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REAL ESTATE MARKET ASSESSMENT USING FIVE DATA POINTS

THE FIVE POINT

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WIN Publishing – The Five Point Reports

Each report delivers five or more methods, measures, or processes that are intended to have a positive impact on your rental property assets. The Five-Point may validate your thinking, provide new knowledge, and sometimes offer further information towards a "course correction" in advance of important decisions.

Books by the author:

How to Read a Rent Roll: A Guide to Understanding Rental Income
Rent Roll Triangle: The Ultimate Rental Property Grading System
12 Steps Homeownership: A Guide for First-time Homeowners

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Summary

Knowing your market saves time, and eliminating sub-par submarkets from consideration saves money. Determining viable markets before ever seeking assets presents that initial "Y-in-the-road" and saves time. Eliminating unworthy submarkets is your best strategy to concentrate limited resources on high-quality rental property acquisitions. Narrowing market selection in advance of seeking assets to buy is the key to utilizing one of your most limited resources, your time.

Market focus allows you to only seek out investments exclusively in viable submarkets that have a future in your portfolio. By its very nature, market selection produces market elimination, which is a good thing because a narrow market focus means you stay in pre-determined geography. Advanced market selection eliminates "the chase" in areas with limited appeal.

Knowing your markets upfront is a competitive advantage because your competition is not as focused. When they look everywhere, you are looking deeper into pre-selected locations that you know well, areas that fit with your investment criteria. Superior market knowledge builds a significant competitive advantage because, over time, you know your markets better than anyone.

Introduction

Whenever a property is purchased, it represents more than just a piece of the earth with a building on it; it represents an investment into a specific market landscape. The investors have decided to dedicate capital, time, energy, and effort into making money in this place from this investment.

Unfortunately, the bad news is that people too often devote more time to deal "analysis" at the expense of market analysis. The proud new owners can tell you all about the property, but nothing about neighboring assets or finding food, medical services, or jobs close to the purchased asset just acquired. Glossing over market data is an error – the new owners have short-circuited the process and are flying blind.

Knowing your market saves time, and eliminating sub-par markets from consideration saves money. This simple market assessment allows a rental property buyer to concentrate their efforts only in those places with a high level of confidence from the get.

Investors are too often enamored by the "squirrel" that jumps in our path. When buying a rental property, that furry little animal represents a HUGE return dangling in front of us. Does it matter that the area is 75% rental assets, and the purchase is 75-years old? Well, yea.

Narrowing market selection in advance of seeking assets to buy is the key to utilizing one of your most limited resources, your time, towards assets that have a future in your portfolio.

Decision making in the real estate business is challenging. There is no standard measurement that works every time to assure potential returns for a possible acquisition. This challenging environment makes due diligence the critical component in the buy decision. A focus on high-level market "markers" is an excellent method to measure markets against each other.

Determining viable markets before ever seeking assets presents that initial "Y-in-the-road" and saves time; eliminating unworthy markets is your best strategy to concentrate limited resources on high-quality rental property acquisitions.

Multiple submarkets represent every "market," and not all submarkets are created equal. By its very nature, market selection produces market elimination, which is a good thing because a narrow market focus means laser focus on pre-determined geography.

The number of existing and proposed housing units in an area and their impact on rent growth correlates to population and income. But a population and income growth where? The "where" is in submarkets. Within a submarket is where rental properties compete/

> *A submarket is a geographic area defined by streets, natural barriers, and the specific properties in which a property must compete for customers. How To Read A Rent Roll: A guide to understanding rental income. - John Wilhoit*

Quality due diligence at the market level allows buyers to eliminate no-go deals quickly, allowing focus on purchase contracts with a higher probability of closing- deals that fit into your business plan in terms of positive market attributes and return on investment.

When reviewing a subject asset, its market, and comparable investments, the following data points set the stage for market-specific asset reviews. It's as essential to understanding the market that your subject asset competes in as it is to understand the asset itself. Each one of the following is important individually, but collectively they paint a picture that shines a bright light into the corners of a potential acquisition and the market where it competes.

Rent Distribution

While finding Effective Gross Rent (EGR) is crucial- understanding the range of rents within a market area is essential. The question to ask is: do asking rents at the subject asset fall into the norm for the market area or outside of it by a small or large percentage? When estimating EGR, it is vital to reflect if you are underwriting if the market will tolerate the same rental increases. Value-add investments are primarily dependent on the surrounding market.

Owner/ Renter Ratio

The historical base for the homeownership rate in the United States is 63%. This rate almost touched 70% in the early 2000s before crashing back to the historical norm. Every market area has its homeownership norm. Recognizing changes in this metric can provide insight into rental availability changes, rental product type, and pricing. A submarket with more than 50% rental property housing stock offers a significant choice to potential tenants, and as a landlord, you must be even more mindful of competition to be successful.

Resident / Commuter Ratio

There is always a correlation between rents and the distance of the rental property from job centers. Market areas with fewer commuters, or market areas with more jobs, are less exposed to the risk of vacancy due to the length of resident commutes. The marginal cost of time lost on a lengthy commute often outweighs the marginal benefit of lower rents, causing people to pay more for greater convenience. Bottom line: high job concentration creates greater potential rent growth.

Competitive Versus Comparative Assets

There is a clear distinction between comparative assets versus competitive assets. Consider two assets two blocks away from each other, both having the same amenities. Although they are comparative, one cannot assume they compete. Albeit, in this example, while they are only two blocks apart, what separates them? Is it a freeway or a park? Upscale retail or train tracks? Differences come into focus so clearly when thinking about famous streets; Broadway in New York, Peachtree in Atlanta, Bourbon Street in New Orleans.

What makes these places so unique with rents multiples higher than surrounding streets? It's something- what is it. People come to these places based on their offerings or history or the perceived elevated mystique associated with a particular address. I believe this is why the American mall will live and then die a swift death; they offer nothing unique or memorable.

Once your thinking becomes submarket specific, determining population growth and income will be an essential part of decision-making. Aligning submarket level information with available housing stock within the submarket, including information about amenities offered, proximity to services, and jobs (the quantity and quality of possible employment), will guide your thinking about the future of vacancy and rent growth. These factors have a significant impact on value. How significant?

Starbucks is known as a luxury brand. From inception, this was the plan. Their first stores in California were always within proximity to five-star hotels. Was this a happy accident? No, this was strategic planning by the founders to associate their product with products known for high quality that did not compete on price. This Starbucks strategy worked so well that many of us believe $5 coffees were always with us.

<u>Asset Age and Comps</u>

The age distribution of area properties indicates the potential income of a property. With rare exceptions, a property built in the 1960s or 1970s

seldom generates more revenue as a property built after the year 2000, even with a significant renovation (there are always exceptions, of course). When underwriting a new construction asset in an area with an older product, your rents should be higher than the competition. Just keep in mind that your new property will be an outlier for the market, for which there is fewer data and, therefore, less certainty in your assumptions.

<u>Number of Units and Unit Mix</u>

In acquisitions and new construction, it is important to match demographics and current inventory. Knowing the number of units currently, absorption and population trends (such as average HH size) can provide insight into whether a market is under-supplied or over-supplied in aggregate and unit type level (1,2, 3 bedrooms.) Recognizing a mismatch in demographics and inventory is a great way to plan unit types for construction or redevelopment.

A snapshot of your market, derived from the above data points, can be worth a million dollars when you can see, digest, use and implement a course of action from a single page of quality information. As a real estate acquisition professional or a developer, a constant flow of information is required to predict outcomes and deliver recommendations. Sitting down to a total market "snapshot" can save hours, even days, during the critical due diligence phase.

Concluding Remarks

Select markets first, then assets to buy. Think about and choosing "markets" in advance of seeking assets for purchase will save you from hours-days-weeks-months of chasing dead-end assets in under-performing market areas.

From Memphis to Mumbai, every major city has market areas with "good bones" and a multitude of places to stay away from for reasons that are very apparent once you scratch beyond the surface. You are doing yourself no favors by running "pillar-to-post" looking at every asset that bubbles up for sale in your price range if the initial cut doesn't consider market attributes.

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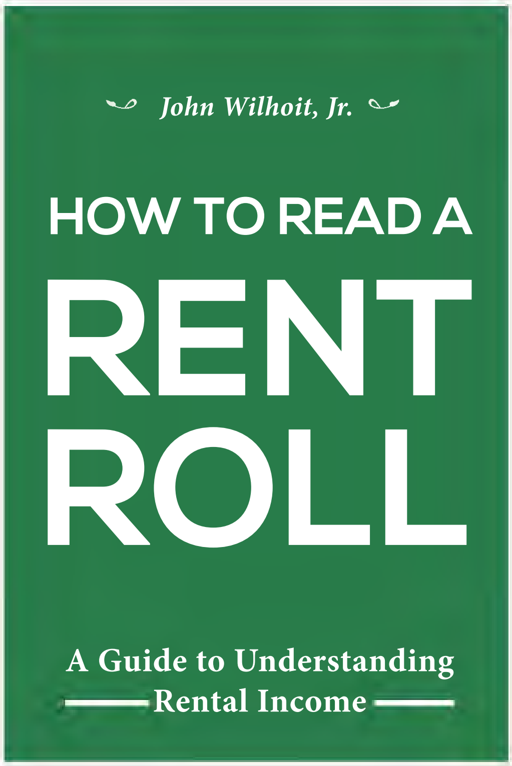

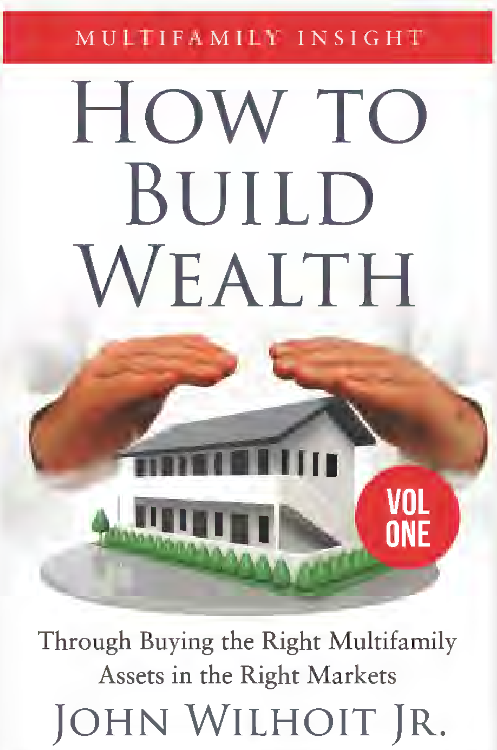

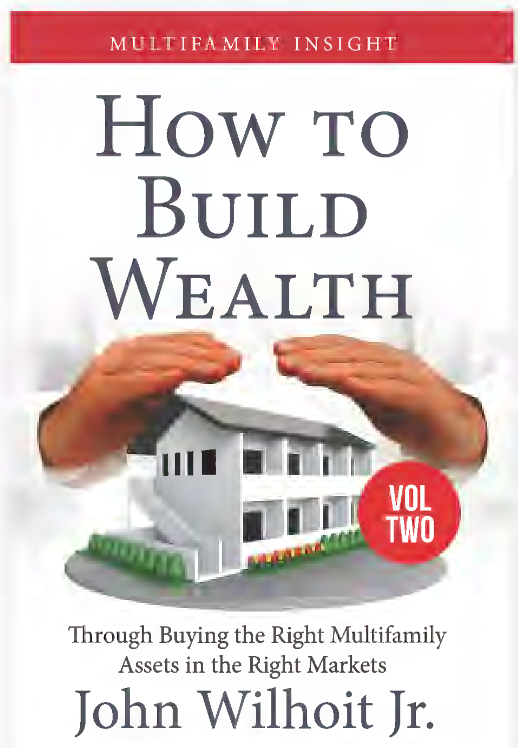

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