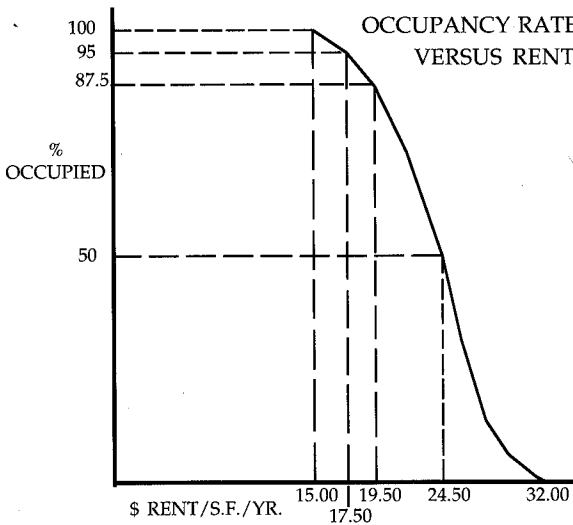


Vacancy Management

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Some property managers see vacant units as personal failures. The majority of managers recognize, however, that a property's vacancy rate results from both market forces and management activity. Such a view would rightly lead to the acceptance of some degree of vacancy in weak markets or for unusual properties.

Yet it is less well understood that, under given market conditions, a higher vacancy rate might actually be preferable to lower vacancy. The key is understanding that a property manager's job is the maximization of net income, not the maximization of occupancy. Maximum occupancy might be realized only at a substantial penalty in terms of lower revenue and higher expenses.



Any rental rate in excess of \$32 per square foot yields zero occupancy, and therefore zero income. The highest gross income total is realized at a rent per square foot of \$19.50, at which occupancy is only 87.5%. A vacancy rate of 12.5% is optimal, then, given the market conditions and abstracting from effects of managerial decisions concerning expenses. Average rent per rentable square foot at this optimal vacancy rate would be $.875 \times \$19.50$, or \$17.06. Lower vacancy,

such as 5% (yielding average rent per rentable square foot of \$16.63, given a corresponding rental level of \$17.50) or even 0% (yielding average rent of \$15), are inferior as managerial objectives in

Consider the revenue side, effective gross income. Suppose that the relationship between the occupancy rate and the gross rental rate can be shown by a backwards S-shaped curve, as in the figure. The question is: "What rental rate would maximize average rent per rentable square foot and, thereby, maximize gross income?" (Because rentable space is constant for a given property, average rent per rentable square foot is the rental rate multiplied by the occupancy rate.) The answer is not an arbitrarily low rate that would assure 100% occupancy. However, what may seem surprising is that the answer also is not necessarily the highest rental that would still produce 100% occupancy.

Note in the figure that \$15 is the highest rent per square foot at which the building would be fully occupied, so any rental below \$15 clearly is not desirable.

the context of the specified market conditions, as shown by the shape and position of the curve in the figure. Vacancy higher than 12.5% is similarly suboptimal; 50% vacancy with a corresponding \$24.50 rental yields an average rent per rentable square foot of \$12.25, while 100% vacancy (zero occupancy) yields zero average rent.

Is the shape of the curve the key to bringing about such a result? The answer is no; the curve need not have the backwards S-shape, though the relationship indicated by such a curve appeals to logic. The key is that the curve is downward sloping; it is reasonable to assume that, within a relevant range, per unit rent must fall if occupancy is to rise. But the flatter the curve, the more likely it is that the occupancy rate leading to maximum gross income would be less than 100%.