

## TOP ASSETS, DISTRESSED PROPERTIES DRAW INVESTORS

In the first half of 2010, occupancy in the Denver area tightened, positioning the market to realize further stabilization and revenue growth over the remainder of this year and into 2011. Thus far in 2010, a release of pent-up housing demand drove vacancy lower, helping to push up rents modestly and enable owners to hold the line on concessions. Job growth must strengthen for these key measures of performance to improve significantly in the second half of the year, and some positive signs emerged in the second quarter. Local private-sector employers started to rehire during the last two months of the period, indicating greater confidence in near-term business conditions and the need to supplement staffing levels depleted through the recession. The pace of private-sector job creation will pick up in the second half, although some setbacks may occur as employers readjust expectations of near-term business volume. While demand generators will strengthen, construction of new rentals remains elevated, which will push up vacancy modestly in the second half and pose an impediment during the early phases of the recovery of the apartment sector.

Over the remainder of 2010, investors will pursue the types of properties that traded most frequently in the first half of the year. On the one hand, a robust market will continue to evolve for well-maintained assets in core locations for less risk-averse investors. These properties include small complexes that performed well during the economic downturn and continue to post solid operating results early in the recovery. Cap rates on these assets typically average in the mid-6 percent to low-7 percent range. Intense interest in distressed properties also persists, even if the asset faces deferred maintenance issues or potential problems related to debt service. Cash-laden buyers remain willing to take on these complexes, provided per-unit pricing aligns with risk. The middle of the market, comprising primarily Class B/C assets in secondary locations, remains largely untapped, as buyers see either too much risk or insufficient opportunity at current asking prices. Further price adjustments will be required to stimulate greater activity in this corner of the investment market.

## 2010 ANNUAL APARTMENT FORECAST



**Employment:** Despite a less vigorous government sector and additional construction layoffs, total employment in the metro area will increase 0.3 percent this year with the creation of 3,500 jobs. In 2009, layoffs claimed 55,800 positions.



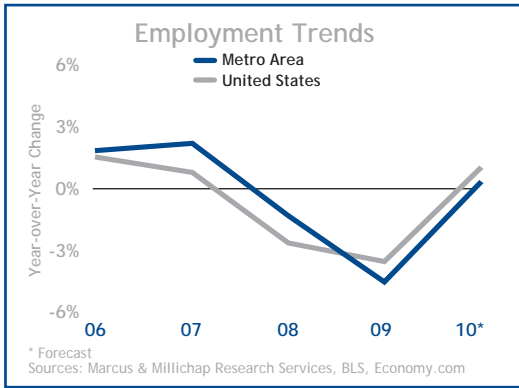
**Construction:** Developers will complete 2,900 apartments in 2010, up slightly from the roughly 2,800 units placed into service last year. No single submarket accounts for the majority of new units slated for delivery this year, but 1,100 units will be added in the submarkets that make up the city of Denver.



**Vacancy:** A gradual strengthening of the job market over the remainder of the year will sustain reasonably strong rental demand, though new construction will result in an uptick in vacancy in the second half. By year end, marketwide vacancy will fall to 6.5 percent, a 150 basis point decline from year-end 2009.

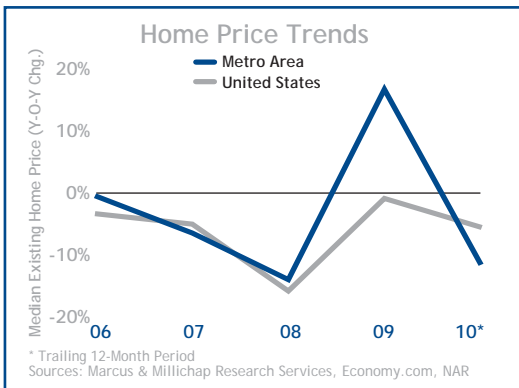


**Rents:** After falling 3.8 percent in 2009, asking rents will advance 1.9 percent this year to \$869 per month. Effective rents will climb 2.5 percent to \$779 per month, following a decline of 3.9 percent last year.



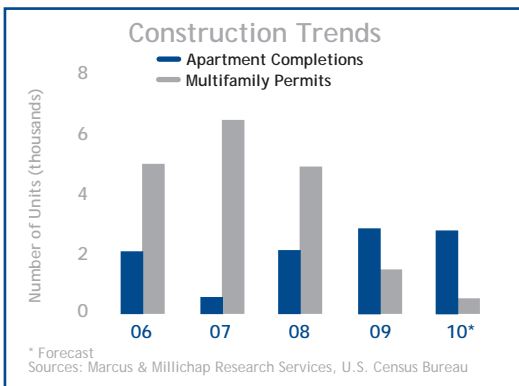
## ECONOMY

- ◆ Local employment conditions remained soft in the first half of the year. An increase of 1,200 government positions was offset by private-sector job cuts affecting 2,200 workers, resulting in a net loss of 1,000 jobs year to date.
- ◆ Although private-sector job growth has faltered, results would be much worse if not for the addition of 2,900 private-sector jobs in the final two months of the second quarter. During this period, professional and business services employers generated 3,000 jobs, while the trade, transportation and utilities sector filled 1,100 positions.
- ◆ Many of the government additions in the first half were census-related and will be terminated in the third quarter. Moreover, after cutting 1,800 jobs in the first half, construction payrolls will shrink further due to continuing weakness in the housing market.
- ◆ **Outlook:** Despite a less vigorous government sector and additional construction layoffs, total employment will increase 0.3 percent this year with the creation of 3,500 jobs. In 2009, layoffs claimed 55,800 positions.



## HOUSING AND DEMOGRAPHICS

- ◆ Driven by the first-time homebuyer tax credit, single-family permit issuance rose 37 percent in the 12 months ending in the second quarter to 3,800 units. Permitting remains well below pre-recession levels, however, as an average of nearly 16,000 permits were issued annually from 2002 to 2006.
- ◆ The tax credit helped boost the number of sales of existing single-family homes 7 percent in the past year, a period during which the median price rose 6 percent to \$232,300.
- ◆ The prime renter cohort of individuals aged 20 to 34 years will grow considerably in the metro area over the next five years. More than 27,000 individuals will be added in this age group, an average of 5,500 per year, or 0.7 percent annual growth.
- ◆ **Outlook:** The monthly mortgage payment on the median-priced home is \$227 more than the average Class A apartment asking rent, and the gap will sustain strong demand for high-end rentals.

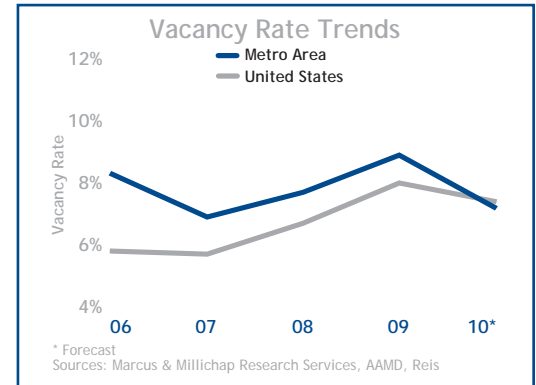


## CONSTRUCTION

- ◆ Construction remains slightly elevated, as more than 2,300 units were delivered in the past year. In the preceding 12 months, 3,300 apartments came online.
- ◆ About 1,300 units were completed in the first half of this year, and another 2,100 apartments remain under construction. Properties put into service in the first half were spread among multiple submarkets, including 570 units in the adjoining Denver-Central and Denver-South/Glendale areas.
- ◆ About 13,000 units are planned in the metro, representing a somewhat sizable 7.5 percent of existing stock. Also, permits for 1,300 units of multifamily housing were issued in the past 12 months, a drop of 53 percent from the prior year.
- ◆ **Outlook:** Developers will complete 2,900 apartments this year, up slightly from the roughly 2,800 units delivered during 2009.

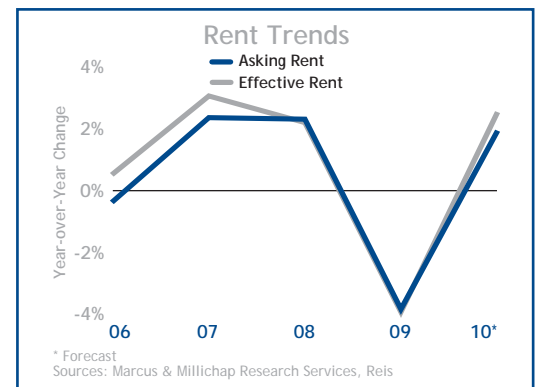
## VACANCY

- ◆ Marketwide vacancy fell 40 basis points in the second quarter to 6.1 percent. The vacancy rate declined 190 basis points in the first half. Led by strong demand for Class A properties, nearly 3,600 units were absorbed in the first six months of 2010, representing a 4.7 percent increase in demand.
- ◆ Class A vacancy was 5.8 percent in the second quarter, down 210 basis points from year-end 2009. Performance of high-end rentals has strengthened considerably since the middle of last year, as net absorption of 4,900 units has been recorded.
- ◆ In the Class B/C segment, vacancy decreased 180 basis points in the first six months of this year to 6.3 percent, including a 40 basis point decline in the second quarter. Year to date, net absorption totals 900 units.
- ◆ **Outlook:** This year, vacancy will fall 150 basis points to 6.5 percent. In 2009, the vacancy rate rose 10 basis points.



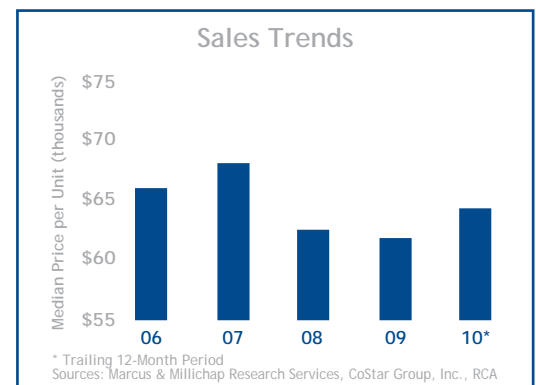
## RENTS

- ◆ So far this year, asking rents in the metro area have ticked up 0.9 percent to \$861 per month, due primarily to a surge in demand for higher-priced Class A units. Effective rents advanced 1.2 percent year to date to \$769 per month in the second quarter.
- ◆ The delivery of new units and continued renter demand for high-end rentals pushed up Class A asking rents 0.9 percent in the first half of 2010 to \$1,022 per month. The Class B/C sector has not yet gained as much traction, as asking rents in that segment of the market have inched up 0.5 percent year to date to \$708 per month.
- ◆ Generally, improvements in tenant demand encouraged many property owners to start to withdraw concessions. In the second quarter, leasing incentives were equal to 10.7 percent of asking rents, down 20 basis points year to date and 120 basis points since the second quarter of last year.
- ◆ **Outlook:** Asking rents will advance 1.9 percent this year to \$869 per month, while effective rents will climb 2.5 percent to \$779 per month.



## SALES TRENDS\*\*

- ◆ In the past year, transaction velocity fell 20 percent. More buyers are becoming active, though, as the number of deals over the last six months was 22 percent more than in the prior half year.
- ◆ Improving fundamentals and more prospective buyers bidding on properties provided a modest lift to the marketwide median price. Over the past 12 months, the median price inched up 4 percent to \$64,300 per unit.
- ◆ Cap rates for top-performing Class A complexes are estimated to start in the 6 percent range. Smaller Class B assets with solid operating histories vary from the mid-6 percent range to the low-7 percent range.
- ◆ **Outlook:** The area's stature as a destination for recent college graduates will consistently support a strong rental housing market. With an economic recovery likely to gain traction in the quarters ahead, the potential for steadily rising returns and asset appreciation will increase.



\*\* Data reflect a full 12-month period, calculated on a trailing 12-month basis by quarter.

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Visit [www.NationalMultiHousingGroup.com](http://www.NationalMultiHousingGroup.com) or call:

**Linwood C. Thompson**

Senior Vice President, Managing Director

National Multi Housing Group

Tel: (678) 808-2700

[lthompson@marcusmillichap.com](mailto:lthompson@marcusmillichap.com)

## Marcus & Millichap

Real Estate Investment Services

Prepared and edited by

**Art Gering**

Senior Market Analyst

Research Services

For information on national  
apartment trends, contact

**John Chang**

Vice President, Research Services

Tel: (602) 687-6700 ext. 6803

[john.chang@marcusmillichap.com](mailto:john.chang@marcusmillichap.com)

Denver Office:

**Michael Hoffman**

Regional Manager

[mhoffman@marcusmillichap.com](mailto:mhoffman@marcusmillichap.com)

1225 17th Street

Suite 1800

Denver, Colorado 80202

Tel: (303) 328-2000

Fax: (303) 328-2010

Price: \$150

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## CAPITAL MARKETS

By WILLIAM E. HUGHES, SENIOR VICE PRESIDENT, MARCUS & MILLICHAP CAPITAL CORPORATION

- ◆ Mixed economic indicators, stock market volatility and concerns surrounding the European debt crisis continue to drive investors to safety. As a result, the yield on the 10-year U.S. Treasury has declined since peaking at 4 percent in April; as of late July, the yield had fallen to 3 percent.
- ◆ Capital markets loosened over the past year, with life insurance companies ramping up lending and CMBS showing renewed signs of life. Nonetheless, the agencies remain the dominant sources of multifamily lending. This trend will continue through 2010 as the GSEs' multifamily portfolios outperform their residential mortgage operations, reducing the likelihood of drastic government-mandated changes to their apartment lending arms.
- ◆ Multifamily loan originations increased 37 percent in the second quarter but remained below levels reported during the same period last year. Fannie Mae and Freddie Mac's origination volume followed a similar pattern, rising in the second quarter but falling short of year-earlier levels.
- ◆ Loan-to-values range from 60 percent to 75 percent for portfolio lenders and push up to around 80 percent for best-of-class, agency-financed deals. All-in rates for five-year agency loans fall into the low-4 percent range, while 10-year loans price between 4.75 percent and 5.15 percent. While life companies will compete at these levels for best-of-class deals, most portfolio lenders are 100 basis points to 225 basis points higher.

## SUBMARKET OVERVIEW

- ◆ So far this year, concessions declined in 17 of 21 submarkets and remained unchanged in two others. In the Lakewood-North submarket, however, concessions inched up 20 basis points to 11 percent of asking rents, as asking and effective rents each continued to recede.
- ◆ While none of the projects planned marketwide is scheduled to start construction soon, potential supply growth is greatest in the Denver Downtown submarket. Five properties containing nearly 900 units, or about 30 percent of existing stock, are envisioned in the submarket.
- ◆ Ecotech Institute, a college that prepares students for careers in renewable energy fields, opened in Aurora during the third quarter. The school expects to eventually enroll from 700 to 1,200 students, which could increase apartment demand in the surrounding neighborhoods.

## SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Douglas County	4.6%	-280	\$932	1.4%
2	Denver-Downtown	5.4%	-190	\$956	1.6%
3	Lakewood-South	5.4%	-170	\$809	1.8%
4	Littleton	5.4%	60	\$744	1.8%
5	Westminster	6.3%	-190	\$713	-0.1%
6	Denver-Far Southeast	6.6%	-50	\$669	-1.4%
7	Denver-Central	6.7%	-180	\$896	0.0%
8	Aurora-South	6.9%	-430	\$884	-0.8%
9	Denver-Northeast	7.0%	-140	\$805	3.6%
10	Arapahoe County	17.5%	20	\$970	-0.4%