

Judging Rent Premiums over the Competition: How Much is Too Much?

- The median variance in average monthly rent among properties built from 2014-2016, and within 1-mile of each other, ranges from 6.7% for low-rise/garden properties in the suburbs, to 11.3% for low-rise/garden properties in urban settings. The variance for mid-rise and high-rise properties falls within these brackets.
- Urban properties exhibit a higher rent variance than suburban properties.

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Background

Developers occasionally assume higher rents for their property than the nearby competition, usually on the basis of factors such as a better location or superior amenities and features. Aggressive rent assumptions may become more common in the current environment of rising construction costs and interest rates.

An important question then for developers themselves, as well as their investors and lenders, is how much of a premium over similar nearby properties is realistic? Previous studies have attempted to quantify the value of specific amenities or locational attributes, however, the inherent difficulty of trying to control for all of the variables that influence a property's rent level limits their usefulness.

Instead of that approach, this paper provides basic summary statistics about the level of rent variance among recently built properties in close proximity to one another across the United States, without controlling for any variables except unit size, building type, and whether the property is located within an urban core or the suburbs. With this information, developers and investors can better assess how aggressive or conservative a premium assumption might be relative to the distribution of premiums currently present in the marketplace.

Methodology

MREP extracted data from CoStar containing the location, average rent, average unit size, and number of stories, of all market-rate apartment properties with more than 100 units built from 2014 to 2016 in the continental United States. Using GIS, MREP "paired" each of these properties with all other properties from the same database within 1-mile. 1,298 unique pairs were identified.

Each property was classified as a high-rise, mid-rise, or low-rise based on the number of stories.¹ Furthermore, each property's location was coded as suburban or urban core, based on the overall household and job density of the census tract in which it was located.²

¹ Properties with 12 stories or more were defined as high-rise, 5-11 stories, mid-rise, and 4 or fewer stories as low-rise/garden.

² Tracts with a total of more than 20 households and jobs per acre in 2010 were defined as "urban." In practice, this includes dense inner suburbs and very dense suburban town centers, as well as inner urban cores. For example, both the U Street neighborhood and Tysons Corner in the Washington, DC metro area are classified as urban.

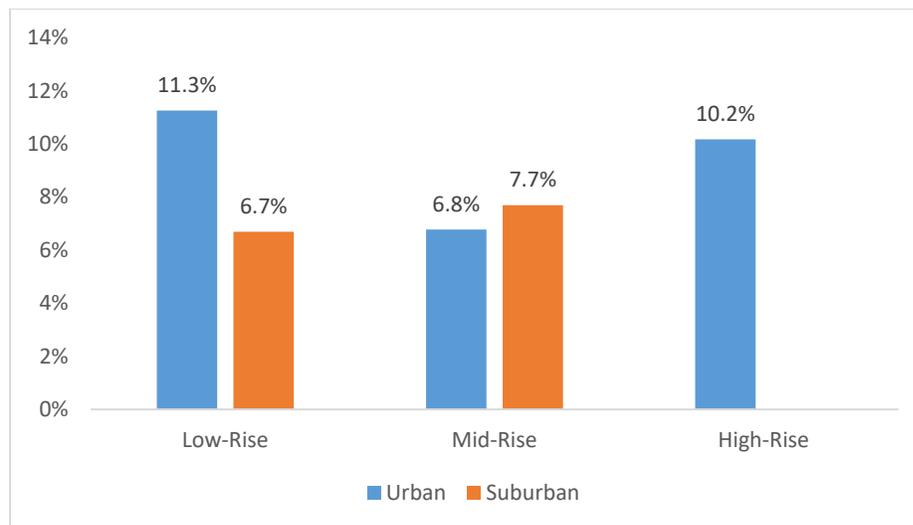
Finally, MREP adjusted rents at each property to account for differences in average unit size among members of each pair. For each pair, MREP calculated the average unit size across both properties. The average rent at properties with a unit size lower than the pair average was adjusted upwards and vice versa. The quantity of the adjustment was based on the difference of the property's average unit size to the pair's average, multiplied by the estimated incremental rent of each additional square foot. This incremental rent was calculated for each property by analyzing how the rent per square foot differed for small and large units within the same property. This calculation of the relationship between rent and size accounts for the fact that in many properties, rents per square foot tend to decline as unit sizes increase. Pairs where the difference in average unit size was greater than 200 square feet, and thus where large and highly speculative adjustments would have been required, were eliminated from the analysis.

The Median Premium Ranges from 6.7% - 11.3%

By comparing the size-adjusted rents of properties built between 2014 and 2016, located within 1 mile of each other, MREP calculated the median and average rent variance among them. This information provides a sense of what is achievable in terms of premiums, taking into account all the variations in property features, amenities, site-specific factors, etc. that are currently present among these properties.

Figure 1 below summarizes the variance in terms of the median size-adjusted rent premium achieved by the high rent member of each pair over the low rent member.

Figure 1: Median Rent Variance Among Properties Built from 2014-2016 and within a 1-Mile Radius



Low-rise properties in the suburbs had the least variance, with a median variance of 6.7%. However, the median variance among low-rise properties increases substantially when they are in urban settings, to 11.3%. A possible explanation is that 1-mile distances are more meaningful in urban settings, where factors such as stark socioeconomic dividing lines, and the presence or lack of transit are all more likely to play a role. That said, the median variance for mid-rises was actually lower among urban properties than suburban ones.

Figures 2-4 below illustrate the distribution of rent variances for each product and geography type. The horizontal axis reflects the variance, or the premium, of the higher rent property in each pair over the lower rent member of each pair. The vertical axis describes the share of unique pairs in the dataset that fell into each of the premium categories. For example, figure 2 shows that 40% of the unique pairs of low-rise suburban properties had a rent variance of 5% or less from one another.

Figure 2: Distribution of Rent Variances Among Low-Rise Properties Built from 2014-2016 and within a 1-mile Radius of Each Other

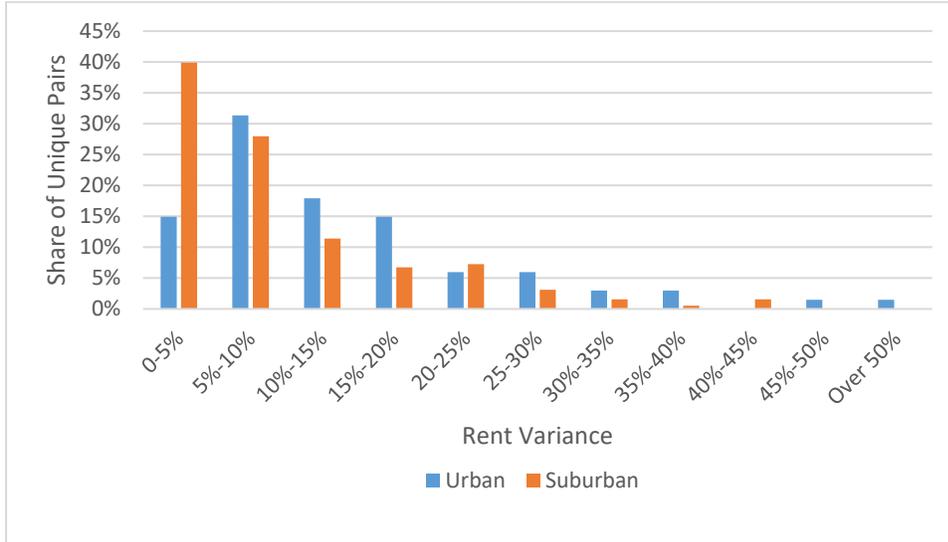


Figure 3: Distribution of Rent Variances Among Mid-Rise Properties Built from 2014-2016 and within a 1-mile Radius of Each Other

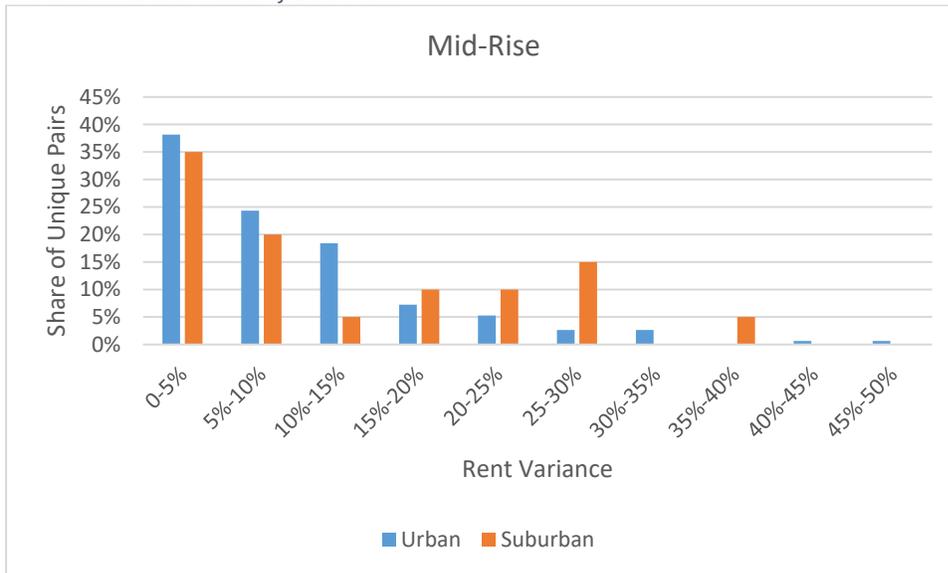
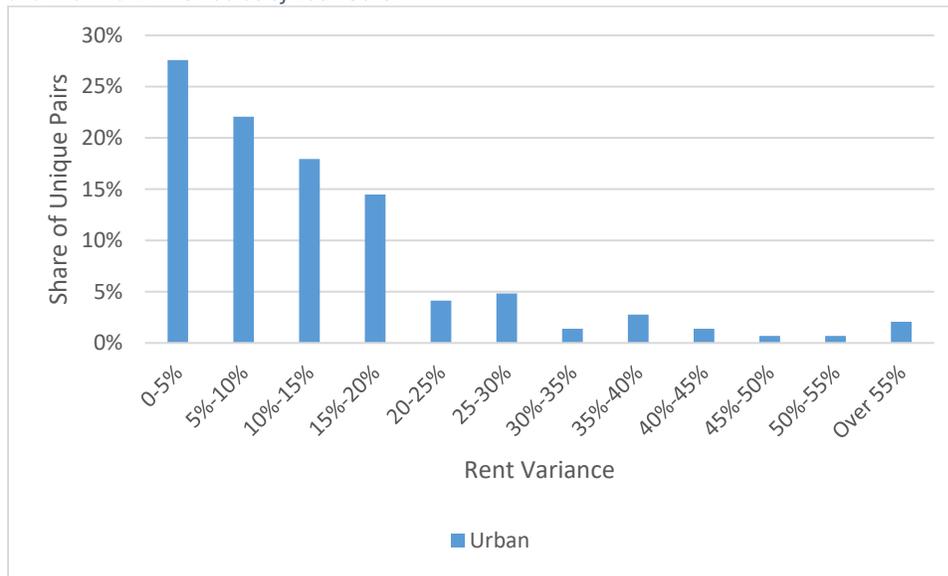


Figure 4: Distribution of Rent Variances among High-Rise Properties Built from 2014-2016 and within a 1-mile Radius of Each Other



Conclusion: Premiums Over 10% - 15% Are Possible but Rare

Most real estate professionals will argue that an “on the ground” understanding of a site and nearby competing projects is crucial and, to some extent, this analysis bears that out. Even among properties built within a narrow age range, in this case from 2014-2016, and within 1-mile of one another, large variances are clearly possible. This is particularly true for properties in the urban core. A 1-mile distance can make a huge difference in the dense urban areas of New York, Boston, San Francisco, etc., especially when factors such as views, and transit access are taken into account.

Even in the suburbs, large variances are possible. For example, Inman Quarter, in Atlanta, is achieving size-adjusted premiums ranging from 17.3% to 40.4% over three nearby competitors. Inman Quarter is located directly in a highly walkable mixed-use development, while its competitors are not.

On the other hand, when one considers all of the variance possible in location quality within 1-mile, and amenities, features, views, fees, utility billing practices, daily pricing algorithms, and management that this analysis made no attempt to control for, it is striking that there is not more variance in rents. 68% of low-rise suburban pairs had a size-adjusted monthly rent variance of less than 10%. Among mid-rise urban properties, 62% of pairs had a variance of less than 10%. It is also worth noting that, to the extent one member of the pair was newer than the other, the newer property was the higher rent member in only 55% of cases.

The lesson is that, while an “on the ground” understanding remains crucial, and significant differences in rents are certainly possible, even among highly comparable properties within a 1-mile radius, size-adjusted premiums of more than 10% for suburban low-rise properties or mid-rise properties, and 15% for urban high-rises are exceptional. The justification for assuming such premiums must be very strong.