

Absorption rate analysis: what it is and how it gives insights into current trends in a real estate market

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What Is Absorption Rate in Real Estate and Why Is It Important?

By Ryan Poelman



Let's start with a dry definition of absorption rate in real estate and then we'll make it a bit more interesting. **Absorption rate is the number of months it would take to sell the currently listed homes in the market.** That sounds simple, and the math is for the most part. However, it's an important concept, and it's used by a great many real estate related businesses to attempt to predict home prices and sales activity going forward.

The Calculation

Most of those who use absorption rate use six months of home sales as their baseline. Let's use a fictional example to illustrate how absorption rate is calculated:

1. In a large urban area, the previous six months report of home sales showed 38,235 homes sold.
2. So, 38,235 homes divided by 6 months yields 6373 homes sold per month.
3. There are currently 28,145 homes listed for sale in this market. We divide this number by 6373, and we find that there is currently a 4.42 month supply of homes for sale in this market. At the current rate, with none withdrawn and none added, it would take 4.42 months to sell them all.

That wasn't hard, but being easy doesn't make it less important. One comparison that is made to help in anticipating market activity and home price action is looking back at historic absorption rate numbers for the market.

Let's say that this particular market has seen several 6 month periods in the recent past with inventories running between 5 and 6 months of homes for sale, a slower rate of absorption. This speeding up of sales, which gives us a faster 4.42 month absorption rate, could mean that prices are climbing or will shortly. It's a supply and demand thing. Let's see how this information is used.

Real Estate Professionals

The real estate broker or agent is interested in absorption rate because they're tasked on a regular basis to value properties to be listed for sale. When they're sitting in front of a listing client, they want to make them happy and tell them that the home is worth every dollar the owner wants to get. In many cases that isn't the case, and it's hard to tell them that they must list it for a lower price and be prepared to bargain on that.

One of the tools they use is the absorption rate. They can show the homeowner that the current absorption rate has slowed, and use that information to justify lowering the listing price. On the other side, if the rate has increased, they may be able to list for more than they anticipated, as there is good demand and a smaller supply. Of course, this changes almost daily, but we must use some measure to help in decision-making.

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How Do You Calculate Absorption Rate?

By Realtor.com Team | Nov 30, 2011



What does it mean when people talk about the absorption rate when it comes to real estate- Realtor® Leslie Monaco of Greenwood Village, Colorado breaks down what the term means and how it is calculated:

ABSORPTION RATE – Is the rate at which homes are selling in a specific area.

There are 3 pieces of information you will need to find absorption rate:

1. The specific time frame
2. The number of sold homes during that time frame
3. The number of active homes right now

Here is how I calculated the absorption rate for the entire Metro Denver area based on October 2011 Residential/Condo Town Homes Market Data (provided by MetroList):

THE DATA:

- 1. Time Frame = **304 days** (total days from January 1, 2011 to October 31, 2011)
- 2. Number of Sold Homes = **33,163** (from January 1, 2011 to October 31, 2011)
- 3. Number of Active Homes = **14,156** (at the end of October 31, 2011)

CALCULATIONS:

- Rate of Home Sales = **.00917** – 1 home is sold every .00917 days. This number is found by taking $304/33,163$ (Time Frame/Number of Sold Homes)
- Absorption Rate = **4.32 Months**. Found by taking $14,156 \times .00917$ (Number of Active Homes x Rate of Home Sales)

What does this tell us?

If market conditions do not change and if **no** new listings come on the market it will take 4.32 months for the current inventory to sell at the current pace of the market. **A balanced market's absorption rate is typically between 5 – 7 months.**