

## Market Study Issues

1. **Primary Market Area (PMA) Delineation.** The MAP Guide requires a description of the geographic boundaries of the market area and a discussion explaining the definition of the market. Most of the market studies we review meet this requirement and also include a map of the delineated PMA. We consider a map of the PMA to be an industry standard and will request a map if one is not included. The best market studies we see include a PMA that has been carefully delineated and a discussion of *how* the PMA was delineated. We consider the market studies that define the PMA as the area within the boundaries of the city or county, without adequate support for that delineation, to be less credible. If the PMA is delineated incorrectly, some of the analyses within the market analysis will be inaccurate, and the report may not be credible. Lenders should make sure that a reasonable discussion of how the PMA was delineated is included in the market study. The following resources from the market study literature are very helpful in understanding this issue.

Fanning, Stephen F. *Market Analysis for Real Estate*. Chapter 7: Market Delineation. Chicago: Appraisal Institute, 2005.

Rabianski, Joseph S. "Apartment Market Area Delineation," *The Appraisal Journal*, Winter 2006. Appraisal Institute, Chicago, Quarterly.

Prior, John, and Scepaniak, Tad. "Determining Market Area," white paper, 2005. National Council Affordable Housing Market Analysts.

2. **Market Rents of the Subject.** The MAP Guide requires an accurate description of a proposed 221(d)(4) project in the market study. This includes accurate proposed rents. HUD understands that sometimes the market analyst is engaged by the lender at the same time the appraiser is engaged, and the sponsor is not yet firm on the proposed rents. The sponsor will probably want the market analyst's input before deciding on the proposed rents. That's fine, but if the rents change during the course of the market study, or after the market study has been delivered, it will be necessary for the market analyst to revise the market study with the *correct* proposed rents. Otherwise, the Demand numbers, the Residual Demand numbers, and the Capture Rates will be inaccurate, and the report may not be credible. Lenders should make sure the proposed base rents that are on their Form HUD-92264 match the proposed base rents in the market study.
3. **Supply Analysis.** HUD has seen some market studies with Supply Analyses that do not include all the apartment projects that are likely to enter the market about the same time as the subject. Projects under construction at the time of the market study that will directly compete with the subject have even been excluded from the supply pipeline. Projects that were being processed by the same HUD office and were further along in processing than the subject project have even been excluded. Lenders should make sure the market analyst has called the local planning office and HUD to get an accurate list of projects in the pipeline. HUD is also concerned about possible impacts of new construction on the existing FHA portfolio. Existing projects

can be found at

[https://www.hud.gov/program\\_offices/housing/comp/rpts/mfh/mf\\_f47](https://www.hud.gov/program_offices/housing/comp/rpts/mfh/mf_f47)

4. ***Residual Demand Analysis.*** The market studies HUD reviews almost always include a conclusion to the Residual Demand Analysis; i.e., an actual positive number indicating Excess Demand, or an actual negative number, indicating Excess Supply. But sometimes the market analyst falls short of providing a number. This should be something the lender notices in reviewing the market study. Lenders should not send the report to HUD without a Residual Demand number. The study period of a Residual Demand Analysis should be no more than 3 years. The demand indicated by the difference between vacancy in a balanced market and actual vacancy in the subject's market should use a balanced market vacancy of 5.0%, not 7.0%. The minimum vacancy required in HUD's underwriting of 7.0% is a risk mitigation measure used by HUD; it is not HUD's opinion of the vacancy rate in a balanced market. Use of a 7.0% market vacancy will inflate demand.
5. ***Study Period.*** The study period for most market studies should be 3 years because that is typically the period of time necessary to complete HUD processing, construction, and lease-up. There can be exceptions with longer study periods when the subject has a large number of units and will have an unusually long absorption period or a high-rise that will have an unusually long construction period. The end of the study period should be when the subject property reaches stabilized occupancy. HUD often sees a 5-year study period for a project that will reach stabilized occupancy in 3 years. Since proposed projects for years 4 and 5 on the supply side have often not been announced, this tends to result in high demand numbers and low supply numbers in years 4 and 5, resulting in an overestimated residual demand number, which is not acceptable to HUD. In the unusual circumstance that a study period longer than 3 years will be used, supply estimates must be carefully supported for any years beyond the third. It is likely that these supply estimates will need to be examined based on recent historical data.
6. ***Competitive Position Analysis.*** The MAP Guide requires this essential component of a market study. In this analysis, the market analyst describes the attributes of the subject and compares them to those of the competing properties in the PMA. This can be done qualitatively or quantitatively. Either way is OK with HUD, but omission of this essential component is *not* OK. Lenders should make sure a good Competitive Position Analysis is included in the market study.
7. ***Balanced Market Analysis.*** HUD has seen an analysis in a few market studies that might be called a Balanced Market Analysis. This analysis includes a table with a column for each year of the study period, which starts with the PMA inventory, shows changes in demand and supply each year, and concludes with the projected PMA vacancy at the end of each year. This is a very useful analysis that indicates the strength of the subject's market through the period in which the subject property is being developed and leased-up. This analysis is not required in Chapter 7 of the MAP Guide, but it may be a best practice in the industry.

8. Lenders should also be aware of the following common issues with market studies:
- Pent Up Demand is only acceptable prior to the first year of analysis (year zero). It is not acceptable as a source of demand in each year of the analysis unless a properly executed balanced market analysis is utilized. Unmet demand from prior years is never acceptable as a source of demand.
  - Units removed from the market can be used only to the extent supported by HUD's CINCH rate data or other well vetted and recognized data. Also, high rates of removal are unlikely in markets with low vacancy.
  - Income Qualified Renter Households are the foundation for the analysis of net demand. These should be extracted from census or other reliable data first by tenure and then by income. Also, please note that it is a very rare occurrence (and then, only when supported by outstanding data and analysis) that HUD will accept additional sources of household growth beyond what the base demographic data supports.