

# Key Issues When Reviewing a Market Study

## New Renter Households (HHs)

- New Renter Households are the Key to Demand
- PMA from Which Renter Households are Drawn is Logical
- Income Qualified Renter HHs Extracted from Correct Data - This Includes:
  - Percent of Income Applied to Rent
  - Setting Upper Income Level

## Things We Watch For

- Adjustments to HH Growth
- In-Migration
- Pent Up Demand in Year 1 vs. Every Year (“Frictional Vacancy”)
- Cumulative Demand
- Forecasts Exceeding 3 Years
- Units Removed from Inventory (CINCH)

# New Renter Households

- **Absolute Key to Every Analysis**
- New Renter Households Should be the Vast Majority of Total Demand
- No Other Source of Demand Should Be Close in Impact
- Other Sources of High Demand Are a Warning Sign
  - Only Acceptable In Very Unusual Cases (perhaps Resort or College Towns)
  - Requires Lots of Additional Research and Analysis (for them and for us)
- Note that Employment is the Key Driver for Household Creation

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**New Renter Households are Drawn from Primary Market Area (PMA)**

# What Makes a Good PMA

- Based on Census Tracts (Allows Better Data)
  - Observes Neighborhood Boundaries
    - Look for This When in the Field
  - Subject is at the Approximate Center of the PMA
    - Not Always but Ideally it Should Be Close
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- Some Analysts Use County-Based Data (like EMAD)
    - Depends on the Area if This Makes Sense
    - Should Then Cut to Finer Neighborhood Data
    - Narrow Down the Competitive Set for Rent

# All Renters vs. Income Qualified Renters

## When Calculating Demand for the Net Demand Calculation

- Some Analysts Use All Renter Households
  - Their Inventory/Supply Estimates Follow Suit
  - Allows for a Certain Estimate of Supply (All Supply within the PMA)
- Some Analysts Use Income Qualified Renter Households
  - Getting Qualified Households is Easy, but Estimate of Supply is Less Certain
    - Inventory & Pipeline Estimates Need to Reflect Only Competitive Units
    - Typically All New Properties (not Elderly or Assisted) Will be Competitive
    - Harder to Know Exactly Which Existing Properties to Include/Exclude
    - What is the Appropriate Criteria? Year Built? Rent Levels? Typically Not a Hard Line

# Income Qualified Renter Households

- **All** Analysts Later Change to Income Qualified Renter Households To:
    - Measure Affordability
    - Calculate Capture & Penetration Rates
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- Must Derive & Calculate Income Qualified Renter HHs in Proper Order
    - Array Renter Households by Income (Income by Tenure)
    - From This Data, Extract the Number of Households that are Income Qualified
  - Why Does it Matter?
    - Renters Have Lower Incomes
    - Can't Assume Renters Have the Same Income As All Residents

# Income Qualified Renter Households

- The Incorrect Procedure We Sometimes See
    - Take All Income Qualified Households (Owners and Renters)
    - Then Apply the Percentage of Renter Households
    - Result is Not the Percentage of Income Qualified Renter Households
  - This Procedure Overstates Income Qualified Demand
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- Demographic Data Suppliers Can Provide this Segmentation
    - The Market Analyst May Need to Order a Custom Report
    - American Community Survey Data Can be Used to Extrapolate the Data

# Minimum Income & Income Qualification

- Minimum Income is the Income that Can be Applied to Cover Rent
  - The Best Analysts & the MAP Guide use Gross Rent or Rent + Utilities
- The Best Analysts Use 30% - 33% of Income for Minimum Income
  - Or about 3 x Rent = Required Income
- Some Analysts Use 40% of Income to Calculate Minimum Income
  - Or 2.5 x Rent = Required Income
  - Potential for Overburdened Renter Households (Not HUD's Mission)

**The Minimum Income Renter Households Need to Cover Rent Drives the Number of Income Qualified Renter Households in the Market**

# Maximum Income & Income Qualification

- Best Analysts Limit the Upper Level of Income for Potential Renters
  - Often \$150,000 to \$200,000 or 3 Times the Lower Income Limit
  - Varies with the Market
- Some Analysts Go “To Infinity and Beyond . . .”
  - Even Though Small, this Can Overstate Income Qualified Demand
  - The Highest Income Group Is Less Likely To Rent a Standard Apartment



# The Correct Procedure

INCOME QUALIFIED RENTER HOUSEHOLDS						
Category	2019 Est. Renter HH		2024 Est. Renter HH		Only Renter HHs	
	No.	%	No.	%		
Less than \$10,000	-	0.00%	-	0.00%		
\$10,000 - \$20,000	-	0.00%	-	0.00%		
\$20,000 - \$30,000	-	0.00%	-	0.00%		
\$30,000 - \$40,000	-	0.00%	-	0.00%		
\$40,000 - \$50,000	(includes 20.9% of income band)	1,618	2.49%	1,660	2.39%	Income Band
\$50,000 - \$60,000		5,625	8.65%	6,148	8.86%	
\$60,000 - \$75,000		6,855	10.54%	7,688	11.08%	
\$75,000 - \$100,000		6,104	9.39%	7,413	10.68%	
\$100,000 - \$125,000		2,794	4.30%	3,589	5.17%	
\$125,000 - \$150,000		1,810	2.78%	2,669	3.84%	
\$150,000 - \$200,000		1,138	1.75%	1,703	2.45%	
Over \$200,000		-	0.00%	-	0.00%	
<b>Total</b>		<b>25,945</b>	<b>39.90%</b>	<b>30,869</b>	<b>44.48%</b>	

Based on minimum required income of \$47,905 (3.0x lowest market rent)

# In-Migration

- In-Migration On Top of the Household Growth Already Estimated
  - Possible, but Rare
  - Must Present Absolutely Convincing Evidence
- Most Often Not an Additional Source of Demand
  - Just What is Already Included in the Demographic Estimate
- Anecdotal Evidence is Not Acceptable (such as): *“Eight of the surveyed properties attract 40% to 85% of their tenants from outside Longmont, with an average of nearly 60% coming from outside the city. The newer surveyed Class A and B properties were more likely to attract higher proportions of renters from outside the area.”*

# Demographic Change Has Only Four Factors

- Births
- Deaths
- **In-Migration**
- Out-Migration



## **Every Demographic Forecast Already Includes these Four Components**

- In-Migration (Over & Above What is Already in the Projections) Can Be Real But Must Be Well Proven - Recent Examples:
  - Resort Area with 15,000 Daily Commuters
  - College Area where College Growth was a Small Kicker to Demand

# Pent Up Demand

- Pent Up Demand is the **Difference Between Balanced Market Vacancy and Current Market Vacancy** in the Base Year (Today)
  - Balanced Market Vacancy is (not surprisingly) the Rate at Which the Market is Considered To Be in Balance – **Typically 5%**
    - Be Careful of Using Higher Figures
    - Using Higher Numbers Looks Like Demand is Being Padded
- 
- If Market Vacancy is 4% and the Balanced Market Vacancy is 5%
  - Then 1% of the Existing Supply is the Pent Up Demand

# Pent Up Demand vs. “Frictional Vacancy”

- Difference Between the Balanced Market Vacancy Rate (5%) and the Current Vacancy Rate is Acceptable in Year One As **Pent Up Demand**
    - Applies to the Base Year (Today)
    - Also Applies to New Supply that Enters the Market During the Forecast Period
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- Not Acceptable to Apply Every Year in the Forecast Period
    - This Goes by Various Names Such as “Frictional Vacancy”
    - Overstates Demand
    - Once the Forecasting Begins, Market Vacancy is a Result of Net Demand

# Cumulative Demand

- “Cumulative Demand” is Household Demand Not Met in Prior Years
- Some Analysts Show the Number of Households that “Should” have Moved to the PMA in Prior Years as an Indicator of Current Demand
- This is Not a Source of Demand
- Any Households Previously Looking to Locate in the PMA Have Either Already Done So or Have Gone Elsewhere
  - Prior Households Are Not in a “Holding Pattern Waiting to Land”
  - Few Households Can Double Up with Family Waiting for Their Own Place
  - The Past is the Past . . .

# Estimating Supply

- The Existing Supply Must be Tallied
- Most Properties Under Construction or Proposed Will Also be Competitive and Should Be Counted in the Pipeline
- Deletions are Acceptable Only When Looking at Competitive Supply & Income Qualified Renter Demand
  - Otherwise, All Projects Go Into the Mix
- Market Analyst Must Explain Each Project Not Included in Pipeline:
  - Uncertain Timeline/Difficult Financing
  - Senior Tenancy or Student Tenancy (Exclusively)
  - LIHTC or Otherwise Assisted

# Projecting the Actual Pipeline

*“... it has been estimated that **all of the projects under construction and all of those listed as likely starts over the next six months** will be developed. Given rising costs and considering the time required to obtain financing and entitlements, it is estimated that **50% of the remaining proposed projects** will begin construction over the next 18 months.”*

Good Analysts Back Up Their Estimate for How Many Future Projects Will Come to Market

<b>PROJECTED NEW APARTMENT SUPPLY</b>	
<b>Period</b>	<b>Number of Units</b>
<b>Under Construction – To Complete Next 18 Months</b>	<b>2,239</b>
<b>Likely Starts Next Six Months</b>	<b>1,719</b>
<b>50% of Possible October 2019 or Later Starts</b>	<b>2,072</b>
<b>Estimated New Deliveries Over Next 3 Years</b>	<b>6,030</b>



# Forecast Period – Should Be 3 Years

- Accurate Pipeline Projections are Only Available for 3 Years
- When a Longer Forecast Period is Used – We Typically Find That:
  - Supply Decreases in Years 4 & 5
    - The information is just not yet available
  - Demand Appears to Outstrip Supply in Years 4 and 5
  - The Project Appears to Work
  - But . . .
  - Net Demand is Overestimated Because the Pipeline Appears to Diminish While Demand Keeps Increasing

# Forecast Periods Longer than 3 Years

**If Project Size or Market Issues Require a Longer Forecast Period, the Market Analyst Should:**

- Analyze the Current 3 Year Pipeline
- Look at Recent Historical Trends

**And then . . .**

- Make Logical Forecasts of New Supply for Years after the First 3
- The Pipeline Will Not Just Trail Off

# Units Removed from Inventory

- Units Removed from Inventory (the Supply)
  - Units Lost or Converted to Other Uses, Including the For Sale Market
- Measured via HUD's Components of Inventory Change or **CINCH**
- CINCH Rate is About 0.27% of All Supply for the Western Region
  - Somewhat Less for Green Fields Areas (often less than 0.2%)
  - We Have Seen this Several Times Higher
  - Markets with high rents and tight market conditions are unlikely to lose units except as they are demolished for newer, more dense projects
- Units Removed from Inventory is a Component of Net Demand
  - But must tie in reasonably to the area CINCH Rate

# Net Demand

## The Key Calculation for the Market Study

- All Sources of Demand  
Less . . .
- All Sources of Competitive Supply  
Results In . . .
- Net Demand
  - Also Called Remaining Demand, Renters Without Competitive Units, etc.
- Answers the Question: *Is there demand for the subject project and the competition coming online during the forecast period (the next 3 years)?*

# Proper Extraction of Demand

<b>Demand</b>			
<i>Projected Change in Household Base</i>			<i>Units</i>
January 2019 Households			27,514
January 2022 Households			28,553
<b>Net Change in Households</b>			<b>1,040</b>
	<b>Housing Stock</b>	<b>Removal Rate</b>	<b>Units Removed</b>
<b>Add: Units Removed from Housing Stock</b>			
2019 Housing Stock	29,042	0.27%	78
2020 Housing Stock	29,393	0.27%	79
2021 Housing Stock	29,743	0.27%	80
<b>Total Units Removed from Housing Stock</b>			<b>238</b>
<b>New Housing Demand</b>			<b>1,278</b>
<b>Average Percent Renter Households over Analysis Period</b>			<b>39.5%</b>
<b>New Rental Housing Demand</b>			<b>505</b>

3 Yr.  
Forecast

Acceptable  
CINCH Rate

Using All  
HHs. Okay

# Proper Look at Supply & Then Net Demand

Add: Multifamily Competitive Vacancy	Inventory	Vacant
Stabilized Multifamily Communities	2,379	79
Communities Under Lease Up	36	18
<b>Total Competitive Inventory</b>	<b>2,415</b>	<b>97</b>
Market Vacancy at 5%		121
Less: Current Vacant Units		-97
<b>Vacant Units Required to Reach 5% Market Vacancy</b>		<b>24</b>

Pent Up Demand

<b>Total Demand for New Rental Units</b>	<b>529</b>
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## Planned Additions to the Supply

	Total Units	95% Occupancy
The Meadows	160	152
Sage View (LIHTC-Senior)	50	48
Chapel Hill Apartments	21	20
Whisper Rock II (LIHTC-Family)	40	38
1330 E. Minnesota Street	24	23
Stonegate	36	34
<b>Subject Property</b>	<b>180</b>	<b>171</b>

New Supply w/ 5% Vacancy

Total Supply

<b>Total New Rental Supply</b>	<b>511</b>	<b>485</b>
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Net Demand

<b>Excess Demand for Rental Housing</b>	<b>43</b>
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# Balanced Market Analysis

- Alternative Way to Calculate and Look At Net Demand
- Recalculates Net Demand Year by Year
- Shows Resulting Occupancy/Vacancy Year by Year
  - Vacancy is a Result, Not a Driver of the Analysis
- Shows the Timeline of Net Demand During the Forecast Period
  
- A Very Nice Form of Analysis But . . .
- Many Excellent Market Analysts Do Not Use It (and it is not required)

# Balanced Market Analysis

SUPPLY-DEMAND TREND ANALYSIS					
Primary Market Area					
	<u>Category</u>	<u>Yr. 0</u>	<u>Yr. 1</u>	<u>Yr. 2</u>	<u>Yr. 3</u>
a	Total Competitive Unit Supply, End of Year (a-g+l)	2,946	3,033	3,233	3,580
b	Less: Average Annual Occupied Units, EOY (b+f)	<u>2,887</u>	<u>3,013</u>	<u>3,139</u>	<u>3,265</u>
c	Annual Vacant Units (a-b)	59	20	93	315
d	Less: Stable Annual Vacant Units (a x 95% Occupancy)	5%	<u>152</u>	<u>162</u>	<u>179</u>
e	<b>Existing Supply Surplus (+)/Deficit (-) (c-d)</b>		-131	-68	136
f	Less: Annual Forecasted Target Household Growth	126	126	126	126
g	Less: Forecasted Annual Demolitions	0	<u>0</u>	<u>0</u>	<u>0</u>
h	<b>Existing Supply Surplus (+)/Deficit (-) (e - f - g)</b>		-257	-194	10
i	Under construction, net of occupied	131	87	44	0
j	Plus: Proposed, excluding subject	311	0	156	156
k	Plus: Subject's Available Units	<u>192</u>	<u>0</u>	<u>0</u>	<u>192</u>
l	= Total Supply Additions (i + j + K)	634	87	199	348
m	<b>Residual Apartment Supply Surplus (+)/Deficit (-) (h+l)</b>		-170	5	357
n	<b>Average Annual Occupancy (b / a)</b>		99%	97%	91%

3 Year Forecast

Balanced  
Vacancy

Income Qual.  
Renter HHs

Net Demand  
Calc. Annually



# Capture Rate

- NCHMA: The percentage of age, size, and income qualified renter households in the *primary market area* that the property must capture to fill the units.
- How to Calculate: Divide the total number of units at the subject property by the total number of qualified renter households in the PMA.  
**Subject Units / Qualified Renter Households in PMA (x 100 as a %)**
- Answers the Question: *What percentage of qualified households will the subject have to capture?*

# Penetration Rate

- NCHMA: The percentage of age and income qualified renter households in the *primary market area* that all existing and proposed properties, to be completed within six months of the subject, and which are competitively priced to the subject that must be captured to achieve the *stabilized level of occupancy*.
- How to Calculate: Divide the total number of competitive units (existing and to be completed – including the subject property) by the qualified renter households in the PMA.  
**Subject & Competitive Units / Qualified Renter Households in PMA (x 100 as a %)**
- Answers the Question: *What percentage of qualified households will the competitive set (including the subject property) have to capture?*

# Summary of Key Issues (1)

- **New Renter Households are the Key Source of Demand**
- Renter Households are Drawn from a PMA that Makes Sense
- Income Qualified Renter Households are from the Correct Base
  - Via Income by Tenure
  - Percentage of Income Applied to Rent is Reasonable (not rent burdened)
  - Reasonable Upper Limit of Income
- Adjustments to Household Growth or In-Migration are Rare
  - If used, they are well-proven by someone with real expertise

# Summary of Key Issues (2)

- Pent Up Demand Can Be Used (Year One Only)
  - Cannot be Applied Annually via “Frictional Vacancy”
  - New Supply enters with a 5% Balanced Vacancy Rate
- Cumulative Demand Cannot be Used
- Forecast Period is 3 Years Except in Unusual Circumstances
- Units Removed from Inventory is In Line with HUD’s CINCH Rate

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- **A Good Market Analyst Can Make All of This Easy**

# Two Other Issues that Deserve Mention

1. Market Study Does Not Consider Project Amenities vs. Those Common in Market
  - Sometimes Called a Competitive Position Analysis
    - Small Unit Sizes
    - Limited Parking
    - Location Relative to the Competition (the selected comps are better)
      - If There is No Competition in the Immediate Area, Is There a Market?
2. Market Study Does Not Examine the Impact on Other FHA Properties
  - Our First Priority is to Our In-Place Projects
    - Both Under Construction and Existing

# Questions & Contact Information

- Always Better to Ask a Question Before Submitting an Application
  - Saves a lot of time and headache for all concerned

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- **Questions?**