The past decade saw an explosion of multifamily development. Sustained economic expansion created new hubs of development. The advent of real estate investment trusts (REITs) made capital available for rental housing, and low-income housing tax credits (LIHTCs) spurred the creation of affordable housing. The number of both single adults living alone and single-parent households continued to increase. And “renters by choice” emerged as a strong market segment as stock market investments competed with homeownership as primary investment strategies.

The next decade should offer continued growth in rental markets. The maturing of the baby boom generation from boomers to empty nesters will affect the rental market in two ways. Children of baby boomers (the “echo” generation) will be leaving their parents’ homes and forming households of their own, most of which initially will be rental. At the same time, their empty-nester parents will be seeking lifestyle alternatives and exploring new places to live, including active-adult communities and center cities. Many empty nesters will become renters by choice, who can afford to own but choose to rent for lifestyle flexibility.

The stock of both affordable and market-rate rental housing has grown in recent years, and this growth is expected to continue. Congress recognized the effectiveness of the LIHTC at the end of 2000 by raising the caps for both LIHTCs and tax-exempt private activity bond caps. (See “Tax Credits Today” on page 30.) These increases translate into the availability of significantly more resources to help finance affordable rental communities.

Strong rental demand from a macro-vantage point, however, does not necessarily translate into strong demand for every market. Both public and private financing entities therefore require market input into their decision-making process. Last year’s congressional action requires that a comprehensive market study of the housing needs of low-income individuals be completed by a disinterested party before any project receives a credit allocation. The U.S. Department of Housing and Urban Development’s (HUD’s) new Multifamily Accelerated Processing (MAP) program also requires a market study at the preapplication stage for new construction or substantial rehabilitation.

As individual actors in the overall economic engine, we all do market analysis. When we first approach a new development, most of us will make some sort of immediate judgment: “That makes sense there” or “Nobody will want to live or shop there.” When a developer first considers a potential real estate project, he or she must conduct preliminary market research to test the reasonableness of the development concept. The real estate information readily available today on the Internet and through independent data services, government agencies, and brokerage operations can easily overwhelm the developer in a blizzard of data. That data, however, must be analyzed and synthesized to enable the developer to understand the potential of a specific real estate project at a given location.

Components of a Market Study
Regardless of product type and location, all market analyses should focus on three basic areas of evaluation: the site, the demand for the product, and the supply of comparable projects.

One of the first steps in a market analysis is to define the market area. A market area for a multifamily project is the region in which that project most likely will compete for tenants. In delineating the boundaries of a housing market area, the analyst must take into account accessibility, natural and built boundaries, and neighborhood definitions. School boundaries, political considerations, and market perceptions all can define a market area. However these boundaries are determined, the analyst should explain the reasoning behind them. There is no rule of thumb about
Site Analysis. The site analysis weighs the site’s strengths and weaknesses, including physical characteristics, surrounding land uses, and accessibility of services and amenities. Are surrounding land uses compatible with multifamily residential development? Is there a neighboring land use—such as an industrial site, interstate highway, or power line—that may be perceived as a detriment to the site? Is the site readily accessible by roads, mass transit, or both? How will people get to work or go shopping? Are any transportation improvements scheduled that would affect (directly or indirectly) access to the site or change commuting patterns in the area? How good are the local schools, and how easy is it to get to them? School accessibility and school quality can have a major impact on a project’s relative success. Rather than simply identifying the schools serving the area, the analyst should rank standardized test scores for all schools in the district.

Demand Analysis. For most rental housing, employment stability and growth are integral to healthy rental demand. For example, the market for an affordable housing project for seniors may be larger than that for a product targeted to families. If the market area does not make sense, neither will the analysis.
demand. Although area unemployment rates are one indicator of the local economy’s strength, the structure of the job base and recent job growth also should be analyzed. In some markets, identifying the top ten employers gives a good indication of the nature of the economy. If those largest employers are population-serving entities such as hospitals and local government agencies, however, the analyst must delve deeper to understand the economy’s foundations. Understanding where the region’s employment nodes are located and how the subject site is oriented to those nodes also is important.

Employment growth also is significant when evaluating housing for seniors. Job growth is an indicator of the overall vitality of the market, and new workers in an area may encourage their aging parents to move there as well, creating demand for this specialized product.

A market study that relies exclusively on growth information from a national data service provides the reader with just one macro-view of a micro-market. Those data should be compared and contrasted with building permit activity and locally derived projections. When assessing the reasonableness of household projections, whether prepared by a national private data vendor or a local public agency, the analyst should examine and weigh recent trends in household and employment growth and in the overall economic and development environment of the market area.

As one measure of demand, analysts can use the number of building permits issued in a particular market, along with employment growth, to establish a housing demand/supply ratio (see Figure 1). This ratio identifies the historic relationships between two key elements of economic growth: new housing units (representing the supply of housing) and new jobs created (representing the demand for housing). Comparing the relationship between annual job growth and annual unit authorizations with the overall relationship of total employment and total housing units allows analysts to examine the level of balance between the demand for and supply of housing. This relationship can represent a significant indicator of pent-up demand for housing or an oversupply of units being developed at a time of economic slowdown.

With the remarkable economic growth experienced over the past five years, many municipalities have had difficulty keeping up with the need and demand for new infrastructure such as water and sewer services, schools, and roads. Any evaluation of household projections, therefore, must temper trend analysis with the growth constraints caused by ordinances requiring adequate public facilities or moratoriums on new construction.

After an analysis has assessed the outlook for future household growth, it should provide some information on the characteristics of the population base, including age,
vacancy rate. Finally, the analyst should estimate what proportion of household growth will consist of rental households, reflecting the breakdown of tenure from the most recent census, adjusted for shifts in overall homeownership rates and the nature of growth in the specific market.

After an analyst has computed rental demand, he or she should quantify the expansion of the supply as identified in the proposed project analysis. Subtracting the number of proposed rental units from demand will identify net demand for rental housing that is not currently addressed by the market. Although not an exacting calculation, this analysis will provide a relative indicator of whether a market is about to be overbuilt.

**Affordability Analysis.** Though sufficient demand may exist for rental units in general, the study should examine whether sufficient demand exists for the type of units proposed. An affordability analysis can quantify the band of households that could afford to rent the proposed units. This analysis is imperative for LIHTC projects that address households at a specific income level. The percentage of households within the specified band of affordability that the project needs to capture is a key indicator of its relative success. There are no hard and fast rules on capture rates. Whereas it may be reasonable for a project in a rural market with no competition to be expected to capture 10 percent of the income-qualified households, that same capture rate may be unreasonable in an urban area with an extensive competitive supply. The analyst not only should compute, but also should interpret, the relevance of the capture rate.

After the individual analyses are conducted, the analyst should summarize the strengths and weaknesses of the subject project compared with its competition and render an opinion as to its marketability. On the basis of historical absorption patterns and growth factors, the analyst also will render an opinion on an absorption rate for the community after it begins initial lease-up.

In summary, a market study is truly a series of tests. Even a project that passes all these tests can still fail as a result of financial or management issues. A red flag raised on any market issue, however, almost guarantees problems.

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