

Apartment ReSources

A Real Estate Research Periodical

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Market Hotline

- Watch out for "media missteps" in reporting housing market increases or decreases. Sometimes area housing data is analyzed without properly defining the size of the market area. Unfortunately, it can be risky to assume that trends are uniform throughout a market area. For example, in 1980, households in the Augusta, Georgia Metropolitan Statistical Area (MSA) increased 40.1% over 1970 levels. But at the same time, households in Richmond County increased only 33.8%. Households in the *city* of Augusta *decreased* 3.9%.
- Also, be wary of "population fixation"--the tendency to assume that population growth correlates to household growth. Even "no-growth" markets can have market potential. (See article on Page 3.)
- Sometimes, leaps in logic occur when discussing housing-cost trends. A change in the median cost for new homes is meaningful, but only if you don't fall into these traps: (1) National trends are meaningless when applied to smaller market levels. Housing prices can

Apartment Resources is a monthly publication designed for apartment developers, lenders, and builders involved in all forms of multifamily housing.

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Market Hotline (Continued)

be driven more by local markets than national trends. (2) *Median* and *average* statistics tend to imply minimum rates to some, but in fact it is impossible to determine market strength at lower price levels from median/average statistics. (3) High medians seem to indicate that only the affluent can afford housing, but entry-level buyers may have a wide variety of options other than new housing.

- *The Best of the Contenders.* Our annual *What's Hot and What's Not* survey separates the major MSAs into hot markets, not-hot markets, and contenders. But make sure that you take a good look at the contenders as well

as the hot markets, because you can find excellent development opportunities in that list as well.

Two borderline hot markets are Cincinnati and Pittsburgh, which finished 20th and 21st, respectively. Both cities are experiencing deficit construction, and although the deficit levels are not as inviting as our hot cities, they are still significant. Further, Pittsburgh holds the same position it had last year in our ranking, and Cincinnati has dropped only two places from last year's ranking of 18. This appears to indicate a consistent inability of the housing supply to keep up with market demand.

Developer's Dictionary

Vacancy Rates

When a developer or lender refers to a project or market area "vacancy rate," keep in mind that his definition of a vacant unit may differ from yours.

Of course, a unit that is not occupied is a vacant unit. But some unoccupied units can be classified in a variety of ways depending on what is being measured. For example, although manager's units and model units are not revenue-generating units, neither are the "vacancies" in these units an accurate indication of the market performance of the project itself. Therefore, calculating a vacancy rate that includes these units would give an inaccurate indication of market performance.

Nevertheless, in some instances it is necessary to include such units in calculating vacancy rates. That is why it is important to remember that depending on the methodology used, vacancy rates in a project can vary by several percentage points.

Most multifamily developers are concerned with two types of vacancies--*market vacancies* and *pro forma vacancies*.

The *market vacancy rate* is the number of units available for rent divided by the total number of

rentable units. A market vacancy rate, however, considers certain unoccupied units to be not vacant:

- *Units that cannot be rented due to damage or lack of one or all appliances. These units require more than the standard preparation to prepare for occupancy due to distress, and are therefore counted differently than normal unoccupied, unrented units that have not been prepared for occupancy.*
- *Nonrevenue units for management.*
- *Units that are vacant but rented and being prepared for occupancy.*

Units that are unoccupied, not rented, and have not been prepared for occupancy are counted as vacant units (unless, as noted above, the units suffer distress that requires more than standard preparation).

The *pro forma vacancy rate* is similar to the market vacancy rate, except the units described above as unoccupied but not vacant are also considered as vacant units. Therefore, the typical pro forma vacancy rate can be 2 to 4 percentage points higher than the market vacancy rate.

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No-Growth Markets Can Be A Moving Experience

A key factor in evaluating a market's housing potential is in-migration--that much appears obvious. A developer's chances for success seem better in an area that people are moving into. For that reason, much attention is paid to "boom" cities, those areas that for one reason or another are attracting the most new residents.

But is in-migration the only factor that determines housing potential? Is it even the most important factor? The truth is that not every "boom" city is a developer's paradise, and, more important, not every "no-growth" market is developmentally inactive. That's because relying on net in-migration* figures alone ignores other basic housing support components.

Among these other components are *internal growth*, *internal mobility*, and the "household shrink" phenomenon. Although internal growth is a contributor to household growth, this article will focus on internal mobility and "household shrink," the two lesser-known components of housing demand. Before discussing these contributors, however, one must first establish the basic principles of housing demand.

Back To Basics

The only important factor in any housing market is the fundamental basis of economics: supply and demand. An area that is attracting new residents may indicate high demand, but that area could already be overbuilt, or in the process of becoming overbuilt. If the supply already exists to meet the housing demand, then new developers in this "boom" market may find some unexpected marketing problems. (Because of this, the Kenneth Danter & Company Housing Demand Analysis [HDA]SM is based not on housing demand alone, but on a comparison of housing demand to housing supply.)

The same principle applies to "no-growth" markets. Although low net in-migration may initially indicate low demand, there may be other forces creating support for new housing: families are moving from apartments to single-family homes, retired couples are moving from single-family homes to apartments, and other residents are stepping up in either apartments, condominiums, or single-family homes. Further, new households are being created within the existing population base through marriages, divorces, and maturing population.

Although not every one of these new households requires a new housing alternative, in many markets the number that do is significant. More important, proper market analysis can usually predict what percentage of these households will desire new alternative housing.

Three Important Housing Demand Components

To understand the relationship between households and market potential, one must first recognize the relationship between *net in-migration*, *internal mobility*, and *household shrink*, three important components of housing demand.

I. THE NET IN-MIGRATION FACTOR

Net in-migration creates an immediate demand for housing, one which can add housing units to a market area on a one-for-one basis. What makes the in-migration component attractive to developers is the increased likelihood that these households will require new housing alternatives. Nevertheless, although in-migration is an important factor in evaluating market potential, the presence of internal mobility and household shrink lessens its overall impact.

* *Net in-migration* here refers to the number of people remaining when *out-migration* is subtracted from *gross in-migration*.

II. THE INTERNAL MOBILITY FACTOR

The *internal mobility* component of housing support is often overlooked in evaluating a market for new housing support. This group comprises those households within a market who wish a housing alternative, with a percentage of this pool seeking new housing alternatives. As the following information will indicate, it is unfortunate that this market is not often addressed in market analysis, because in some areas it is one of substantial impact. However, internal mobility is far more difficult to determine than calculating net in-migration. It's a lot easier to compare net population change than to find out what percent of the existing population would move if acceptable housing alternatives were available.

To determine the extent to which internal mobility is a factor in housing markets, Kenneth Danter & Company conducts extensive ongoing consumer telephone surveys to determine step-up and lateral support created by residents within a market area. The results of these surveys, when compared with information collected during the decennial census, forms the basis of the internal mobility factor in our HDA.

The Impact Of Internal Mobility

Our research has shown that for any single year, up to 12% of the existing households will move. Of this 12%, one-fifth (20%) may seek or prefer new housing..

In some areas, this could be a sizeable housing market. Consider Cleveland, Ohio in Cuyahoga County, long perceived as a "no- growth" area. In 1980, Cuyahoga County had 563,478 households, which increased only 0.6% in 1985 to 567,014 households, a gain of 3,536. However, if 12% of its households moved in 1985, and, among these households moving, 20% were seeking new housing alternatives, the demand for new housing could be as high as 13,600 units.

Good News And Bad News

13,600 units? In Cleveland? Although it's true that internal mobility demand in Cleveland could be that high, it is also true that there is no

realistic way of supplying product to accommodate that demand. The bad news is that a number of limiting factors inhibit internal mobility demand.

First, a specific demand must exist for the homes people are selling. Unlike external mobility households, internal mobility households have the option of staying put or even remodeling their existing residences if new homes do not specifically meet their needs or wants. Also, developable, zoned land and infrastructure (water, sewer, gas, and electric services) must be available. Most important, to capture 100% of this market, overbuilding is usually required to make all desired locations, amenities, styles, and price ranges available. Since the trade-off for such a high capture may be a crippling vacancy rate, such development is unfeasible. Therefore, all of these factors reduce the realistic capturable share of the internal mobility market.

The good news is that although it is not possible to capture 100% of the internal mobility demand, the number of such households in many markets is high enough to sustain a well-conceived development, even in "no-growth" markets.

III. THE HOUSEHOLD SHRINK FACTOR

Household shrink refers to the current phenomenon of the declining number of persons per household. Several factors are responsible for this decline:

- *Different life expectancies between men and women, which can create a high number of single-person, elderly households.*
- *A trend toward later marriages resulting in a higher percentage of single-person households.*
- *A trend toward smaller families.*

Even if an area's population remains the same, as the population per household declines, the number of units needed to house this population increases. In some markets, even changes of less than a percentage point can make a significant difference.

Consider an MSA whose population in 1970 was 476,500, when the national average population per household was 2.74%. If the population had remained the same in 1980, by which time the population per household had become 2.41%, this MSA would have added 2,381 households annually during that decade--a total of 23,812 households.

Although the decline in persons per household cannot continue indefinitely, it is important to recognize this trend as it currently affects household growth figures.

The Relationship Between Household Growth and Housing Demand

Therefore, although the media often depicts housing demand as a function of net population growth (net in-migration), this component

cannot indicate the full range of demand present in a market. The real market for housing is the total number of households "on the loose," and net growth is not a full measure of this potential.

In fact, the number of households "on the loose" can be far greater than net growth. The chart on this page contains comparisons of the net growth and gross growth of major MSAs. As the chart indicates, even in so-called "no-growth" markets, potential exists for successful development, as long as the product serves the needs of potential residents.

So while other developers are rushing into "high-growth" areas, you might do well to take a second look at "no-growth" markets. Remember, moving vans are pretty much the same to your project, whether they come from across the state or across the street.

Comparison of Housing Support Components

Market Area	Average Annual Household Growth 70-80 ¹	Average Annual Internal Mobility 75-80 ²	Average "Household Shrink" Adjustment 75-80 ³	Average Annual Households "On the loose" 75-80
Columbus MSA	9,490	37,368	6,041	52,899
Cleveland MSA	4,426	43,905	11,958	60,289
Detroit MSA	18,522	105,034	15,847	139,403
Atlanta MSA	24,001	64,294	9,285	97,580
Raleigh MSA	6,655	16,946	3,416	27,017
Orlando MSA	10,912	23,479	3,479	37,870
Milwaukee MSA	6,801	3,563	5,742	48,174
Pittsburgh MSA	6,921	43,253	6,778	56,952
Tucson MSA	8,467	22,343	1,943	32,753
Cincinnati MSA	6,792	36,379	5,140	48,311
Portland MSA	11,492	44,968	6,132	62,592
Indianapolis MSA	7,159	33,276	4,858	45,293

¹ Based on US Census household growth statistics.

² Residents who moved, but remained within the MSA, adjusted for 1970 population-per-household statistics.

³ Increase in actual internal mobility, as indicated by 1980 population-per-household statistics.

Source: Kenneth Danter & Company

Gap Management: The Key To Balanced Absorption

"On the last day of rent-up, the final two units were leased: a one-bedroom unit and a two-bedroom unit."

A developer who can make that statement has just completed a successful rent-up of his project. The absorption of his project has been perfectly balanced and in tune with the demands of the market.

But for many developers, some product in a development moves more quickly than others, leaving an excess of a particular unit type after all the others have been leased. In spite of best attempts to develop the best mix of supportable units for a market area, some units seem to lag behind in tenant preference. This could be the result of amenities desired, "perks" offered on competitive units at other projects, competitive project advertising, or a combination of these and other elements. Regardless of the cause, unless project management is unable to reverse the trend, a project may end up with a number of empty one-bedroom units and no two-bedroom units to offer, or vice-versa.

One way to reverse this trend is proper "gap management."

The Gap: The Price Makes The Difference

Basically, the gap is the price difference between unit types that will yield a balanced absorption. The key to proper gap management is to price your unit types so that one does not overshadow another in popularity.

The best way to do this is to calculate a gap that fits your ratio of units. For example, suppose you have an even mix of one- and two-bedroom units. Assume that your research indicates that a gap of \$70 between those units will yield a 1:1 absorption ratio. All other things being equal, as long as you maintain that gap your project will enjoy a balanced absorption. In that same project with a different ratio of units, a \$70 gap would be inappropriate. If, for example, the project had a mix of 30% one-bedroom and 70% two-bedroom units, then such a gap would favor one-bedroom absorption. The gap

would need to be adjusted downward to increase the pace at which two-bedroom units are absorbed.

To achieve precise control over rents, one needs to practice effective gap management in each different unit type: townhouses, garden units, and units with special features (amenities, views, or floor placement). Every unit that for some reason carries a rent different from the others requires gap management.

Proper Gap Management Needs a 100% Field Survey

Gap ratios are not a fixed formula, but instead vary from market area to market area. Although a \$70 gap may be appropriate for a project with a 50/50 mix in one market area, it may be inappropriate for the same development in another market area. Therefore, careful market area research is required to determine the correct rental gap.

The information required to determine this gap can only be obtained in a 100% field survey of market area projects. Only by plotting the absorption performance of other units in the market can one determine the value placed on different unit types. For this reason, Kenneth Danter & Company performs a 100% field survey of every market area we analyze. One objective in doing so is to establish a "Standard of Gap" (SOG) for each market area--that is, the normal gap experience for that market area along with the ratio that best suits that gap. If field analysis determines, for example, that a particular market area is best able to support a one- to two-bedroom ratio of 40/60 with a gap of \$70, then our Project Directors can use this information in their final mix and rent recommendations.

However, gap management can also benefit projects currently in the rent-up process. If you would like more information on how you can increase your gap-management effectiveness, call us today at (614) 221-9096. We'd be happy to discuss your current project needs.

Kenneth Danter & Company has assisted successful development in over 2,000 communities. Our research team, which maintains a 100% data base on markets in over 40 states, has analyzed development alternatives for builders, lenders, and government agencies in a variety of markets.

Market-rate apartments
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● **Market Feasibility Studies**

-Condo Closings

Market feasibility studies are based on an Effective Market Area (EMA)SM analysis of a 100% data base. The EMA methodology was developed by Kenneth Danter & Company to determine the smallest geographic area from which a project can expect most of its support.

● **Economic-Impact Studies**

Economic-impact analysis can determine the dollar effect an industry or organization can have on a community. Our analyses incorporate the Bureau of Economic Analysis' RIMS II methodology for maximum accuracy in determining economic impact.

● **POP (Project Opening Plan)SM**

The Project Opening Plan (POP)SM is a 12-month analysis of a project during its rent-up period. Constant feedback from field analysis of competitive projects, visitor surveys, advertising analysis, and shopping reports allows project management to maintain a balanced absorption at the maximum achievable rents.

● **REAL/LINESM On-line Data Base**

If you own a computer and modem, you have apartment and demographic data at your fingertips with the REAL/LINESM on-line data base. REAL/LINESM reports deliver the most up-to-date information available in major market areas--at a fraction of the cost you'd expect to pay.

● **Publications**
-Apartment Trends
-Apartment Resources

Kenneth Danter & Company produces a number of publications based on proprietary research. Among these publications are *Apartment Trends*, a series of complete analyses for major market areas, and *Apartment Resources*, our client newsletter that offers insight into the multifamily development process.

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