// Apartment ReSources

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Apartment ReSources

November Market Hotline!

- One of the surprises our annual *What's Hot and What's Not* survey uncovered is the speed at which overbuilding can impair development potential. Several cities that plunged in our rankings between 1986 and 1987 include Sacramento (which was 40 places lower in our 1987 ranking than in 1986), Minneapolis (71 places), and San Diego (95 places). Unfortunately, when developers are unaware of pipeline product, the stage for overbuilding can be set years before its effects are noticed in the marketplace.

- What is an amenity? (revisited)—Tenants appreciate attractive surroundings as well as laundry rooms and garage door openers. If some of your units offer appealing views, then you should consider those views as

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

In This Issue:

amenities when calculating your price structure.

- **How big is big? We're currently working on a special report to determine what influences a potential renter's perception of unit size. Early research indicates that design and placement within the unit can have as much impact as differences in square feet. Some key features that seem to have an influence on a renter's perception of space include**

  –***Apparent entry spaciousness (usually, the distance between the front door and the facing wall)***

  –***Size of the second bedroom***

  –***Apparent closet space***

  –***Vistas***

- **During these times of positive cash flow, don't leave revenues behind by "gang-pricing" units. Consider each unit in terms of location, view, floor, etc. If you attach "premium pricing" to each of these components, you'll be more likely to achieve a balanced distribution of units, and your tenants will be better able to select units through a price/value comparison rather than through luck (i.e., what units are available at the time).**

- **In this issue of *Apartment Resources*, we've devoted *Knowing Your Market:* to internal mobility patterns, specifically the mobility of the population outward along radial patterns. However, we've noticed lately an increasing mobility of tenants into downtown areas in a number of metropolitan areas and an increase of developer interest in downtown revitalization.**

  Our survey included downtown high-rise developments in Baltimore, Cincinnati, Denver, Memphis, Minneapolis, and Wilmington (Delaware). In these developments, which contained an average of 240 units, the lowest vacancy rate for a project not in rent-up was 92%. Managers in many of our interviews noted that suburban dwellers can be attracted to the convenience of downtown living, providing the projects feature upscale, high-quality construction and amenities, along with a consumer-oriented apartment management team.

  Also stressed by managers of these projects is the importance of frequent advertising targeted to young professionals (although some managers targeted equally to older adults) that emphasized the convenience of downtown living in general and the project's convenience in particular. We'll be bringing you more results of this survey in future *Market Hotline!* reports.

- **Speaking of downtown housing, don't overlook housing as a use for historic or older structures. We've noticed a renewed interest in loft apartments and rehabilitation development. Loft apartments have long been a standby in dense urban areas, but are now becoming chic in traditionally conservative areas of the country.**

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Capture Factors—The Ultimate Fallacy Symbol

Market studies regularly make use of capture factors in market analysis. In practice, a capture factor represents the percentage of a market area or target market that a project must capture to be successful.

But capture factors can be misleading. Unless your market analyst knows the ins and outs of applying capture factors, you run the risk of misreading project potential.

WHAT CAPTURE FACTORS MEAN TO YOU

Using capture factors is a viable methodology to compare similar markets and to apply experience gained in tested markets to new markets. But for the capture factor methodology to work, an accurate Effective Market Area (EMA)[SM] and target market for a project must be accurately defined. Specifically, the market analyst must define the smallest area from which the project can expect to attract a predetermined share of its support. Analysts have attempted to define market areas at various geographic levels such as census tracts, counties, or corporation boundaries. Attempts have also been made to define market areas by a radius/distance method. Kenneth Danter & Company defines market areas through an analysis of mobility patterns, interviews with area planning officials, demographic analysis, and our proprietary research and surveys. These resulting market areas, termed Effective Market Areas (EMAs)[SM], generally transcend political subdivisions (such as city or county limits) and are influenced by natural and manmade boundaries and changes in the socioeconomic makeup of neighborhoods.

Just how important is market area selection in determining appropriate capture factors? Consider this hypothetical situation: a market area for a congregate-care project has been defined as a four-county area of 500,000 households. Within this market, 2.2% of the total households are age- and income-qualified, which limits the market to 11,000 households. The market consultant for this project, after analyzing the area, conservatively assigns a 2.5% capture factor to the project, which he bases on various demographic characteristics unique to the market.

Therefore, out of 11,000 households, the analyst has found support for 275 units. After receiving the report, the elated developer tries to convince a lender that he can build a 275-unit congregate-care project.

Right number, Wrong Market: *The market analyst for this project mistook the Metropolitan Statistical Area (MSA) for the actual Effective Market Area of the project—with disasterous results. Instead of the indicated support for 440 units, only 66 units were supportable in the area.*

Comparison of Supportability	Market Analyst's Report	Actual Effective Market Area (EMA)[SM]
HOUSEHOLDS:	500,000	75,000
PERCENT Age/Income Qualified:	2.2%	2.2%
TOTAL Age/Income Qualified:	11,000	1,650
CAPTURE FACTOR:	2.5%	2.5%

Even if the lender trims over a hundred units from the project, both the lender and the developer will soon discover they have a major problem on their hands. Even though the market analyst correctly identified the capture factor, the project is doomed to high vacancies because the market area is wrong.

WHAT WENT WRONG?

In this case, the project simply doesn't draw from a four-county area because a complex highway system has limited the mobility patterns of the area elderly. And past experience with congregate development has already indicated that mobility patterns of potential tenants for this type of project in general are quite different from those for other housing projects. And there are competing facilities more conveniently located to serve the target population. All of these factors will significantly limit the original market area.

If an EMA analysis had been performed, it would have indicated that the realistic market area consists of only 1,650 age- and income-qualified households, and the actual potential of the site, using the capture factor of 2.5%, is 41 units—and that's assuming that the market analyst properly identified the appropriate demographic characteristics for the target market. Remember, identifying the target market requires at least as much research as seleccting the market area.

BUT THAT DOESN'T REALLY HAPPEN, DOES IT?

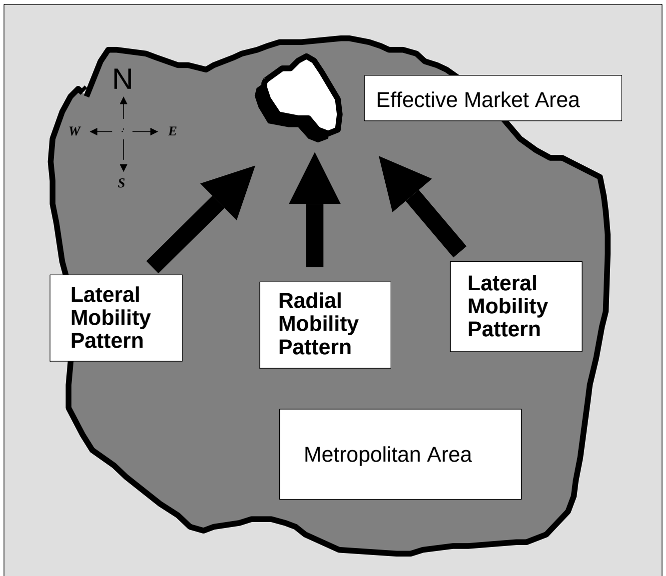
Although it may seem ludicrous that a developer could assume such a large market area for his project, we recently had the opportunity to review a retirement community market study performed for an area lender. In this case, the market analysis was conducted in a mid-size Northeast city. The lender on the project was excited because the capture factor of qualified residents was less than 1.0%. A further review of the study found that to achieve the less-than-1.0% capture rate, the project analyst applied it to the entire Metropolitan Statistical Area (MSA)—a total of five counties! Although certain specialized retirement communities have been able to achieve such success levels, it has been only through the sponsorship of a strong nonprofit institution, which lends wide-spread name recognition and regional support to the project. Unfortunately for our lender, this proposed project did not enjoy such a sponsorship.

SORRY, RIGHT NUMBER

That is why it is critically important to consider not only the capture factor in your evaluation of market studies, but also the market area to which the capture factor is being applied. Ask yourself, "Is this the *minimum* geographic area from which the proposed project can expect to generate 60.0% to 70.0% of its support? How will competition, area income levels, housing trends, and mobility patterns effect my project's ability to attract tenants?" Question the boundaries of your market area until you are convinced that your EMA is valid. Until you are able to develop a viable EMA, a correct capture factor is simply the ultimate fallacy symbol—a right number that can cause a project to go very wrong.

An Insider's Look at Mobility Patterns

You often hear market analysts discuss *mobility patterns* and their relationship to a market area—but rarely do you hear anyone discuss precisely what mobility patterns are, and how you can use them to better understand the dynamics of a housing market.



Patterns of Internal Mobility

Far from being just an industry buzzword, *mobility patterns* refers to the ways in which relocating households tend to move from one area to the next. Of course, households usually move for individual reasons—the need for new housing, changes in jobs, marital status, etc. But while **why** people move is an individual phenomenon, **where** people move is often a group phenomenon. And by tracking the *mobility patterns* of this group phenomenon, a qualified market analyst can more accurately determine support for your project.

Two types of households seek new housing in a metropolitan area—internal mobility households (households already located in the area) and external mobility households (households coming into the area from somewhere else). In this issue, we'll be discussing only the patterns of internal mobility households. As noted in previous issues, internal mobility can supply up to 70% of support for new housing, even though it is never noted in growth statistics.

Within the internal mobility portion of an area's housing market, two important patterns occur: *radial mobility* and *lateral mobility*.

Over and Out—Where Move-outs Move

Radial mobility refers to the tendency of people to stay in the same radial path from the center of the city as their previous residence. In other words, a north-end resident who relocates is more likely to move along the radius to the north than to any other area of the city.

Lateral Mobility describes those relocating households who do not fit the above description. In other words, those near-north residents who move northeast, northwest, or any other compass point away from the north radial line make up the *lateral mobility* patterns for those areas.

Your potential for success in an EMA can depend largely on how these two patterns interact.

High Radiation Levels Mean Investment Opportunity

Our research consistently indicates the tendency of people to move along a radial path. Therefore, one of the market attributes our analysts pay attention to is the population base that lies between the Effective Market Area and downtown. If that population base is dense, then the Effective Market Area has a better chance of sustaining a strong internal mobility. If, on the other hand, the population base is sparse, then the Effective Market Area will have to rely more on lateral mobility and growth (external mobility).

The importance of radial mobility increases when you consider that businesses tend to go where their customers go. Therefore, a dense population base that feeds a strong radial mobility pattern to an Effective Market Area will also tend to carry commercial establishments along with it.

The Pitch-out

Does the importance of radial mobility mean you can afford to ignore lateral mobility? Not at all. Although strong radial mobility patterns are the first thing you should look for when developing a market, lateral mobility patterns indicate another kind of market strength.

The difference between the causes of radial mobility and lateral mobility is this: radial mobility is a function of habit, lateral mobility is a function of perception. In other words, households move in a radial path because they are familiar with the area and are accustomed to living in that direction from downtown. Households who move in a lateral path do so because they find something attractive about the new market area.

If enough households find a new market area attractive to cause substantial lateral mobility, then that should indicate a favorable perception of the area by the population in general. More important, if that perception is favorable, then households who are relocating from some other city (external mobility) will tend to be directed to the new market area. An area that benefits from strong lateral patterns in the city's internal mobility will also benefit from the city's growth, or external mobility.

The People In The Know Are Your Future Tenants

Now that you know how internal mobility patterns can affect your market area, you'll be better able to identify potential for your development. Just remember that the true industry experts in any real estate market are your potential tenants. If you can tell what they're saying about your area, your chances for success will improve.

Developer's Dictionary

Metropolitan Statistical Area (MSA)

Too often, people refer to a market area without specifying its size. For example, someone discussing a metropolitan market can be talking about the area within the city limits, the principal county, or a several-county area, depending on the context.

The error that occurs most often is using the Metropolitan Statistical Area (MSA) to mean an area roughly limited to the city boundaries. For example, when you examine population characteristics in the Tulsa MSA, you're actually discussing a five-county area. Although housing and demographic information at MSA levels is important, the usefulness of this information is lessened if it is interpreted to refer specifically to a smaller marekt area.

An MSA is an area aggregated by the US Census Bureau for statistical purposes. It usually covers the widest possible area that can be considered to interact socially and economically with the central city. Therefore, it is not unusual for an MSA to comprise several counties that surround a core metropolitan area.

An area can qualify as an MSA in one of two ways: (1) if it contains a city of at least 50,000 population, or (2) if it contains an urbanized area of at least 50,000 with a total metropolitan population of at least 100,000. An MSA includes the county containing the central city as well as any additional counties that interact either socially or economically with the central county.

Occasionally, one encounters terms similar to MSA, such as SMSA, PMSA, and CMSA. These terms are defined as follows:

SMSA (Standard Metropolitan Statistical Area)—Prior to 1980, MSAs were known as SMSAs. The name was changed to reflect the Census Bureau's revised standards for calculating population.

PMSA (Primary Metropolitan Statistical Area)—Very large metropolitan areas (those with populations greater than 1 million) may be designated as PMSAs. The population in a PMSA tends to interact only with the central city.

CMSA (Consolidated Metropolitan Statistical Area)—When two or more PMSAs are contiguous, they are designated by the Bureau as a CMSA.

Microwaves—Buy one, Get one free!

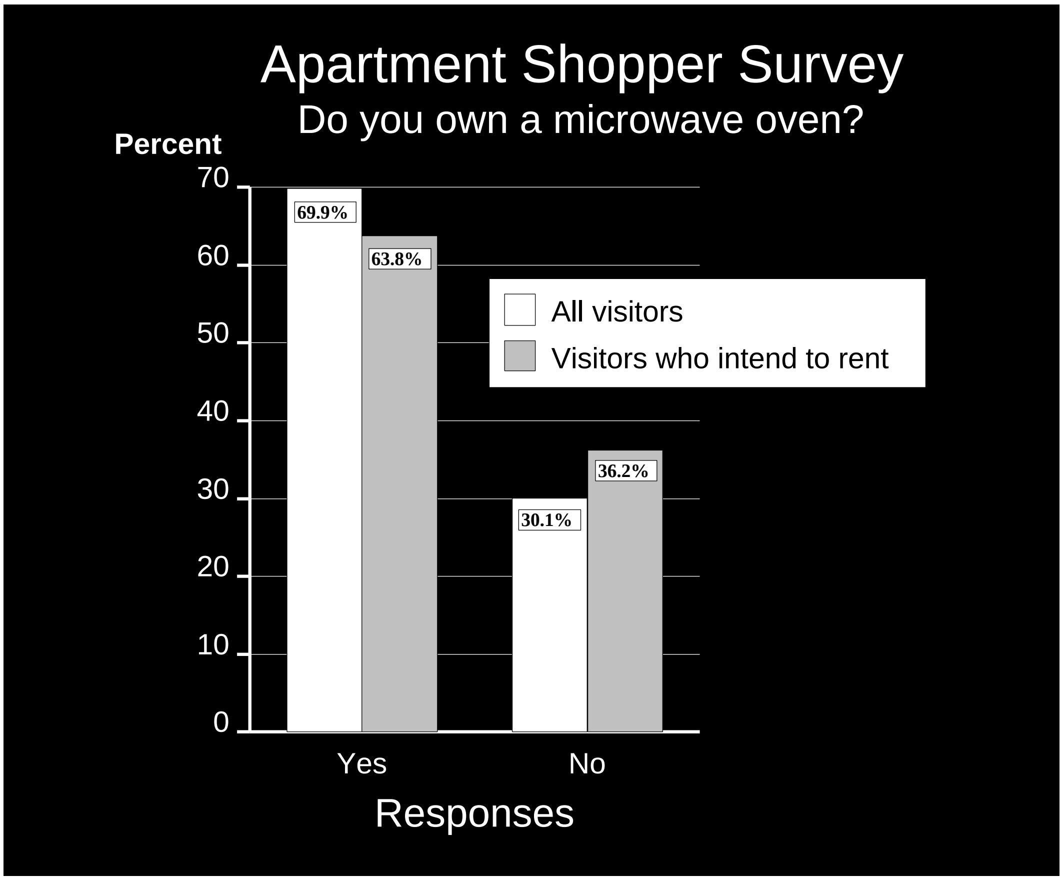
Are you offering free microwave ovens as part of a rental incentive? If so, you may soon discover that your renters are not as interested in this offer as they have been in the past.

Our latest Project Opening Plan (POP)℠ results indicate that more renters than ever *already own* microwave ovens. In fact, over 63% of apartment shoppers who definitely intend to move to an apartment in the next 12 months own microwaves. Once a desirable luxury, microwave ovens have become a necessity to today's apartment dweller. And the falling prices that made microwaves seem like a good marketing tool to you, have made these appliances easily within the reach of your tenants.

The accompanying graph shows how our respondents answered the question, "Do you own a microwave?" We have included the results of all those who participated, and also of only those participants who intend to rent an apartment in the next 12 months. In both cases, the survey indicates that microwave ovens are no longer a novelty appliance.

Therefore, for the majority of your future tenants, this perk is simply another case of buy one, get one free. Unfortunately, two microwaves is usually one too many.

Look for more **POP Results** in each issue of Apartment Resources.



The POP Results:

One of the real estate research services offered by Kenneth Danter & Company is the Project Opening Plan (POP)℠, a 12-month study of an apartment project's rent-up process. The objective of our POP studies is to give the project's development and management team all of the necessary information required to fine-tune rents and marketing strategies during the first year. Among the analyses conducted are comparative shopping reports of the project and its competitors, an analysis of the Effective Market Area (EMA)℠, an area advertising/marketing analysis, and rent-up tracking by unit type.

Another analysis conducted is an in-depth survey of all visitors who shop the project in its first 12 months. These surveys provide management with detailed shopper profiles within the EMA.

To produce **The POP Results**, we've aggregated the results of all of our POP surveys to provide the most accurate overall tenant profile available today.

We'll be bringing you more POP results in every issue of ***Apartment Resources***.

Coming Up in Apartment Resources

Some of the projects we're working on for future issues of *Apartment Resources* include

- ***Tenant perception and unit size—How big is big?***
- ***An up-to-date building permits analysis based on prepublication Census data***
- **The POP Results—*What percent of the apartment market is "adults only"?***
- ***In-depth analyses of* <u>What's Hot and What's Not</u> *major market areas***

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