EVALUATING THE RESIDENTIAL INVESTMENT POTENTIAL IN OLDER URBAN AREAS:

A CASE STUDY

by Richard Gsottschneider, CRE, & Fred Pulitzer

Since 1992, the beginning of the current economic expansion, residential real estate has performed very well across much of the U.S., however the evidence suggests that much of this appreciation has occurred either in the suburbs or in the major cities (e.g., New York, Boston, San Francisco). For example, in Massachusetts median housing values for the entire state increased by 10.8 percent for the period from 1990 to 1998, whereas in Boston they increased by 41.7 percent. In contrast, smaller cities in Massachusetts with populations between 50,000 and 100,000 people experienced an overall 2.8 percent decline in residential property values during the same time frame. The purpose of this manuscript is to both explore the question of whether or not these smaller, older urban areas represent an investment opportunity in this new millennium, and to identify what criteria an investor should utilize in helping to evaluate future investment potential in these areas. A case study approach is used to help address this question, and eight cities in Massachusetts form the basis for this analysis. These cities, and their estimated 1998 population, are listed in *Table 1*.

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WHY IS THIS ISSUE RELEVANT?

One school of thought regarding the investment potential in an older urban area might be to simply avoid it; too much risk and uncertainty. However one only has to think back 30 years to realize that some of our major cities (e.g., Boston) were once questionable locations for residential investment, and today they represent some of the highest residential values in the U.S. Do the smaller cities represent a similar growth

Table 1

1998 Population of Targeted Cities in Massachusetts

City	1998 Population	% Change Since 1990
Lowell	100,663	-2.7%
New Bedford	96,108	-3.8%
Brockton	92,379	-0.4%
Fall River	90,443	-2.4%
Quincy	85,733	0.9%
Lynn	80,786	-0.6%
Somerville	74,222	-2.6%
Lawrence	68,563	-2.3%

Source: Claritas, Inc. and RKG Associates, Inc.

opportunity when viewed from an investment perspective? The authors believe they do, under certain circumstances.

Several overall trends suggest that the smaller, older urban areas will see improved performance of their residential real estate, and each of these trends are discussed briefly:

- *Smart Growth:* Most of the politicians want to place more emphasis on good planning and mass transit and place less emphasis on suburban sprawl. This should translate into more funding for urban redevelopment, which would directly benefit the small- to medium-sized cities which have the available infrastructure to accommodate growth. Equally important, many suburban areas throughout the U.S., and particularly in the Northeast, are seeking to slow growth.

- *Lifestyle and Demographics:* Two age cohorts, the 20 to 29 year-olds, and the 55 and over groups, have the potential to be attracted into older urban areas if the cultural amenities can be sufficiently enhanced to appeal to the lifestyle interests of these groups. Many smaller cities, such as Portsmouth, NH; Burlington, VT; and Portland, ME, have already demonstrated this potential by focusing on culture, restaurants, and specialty retail, taking advantage of their waterfront selling. The potential for this trend to continue is substantial, and the opportunity to link this initiative together with colleges located in older urban areas will become increasingly important. Likewise, many smaller cities are becoming more sophisticated, developing urban entertainment centers and sports and cultural attractions, again directed to these targeted markets.

- *Growth in Downtown Employment in the Major Cities:* Many of the major cities in the U.S. have experienced a tremendous resurgence in their downtowns as a result of concerted planning efforts over the last 20 years. For example, Boston has created over 50,000 new jobs in the past decade, many in the financial and legal services and technology sectors. This factor, coupled with the related development of cultural/restaurant venues, has lured workers to the major metropolitan areas, and in turn these people need a place to live. With residential prices escalating in the major cities, close-in urban locations with relatively more affordable housing would be likely beneficiaries. As the following analysis will indicate, this fact is starting to happen in Massachusetts, and is likely to occur elsewhere in the U.S.

CAN SOCIO-ECONOMIC DATA BE USED TO IDENTIFY INVESTMENT OPPORTUNITIES?

For this case study, 20 variables were evaluated to see whether or not they could help explain the performance of the residential housing market in eight cities in Massachusetts *(referenced in Table 1)* from 1990 to 1998. Although these cities, when averaged together, under-performed the overall market, some performed better than others. The objective was to see if selected socio-economic data could be used to explain the performance differential between the eight cities, as well as provide a basis for predicting future performance. Residential market performance was measured in terms of median single-family and condominium unit pricing, as well as median rents.

The 20 key variables used in this analysis were grouped into three broad categories, and are discussed below. This data was chosen because it is readily available to prospective investors through both the public sector and private vendors, and because it provides a broad socio-economic overview of a city.

- *Demographic Trends:* These variables included population and household trends; social and ethnic composition; age distribution of the population; change in median household income; and Scholastic Aptitude Test (SAT) scores.
- *Economic Trends:* These variables included labor force and employment trends; trends in the number of businesses; average annual wages; and property taxes.
- *Housing Characteristics:* These variables include the mix of single-family and multi-family units; unit density per acre; the mix of renter versus owner-occupied housing; the age of the housing stock; and the number of rental-assisted housing units in the city.

HOW DID THE RESIDENTIAL MARKETS IN THE EIGHT CITIES PERFORM, AND WHY?

Referring to *Figure 1* and *Figure 2*, the housing market performance of each of the eight cities is graphed. In *Figure 1*, median single-family residential prices are illustrated for 1990 and 1998. As the graph illustrates, Somerville and Quincy, two cities outside of Boston, outperformed the residential market of the State as a whole, whereas the remaining six cities actually experienced a decline. For residential condominiums, the performance of all eight cities was significantly below that of the State as a whole (no illustration is provided). Referring to the data in *Figure 2*, residential rents increased in all eight cities, as well as the state, from 1990 to 1998.

Most of the politicians want to place more emphasis on good planning and mass transit and place less emphasis on suburban sprawl. This should translate into more funding for urban redevelopment, which would directly benefit the small- to medium-sized cities which have the available infrastructure to accommodate growth. Equally important, many suburban areas throughout the U.S., and particularly in the Northeast, are seeking to slow growth.

The greatest percentage increases in residential rents were in Somerville and Quincy, the two cities which also experienced the greatest increase in single-family housing values.

Can readily available socio-economic data help explain the overall under performance of the eight urban areas, when averaged together? Secondly, can this same data help explain why Somerville and Quincy outperformed the other six urban areas? The answer, in part, is yes. Let's explore why.

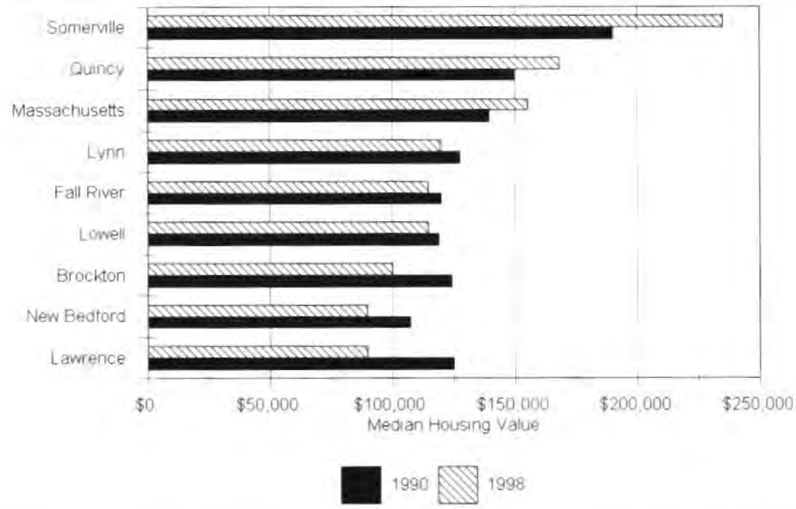
In general, the demographic statistics appeared to be the most revealing, and data relative to the housing stock, the least important in terms of explaining residential appreciation rates. More specifically, all eight urban areas either experienced overall population declines, or exhibited no real increase in population *(Table 1)*. However, while the population was declining, the number of households in a number of cities, particularly Quincy and Somerville, was increasing. Also, the best performing markets had the highest concentration of people in the 20 to 29 age group, which correlates closely with the increase in the number of households.

Figures 1 - 3

Figure 1

Trends in Single-family Median Values

Eight Cities & Massachusetts (1990 - 98)

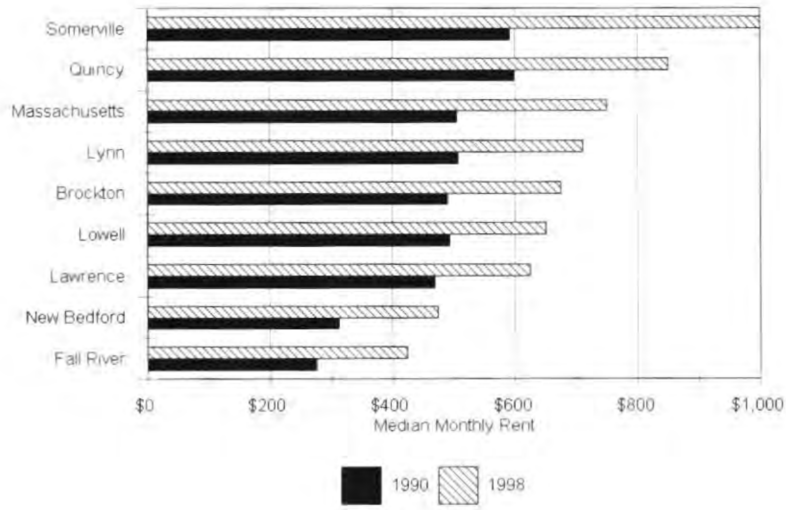


Source: Banker & Tradesman

Figure 2

Trends in Estimated Median Rents

Eight Cities & Massachusetts (1990 - 98)

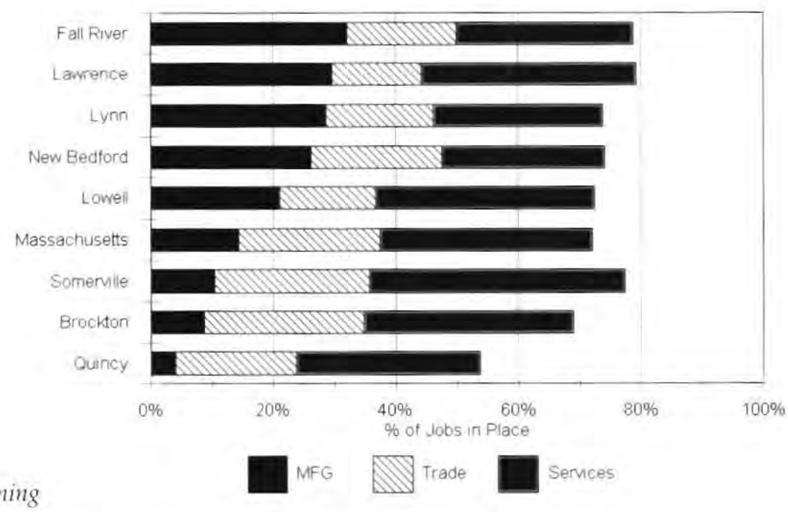


Source: U.S. Census and RKG Associates, Inc.

Figure 3

Distribution of Employment

Eight Cities & Massachusetts (1998)



Source: MA Database of Employment and Training

Concentrations of one ethnic group alone appeared to be a negative factor, but the data was not entirely conclusive in this regard, since ethnic diversity appeared to be a positive factor from a value perspective. Of particular interest was the lack of a direct linkage between residential market performance and SAT scores. In all eight cities, SAT scores were below the state average.

Employment growth in six cities had either declined, or was relatively flat, compared to an eight to 10 percent employment growth in Quincy and Somerville from 1990 to 1998. What also appeared to be significant in explaining residential values was the mix, or type of employment, particularly the mix between manufacturing, trade and services employment. Those cities with the least reliance on manufacturing jobs (e.g., Quincy) tended to exhibit the best performance within their residential markets *(Figure 3)*. Cities like Fall River, Lawrence, and Lynn which were relatively more reliant on traditional manufacturing employment, and their for-sale residential market values had declined from 1990 to 1998. It is unclear whether this is a reflection of pay scale differential between manufacturing employment and trade/service employment or a "stigma" associated with living in an older manufacturing community. However, what is true is that the cities in Massachusetts with the greatest concentration of manufacturing were also the furthest away from Boston, the "center of growth," so perhaps they have been slower to transform their economic base to a more service-oriented economy.

Finally, housing stock characteristics were relatively insignificant in explaining for-sale and rental rate differentials between cities. More specifically there was no direct correlation between either the age of the housing stock, or the owner/renter mix, or unit density, in explaining value differences. Also, because these cities are largely built-out, there had been no major additions to the supply of housing during the past decade. Naturally the data utilized did not factor in such intangibles as architectural detail. However, one housing variable did prove to be important, and that related to the percent of the rental stock that was subsidized. This data suggested that cities with more than 10 percent of their rental housing stock allocated to subsidized housing were the most adversely impacted from a residential real estate values perspective.

CONCLUSIONS

Older urban areas outside of major U.S. cities represent a good residential investment opportunity in the new millennium. Selected socio-economic data can be useful in helping identify which older urban areas to invest in, however by themselves, the data only provides part of the answer for an investor. Demographic trends appear to be important indicators of future residential performance, so an older city which seeks to reposition itself for the 20 to 29 year-old market is one to watch, even if its population is declining and its school system (as measured by SAT scores) is below average. Also of importance appears to be the mix of business within a city, particularly if the emphasis is on the service sector.

Finally, and perhaps most important, the question of location remains an important variable, although one which was not quantified in the case study. For example, both Quincy and Somerville have direct, frequent connections to the Massachusetts Bay Transit Authority (MBTA) rail system, which makes them relatively more accessible to downtown Boston. Other cities, such as Lynn, Brockton, and Lawrence also have rail connection to Boston, however the frequency of service is substantially less than Quincy and Somerville. Clearly the MBTA has market appeal to the 20 to 29 year-old age group, because they are the ones who are driving up residential values in the older urban cities outside of Boston.REI