

PROPERTY PERSPECTIVES

# Why Micro-Units are a Win-Win Solution to the Urban Affordable Housing Crisis

As density restricts new development and housing prices show no signs of letting up, micro-units are a solution to today's affordable housing crisis.

by **Lauren III**

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Rents and demand have reached new heights in most major cities across the United States. As density restricts new development and housing prices show no signs of letting up, micro-units are being developed as a solution to today's affordable housing crisis. With an interest in all new and emerging [asset classes](#), CrowdStreet has been searching for and evaluating investments within this product type. We've consulted trusted sponsors who have operated in this space, along with market experts at the Urban Land Institute (ULI), and a number of other sources. Here is a brief introduction to this asset class and a summary of viewpoints on why micro-units are an attractive asset class right now.

## What is a Micro-Unit and Why Now?

A growing trend has emerged in multifamily developments that reflect a shift in the tastes and preferences for a critical segment of renters: young professionals living in expensive, high-growth or population-dense, urban markets. This cohort of renters tend to edge towards minimalism and value location, experiences, economy, and high-quality amenities over larger, more costly units. They are highly mobile, tending to move frequently to follow opportunities and jobs, and they have a renewed interest in urban, "authentic" locations – transit-rich locations are a plus, but walkability is a must. And with 49% of the United States' rental market represented by this 30-and-under demographic, this is not a group whose needs you want to ignore!<sup>5</sup> Enter the micro-unit.

A micro-unit is best described by ULI as "a purpose-built, typically urban, small studio or one-bedroom using efficient design to appear larger than it is and ranging in size from as little as 280 square feet up to as much as 450 square feet."<sup>1</sup> ULI mentions that this space is also to include a fully-functioning and accessible kitchen and bathroom. At first glance, this description of a tiny apartment might seem unlivable. But then, why is this trend expanding and why is anyone buying into it?



olds, fresh into their new careers, do you know that can afford \$2,700 in rent, alone? Add to this a need for utilities, food, a high probability of student loans, and it's no wonder today's Millennials are more in debt than any other generation and taking longer and longer to dive into the housing market.<sup>3</sup>

Micro-units sit at an average cost roughly 20-30% below that of conventional units.<sup>1</sup> Taking into account developers' priority to make them feel larger and luxurious while placing them in prime, walkable, trendy locations, it becomes a lot easier to imagine why the micro-unit developments are taking hold across the country. Based on discussions with our expert network, it's important that the developer provide extensive amenity space in the common space in the development to compensate for the lack of space in the individual units. Common amenities might include a common "living room" with a big screen tv, large reservable gourmet kitchen, pool, fitness room, cafe, rooftop deck, etc. Again, thinking about the target market for this asset class, micro-units are generally for young professionals looking to live in a downtown location – the type of individuals that spend most of their day either at work or bouncing from restaurants, to events, to gatherings with friends, but would like to come home to a place that is 100% private and 100% theirs. They feel a bit too old for roommates and this affordable option gives them the opportunity for their own space, along with a nice place to wake up in the morning, walk right downstairs to the nearest coffee shop, and make their way to work.

## Investment Analysis

Won't more units per square foot amount to more development costs? Yes, roughly "5 percent to 10 percent more per square foot because of the relatively fixed cost associated with building a kitchen and a bathroom, which is generally the same for a micro-unit as for a conventional apartment."<sup>1</sup> More management costs? Also, yes. More units mean more operational costs. But the added costs have a payoff. "Developing and operating a rental apartment community with micro units is more expensive, but the premium rent per square foot achieved more than makes up for the added cost."<sup>1</sup>



individuals, it is much less than each of them opting for a one-bedroom. Micro-units operate the same way. Smaller apartment, higher cost per square foot, but because the square footage is so small, it is much more affordable for the renter.

Micro-units are one of the best examples of a win-win in residential real estate, to date. Renters get exactly what they want, the best location, privacy, and their own unit, while operators get exactly what they want – the highest rent per square foot. This product-market fit bodes well for the long-term prospects of the asset class as a whole. And we may not have even mentioned the best part, occupancy levels. Reported in Aug, 2019, “Occupancy rates are on the rise for the nation’s smallest apartments, according to a recent CoStar Group analysis, outperforming larger units. This is especially true in high-demand submarkets where soaring rental rates and strong job growth lead renters to prioritize location over total living space.”<sup>4</sup> The article goes on to mention the \$1.49 trillion in student debt, the fact that household incomes have only risen by 2.9% each year, and the fact that demand has outpaced supply in 2019, all of this amounting to the fact that the “national average vacancy rate for the smallest one-bedroom apartments has fallen by 40 basis points since 2015, or 30 basis points below the vacancy rate for the largest.”<sup>4</sup> So the demand is here and growing, now it’s time for the supply to keep up!

Every new trend in the real estate industry must be closely monitored and evaluated in order to determine its long-term viability. The micro-unit seems to be the next logical step in allowing the free market to effectively address our nation’s affordable housing crisis. For some great additional reading on this topic, please look into the sources below. ULI has done a phenomenal job at presenting an in-depth analysis of this emerging asset class and we suggest you check out their findings.

<sup>1</sup>[https://uli.org/wp-content/uploads/ULI-Documents/MicroUnit\\_full\\_rev\\_2015.pdf](https://uli.org/wp-content/uploads/ULI-Documents/MicroUnit_full_rev_2015.pdf)

<sup>2</sup><https://www.businessinsider.com/cost-of-studio-in-manhattan-hits-eleven-year-high-2019-9>

<sup>3</sup>“New findings from the New York Federal Reserve reveal that millennials have now racked up over US\$1 trillion of debt. This troubling amount of debt, an increase of over 22 percent in just five years, is more



<sup>5</sup><https://www.statista.com/statistics/743445/share-of-residents-who-are-renting-usa-by-age/>



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