

# ApartmentResearch

M A R K E T U P D A T E

Marcus & Millichap

Denver Metro Area

Fourth Quarter 2009

## SINCE FIRST QUARTER LOWS, CLOSINGS HAVE GAINED MOMENTUM

Similar to many U.S. apartment markets, economic pressures in Denver will ease renter demand during the final months of 2009; however, years of modest rent growth are expected to help limit the rate of rent declines. After the dot-com bust, local operators refrained from implementing aggressive rent hikes, averaging annual rent gains of less than 1 percent since the beginning of the decade. Although the pace of job cuts has intensified over the past year, the metro's unemployment rate remains below that of the nation, sustaining a healthier level of renter demand. As a result, year-to-date rent reductions have been shallower than in many neighboring western metro areas. In the quarters ahead, however, above-trend inventory growth that will be nearly twice as high as the metro's five-year annual average will drive up both vacancy rates and leasing incentives. Areas east of the metro, such as Aurora, where construction efforts are concentrated, will post the largest rise in concessions, reaching almost 15 percent of asking rents this year.

While Denver's apartment closings are down from year-earlier periods, local sales activity has begun to gain traction, as buyers' and sellers' price expectations have moved more closely in alignment. Recent transactions have highlighted emerging investment strategies, with buyers focused on stabilized assets in infill cities close to downtown employment centers. Areas such as Lakewood, Littleton, Arvada and Englewood have posted steadier operations over the past year and have garnered considerable interest in recent months. Distressed-asset sales have been limited and are concentrated in older areas of Aurora, particularly in the northwest. Cap rates for properties in Aurora with deferred maintenance are well above the metrowide average at around 9 percent and, in some instances, 10 percent.

## 2009 ANNUAL APARTMENT FORECAST



**Employment:** Metro employers are forecast to shed 36,000 jobs this year, a 2.9 percent decrease. In 2008, total employment contracted by 1.9 percent, or 23,700 positions.



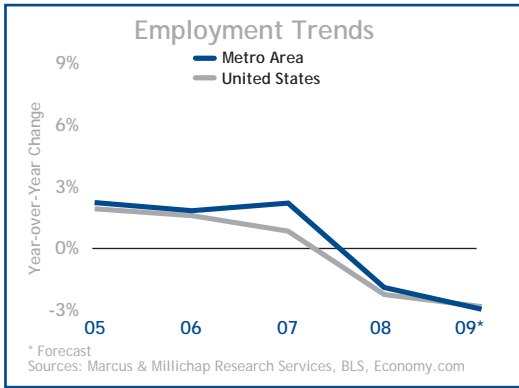
**Construction:** Approximately 2,730 apartment units will be added in 2009, up from 1,795 units last year. This year's deliveries will represent a 1.6 percent increase in stock.



**Vacancy:** With completions expected to be above-trend and renter demand softening, vacancy is forecast to reach 9.4 percent in 2009, 180 basis points higher than last year, when vacancy increased 70 basis points.



**Rents:** Owners will continue to combat weaker fundamentals by lowering rents and raising leasing incentives. Asking rents are expected to drop 0.8 percent to \$880 per month this year, while effective rents will decline 2.7 percent to \$770 per month.

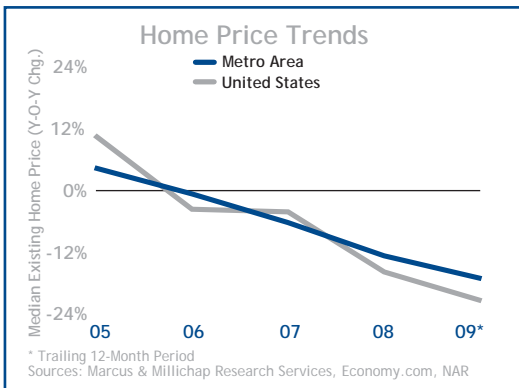


## ECONOMY

- ◆ Year to date, employment in the Denver metro has contracted by 2.6 percent with the loss of 31,700 jobs. During the first three quarters of 2008, local employers added 600 workers.
- ◆ Economic strains have reduced consumption, dragging down business and retail spending. In response to lighter demand, the trade, transportation and utilities sector has posted the largest absolute job loss with the release of an estimated 14,000 employees over the past year, a 5.7 percent decline.
- ◆ Denver's education and health services sector remains a bright spot, as more than 2,900 positions have been added during the past 12-month stretch, a gain of 2.2 percent.
- ◆ **Outlook:** Metro employers are forecast to shed 36,000 jobs this year, a 2.9 percent decrease. In 2008, total employment contracted by 1.9 percent, or 23,700 positions.

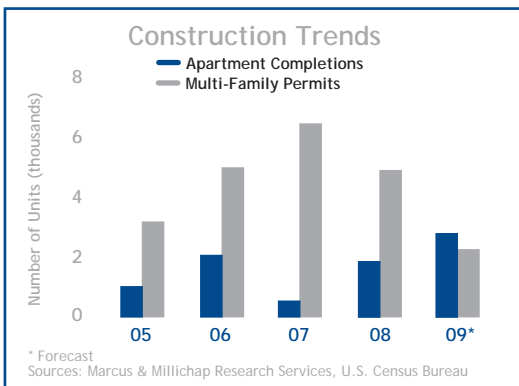
## HOUSING AND DEMOGRAPHICS

- ◆ In the past year, approximately 3,380 single-family housing permits have been issued, 28 percent fewer than in the previous 12 months. Developers have pulled 2,180 multi-family permits in the last year, down 60 percent one year earlier.
- ◆ Year over year through the third quarter, the median home price in Denver declined almost 17 percent to \$182,400. In that time, the median household income level receded by 3.3 percent to \$64,900 per year. The median household income is \$18,500 more than the amount required to meet the monthly mortgage obligations on a median-priced home, using traditional financing. One year ago, the surplus was just \$4,800.
- ◆ At present, the average Class A asking rent is nearly identical to the typical mortgage payment on a median-priced home.
- ◆ **Outlook:** While job market turbulence will likely dampen the migration of some renters into homeownership, rising housing affordability will allow many residents in stable employment situations to take advantage of price declines.



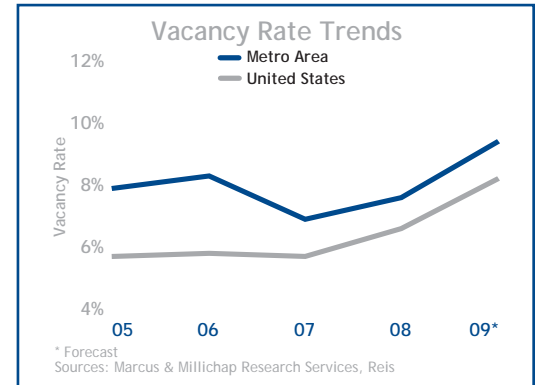
## CONSTRUCTION

- ◆ Existing inventory has increased by an estimated 1.5 percent over the last 12 months with the completion of nearly 2,570 rental units. In the prior year, 1,953 units were delivered.
- ◆ Roughly 3,160 apartment units are under construction in the Denver metro. The planning pipeline, meanwhile, consists of 8,750 rental units, though only a few projects have a definitive groundbreaking date.
- ◆ For-sale development persist as builders work to complete under way projects. At present, more than 2,000 condo units are under construction; however, only 674 units are slated for delivery in 2009. Year to date, 800 for-sale units have come online.
- ◆ **Outlook:** Approximately 2,730 apartment units will be added in 2009, up from 1,795 units last year. This year's deliveries will represent a 1.6 percent increase in stock.



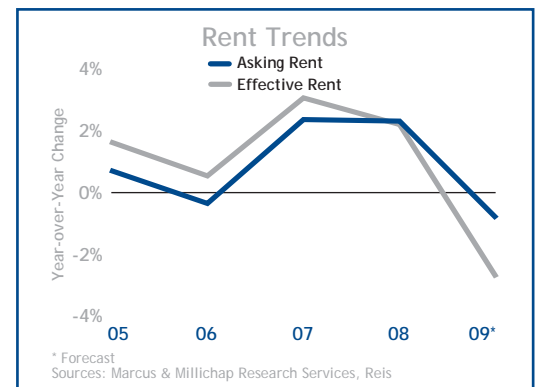
## VACANCY

- ◆ Ongoing construction efforts at a time when renter demand is moderating pushed up the average vacancy rate in Denver 240 basis points year over year to 9.1 percent in the third quarter, after a 40 basis point improvement was recorded in the previous 12-month period. During the past six months, the metro's vacancy rate has risen 60 basis points.
- ◆ Year to date, robust additions to inventory have underpinned a 140 basis point increase in Class A vacancy to 9.2 percent.
- ◆ Layoffs in blue-collar sectors have softened conditions in the Class B/C segment. Lower-tier vacancy has risen 160 basis points since the end of 2008 to 9 percent.
- ◆ **Outlook:** With completions expected to be above-trend and renter demand softening, vacancy is forecast to reach 9.4 percent in 2009, 180 basis points higher than last year, when vacancy increased 70 basis points.



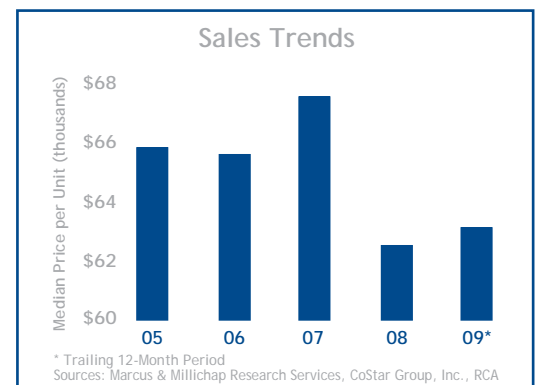
## RENTS

- ◆ According to preliminary third quarter data, asking rents fell an estimated 0.7 percent since the beginning of this year to \$881 per month, while effective rents retreated 2.4 percent to \$772 month.
- ◆ As owners of recently completed developments have sought to boost occupancy levels, top-tier asking rents have slipped 1.1 percent year over year to \$1,047 per month. Asking rents at Class B/C complexes, meanwhile, have declined 1.4 percent to \$729 per month.
- ◆ Revenues are contracting in response to rising concessions and waning occupancy levels. After a 3.8 percent gain was recorded during the previous 12-month period, revenues have contracted by 5.6 percent over the last year.
- ◆ **Outlook:** Owners will continue to combat weaker fundamentals by lowering rents and raising leasing incentives. Asking rents are expected to drop 0.8 percent to \$880 per month this year, while effective rents will decline 2.7 percent to \$770 per month.



## SALES TRENDS\*\*

- ◆ During the most recent 12-month period, sales velocity dropped 50 percent, as buyer caution emerged in the market. While year-over-year sales have slowed considerably, investment activity in the second and third quarters was up from the first quarter.
- ◆ The median price of an apartment property in Denver has increased 1 percent to \$63,100 per unit in the past year.
- ◆ At present, cap rates average in the low-8 percent range, approximately 170 basis points above 2008 levels.
- ◆ **Outlook:** Buyers will remain keen on smaller assets priced below \$3 million due to the greater availability of financing. Over the past six months, roughly 85 percent of assets sold in the metro area were priced below \$3 million, compared with 70 percent during the corresponding period one year ago.



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

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## CAPITAL MARKETS

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

- ◆ Compared to other core property sectors, apartments have fared best due to the availability of financing through government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. Recent modifications to GSE guidelines will impact lender decisions, however, as borrower requirements include more substantial apartment ownership experience.
- ◆ Loan-to-value requirements range from 55 percent to 75 percent. Portfolio lenders are issuing loans at all-in rates of 6.00 percent to 6.75 percent for a five-year term and 6.9 percent to 8.0 percent for a 10-year term. Rates among agency lenders are roughly 150 basis points to 175 basis points lower. The government recently assumed full control of Fannie Mae and Freddie Mac, which may boost confidence in the GSEs, putting downward pressure on rates, but it also creates several near-term uncertainties.
- ◆ Delinquencies will rise further as a wave of maturities approaches; however, at-risk borrowers may find lenders amenable to loan extensions/modifications. Furthermore, Freddie Mac is under way on its second securitization of multi-family debt this year, and the government's TALF program is expected to at least provide a much-needed spark to the traditional CMBS market.

## SUBMARKET OVERVIEW

- ◆ During the past year, the completion of two large developments added nearly 670 apartment units to the Arapahoe County submarket, expanding the area's inventory by approximately 15 percent. As a result, the submarket's vacancy rate has climbed 940 basis points in that time to 15.2 percent.
- ◆ Construction is impacting fundamentals in the Aurora-South submarket, where vacancy rose to the mid-11 percent range in the third quarter. Year to date, the area has received more than 780 apartment units. In 2010, another 400 units are slated for delivery.
- ◆ Despite a lack of building activity, the Class B/C sector in the Aurora-Central-Southwest submarket is posting a metro-high vacancy rate of 19 percent. Elevated vacancy stems from job cuts in the metro's blue-collar sectors that have led to an 11 percent year-over-year contraction in Class B/C renter demand.

## SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Littleton	4.9%	-10	\$753	-6.1%
2	Englewood/Sheridan	7.0%	90	\$726	-4.0%
3	Denver-Far Southeast	7.0%	120	\$656	-4.8%
4	Arvada/Broomfield	7.2%	60	\$729	-5.0%
5	Lakewood-South	7.3%	0	\$819	-1.6%
6	Denver-Southeast	7.4%	10	\$704	-3.9%
7	Denver-Downtown	7.5%	260	\$966	-4.6%
8	Douglas County	7.6%	120	\$939	-4.1%
9	Northglenn/Thornton	7.8%	200	\$737	-4.9%
10	Denver-South/Glendale	8.5%	320	\$640	-6.9%