needs, because households, by definition, are occupied housing units. We have updated household growth trends, incorporating recently released 2000 Census data.

- As of 2000, there were 42,872 households in the Duluth Study Area and 82,619 households in St. Louis County. Thus, the Study Area accounted for 52 percent of St. Louis County's household base.
- Both population and household growth in the Study Area were relatively strong during the 1990s, much greater than during the 1980s. During the 1980s, the number of households in Duluth dropped by -800 (-2.3%). During the 1990s however, Duluth gained 937 households (2.7%). The Remainder of the Study Area added 909 households (14.1%). The total number of households added in the Duluth Study Area was nearly half that added in all of St. Louis County during the 1990s.
- The significant household decline during the 1980s paralleled the drop in population. Duluth and the Iron Range experienced more severe economic hardship during the 1980s than did other areas of the State. Duluth, in particular, has capitalized on a significant and growing tourist business in addition to becoming a recognized regional center for health care.
- The City proper continues to struggle with a lack of land available for new housing development, a severely aging housing stock, and development constraints such as hillside development and substantial areas of bedrock. While new development has occurred at the upper-end of the price spectrum, the development of affordable housing in the community to serve the general workforce population has been severely curtailed.
- Household growth in the Study Area is forecast to continue over the next two decades, but is expected to taper-off somewhat from the level of the previous decade. Most baby boomers had already formed their households by 1990 and the subsequent baby bust generation is much smaller than the preceding baby boom. A slight upswing in household growth is projected for 2000 to 2010, as the baby boomlet (1977 to 1995) continues to age into its household creation years. The Study Area is expected to add 1,116 households (2.6%) during the 2000s. This is a figure somewhat below the level of growth that occurred during the 1990s, but is a substantial increase over the decline that occurred during the 1980s. St. Louis County is projected to add 2,381 households (2.9%) during this same period.

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**TABLE 2
HOUSEHOLD GROWTH TRENDS
DULUTH STUDY AREA
1980 - 2010**

	U.S. Census				Forecast	Change					
	1980		1990			1980 - 1990		1990 - 2000		2000 - 2010	
	No.	Pct.	No.	Pct.		No.	Pct.	No.	Pct.	No.	Pct.
Duluth City	35,363	34,563	35,500	36,150	-800	-2.3	937	2.7	650	1.8	
Remainder of Study Area											
Proctor	1,170	1,196	1,196	1,210	26	2.2	0	0.0	14	1.2	
Hermantown	2,057	2,192	2,726	2,950	135	6.6	534	24.4	224	8.2	
Midway Twp.	459	462	495	530	3	0.7	33	7.1	35	7.1	
Canosia Twp.	541	629	751	831	88	16.3	122	19.4	80	10.7	
Rice Lake Twp.	1,220	1,373	1,494	1,566	153	12.5	121	8.8	72	4.8	
Lakewood Twp.	524	611	710	751	87	16.6	99	16.2	41	5.8	
Subtotal	5,971	6,463	7,372	7,838	492	8.2	909	14.1	466	6.3	
Study Area Total	41,334	41,026	42,872	43,988	-308	-0.7	1,846	4.5	1,116	2.6	
St. Louis County	81,482	78,901	82,619	86,000	-2,581	-3.2	3,718	4.7	3,381	2.9	
Minnesota	1,445,222	1,647,853	1,895,127	2,150,200	202,631	14.0	247,274	15.0	255,073	11.6	
Sources: U.S. Census Bureau, MN Planning, Woods and Poole, Maxfield Research Inc.											

- The City of Duluth is projected to add 650 households during the 1990s, an increase of 1.8%. The Remainder of the Study Area (adjacent cities and townships) combined however, is projected to add 466 households, somewhat less than the City. The greater household growth in Duluth proper reflects more in-fill and redevelopment in the City over the next decade. The Remainder of the Study Area however, does have a greater amount of land available for new housing development. Several of the townships can accommodate only large lot development due to zoning restrictions and a lack of substantial infrastructure. Duluth's lack of land for new development will continue to constrain its growth unless more redevelopment occurs.

Comparing Tables 1 and 2 reveals that household growth has occurred in the face of slower population growth. This has been a result of social and demographic factors that began in the 1960s and continue today. Large numbers of households were formed by the "baby boom" generation (persons born between 1946 and 1964) starting in the late 1960s and continuing through the 1980s. The increases in the number of households did not have a corresponding increase in population as household size declined.

Couples' decisions to have fewer or no children, increased divorce rates, and a shift from traditional to non-traditional households were the major factors contributing to smaller household size. Today, the disparity between household and population growth rates is

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lessening, as the “baby bust” generation (persons born between 1965 and 1976) is now the driving force of household formation. In addition, baby boomers held off having children longer than their parents, resulting in a “baby boomlet,” which lasted almost 20 years (1977 to 1995). The children of baby boomers will begin entering the housing market this decade (2000s), but their full impact will not be felt until midway through the next decade.

In the Study Area, growth rates for population and households will begin to equalize this decade as younger households, some with children, move into homes currently occupied by empty-nesters and seniors. Study Area households, and particularly senior households, have experienced difficulty finding alternative housing in the community. The City has only recently experienced some significant housing development within the past three years (since 1998). This has not, however, been sufficient to satisfy pent-up demand for a variety of housing products in the Duluth market.

As noted in the most recent release of Census 2000 information, the rate of housing development in the State did not keep pace with increasing demand. The 12.0 percent rate of increase for dwelling units in the State was the lowest it has been since 1940 and yet in most areas of the State, including Duluth, still exceeded the rate of population growth for the period.

Population Age Distribution

Age distribution data for the Study Area’s population was updated on Table 3 showing figures for 1990, 2000 and 2006. The 1990 and 2000 data is from the US Census while the 2006 projections are from Claritas, Inc. a nationally recognized demographic services firm and were adjusted by Maxfield Research Inc. to reflect the most recent total population figures from the 2000 Census.

- The Study Area, like St. Louis County and Minnesota (and much of the nation) is growing older and will continue to do so into the foreseeable future as the baby boom generation ages.
- During the 1990s, the Study Area’s 25 to 34 population declined by roughly –3,200 people (-20.5%). Meanwhile, the 18 to 24 and the 35 to 44 cohorts both experienced population increases, 2,037 people and 371 people, respectively. The increase among 18 to 24 year olds is a result of increasing enrollments at local colleges and universities. Updated enrollment figures for 2001 and 2002 (after the Census) show strong enrollment increases in each of those years, further expanding the student age cohort in the Duluth area. According to information gathered by St. Louis County, student enrollment at local colleges and universities in Duluth and Superior Area since the 2000 Census has increased by 2,108 students.
- Enrollments at Duluth’s post-secondary institutions are expected to continue to rise during the 2000s due to the demographic growth of the echo boom generation and peak sometime after 2010. This age group (18 to 24) coupled with the entry-level renter population (age 25 to 34) typically accounts for the highest proportion of the renter population in the community.

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**TABLE 3
PROJECTED AGE DISTRIBUTION
Duluth Study Area
1990 to 2006**

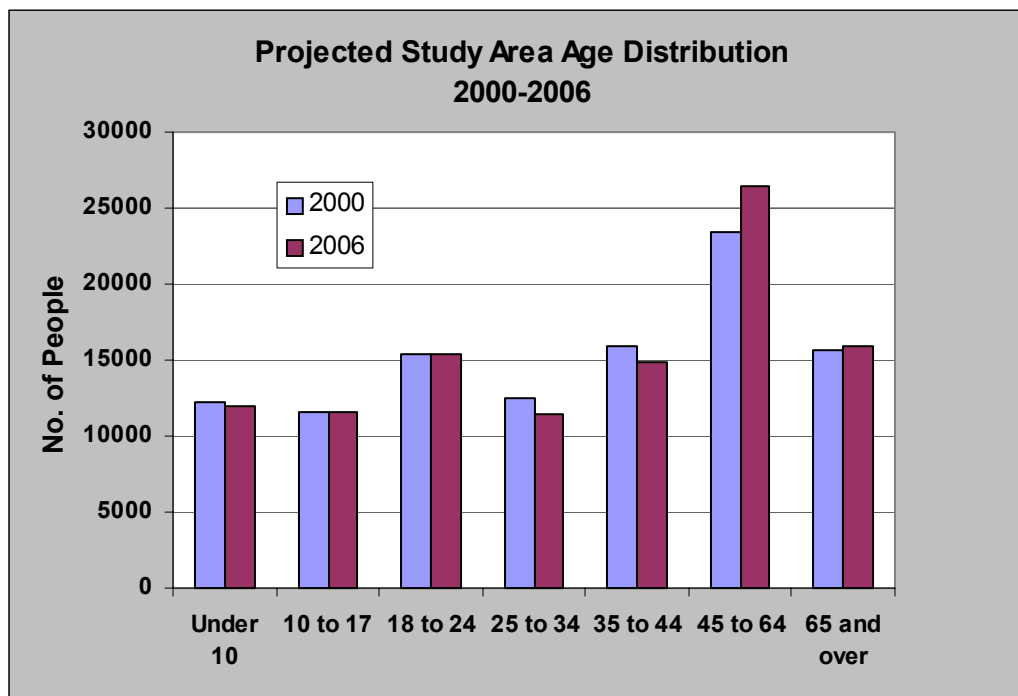
Age	U.S. Census		Claritas	Change						
	1990	2000	Forecast	1990-2000		2000-2006		1990-2006		
			2006	No.	Pct.	No.	Pct.	No.	Pct.	
<i>Duluth City</i>										
Under 10	11,235	9,619	9,297	-1,616	-14.4	-322	-3.5	-1,938	-17.2	
10 to 17	8,357	8,902	9,155	545	6.5	253	2.8	798	9.5	
18 to 24	11,898	14,038	13,500	2,140	18.0	-538	-4.0	1,602	13.5	
25 to 34	12,753	10,484	9,455	-2,269	-17.8	-1,029	-10.9	-3,298	-25.9	
35 to 44	12,202	12,222	12,182	20	0.2	-40	-0.3	-20	-0.2	
45 to 64	14,443	18,506	20,526	4,063	28.1	2,020	9.8	6,083	42.1	
65 and over	14,605	13,147	13,283	-1,458	-10.0	136	1.0	-1,322	-9.1	
Total	85,493	86,918	87,398	1,425	1.7	480	0.5	1,905	2.2	
<i>Remainder of Study Area</i>										
Under 10	2,738	2,661	2,618	-77	-2.8	-43	-4.6	-120	-4.4	
10 to 17	2,264	2,681	2,443	417	18.4	-238	7.3	179	7.9	
18 to 24	1,510	1,407	1,876	-103	-6.8	469	19.5	366	24.2	
25 to 34	3,022	2,059	2,025	-963	-31.9	-34	-49.2	-997	-33.0	
35 to 44	3,313	3,664	2,705	351	10.6	-959	-22.5	-608	-18.4	
45 to 64	3,684	4,968	5,937	1,284	34.9	969	37.9	2,253	61.2	
65 and over	2,129	2,489	2,641	360	16.9	152	19.4	512	24.0	
Total	18,660	19,929	20,245	1,269	6.8	316	7.8	1,585	8.5	
<i>Study Area Total</i>										
Under 10	13,973	12,280	11,915	-1,693	-12.1	-365	-3.1	-2,058	-14.7	
10 to 17	10,621	11,583	11,598	962	9.1	15	0.1	977	9.2	
18 to 24	13,408	15,445	15,376	2,037	15.2	-69	-0.4	1,968	14.7	
25 to 34	15,775	12,543	11,480	-3,232	-20.5	-1,063	-9.3	-4,295	-27.2	
35 to 44	15,515	15,886	14,887	371	2.4	-999	-6.7	-628	-4.0	
45 to 64	18,127	23,474	26,463	5,347	29.5	2,989	11.3	8,336	46.0	
65 and over	16,734	15,636	15,924	-1,098	-6.6	288	1.8	-810	-4.8	
Total	104,153	106,847	107,643	2,694	2.6	796	0.7	3,490	3.4	
Sources: U.S. Census Bureau, Claritas, Inc., Maxfield Research Inc.										

- The 45 to 64-age cohort had the largest increase during the 1990s, adding a total of 5,347 people (29.5%). The growth in this age cohort can be primarily attributed to the aging of the baby boom generation into their mid-age adult years. The oldest baby boomers have turned 56 in 2002. The youngest of this group is age 38. The majority of these households are in an age group where they consider move-up housing.

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- The number of seniors in the Duluth area decreased between 1990 and 2000. The Study Area lost nearly -1,100 seniors (-6.6%). During the 2000s, the number of seniors is forecast to increase slightly to 2006, an increase of 288 persons (1.8%). As the baby boom generation ages however, this group's numbers should swell considerably again after 2010.
- The age 10 to 17 cohort is projected to slow its rate of growth to 2006, as each successive five-year age cohort is smaller than the one preceding it. Through 2006, we expect that local high school enrollments will increase modestly and then decline as these smaller age cohorts in the Duluth area move through. The number of persons age 18 to 24 however, is expected to continue to increase locally due to increasing enrollments at local colleges and universities that have been attracting non-local students to the area. The substantial decline in rental vacancy rates in Duluth is evidence of this as local colleges and universities continue to actively recruit students. The 18 to 24-age population in Minnesota is expected to peak by 2010 and then decline thereafter. There are other factors, such as a higher proportion of high school students going onto post-secondary education that may continue to support higher enrollments beyond 2010.
- By 2010, we expect the number of persons under age 35 should begin to stabilize with some small increases likely thereafter as the echo boom generation moves through these younger age cohorts (age 18 to 35).

The following chart visually depicts the trends discussed in this section. As shown, growth is projected among older adults with some slightly growth among the senior population continued growth among the age 10 to 17 and 18 to 24 cohorts.



Duluth Metro-Area Population Projections

Table 4 presents population projections by age for the Duluth-Superior Metropolitan Area. These projections were recently released by Minnesota Planning, the State’s demographer and reflect figures for the Minnesota portion only of the Metro Area. The City of Duluth accounts for just over 40% of the population in the Metro Area. The projections show that the MN portion of the Duluth MSA is projected to increase its population by 5,400 people during the 2000s and by another 5,100 people during the 2010s. The majority of this increase is expected to occur among the aging baby boom population, the 45 to 64 age cohort.

**TABLE 4
PROJECTED AGE DISTRIBUTION
Duluth-Superior Metropolitan Area (MN Portion)
2000-2030**

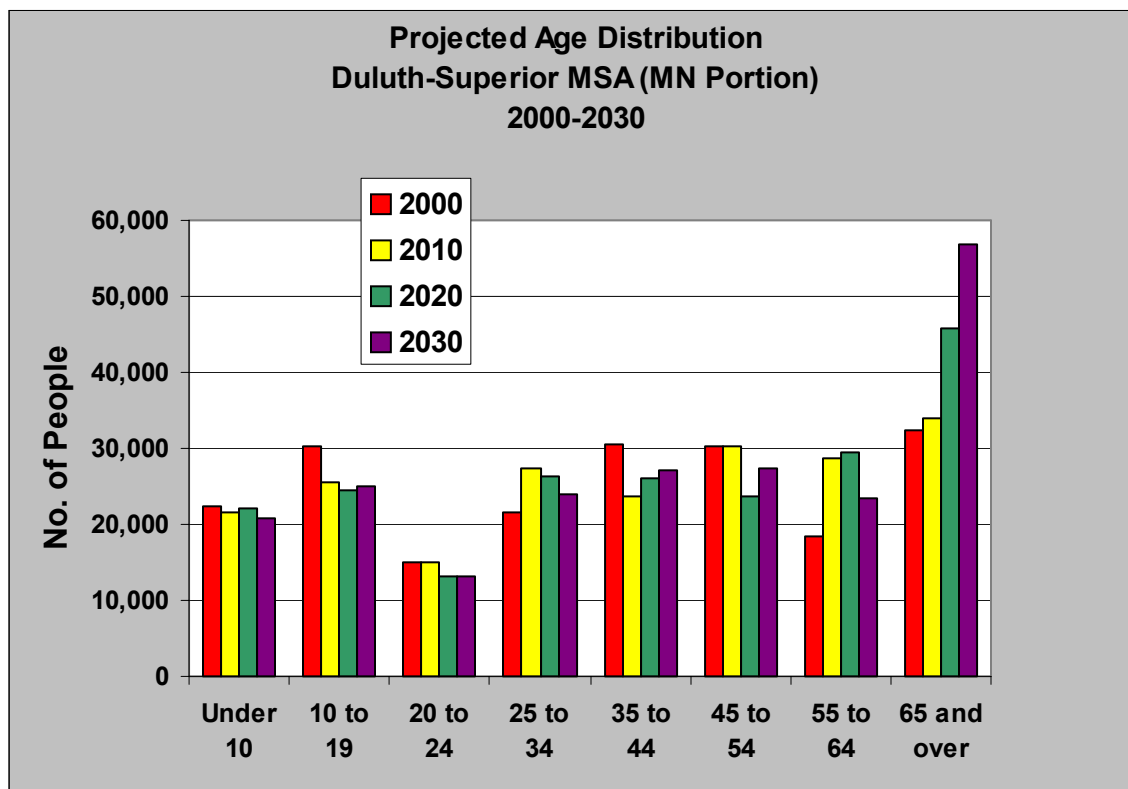
Age	U.S. Census 2000	MN Planning Forecast			Change					
		2010	2020	2030	2000-2010		2010-2020		2020-2030	
					No.	Pct.	No.	Pct.	No.	Pct.
Under 10	22,367	21,650	22,090	20,830	-717	-3.2	440	2.0	-1,260	-5.7
10 to 19	30,312	25,400	24,380	25,000	-4,912	-16.2	-1,020	-4.2	620	2.5
20 to 24	14,917	14,890	13,120	13,230	-27	-0.2	-1,770	-13.5	110	0.8
25 to 34	21,581	27,390	26,210	23,840	5,809	26.9	-1,180	-4.5	-2,370	-9.0
35 to 44	30,439	23,570	26,150	27,200	-6,869	-22.6	2,580	9.9	1,050	4.0
45 to 54	30,196	30,390	23,790	27,360	194	0.6	-6,600	-27.7	3,570	15.0
55 to 64	18,442	28,660	29,480	23,420	10,218	55.4	820	2.8	-6,060	-20.6
65 and over	32,274	33,940	45,770	56,910	1,666	5.2	11,830	25.8	11,140	24.3
Total	200,528	205,890	210,990	217,790	5,362	2.7	5,100	2.4	6,800	3.4

Sources: U.S. Census Bureau, MN Planning, Maxfield Research Inc.

The table shows the aging of the baby boom generation into their older adult and senior years beginning this decade and extending through 2030. This trend indicates there will be a growing demand for alternatives to the traditional single-family home as these households seek greater freedom for leisure pursuits. Cultural and social trends continue to encourage the demand for more conveniences. More divorces, fewer households with children, increased work hours, and a desire for more leisure time, has enhanced the popularity for housing offers less maintenance.

Not only are empty-nesters and seniors among those that are embracing multifamily housing alternatives, but young singles and couples with busy work lives and active social lives are also turning to multifamily housing as a desirable housing option.

While these two groups, at opposite ends of the spectrum, tend to prefer somewhat different product types (price points and features); they both are looking for the flexibility and convenience that this type of housing product can provide.



Household Incomes

Table 5 displays updated household income distributions for the Duluth Study Area for 2002 and 2007. This data was calculated using household distributions from the 2000 Census and from Claritas, Inc., a national demographic services firm and adjusted by Maxfield Research Inc. to reflect updated household projections based on Census 2000 information. This data is important in determining the size of the potential market that can afford specific price ranges. We consider housing to be “affordable” at a cost for households of 30 percent of income, which is the level used by the Department of Housing and Urban Development (“HUD”). However, it is also important to note that senior households are often able and willing to spend up to 40 percent of their income on housing, since they generally do not have as many expenses (i.e. child care, saving for children’s education retirement, etc.) as do younger households.

We also note that households with substantial equity in an existing home and households with annual incomes of \$75,000 and above often spend a somewhat smaller proportion of their income on housing, approximately 25% to 28%.

- As of 2002, the median household income among households within the Duluth Study Area was estimated to be \$51,855, up from \$49,861 as of the 2000 Census. Householders in the age cohorts 35 to 44 and 45 to 54 had the highest median incomes at \$56,100 and \$61,914. In most markets however, the majority of renters are younger than 34 and older than 65. The 2002 estimated median income of households age 15 to 24 is \$30,512 while households age

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25 to 34 is \$44,698. The 2002 median income of households age 65 to 74 was \$28,550 and households over age 75 had a median income of \$20,646.

- The median household income in the Study Area is expected to increase by 15.4 percent over the next five years to \$59,818. All of the age cohorts are expected to see increases in income, some more significant. Increases are projected to range from a low of 1.5 percent among householders age 65 to 74 to a high of 23.6 percent for households age 75 and over.
- Table 5 shows there are an estimated 6,885 households in the Study Area with incomes of \$75,000 and above who would be a potential market for upper-end for sale unit. Of those, 6,589 are between the ages of 15 and 64. We have excluded households age 75+, as many of these households often require support services. Households with incomes of \$40,000 or more would be able to afford rents of at least \$1,000 per month, allocating 30% of their income for housing costs. Depending on the location and features of housing in the Downtown, there is a substantial number of households in the Duluth area within sufficient incomes to afford housing priced at this level.
- According to the Duluth Area Association of Realtors, home prices climbed 10.3 percent in 2001 over 2000. Low mortgage interest rates have spurred home purchases, causing prices to rise in the wake of product shortages. In 2001, real estate sales agents in Duluth sold 2,032 homes, up from 1,958 homes in 2000. The median sales price of homes sold was \$98,200 as of 2001, up from \$89,000 in 2000. Low mortgage interest rates are also increasing the amount of home that buyers can afford.
- Seniors are willing to pay up to 40 percent of their income on housing that meets their needs. For some types of housing with intensive support services, seniors will pay up to 100 percent of their income and even spend down assets to avoid being placed in a nursing home.
- The primary draw area is projected to grow by about 557 households by the year 2007, with a greater proportion of the growth expected to occur among households in the upper income categories with incomes of \$75,000 and above. This indicates the potential for increasing demand for for-sale housing and market rate rental housing with a portion of those households likely to be attracted to units located within the Downtown.

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**TABLE 5
HOUSEHOLD INCOME BY AGE OF HOUSEHOLDER
DULUTH STUDY AREA
2002 & 2007**

Household Income in 2002	2002 Households by Age of Householder							
	Total	15-24	25-34	35-44	45-54	55-64	65-74	75+
Under \$10,000	4,809	802	476	706	712	626	507	980
\$10,000-\$14,999	3,770	546	523	418	331	306	550	1,096
\$15,000-\$24,999	6,253	883	1,086	928	737	544	792	1,283
\$25,000-\$34,999	5,890	547	966	1,252	781	745	782	817
\$35,000-\$49,999	7,202	448	1,476	1,604	1,418	806	824	626
\$50,000-\$74,999	8,287	255	1,299	2,299	2,315	1,136	619	364
\$75,000-\$99,999	3,818	63	419	971	1,375	545	290	155
\$100,000 or More	3,067	2	164	835	1,129	556	240	141
Total Households.	43,096	3,546	6,409	9,013	8,798	5,264	4,604	5,462
Median Income....	\$51,855	\$30,512	\$44,698	\$56,100	\$61,914	\$47,436	\$28,550	\$20,646
Household Income in 2007	2007 Households by Age of Householder							
	Total	15-24	25-34	35-44	45-54	55-64	65-74	75+
Under \$10,000	2,681	375	258	654	245	246	236	667
\$10,000-\$14,999	2,486	420	277	368	189	211	351	670
\$15,000-\$24,999	6,612	882	1,074	998	552	734	1,032	1,340
\$25,000-\$34,999	5,222	623	935	829	716	717	677	725
\$35,000-\$49,999	6,724	362	1,392	1,427	1,195	1,027	761	560
\$50,000-\$74,999	8,164	233	1,418	1,897	2,207	1,187	665	557
\$75,000-\$99,999	5,620	131	887	1,107	1,664	994	490	347
\$100,000 or More	6,144	118	952	1,233	1,705	1,075	809	252
Total Households.	43,653	3,144	7,193	8,513	8,473	6,191	5,021	5,118
Median Income....	\$59,818	\$35,500	\$50,996	\$64,152	\$70,200	\$55,456	\$28,981	\$25,509
Income	Change in Households by Age of Householder (2002 to 2007)							
	Total	15-24	25-34	35-44	45-54	55-59	65-74	75+
Under \$10,000	-2,128	-427	-218	-52	-467	-380	-271	-313
\$10,000-\$14,999	-1,284	-126	-246	-50	-142	-95	-199	-426
\$15,000-\$24,999	359	-1	-12	70	-185	190	240	57
\$25,000-\$34,999	-668	76	-31	-423	-65	-28	-105	-92
\$35,000-\$49,999	-478	-86	-84	-177	-223	221	-63	-66
\$50,000-\$74,999	-123	-22	119	-402	-108	51	46	193
\$75,000-\$99,999	1,802	68	468	136	289	449	200	192
\$100,000 or More	3,077	116	788	398	576	519	569	111
Total Households.	557	-402	784	-500	-325	927	417	-344
%	1.3%	-11.3%	12.2%	-5.5%	-3.7%	17.6%	9.1%	-6.3%
Median Income....	\$7,963	\$4,988	\$6,298	\$8,052	\$8,286	\$8,020	\$431	\$4,863
%	15.4%	16.3%	14.1%	14.4%	13.4%	16.9%	1.5%	23.6%
Sources: Claritas, Inc.; Bureau of the Census; Maxfield Research Inc.								

Household Tenure by Age of Householder

Table 6 presents data on the number of renter and owner households by age group within the primary draw area in 2000 from the U.S. Census. This information is useful in assessing the potential target market groups that are most likely to own and rent their housing. The following are the key points from the table.

- As of 2000, there was a total of 28,520 households that owned their housing in the Study Area, accounting for 68 percent of all households. The remaining households, 13,642, rented their housing, accounting for 32 percent of all households.
- Owner households are clustered among the middle and older age cohorts up to age 75, when the need for support services and a desire for freedom from ownership becomes more prevalent. Thus, households between the ages of 35 and 74 tend to own their housing in much higher proportions.
- As is shown on the table, these mid-age and older households own their housing in proportions ranging from 75 to 82 percent.
- Conversely, renter households are clustered in both the youngest and the oldest age cohorts. Also, the large number of students attending the University of Minnesota and the College of St. Scholastica affects the stability of and the demand within the local rental market. As of 2000, there was a total of 3,074 renter households between the ages of 15 and 24 (85.4%) and 2,891 renter households between the ages of 25 and 34 (46.2%).
- In more rural areas and regional centers in Greater Minnesota, the proportion of owner households age 25 to 34 tends to be higher than in the Twin Cities Metropolitan Area. This higher proportion of younger owner households reflects housing prices that are usually much lower and these households are somewhat less mobile. In addition, rental housing is usually scarcer.

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**TABLE 6
TENURE BY AGE OF HOUSEHOLDER
DULUTH STUDY AREA
2000**

Age	Duluth		Remainder of Study Area		Study Area Total		St. Louis Cty.		Minnesota		
	No.	Pct.	No.	Pct.	No.	Pct.	No.	Pct.	No.	Pct.	
15-24	Own	453	13.3	71	38.0	524	14.6	975	18.5	23,513	21.8
	Rent	2,958	86.7	116	62.0	3,074	85.4	4,298	81.5	84,249	78.2
	Total	3,411	100.0	187	100.0	3,598	100.0	5,273	100.0	107,762	100.0
25-34	Own	2,738	50.6	634	74.9	3,372	53.8	6,485	59.7	200,820	60.1
	Rent	2,678	49.4	213	25.1	2,891	46.2	4,369	40.3	133,169	39.9
	Total	5,416	100.0	847	100.0	6,263	100.0	10,854	100.0	333,989	100.0
35-44	Own	4,932	71.1	1,509	89.4	6,441	74.7	13,341	79.7	362,414	79.9
	Rent	2,004	28.9	178	10.6	2,182	25.3	3,398	20.3	90,901	20.1
	Total	6,936	100.0	1,687	100.0	8,623	100.0	16,739	100.0	453,315	100.0
45-54	Own	5,411	78.7	1,548	93.6	6,959	81.6	15,181	85.8	326,757	85.2
	Rent	1,468	21.3	106	6.4	1,574	18.4	2,506	14.2	56,857	14.8
	Total	6,879	100.0	1,654	100.0	8,533	100.0	17,687	100.0	383,614	100.0
55-64	Own	3,351	79.5	810	93.7	4,161	81.9	9,499	86.8	206,869	87.2
	Rent	866	20.5	54	6.3	920	18.1	1,445	13.2	30,343	12.8
	Total	4,217	100.0	864	100.0	5,081	100.0	10,944	100.0	237,212	100.0
65-74	Own	2,865	78.0	701	88.3	3,566	79.5	8,260	84.8	157,570	85.0
	Rent	829	22.0	93	11.7	922	20.5	1,480	15.2	27,764	15.0
	Total	3,694	100.0	794	100.0	4,488	100.0	9,740	100.0	185,334	100.0
75 +	Own	3,023	0.6	474	74.9	3,497	62.7	7,942	69.8	134,922	69.6
	Rent	1,924	0.4	159	25.1	2,083	37.3	3,440	30.2	58,979	30.4
	Total	4,947	1.0	633	100.0	5,580	100.0	11,382	100.0	193,901	100.0
Total	Own	22,773	0.6	5,747	86.3	28,520	67.6	61,683	74.7	1,412,865	74.6
	Rent	12,727	0.4	915	13.7	13,642	32.4	20,936	25.3	482,262	25.4
	Total	35,500	1.0	6,662	100.0	42,162	100.0	82,619	100.0	1,895,127	100.0

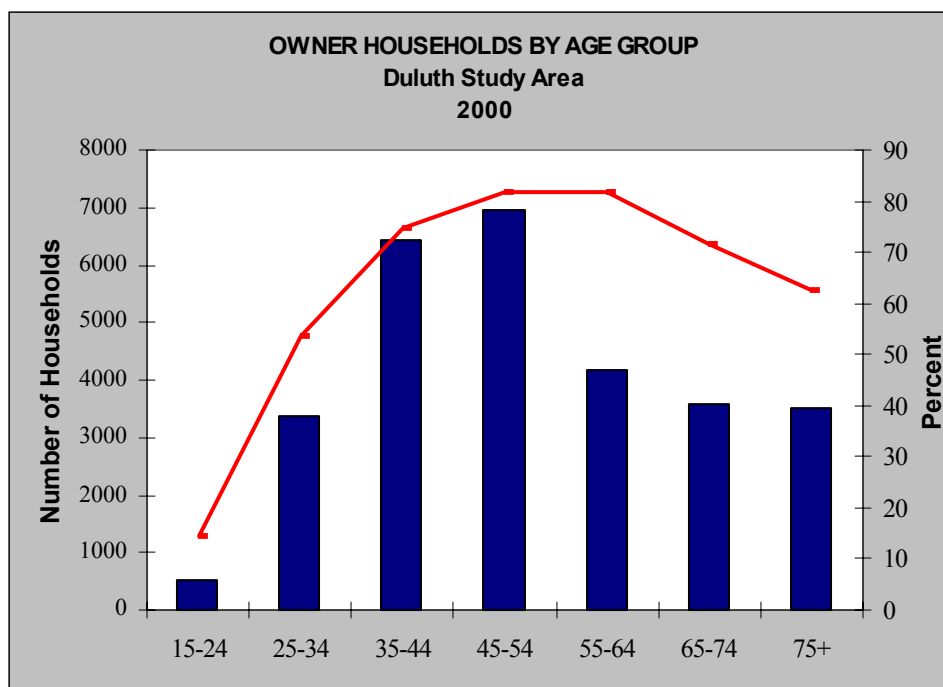
Sources: U.S. Census Bureau; Maxfield Research Inc.

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As the graph on this page shows, the propensity of a household to own its housing increases until it reaches its peak between the ages of 65 and 74 when it decreases again with older senior households (75+).

The younger age groups (predominantly renter) tend to be mobile, are more likely to be single, may not have yet accumulated a down payment for a single-family home or do not yet necessarily want to settle into homeownership. Seniors often no longer need the space of a single-family home, some travel frequently or have a second home in the warmer climates, and others just want/need to rid themselves of the burden of home maintenance.

- Younger households (age 15 to 34) are much more likely to rent their housing than any of the other age cohorts, and it is this group that comprises the largest number of renters in the Duluth Study Area (5,965 households), accounting for nearly 44 percent of all renters as of 2000. The 35 to 54 age cohort had the second most, accounting for 27.5% of renters. The significant number of renter households in this age cohort however, was due, in part, to the sheer size of this cohort that encompassed a large share of the baby boomers in 1990.



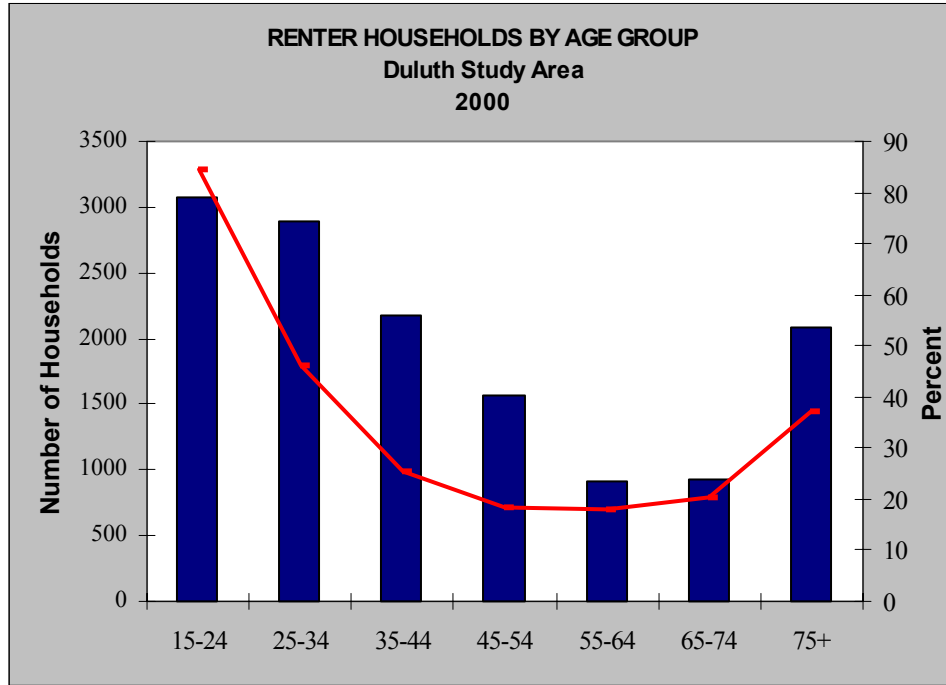


Table 7 shows a summary of the change in owner and renter households in Duluth city and in the remainder of the Study Area in 1990 and 2000 with a projection for 2005. This projection estimates based on household growth and planned development, the number and proportion of renter and owner households over the next five years.

The table reveals that the proportion of renter households in the Duluth Study Area is projected to remain stable over the next five years. Despite low mortgage interest rates and a strong for-sale housing market, there continues to be increasing demand for rental housing in the Study Area as university enrollments increase and as local employers continue to search for new hires from outside of the immediate Duluth area.

Comparing the age distribution trends presented earlier in this section to the propensity to rent figures stated above it would seem to indicate that demand for rental housing is at a lull with number of younger households stabilizing. We note however, that between 1990 and 2000, the number of renter households in the Duluth Study Area actually increased by a greater number than owner households, 652 renter households versus 484 owner households, documenting an increase in the demand for rental housing.

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**TABLE 7
HOUSEHOLD TENURE
DULUTH STUDY AREA
1990, 2000, 2005**

	1990				2000				2005			
	Own		Rent		Own		Rent		Own		Rent	
	No.	Pct.	No.	Pct.	No.	Pct.	No.	Pct.	No.	Pct.	No.	Pct.
Duluth	22,275	64.4	12,288	35.6	22,773	64.1	12,727	35.9	22,968	64.1	12,857	35.9
Remndr. Of Study Area	5,761	89.1	702	10.9	5,747	86.3	915	13.7	5,910	85.7	985	14.3
Study Area	28,036	68.3	12,990	31.7	28,520	67.6	13,642	32.4	28,878	67.6	13,842	32.4

Sources: Maxfield Research Inc.; Bureau of the Census

Employment Growth Trends

This section presents trends in employment growth for the Duluth Study Area including information on both place of residence and place of work employment. Maxfield Research Inc. also identified major employers in the Duluth Study Area and provides a review of employment growth trends at these firms from 1994 to 2002.

Labor Force (Place of Residence Employment)

Table 8 shows growth in the labor force, employment and unemployment for Duluth city and St. Louis County from 1990 through October 2002. This data is compiled by the Minnesota Workforce Center and documents the number of employed residents in a given area. This data is place of residence employment.

The following are key points from the Table 8.

- In Duluth, the labor force increased by 4,918 people through October 2002. Employment during the same period increased by 5,837, resulting in a net drop in unemployment of -919 people. The unemployment rate in the City declined consistently from 5.7% in 1996 to a low in 2001 of 2.5%. Due to a slowing in the economy and other worldwide events, unemployment increased somewhat in 2002 to 4.3% as of the end of June 2002, but declined again to 3.1% by October 2002. Duluth's unemployment rate has consistently remained below that of St. Louis County, which had an unemployment rate of 7.1% in 1990 and a 2000 unemployment rate of 4.5%. As of October 2002, St. Louis County's unemployment rate had decreased to 3.8%.

TABLE 8
ANNUAL AVERAGE RESIDENT EMPLOYMENT
DULUTH AND ST. LOUIS COUNTY
1990 through October 2002

Duluth City						
Year	Labor Force	Employment	Unemployment	Comparative Unemployment Rates		
				City	County	State
1990	41,118	38,794	2,324	5.7%	7.1%	4.9%
1995	44,191	41,870	2,321	5.3%	6.0%	3.7%
2000	44,577	42,656	1,921	4.3%	4.0%	3.3%
2002	46,036	44,631	1,405	3.1%	4.3%	3.5%
Change, 1990 through October 2002						
No.	4,918	5,837	-919	N/A	N/A	N/A
Pct.	12.0%	15.0%	-39.5%	N/A	N/A	N/A
St. Louis County						
Year	Labor Force	Employment	Unemployment	Comparative Unemployment Rates		
				County	Region	State
1990	93,245	87,097	6,148	6.6%	7.4%	4.9%
1995	100,583	94,883	5,700	5.7%	6.5%	3.7%
2000	103,110	98,512	4,598	4.5%	6.7%	3.3%
2002	106,849	103,075	3,774	3.5%	3.8%	3.5%
Change, 1990 through October 2002						
No.	13,604	15,978	-2,374	N/A	N/A	N/A
Pct.	14.6%	18.3%	-38.6%	N/A	N/A	N/A
Minnesota						
Year	Labor Force	Employment	Unemployment	Comparative Unemployment Rates		
				County	Region	State
1990	2,385,802	2,268,780	117,022	6.6%	7.4%	4.9%
1995	2,594,906	2,498,821	96,085	5.7%	6.5%	3.7%
2000	2,692,802	2,625,464	67,338	4.5%	6.7%	2.5%
2002	2,862,853	2,763,602	99,251	3.5%	3.8%	3.5%
Change, 1990 through October 2002						
No.	477,051	494,822	-17,771	N/A	N/A	N/A
Pct.	20.0%	21.8%	-15.2%	N/A	N/A	N/A
Sources: Minnesota Workforce Center; Maxfield Research Inc.						

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- In every case, the 1990s have experienced modest increases in the labor force, but more rapid gains in employment resulting in strong employment gains. The strong economic growth experienced by the region and the nation as a whole up until the 4th Quarter of 2001 continued to place pressure on employment. An unemployment rate of 4.5% is considered to indicate full employment. With a current unemployment rate at 3.1%, Duluth is now considered to be once again below full employment, with labor shortages noted particularly in the health care industry.

- Although the sizeable student population helps to support the labor force in the community, particularly with respect to service positions, there continues to be a shortage of skilled workers in specific job categories, which acts as a constraint to future employment growth. Labor shortages coupled with a tight housing market, rental and owner-occupied, is likely to constrain economic development over the long-term. Efforts to create a technology incubator, business expansions, new housing and links to education will assist the community in creating the skilled labor and infrastructure necessary to sustain new employment growth.

Employment by Industry (Place of Work)

Table 9 shows employment growth by industry or the number of jobs in a given area from 2000 to 2001. This data represents employment covered by worker's compensation and as such, excludes smaller classes of workers such as railroad workers, workers of very small farm operations, among others. This data is also compiled by MN Workforce Center. Also shown is the average weekly wage for the various industry sectors.

The table shows that Education and Health Service, Government, and Finance/Insurance/Real Estate Sectors added the greatest number of jobs over the past year. Conversely, job declines were noted in Manufacturing, Trade, Professional and Business Services and Agriculture and Construction. Duluth experienced a net loss of -287 jobs during this period.

Nevertheless, there has been job growth in some sectors. Health care and education industries have continued to post job increases. Among the major hospitals, there are currently jobs that are unfilled due to a shortage of skilled workers. The health care sector of the Duluth economy is growing and actively recruiting employees. A major expansion planned for SMDC will bring even more jobs to Duluth. In addition, SMDC's decision to locate its new facility closer to the Downtown will increase the potential demand for housing. A portion of these new workers are likely to be interested in living in the Downtown, within walking distance of work, entertainment, restaurants, and other goods and services. St. Luke's Hospital and Regional Trauma Center is also planning a revamping of its campus and is expected to continue to focus its efforts on attracting physicians with highly specialized skills. St. Luke's is currently undergoing planning efforts to develop a master plan for its facilities over the next few years.

The continued growth projected for the Health Services sector in Duluth will bring increased opportunities to provide additional housing and more housing located in close proximity to these employment centers. The Downtown and Canal Park areas with their base of retail, entertainment and other services are prime locations to attract a portion of new employees from the medical employers.

**TABLE 9
COVERED EMPLOYMENT TRENDS
CITY OF DULUTH
2000 TO 2001 (3rd Quarter)**

	Estimates		Avg. Weekly Wage		Change-# of Jobs	
	No. of Jobs		2000	2001	2000 to 2001	
	2000	2001	2000	2001	No.	Pct.
Agriculture ¹ and Construction*	2,420	2,353	\$769	\$948	-67	-2.8
Manufacturing	3,389	3,277	\$697	\$727	-112	-3.3
Trade and TCU ²	11,426	10,730	\$516	\$555	-696	-6.1
FIRE ³	2,767	3,063	\$812	\$952	296	10.7
Services						
Professional/Business Serv.	4,427	4,140	\$572	\$628	-287	-6.5
Education/Health Serv.	12,275	12,768	\$642	\$684	493	4.0
Leisure/Hospitality Serv.	6,669	6,760	\$229	\$217	91	1.4
Other Services	3,975	3,746	N/A	\$344	-229	-5.8
Government	10,867	11,091	\$685	\$724	224	2.1
Total/Average	58,215	57,928	\$581	\$612	-287	-4.1

* 2000 figures exclude agriculture category while 2001 figures include it.

¹ Agriculture, Forestry, Fishing, and Mining

² Transportation, Communication, and Utilities

³ Finance, Insurance, and Real Estate

Sources: Minnesota Workforce Center
Maxfield Research Inc.

Over the next ten years, the Services sector is projected to continue to experience the strongest employment growth as our economy moves toward a predominantly service-based function. From 1990 to 2000, Duluth city added 5,766 jobs in the Service sector, followed by 1,428 jobs in Retail Trade. During the 2000s, the City is projected to continue to add the greatest number of jobs in these two categories, followed by relatively strong growth in Government and Wholesale Trade as well. Similar trends are forecast for St. Louis County and Minnesota although the State as a whole is projected to have a greater increase in manufacturing jobs. These jobs will, no doubt, be located in a region other than Northeastern Minnesota.

Major Employers

Table 10 shows the major employers in the Duluth Study Area with total employment figures as of 1994, 2001 and 2002. This information was compiled through a survey of existing employers and database information on publicly and privately held companies in Minnesota and the Region.

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**TABLE 10
MAJOR EMPLOYERS
DULUTH STUDY AREA
June 1994 to June 2002**

Name of Company	Product/Service	June '94	May '01	June '02
		# Empl.	# Empl.	# Empl.
		Total	Total	Total
Duluth Employers				
St. Mary's/Duluth Clinic	Hospitals and Nursing Homes	2,200	3,782	3,800
Duluth Public Schools-ISD #709	Elementary & Secondary Schools	2,500	2,700	1,700
St. Louis County	Government Offices	2,325	2,140	1,640
University of Minnesota-Duluth	Post-Secondary Education	1,450	1,871	1,571
Duluth Clinic, Ltd.	Physician's Offices	1,400	1,393	N/A
City of Duluth	Municipal Offices	930	1,060	1,060
St. Luke's Hospital	Surgical Hospital	1,300	1,378	1,143
US Post Office-Main	Mail Delivery	440	930	930
US Government	Government Offices	N/A	970	850
Uniprise (United Health Care)	Insurance	N/A	N/A	900
Miller-Dwan Medical Ctr.	Surgical Hospital	775	800	325
Allete (Minnesota Power)	Electric Utility	960	796	768
Cirrus Design	Aircraft	N/A	N/A	550
Minnesota Air National Guard	Armed Forces	1,050	1,050	450
USPS Remote Encoding Center	Postal Encoding	N/A	N/A	450
College of St. Scholastica	Post-Secondary Education	N/A	545	425
Wells Fargo Bank	Banking	N/A	N/A	425
Grandma's Restaurants	Restaurants	N/A	N/A	450
Georgia Pacific	Paper Mills	N/A	399	175
Northwest Airlines	Aircraft	N/A	N/A	450
MN Department of Transport.	Government-Transportation	440	240	200
Benedictine Health Systems	Nursing Homes	N/A	N/A	290
ZMC Hotels	Hotels, Motels	N/A	N/A	325
Stora Enso	Paper Mills	N/A	N/A	325
Monson Trucking	Trucking	N/A	N/A	225
Luiginos	Eating Places	N/A	N/A	240
Perkins Family Restaurants	Eating Places	N/A	N/A	265
Duluth News Tribune	Newspapers	N/A	N/A	235
Target	Department Stores	N/A	N/A	275
Advanstar	Publishing	340	325	309
Total Employment		16,110	20,379	20,751
Remainder of Study Area				
Proctor School District #704	Elementary & Secondary Schools	210	220	300
Iron Range Railroad	Railroads, Line Hauling	200	300	300
Wal-Mart	General Mdse. Retail	170	150	150
Natural Resource & Research Inst.	Commercial Physical Research	N/A	140	140
Curtis Oil & Tire	General Auto Repair	N/A	110	120
Menards	Building Supplies & Hardware	80	90	154
Sam's Club	General Mdse. Retail	72	70	142
Eggebrecht Chevrolet	Auto Sales	65	65	70
Blackwoods Bar and Grill	Restaurant	N/A	35	88
Knox Lumber	Building Materials	42	40	50
Arrowhead Concrete	Concrete Products	20	25	25
Total Employment		859	1,245	1,539
Duluth Study Area		16,969	21,624	22,290
Sources: MN Dept. of Trade and Economic Development, Maxfield Research Inc.				

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- The table shows that despite some declines job declines among existing major employers in the area, several new larger employers have been added to the table over the past two years, including Northwest Airlines, Stora Enso, Uniprise and ZMC Hotels, among others. In total, major employers in the Duluth area now have a total employment base of roughly 22,900 employees. Some companies reduced their workforce while others increased.
- Duluth has become a regional health care center serving all of Northern Minnesota and portions of Central Minnesota. Three hospitals are located in Duluth, unusual for a city of its size. In fact, all of these facilities are within walking distance of each other, located in the East Hillside and East End districts of the City and are near to the Downtown commercial core.
- The Duluth Clinic, which combined with St. Mary's Hospital, houses physicians' offices, also employs a substantial number of people.
- Other major employers include Federal government offices, city and county government, the public school system and the University of Minnesota.
- Other major employers in the Study Area outside of Duluth include primarily manufacturing businesses and large retail and wholesale outlets.

Commercial Construction

Table 11 shows the number of permits and valuation of commercial and industrial construction in the City of Duluth from 1996 through 2001. This table includes large parking garages, but excludes single structure garages.

Type of Structure	1996		1997		1998		1999		2000		2001	
	No.	Valuation	No.	Valuation	No.	Valuation	No.	Valuation	No.	Valuation	No.	Valuation
<i>Commercial/Industrial</i>												
Recreation	1	\$87,948	1	\$32,000	0	\$0	3	\$13,623,721	2	\$609,000	1	\$30,000
Churches/Religious	2	\$1,131,000	1	\$293,000	2	\$918,715	1	\$400,023	0	\$0	0	\$0
Industrial Bldgs.	3	\$806,000	6	\$4,567,000	0	\$0	3	\$1,037,891	3	\$1,050,000	2	\$510,000
Service Station/Auto Repair	0	\$0	0	\$0	0	\$0	0	\$0	1	\$125,000	0	\$0
Parking Garages	1	\$6,307,794	0	\$0	0	\$0	2	\$8,925,000	1	\$458,000	0	\$0
Hospital/Institutional	0	\$0	3	\$1,008,990	0	\$0	0	\$0	1	\$2,824,000	1	\$825,000
Office, Bank, Professional	3	\$1,010,000	4	\$1,760,000	4	\$4,318,051	8	\$14,758,000	4	\$9,158,000	1	\$392,000
Public Works/Utility	1	\$1,250	0	\$0	1	\$49,920	2	\$18,331,149	1	\$581,652	0	\$0
Schools/Educational	0	\$0	1	\$35,000	1	\$59,000	0	\$0	0	\$0	1	\$2,500,000
Stores	5	\$1,000,500	10	\$2,742,949	2	\$1,746,500	3	\$857,517	6	\$6,793,986	1	\$780,000
Other Buildings	23	\$312,997	35	\$611,369	21	\$481,880	25	\$655,935	26	\$1,024,208	25	\$759,738
Hotels, Motels	1	\$1,827,500	0	\$0	1	\$1,300,000	3	\$6,406,782	0	\$0	0	\$0
Structures, Not Buildings	7	\$49,341	9	\$745,708	10	\$885,915	5	\$1,723,165	5	\$305,980	0	\$0
Total	47	\$12,534,330	70	\$11,796,016	42	\$9,759,981	55	\$66,719,183	50	\$22,929,826	32	\$5,796,738

Source: Duluth Building Inspections

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The table reveals that the City has experienced a considerable amount of commercial/industrial construction over the past five years. While the number and valuation of permits has fluctuated over the period, activity has, nevertheless, remained strong.

Retail and office development was strong with nearly 50 permits issued with a total valuation of more than \$44.0 million. Five new motels have also been built during this period. The year of greatest construction was 1999, followed by 2000. Commercial construction dropped again in 2001 to only about \$5.8 million. This is usually typical in communities that have experienced several years of strong growth. Also, a slowing in the economy has likely constrained new commercial development to some extent. We believe that commercial and industrial development will increase as the economy strengthens.

Summary of Demographic and Economic Trends

The following paragraphs summarize the key points from the demographic analysis that have the greatest potential to impact potential housing development in Duluth in general and in Downtown Duluth specifically.

- The population decline that occurred in Duluth during the 1980s reversed itself during the 1990s due to strong economic and household growth in the community. Projections show the Duluth area to gain another 1,326 people during the 2000s, compared to a loss of -7,450 people during the 1980s. Much of the gain during the 2000s will be due to new household formations by younger households and increased redevelopment activity within the City and in the Study Area.
- Household growth reversed itself during the 1990s, from a decline during the 1980s to positive growth during the 1990s. This growth is expected to continue during the 2000s, with the Duluth area forecast to add about 1,116 households, a growth rate of 2.6 percent.
- The Duluth area has an aging population with the greatest growth projected to occur among people age 55 to 64 over the coming decade. It is this group that presents a strong potential for alternative housing, a specifically for-sale housing in the Downtown. There is a growing trend toward greater mobility among this age group and we are continuing to see households within this age group choose greater flexibility in their lifestyle.
- Household incomes are increasing, however the median household income in the Duluth area remains modest, \$42,000 as of 2002. As of 2002, there were an estimated 6,560 households in the Duluth area with incomes of less than \$15,000 annually. By 2007, the median household income in the Study Area is projected to increase to \$50,975 with only 4,319 households with incomes of under \$15,000.
- Employment growth in the Study Area was strong during the 1990s. Although we believed that the unemployment rate in Duluth had bottomed out in 1998 at 3.5%, at the end of 2001, the rate hit a new low at 2.5%, the lowest rate in more than 20 years. A slowing in the economy regionally and nationally caused the unemployment rate to increase to 4.3% as of

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the end of 2nd Quarter 2002, but this rate decreased again to 3.1% as of October 2002. Strong growth in the Services and Retail Trade Sectors fueled employment gains in the area and this situation is expected to continue during the 2000s, albeit slightly more slowly that occurred during the late 1990s. Much of the previous job growth and the most recent job increases have occurred in health care, a strong industry in the region.

- Commercial construction experienced an unprecedented boom in 1999 with a total valuation in permits issued of \$66.9 million in new structures, excluding garages, but including municipal and private parking structures. This figure greatly surpasses the annual valuation in each of the past four years. Commercial construction tapered-off somewhat in 2000, following the boom in 1999, but nevertheless, experienced the second highest valuation total of the five-year period at \$22.9 million. Construction in 2001 was down again, valued at \$5.8 million, most likely a result of the softening economy. We expect commercial development to increase again as the economy strengthens.
- The growth in the household and employment bases, the recent strong investment in the economic infrastructure of the community however, indicates a very positive upward growth trend. Although this growth may be slowed slightly due to a recovering economy, we project that as the region recovers, job growth will again accelerate. We note too, that the housing markets in Duluth, both for-sale and rental have not been negatively affected by the sluggish economy. Rental vacancies have remained low and for-sale housing prices continue to increase.
- Tourism in the Duluth region has escalated dramatically during the 1990s and the community has capitalized on this with the redevelopment of the Lake Walk and warehouse district near Canal Park and the Aerial Lift Bridge. Most recently, remaining land near the Aquarium on the Bayfront is being considered for additional development. New hotels, national chain restaurants and other specialty shops have opened, creating a regional tourist attraction. The annual Grandma's Marathon, which attracts athletes from all over the world, has placed Duluth on the global radar screen. This trend shows no signs of diminishing.

Introduction

This section presents an overview of current housing market conditions in the Duluth Area and discusses housing in Downtown Duluth. This section provides information on residential construction trends, recent home resales as of year-end 2001, and current rental housing conditions and pending housing developments in the Downtown. A substantial portion of the City's housing stock was built prior to 1940. As a result, renovation and revitalization of the City's housing stock, and particularly within the Downtown core neighborhoods, has become a vital issue during the 1990s and continues to be a key issue now in the 2000s.

Residential Construction

Table 12 shows residential construction from building permits issued in the City of Duluth from 1996 through 2001. The table reveals that Duluth city has experienced increasing construction of residential units over the past four years, testament to the strong demand for housing in the community. Most recently, several multifamily buildings have been erected. However, the majority of this housing has been targeted to seniors only and has included independent and assisted living senior housing. Very few apartments have been built for general occupancy.

The table shows that permits were issued for a total of 670 units, including 317 single-family homes. The majority of these units have been built on land over the hill. Very little new residential development has occurred in the central city. There is one multifamily building (approximately 40 proposed units) located at 9th Avenue East on 2nd Street East that has been under construction for more than five years. The property was designed to fit with the character of the older surrounding multifamily buildings. The developer experienced financial difficulties and the building currently stands vacant. It is uncertain at this time what will happen to the building.

Permits were issued for an average of 134 units annually over the five-year period. There was a significant increase in the number of residential permits issued in 1998 and 1999. The number of permits issued in 2000 declined somewhat, most likely due to an increase in mortgage interest rates during this period. According to recent interviews with local real estate sales agents and builders, housing demand remains strong. In 2001, residential construction again increased with a total of 94 new single-family homes built. Again, the lower mortgage interest rates played a role in this new development.

DOWNTOWN HOUSING MARKET SITUATION

**TABLE 12
RESIDENTIAL CONSTRUCTION
CITY OF DULUTH
1996 through 2001**

Type of Structure	No. of Units					
	1996	1997	1998	1999	2000	2001
<i>Residential</i>						
Single Family Dwelling	38	59	80	81	59	94
Townhouse	4	0	0	0	0	0
Duplex	10	0	4	4	2	4
3-4 Units	0	3	3	0	44	12
5+ Units	0	0	78	201	0	0
Total	52	62	165	286	105	110
<i>Total Demolitions</i>	0 units	10 units	0 units	0 units	8 units	N/A
* One building developed with 5+ units; total number of units not known.						
Sources: City of Duluth, Building Inspections; Maxfield Research Inc.						

Downtown Residential Environment

Downtown Duluth is home to a number of older buildings, some of which have been given a formal historic designation. Some of these older buildings originally provided housing to Duluth workers even prior to 1900. A number of these buildings still stand today in the Downtown.

There are more than 1,500 housing units located in and on the periphery of the Downtown, but most are targeted to serving households with low- and moderate incomes. Some older buildings with deferred maintenance have de facto become low-income housing. Some of these properties have been developed specifically to meet the needs of households that require additional lifestyle assistance. Many of these households prefer to be in the Downtown in order to be close to service providers, public transportation and other services.

There is a very limited amount of new housing (renovated) that is market rate either for-sale or for rent. In part, this situation arose because of a mismatch between achievable market rents/sales prices, the high cost of developing residential units in small buildings, and a lack of parking, among others. In addition, the demographic characteristics of the population did not sufficiently support Downtown housing.

Strong employment growth in the 1990s, a growing base of professionally employed workers, changing lifestyles and an aging population (growth in the baby boom cohort) has led to increased interest in alternative housing and in housing that would be located in the Downtown.

DOWNTOWN HOUSING MARKET SITUATION

Housing in the Downtown offers several benefits yet presents several challenges. The Central Business District is situated in close proximity to Lake Superior. Views of Lake Superior from areas east of Lake Avenue are striking. Views of the Harbor are also extremely attractive, although more obstructed. The Downtown is connected to many buildings via skywalk and Canal Park and the Lake Walk provide a substantial amount of recreational and entertainment opportunities for both tourists and area residents. The challenges include identifying buildings and/or spaces suitable within buildings to create housing, creating a sufficient amount of housing to achieve a “critical mass,” creating housing that will meet the market demands for price/features/location, and creating momentum to initiate a revitalization of the Downtown.

There is currently a perception that housing in the Downtown is only for low- and moderate-income households. In part, this perception is supported by the greater amount of this product that is located in the core of Downtown. Community and Federal financial incentives have traditionally focused on providing assistance for households that would not otherwise have been able to afford “market rate” housing. What has occurred however, is that the upper middle-income groups, those who could afford to pay rents of between \$700 and \$900 per month for rental housing or those who could afford to purchase a unit priced between \$150,000 and \$250,000 have been excluded from the market because housing developers have not been able to produce this housing in sufficient quantities or in any quantity in the Duluth market to make it economically viable.

For-Sale Housing Market

The for-sale housing market in Duluth remains tight, with strong demand in the mid-price ranges and very little housing available. According to recent figures released by the Duluth Association of Realtors, the median home price in Duluth as of 2001 was \$98,500, up from \$89,000 in 2000, an increase of 10.7%. Low mortgage interest rates have allowed more households into the for-sale market. As a result, the prices of the limited supply are being bid up. According to the 2001 Housing Market Indicators report, compiled for Duluth, a total of 800 new housing units will be needed over the next decade to support projected demand, including demand from new household growth and replacement needs. Currently, the City has been producing roughly 58 units per year, insufficient to meet the demand.

- Housing construction has been constrained by a number of factors, some unique to Duluth. These factors include:
- Limited land availability in the central city for new construction;
- Difficult topography in many areas of the City restrict the number of sites suitable for new construction;
- Soil conditions (bedrock) limiting developable sites;
- Constrained by westward growth (Lake Superior forms eastern barrier);

DOWNTOWN HOUSING MARKET SITUATION

Within the past three years, a very few housing units (less than ten units) have been developed by private local developers with price tags targeted to upper-income individuals. These units, priced at \$400,000 and above, have sparked additional interest from other empty-nesters and young professionals also interested in a similar product.

A building located at the corner of Superior Street and Lake Avenue is under renovation and is likely to be available for occupancy in 2003. The building will contain two condominium units (for-sale) above retail space on the first floor. The retail space on the first floor is tentatively leased to a tenant. The condominium units are expected to sell for roughly \$400,000 each. The developer also has plans to renovate the adjacent building to the west again to condominiums. The building to the west may potentially house three to four units, but no formal building layouts have been completed. Views of the Lake will be virtually unobstructed. Because the building sits on the corner, the units will have windows on two sides.

Most of those we spoke with believed there would be a greater market for for-sale housing in the Downtown than for rental housing. The potential target markets for for-sale housing, mid-age professionals and empty-nesters would be more likely to want to purchase, rather than rent their housing. Again, the proportion of homeowners in these age groups (45 to 64) tends to be higher, 80% or greater. Many have an existing home they may want to sell. The housing market is a seller's market currently. A portion may have a second home or seasonal cabin elsewhere.

Again, these potential homeowners will desire certain features and amenities if they are to purchase a unit in the Downtown, particularly, if they purchase a unit at an upper-end price point. Unit size will be important, however typically the square footage of a unit is balanced against other desirable features and amenities such as high ceilings, large windows, plenty of natural light, hardwood floors/woodwork, upscale unit finishes, water views, secured building, convenient, secured parking, elevator (if multistory building), and convenient to retail goods and services.

Rental Housing

Maxfield Research Inc. identified one upscale rental property, The Harbours, located in Downtown on Michigan Avenue. Units at The Harbours are connected by skywalk to Downtown office buildings and to the Arena/Auditorium complex. The tenant profile of the property is primarily mid-age professionals, empty-nesters and young seniors who prefer the convenience that this option offers. Several of the residents have homes located elsewhere in the United States or lake cabins near Duluth. Some of these residents may have been willing to purchase their housing, but there were few if no options available at the time they made their decision. Rents at the 38-unit Harbours range from \$800 to \$1,400 per month for one-, two- and three-bedroom units. Parking is available in a secured garage/ramp below the building.

There is a wide variety of rental housing options within the Downtown area. Many of the buildings are older and offer, few if any amenities. Some exhibit a substantial amount of deferred maintenance. Some apartment units are housed in 1960s and 1970s buildings, serving

DOWNTOWN HOUSING MARKET SITUATION

low and moderate-income seniors and others serve the general market, again targeted to a low and moderate-income household.

Some of the rental housing in Downtown and in areas adjacent to the Downtown is a result of the older age of the housing stock. Its older age and lack of maintenance has de facto created low-income housing. Despite the fact that some of this housing is currently being renovated, it does not provide the modern features and amenities desired by most of today's renters, and particularly upper-income renters. Thus, the current Downtown housing stock is not likely to attract an upper-income clientele because the housing product is missing. There are likely some market rate rental units located above some retail spaces in the Downtown. These units may have attracted young to mid-age households that prefer a "unique" living environment and have found a place that suits their needs. The number of these units however, is small and there is not a clear massing to suggest that there is a growing number of households living in the Downtown.

New market rate rental housing is currently marketing in the East End of Duluth and in Hermantown. Rents range from \$825 to \$895 per month for two-bedroom units. According to the developer, although these rents are market rate, they remain roughly \$50 to \$100 per month below what should be charged in order to cover all costs and receive a reasonable rate of return on investment.

In September 2002, the St. Louis County Planning Department conducted a survey of larger rental buildings in the Duluth area. Findings were published in *2003 State of Housing: Facts and Figures*. According to the survey, the overall rental vacancy rate in Duluth was 2.6% as of September 2002. This is below the level needed to support market equilibrium (5.0%) that would allow sufficient consumer choice and turnover. This vacancy rate excludes new units that are in their initial lease-up period. The vacancy rate for owned housing units is even lower.

The rental survey also identified vacancy rates by rent range. The survey found the highest rental vacancies among units at the lowest end of the rent spectrum with rents of less than \$300 per month. Among units ranging in price between \$800 and \$1,200 per month, vacancies were the lowest. We note however, that the number of units surveyed in this price range accounted for 12% of all units surveyed.

Construction of new market rate rental housing in the Downtown, depending on the building and the site, is likely to require monthly rents of between \$900 and \$1,500 per month. Although we believe there is a modest market for rental units at this price level, renters willing and able to pay these rents also insist on certain features and amenities in the units such as full kitchen appliance package, elevator if multistory building, walk-in closets, large windows with natural light, covered or reserved parking (secured), convenient access to goods and services and attractive views, potentially of the Lake/Harbor or Downtown. These features must be provided in sufficient quantity to support the rental value. We note also, that a development with less than 20 units would be unlikely to achieve monthly rents even at this level. Many of the existing buildings in the Downtown that possess view of the Lake could accommodate no more than a small handful of units. A few of these units, if equipped with all of the amenities and located in a desirable area, could command rents of \$1,500 per month. We note however, that the potential market for units at this price point would be very limited. Additional constraints of living in a

DOWNTOWN HOUSING MARKET SITUATION

building with few units and isolated would also inhibit the ability to lease at the higher rate. Most people prefer to be located in a building with more than just one or two units as it increases the sense of security.

Pending Downtown Residential Developments

George Sherman Associates of Minneapolis is currently planning to develop nine units of market rate rental housing in an existing building in the Canal Park area of Duluth. The units would be located above ground floor commercial space. The developer was forgiven an existing loan with the City in order to be able to develop these units at a price point necessary to meet market demand. Rents have not been determined as yet but are likely to begin at \$850 or \$900 per month for a one-bedroom unit. Units are scheduled to come on-line sometime in late 2003 or in 2004.

Bruce von Riedel and Jim Jarocki are in the process of completing the renovation of a building at the corner of Lake Avenue and Superior Street. There will be two condominium units, one each on the 2nd and 3rd floors of the building with garage parking built in the back of the building. The ground floor will be leased for retail. They plan also to renovate the building adjacent to the west into additional for-sale units with some retail on the first floor. The condominium units are planned to be ready in 2003. The development timing of the second building is uncertain.

The City of Duluth has solicited RFPs from qualified developers to redevelop the former Bridgeman Russell Building on 1st Street West to housing. The City is currently working with the preferred developer on a plan for the building's redevelopment. It is likely that the units will be market rate rental, although this is undecided. This building may accommodate between six and eight units.

Suitability of Downtown Buildings for Housing

In the past three years, a very few housing units have been developed by private local developers with price tags targeted to upper-income individuals. These units have sparked additional interest from other empty-nesters and young professionals also interested in a similar product.

There is a considerable amount of vacant commercial space in Downtown Duluth, currently more than 200,000 square feet. Some of the vacant space is located in traditional office buildings and some is located in older buildings situated on the fringe of the Downtown or in Canal Park that have features and a location that would be attractive for residential units. These features include high ceilings, large windows, concrete or hardwood floors, historic architecture, unobstructed views of Lake Superior, close proximity to employment and/or entertainment concentrations.

Challenges associated with converting space within existing properties to housing include:

- historic designation limits exterior changes;

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buildings that have received historic designations cannot change the exterior facades of the buildings; windows must conform to specific requirements and nothing may be attached to the outside of the building such as balconies.

- small floor plates and buildings that have only two or three stories limit the number of units that can be created to achieve economies of scale;

there is often a trade-off between designing a few larger size units and pricing these units at the high end of the market to cover the necessary costs, versus creating smaller size units and thus, positioning the units to appeal to a more price-sensitive target market; there are benefits and challenges to both options that requires careful consideration being given to other factors such as views, adjacent uses, and building characteristics. Floor plan designs are sometimes unusually configured to accommodate existing support beams, plumbing and heating systems, among other structural items.

Higher construction costs overall to retrofit existing buildings (especially with today's building codes);

Building renovations can result in significantly higher construction costs; many cities today, wanting to preserve existing historic structures and realizing the limitations involved in converting these older buildings to alternative uses, have begun to develop specific codes designed to address the unique characteristics associated with retrofitting these buildings. Although safety of building occupants remains of paramount concern, communities are finding ways to meet both safety codes and provide for reasonable upgrades to enable these buildings to function to contemporary standards.

- limited or no parking (almost no covered parking).

Providing sufficient parking is always a key issue in developing housing in urban areas, regardless of whether the building is older and renovated or is new construction. Certainly, creating parking in older historic buildings can be very problematic and expensive. Usually, the higher the price of a residential unit, the greater the desire for parking that is enclosed and in close proximity to the unit. Security and safety of parking areas are also critical issues in developing residential units in Downtown areas.

Housing units can be developed in these buildings. Because of the limitations however, the price point of most of these units will target upper-income households, those with annual incomes of \$75,000 or more with sales prices of approximately \$400,000+ or annual incomes of \$45,000+ and monthly rents of \$1,100 or more. Again, these upper-income households are typically business owners, those employed in the professions, health care or high-tech industry (although high-tech employment is currently depressed).

Households from outside of the Duluth area coming from housing markets where there is greater diversity and where housing prices are, on average, higher, are more likely to view housing in the Duluth market as being affordable. Thus, workers relocating to Duluth to take senior level management positions or those who are looking for a second residence are more likely to accept

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these higher price points. Over the past ten years, other large urban areas have been revitalizing their central cities and creating new housing in their Downtowns. High-income households coming from other communities are more likely to include the Downtown as an option in considering a residence provided there is a product available to suit their needs.

Existing Buildings

Maxfield Research Inc. reviewed an inventory of available commercial space in the Downtown commercial core and in Canal Park. In addition, we reviewed a list of potential residential buildings in the Downtown that was compiled by the Greater Downtown Council, Building Owners and Managers Association, and Local Initiatives Support Corporation.

We have categorized the following buildings as having high, medium or low potential for the development of market rate rental and/or for-sale housing. The ranking is based on:

- 1) the property's location in the Downtown
- 2) the size of the building
- 3) potential views from units
- 4) potential building amenities (architecture, interior features)
- 5) adjacent property's/uses

Maxfield Research Inc. did not conduct a walk-through of these properties. The spaces identified herein do not indicate the availability of the space for development, nor do they indicate the potential timing. A property's inclusion on the list does not signify a target for development, but merely that the building possesses attributes that may be considered attractive for residential use. A high ranking indicates the building has a location, views or architectural features (or a combination of these) that make it a strong candidate for residential use. The building's existing floor plate configuration also may make it suitable for renovation.

A ranking as medium or low does not mean the building is unsuitable for residential use. Rather it indicates that the location and characteristics of the building may be less desirable to the marketplace, depending on the costs to renovate and the market positioning proposed for the property. Of course, final unit plans, interior finishing details, building amenities, and pricing are all factors that would result in a potentially successful development.

Despite a property being ranked as high, it will still present development challenges.

DeWitt-Seitz Marketplace (upper floors) – High
Duluth Plumbing Supply Building – High
Pfiefer Hamilton – Medium
307 Canal Park Drive - High

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Ranked High Because of Views of the Lake and Close Proximity to Lake Walk

Abalon - High
Schwerdt Building - High
Electric Fetus - High
Sheldon Reproduction - High
Architectural Resources - High
Carlson Books – Medium (building condition a concern)

Gardner Hotel – Medium
Bridgeman-Russell Building-Medium
Arvig Building-Medium (good ceiling heights and large windows, exterior already upgraded)
Missabe Building - Medium
Hunter Building - Medium
Temple Opera Building - High
Wells Fargo – Top Floors (Penthouse) – High

In addition to the renovation of existing buildings for housing, other sites in the Downtown and on the waterfront should be considered for new construction. Housing could be incorporated as a component of a mixed-use development that would potentially include office, retail and/or hospitality uses in addition to housing. Housing could also be developed as one component along with other uses on the bayfront. Developing a mix of new construction and renovated units would enhance the variety of market segments attracted to the Downtown through offering a broader mix of housing product.

Condominium Market Trends

Historical

The market for condominiums in many areas of the country was extremely active during the late 1970's and early 1980's. Much of the activity involved conversions of existing buildings from rental housing to condominium ownership. This was fueled, in part, by demand from baby boomers purchasing their first homes. New projects were also constructed in some communities where demand existed primarily from the empty-nester and senior segments of the market that were looking for retirement housing. Typically, condominiums were initially touted as affordable housing in areas where land costs were high, although developments in smaller communities often appealed to the higher-income segment of the market.

During this period, condominium and townhouse sales were robust. Developers sold units to investors who were seeking asset appreciation. When mortgage interest rates began to rise dramatically, peaking in 1983, sales slowed and many developers and investors could not sell their units. When rates finally began to drop in 1985, single-family home sales soared. Condominium and townhouse sales however, remained sluggish and despite plunging interest rates, values declined during the mid-1980s. Stabilized values and more favorable mortgage

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interest rates began to fuel demand for these products during the early 1990s, along with a primarily new buyer niche, the older adult and empty-nester market.

Current Trends and Second Residences

Recently, however, strong economic growth in the 1990s, strong home appreciation and an increasing empty-nester demographic have all combined to shift the market toward multifamily ownership at a higher average price points and toward more luxurious units. We have seen this trend occur in major metropolitan areas as well as in seasonal and resort areas such as the Brainerd Lakes area in Northern Minnesota.

A recent article dated August 24, 2001 in *Business First Columbus* presented the following statistics on the dramatic increase in second home ownership in the United States:

- “More people are investing in second homes because it has become easier according to the financial banking industry.”
- The U.S. Census Bureau reports that Americans own more than 6 million second homes, including timeshares, seasonal homes, and condominiums. Of those, the National Association of Realtors (NAR) estimates that 3.1 million of them are recreational properties, some of which are rented out part of the year. An NAR survey shows that the median age of second-home buyers in 1999 (the last full year studied) was 43, the median income was \$68,800, and 79 percent are married couples.
- NAR forecasts that the demographic impact alone from large numbers of people in their 40s and 50s entering the second home market will add 100,000 to 150,000 housing starts each year nationally through 2010.
- Lenders have changed their views on qualifications for a mortgage on a second home, according to Tom Piecenski, vice president and mortgages sales manager at Fifth Third Bank. Before, the borrower had to have a strong balance sheet to get a second home. Now, lenders treat second homes as they would primary homes with the same types of financing available.”
- National lenders are now aggressively marketing second home mortgages.
- Some buyers prefer being no more than an hour or two away from home, some prefer traveling up north and others prefer the heat of Arizona, Florida or California as their getaway.
- Second homebuyers purchase for several reasons including 1) as a weekend getaway, 2) as a potential retirement home and/or 3) as a long-term investment.
- Many in the real estate industry expect this trend to continue to grow, spurred in part by the Internet. It is easier for companies to market their properties through the Internet and attract a diverse range of prospective buyers.

Introduction

This section calculates the potential demand for housing in the Downtown over the next seven years. Demand is calculated for for-sale and rental housing from the Market Area in addition to demand that would be generated from households coming to Duluth seeking a second residence. This section also discusses factors that will support and/or inhibit Downtown housing development.

The development of a critical mass of market rate housing in the Downtown is likely to require public/private partnership in order to achieve a broader range of housing types at varying price points. Housing has been a part of the Downtown since the City's inception. People living in close proximity to employment, entertainment and retail goods and services is not a new concept, but one that had been lost for a time until there was a renewed focus on a return to urban living.

The majority of the demand for housing in the Downtown is projected to come from the primary draw area (Study Area), from workers who want to live in close proximity to their place of employment, and from others who want to live in the Downtown because it offers a distinctive environment and housing product, not found elsewhere. Initial Downtown residents have been "urban pioneers." They live in the Downtown because they find strong reasons to do so (i.e. close proximity to work, convenience, desirable amenities (cultural, recreational, entertainment), and increased flexibility).

A larger group of Downtown residents will evolve once a critical mass of housing is established Downtown and/or once a neighborhood or neighborhoods have been identified. The establishment of a critical mass of Downtown housing may require the designation of an area or areas for redevelopment and new construction. More housing units in the Downtown may be developed, but a small number of units developed in a few buildings will extend the process of Downtown revitalization by dampening the momentum that could be achieved through a larger (re) development.

A greater variety of housing in the Downtown (upper-income, middle-market) will enhance the vitality of Downtown's after hours environment and in a sufficient amount, will spur increased retail development. Downtown residents are more likely to consider the Downtown as their neighborhood and spend money for entertainment, recreation and other retail goods and services in close proximity to where they live and work.

For-Sale Demand-Primary Residence

Table 13 presents our demand calculation for primary residence for-sale housing in the Duluth Study Area and an estimate of the proportion of demand capturable by the Downtown. It has been our experience that the Downtown can usually capture a range of total demand of between 10% and 20% depending on its draw area, sites available for development, projected growth and current housing conditions in the CBD. We believe that Downtown Duluth will be able to support a capture rate closer to 20% or 25% over time as more housing units and a greater mix of price points becomes available in the Downtown. We project that initially; the capture rate will

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be in the lower portion of this range, approximately 10%. Downtown's capture rate, however may be constrained by lack of sites and the increased challenges of renovating older buildings to satisfy demand.

TABLE 13			
PROJECTED DEMAND FOR FOR-SALE HOUSING			
DULUTH MARKET AREA			
2003-2010			
		2003-2010	
Projected HH growth in the Market Area		900	
(times) Proportion of households that would be interested in owning their housing	x	<u>80%</u>	
(equals) Estimated no. of potential owner households from HH growth	=	720	
		<u>Single-Family</u>	<u>Multifamily</u>
(times) Number interested in single-family versus multifamily	x	<u>60%</u>	<u>40%</u>
(equals) Potential Market Area owners by category	=	432	288
(less) For-Sale units planned for development in the Market Area	-	<u>300</u>	<u>50</u>
(equals) Potential additional demand for for-sale housing	=	132	238
(plus) Demand from outside Market Area	+	<u>25%</u>	<u>25%</u>
(equals) Demand for for-sale housing from HH growth	=	165	298
(plus) Pent-up demand for for-sale housing	+	<u>188</u>	<u>114</u>
(equals) Total demand from HH growth and pent-up demand	=	353	412
(times) Proportion of Market Area capturable by Downtown	x	<u>0%</u>	<u>10% to 20%</u>
(equals) Total potential demand for Downtown (seven years)	=	0	41 to 84

Source: Maxfield Research Inc.

Table 13 calculates for-sale demand from household growth over the next seven years. We have projected a higher proportion of prospective buyers will desire multifamily housing due to significant growth in the age 45 and over population and a desire for greater mobility and flexibility in their lifestyles. We also include pent-up demand, as there is currently a shortage of housing in the Duluth market at nearly all price points. Demand for for-sale housing for primary residences is estimated at 41 to 84 units to 2010. If employment growth accelerates and produces increased in-migration, these figures will increase.

Rental Housing-Primary Residence

Over the past decade, major metropolitan areas have experienced an increase in “lifestyle” renters, those who prefer to rent rather than own despite the fact they could own their home. This group includes young professional couples and singles, empty nesters and seniors (typically independent and mobile). They usually have higher incomes and in the case of the younger households, prefer to live in close proximity to their place of work (this according to a study conducted by the National Multihousing Council on the characteristics of the lifestyle renter).

Downtown Duluth has a growing base of young and mid-age professional workers primarily in the health care industry. A portion of those households may prefer to rent their housing initially, especially if they are new to the community. Incomes for this group are likely to range from \$40,000 and over. Using an allocation of 30% of income for housing costs would generate an affordable rent of \$1,000, including utilities. In order to achieve this rent level, the unit, location and building characteristics must be commensurate with the perceived value. If a renter is to pay this amount, they must view distinctive benefits for this higher amount, such as within convenient walking distance to work, close to shopping and entertainment, views, and upscale unit finishing. In order to achieve rent levels of \$1,000 or more per unit, off-street, reserved parking must be available in a well lit and reasonably secure area.

We believe that there is also demand for units that would be priced between \$750 and \$1,000 per month for one- and two-bedroom units in the Downtown and that the number is greater than for the top end of the rent spectrum. Our conversations with local developers and property managers of rental housing indicate that a subsidy of some sort would be required to reduce rents to this level for either new construction or renovation in the Downtown. These units would be priced to a moderate-income market with incomes of between \$30,000 and \$40,000. Units priced at the above level would be considered “affordable,” yet would be targeted to a household earning between 60% and 80% of the Duluth median household income.

The demand calculations for rental housing in Downtown Duluth are shown on Table 14.

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**TABLE 14
PROJECTED DEMAND FOR RENTAL HOUSING
DULUTH MARKET AREA
2003-2010**

	2003-2010	
Projected HH growth in the Market Area	900	
(times) Proportion of households that would be interested in renting their housing	x	<u>35%</u>
(equals) Estimated no. of potential renter households from HH growth	=	315
	<u>Market Rate</u>	<u>Affordable</u>
(times) Number interested in market rate versus affordable housing (not mutually exclusive-some overlap)	x	<u>50%</u> <u>65%</u>
(equals) Potential Market Area renters by category	=	158 205
(less) Rental units planned for development in the Market Area (minus 5%)	-	<u>92</u> <u>91</u>
(equals) Potential additional demand for rental housing	=	66 114
(plus) Demand from outside Market Area	+	<u>20%</u> <u>25%</u>
(equals) Demand for rental housing from HH growth	=	79 142
(plus) Pent-up demand	+	<u>136</u> <u>222</u>
(equals) Total Demand from HH growth and Pent-up Demand	=	215 364
(times) Proportion of Market Area capturable by Downtown	x	<u>10% to 15%</u> <u>15% to 20%</u>
(equals) Total potential demand for Downtown	=	22 to 32 55 to 75

Source: Maxfield Research Inc.

Second Residence/Vacation Rentals

Table 15 shows our calculation of demand for second residence units in Duluth based on the growth in the target market base, households age 45+ with household incomes of \$100,000

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TABLE 15 PROJECTED OWNER HOUSING DEMAND-Second Residence DULUTH STUDY AREA 2002-2007		
No. of HHs age 45 to 74 w/incomes of \$100,000+ (Twin Cities/St. Cloud MSAs)	97,318	Households
(times) 5.5% capture rate	<u>5.5%</u>	
(equals) Demand from existing base	5,352	Households
(plus) Projected growth in HHs' w/incomes of \$100,000+	75,001	Households
(times) 5.5% capture rate	<u>5.5%</u>	
(equals) Demand from household growth in target market	4,125	Households
Potential Market for Second Homes from Primary Buyer Area	9,478	Households
(times) Proportion that would come from other locales	10%	
(equals) Gross Demand for Second Homes, 2002-2007	10,425	Units
(times) Proportion capturable by Duluth	<u>2.0%</u>	
(equals) Potential short-term demand in Duluth for second homes	209	
(less) Units Planned for Development	0	Units
Remaining Demand	209	
Short-Term Demand (three to five years) (second homes-for-sale/rentals)	52	
Source: Maxfield Research Inc.		

or more. We have utilized this category as a benchmark because prices for upscale condo/townhome units continue to escalate and most buyers from this market purchasing a second home are likely to have incomes at or above this range.

The success of upscale second residence condominium development in Downtown Duluth is predicated on the following factors: increased growth in the 45+ age group over the next ten to twenty years, continued low mortgage interest rates, and reasonably strong economic growth (in major metropolitan areas where the majority of buyers will be coming from). Currently, all of these factors have combined, increasing the demand for second homes in recreational and resort communities in northern Minnesota and in other areas across the country. Many mid-age buyers who are still working prefer to purchase a second home in close proximity to their current residence (one to two hours away). Although not mentioned directly by real estate sales agents, there is an indication that a greater number of potential buyers who may have previously considered a unit in the southwestern or southeastern United States are staying closer to home, within driving rather than flying distance. This is primarily due to increased security concerns post-9/11.

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We have utilized households in the Twin Cities and St. Cloud MSAs to calculate base demand. Additional demand for second homes will come from households currently residing in other locales. We have utilized a factor of 10% of total demand that would come from this group.

The National Association of Realtors has identified a ratio of second home ownership at 5.5% nationally. Maxfield Research Inc. compared this ratio to the ratio of seasonal units in Minnesota to the total Minnesota household base as of the 2000 Census and found an identical ratio of 5.5%. Therefore, we have used this ratio as a capture rate for the target market.

We have identified a capture rate for this analysis of 5.5% of existing households and 5.5% of projected household growth over the next five years. This results in potential demand from the Primary Buyer Area of 9,478 households. Factoring that 10% of the demand for second homes is likely to come from outside of this market adds another 947 households for a total of 10,425 households. We estimate that Duluth should be able to capture 2% of the potential demand for second homes. This would result in total demand for 209 units. We reduce this demand by the number of units under construction, currently being marketed and planned which totals 0 units, resulting in remaining demand for 209 units over the next ten to fifteen years. We project that demand in the short-term would be front-ended, with 25% of this demand supportable within the next five years. This demand calculation does not account for units that would be used as primary residences.

Target Markets

As stated, the primary target markets for upper-end condominium units in Downtown Duluth will be generated predominantly by buyers age 45 to 74 who are either purchasing a second home or are purchasing a retirement residence and are selling their primary residence. This includes units purchased as investment property. Buyers at the upper range of the target age group are more likely to purchase a unit as their primary residence while younger buyers would be more likely to purchase a unit as a second residence or as an investment property.

The traditional target markets for condominiums and townhouses have been predominantly empty-nesters and younger seniors, although young and middle-age professionals are now often considering these housing types as attractive alternatives to a single-family home because they are seeking increased leisure time and a reduction in maintenance responsibilities that would be associated with maintaining a single-family home.

The projected employment increases at local health care employers combined with increased employment at the new Downtown Tech Center and increasing student enrollments at the colleges and universities encompass a variety of market segments that are likely to be interested in housing located in close proximity to work and school along with entertainment, recreation and other retail goods and services. Housing in urban areas is increasing in popularity and many potential residents moving to Duluth from outside of the community may be coming from locations where Downtown housing has already been developed and are thus, more familiar and accepting of the concept.

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Downtown Duluth possesses several characteristics that would be attractive to potential buyers or to short-term renters (vacation rentals). Close proximity to entertainment, recreational amenities and shopping (i.e. Lakefront, Canal Park, Harbor, Lake Walk, Downtown goods and services, North Shore), convenient access from I-35 to the Twin Cities and St. Cloud.

There are few units in the Downtown that have unobstructed views of Lake Superior and/or the Duluth Harbor. We believe that units with unobstructed views would generate the highest prices. Other features and amenities, too, should support upscale pricing. We believe however, that direct views of Lake Superior also may result in some compromise on other features, depending on the units' price points. Units with direct views of Lake Superior and commensurate upscale finishing could likely achieve sales prices of at least \$400,000 or more. Of course, this depends on the size of the unit, its location, the building, adjacent and surrounding land uses, and other features.

Other features that are likely to be popular with upper-income buyers include:

- High Ceilings;
- Large windows;
- Options for hardwood floors and other flooring options including tile and stone;
- Gas Fireplaces;
- Generous lighting allowance (\$2,000 minimum);
- Center kitchen islands;
- Corian or granite countertops;
- Private deck;
- Covered Parking;
- Pre-wiring for all communications connections (telephone, internet, cable TV, security – entrance and in-unit);
- Enclosed, secured parking;
- Skywalk connection (preferred, but not essential)

Summary Conclusions

- Demand for housing in Downtown Duluth will be driven by growth trends at opposite ends of the age continuum, increased employment base of young households and the aging baby boom generation considering alternative housing options. Both groups will be attracted to housing in Downtown Duluth, but at different price points, different product types and different tenure formats.
- Employment growth among Duluth's health care and hi-tech employers will increase the potential demand for housing in the Downtown. These employers are already located in the Downtown and a portion of their current and future employees are likely to be interested in housing located in close proximity to their work. Being located close to work has been cited as a key criteria in their selection of a housing unit in surveys of upscale renter households and urban residents in other metropolitan area across the country.
- The expanding student base in the Duluth area also presents opportunities to develop housing specifically to meet the needs of this market segment and we believe that Downtown is a location that would be very attractive to this group. Student specific housing may be one option in addition to developing more traditional housing units that may be shared.
- Demand for upper-bracket condominiums/townhomes from local residents and from those outside of the region will be driven by strong projected household growth in the 45 to 64 age group and among households with incomes of \$100,000 and above. These households will prefer high-amenity sites and a high level of unit finishing.
- A broader mix of housing is needed in Downtown to attract a variety of target markets and enhance the vitality of the Downtown. Increasing the mix of housing, particularly at the upper price levels will provide a more diverse and dynamic living environment in the Downtown.
- There is potential for some premier locations in the Downtown Duluth area with direct views of Lake Superior including the bayfront; optimizing the use of these sites may require redevelopment.
- Strong growth in the second home market due to shifts in lending practices, low mortgage interest rates, strong primary residence appreciation over the past decade resulting in additional home equity for many baby boomer households will result in greater demand for vacation rentals and second residences;
- Growing interest in Duluth as a tourist and retirement location will continue to attract potential buyers to the Duluth area and increase the potential demand for housing in the Downtown;

Recommendations

The City is currently working with a private developer on the potential renovation of the Bridgeman-Russell building to residential units. Efforts such as these targeting specific buildings can increase the amount of housing in the Downtown and can potentially provide housing at locations that may not have been considered previously.

Ongoing discussions regarding the development of housing in the Downtown have revealed that some of the more important challenges developers face are: code restrictions, parking requirements, and a lack of programs available to cost effectively develop certain types of housing in the Downtown. It is important that private developers and local community organizations work with the various municipal entities such as the Planning, Building Inspections, the EDA, the HRA and others to tap into their specific areas of expertise to enhance development opportunities and streamline the development process.

Lack of sites available for development of new housing is also a challenge to meeting economies of scale in providing moderately priced housing units. We recommend that local organizations and the City work in cooperation to identify potential funding alternatives to traditional federal and state programs that limit the type of housing that can be developed. Other programs that have been utilized include density credits, tax exempt bonds, and other types of loans, land acquisition, tax increment financing, tax abatement, among others.

Many communities throughout the State and throughout the country are currently incorporating housing as a part of their marketing plans. Regularly promoting the Downtown as a great place to live, work and play, is a theme now heard often in small and large Downtowns. The promotion of Downtown as a place to live is two-fold, promoting the Downtown to prospective residents and promoting the Downtown to developers as an investment.

Developing housing in the Downtown will most likely require public-private partnerships for any sizeable project. Working together to achieve a common goal, of providing a variety of housing that creates a “Downtown neighborhood” will also strengthen the commercial core of the City and its community image among all residents.