Confronting the Question of Market Demand for Urban Residential Development*

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Abstract

This article considers new methods for determining the market demand for urban residential development. Traditional supply/demand analysis often underestimates demand because it ignores the potentially significant impact of newly introduced housing supply in urban areas on settlement patterns, particularly when that supply is specifically targeted to match the housing preferences and economic capabilities of draw area households. By using methods such as target marketing, the demand for different types of residential development can be estimated for neighborhoods that currently feature no such housing.

Although demand for urban housing cannot be quantified, the characteristics of the various types of households that represent the potential market for urban housing can be determined. An understanding of these household characteristics can guide the public and private sectors toward adopting strategies for developing and sustaining urban neighborhoods. The most difficult challenge is to marshal economic forces through proper positioning, timing, and phasing to exert a positive influence on urban settlement patterns.

Keywords: Markets; Housing; Development/Revitalization

Introduction

"Demand" for housing is often an illusory concept, particularly when applied to urban neighborhoods. The depth and breadth of the potential market for urban housing, however, can be determined and is often substantial, even in cities that have seen little or no new housing produced in years.

Historically, urban areas have experienced population loss, often severe, and conventional supply/demand analyses typically project that trend to continue, with the result that forecasts of demand are often minimal, if not negative. Conventional supply/demand analyses ignore the potentially significant impact of newly introduced housing supply in urban areas on settlement patterns, particularly when that supply is specifically targeted to match the housing preferences and economic capabilities of draw area households.

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Research Methodologies

All too often, research methodology limits the scope of possible results. For example, if housing market analysis is focused only on the supply side—i.e., values and occupancies of existing dwelling units (typically, adjacent neighborhoods) and values and absorption rates of new residential construction (typically, in greenfields locations)—then the "demand forecast" will be limited to those housing types that are currently available. Even the most rigorously applied supply/demand methodology rarely reveals the actual scope of new housing potential. This is because most "market analysis for real estate uses general marketing theory; however, out of necessity, it must consider the geographical concerns of spatial concentrations of supply and diffused demand" (Grissom and Liu 1994, 79). Rarely is this mismatch adequately resolved.

Because of this mismatch, demand for new housing in a specific location cannot be definitively determined through research, however rigorous. The multiple factors that enter into the housing decision cannot be statistically isolated even through the most complex empirical analysis. Thoughtful observers of residential settlement patterns know that, when it comes to housing analysis, rigorous empirical inquiry only leads to additional questions.

Although demand for urban housing cannot be quantified, the characteristics of the various types of households that represent the potential market for urban housing can be determined. An understanding of these household characteristics can guide the public and private sectors toward adopting strategies for developing and sustaining urban neighborhoods. The most difficult challenge is to marshal economic forces through proper positioning, timing, and phasing to exert a positive influence on urban settlement patterns.

The challenge is an important one. The creation, re-establishment, restoration, or enhancement of neighborhoods is the foundation of any rational initiative for sustainable regional development. Without the connections between residents and shopping, employment, and recreation, infrastructure and resource efficiencies will continue at the current low levels.

Supporters of the status quo maintain that if there were a genuine market for urban housing, there would already be plenty of it. Apologists for the current leap-frogging pattern of low-density, narrowly targeted, single-use development still argue that the current pattern is simply continuing "the relentless outward expansion of cities into suburbs and beyond" (Gordon and Richardson 1997, 75–76). This thinking suggests that we are ultimately headed toward some sort of housing entropy, in which every household is equidistant from every other household, and all community and commerce is experienced in cyberspace out of necessity.

Those same supporters also cite as "empirical evidence" decades of American household movement to environments characterized by steadily decreasing densities. However, this "evidence" is largely meaningless. In most metropolitan areas, American households buy into the current settlement patterns because they lack genuine choice.

Housing production generally follows the path of least resistance: easy-to-finance and easy-to-build units on land that is environmentally "clean," in a "good" location in a metropolitan area that is experiencing reasonable job growth, for which it is deemed appropriate zoning and approvals can be readily obtained. The builders and developers follow the well-defined and efficient delivery system of housing as “product” that is the end result of a long conspiracy of good intentions, from the Euclid zoning decision to the Americans with Disabilities Act. This usually translates into the efficient “unibox” detached houses on former agricultural land. There is more residential development in fringe locations, then, simply because it is significantly easier to accomplish than development on urban sites: Exurban tracts are larger; entitlements are less complicated; and a majority of acquisition, development, and construction lenders have a high comfort level with single-use greenfields development. It is the higher degree of difficulty that has made urban residential development a “niche product.” This does not mean that urban housing can find only a “niche market.” Compact urban development is beginning to be embraced by too many builders, developers, financial institutions, and government agencies—from local to federal—to remain marginalized as a “niche.”

Supply-Side Research in Urban Locations

Conventional housing market analysis generally does not attempt to address the specific needs or desires of the increasingly diverse pool of housing consumers. Supply/demand analysis is generally the analytical tool of choice. But the type of supply/demand analysis that often passes for new housing research is nothing more than an analysis of the market performance of currently marketed subdivisions and master-planned communities, combined with simple, often marginally related demographic data. If forecasts of household change are included, they are usually straight baseline projections, which assume that the recent pattern of change in the numbers of households will continue into the future. Analysis of supply-side data can range from rudimentary to quite sophisticated. Nevertheless, most new housing research is predicated on two very questionable premises: 1) that the change in the number of households will continue the trend of the recent past, and 2) that the only housing types that will meet with market acceptance are those that have demonstrated sales success in comparable locations.

Reliance on supply-side analysis often leads to local myopia. Builders, real estate brokers, and other real estate observers are often subject to an antiurban bias, justifying their opinions with supply-side data.

The distortion of supply-side analysis is often aggravated in urban areas by the mismatch of existing urban housing units and the households that have the potential to move to urban neighborhoods. In some cities—for example, St. Louis—the market feasibility of new housing construction has been dismissed because large houses already existing in the city do not sell despite prices that are quite low. In these instances, the issue is not the prices, but rather the sizes of the existing houses. A significant number of the grand older urban houses have hundreds, even thousands of square feet more than the market really requires; this is particularly true when the market consists of young singles and childless couples who are seeking convenience and location rather than space. An understanding of the characteristics of the potential market for urban housing, then, can reveal these mismatches.

The heavy reliance on competitive sales data has led the housing industry into a peculiar self-referential inward spiral, in which the houses of many builders are converging into amazingly similar units. Continued *ad absurdum*, this convergence means that in the future there will be just one house type built in America. A benefit of this scenario of monotony, one would assume, is that production would be very efficient.

Academicians generally dismiss these limited housing research studies: "...in recent years the quality of market studies in real estate has been widely criticized" (Myers and Beck 1994, 259). However, despite many decades of scholarly analysis of empirical real estate–related data, few of the scholarly research techniques have been adopted by housing developers. Only real estate portfolio analysts and acquisition managers have empirical tools on which they can rely. Just as supply/demand analysis often works quite well in describing the market for packaged goods, if carefully applied, it can also provide useful insights into performance projections of investment-grade income-producing real estate assets.

In contrast, those seeking practical tools with which to gauge the potential for new residential initiatives—public and private sectors alike—have, as often as not, been led astray by supply/demand analysis. The emphasis often placed on unquantifiable "demand" can be misguided.

Forecasting the demand for new housing is so challenging because housing dynamics are fundamentally different than those of other consumer durable items. Unlike other purchase transactions of consumer goods (from impulse items to big-ticket items), housing is a product that is fixed in place requiring that the purchaser must move to acquire it. As Dowell Myers has pointed out (Myers 1990), this creates the unique causal relationship between population and housing in which the arrow of causation changes direction depending upon geographic scale.

The relationship between the demand for housing and the number of new households may vary significantly depending on scale. At the broadest geographic scale (metropolitan statistical area and above), housing demand—and its corollary, the number of new housing units that is required to respond to that demand—is derived primarily from projected increases in the number of households; barring wholesale demolition, fire loss, and abandonment of existing housing stock, new housing is not likely to be absorbed without a corresponding increase in households. At the local level, however, and assuming a neighborhood's housing units are at "stabilized full occupancy," there can be no increase in households if there are no new housing units built in which they can be housed.

Housing, therefore, is unique among consumer items; because it is fixed in place, supply can create its own "demand," the results of which are seen in the low-density settlement pattern of the past several decades. However, this peculiar dynamic of "build it and they will come" can only occur when those new housing units are well-matched to the characteristics of the households that comprise the potential market. The success of dispersed, relatively low cost per square foot detached housing has been its match with the demographic bulge of family households that is now beginning to wane as the Baby Boom generation—those born between 1946 and 1964—begin to move from "full nest" to "empty nest" life stage. (The recent remarkable increase of high-priced detached houses is simply matching the expectations of the Baby Boom households in the peak earning years—the first generation in American history in which it is common to have two incomes contributing to those peak earnings.)

Survey Research in Urban Locations

The critical question for urban housing, then, becomes not so much the quantities of market demand but rather the qualities of the market potential.

Because of the lack of meaningful “comparables” in urban locations, the methodology most often employed to determine both quantity and characteristics of the market for urban housing has been some kind of survey research. Survey research can be effective if its objectives are set with the recognition that what can be quantified is not market “demand” but rather market “potential.” The two pitfalls of survey research regarding urban housing (or any housing, or any survey for that matter) have to do with the sample—*i.e.*,who one asks—and questions—*i.e.*,what one asks.

A sample can be biased despite the most rigorous efforts. Projecting survey results based solely on sample demographics can be perilous. Households with virtually identical demographics can have very different attitudes. If a sample does not have the same cultural values as the population as a whole, survey results could over- or underestimate the potential market for urban housing. Some cultural values have correlated positively with a preference for compact and urban neighborhoods. For example, households that place greater value on experience than on material goods are more likely to value the diversity and cultural opportunities associated with urban living (Rey 1996).

A more serious flaw with survey research is the difficulty of conveying an appropriate image of an urban neighborhood. Questions are often vaguely worded, asking the respondent’s attitude toward living “downtown” or “in the city.” Often the vagueness is purposeful, to allow the most open interpretation and least bias from a population that has little familiarity with urban living. There is no single urban residential archetype; the neighborhoods of American cities vary greatly in both density and character, from the detached houses of Charleston to the apartment buildings of Manhattan. The fundamental problem is that many, if not most, Americans, lacking an urban frame of reference, are unable to conceive of an urban neighborhood as a habitable place. Many suburbanites have simply no idea what a stable urban neighborhood would look like or be like; for them, the word “urban” still conjures images of crime, congestion, and blight.

If these limitations and difficulties are recognized, well-designed survey research is probably the least complicated conventional methodology that is capable of providing approximations of both the quantity and characteristics of households that make up the potential market for urban housing.

Professionally facilitated qualitative research, including focus groups and interviews, can help distinguish the characteristics of potential urban residents and can determine individual unit and neighborhood preferences at a relatively detailed level. Even the best qualitative researchers, however, require guidance in assembling panels or prospective interviewees; they must, in effect, know who the market is in order to learn about it in detail. No qualitative research is capable of determining the depth and breadth of the market.

Target Market Methodology

It is from analysis of migration trends and mobility rates that the depth and breadth of the potential market can be determined. Migration data quantifies how many households move into a market area, and from where they are moving. Mobility rates quantify those households that move within a market area.

The number of households that could potentially move to a given location in a given year describes the practical upper limit on market potential.

Migration analysis need focus only on in-migration, rather than out-migration or net migration. Net migration is of little consequence even when a local market has been stigmatized by precipitous household loss. For example, the cities of St. Louis and Detroit have both experienced dramatic out-migration; nevertheless, there is still market potential for the downtown areas of both cities. Thousands of households move into both cities every year; until recently, those numbers have simply been lower than the numbers of households that have moved out.

While migration and mobility analysis provide a means for determining the quantity of those households that could potentially move to an urban location, the more difficult task is determining their qualities and characteristics, and how those qualities and characteristics influence housing preferences.

Some household characteristics can be obtained through conventional research techniques, as noted above. Triggered by our work, geodemographic analysis, a methodology not previously applied to housing, has been proposed as a means of identifying which middle-income suburbanites have the potential to relocate to central cities (Lang, Hughes, and Danielsen 1997). Even without the refinements of migration and mobility analysis, target marketing was found to augment conventional data, and to have the potential to provide cities with a deeper understanding of their market advantages.

Over the past decade, we have used our proprietary target market methodology, which combines geodemographic data with migration and mobility analysis, to determine the depth and breadth of the potential market, and the optimum market position for new development or redevelopment based on the characteristics of that market.

It is important to emphasize that the supply-side context cannot be ignored; the supply-side context provides benchmarks of housing value. Although proposed new housing units need not be hostage to the supply-side context, neither can new construction be positioned in ignorance of supply.

Case Study: Norfolk, Virginia

Until the groundbreaking of Heritage at Freemason Harbor in 1998, very little new housing construction had occurred in or adjacent to downtown Norfolk since the 1970s. The city’s household population had dropped by more than 10,000 households over the same period, convincing most market analysts that there was little demand for new housing units anywhere in the city, much less the downtown. However, the Norfolk Redevelopment and Housing Authority had acquired three city blocks adjacent to downtown and sought a private developer to produce a mix of rental and for-sale housing on the site. Connecticut-based Collins Enterprises, the developer, asked Zimmerman/Volk Associates to undertake a target market analysis of the site in part because local experts were highly skeptical that there was any market for housing on the site, in part because that very small market was thought to be for very large units at relatively low rents and prices, and in part because the only “comparables” were new resort-oriented condominiums in Virginia Beach, a much more suburban residential environment.

The housing program proposed by Zimmerman/Volk Associates for Heritage at Freemason Harbor was derived from our proprietary target market analysis, which determines not only the depth and breadth of the potential market, but also who those households are, where they are moving from, what their housing and lifestyle preferences are, and how much they can afford to pay.

The foundation of our methodology is the fact that, on average, between 16 and 20 percent of American households move each year, primarily because of changes in lifestyle, economics, or family status. Although household mobility rates vary depending on location (Westerners move at much higher rates than Easterners), by tenure (renters move more than owners), and by age (the young move more than the old), those moving households represent the broad potential market for housing, both existing units and new construction.

The target market methodology is actually quite straightforward. After an evaluation of the site, Zimmerman/Volk Associates determines where the potential buyers and renters will move from (draw areas), who currently lives in those draw areas (target household groups), how many of those households are likely to move to the site (market potential), what their housing preferences (tenure and housing type) are, and what their alternatives (other housing properties) are.

Field investigation and taxpayer migration data, obtained from the Internal Revenue Service, provide the framework for the delineation of the draw areas. U.S. Bureau of the Census data, combined with PRIZM geodemographic data obtained from Claritas, Inc, is used to determine the number of households in each target market group that will move from one residence to another within a specific jurisdiction in a given year.

In this case, migration analysis showed that, in addition to households already living in the city of Norfolk, households moving from outside the city comprised a significant segment of the potential market for new housing units in downtown Norfolk. Households moving from Virginia Beach represented approximately 20 percent of all households moving into Norfolk each year, and households moving from Chesapeake approximately 5 percent. The remainder of the households were moving from cities or counties that, individually, comprised well below 4 percent of Norfolk’s annual total in-migration.

The result was that more than 5,100 households represented the potential market for new and existing housing units in the city of Norfolk in the year of the analysis. The specific analysis of those households is based on geodemographic segmentation; in this instance, Claritas’ PRIZM analysis, where clusters of households are grouped according to a variety of significant factors, ranging from basic demographic characteristics, such as income qualification and age, to less frequently considered attributes such as mobility rates, lifestyle patterns, and compatibility issues. We have refined the analysis of these household clusters through the correlation of more than 500 survey data points related to housing preferences and consumer and lifestyle characteristics.

From that target market analysis, it was determined that not all of those 5,100 households represented the potential market for housing in downtown Norfolk; some target groups—particularly traditional families, those currently living in very low density areas, and those with lower incomes—were likely to move to more suburban, less expensive areas of Norfolk, but not to the city's downtown core.

However, more than 1,100 target households were determined to comprise the depth and breadth of the potential market for new housing units on the downtown Norfolk site, a number considerably higher than local estimates. As might be expected, the potential market was dominated by younger singles and couples: the career- and convenience-oriented *VIPs*, *Fast-Track Professionals,* and *Yuppies & Eggheads,* and the "indicator species" of emerging hip neighborhoods, the *New Bohemians*. The potential market also included affluent older households, from the sophisticated *Urban Establishment* to the *Post-War Suburban Pioneers*, older couples moving from suburbia to downtown after their youngest children have left home. Perhaps surprisingly, the potential market also included a percentage of compact family households: both the city-savvy *Full-Nest Urbanites* and *Cosmopolitan Families*, as well as *Unibox Transferees*, who typically rent a quality apartment while waiting to take occupancy of their new house.[1]

Our determination of the composition of the potential market—more than 53 percent younger singles and couples, approximately 28 percent empty nesters and retirees, and 19 percent compact families—was also at odds with the local experts, who perceived the market to be considerably smaller and almost entirely composed of older couples.

The market performance of Heritage at Freemason Harbor has borne out the analysis. Tenant and buyer profiles quite closely reflect the distribution of the market analysis. Although the property has achieved rents and sales prices dramatically higher than other new construction in the Norfolk area, there is a waiting list for the existing rental apartments, the third and final rental building was almost entirely pre-leased months before construction, and nearly all of the for-sale units were pre-sold several months before groundbreaking.

Perhaps the most dramatic application of the detailed market knowledge provided by the target market analysis was the success of the "maisonette" units—direct-entry apartments facing Boush Street, a high-traffic arterial. These apartments have become a desirable "address" for urban residents and have transformed the public perception of Boush Street from an inhospitable highway to a comfortable urban boulevard.

[1] The nomenclature in this paragraph was developed by Zimmerman/Volk Associates, which renamed the Claritas PRIZM household groups to emphasize housing propensities and integrate survey data into the target groups' descriptions.

Other Significant Urban Market Issues

A thorough understanding of urban residential dynamics has implications far beyond typical supply/demand concerns. Issues range from physical form to phasing:

There is no single housing formula.

Seeing urban markets as a function of market potential specific to an area means that one must accept that there is no formulaic housing mix to attract new households to urban neighborhoods. Good neighborhood revitalization must be responsive to local market dynamics—*i.e.,*the preferences of the different household groups that make up the market for new urban housing. Household mix—the proportions of empty nesters, younger singles and couples, and families that make up the new housing market—can be very different from city to city and from neighborhood to neighborhood. Two cities that are commonly considered to have very similar dynamics—St. Louis and Detroit—in fact, have very different markets: Detroit's new housing market is predominantly family households, albeit nontraditional ones, whereas St. Louis has much higher proportions of empty nester/retirees and younger singles and couples and comparatively few families.

The market potential for urban housing need not be a "zero-sum game."

A corollary to the concept that housing supply can create its own demand is that, citywide, the creation of new housing in any one neighborhood need not be a "zero-sum game." This is an important issue when many city neighborhoods perceive themselves to be in competition for a limited number of households. New housing can be introduced into an urban neighborhood without cannibalizing other emerging neighborhoods. The key is neighborhood positioning. Careful positioning is second nature to the best developers of master-planned communities, but is usually ignored by municipalities and sponsors of neighborhood revitalization. Emerging neighborhoods that target the proper potential market can change housing dynamics in the entire city. When new housing options are created within a city, these new units can capture households that otherwise might have settled elsewhere. They may also retain households that, because of a lifestage or economic change, might otherwise have moved out of the city.

New construction has the power to attract the potential market.

A powerful rationale for an increasing number of households to leave familiar urban neighborhoods is the desire for newly constructed housing. In the same regard, introducing newly constructed housing into an existing neighborhood usually presents an attractive alternative to former residents of the area who have previously moved out of the city. The expense and aggravation of continued repairs to older housing stock can overwhelm many households; new construction—with new appliances in kitchens and baths, floorplans that match modern lifestyles, and ample closet space in the bedrooms—becomes increasingly attractive.

Phasing can influence the market.

To attract the potential market, new urban housing construction must be seen not only in spatial terms—*i.e.*, where and in what form housing should be built—but also in temporal terms—*i.e.*, when each housing type should be introduced to the market. Just as with any suburban development, the first phase can make or break the development. What is at stake is more than the obvious efficiency of infrastructure and a careful matching of expenses with revenues. The first phase can have an impact on the potential market as well.

The first phase must consider the image that is presented to the community at large. The type of housing built at the property's most visible edge must be very carefully targeted; it will convey most powerfully the character of the neighborhood to the potential market.

Finally, the tenure mix of early phases can be critical. Despite the widespread objective of bringing homeownership into the city, rental housing can be an excellent first phase for neighborhood revitalization. Rentals can quickly transform neighborhoods, particularly those that have nonresidential elements. Rental units are leased at a much faster pace than for-sale units are sold. Renters typically spend more time in the public realm because they are generally younger and their units are generally smaller than those of homeowners.

The public realm should be matched to the market.

Just as it is important to provide a range of housing matched to the potential market, it is equally important to provide a public realm that meets the cultural and leisure interests of that market. The commerce and culture of urban locations usually attracts young singles and childless couples, both young and older.

Family households may also appreciate these attributes, but schools and security issues frequently deter households from remaining once children appear. Cities can retain families if they provide the three significant community elements that are required to establish or sustain urban residential neighborhoods—safe and secure streets, sufficient green space, and good schools.

The urge to suburbanize should be avoided.

Knowledge of the characteristics of households that have the potential to populate urban neighborhoods provides a final important insight: They will be attracted to appropriate urban design, not to an urban reinterpretation of low-density suburban forms. Good urban design places as much emphasis on creating quality streets and public places as on creating quality buildings.

Design should not signal socioeconomics.

For urban neighborhoods to attract and sustain a diverse mix of households, a neutral socioeconomic design is required. The affluent will live in mixed-income neighborhoods if the occupants' income level or tenure is not discernible from the street. This can be achieved through consistent construction quality and the mixing of rental and for-sale buildings and units throughout the community.

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