



Real Estate Research
Providing Comprehensive
Market Information
and Feasibility Studies

Watertown Housing Demand Study Updated Findings

Presented to: Watertown Development Company
Stakeholders

Presented by: Matt Mullins, Vice President
Maxfield Research & Consulting, LLC

July 13, 2023

Maxfield Research & Consulting, LLC

We are a full-service real estate advisory company providing strategic value to our private and public sector clients' real estate activities.



OVERVIEW

- 40 Years Experience
- Diverse Client Base
- **Multi-Sector Capable**
 - *Residential*
 - *Commercial*
 - *Public & Private Entities*
- Market Driven Strategies
- Recommending Highest & Best Uses
- Provide Actionable Plans

Project Scope

OBJECTIVE

Provide housing demand update

APPROACH

Identify current & future housing needs for residents in Watertown and provide framework for meeting housing needs

PROJECT DELIVERABLES

- Short and long-term housing needs
- Recommendations guiding future housing development

KEY DATES

- Data collection: 1st/2nd Quarters 2023
- Draft: June 2023
- Presentation: June 13, 2023
- Final Report: TBD after Review & Comment Period

Background

- Previous housing studies completed (Maxfield Research):
 - 2019
 - Downtown Watertown Commercial + Housing (2019)
- 2023: Demand Update Only; NOT full Comp Housing Analysis
- 2020 Census. Study incorporated 2020 redistricting numbers, but full release of data yet to be released. ETA late 2023?
- COVID-19 recovery, inflation impacts, interest rate hikes, recession on horizon?



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Market Area

Demographics & Economics

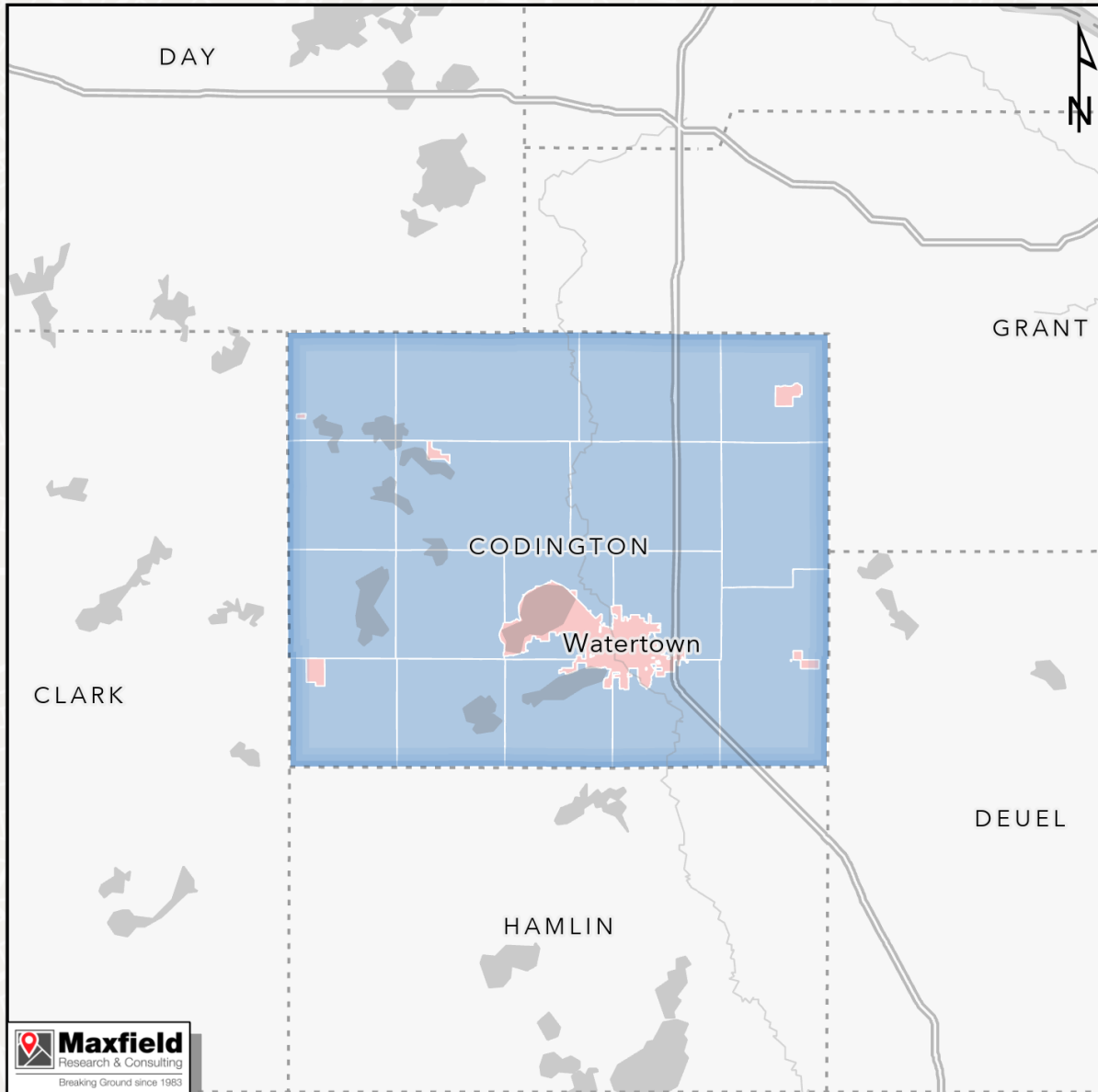
Market Overview

Demand & Recommendations

2023 Mid-Year Outlook

Discussion

Watertown Primary Market Area (“PMA”)



- Consistent with previous housing study
- Codington County = PMA
- 23 Geographies
 - ✓ 17 Townships
 - ✓ 6 cities
- Watertown is economic driver of PMA



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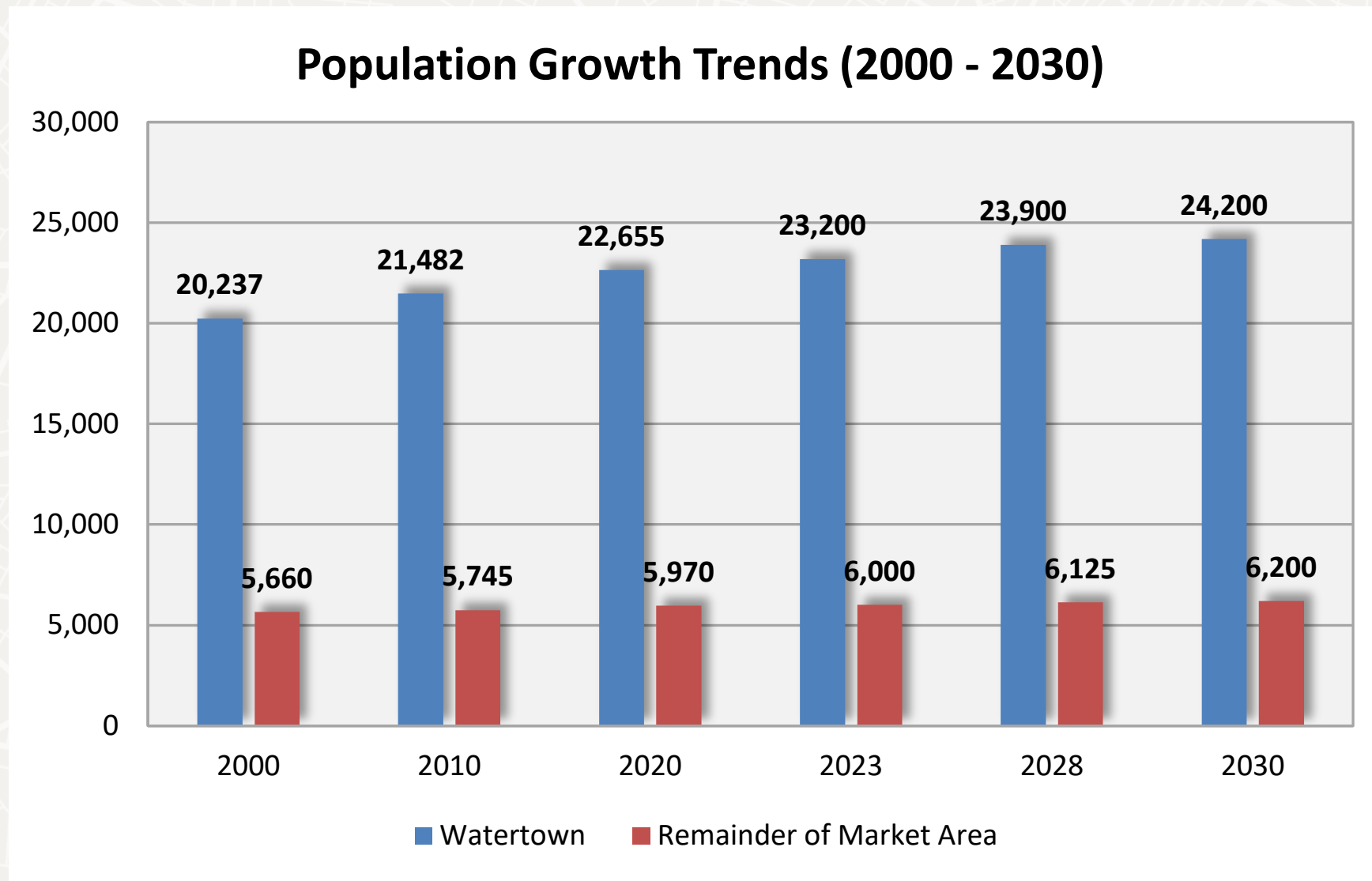
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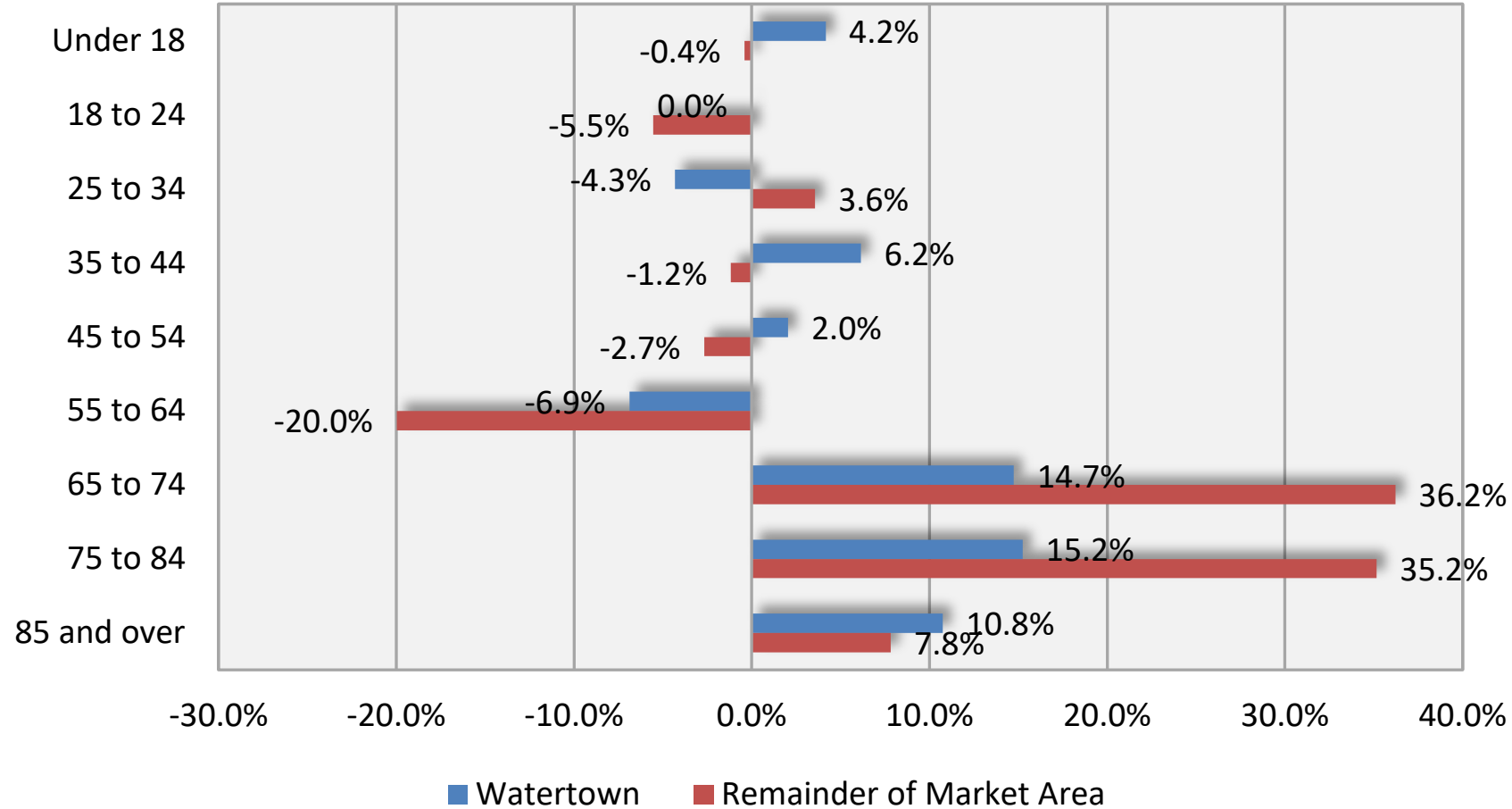
Discussion

Population Growth Deaccelerating w/each Decade...

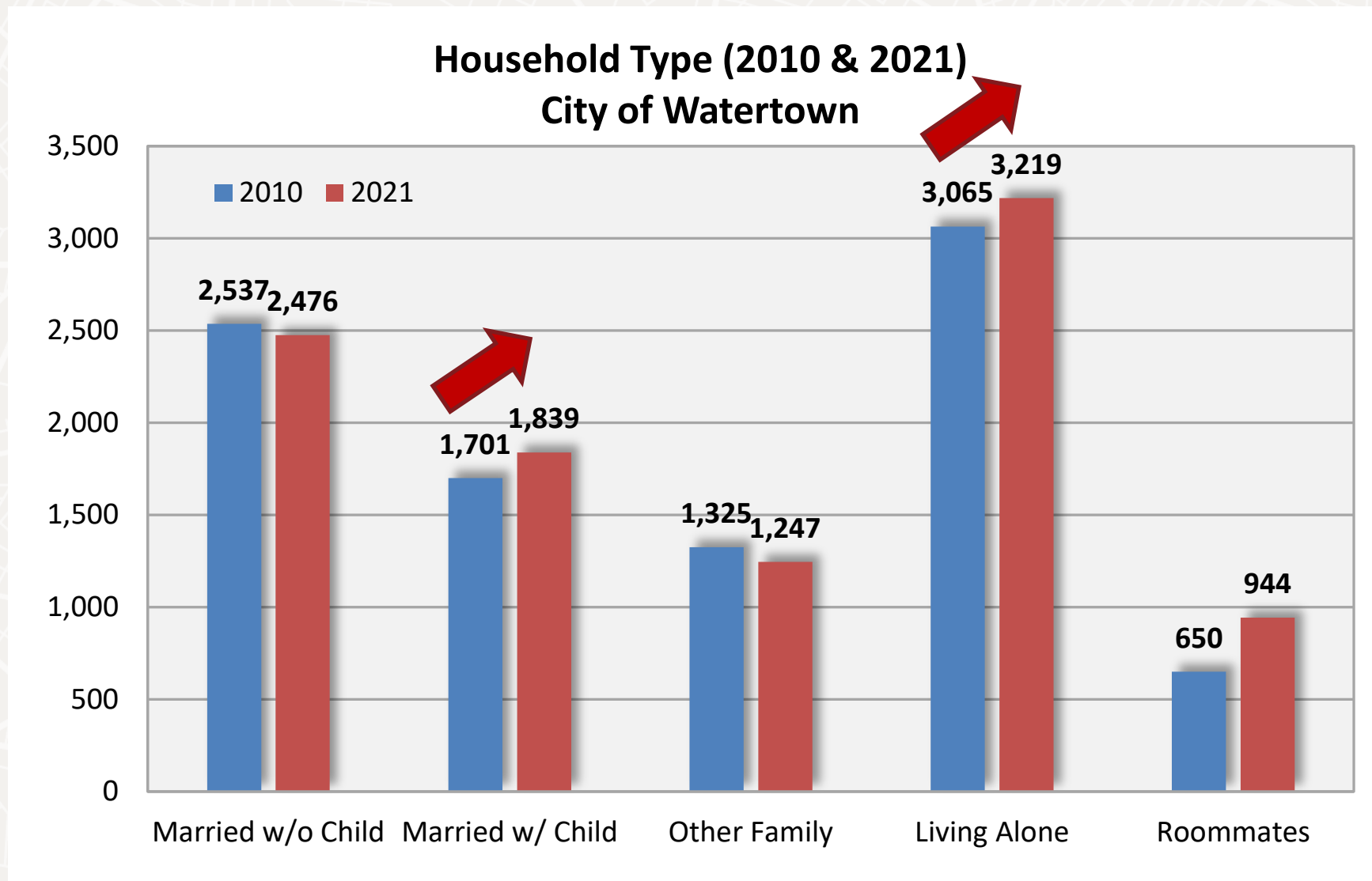


65+ population driving growth in near-term

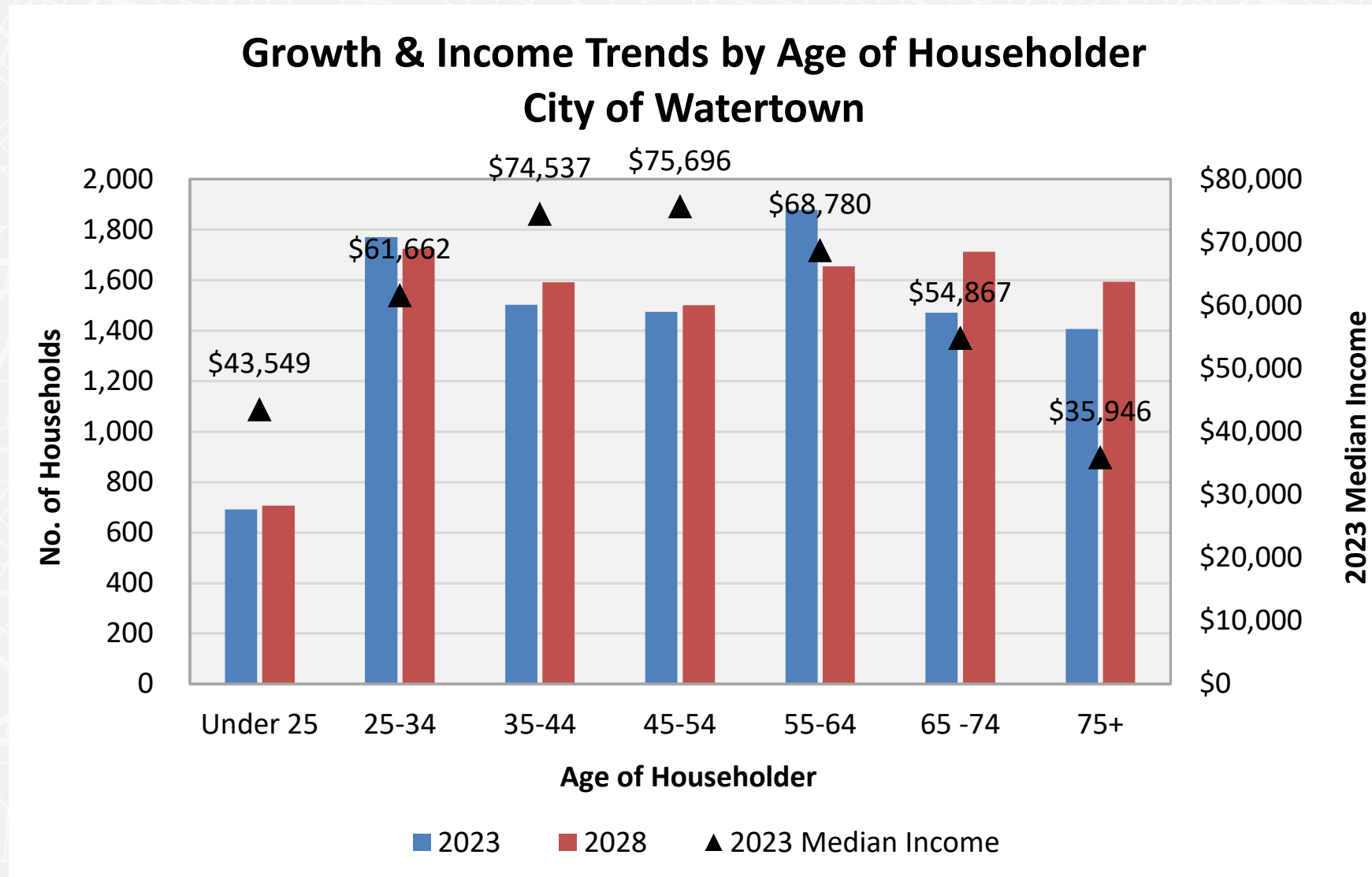
Population Change (%) by Age Group (2023 - 2028)



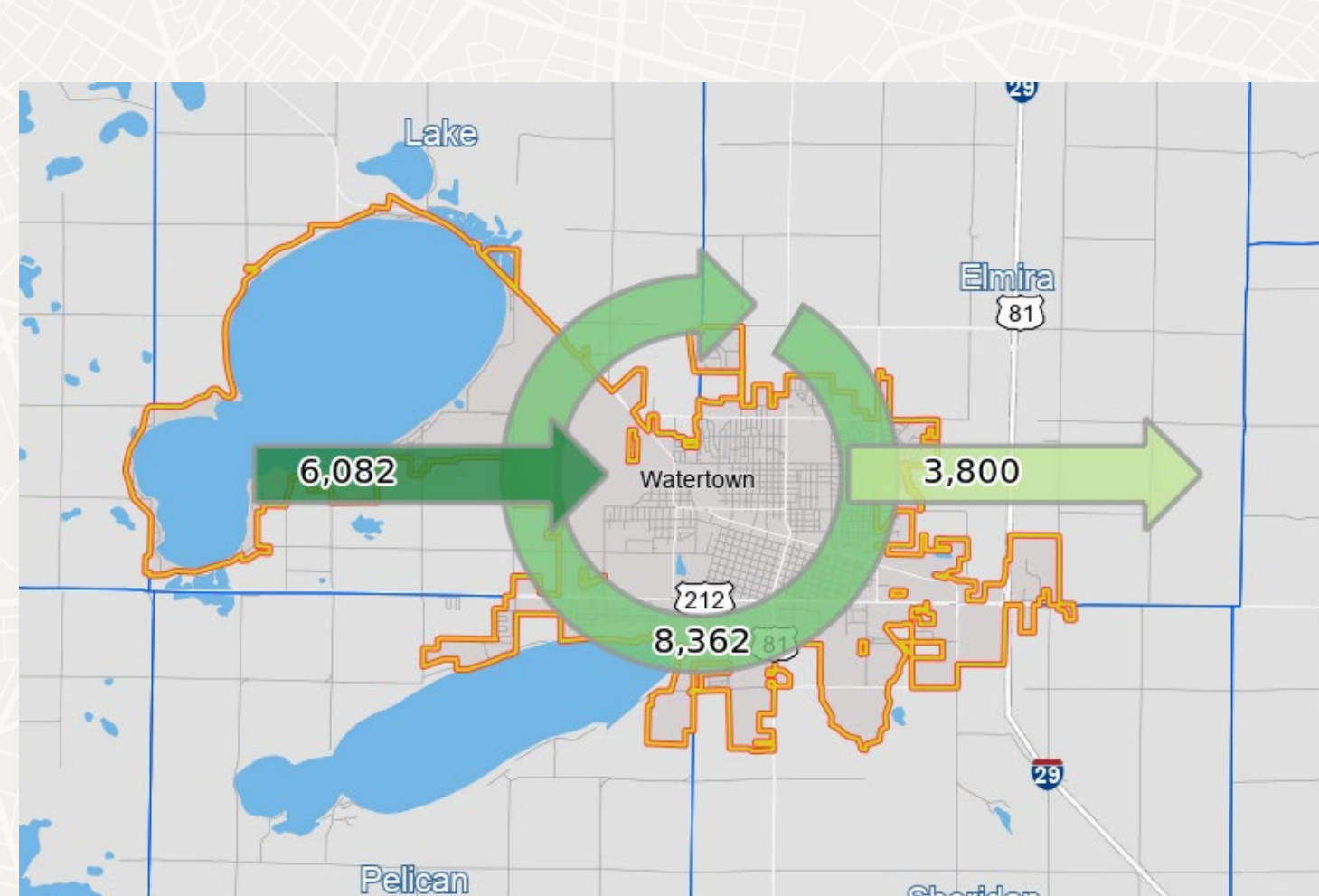
One-third of household Live Alone!



Gen. X & Millennials strongest household incomes...

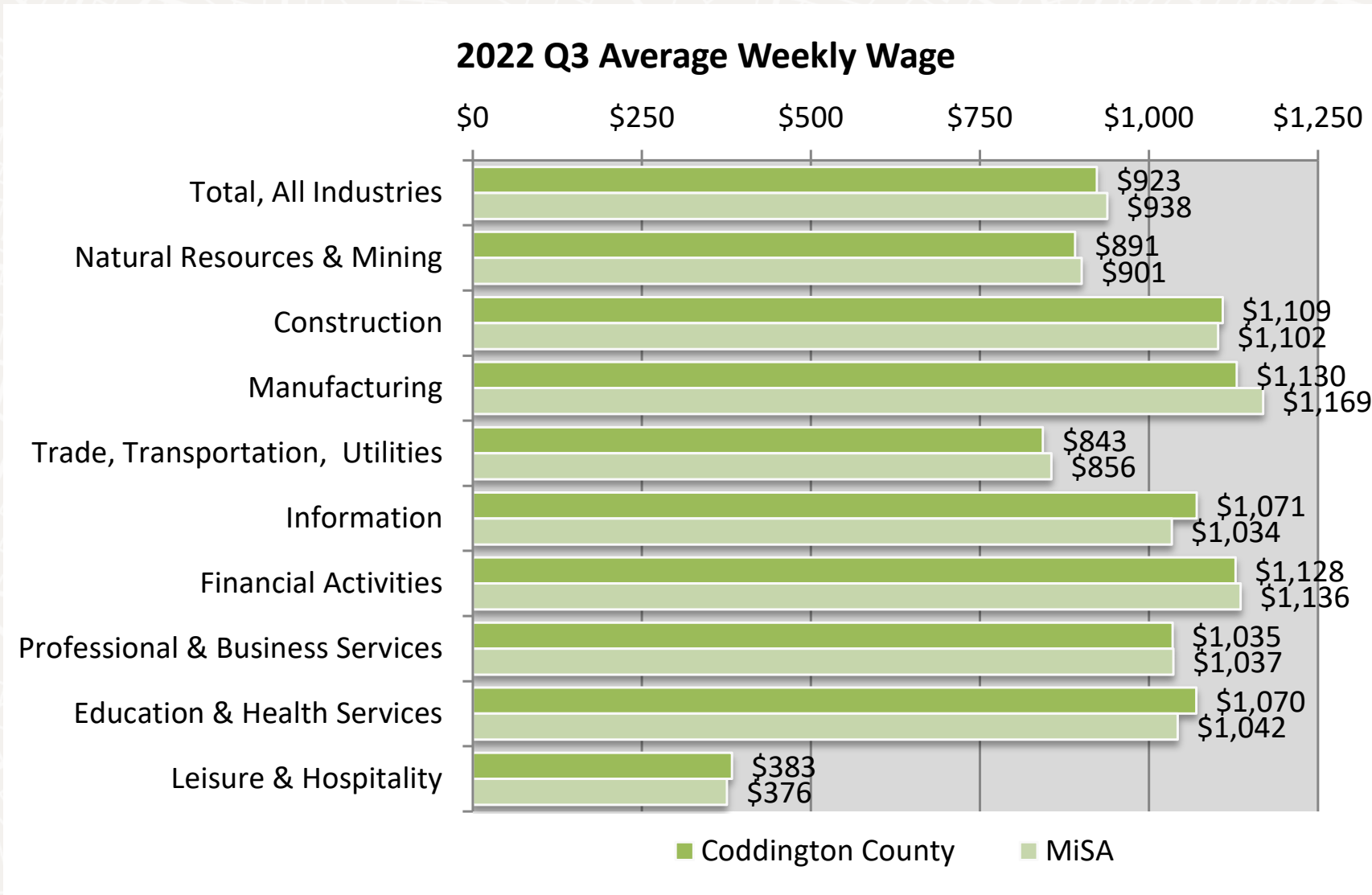


Watertown is both a job exporter & importer

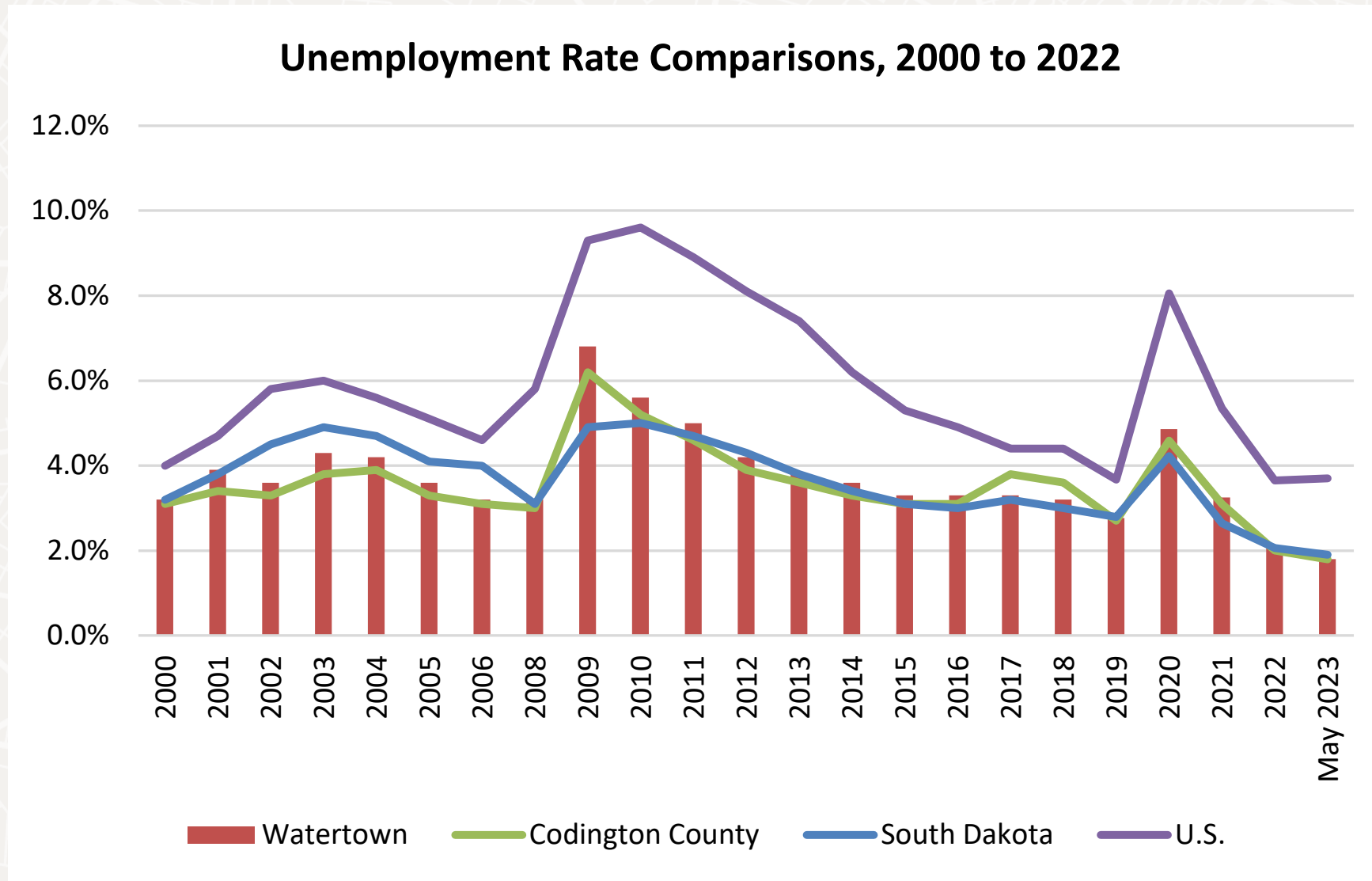


- Watertown: 12,189 jobs (resident emp.) (2022)
- Key Industry Sector Jobs (Codington Co.):
 - Trade, Transportation, and Utilities: 27%
 - Manufacturing: 22%
 - Education and Health Services: 14%
- Avg. weekly/annual wage (Q3 2022):
 - \$923 | \$47,996 (Codington Co.)
 - \$938 | \$48,776 (Micro. Statistical Area)
 - \$1,052 | \$54,704 (South Dakota)
- 33% Inflow, 21% Outflow, 46% Interior Flow

Wages by industry...

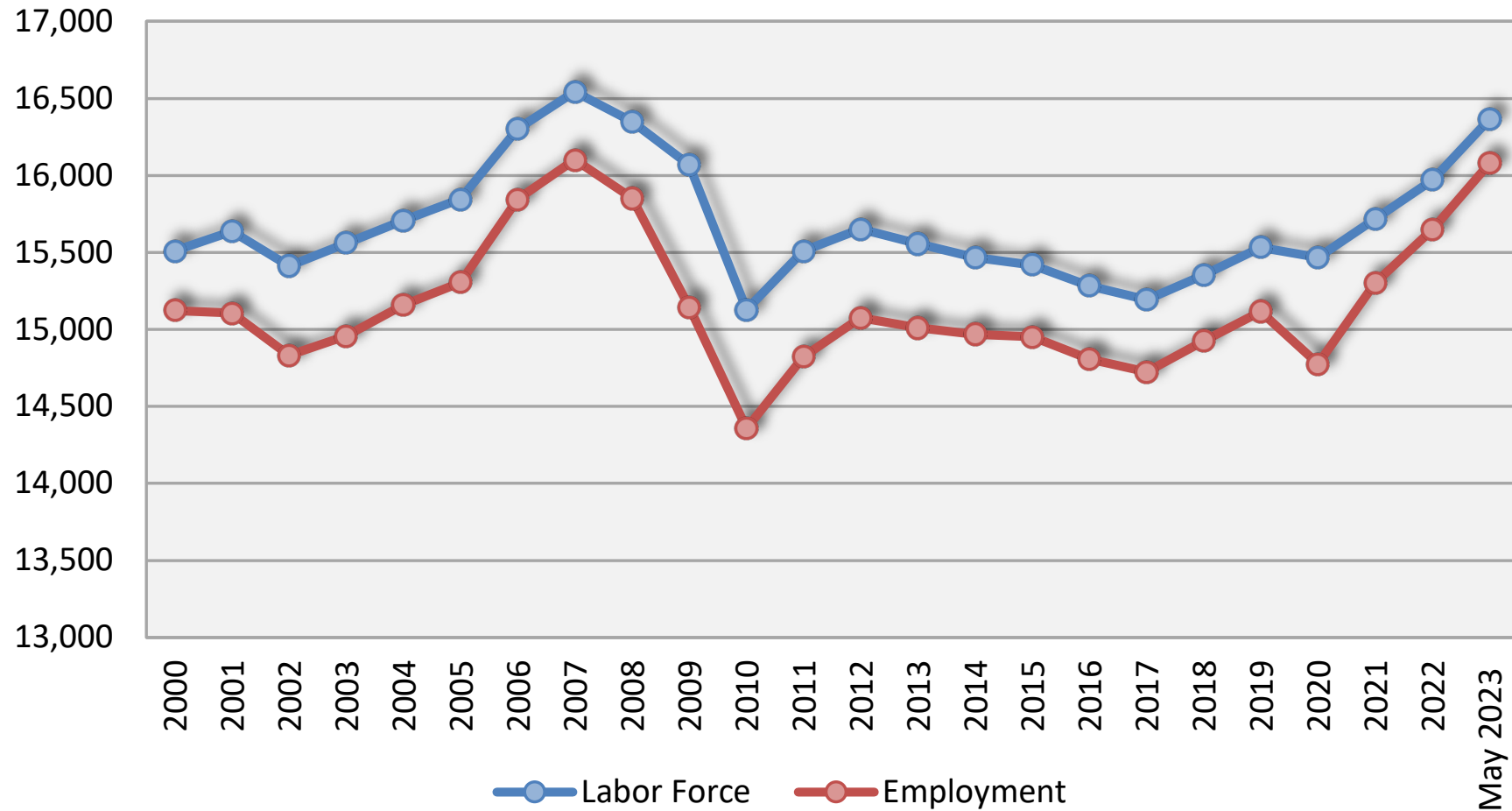


Unemployment rate lower than pre-pandemic

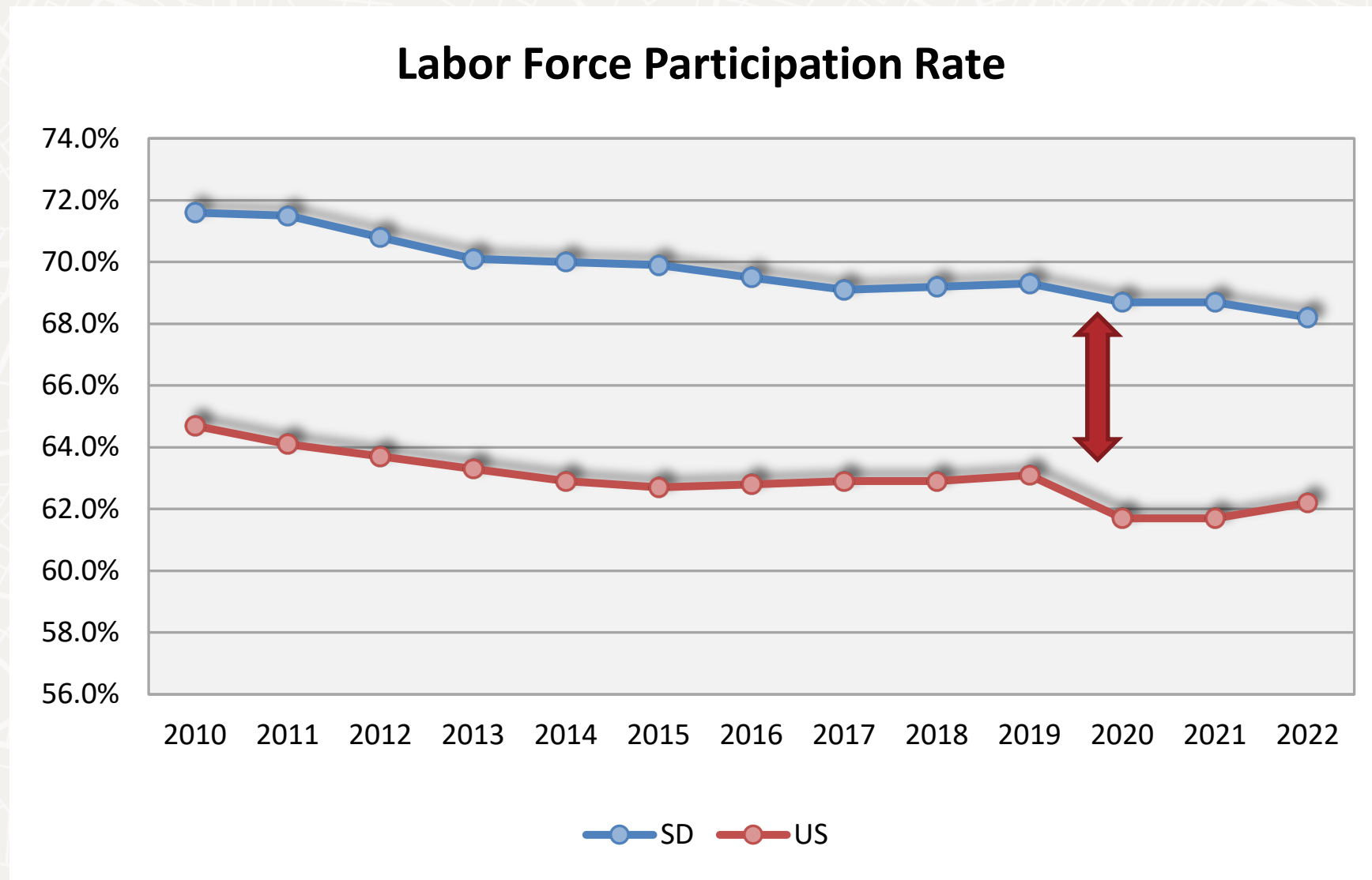


Labor Force & Employment up since Pandemic...

Labor Force vs Employment Comparison (Codington Co.)



Labor Force Participation Rate Down...but higher than US





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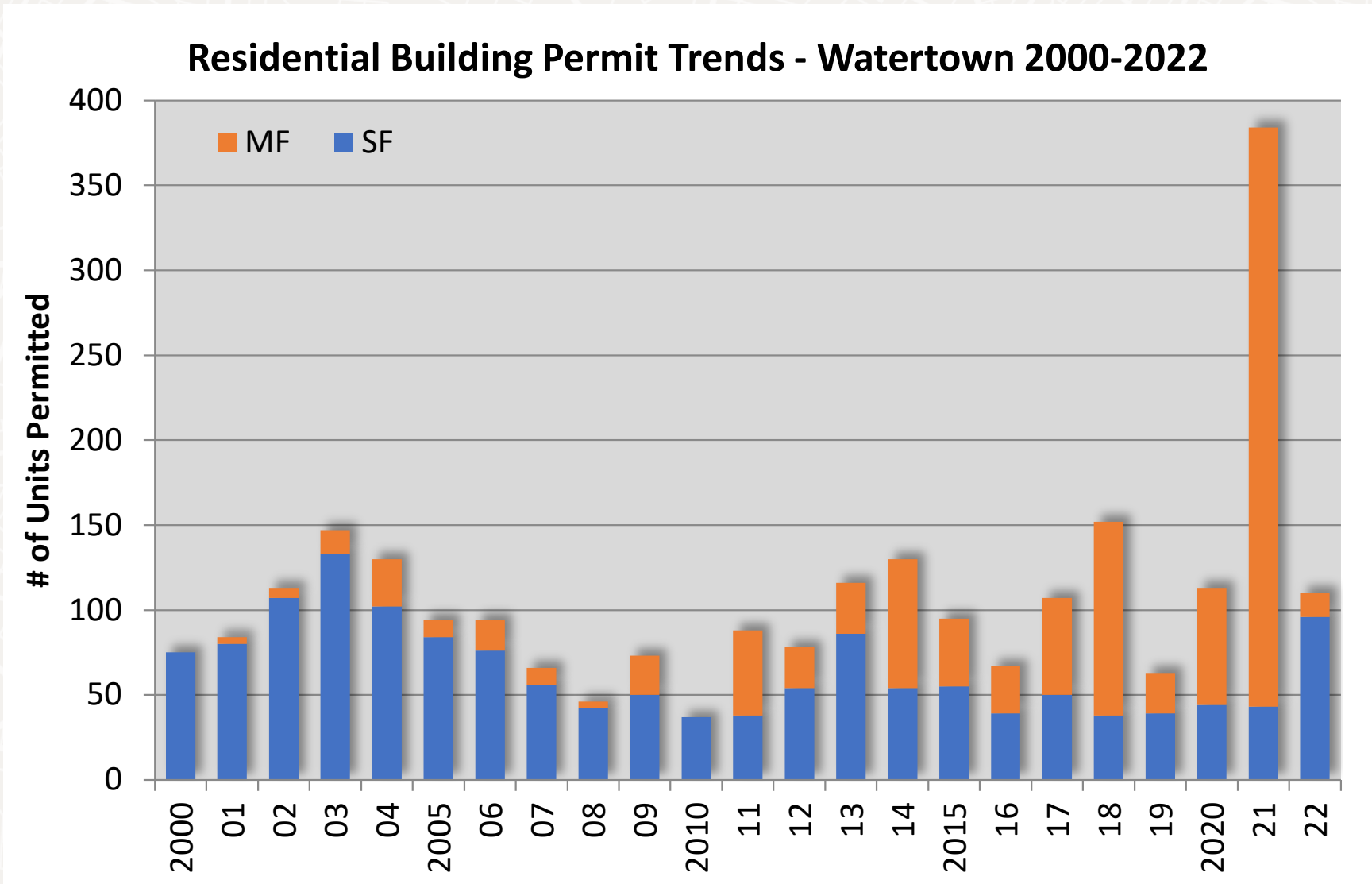
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Recent Boom in Multifamily Construction



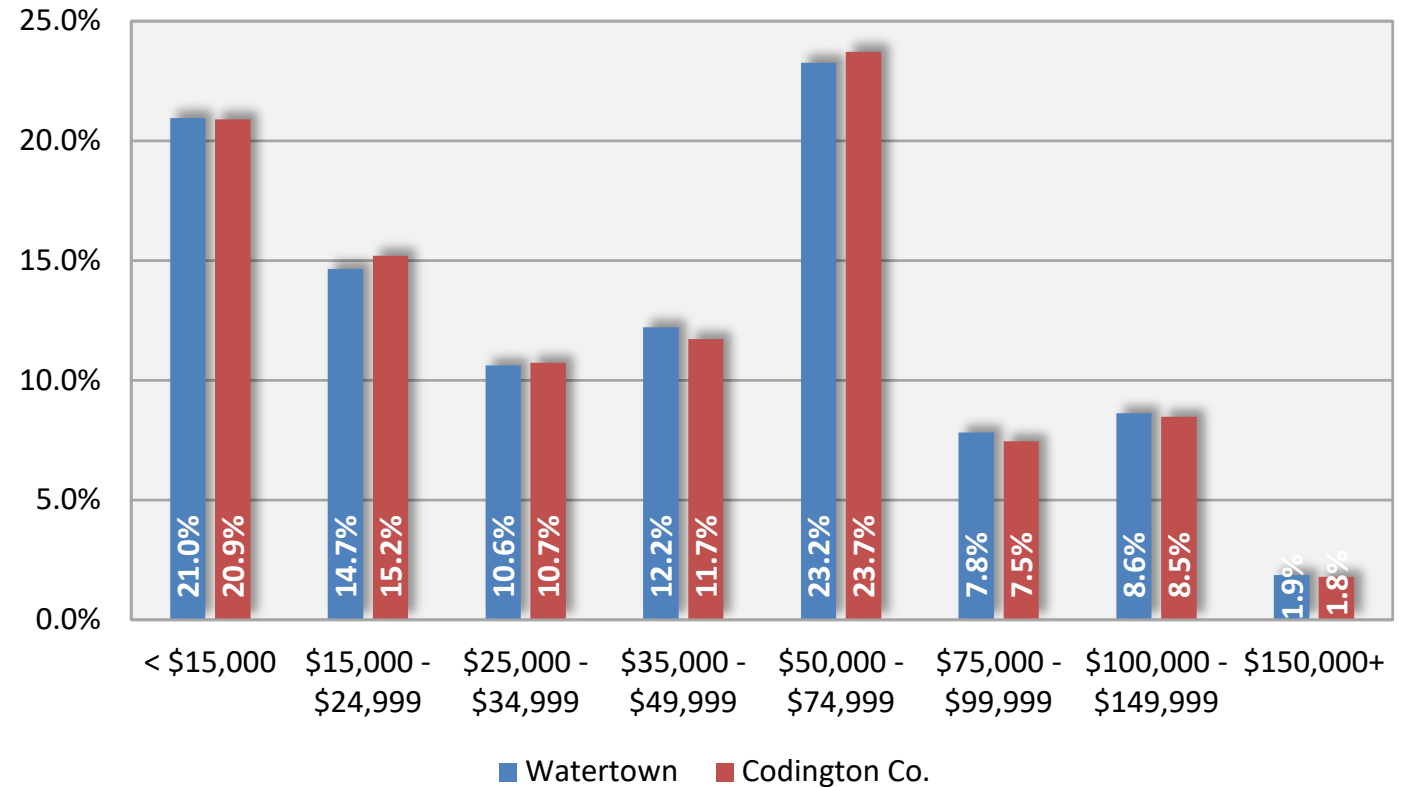
Rental Housing Overview

- 38% of households are renters
- SF Detached & Townhomes = 33% of rental stock
- 65% of existing renters qualify for market rate housing; rise in lifestyle renters
- 48% of renters 1 person HH, 75% 1 & 2 pers HHs

New Construction

- 530 units | 6 projects
- 1.5% vacancy rate
- Avg. Rent \$1,056 | \$1.34 PSF

% of Renter HH by Income Group (2021)



Rental Housing Boom – New Construction Projects



The Plains Apts.

- Avg. Rent \$1,053 | \$1.30 PSF
- 0.0% Vac. Rate



Parkside Place

- Avg. Rent \$980 | \$1.28 PSF
- 0.0% Vac. Rate



Flats on 8th

- Avg. Rent \$985 | \$1.41 PSF
- 0.0% Vac. Rate



The Lofts

- Avg. Rent \$997 | \$1.67 PSF
- 5.1% Vac. Rate



The Oaks

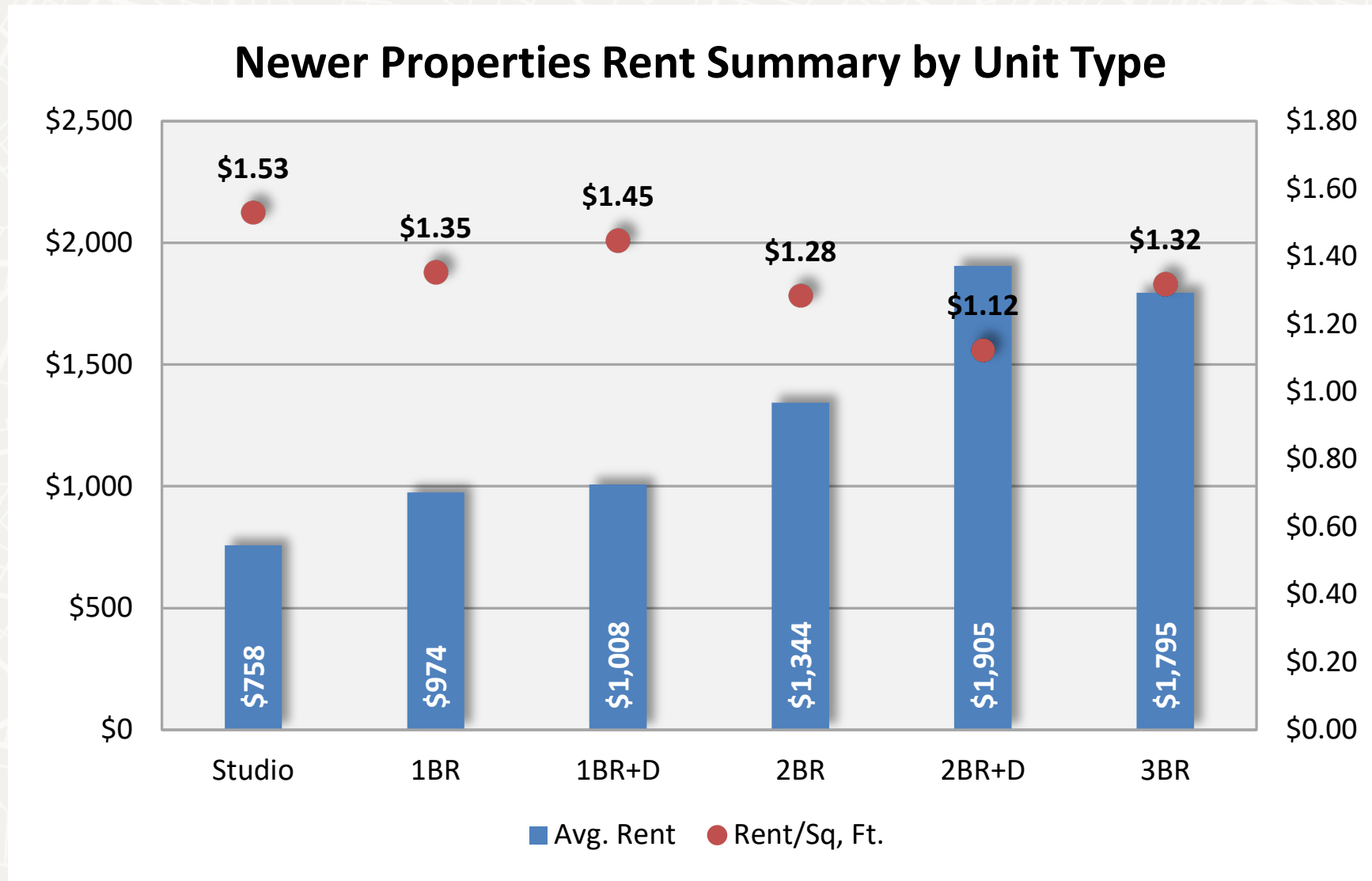
- Avg. Rent \$874 | \$1.41 PSF
- 5.6% Vac. Rate



One/Two Willow Creek

- Avg. Rent \$1,306 | \$1.31 PSF
- 2.4% Vac. Rate

New Construction Rent Summary

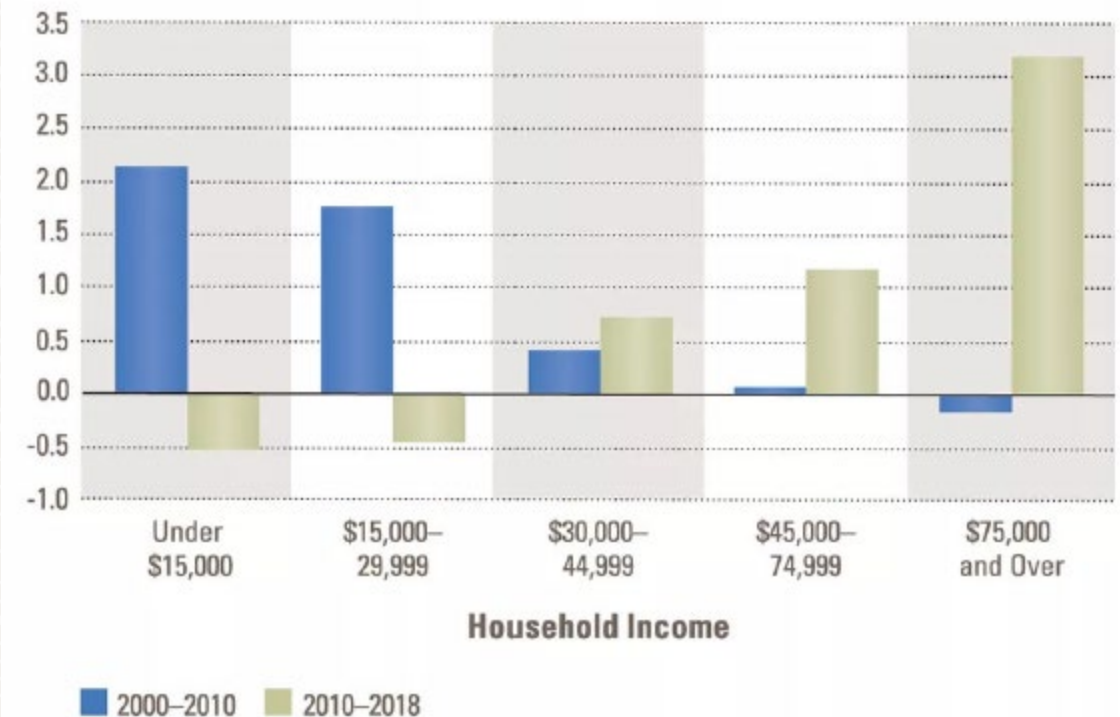


Lifestyle Renters Driving Rental Growth...

- High-earning renters: +45% last decade
- Barbell: Millennials & Baby Boomers
- Young, college educated with high incomes
- Baby Boomers: Lack of active adult product, desire to right size, simpler lifestyle, etc.
- Married couples w/kids: +14%
- Fewer renters “doubling up” in the pandemic recession

High-Income Households Have Driven Most of the Growth in Renters Since 2010

Net Change in Renter Households (Millions)



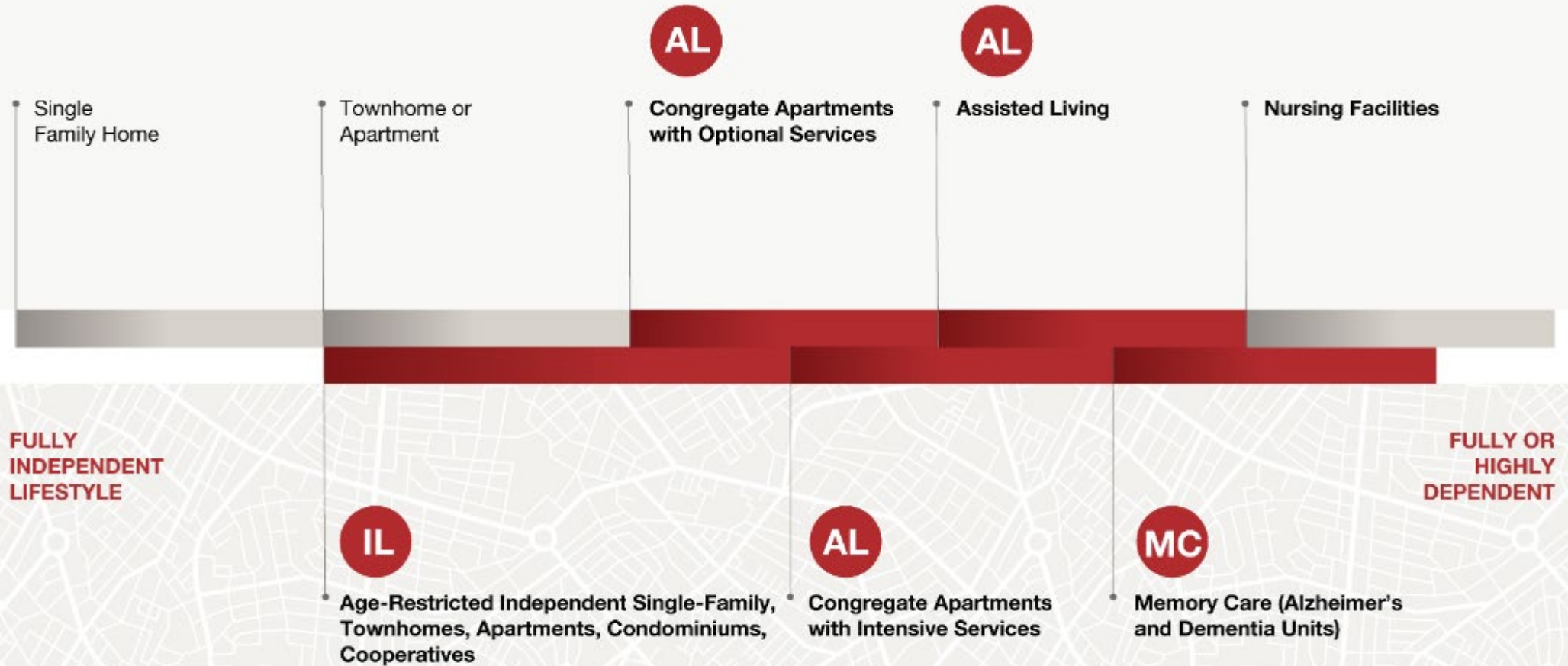
Note: Incomes are adjusted for inflation using the CPI-U for All Items.

Source: JCHS tabulations of US Census Bureau, American Community Survey 1-Year Estimates.

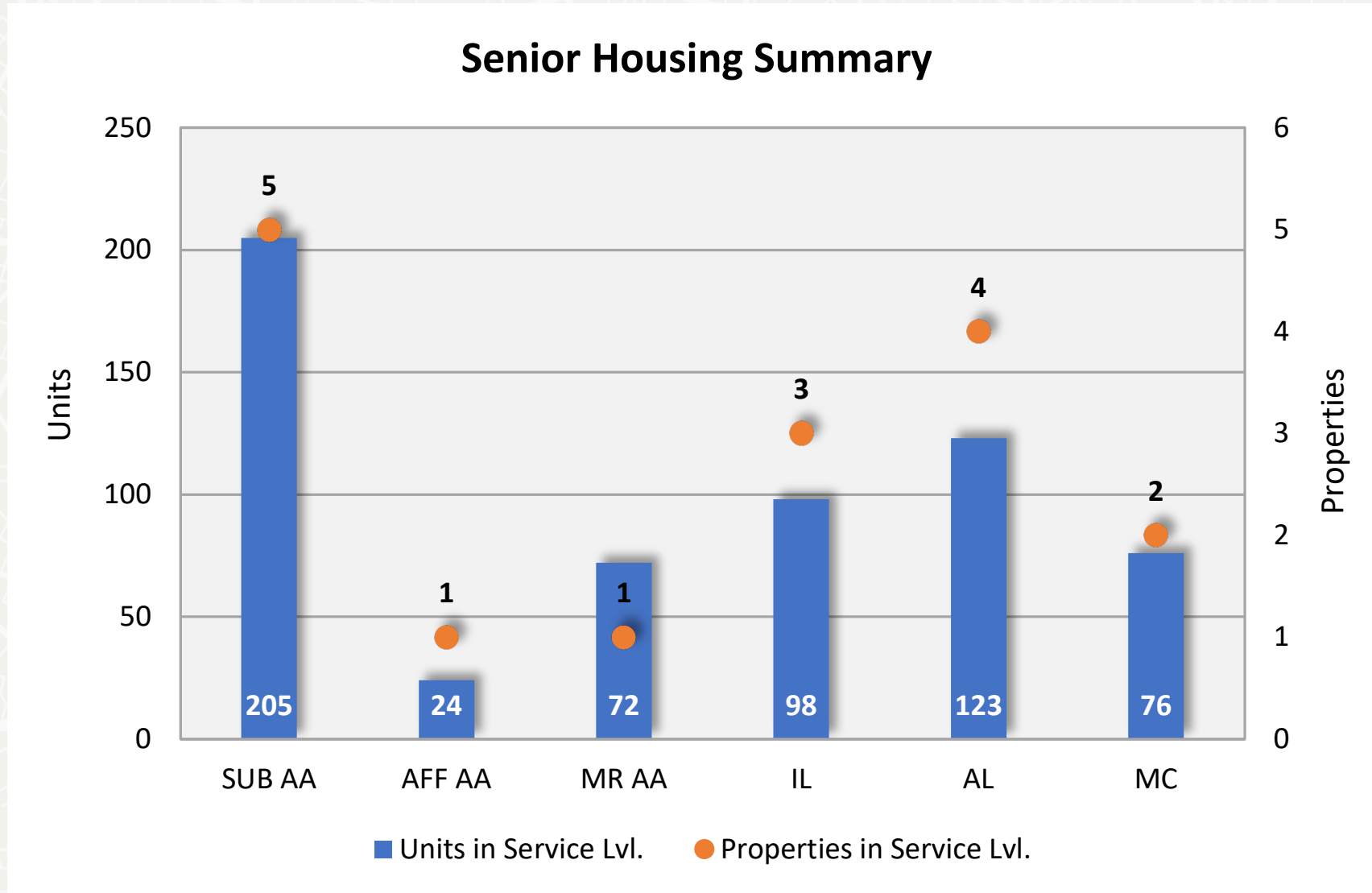
Apartment Development Trends

- Preferred asset class from developers, investors, & lenders
- Demand driven by strong demographics: Millennials & Baby Boomers (“barbell”)
- Renters by choice (“lifestyle renters”) driving market w/higher incomes
- Amenity driven; today’s renters have higher expectations
- Strong desire for rental units with more space, yards, etc. (townhomes, single-family, etc.)
- Lack of for-sale supply & higher mortgage rates has fueled renter demand
- Low vacancies = pent-up demand
- Hospitality moving into rental space (i.e. short-term rentals)
- Challenges delivering new product @ reasonable price points
- New construction difficult to pencil in higher interest rate environment...

Senior Housing Continuum



Senior Housing Inventory | Nearly 600 units

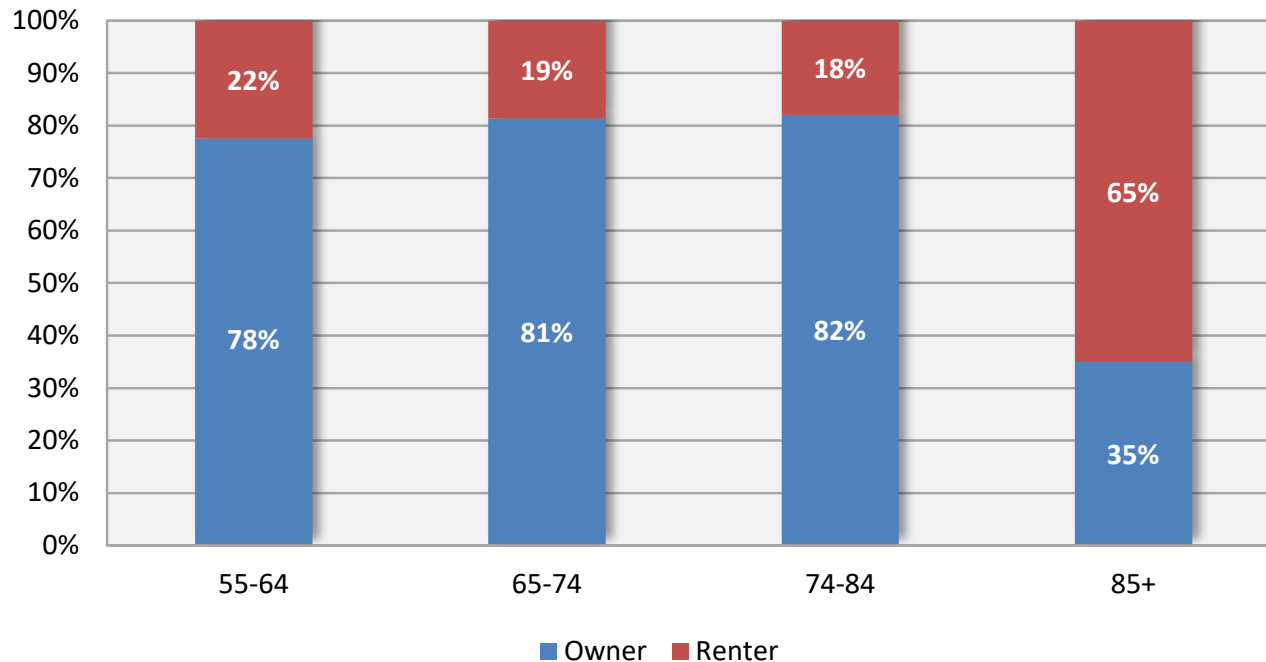


Strong Senior Homeownership Rates

➤ Senior incomes

- 55 – 64: **\$68,780** (Watertown) | **\$71,891** (Codington Co.)
- 65 – 74: **\$54,867** (Watertown) | **\$56,225** (Codington Co.)
- 75+: **\$35,946** (Watertown) | **\$35,893** (Codington Co.)

**Senior Homeownership Rate
City of Watertown (2021)**



StoneyBrook Suites

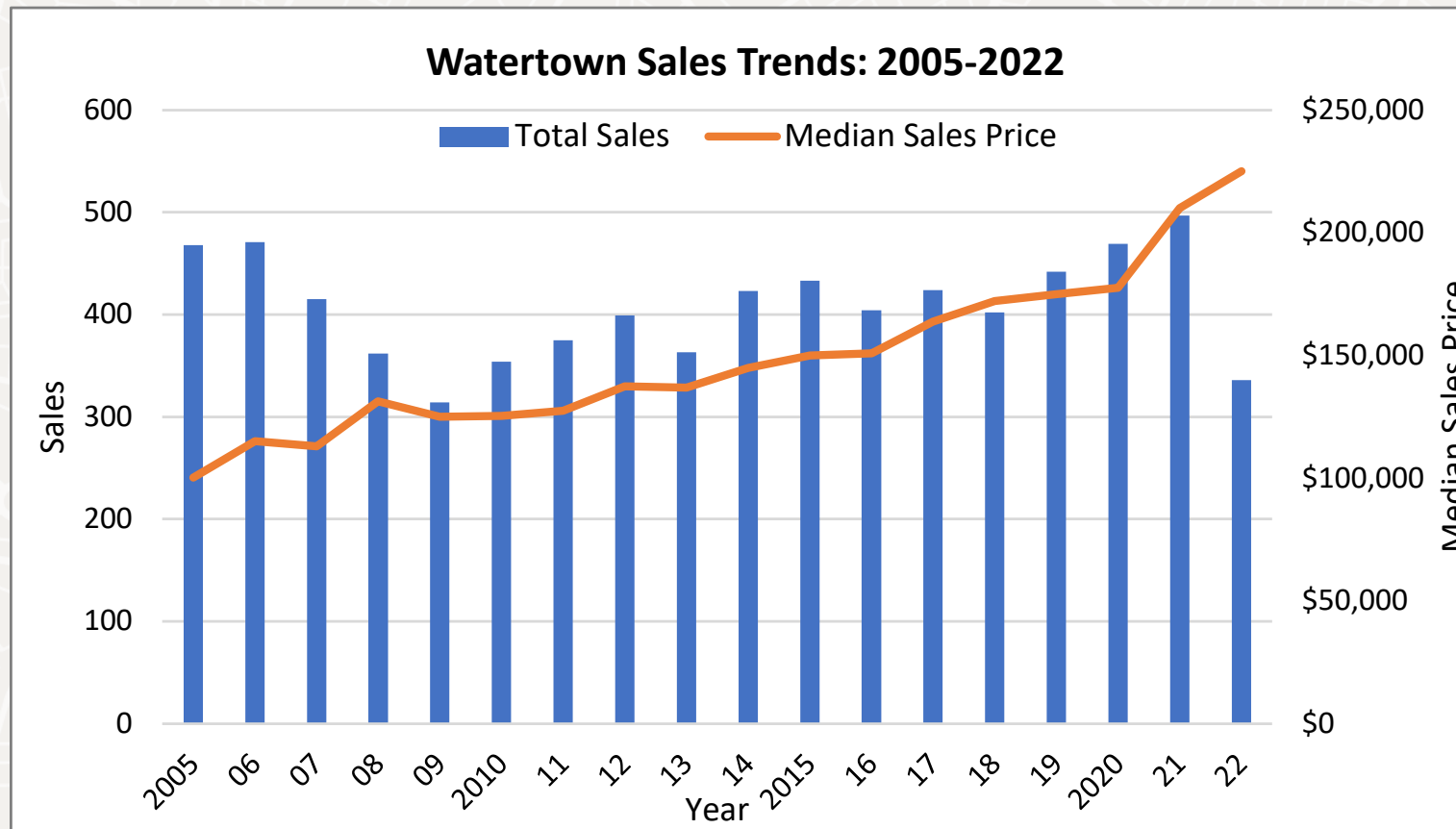


Jenkins Living Center

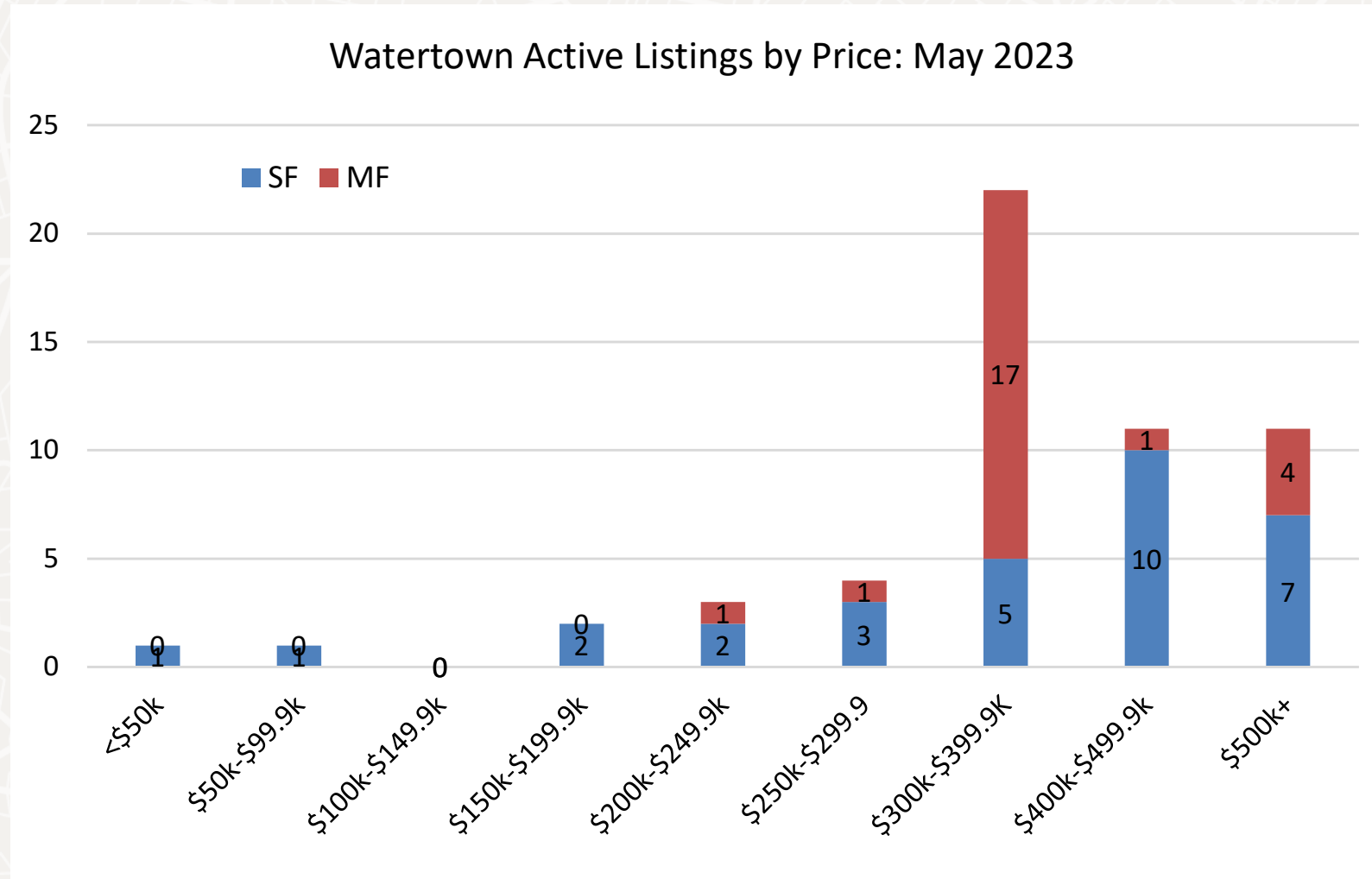
Pandemic Housing Boom drove prices this past 2+ years...

Overall

- Avg. about 400 transactions annually since 2005
- Strong appreciation in 2021 – pandemic boom
- Low inventory of homes for sale = lower sales rates in 2022 & 2023
- Slowdown resulted from rising interest rates of the past year...



Record low supply...



- 163 Listings in 2019 study...down 66% today
- 50% of listings newer construction

Lot Inventory | New Construction

Lot Inventory/Supply

- Sufficient lot supply – near-term
- 13 subdivisions w/lots – 296 vacant
- ½ of vacant lots in the Valley View Additions Subd.
- Avg. assessed values:
 - Lot: \$48,864 | Building: \$284,200
- Lot prices: Avg. \$40k to \$65k



New Construction Ranch Style Home

New Construction Market

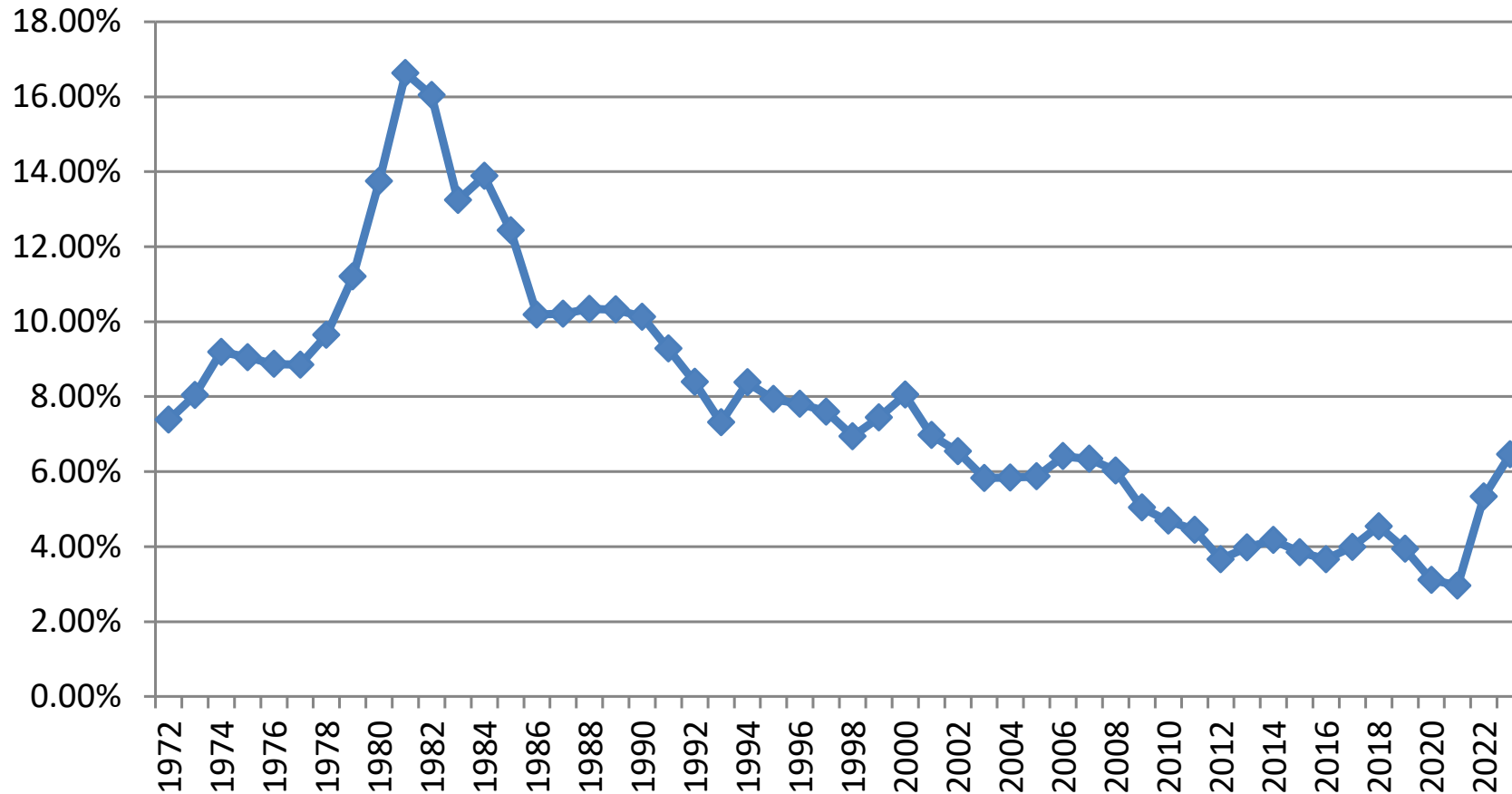
- Targets move-up buyers
- Avg. price \$370k | \$198 PSF
- No production builders – all local
- Lack of entry-level product



The Pointe Condos

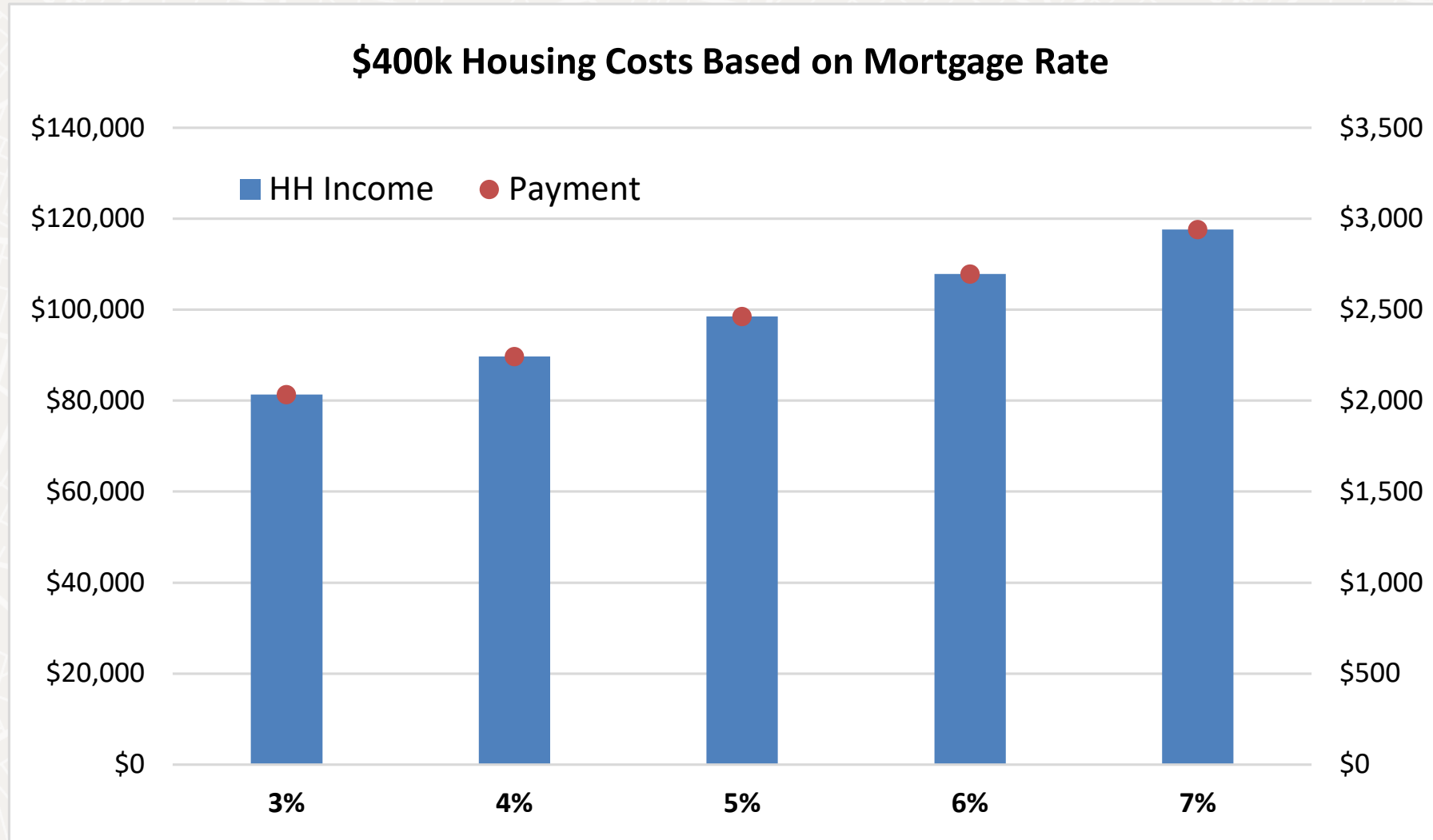
Interest Rates Rising...still historically low

Historic 30-year Mortgage Rates 1972 to 2023 YTD



FOMC Mtg. Mtg. Date	Rate Chage (bps)	Federal Funds Rate
3/3/2020	-150	1.0% to 1.25%
3/16/2020	-100	0.0% to 0.25%
3/17/2022	+25	0.25% to 0.50%
5/5/2022	+50	0.75% to 1.0%
6/16/2022	+75	1.5% to 1.75%
7/27/2022	+75	2.25% to 2.5%
9/21/2022	+75	3.0% to 3.25%
11/2/2022	+75	3.75% to 4.0%
12/14/2022	+50	4.25% to 4.5%
2/1/2023	+25	4.5% to 4.75%
3/22/2023	+25	4.75% to 5.0%
5/3/2023	+25	5.00% to 5.25%
6/14/2023	0%	5.00% to 5.25%

Housing Costs (via rate hikes alone) +45% Over Past Year...

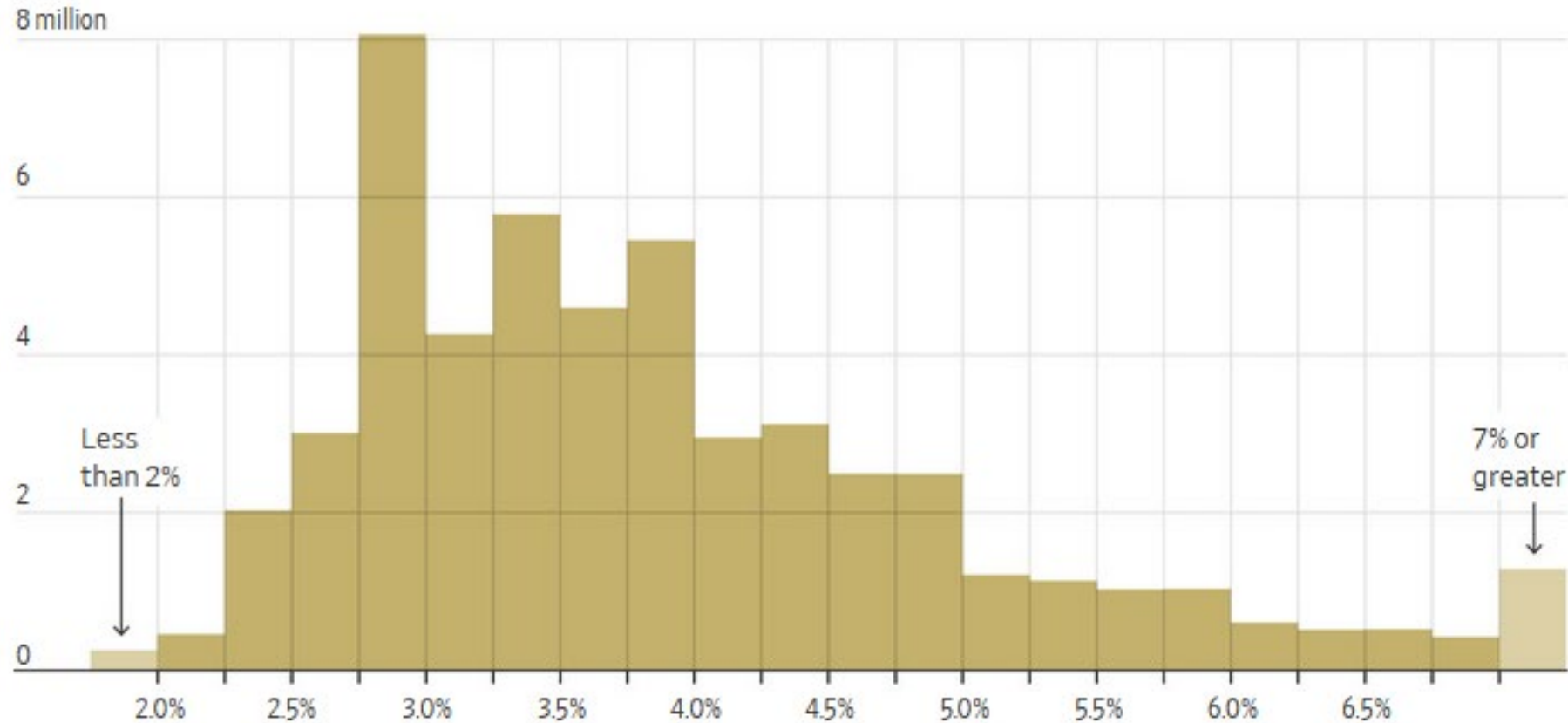


Note: Based on 10% down, 30-year fixed, good credit, HO insurance, property taxes, and PMI. Change between 3% and 7% mortgage rate.

Mortgage Rate Lock In Effect...holding back supply

Nearly 75% of existing mortgages are under 4%!

Active primary mortgages by interest rate



Note: As of March 31
Source: Black Knight

Why is the entry-level & middle market missing?

- Zoning regulations
- Density requirements
- Design/material requirements
- Permit/impact fees
- Infrastructure costs
- Building code changes
- Increasing labor and material costs
- Land/acquisition costs increasing
- Financing challenges for smaller developers/builders
- Lenders tightening underwriting standards/bank regulation increasing with bank failures
- Economies of scale needed



Tools to alleviate costs | New production not keeping pace

Multiple Strategies needed to address supply & demand challenges...

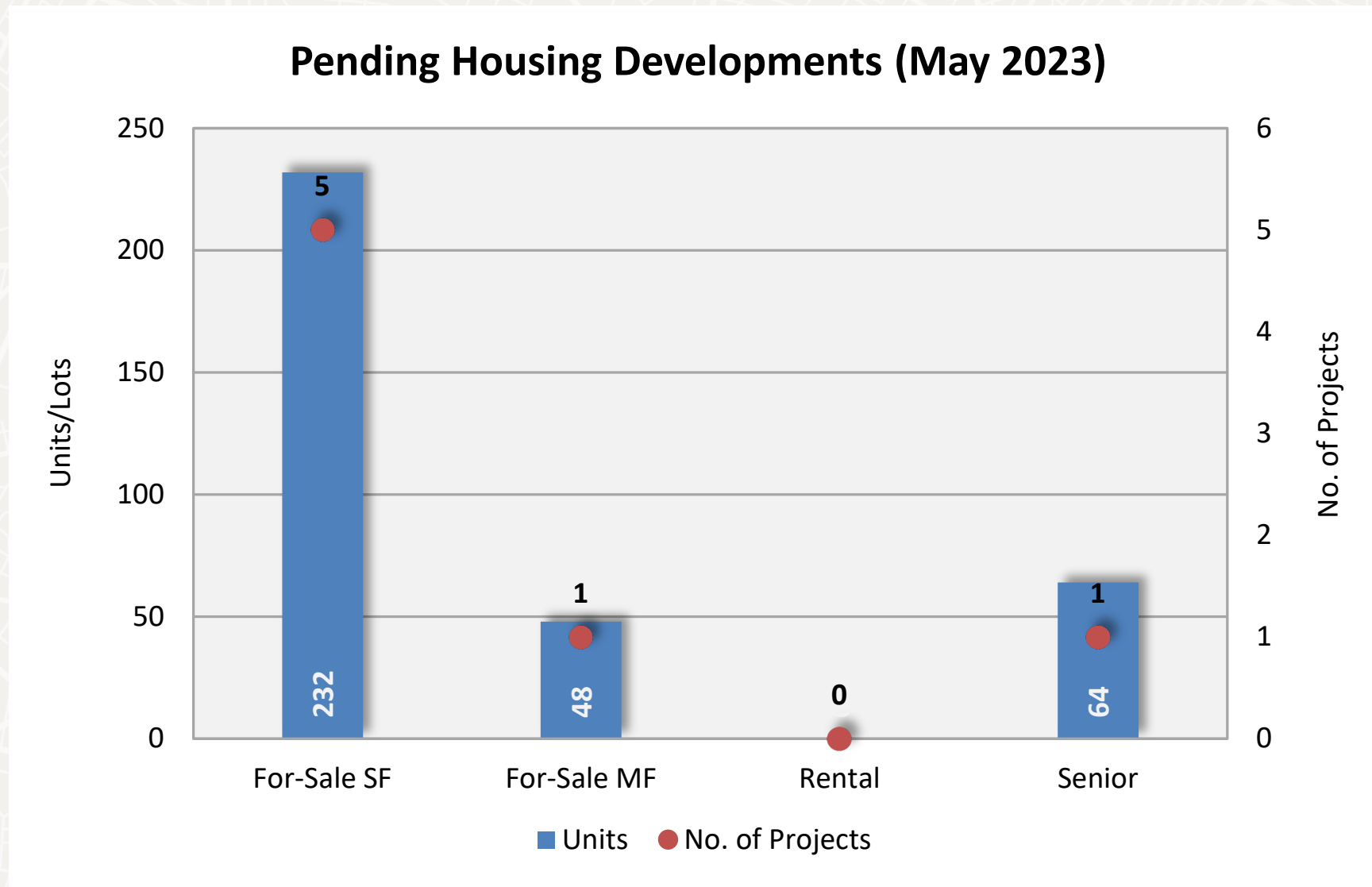
Public Sector (sample)

- Relax zoning requirements (density, lot size, parking, etc.)
- Regulatory fees (passed to end consumer)
- Fee reductions (Entitlement, permit, impact)
- Fast tracking (time is money)
- Tax abatement/TIF, etc.
- Housing Trust Funds & other housing programs
- Land acquisition contribution, infill sites, etc.
- Opportunity zone tax breaks
- Accessory Dwelling Units (ADU), Multi-gen, tiny homes, etc.
- Financing instruments
- Private-public partnerships

Improving Productivity

- Modular housing or Prefab
- Emerging construction (AI, 3D printing, automatize, etc.)
- Alternative construction materials
- Design innovations
- Promotion of the trades (schools)
- Builders in interim:
 - Reduce lot size
 - Reduce square footage
 - Less expensive finishes

Development Pipeline





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Demand Methodology

Demand Overview

- Household growth & tenure
- Turnover
- Income-qualified households
- Demand by product | Preferences

Demand Driver Examples

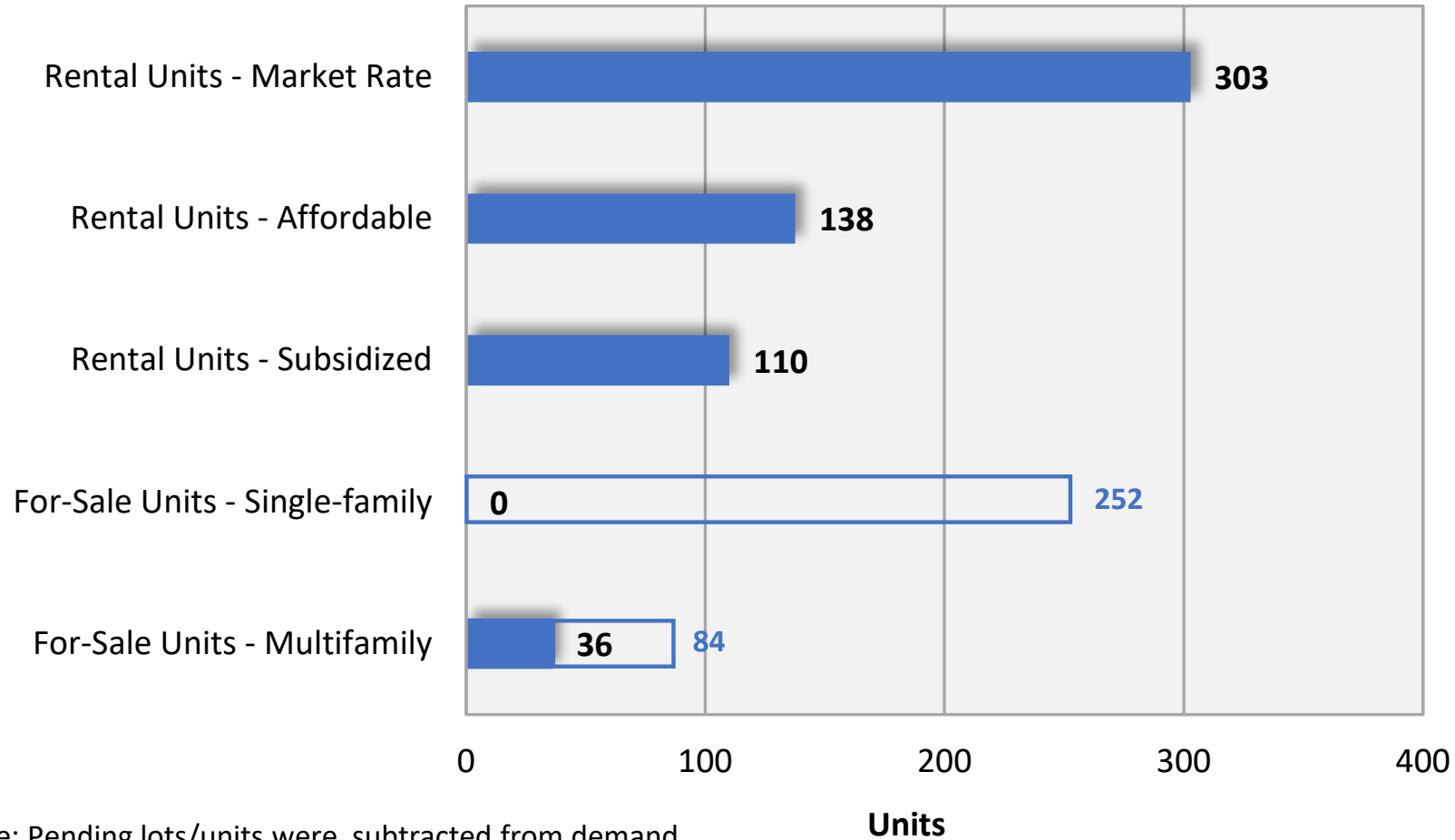
- Demographics
- Economy & Job Growth
- Consumer Choice | Preferences
- Turnover/Mobility
- Supply (i.e. Existing Hsg. Stock)
- Replacement need (i.e. functionally /physically obsolete)
- Financing

Demand Assumptions/Methodology

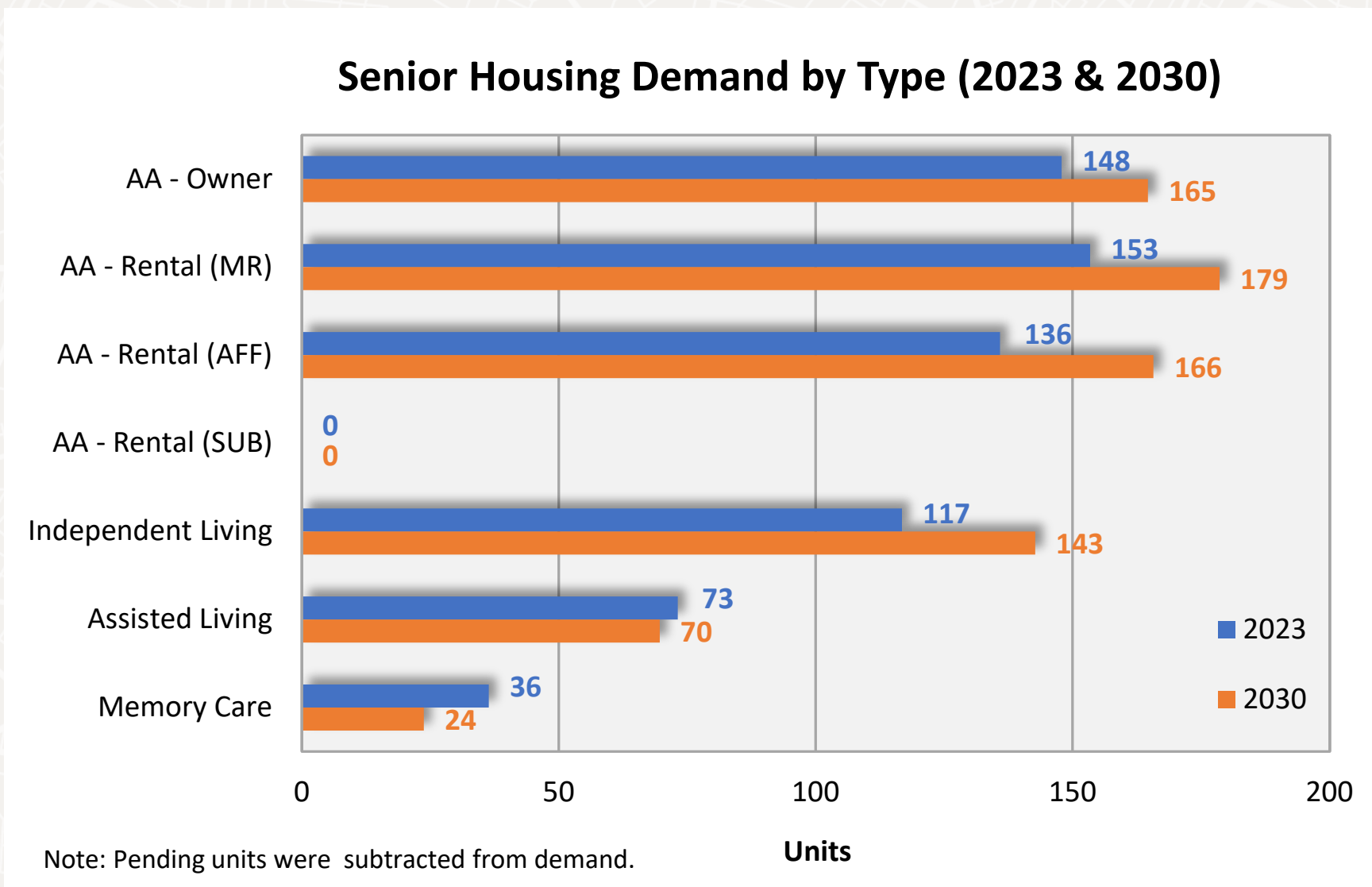
- Household growth adjusted for local factors (i.e. economy, building permits, etc.)
- Senior demand estimates apply capture and penetration rates and are presented as “Point in Time” vs. Cumulative

Demand for about 900 General-Occ. Units through 2030

General-Occupancy Demand by Type (2023 - 2030)



Demand for 745 Senior Housing Units by 2030



For-Sale Housing Recommendations

Single Family

- Recommend 3 to 5-year lot supply
 - Current lot supply is sufficient in near-term (300 lots + 230 prelim)
 - Need for diverse lot types (walk-outs, look-outs, etc.)
- Demand for 250+ SF homes
- Demand across all price points
 - However, entry-level difficult to build due to development cost



Multifamily

- Demand for 84 units
- Strong demand for association-maintained product
 - Popular with older adult and senior households
- Potential housing types:
 - Twin homes/townhomes
 - Detached townhomes
 - Quad homes/rowhomes



Rental Housing Recommendations

- Demand for all incomes, HH types, and product types
- Recent construction boom...only a 1.5% vacancy rate suggests pent-up demand
- Demand for 550+ units
 - 303 market rate
 - 138 affordable
 - 110 subsidized
- Strong demand for SF rentals, Townhome rentals, etc.
- Potential Williston Addition: still concept plan



One Willow Creek



Downtown Rehab

Senior Housing Recommendations

- Demand for 700+ senior units across all service levels
- Significant demand through this decade & beyond..(i.e. boomers)
- Strong Demand for all senior types except for senior subsidized housing (i.e. existing stock):
 - Active Adult
 - Ownership (cooperative/twinhomes)
 - Affordable Rental
 - Market Rate Rental
 - Independent Living
 - Assisted Living
 - Memory Care



Edgewood



Colonial Senior Living

Key Takeaways

- Deaccelerated growth last decade | Stronger growth since 2020 driving gains this decade
- Growth led by Millennials & Boomers | 65+ growing fastest = alternative housing products
- Living Alone (33%) & Empty/never nesters (25%) and those are highest of all HH Types
- Low 2% unemployment rate | Labor force up from 2020 | labor participation rate strong vs. US avg.
- Watertown is job importer | 58% of workers live & work in Watertown | Strong manufacturing sector
- Rental housing construction boom | Very Low rental vacancy rates | Pent-up demand
- Senior housing market poised for strong growth | Active adult & independent living highest demand
- For-sale market strong | Tight supply | Interest rates impacting sales/affordability
- Lot supply sufficient in short-term...more platted lots in the pipeline
- New construction pricing targets move-up buyers | Need for all price-points
- Inflation, higher mortgage rates, and high construction costs impact development



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Economic Outlook...soft landing or recession?

On the Bright Side

- 2x as many job openings as unemployed
- Limited distressed real estate..for now
- Inflation is easing
- Retail brick and mortar on solid footing
- Shipping container costs leveled out
- Strong dollar
- Rising wages
- Consumer confidence inching up
- Labor “quit-rates” leveling out

Headwinds

- Persistent high inflation
- Hiring slowing
- Federal Reserve raised rates 10x....more rate hikes coming?
- Housing market cooling
- Supply chain disruption
- Labor shortage/Participation rate
- Geopolitical risk
- Gas prices

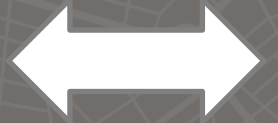
Pandemic Impact on Local Housing Markets – Big Picture

- Mobility rates high...movement for affordability/less costly housing markets (South Dakota)
- Residents spend more time @ home
- Importance of work/life balance (WFH/WFA)
- Emphasis on healthy living, cleanliness, air quality, natural light, green space, & fresh air
- Demand for homes w/home offices, flex space, home-schooling, technology upgrades, etc.
- More outdoor spaces (open space, balconies, patios, decks, gardens,)
- Desire for additional exterior entrances (i.e. townhomes, SF rentals, etc.)
- Demand for multigenerational living and ADUs
- Movement to less-costly and smaller communities slowing down from peak...but still higher than pre-pandemic (positive for Watertown)

Pandemic Housing Boom deflating with rising rates...

- Mortgage rates up significantly in 2022/03 (3% vs. 7%)
- Buyers priced out/on sidelines
- Rate lock-in effect: will home-owners stay put with historic low rates?
- Builder buy-downs to move inventory
- Land demand...2009 conditions?
- Construction starts stall, but confidence up

Median Sales Price



Home Sales



Housing Starts



Interest Rates



Inventory



Days on Market



Affordability



2023 Mid-Year Rental Housing Outlook...

- HH formations slowing w/slowing economy
- Record breaking supply (across USA)
- Lack of for-sale product & rising interest rates boosts renter demand
- Hybrid work drives new submarkets
- Affordability mobility preference
- Rising debt & construction cost constraints...
- Rising Op Ex. (taxes, labor, etc.)

Deliveries



Absorption



Rent Growth



Vacancies



Transactions



Concessions



Affordability



2023 Mid-Year Senior Housing Outlook...

- Pop. growth led by younger seniors
- Strongest demand for independent & middle market products
- Labor shortages hinder occupancies
- Another year+ of recovery until we reach pre-pandemic occupancies
- Transactions muted w/higher int. rates
- Margin compression: expenses rising faster than revenue
- More aggressive rent growth

Deliveries



Vacancies



Rent Growth



Housing Values



Transaction Activity



Concessions



Affordability





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