

EXECUTIVE SUMMARY

The Water Adequacy for Residential Development (WARD) Initiative, a measure on the 2025 Bozeman Municipal Election ballot, requires developers of projects of three units or more who pay Cash-in-Lieu of Water rights, a mechanism used by 98% of new residential developments, to provide 33% of units at below market rates. This work group examined three recent below-market housing projects in Bozeman and identified the key barrier to creating new below-market housing is the capital gap – the difference between the high cost of creating a unit of housing, and the below-market price to rent or sell it to a given target population. If capital gaps are not filled – whether through government grants and tax credits or philanthropic donations – below-market housing development cannot happen. Capital gaps exist across all types of new below-market housing development and represent the single largest barrier to growing the development pipeline of below-market homes.

The costs to create housing are the same for both market-rate and below-market housing production. A policy that mandates a high level of affordability without providing subsidies that make it possible will make most market-rate development in Bozeman financially unfeasible, increasing housing costs across the board and encouraging development outside of City limits, where infrastructure is less developed.

There are a number of policy tools that can be considered by decision-makers and community members to directly address the capital gap and increase the pace of below-market housing production in Bozeman and Gallatin County.

PROJECT ABSTRACT

Convened by One Valley Community Foundation, the Regional Housing Coalition (RHC) plays a pivotal role in driving transformative collective change in Gallatin County’s housing landscape. By uniting diverse experts and decision-makers such as government leaders, housing developers, banks, realtors, employers, and others, the RHC ignites collaboration and innovation to tackle the region’s pressing challenges of housing attainability and stability head-on. Learn more at onevalley.org/regionalhousing.

A key goal of the RHC is to provide credible, objective, and data-driven public education to ensure everyone in Gallatin County has equitable access to reliable information so they can make informed decisions on public issues. The WARD Initiative is one such public issue. The RHC determined that providing information on the WARD Initiative, grounded in the experience and expertise of affordable housing practitioners in the coalition, would positively contribute to the public conversation both on WARD and on affordable housing more generally.

The RHC formed a workgroup to study the WARD initiative language and to provide additional context according to the experience of local affordable housing practitioners. WARD is an initiative that connects two issues – water conservation and affordable housing production. The RHC has a wealth of ground-level experience on the latter, but less so on the former. In the interest of contextualizing any policy analysis within the experience of housing practitioners in the RHC, this workgroup made the decision to focus our analysis on the housing component of the initiative, and how the initiative may affect growth and development patterns – and housing prices – both in Bozeman and in Gallatin County.

For more information on the water component of WARD, interested parties should look to the [City of Bozeman’s 2023 Water Conservation Efficiency Plan](#)ⁱ and the [Gallatin Conservation District’s Gallatin Water Supply Outlook Reports](#)ⁱⁱ.

CASH-IN-LIEU OF WATER RIGHTS

Bozeman sits in a “closed basin,” which means all existing water rights have been legally allocated. For this reason, Bozeman has, for the past several decades, required new development to provide water to account for the impact on water consumption that a new development creates. A new development can meet this requirement in three ways: 1) reduce demand with water conservation systems and techniques; 2) bring existing usable water rights to the City; 3) pay Cash-in-Lieu of Water Rights (CILWR) to the City. Cash-in-Lieu payments fund City efforts to develop Bozeman’s water supply at the community level, rather than on a project-by-project basis.

The Cash-in-Lieu option is generally favored by developers, as acquiring an existing water right can take several years without a guarantee of success at the end of the process. As such, 98-99% of new development in Bozeman since the 1980s has paid CILWR to the City.

THE WATER ADEQUACY FOR RESIDENTIAL DEVELOPMENT INITIATIVE

The Water Adequacy for Residential Development (WARD) Initiative is a ballot measure that will appear on the 2025 Bozeman Municipal Election ballot. Per the initiative’s authors, this measure aims to accelerate the production of new below-market housing by requiring developers that pay the City of Bozeman cash-in-lieu of water rights (CILWR) to price 33% of units at below-market rates (60% AMI for rental and 120% AMI for ownership). CILWR is a fee paid to the City of Bozeman by a developer when they do not have water rights committed to their project. Projects that bring their own water rights would be exempt from the below-market housing requirement. This policy would apply only to projects of three units or more.

This work group reached out to authors of the WARD initiative to better understand the economic analysis that informed this policy, but the authors declined the RHC’s invitation to participate in a meeting. The initiative’s authors directed us to their [website](#)ⁱⁱⁱ, which contains information on both the housing and water components of their proposed policy.

THE COST DRIVERS OF HOUSING DEVELOPMENT

WARD and the RHC share the stated goal of accelerating the production of below-market housing in Bozeman and Gallatin County. Understanding how housing gets built is necessary to understanding the impediments to this goal and how the WARD effort addresses or does not address these impediments.

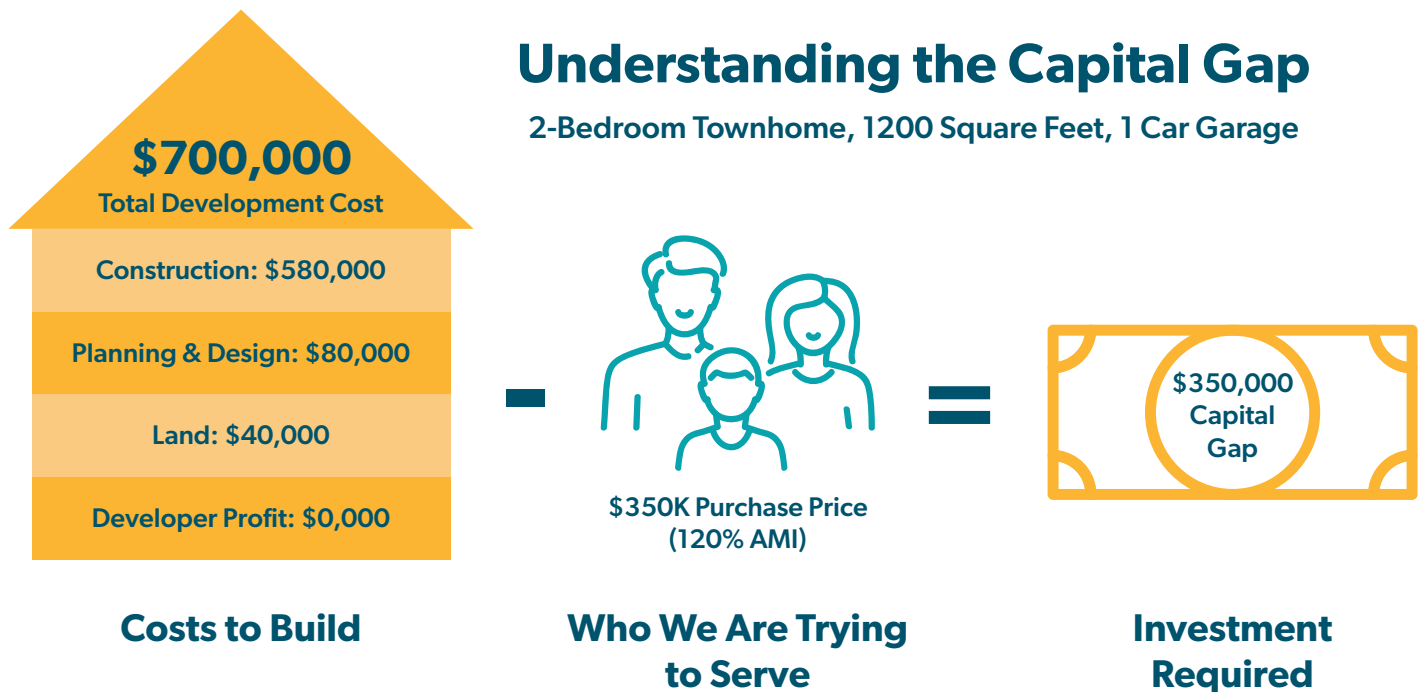
There are four core inputs that drive the cost of housing production: land, labor, lumber, and lending. Bozeman faces particularly high costs in the first three categories; national markets and interest rates tend to drive the latter two. All developments in our community, whether for-profit market-rate or nonprofit below-market, deal with these same costs.

A market-rate project needs its projected income (via rents or sales) to be greater than its projected costs to be economically viable – i.e. profitable. If a project is not projected to be profitable, it will not happen. A below-market project developed by a nonprofit needs to break even to be economically viable. If a project is not projected to break even, it will not happen. The fundamental problem in creating new below-market housing in Bozeman is that the cost of developing a unit of housing is greater than the price that is affordable to a given target population. Housing practitioners call this difference “the capital gap.” For a below-market project, this capital gap must be bridged in order for a project to break even, and get built.

The RHC’s membership includes several market and below-market housing developers. Below-market developers include Headwaters Community Housing Trust and HRDC, both of which are represented in this workgroup. Both know from extensive experience that the capital gap is the main barrier to producing more below-market housing options. Work has been done **regionally**^{iv} and **nationally**^v to illustrate the nature of capital gaps.

To illustrate this point, this workgroup looked at three recent projects brought to market by members and community partners. capital gaps existed across all three.

In the Bridger View neighborhood, developed by workgroup member Headwaters Community Housing Trust, the capital gap to price a unit so that it was affordable to a middle-income household was in the \$250,000-\$350,000 range (depending on the unit size). Without philanthropic grants to bridge that gap, the project would not have been possible.



Real figures from a below-market home in the Bridger View neighborhood.

Multifamily rental developments such as the Hidden Creek Apartments, currently under development by United Housing Partners and HRDC, will leverage land donated by Gallatin County to bring 182 fully affordable rental homes to Bozeman. To make this housing 100% affordable, an additional \$26 million in Low Income Housing Tax Credits, \$2.5 million from Gallatin County State and Local Covid Response Funds, \$1.5 million in from the Federal Housing Trust Fund, \$2 million in Gallatin Impact Funds through the City of Bozeman and additional sources of below market loans, bond financing and the dedicated Housing Choice Vouchers to cover the cost of the \$65 million development.

This work group spoke with representatives from the Bozeman Co-Housing project, a 43-unit development that includes two below-market homes priced to be affordable to middle-income households. The Co-Housing project team had hoped to include more affordable units but was unable to secure enough subsidy to dedicate more than two units (a little under 5% of the project total). The subsidy on those two units (a 2-bedroom unit and a studio) totaled \$322,104.

This workgroup’s experience with bringing below-market housing to Bozeman has informed a number of findings that guide how we approach our work:

- Capital gaps exist across project types and target incomes, whether an ownership product targeting households between 80-120% AMI, or a below-market rental project serving households under 60% AMI.
- Hard subsidies (in the form of land and grants – usually both) are required to make below-market projects financially feasible.
- For mixed-income projects, profits from market-rate units are not sufficient to subsidize a significant number of below-market units.

The existence of capital gaps makes it difficult for this group to envision how market-rate developers providing cash-in-lieu of water rights would be able to meet a 33% affordable requirement in new housing production without the use of subsidies. Indeed, if such projects were economically feasible without subsidies, RHC nonprofit member organizations would be scaling their output of below-market housing freely and without need for incentive programs, discounted land, lower-cost lending, or any of the many mechanisms currently being deployed and sought after to make our work possible.

The **WARD Policy Brief**^{vi}, written by the initiative’s authors, notes that the 33% below-market threshold was selected based on the urgent need for additional below-market units; in reviewing the content the initiative’s authors provided to this workgroup, this workgroup found that the 33% affordability threshold is not based on any modeling or financial analysis of contemporary Bozeman below-market housing projects. While we share WARD’s fervent desire to see an increase in the pace of production of below-market housing, a significant **body of research**^{vii} indicates that an affordability requirement that is not finely tuned can slow **overall housing production and lead to increased prices across the housing spectrum**^{viii}.

LIKELY IMPACTS OF INCREASED DEVELOPMENT OUTSIDE OF BOZEMAN

Without answers from the WARD authors on how market-rate developers will be able to meet affordability requirements, it is logical to project that developers who are unable to obtain their own water rights for Bozeman projects will instead look to opportunities in parts of the Valley not governed by the WARD measure. This is a noted possibility in the **WARD Policy Brief**^{vi}.

Areas outside of Bozeman’s city limits fall under Gallatin County’s jurisdiction. The County’s guiding plans, which are built upon extensive public input, research, and best practices, recognize that municipalities are best suited to accommodate new development. This is because municipalities have existing well-run and maintained water and sewer infrastructure, relatively short emergency response times, and are proximal to jobs and essential services. Ultimately, developing in cities as opposed to the County reduces sprawl and impacts on wildlife and sensitive lands, all of which have been identified as top priorities by our community.

Unlike Bozeman, the County does not own and operate its own water and sewer infrastructure and has no influence over the expansion of such utilities. This means that development outside of a municipality must either 1) connect to an independent water and sewer district or 2) have a well and septic system installed on site. When development does occur in the County, guiding plans note that connection to a water and sewer district is preferable over construction of new wells and septic systems. This is because districts are required to periodically conduct tests and report results of both water and wastewater to ensure applicable standards are being met. Conversely, maintenance of wells and septic systems typically falls to

individual property owners or their HOA, with very little to no oversight. Septic systems have also been identified as a contributor of nitrates to our groundwater, which decreases its quality. Groundwater can also intermingle with surface water, contributing to the impairment of streams and rivers.

When it comes to preserving water quality and quantity, the “gold standard” is for development to connect to a municipal system, like the City of Bozeman’s. Without this option, the remaining water and sewer opportunities available in the County are few, and where available, they are not conducive to the goal of conscientious consumption and management on a large scale.

In addition to impacts on water quality and quantity, increased development pressure in the County is likely to result in accelerated sprawl and fragmentation of agricultural lands and open space, making it **difficult for producers to do their work and for wildlife to pass through**^{ix}.

Ultimately, a policy that makes it more difficult to develop in the City of Bozeman would likely make it more attractive to develop in the County, where infrastructure and services are not equipped to handle larger populations, and where the proliferation of new wells and septic systems can greatly impact the Gallatin Valley’s water quality and quantity, agricultural operations, and wildlife.

LOCAL POLICIES TO INCREASE PRODUCTION OF NEW BELOW-MARKET HOUSING

WARD’s stated goal of accelerating the development of below-market housing is commendable and shared by members of the Regional Housing Coalition and this workgroup. It is at the same time appropriate to consider supplemental or alternative policies that could accelerate below-market housing production by addressing what this work group understands to be the key limiting factor – the need for reliable and large sources of subsidy to bridge capital gaps and make new below-market projects financially possible. There are a number of options that could meet this need – some could be (and have been) actioned by local jurisdictions, others would need voter approval (similar to WARD), and others still would require statutory changes from the State Legislature in Helena. The options listed below are not specific and immediate policy proposals, but represent a number of tools that could address the need for new sources of public subsidy to create more below-market housing.

Tools available to local governments

- **Make publicly-owned land available to below-market housing development.** We are seeing this in practice today in projects like Gallatin County’s Hidden Creek development, and the City of Bozeman’s Fowler project. Both are instances in which local governments have contributed land at no cost to make projects happen. In both cases, additional subsidies are needed to make projects economically feasible, but land contributions are a very powerful way to get the ball rolling on a new below-market housing development.
- **Use incentive programs to get below-market units from for-profit projects.** This is in practice in Bozeman through the City’s Affordable Housing Ordinance, which allows developers additional building height in exchange for a percentage of units set aside at below-market rates. This policy works because allowances like an additional story have real dollar values that act as non-cash subsidies, allowing a project to be economically feasible.
- **Allocate additional resources to below-market housing via local government budgeting processes.** Understanding that local governments have limited revenues and many responsibilities, housing nonetheless remains a key issue for our community and warrants persistent conversations around regular budget processes.

- **Connect public infrastructure investments to affordability requirements.** When Big Sky voted to expand its Water/Sewer District, they dedicated a quarter of the new hook-ups to below-market projects. This has created significant opportunities for below-market housing production in Montana’s most expensive construction environment. If communities in Gallatin County vote to invest in public infrastructure, they can consider connecting such an investment to affordability requirements in market-rate projects that benefit from said infrastructure.

Tools available to Bozeman and Gallatin County via Ballot Measure

- **Pass a levy or bond issue to create a new source of funding for below-market housing projects.** Bozeman attempted to pass an affordable housing levy in 2020, and the measure failed by a small margin of less than 200 votes. Local governments could consider asking voters to reconsider a similar effort. In the last 25 years, Gallatin County voters have funded two Open Lands Preservation bonds and one Open Lands Levy totaling more than \$40 million. A similar effort to fund below-market housing projects to meet our housing needs could be seriously considered by voters and policymakers.

Tools available to Bozeman and Gallatin County requiring Statutory Change at the State Level

- **Allow communities with high tourism impacts to implement local-option sales taxes and to use revenues to fund housing.** Montana resort communities have generated significant revenue from a tax on goods and services used heavily by tourists, including lodging, food and beverage, recreation, and luxury consumer goods. To date, the Legislature has not permitted Bozeman to levy such a tax, despite the heavy impact from tourism on public infrastructure and costs of living.
- **Allocate existing bed tax revenue to localized housing funds. Montana levies a statewide 4% tax on lodging facilities (like hotels and short term rentals).** This amounted to more than \$62 million in 2024, a little over \$20 million of which was collected in Gallatin County alone. Carving off just a quarter of that locally collected revenue would create an annually recurring \$5 million in funding for new below-market housing.
- **Allocate existing rental vehicle tax revenue to localized housing funds. Montana levies a statewide 4% tax on rental vehicles.** 75% of this revenue goes to the state general fund. Lawmakers could consider directing a portion of this revenue to high-tourism communities like Bozeman and Gallatin County.

This list is not exhaustive; the RHC will continue to research, develop, and seek out new tools to aid and accelerate the production of new below-market housing.

CONCLUSIONS

The key challenge in creating new below-market housing in Bozeman is the capital gap that exists between the cost to create new housing and the price at which it is affordable to a target population. Requiring a high volume of affordable units in market-rate projects without providing subsidies or incentives that make them possible will likely slow housing production in Bozeman altogether, leading to higher housing prices across the board over time as current vacancies are absorbed.

Nonprofit developers of below market housing are hindered in their work by a lack of access to reliable sources of funding to bridge capital gaps and help projects come out of the ground. A number of policy tools to address this key barrier are possible and should be seriously considered by citizens and policymakers concerned with accelerating the pace of below-market housing production.

ACKNOWLEDGEMENTS

Authors

Nathan Stein | Executive Director, Headwaters Community Housing Trust

Lila Fleishman | Community Development Director, HRDC

Ashlie Gilbert | Senior Planner, Gallatin County

Regional Housing Coalition Project Lead

Mark Bond | Community Engagement Manager, One Valley Community Foundation

ⁱ<https://www.bozeman.net/home/showpublisheddocument/13465/638773831096230000>

ⁱⁱ<https://gallatincd.org/gallatin-water-supply-outlook-reports/>

ⁱⁱⁱ<https://www.wardbn.com/>

^{iv}https://apps.urban.org/features/cost-of-affordable-housing/?utm_medium=email&utm_source=govdelivery

^v<https://shelterforce.org/2025/05/28/affordable-housing-finance-101/>

^{vi}https://static1.squarespace.com/static/6797fc70060fdb0bc6addb84/t/67b549d9ff16281201bf0423/1739934171489/Water+Conservation+Policy+Brief_2-4-2025+%281%29.pdf

^{vii}<https://www.mercatus.org/research/working-papers/inclusionary-zoning-and-housing-market-outcomes>

^{viii}<https://ternercenter.berkeley.edu/wp-content/uploads/2024/04/Inclusionary-Zoning-Paper-April-2024-Final.pdf>

^{ix}https://www.gallatinmt.gov/sites/g/files/vyhlf606/f/pages/gallatingrowthpolicy_dec2024_0.pdf

The City of Belgrade did not participate in the production or dissemination of this document or its contents