# Real Estate Market Analysis

## What it is & how to perform one

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Whether you plan to flip a home or buy and hold a property, an accurate real estate market analysis is key to your success. This goes beyond comparing similar properties—although that's an important step! You need to develop a comprehensive understanding of the local real estate market to ensure your "diamonds in the rough" stand up to scrutiny.

During a market analysis, you'll assess details like the economic, employment, educational, and even ecological health of the area. You should examine local social, technology, and political issues, and determine whether those factors match your personal and financial goals and preferences.

If all that sounds overwhelming, don't fear. This guide explains exactly how to perform a market analysis, which will help you decide if an individual property matches your investment targets. In the process, you'll develop a scorecard to compare strengths and weaknesses and opportunities and risks of different real estate markets. Whether you're investing in Tampa or Seattle—or trying to decide between two different areas—a proper market assessment is essential.

## Real estate market analysis vs. comparative market analysis

A comparative market analysis (CMA) uses similar, recently sold properties to price a home. But sale price, square footage, lot size, number of bedrooms and bathrooms, and proximity to amenities are all just parts of the picture.

Is there an over- or under-supply of homes compared to demand? What are the demographics of buyers who will be interested in a particular neighborhood? Do existing roads and businesses adequately support current residents? Is the area prone to flooding or near areas with a high wildfire risk?

Keep in mind that a CMA and real estate market analysis are both subjective, but a broader market analysis is based on a larger number of factors and data points. Also, they are both different from a property's appraised value, which is done by a certified appraisal professional.

# Where to find real estate market information

In general, market analysis resources should be objective and unbiased. Of course, consulting with seasoned professionals is important—and they will have their own subjective views. But you need to balance their input with hard data. Your research should include:

- Local newspapers
- The National Association of Realtors and local real estate organizations and agents
- Government sources, like:
  - U.S. Census Bureau and U.S. Department of Labor
  - The Federal Housing Finance Agency (FHFA)
  - The FHFA House Price Index
  - Local county registers of deeds and tax assessors offices
- Online listing services like Zillow, Trulia, and Redfin
- Services like NeighborhoodScout

# Essential real estate numbers and terms

Don't dive into your market analysis without knowing the essentials first. Understand these concepts before diving into your assessment.

## Days on market

How long is the average property on the market before it sells? This number is called "days on market" (DOM), and it can be used in two different ways:

- To assess the status of an individual property
- To determine the average DOM—which provides perspective on an area's overall market

## Rental prices

The amount of rent you charge should be based on the market value of your property and rental costs for comparable homes. The BiggerPockets Rent Estimator provides estimated rent pricing for any property based on local comps. Check it out here.

A good guideline is to charge monthly rent that's between 0.8% and 1.1% of the property value. If the home is worth $100,000 or less, you can price rent at the higher end of the range. Depending on the local market, rent for homes valued at more than $350,000 should be adjusted to a lower percentage to help attract tenants. However, this might not be as important in very expensive markets like San Francisco or Miami.

When determining rent, be sure to:

- Include your costs for expenses like repairs and maintenance, taxes, insurance, and other fees as you calculate cash flow and profit margins

- Account for washers and dryers, recreation areas, or other add-on amenities that justify higher rent

- Take local economic conditions and seasonality into account, since they affect demand and tenants' spending power

Fully research local laws that regulate rent. Communities in California, Maryland, New Jersey, New York, and Washington, D.C., have rent control laws that strictly govern how much rent can be raised each year.

## Cash-on-cash return

Cash-on-cash return lets you compare annual cash income (projected or actual) against the cash you've invested. It's different from standard return on investment (ROI) because it only looks at cash, not the total return.

To calculate cash-on-cash return, divide annual pre-tax cash flow by cash invested. So, if you paid $100,000 with a $90,000 mortgage and sell after 1 year for $110,000:

**First-year cash expenses**

- Down payment: $10,000
- Closing costs, insurance, and maintenance: $1,000
- Loan payments: $2,500, including $500 to principal

Total expenses: $13,500

**First year cash inflow**

- Sale price minus mortgage payment: $20,500

**Total inflow: $20,500**

Cash flow: $7,000 ($20,500 – $13,500)

Cash-on-cash return: 51.9% ($7,000 / $13,500)

## Price-to-rent ratio

The price-to-rent ratio compares the median home price and median rent to evaluate the potential profitability of an investment.

To determine the ratio for an individual home, divide the purchase price by the total annual rent for an individual home. (For a larger market, divide the median annual price by the median annual rent.) The rule of thumb is to consider buying when the ratio is less than 15.

## Gross rental yield

For an individual property, divide the annual rent by the total property cost, including purchase price, closing, and renovation costs. Then multiply by 100 to create a percentage. The results can be used to compare comparable homes.

## Capitalization rate (cap rate)

This is like gross rental yield, but cap rate uses net income to determine your rate of return

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Divide your expected annual net operating income, including management fees, upkeep, and property taxes, by the property asset value to get a percentage value.

There isn't a "recommended" cap rate, but the percentage can be used to compare properties. Typically, the expected cap rate depends on the market—hence why a proper market analysis is so important. One other thing to consider: A lower cap rate often corresponds to better valuation, higher potential return, and lower risk.

The results can also help determine the time to recover your investment.

## Property taxes

Common wisdom views high property taxes as a bad thing. But don't cross off any locations with high taxes during your market analysis! High-quality, in-demand neighborhoods that attract long-term tenants often have high taxes. You must balance the risks and rewards.

If a property listing doesn't include estimated or recent property tax figures, ask your agent. The local tax assessment office will also have all tax data on file. Do research into whether future increases are likely and to assess recent trends. This will help you ensure that competitive rental prices can accommodate anticipated tax loads and your personal cash flow.

## Essential market numbers

Buyer's markets vs. seller's markets aren't specific numbers, but they're indicted by statistics like DOM, price increases or decreases, and overall inventory of homes for sale. Your market analysis must include a determination of what kind of market you're working with.

- A **buyer's market** has more supply and less demand—think of the 2008 recession. Home prices dropped, construction nearly stopped, and foreclosures increased. This gave buyers tremendous leverage in negotiations.
- A **seller's market** is created when there's more demand than supply. This happened just before the crash in 2008, when home prices rose dramatically.

Areas with struggling economies are frequently buyer's markets. Cities with growing industries and lots of jobs tend to be seller's markets, leading to bidding wars and multiple offers on individual properties.

You can find local home inventory data via Zillow, Movoto, the U.S. Federal Reserve, the National Association of Realtors (NAR), and local real estate organizations.

NAR provides a wide range of important information, both on a national and local level. Their resources include:

- **Existing home sales**: National statistics on total sales, median price, year-over-year changes, inventory, market conditions (such as the percentage of first-time buyers and sales to investors), and sales by region and price range, among others. Need information on the state, city, and county level? Contact state and local Realtor associations.

- **Pending home sales index:** Housing contract activity, including details on monthly indexes and quarterly forecasts. If you're not an NAR member, historical information is available for purchase.

- **Metropolitan median area prices and affordability**: Median home prices, percentage changes, and information on construction and employment activity for more than 140 metropolitan areas.

- **County median home prices and monthly mortgage payment:** Data for individual counties.

- **Housing shortage tracker:** Data based on how many new building permits have been issued in 178 metro areas. Includes alerts for areas that need more inventory to address increased demand.

- **State housing statistics**: An interactive map that provides different details for each state.

## Understand what amenities sell

Before diving into a market, it's important to know what sells. This applies to both resales and rentals, but the specifics might be different. Certain basics—hardwood floors, washer/dryer, modern kitchen, a balcony, covered or garage parking, heat and air conditioning—generally make properties much more appealing. Most renters will want these amenities.

For the most part, these elements won't vary between markets. But there will be differences, and it's important to know what those regional differences are. In Arizona, for example, buyers and renters may expect a backyard pool.

Match amenities to your real estate plans. Who do you want to rent to? Carpet might be more desirable to a family with small children. Older buyers might prefer a single-story house. Upgrades, like tile backsplashes, might be too expensive for a particular home, for the neighborhood, or your desired price point.

Make sure you strike the right balance between what's right for the home, for your target tenants or buyers, and for your investment objectives.

## Interpreting sales activity on comparable properties

The rule of thumb is, the fresher a listing seems, the better. Older listings imply that they haven't sold because something is wrong with them.

You can use the following types of information to assess trends in a specific real estate market—and to compare specific properties you might be interested in. Or, read BPInsights' in-depth articles for deep dives into local market trends.

## New and existing home sales reports

Consult:

- Your real estate agent for recent local activity on comparable homes
- U.S. Census Bureau for data on new residential construction
- National Association of Homebuilders for annual, quarterly, and monthly data on new and existing home sales

This information can reveal early indicators of developing economic shifts, changes in consumer behavior, regional trends, and future housing demand.

## Current sales

There are two categories to investigate during your market analysis:

- Pending sales provide the most current values for comparable homes.

- Closed sales give historical perspective on how prices have trended over time.

You can check recent sales by neighborhood on Zillow, Realtor.com, Redfin, Trulia, and RealtyTrac, among others. Use this information to develop the average sale price in the area you're interested in.

## Days on market

As mentioned earlier, DOM can be a powerful indicator for both an individual property and for regional trends.

To illustrate the power of DOM, Zillow found that a home that sells within five days has a 57% chance of selling for list price. In subsequent weeks, that chance falls to 50%, then 39%, and so on. A property may be on the market for longer than average because it's overpriced or needs repairs or upgrades.

The average DOM—based on all the homes listed and/or sold in a given area—indicates the status of various factors in the overall market. These include oversupply, negative economic indicators, or a major business or industry downturn.

Keep in mind that these numbers are relative. If a region has high DOM, check for patterns over the past year or two to find out if the time to sell has always been higher than other areas.

DOM is typically available via the multiple listing service (MLS). It can also be found on commercial listing sites like Zillow and Redfin—or ask your agent.

## Price reductions

Lowering a home's asking price clearly indicates something was miscalculated at the beginning of the sales process.

Try to determine the specific reasons why any property is faced with high DOM or price reductions. In addition to structural or design issues, the home may have appraised significantly below its original asking price.

If price reductions have occurred with multiple properties in the market you're assessing, it's important to understand the reasons so they can be part of your negotiating strategy. Perhaps more importantly, that understanding can also provide critical insight into whether the area is a viable investment opportunity.

## Seller credits

Closing costs paid in part or in full by the seller—also called seller credits—are usually part of negotiations for an individual sale. They can reduce the cash required from buyers and the sale price for sellers if the deal includes an arrangement to finance the seller credits into the mortgage package.

But take a broader view. Are seller credits common in the local area? This will be shown in details for closed listings and could enhance your investment position by reducing your cash outlay.

## Understanding the broader market

Before investing in a market, you need to understand its history and any potential changes.

## Local Realtors, agents, and investors

During your market analysis, develop contacts with and strategies around these important local players.

- Which agents have the most listings? You're looking for a balance between who will be the most knowledgeable and who will devote the most personal attention to your goals.

- Do you have any personal referrals? This includes agents you've worked with in the past.

- Who are the community leaders? Find real estate professionals active with civic groups, education organizations, charities, and local business. They have more expertise on factors that can impact your investments.

- What are the local business publications? Stay up-to-date

- What associations impact housing policy? Network with builders' associations, business organizations, and local developers.

- Are there any local zoning issues? Be aware of upcoming changes and anticipate how they are likely to impact property values.

## Historic data

Any thorough market analysis involves an investigation into historic data. Public records can show neighborhood trends and price increases and decreases. It also highlights events like ongoing easements that allow growing commercial encroachment into a residential area.

## Property information

Search the county tax assessor's office, county recorder, or city hall to find a home's transaction history. Public records can reveal past mortgages, easements, foreclosures, tax liens, or if a current listing is a short sale. You can also check with a real estate agent or CRS Data for information. Online real estate sites often have similar data, but they may not be completely accurate or up to date.

## Demographics

What are the ages, income levels, professions, and other characteristics of the buyers or tenants you want to attract? Who are the most prevalent buyers in a specific area—are they families or single twenty-somethings who work in tech? With this information, you can tailor your investment and marketing decisions.

For example, older, more affluent buyers may want to downsize to smaller but still well-appointed homes. Younger tenants are likely to be drawn to smaller, more affordable housing closer to a city center and entertainment.

You can find helpful information at Census Reporter. The site provides a range of city and county data, like population, median age, sex, income, types of transportation, housing occupancy, and types of structures. It also provides context for these details, such as how they compare to other parts of the same state.

The Federal Reserve also offers a treasure trove of searchable information.

## Getting familiar with economic shifts

You need to know more than who lives in the area you're targeting. Your market analysis must include an economic history so you can prepare for future shifts.

## Employment

Stay up-to-date with local business and employment developments. If a major employer is closing or laying off workers, the local economy suffers—after all, former employees have less purchasing power and may also have to leave the area to find jobs.

On the other hand, if a new company is coming to town, what types of jobs will be available? Blue collar? White collar? What kinds of homes will those employees be able to afford? Anticipate their needs and preferences to greatly improve the effectiveness of your investment strategy.

Check the U.S. Bureau of Labor Statistics for important information on how a specific area rates for job quality and availability.

## Mortgage rates

Shifting mortgage interest rates have a huge impact on real estate markets. Rates directly affect how much home you—or your buyers—can buy. Use a mortgage calculator to determine the right balance between the amount you borrow and the monthly payments you can afford.

Monitor Federal Reserve activity and local lenders' marketing to stay on top of the best rates to meet your investment goals. Keep in mind that the lower rates go, the greater demand for real estate, which drives up prices.

## Government policies and subsidies

Legislation can have a sizable impact on property demand and prices. This happens though tax credits, deductions, and subsidies that increase or push down demand. Monitor government actions that may impact inventory, benefit you as an investor, or affect particular types of property in particular areas.

## Recession

During a recession, national economies slow down. Decreased gross domestic product GDP, higher unemployment, tighter credit, and reduced construction are all common. But investing during a recession can certainly be done! If you have readily available capital, you can benefit as an investor—after all, both real estate values and mortgage interest rates tend to fall.

Pay attention to economic forecasts so you can appropriately adjust your financial position to handle upcoming events and your risk tolerance.

## Environmental concerns

A complete comprehensive market analysis or comparative market analysis of two locations should include environmental factors that can impact an investment. Any of these can affect tenant/buyer appeal, property value, insurance rates, and ongoing maintenance and upkeep.

- Location, boundaries, and neighboring properties. Do they add value? Do they fit with the rest of the neighborhood? Are there bodies of water or other natural features that add appeal?

- Air and water quality. Are there systemic issues? Is there industry nearby that could—or has—threatened the environment?

- Climate and weather. Have there been changes in normal patterns or increased numbers of extreme events? Is the area vulnerable to flooding, wildfires, hurricanes, or tornadoes?

- Topography and soil conditions. Is the property in a flood plain? Is there adequate drainage or excess runoff? Is there surrounding land suitable for future development?

- Transportation patterns. What's the current status? Is it adequate? Will proposed plans enhance or interfere with easy access or traffic volume?

Consult with the Environmental Protection Agency (EPA), local environmental agencies and organizations, and local real estate agents for information.

## Analyzing a market before rehabbing properties

Before rehabbing your new purchase, as with a fix-and-flip or BRRRR, there are a number of additional considerations to keep in mind.

A good guideline for flipping a property is to keep the purchase price and rehab costs at 70%, minus repairs, of the after-repair value (ARV). That figure is less important when rehabbing for a rental, where long-term income and cash flow are more important.

Make sure all planned features, amenities, and upgrades are appropriate for the price point, the style of the home, the neighborhood, and the overall market. For example, a swimming pool might be common for southern California, but probably not in Vermont.

If you're rehabbing to rent, keep a renter's perspective. In other words, "good enough" may be just fine when it comes to fixtures and finishes. In a home for sale, you would consider more extensive—and expensive—upgrades since buyers are making a longer-term commitment to the home.

Also stay focused on upgrades and features that add value to the property, such as a new kitchen, updated bathrooms, or covered/garage parking.

## How to use your market analysis

We've covered a very broad range of topics that help you get to know local economies and their real estate markets. It may be hard to make sense of so many different details and perspectives.

Here's a practical example of how to put all the information together to use in the real world.

You see a report on the U.S. Census's ranking of the country's fastest-growing cities. One of them is a small community in the state where you grew up, so you decide to take a closer look.

The town is a suburb of a larger city with a half-million people, home to a well-known private university. That means there will be a fairly steady pipeline of prospective tenants, either students—perhaps not so desirable—or faculty. You also discover:

- Census Reporter shows the median household income is in the top 15% for the state, probably due to the university and professionals who live in the suburb and commute to work in town
- There are slightly more multi-unit structures than single-family homes. Also, 90% of all housing units are occupied, and 20% of residents moved in within the last two years, which is a positive indicator.
- The NAR Housing Shortage Tracker indicates the area needs additional units and may be experiencing a seller's market.
- Articles in a local business journal describe ongoing municipal infrastructure upgrades and that a major company is considering bringing in a new logistics hub. Because the hub's main focus will be warehouse operations, it will bring more blue-collar, low- and mid-level jobs to town than technology and executive positions.

- Articles in a local business journal describe ongoing municipal infrastructure upgrades and that a major company is considering bringing in a new logistics hub. Because the hub's main focus will be warehouse operations, it will bring more blue-collar, low- and mid-level jobs to town than technology and executive positions.

- Days-on-market increased 10% last year, but that was because of higher mortgage rates and a local manufacturer that went out of business after 30 years. Since then, DOM is trending lower.

- Zillow and Redfin show listings in your price range in three different neighborhoods, but one has been trending lower for average sale price, so you eliminate that one from consideration.

- One of the other neighborhoods is within walking distance of a new commercial and cultural district. It's very attractive, but you decide that increasing traffic congestion is likely to scare away the tenants you want to attract.

With all this information, you contact a local agent who is handling many of the listings in your prime neighborhood. You ask her about local rent guidelines and the status of a pending environmental ordinance you read about that could begin to impact home sales three months from now.

Based on her information and what you have to invest, you forecast expected cash flow to be almost exactly the same as your target amount. However, because of the uncertainty of the local environmental ordinance, and because mortgage rates are expected to drop slightly in the next quarter, you decide to wait and watch developments in the neighborhood for a few more months.

Starting with an understanding of the market—and the ability to identify and analyze similar properties—is essential to real estate investment success.