

# FEASIBILITY OF WATER REQUIREMENTS BALLOT INITIATIVE

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The Economics of Land Use

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# WATER BALLOT INITIATIVE

Development of three or more residential dwelling units shall only be allowed to issue a payment to the city of cash-in-lieu of water rights if the development contains 33% or more of affordable dwelling units restricted by deed for 99 years or as long as the law allows at 120% or less of area median income (AMI) for sale or at 60% or less of AMI for rent. The affordable dwelling units must be of the same quality and size as those sold or rented at market rate. The affordable dwelling units must be evenly distributed among and within all buildings and floors in any such development as applicable. The city shall allocate the affordable dwelling units for sale and for rent by random lottery.

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# WHAT DOES THIS MEAN FOR DEVELOPMENT?

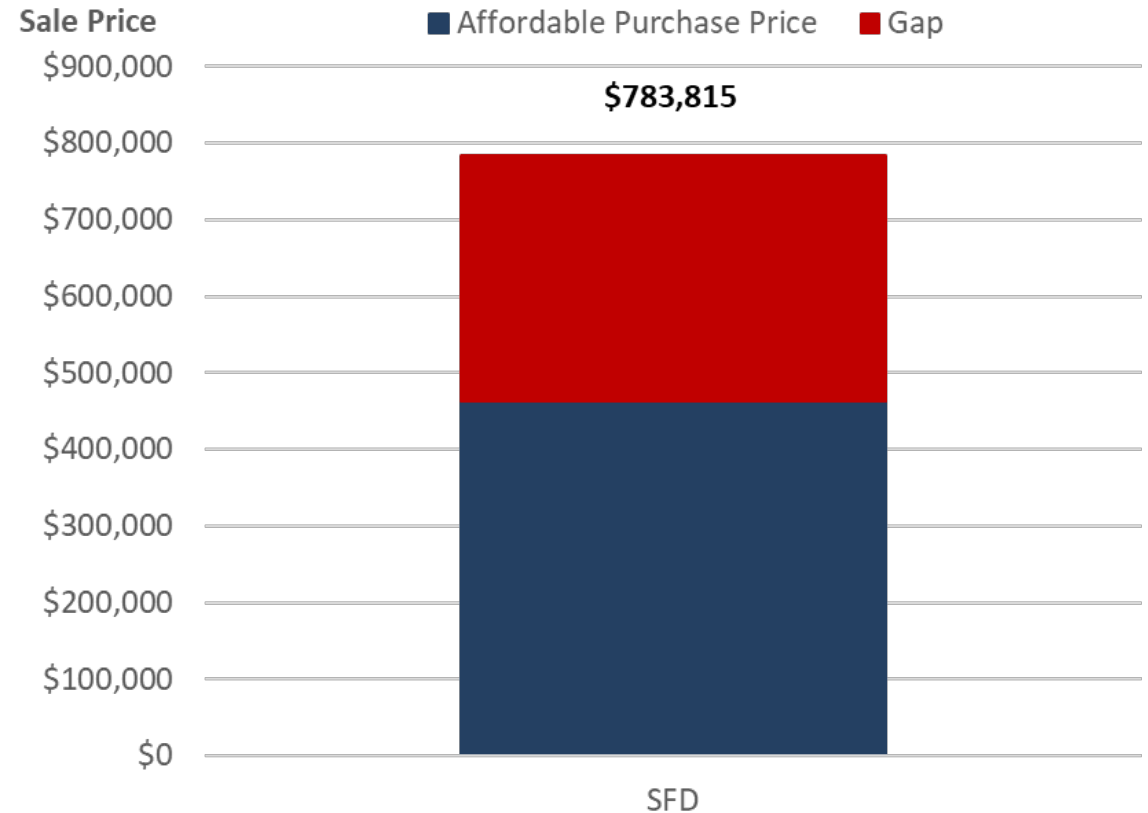
- Feasibility
  - Less development revenue generated by for-sale and rental housing with an affordability requirement
  - Cost to build stays about the same
- Development will need to purchase water rights if they do not meet the affordability requirements
  - Water is not sold in a “retail” market
  - Difficult lengthy process to purchase water rights for municipal use
- The cost of development in Bozeman will likely increase
- The supply of housing in Bozeman will likely not keep up with demand
- Due to the laws of supply and demand, the cost of existing housing may also increase, reducing affordability for everyone

# TESTING THE IMPACTS

- Premise
  - A development project needs to generate enough profit/return to happen
  - Builders and developers need to earn a profit like any other business
- What is a real estate proforma analysis?
  - Estimates development costs and revenues
  - Calculates profit margins and rates of returns
  - Planning tool to determine if a project will be feasible and worth doing
- If housing development is not profitable (feasible), it will not occur

# FOR-SALE AFFORDABILITY GAP

- Difference between cost to build and affordable purchase price at 120% of AMI
- Single-Unit Detached Home
  - Cost to build: \$783,815 (1,500 sq. ft.)
  - 120% Area Median Income (AMI) purchase price: \$462,632
  - Affordability gap: \$321,183
- Ballot measure does not propose any means of closing this gap



# SINGLE UNIT DETACHED SCENARIO

- Assume a 30-unit project
- Scenarios
  - Baseline: 30 homes, all market rate
  - Proposed: 10 affordable homes (33%), 20 market rate homes
- Home prices
  - Market rate: \$783,815
  - Affordable 120% AMI: \$462,632
- The weighted average price per home is \$107,000 less in the affordable scenario

Description	Baseline Scenario	Proposed Initiative
	All Market Rate	33% Affordable
<b>Market Rate Homes</b>		
Units	30	20
Sale Price	\$783,815	\$783,815
<b>Revenue</b>	<b>\$23,514,451</b>	<b>\$15,676,301</b>
<b>Affordable Homes</b>		
Units	0	10
Sale Price	\$462,632	\$462,632
<b>Revenue</b>	<b>\$0</b>	<b>\$4,626,316</b>
<b>Total Sales Revenue</b>	<b>\$23,514,451</b>	<b>\$20,302,616</b>
<b>Weighted Average Price per Home</b>	<b>\$783,815</b>	<b>\$676,754</b>

Source: Economic & Planning Systems

# SINGLE UNIT DETACHED PROFIT MARGIN

- Profit = revenue minus cost
- Baseline scenario (no affordability requirement)
  - 10% profit or ~\$78,000 per home
  - Total profit of \$2.35 million on 30 market rate units
- 33% affordability requirement
  - **Negative 3.7% profit**
  - **Loss of ~\$25,000 per home**
  - Total loss of ~\$750,000 on 20 market rate and 10 affordable units

Description	SFD Baseline	SFD 33% Set Aside
<b>Profit Margin per Unit</b>		
Sale Revenues	\$783,815	\$676,754
Land cost	-\$150,000	-\$150,000
Construction costs	-\$528,000	-\$528,000
Cost of sale	<u>-\$27,434</u>	<u>-\$23,686</u>
Profit/Loss	\$78,382	-\$24,933
<b>Profit Margin</b>	<b>10.0%</b>	<b>-3.7%</b>
Total Units	30	30
<b>Total Profit/Loss</b>	<b>\$2,351,445</b>	<b>-\$747,975</b>

Source: Economic & Planning Systems

# MULTIFAMILY RENT REVENUE

- Rents
  - Market rent ~\$2,100/month for a 2 bedroom
  - 60% AMI affordable rent: \$1,606/month for a 2 bedroom
- Affordable Scenario brings in \$177,840 less revenue annually
- Net Operating Income (NOI) is derived from this after accounting for operating expenses

Description	Baseline	33% Set Aside	Difference
Market Rate Rent	\$2,100	\$2,100	
Market Rate Units	90	60	
<b>Market Rate Rental Income</b>	<b>\$2,268,000</b>	<b>\$1,512,000</b>	
Affordable Unit Rent	\$1,606	\$1,606	
Affordable Units	0	30	
<b>Affordable Unit Income</b>	<b>\$0</b>	<b>\$578,160</b>	
<b>Total Rental Income</b>	<b>\$2,268,000</b>	<b>\$2,090,160</b>	<b>-\$177,840</b>

Source: Economic & Planning Systems

# MULTIFAMILY FEASIBILITY COMPARISON

- The ratio of Net Operating Income to costs needs to be about 6.5% to 7.0%
  - This is the yield-on-cost (YOC) hurdle rate
- Development Costs are the same for both scenarios: **\$26.8 million**
- The feasible development cost is NOI divided by the YOC rate
- The NOI is lower in the affordable scenario due to less rental income
  - This results in a lower feasible development cost in an already challenging market
  - **Neither project is feasible in the current market**

Description	Baseline	33% Set Aside	Difference
<b>Total Development Costs</b>	<b>\$26,820,000</b>	<b>\$26,820,000</b>	<b>\$0</b>
Net Operating Income	\$1,344,600	\$1,175,652	-\$168,948
Yield on Cost Target	6.5%	6.5%	--
<b>Feasible Development Cost</b>	<b>\$20,686,154</b>	<b>\$18,086,954</b>	<b>-\$2,599,200</b>
<b>Value/Profit or Gap</b>	<b>-\$6,133,846</b>	<b>-\$8,733,046</b>	<b>-\$2,599,200</b>
per Unit	-\$68,154	-\$97,034	-\$28,880

Source: Economic & Planning Systems

# MULTIFAMILY VALUE/PROFIT OR GAP

- Baseline (market rate) project has a development feasibility gap of \$6.1 million: **not feasible in today's market**
- High costs and high interest rates are making feasibility challenging in many areas of the U.S.
- **33% Set Aside project is even less feasible with a gap of \$8.7 million**
  - Almost \$100,000 per unit
  - \$2.6 million difference from baseline
- The ballot measure does not provide any means for closing this gap

Description	Baseline	33% Set Aside	Difference
Yield on Cost Target	6.5%	6.5%	
Actual Yield on Cost	5.0%	4.4%	
<b>Value/Profit or Gap</b>	<b>-\$6,133,846</b>	<b>-\$8,733,046</b>	<b>-\$2,599,200</b>
per Unit	-\$68,154	-\$97,034	-\$28,880

Source: Economic & Planning Systems

# FINDINGS

- For-Sale Residential

- A 33% set aside requirement for SFD would make most development infeasible
- All else equal, the sale price of a market rate single unit home would need to be just around \$950,000 to cover the loss and hit 10% profit

- Multifamily

- Development is already challenging in current market
- High interest rates requires higher rates of return (the YOC hurdle rate)
- Construction costs have continued to increase since the pandemic
- A 33% set aside requirement makes most multifamily development even more infeasible

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## MAIN TAKEAWAYS

- It is unrealistic for most development to bring its own water, which would then trigger the 33% affordability requirement
- Affordable housing typically needs free or heavily discounted land, and other incentives to be feasible
- The proposed ballot measure is likely to restrict the housing market's ability to keep up with labor force demand
- The proposed measure creates an additional cost hurdle in an already challenging development market

# TECHNICAL APPENDIX

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# 2025 BOZEMAN INCOME LIMITS

- HUD sets Income Limits by AMI for For-Sale products annually
  - At 120% AMI, 1-person income limit is \$100,000 in Bozeman
  - For a 2-person household, it is \$114,400
- The Water Ballot Initiative sets the AMI at 120% for for-sale housing and 60% for rental housing
  - The rental analysis uses maximum rent in place of maximum income
  - For-Sale affordability is determined using 120% AMI for a 2.5-person household to approximate an average household size

Description	1 person	2 person	3 person	4 person
<b>AMI HUD Income Limits</b>				
30%	\$25,000	\$28,600	\$32,150	\$35,700
40%	\$33,300	\$38,100	\$42,800	\$47,600
50%	\$41,650	\$47,600	\$53,550	\$59,500
<b>60% - Rent Limit</b>	<b>\$49,980</b>	<b>\$57,120</b>	<b>\$64,260</b>	<b>\$71,400</b>
70%	\$58,300	\$66,700	\$75,000	\$83,300
80%	\$66,650	\$76,200	\$85,700	\$95,200
90%	\$75,000	\$85,800	\$96,400	\$107,100
100%	\$83,300	\$95,300	\$107,100	\$119,000
<b>120% - For Sale Limit</b>	<b>\$100,000</b>	<b>\$114,400</b>	<b>\$128,500</b>	<b>\$142,800</b>
130%	\$108,300	\$123,900	\$139,200	\$154,700
140%	\$116,600	\$133,400	\$149,900	\$166,600
150%	\$125,000	\$143,000	\$160,700	\$178,500
200%	\$166,600	\$190,600	\$214,200	\$238,000

Source: State of Montana; Economic & Planning Systems

# 2025 BOZEMAN AFFORDABLE RENT LIMITS

- Defined by HUD
- Rental scenario uses the 60% AMI Rent Limit for a 2-bed unit
- In 2025, the limit is \$1,606 per month rent in Bozeman
- Rent Limits are updated annually using an inflationary factor that has led to rents and income definitions increasing faster than actual incomes and wages

Description	Studio	1-bed	2-bed	3-bed	4-bed
<b>AMI HUD Rent Limits</b>					
50%	\$1,041	\$1,115	\$1,338	\$1,547	\$1,726
<b>60% - Rent Limit</b>	<b>\$1,249</b>	<b>\$1,338</b>	<b>\$1,606</b>	<b>\$1,857</b>	<b>\$2,071</b>
65%	\$1,334	\$1,431	\$1,719	\$1,977	\$2,186
100%	\$1,448	\$1,626	\$2,087	\$2,924	\$3,453

Source: State of Montana; Economic & Planning Systems

# SINGLE UNIT DETACHED AFFORDABLE PRICE

- Affordable SFD Home Price for a 2.5-person household earning 120% of AMI is \$462,632
- Estimated Sale Price for a new 1,500 sq. ft. SFD is \$783,815
- Affordability Gap of \$321,183

		120% AMI
<i>Household Size</i>		
Household Income	2.5-Person	\$121,450
Monthly Housing Cost at 30%		\$3,036
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<b>Affordable Monthly Payment</b>		
Less: Insurance	\$2,500 / Year	-\$208
Less: Property Taxes	0.93% ass't rate    158.170 mills	-\$50
<b>Affordable Mortgage Payment (Monthly)</b>		<b>\$2,778</b>
<b>Valuation Assumptions</b>		
Loan Amount		\$439,500
Mortgage Interest Rate	6.5%	6.5% int.
Loan Term	30-year term	30-year term
Down payment as % of Purchase Price	5.0% down pmt	5.0%
Down payment amount		\$23,132
<b>Single Family Detached Affordability Gap</b>		
Estimated Sale Price for Single Family Detached (2025)	\$783,815	\$783,815
Maximum Affordable Purchase Price		-\$462,632
<b>Gap</b>		<b>\$321,183</b>

Source: City of Bozeman; Economic & Planning Systems

# FOR-SALE DEVELOPMENT COSTS

- Single Unit Detached

- Estimated Home Price: \$783,815
- Home Size: 1,500 sq. ft.
- Finished Lot Price at \$150,000
- Hard Costs are estimated at \$320 per sq. ft.
- Soft Costs are estimated at 10% of Hard Costs
- Profit is 10% of Sale Price
- Cost of Sale is 3.5% of Sale Price

Description	SFD
<b>Market Rate Costs</b>	
Finished Lot Price	\$150,000
Home Size Sq. Ft.	1,500
Hard Cost per Sq. Ft.	\$320
Hard Cost	\$480,000
Soft Costs as % of HC	10.0%
Soft Costs	\$48,000
Profit % on Sale Price	10.0%
Profit	\$78,382
Cost of Sale % on Sale Price	3.5%
Cost of Sale	\$27,434
<b>Home Price</b>	<b>\$783,815</b>
<b>Market Rate Cost (No Land)</b>	<b>\$633,815</b>

Source: Economic & Planning Systems

# MULTIFAMILY DEVELOPMENT COSTS

- Development costs total \$26.8 million in both multifamily scenarios
- 90 units in both scenarios
  - \$25,000 per unit for land
  - \$210,000 per unit for hard costs
  - Soft costs are 30% of hard costs

Development Costs	Factor	Total
<b>Land Costs</b>		
Site Acquisition	\$25,000 per residential unit	\$2,250,000
<b>Subtotal</b>	<b>\$25,000 per residential unit</b>	<b>\$2,250,000</b>
<b>Hard Costs</b>		
General Hard Costs	\$210,000 per residential unit	\$18,900,000
<b>Subtotal</b>	<b>\$210,000 per residential unit</b>	<b>\$18,900,000</b>
<b>Soft Costs</b>	<b>30.0% % of hard costs</b>	<b>\$5,670,000</b>
<b>Total Multifamily Development Cost</b>		<b>\$26,820,000</b>

Source: Economic & Planning Systems