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COMPANY**

Apartment Resources

A Real Estate Research Periodical

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

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A Tale of Two Cities: Cleveland and Phoenix

Ten years ago, Cleveland and Phoenix were cities going in opposite directions. Cleveland was “The Mistake on the Lake,”—the city was in default, the Cuyahoga River had caught on fire, and plants were closing right and left. Phoenix, on the other hand, was growing and thriving, and poised for more growth.

Today, however, things are different. Phoenix is struggling to rebound from tremendous overbuilding, while Cleveland is in the midst of an economic renaissance and presents tremendous opportunities for housing development. What made the difference?

Cleveland—Checking All The Demographics

Over the last ten years, despite economic fluctuations and much-publicized employment losses in some sectors, Cleveland has remained a prime location for housing development. This year, our *What’s Hot and What’s Not* ranking listed Cleveland as a “Sizzler” market, indicating that Cleveland still has a substantial net housing deficit. Some of the reasons for our ranking and our confidence in the Cleveland market are as follows:

Housing Demand Analysis (HDA)SM

- The Cleveland MSA has run a substantial net housing deficit throughout the decade of the 1980s.
- The area has a substantial resident population that can support new options in housing (internal mobility). This population base has not been offered very many options throughout the 1980s since new housing development levels have remained low.
- New housing development declined dramatically in the early-to-mid-1980s as national developers lost interest in the area—apparently because of the state of the local manufacturing economy. The local builders and developers that remained have tended to be conservative.
- The Cleveland MSA has also been a difficult market for multifamily

development because of zoning difficulties. Many communities have stringent codes for multifamily development. While these regulations can be frustrating to developers because they increase building costs, the lack of development in the area has kept rents high.

Population, Households and Income

- Although population has decreased steadily since 1970, Cleveland *households* have increased 4.6% between 1980 and 1990, and are expected to increase an additional 1.7% by 1995. Households are a more reliable indicator of housing demand than population figures.
- Cleveland has a substantial amount of gross mobility. With 13 Fortune 500 industrial firms headquartered in Cleveland, the city is tied with Houston for the fourth-highest number of Fortune 500 industrial headquarters. As a result, Cleveland has a substantial amount of transfer activity.
- Median household income has increased 81.5%, from \$19,111 in 1979 to an estimated \$30,505 in 1990. Projections for 1995 indicate an additional increase of 19.0% to \$36,298.

Economy and Employment

- Cleveland’s economy has gradually been shifting away from its heavy dependence on manufacturing into a more diversified economy. Manufacturing represented 30.8% of employment in 1976, but only 22.3% of employment in 1988. Services represented 18.7% in 1976, but increased to 26.4% in 1988.

	Cleveland MSA		Phoenix MSA	
	Population	Households	Population	Households
1970 Census	2,063,733	650,438	968,488	302,985
1980 Census	1,898,825	694,401	1,509,052	544,759
Change 1970-1980	-8.0%	6.8%	55.8%	79.8%
1990 Estimated	1,842,553	726,318	2,130,850	827,527
Change 1980-1990	-3.0%	4.6%	41.2%	51.9%
1995 Projected	1,811,400	738,451	2,420,332	952,747

■ Total job growth in the Cleveland area is expected to increase 0.8% annually from 1988 through 2000, with 60% of the new job creation expected to occur in the services-producing industries. Construction employment is expected to increase by 6.9%.

Other Factors

■ Cleveland has improved its image both nationally and locally. Public-private partnerships have spurred substantial development in the downtown area. This active promotion has caused a resurgence of public perception that the Cleveland area is a good place to live.

Phoenix: Checking the Demographics—But Not the Pipeline

The greater Phoenix area continues to grow with remarkable speed. According to 1990 estimates,

Phoenix MSA population has increased 41.2% between 1980 and 1990. Households increased 51.9% during the same period. Almost 350,000 new jobs were added to the Phoenix MSA employment base between 1979 and 1989. Forecasts are for this phenomenal growth to continue.

If Phoenix is growing so fast, and will continue to grow, then why is Phoenix listed as a “Not” city on the most recent *What’s Hot and What’s Not List?* Phoenix is still trying to recover from an incredible building boom in the mid-1980s because developers apparently failed to do one of the most critical steps in the development process—*check the pipeline*.

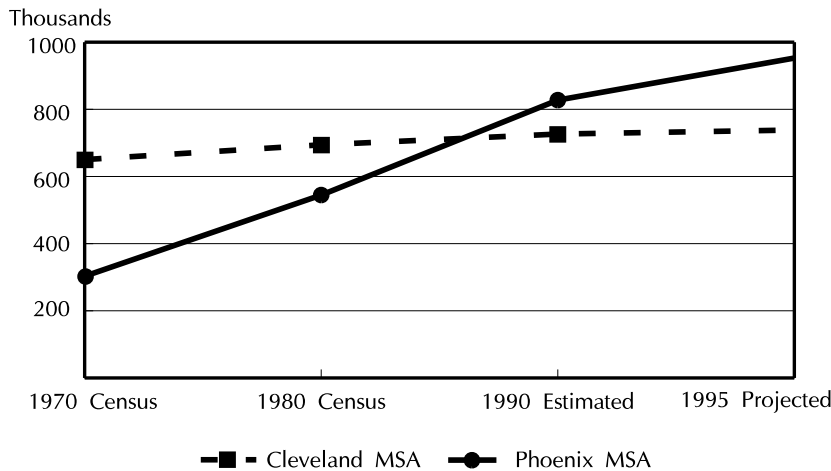
Pipeline Product

Developing an apartment complex is typically a 3-year process from start to finish. Obtaining the site,

securing financing, jumping through government regulatory and zoning hoops, preparing the site, and constructing a project can be a long process. Because of this development timetable, overbuilding can be avoided if developers have the foresight to check the pipeline for competitive projects in the planning stages.

A look at the HDA indicates what happened to Phoenix. In the early 1980s, the housing market there was tight—new housing development was not keeping up with household growth. Developers noticed Phoenix’s substantial household growth and flocked in to develop new housing projects. A substantial amount of new housing came on the market. Upon seeing that this new product was doing well (because it was meeting previous deficits), developers planned more new product at the same levels. However, by the time the new product came on the market three years later, the deficit had been absorbed and a market no longer existed. Thus, the market became overbuilt.

**Household Growth
Cleveland and Phoenix**



“The Tortoise and the Hare”

Comparing household growth in Cleveland and Phoenix is a lot like watching a race between the tortoise and the hare.

Like the fable, this race can end with similar results. Phoenix became so attractive to developers that it developed a glut of housing in the mid-1980s.

Meanwhile, Cleveland continues a pace of moderate, continued growth.

Developers often overlook such markets, preferring the apparent “easy market” boom towns. In such cases, demand in markets such as Cleveland begins to create excellent opportunities.

There is good news, however, because Phoenix's phenomenal growth will most likely absorb the housing surplus in the market if current housing development remains low. This may result in Phoenix becoming a good housing development market again—if developers exercise caution and restraint. Our projections and analysis are based on some of the following factors.

Housing Demand Analysis

- The Phoenix HDA indicates that construction levels have been down substantially in Phoenix over the last three years. However, this reduced construction is not yet enough that Phoenix has absorbed the huge deficits of the mid-1980s. With continued household growth, Phoenix may become a “contender” by 1992 or 1993.
- Multifamily starts are down sharply, from 37,544 units in 1984 to 1,714 units in 1989.

Population, Households and Incomes

- Population in the Phoenix area has increased dramatically, from 1,509,052 in 1980 to an estimated 2,130,850 in 1990, a 41.2% increase. This growth is expected to continue, with population projected at 2,420,332 in 1995, a 13.6% increase over 1990.
- Households increased from 544,759 in 1980 to an estimated 827,527 in 1990, a 51.9% increase. This growth will also continue, increasing to a projected 952,747 households in 1995, and increase of 15.1% over 1990.
- Median household income increased from \$17,737 in 1979 to an estimated \$31,994 in 1990, an 80.4% increase. Median household income is projected to be \$40,773 in 1995, an increase of 27.4% over 1990.

Economy and Employment

- Total employment in the Phoenix MSA has increased to 1,035,748 in September 1990 from 671,200 in 1979, an increase of 54.3%. Based on seasonally adjusted 1989 figures, an average of 34,411 new jobs have been created each year for the last decade. Employment is projected at 1,356,812 in 1999, an increase of over 300,000 over the September 1990 level.

- The unemployment rate for the Phoenix MSA is 4.0% for September 1990, compared to the Arizona rate of 5.1%. The highest the unemployment rate has been in the last ten years in the Phoenix MSA was 7.9% in 1982.

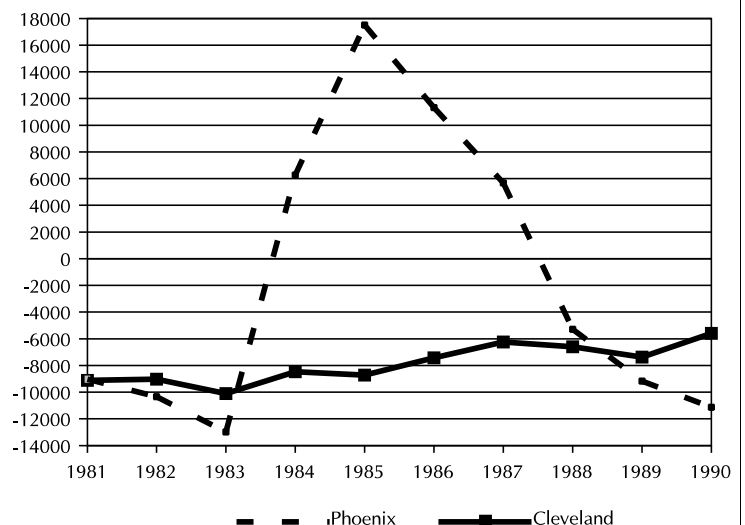
HOUSING DEMAND ANALYSIS CLEVELAND AND PHOENIX METROPOLITAN STATISTICAL AREAS 1981-1990

	Cleveland		Phoenix	
	Total Units Authorized*	Net Housing Starts**	Total Units Authorized	Net Housing Starts
1981	2,955	(9,105)	25,577	(9,023)
1982	2,953	(9,027)	25,465	(10,335)
1983	1,681	(10,099)	27,825	(12,975)
1984	3,524	(8,456)	47,083	6,283
1985	3,890	(8,710)	60,723	17,523
1986	5,374	(7,426)	52,723	11,323
1987	6,774	(6,226)	44,679	5,679
1988	6,806	(6,594)	29,712	(5,288)
1989	5,813	(7,372)	23,832	(9,168)
1990	7,016	(5,584)	15,874	(11,126)

*The *total units authorized* figure is based on building permits issued for the previous year and includes mobile home additions.

***Net housing starts* are total housing starts minus household growth and internal mobility.

NET HOUSING STARTS 1981-1990
Cleveland and Phoenix



Where are Your Tenants Coming From?

One of the most important pieces of information for an apartment manager is where the community's prospective tenants are likely to come from. However, most apartment managers assume "where" refers only to geography. To really understand the nature of your market, you must understand where your tenants are coming from not only geographically, but also financially—and how those two factors are interrelated.

Geographically—The Effective Market Area(EMA)SM

In order to determine where tenants are likely to come from geographically, the Danter Company developed the Effective Market Area (EMA). The EMA is defined as the smallest geographical area from which a project can expect to generate between 60% and 70% of the support for a project.

How We Determine an EMA

When we determine an EMA for a project, we look at several factors, including geography, demographic analysis, mobility patterns, and area perceptions.

- Geographical factors—rivers, railroads, freeways, hills, and major arteries which often define neighborhood boundaries.
- Demographic factors —population and household trends; housing and income characteristics; differences in the socioeconomic makeup of individual neighborhoods; and household, employment, and economic growth figures.
- Mobility factors—gained from interviews with area real estate professionals and civic officials and our previous experience with mobility pattern analysis.
- Local interviews—area real estate professionals, civic officials, and telephone surveys of area tenants.

The Importance of a 100% Data Base

Once we have determined the EMA, we survey all the apartments in the area to find out rents, project amenities, unit amenities, etc. This provides us with an accurate picture of the supportive apartment market.

Typically, our EMAs are *Supportive* EMAs. These EMAs should not be confused with *Competitive* EMAs. A Competitive EMA includes those projects most likely to compete with the subject site for support. Therefore, the Competitive EMA is likely to include those projects similar to yours in price points, amenities, and location, and is likely to be a subset of the Supportive EMA.

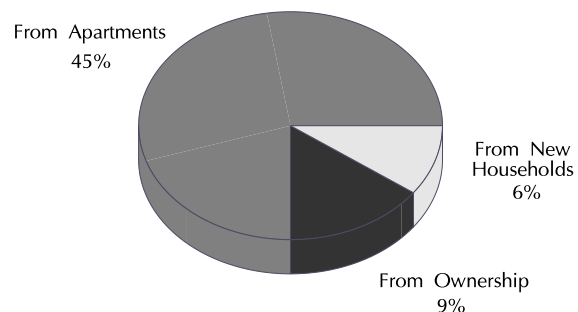
A 100% apartment data base is necessary because the primary component of support for an apartment project is likely to come from apartments *within the EMA*. Our series of reports on the Market Support Matrix(MSM)SM (*Apartment Resources*, January and March 1989) found that 45% of households moving into a typical apartment project are coming from other apartments in the EMA. Add support from within the EMA due to new household formation and from household ownership, and this total EMA support increases to 60%.

Financial Factors—The Step-up Support Base

Our extensive surveys of tenants of rental housing indicate that renters will incur rent increases, or "step up" their rent for a rental alternative that they consider a value. This amount varies with the rent range of the

Tenant Origins

Distribution of Internal Mobility (New tenants from within the EMA)



Sixty percent of your tenants come from within the EMA. Of these, about 45% come from other apartments.

project in question, but is generally around \$75, with a \$100 chokepoint.

From this step-up support figure, we generate what we call the “step-up base.” The step-up base are those units with rents within \$75 to \$100 below the rents of the subject project. We then calculate a ratio of proposed units to “step-up” units—the lower the percentage, the better.

Interrelations—Step-up Support and Market Area

We use step-up support to indicate how support is likely to vary from established norms. An average of 60% of support for an apartment community comes from within the EMA—45% from apartments and 15% from other housing options. An average of 20% of support can be expected from within the area but from outside the EMA, and an average of 20% can be expected from outside the market area. Of course, support will vary from project to project and market area to market area.

For example, a project with a substantial step-up base may experience more support from within the market area, since it will be perceived as a value by those living in apartments within the EMA.

A site without a substantial step-up base will most likely have to depend on support from external mobility and new household formations to meet absorption. As a result, this might extend absorption.

Other Deviations

In addition to step-up support, we consider other factors in determining how support at a site will deviate from established norms. One such factor is the area’s growth rate. Economic growth and expansion of the employment base can create higher-than-normal growth from external mobility.

A second factor concerns mobility factors within an area. Area mobility can be either *radial* (moving in a straight line outward from the center of a metro area) or *lateral* (moving laterally across suburban or outer portions of a metro area). A household moving from the north side of town to the east side of town would be following a lateral mobility pattern. Characteristics which define areas of high lateral mobility potential

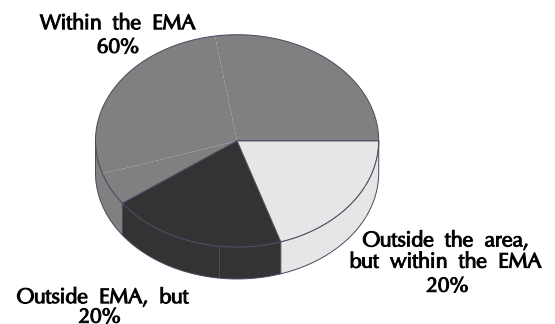
are generally related to desirability—good schools, being the “place to be,” new plant openings, or new freeways are some of the things that make an area likely to experience high levels of lateral mobility, and thus make a project in that area less dependent on support from apartments within an EMA.

Applications

One application of the relationship between step-up support and market area is in the area of rental increases. Arbitrarily increasing the rents every year might not be a good idea, because you might be pricing yourself out of your step-up support range. As a result, it may become more difficult to replace the normal turnover that occurs, and you might end up with vacant units that are considered overpriced by renters in the market.

Conversely, if you find that you are generating more-than-proportionate support from apartment dwellers within your EMA, then your project may be too much of a value, and you may not be getting enough out of your project. A small rent increase could generate more money while still leaving a good base of step-up support.

Tenant Origins Distribution of support (Geographic distribution of move-ins)



How important is area household growth? Very. But most market areas demonstrate strong internal mobility patterns, and

contain a base of tenants ready to step-up to better housing. These factors mean that most of your

Guest Cards—Your Powerful Marketing Tools

Our field research indicates that a surprising number of communities are still not using guest cards. This article will examine some of the benefits you can derive from fully using your guest cards.

Determining an EMA

The first benefit is estimating your Effective Market Area(EMA)SM—the smallest geographic area where you can expect to find the majority of the support for your project.

You can obtain this estimate by mapping your most recent guest cards. On a map of your area, plot the addresses of those people visiting your community. Most will probably be concentrated in an area surrounding your project. Drawing boundaries around these areas will allow you to roughly estimate your own EMA.

Once you have defined this area, you can begin to find more effective ways of focusing your advertising within your EMA:

Neighborhood newspapers—Many areas now have weekly or biweekly newspapers that cover a specific neighborhood. Such newspapers present an opportunity to reach specifically the people who live and are interested in living in that neighborhood.

Focused mailings—Mass mailing only to apartment residents in your EMA can be relatively inexpensive, and effective in drawing people to your community.

Billboards—Renting space on billboards across a metropolitan area is usually wasteful, but renting space on a single billboard along a major artery in your EMA can be cost effective.

Evaluating Marketing Procedures

Marketing programs need evaluation in order to measure success and adjust to changing market

conditions. One simple way of evaluating the success of your marketing programs is simply to ask. On your guest card, ask your visitors how they heard about your community. Continually tally the responses to maintain an up-to-the-minute advertising evaluation.

Prospect Follow-up

Effective sales professionals know that the sale is not always made on the first call. Your guest card can give you the opportunity to follow up on prospective tenants that leave without making a decision. In addition, should the prospect have chosen another community, it gives you the opportunity to scout out the competition and do some self-evaluation of your community.

Focusing on Demographics

Guest cards can also be an effective way of discovering the demographics of those attracted to your community in order to focus your marketing efforts. Asking a guest's age, unit preference, marital status, place of work, etc., can provide you with a base of demographic information that can be used to refine your marketing efforts. Are your visitors mainly single people? Married people? Families? Senior citizens? Students? People who work nearby? People who work downtown? Knowing who your visitors are likely to be can help you pinpoint your marketing efforts, making them more effective.

In addition, knowing who your visitors and renters are can give you insight into how to upgrade your facilities to appeal to certain demographic groups. If you find that you are being visited by an increasing number of senior citizens, then consider adding security systems to some units. If you find that you are attracting families, consider adding a playground.

Don't Just File Them Away

Guest cards are one of the most effective and least expensive marketing tools an apartment community



Looking Forward

- Look for us at the National Association of Home Builders gathering January 18-21, 1991 at the Georgia World Congress Center in Atlanta.
- Did you subscribe to REAL/LINE prior to June 1988? If you did, you'll be happy to hear that your old REAL/LINE account has been re-entered into the new system, including your old password. However, on the new REAL/LINE system, you have the capability of changing your password at any time. We think you'll be surprised at the new system features, and we will offer the most recent apartment market information available in major markets

throughout the US. If you have any questions, please call us at (614) 221-9096 and ask for the REAL/LINE coordinator.

- Want a free peek at REAL/LINE? Call us, and we'll tell you how to get guest access to the system today. Also, we'll be happy to mail or FAX you a sample copy of a REAL/LINE Report. This report contains data for a non-existent market area, but shows you how the REAL/LINE report is designed, along with tips on how to get the best use from REAL/LINE reports.

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