Demand and Capture Rate Methodology

Introduction:

An estimate of demand is a measure of the number of income-qualified households with the propensity to move to the subject property. Demand estimates can vary significantly based on the components used and the variables applied to measure propensity to move. The components of demand are often based on the goal of the report's end-user. The goal of NCHMA's demand model is to provide a base estimate of income-qualified renter households. Refinements to this demand model can be made to address a more discrete target population on a case-by-case basis. The intention of this demand model is to provide a consistent methodology for comparison purposes.

After developing the estimate of demand, a capture rate can be determined. A capture rate is the percentage of the demand that the subject development must capture in order to become fully leased. The capture rate is generally a major determinant of a project's viability. Its importance will be discussed.

Many demand models may not necessarily provide an accurate estimate of the likelihood of the project's success, as they do not address the health of the competitive rental environment or the appropriateness of the proposed rents. It is quite possible for a demand estimate and capture rate to indicate sufficient demand for a proposed project without an existing need for additional rental units.

Demand vs. Need:

At its root, an estimate of demand should include all income-qualified renter households that would consider the subject development as an acceptable shelter option. This approach does not address the impact of proposed units on existing rental communities in the market area and addresses only the subject development's ability to achieve stabilization with proposed rent levels.

When looking at a proposed development, it is imperative to be concerned with the overall performance of affordable rental housing in the subject property's market area. In addition to the ability of the subject development to achieve stabilization, one should be concerned with the impact of the proposed development on existing rental communities, especially other affordable housing communities. While there may be sufficient demand to support a proposed development, it may lease up at the expense of older affordable developments. In this case, there would be Demand for the proposed units, but not a Need for additional affordable rental units in the market area. Many states use their "Demand" estimates to determine not only the likelihood of the proposed development's success, but its impact on
existing communities. This is often referred to as a “Net Demand Model” and will be addressed as an additional variable of consideration, but is not part of our standard model.

**Factors of Demand Methodology – The NCHMA Standard Model:**

The factors applied to the NCHMA standard demand model are considered the basic requirements of housing demand methodology. They should be considered and applied by members as at least one of the models used to establish a supportable capture rate. This demand model applies to a family or non age-restricted project.

- **Market Area:**
  - The model requires an estimate of a supportable market draw area. Refer to the NCHMA white paper “Determining Market Area”.

- **Tenure:**
  - The demand model will account only for renter households.

- **Household Size:**
  - Demand will be broken down by household size, which correlates to the type of unit being studied. The NCHMA standards will apply as follows:
    - One-bedroom units: 1-2 person households.
    - Two-bedroom units: 2-4 person households.
    - Three-bedroom units: 4-6 person households.
    - Four-bedroom units: 5 or more person households.
  - There will be overlap if there are multiple unit types. This is accounted for by first establishing supportable capture for each unit type by household size and then applying a weighted average in order to correlate to a total project capture.

- **Income:**
  - The renter households must be factored for income qualification. The demand model applies the following guidelines:
    - The minimum income necessary to “afford” the project will be based on the tenant paying 35% of their income for rent (inclusive of all utilities, or gross rent). This ratio is a generally supported statistic used to measure affordability.
    - The upper end of the income-qualified range will be based on the tax credit maximum levels for the location in question.
    - For the demand model this is a basic range from low end to high end of the rent for each unit type. There may be a need to apply more specific and more detailed variables here based on specific requirements of the
user. For example, it may be necessary to provide two different income qualification levels for a project that will have some units set at the 50% vs. 60% AMI maximums. In this case, individual capture rates can be set by unit with the project capture again reflecting the weighted average of the results.

By properly applying these factors, a capture rate can be estimated by unit type and subsequently for the entire project.

Additional market variables can be applied separately, but the factors outlined should be applied in all cases as the NCHMA Standard Model. Some of these “Additional Variables to Consider” will be discussed in a subsequent section.

Evaluating Demand Estimates and Capture Rates:

While capture rates are certainly an important measure of the strength of proposed development, a determination of a project’s viability should not be based solely on one number. A low capture rate does not automatically equate to demand for the proposed development. Conversely, a higher capture rate may be acceptable if the project is properly positioned.

A capture rate should be evaluated based on:

- **Size of the Market Area:** A capture rate with a county as a market area may be low, but are people willing to move 15+ miles for rental housing? Capture rates for market areas based on immediately surrounding neighborhoods may be higher, but the likelihood of these renters to move may be much higher.

- **Components of Demand:** More restrictive demand models are generally accompanied by an acceptance of higher capture rates. It is important that the reader understand what is being measured in the demand estimate, for example all income qualified renters or specifically targeted households based on a public/special purpose. These two approaches will result in significantly different capture rates.

An acceptable capture rate only indicates sufficient demand to support the proposed number of units at the proposed income levels. It does not include an evaluation of the subject development versus the existing rental stock. The likelihood of the subject development to lease up should also be evaluated based on:

- **Location:** Surrounding land uses may attract or prevent renters from moving to the site.

- **Proposed Rents:** Demand estimates indicate the number of households able to pay the proposed rents, not their willingness to do so. If the proposed rents are not properly positioned based on community design, unit size, and amenities, income qualified households will not move.

- **Vacancy Rates:** Rental markets with high vacancy rates may reflect an oversupply of available housing. The overall health of the rental market may impact the ability of a proposed development to reach stabilization, despite strong demand estimates and properly positioned rents. Older developments may offer significant incentives to
compete with a new rental property. Income qualified renters may be unwilling to pay more for higher quality housing.

**Recommended Best Practices:**

- Verify validity/reasonableness of household projections and estimates.
- Explain variables used in capture rate.
- Explain/illustrate calculations resulting in estimates of demand.
- Apply the Demand Model as a basis for establishing a capture rate for the project.
- Evaluate the capture rate in relation the existing rental market.
- Capture rate conclusions should be factored in absorption estimates.