

**Work Group on
Inmate-Built Modular Housing
2006 Report to the Legislature**

January 2006

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INTRODUCTION

Minnesota Laws 2005, Chapter 136, art. 1, sec. 13, subd. 2, reads:

The commissioner of corrections and the commissioner of the Minnesota Housing Finance Agency shall convene a working group to study the feasibility of using inmate labor to build low-income housing manufactured at MCF-Faribault. The working group shall consist of: the chief executive officer of MINNCOR Industries; representatives from the Builders Association of America, Minnesota AFL-CIO, Association of Minnesota Counties, Minnesota Manufactured Housing Association, Habitat for Humanity, and Minnesota Housing Partnership, selected by those organizations; and any other individuals deemed appropriate by the commissioners. By January 15, 2006, the working group shall report its findings and recommendations to the chairs and ranking minority members of the senate and house of representatives committees and divisions having jurisdiction over criminal justice and jobs, housing, and community development policy and funding.

This report is submitted in accordance with the reporting requirement of this legislation.

WORKING GROUP MEMBERSHIP

In accordance with statute, the commissioners of corrections and housing finance jointly convened a work group with legislatively-mandated representatives as well as other interested parties. Members included:

- Dick Anfang, St. Paul Building Trades
- Larry Barber, Otter Tail Wadena Community Action Program
- Dennis Benson, Deputy Commissioner, Minnesota Department of Corrections (DOC)
- Mark Brunner, Minnesota Manufactured Housing Association
- Barbara Cox, DOC Legislative Liaison
- Doug Grout, Brainerd Housing & Redevelopment Authority
- Sue Haigh, Twin Cities Habitat for Humanity
- Anne Higgins, League of Minnesota Cities
- Ray Joachim, Department of Labor & Industry
- The Honorable Tom Neuville, State Senator
- Tonja Orr, Assistant Commissioner, Minnesota Housing Finance Agency, Housing Policy
- Chris Pizinger, DOC MINNCOR Chief Executive Officer
- Scott Simmons, Association of Minnesota Counties
- Deb Sjoberg, DOC (staff)
- Ron Solheid, DOC Institution/Community Work Crew (ICWC) Program Director
- James Vagle, Builders Association of Minnesota

ACTIVITIES

The work group met three times. The first meeting discussed how to meet the goals of the legislation and reviewed ICWC, the DOC's existing industry and house-building program. At the second meeting, members discussed how the South Dakota Inmate Modular Home Program

could or could not be implemented in Minnesota. The third meeting was spent reviewing the work group's findings on the feasibility of a South Dakota-style inmate house-building program.

Additional activities of the work group included a tour of the Inmate Modular Home Plant in Springfield, South Dakota.

FINDINGS

The work group's analysis found that it is not financially reasonable to construct a modular housing factory within a Minnesota prison. This finding is based on input from several work group members. Work group members' concerns are outlined in the following paragraphs.

1. Cost

MINNCOR's financial analysis concluded that the start-up cost of constructing a plant was highly prohibitive and would conflict with MINNCOR's statutory mandate to operate without a state subsidy. To build the designated goal of 180 houses per year, the state would never recoup its initial investment of \$5.3 million because every house sold would be done so at a loss. (See Attachment A, which details the fiscal result of a house-building factory.)

This analysis is based on a number of assumptions:

General

- Manufacturing facility will be located at Faribault
- South Dakota model was used as the basis of this analysis
- MINNCOR must recover all business-related costs
- MINNCOR and ICWC programs can coexist
- Permits can be obtained for transporting houses of this size
- Required acreage for this project is available at Faribault inside the secure perimeter

Sales and Marketing

- Sell and manufacture 15 homes the first year; the quantity would increase until the goal of 180 houses is reached in seven years
- Sales staff would be hired and supervised by MINNCOR
- Based on existing market conditions, it is estimated that a 1,050 square-foot house would have to be sold by MINNCOR for about \$80,000 for the home only (figure does not include cost of foundation, driveway, well, garage, etc.)

Start-up Costs

| | |
|---|--------------------|
| • Building 30,000 square feet at \$120 per square foot | \$3,600,000 |
| • Furniture, fixtures, and equipment | 100,000 |
| • Manufacturing tools and equipment | 125,000 |
| • Transportation equipment | 700,000 |
| • Site preparation (includes 30 concrete pads, utilities, construction fence, and widening perimeter gate and road) | 351,000 |
| • Inventory and supplies to construct 10 houses | 430,500 |
| • <u>Insurance</u> | <u>5,000</u> |
| <i>Total program start-up costs</i> | <i>\$5,311,500</i> |

Continuing Operations Cost Per House

- Material cost of 1,050 square-foot house at \$41 per square foot \$43,050
- Inmate labor and factory overhead at 1,500 hours/house using a \$6.50 overhead rate 9,750
- Administrative costs per house (increases to \$15,000 after 60 houses) 10,000
- Transportations costs (includes equipment, permits, insurance, and subcontract drivers) 5,000
- Staffing costs - 4 MINNCOR staff, 1 correctional officer (after 90 houses, staffing increases by 1) 19,666

Total per home cost, first year \$87,466

Home sale price, first year \$80,000

2. Competition

The Minnesota Manufactured Housing Association (MMHA) reviewed the analysis detailed above and expressed concern that the production of up to 180 houses would significantly impact an industry that in Minnesota is already on the decline and facing competition from Canadian manufacturers. (See attachment B for MMHA’s comments.)

3. Marketing

The Minnesota Housing Finance Agency (MHFA) stated that it would be difficult to model the Minnesota program after the South Dakota program without a newly-created marketing apparatus. MHFA is not a developer of housing, nor does it have any experience in marketing housing. Typically, MHFA will provide financing for the development of housing, but the developer is responsible for marketing the product. While much of the marketing is done in South Dakota via the internet and MHFA could link its website to marketing information, it would be difficult to rely on this method alone to sell the number of homes required to meet MINNCOR’s break-even mandate.

4. Compliance

A review of issues by the Minnesota Labor & Industry Building Code Enforcement Division concluded that there are no significant differences between the building code in South Dakota and those that would apply in Minnesota. Their assessment found that the real cost would be in enforcement. Minnesota, unlike South Dakota, would monitor code compliance at the prison-based facility.

RECOMMENDATION

The work group concluded that taxpayer dollars devoted to increasing the amount of low-income housing in Minnesota with the use of inmate labor would be best utilized by an expansion of the existing DOC ICWC program.

ICWC is a voluntary program for offenders who must meet strict criteria to participate. No predatory offenders are allowed. The program prioritizes participation of offenders who are within 48 months of release and can most benefit from gaining valuable job skills. Offenders work under the supervision of DOC staff and are housed at local jails. Since its 1998 inception, ICWC has constructed 203 homes. In addition, crews have rehabilitated 24 homes and com-

pleted repairs to 60 flood-damaged homes in the Red River Valley. ICWC currently has the capacity to construct 55 homes per year, provided adequate construction funds are available to the partnering agencies.

Increasing the existing revolving fund for ICWC by \$6.636 million would result in an increase of 70 houses per year. This figure is based on a number of assumptions:

- Two offender crews per year
- Five-year phased-in implementation
- Two offender crews per year will be added (to a total of 10 crews and 60 offenders employed in five years)
- 14 additional new houses a year will be built until the goal of 70 homes per year is reached in five years
- At the end of the five-year development phase, the total value of housing built will be \$31 million; in excess of \$11 million in housing value will be added in each subsequent year
- The property tax effect on \$31 million at .017 percent is \$527,000; the subsequent tax effect on \$11 million annually is \$187,000
- There will be local economic benefits resulting from homeowner spending
- MINNCOR can currently provide all the cabinetry required and may add additional construction products; the purchase of MINNCOR products should be tied to construction loan financing

Sales

- Agencies contracting for ICWC construction crews are the developer/general contractor and are responsible for marketing and selling the homes
- Homes will generally include 1,050 square feet; a two-car attached or unattached garage; egress windows; and a lower-level, roughed-in bathroom for future expansion
- Average value will be about \$130,000

Start-up Costs

- Approximately \$240,000 per year for five years (two crews per year - includes vans, trailers, tools, and staffing)
- \$6,636,419 in revolving construction loans

Cost of Continuing Operations

- \$90,000 a year in equipment maintenance costs
- \$199,092 a year in construction loan inflation costs
- \$90,000 a year for staff support adjusted for cost-of-living increases

The unique structure of the program mitigates the following concerns expressed by work group members about South Dakota's prison-based house building model:

Cost - Attachment C shows that an additional \$6.636 million would result in inmate construction of an additional 70 houses within five years.

Competition - ICWC utilizes local contractors to complete plumbing, HVAC, electrical, and excavation. In addition, all materials for the houses are purchased through local vendors. County jails are paid the state per diem to house crews. By partnering to this extent with

non-state businesses and organizations, ICWC has been able to avoid criticism for promoting unfair competition.

Marketing - Unlike the South Dakota model in which the state is responsible for marketing, the ICWC model contracts with a community agency (usually the local Community Action Program) to serve as general contractor and marketer of the homes built. Houses are marketed and sold to households with incomes of up to 80 percent of state median (115 percent is allowed in some cases).

Compliance - Because ICWC is an existing program, no new code or compliance issues should apply.

SUMMARY

The Inmate-Built Housing Feasibility Work Group determined from discussion, research, and financial analysis that the creation of a prison-based, house-building factory would be costly, difficult to implement, and present a significant competitive threat to existing manufactured house-building businesses. The work group found that the state would be better served to increase investment in the existing ICWC inmate house-building program in order to increase the amount of low-income housing and provide skill-building opportunities for inmates.

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APPENDIX A

**Financial Analysis of MINNCOR House Manufacturing
January 2006**

Total Expense Detail

| <i>Description</i> | <i>Total Cost</i> |
|-------------------------|----------------------|
| • Building Costs | (\$4,056,000) |
| • Equipment Costs | (825,000) |
| • Inventory | (430,000) |
| Total Investment | (\$5,311,500) |

Recurring Savings/(Expense)

| | |
|--|--------------------|
| • House Sale Price | \$80,000 |
| • Cost to Build | 87,466 |
| • Loss per House | 7,466 |
| Total Loss/15 Houses First Year | (\$112,000) |

Financial Analysis of Subsequent Year Operation

| | <i>Year 2</i> | <i>Year 4</i> | <i>Year 6</i> | <i>Year 7</i> |
|-----------------------------|-------------------|--------------------|--------------------|----------------------|
| • Number of Houses Produced | 30 | 90 | 150 | 180 |
| • House Sale Price | \$80,000 | \$80,000 | \$80,000 | \$80,000 |
| • Total House Sales | \$2,400,000 | \$7,200,000 | \$12,000,000 | \$14,400,000 |
| • *Cost to Build | \$81,516 | \$83,688 | \$86,403 | \$85,596 |
| • Total Cost to Build | \$2,445,480 | \$7,531,920 | \$12,960,450 | \$15,407,280 |
| Total Loss per Year | (\$45,480) | (\$331,920) | (\$960,450) | (\$1,072,100) |

*Total cost to build vary because of staffing levels required to meet production needs

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MINNESOTA MANUFACTURED HOUSING ASSOCIATION

Opening doors to better living

November 22, 2005

(4 pages total)

Mr. Dennis Benson
Deputy Commissioner
Minnesota Department of Corrections
1450 Energy Park Drive, Suite 200
St. Paul, MN 55108

Dear Commissioner Benson:

Thank you for the opportunity to participate as a member of the Department's Inmate-Built Housing Work Group. I found the meetings informative with the Department giving appropriate attention to critical areas related to determining the feasibility of using inmate labor to produce modular homes at the Faribault State Prison. I am writing to provide the Department with a summary of the industry's concerns regarding the proposal.

Background: The industry built approximately 3,000 new modular and manufactured homes for Minnesota families last year at 8 plants; it employs around 3,500 workers at 1,500 mostly small businesses, and did nearly \$1 billion in annual sales of goods and services last year. The plants building modular homes are located in Redwood Falls, Montevideo, Red Lake Falls, Marshall, Tracy, Verndale, Worthington, and Detroit Lakes. These plants are typically the largest employer, if not one of the largest, in their respective host communities.

Concerns with a State Sponsored Enterprise: While the industry believes there is a genuine intent on the part of the Legislative proponents to provide inmates with meaningful job skills and address a societal need for affordable housing; it has serious concerns about the State of Minnesota becoming one of the largest homebuilders in the industry without respect to the market-forces that drive the homebuilding industry. Based on the initial MINNCOR "Low Cost Housing Assumptions" for operating a modular plant at the Faribault State Prison; annual production will be ramped up to 180 homes within seven-years, yet there is no accompanying marketing plan or strategy describing how this level of production will be achieved without impacting private sector builders. This level of annual production would place the inmate modular plant in the top-three volume builders of modular homes in Minnesota.

Production of new modular !BC labeled homes in Minnesota was only at 1,635 for FYO5. Of the 8 plants currently building modular homes, 4 of them also build manufactured homes. These 4 plants, like the rest of the manufactured home industry nationally, have witnessed a decrease in production of manufactured homes, and are down 40 percent from 2002. This translates to nearly 1000 fewer homes being built each year at these Minnesota plants. This precipitous drop in manufactured home production has not been offset by increased modular home production, so even discussion of a State sponsored plant coming on line raises concerns with the owners of these plants. Some of the plants witnessed partial shutdowns this past summer due to slower demand, this at the busiest time of the year for new home production. A few months ago I met with Members of the Minnesota Congressional delegation and State Legislators regarding the impact of subsidized modular homes currently imported from Canada and how it is hurting production at the employee owned modular plant in Red Lake Falls. Another example of how fragile the marketplace is today would be the modular plant that opened 4 years ago in Hugo; it closed after 2 years of operation and building only a handful of homes. The closure was due to in part to significantly higher than anticipated startup and production costs and far less demand than had been projected.

Marketing of Inmate Homes and Inmate Wages: The South Dakota program utilizes the Internet as the principal marketing tool for selling its modular homes to the public. It also statutorily establishes local selection committees, consisting of individuals appointed by the Governor, to award the low-cost homes to qualified applicants. Posting the inmate-built modular homes and selling prices on the Internet would create significant issues for private sector builders of modular homes; for example, the per square foot cost of inmate homes based on inmate wages would become the basis for consumers' comparison to the cost of private sector modular homes creating the false impression that the price difference is the profit margin of private sector builders. While we understand that it would not be the intent of the program to compete with private sector modular builders, the South Dakota Manufactured Housing Association reports they are aware of cases where those who purchased a Governor's Home could have qualified for a private sector modular home. The industry has concerns that the inmate-built homes will become a part of the Fannie Mae and FreddieMac modular home comparison databases used by appraisers and underwriters to determine loan amounts for buyers of new modular homes.

Regulatory Issues: Under the Industrialized Building Conference (IBC), of which Minnesota is a member, a modular plant built at the Faribault State Prison would not be exempt from the MN State Building Code Chapter 1361 or the IBC requirements. Specifically, the IBC's conflict of interest policy would likely preclude the Department of Labor and Industry from serving as the third-party inspector of the plant and modular homes built at a facility owned and operated by the State of Minnesota. The IBC's conflict of interest policy addresses the relationship between third-party inspectors and the builder/owner of the modular plant.

The Department may want to secure an opinion from the MN Department of Labor and Industry regarding this issue. If a conflict exists, the Department would need to issue an RFP for a private sector third-party inspection firm to do the work. Additionally, all work completed on-site related to the installation of the modular home, including the basement and foundation would require licensed contractors per MNStat.326.83. I have attached the IBC's "Procedural Manual for Manufacturers" that outlines requirements to obtain certification of a modular plant. For more details on Industrialized Building Commission requirements, the IBC can be reached at: 505 Huntmar Park Drive, Suite 210 Herndon, VA 20170. One additional item pertaining to the start up cost assumptions and ongoing operating costs related to inspections, systems approvals, and plant certification. I am told that systems approval and plant certification usually requires between 120 to 140 hours at \$65/hr. and there would be the routine inspections of the homes during the construction process and that too would be \$65/hr. plus mileage and expenses. Under MNStat 169.80, the transportation costs of moving the modular homes from a plant in Faribault to the home site needs further review. Depending on the height and width of the homes, and the required route, it may be necessary for the Department to hire Licensed Protective Agents, LPA's to the escort the homes. This may be the case for even short distances of only few blocks depending on the MNDOT route requirements. The hourly rate for an LPA is \$100.00 per hour, plus commute time to and from the LPA's point of origin. Most LPA's are based in the Twin Cities area so travel time is an issue. The requirement to become an LPA is essentially 2 years of prior experience as a licensed law enforcement official. The industry's experience with this expense has been that LPA's can add an additional \$500 to \$1,000 to the cost of a home. There is also the cost of transporting the modular home's removable chassis back to the plant that should be calculated.

Zoning Issues: It was my understanding from comments made by the staff at the Mike Durfee State Prison during our tour that the South Dakota Legislature enacted anti-discriminatory zoning statutes concurrently with the Governor's House initiative. Apparently the Statutes prohibit municipalities from excluding the Governor's prison homes from being placed anywhere in the State. Minnesota does not have a similar anti-discrimination zoning statute for modular homes. The Department should take this into consideration when determining projected sales for the inmate built homes. The industry is concerned that municipalities will enact discriminatory zoning barriers for placement of all modular homes under the guise of precluding placement of the prison built homes. This type of discrimination is already occurring where municipalities subdivide city owned land for affordable housing, and establish what they call "private covenants," barring modular homes and manufactured homes from being placed in the subdivision.

Conclusion: While the industry understands the policy goals and global benefits of providing meaningful job skills training for inmates at the Faribault State Prison, there is too significant of a downside to the private sector as outlined in the preceding paragraphs. Thus, the industry opposes the establishment of a state sponsored enterprise to build modular homes. However, there are clearly alternatives to the current proposal that would provide inmates with job training relevant to the construction industry. Factory-built construction has applications beyond modular homes and we encourage the Department to consider alternatives such as prefabricated/modular daycare centers for use in Greater Minnesota communities, portable construction-site trailers, and commercial building or residential housing components built for export to domestic and international markets not served by Minnesota businesses.

The industry appreciates the opportunity to bring its perspective to the Inmate-Built Housing Work Group. Please let me know if the Department needs any clarification of the concerns I have addressed. Thank you.

Sincerely,

A handwritten signature in blue ink that reads "Mark Brunner". The signature is written in a cursive, flowing style.

Mark Brunner President

cc: Senator Thomas Neuville and others
enclosure: 1 IBC Manual

APPENDIX C

ICWC Expansion
Minnesota Model
January 2006

| One Time | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 |
|-------------------------------|------------------------|------------------------|------------------------|------------------------|------------------------|------------------------|-----------------------|
| *Start up Cost | \$ 160,000.00 | \$ 169,600.00 | \$ 179,776.00 | \$ 190,562.56 | \$ 201,996.31 | \$ - | \$ - |
| Maint. Cost | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 90,193.49 | \$ 99,212.84 |
| New Crews | 2 | 2 | 2 | 2 | 2 | | |
| Cum. Crews | 2 | 4 | 6 | 8 | 10 | | |
| | | | | | \$ 901,934.87 | | |
| Incremental | | | | | | | |
| **Const. Financing | \$ 1,250,000.00 | \$ 1,287,500.00 | \$ 1,326,125.00 | \$ 1,365,908.75 | \$ 1,406,886.01 | \$ - | \$ - |
| Infl. Increase | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 199,092.59 | \$ 205,065.37 |
| Units Built | 14 | 14 | 14 | 14 | 14 | 0 | 0 |
| Cum. Units | 14 | 28 | 42 | 56 | 70 | 70 | 70 |
| | | | | | \$ 6,636,419.76 | | |
| ***Staff/Admin Expense | \$ 80,000.00 | \$ 81,600.00 | \$ 83,232.00 | \$ 84,896.64 | \$ 86,594.57 | \$ 88,326.46 | \$ 90,092.99 |
| Inmate Emp | 12 | 12 | 12 | 12 | 12 | 0 | 0 |
| Cum. Inmate Emp | 12 | 24 | 36 | 48 | 60 | 60 | 60 |
| Annual Funding Costs | \$ 1,490,000.00 | \$ 1,538,700.00 | \$ 1,589,133.00 | \$ 1,641,367.95 | \$ 1,695,476.90 | \$ 377,612.54 | \$ 394,371.20 |
| Revolving Fund Balance | \$ 1,250,000.00 | \$ 2,537,500.00 | \$ 3,863,625.00 | \$ 5,229,533.75 | \$ 6,636,419.76 | \$ 6,835,512.36 | \$7,040,577.73 |

*Start-up costs include an annual 6% inflation factor

**Construction financing includes an annual 3% inflation factor

***Staff/admin expense cost increases at a rate of 2% annually

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