

ApartmentResearch

MARKET REPORT

Marcus & Millichap

Denver Metro Area

Third Quarter 2013

Public Transit Development Paves the Path for Projects

Employment opportunities in Denver are attracting residents to the growing region and encouraging multifaceted development across the metro. New projects are largely centered around the redevelopment of Union Station in downtown Denver. Residential, office, and retail projects are popping up in the area immediately surrounding the future multimodal transportation hub. The building of rail lines extending from this project has encouraged investment along these future paths. In Douglass County, a number of financial services companies, such as Charles Schwab, Visa, Redwood Trust and Fidelity will add thousands of jobs over the next several years. Hitachi Data Systems opened in the spring, adding 200 workers in the county and plans for the region to be the site for all future expansion. Growth in the area's high-tech sectors has led to the passing of the Colorado Advanced Industries Acceleration Act, designed to provide proof-of-concept grants for seven high-tech industries, including advanced manufacturing, aerospace, energy and natural resources, and engineering and information technology. This initiative is expected to encourage additional expansion and growth in the region, spurring demand for apartments in the metro.

A bright economic outlook and stabilizing property operations are drawing investors to expand portfolios in the metro. High demand for assets located in downtown and urban infill locations is pushing yield-seeking investors to secondary and tertiary submarkets. Many of these buyers will seek properties with value-add potential where capital infusions or management improvements will allow owners to raise rents. Properties located along future rail lines, such as the East Rail Line, Gold Line, and I-225 Rail Line, all set to open in 2016, are gaining traction, and investors seeking to capitalize on future growth corridors may find value-add opportunities. Competition for institutional-grade assets in the core has intensified; however, projects coming online throughout the next couple of years will provide new opportunities in high-growth areas such as the CBD, and Broomfield and Douglass counties.

2013 Annual Apartment Forecast



Employment: Employers will add 35,000 jobs in the metro during 2013, annual growth of 2.8 percent. Gains in the trade, transportation and utilities and professional and business services sectors will lead additions through the remainder of the year. Last year, payrolls expanded by 2.6 percent in the metro.



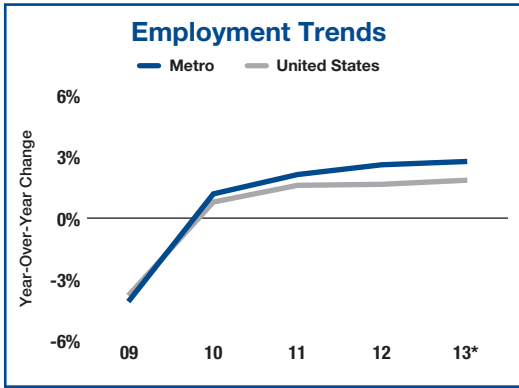
Construction: Builders will complete 4,600 units during 2013, increasing inventory in the metro by 2 percent. Several large projects, including Arvada Station, Yards at Denargo Market, Veranda Highpointe, and AMLI at Interlocken, will be among those delivered this year. Just over 1,900 apartments were completed in 2012.



Vacancy: Job and population growth will spur additional demand for apartments through the year and vacancy will fall to 4.4 percent, down 60 basis points from 2012. Vacancy also dipped 60 basis points last year.

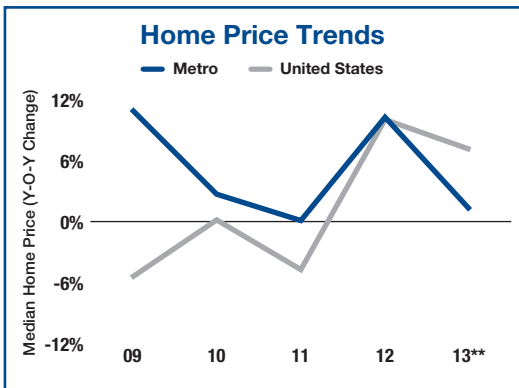


Rents: Average asking rents will rise to \$1,028 per month while average effective rents reach \$948 per month, an increase of 5.8 percent and 6.5 percent, respectively. In 2012, asking rents rose 5.2 percent while effective rents climbed 5.7 percent.



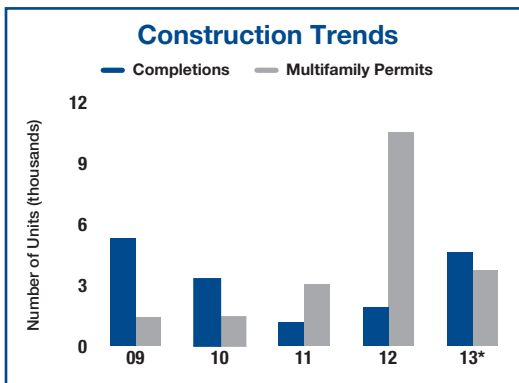
Economy

- Metro employers added 32,000 jobs during the last four quarters, expanding payrolls by 2.6 percent. Employment pushed 1.5 percent above the prior peak during the period.
- Job gains were led by the professional and business services sector, adding nearly 8,500 workers during the year. The education and health services sector followed with the creation of 6,900 positions during the period.
- Seven Step, a recruitment process outsourcing firm, has leased space in Denver's CBD. This company will hire 250 employees in the metro. The booming high-tech market and large pool of highly educated workers were major drivers for the company to choose Denver for expansion.
- **Outlook:** Employers will add 35,000 jobs in the metro during 2013, annual growth of 2.8 percent. Gains in the trade, transportation and utilities and professional and business services sector will lead additions through the remainder of the year.



Housing and Demographics

- Single-family permitting issuance accelerated 17 percent from the second quarter of last year as builders obtained nearly 5,800 permits.
- The median price of a single-family home rose 1 percent in the last year to \$260,000. Meanwhile, the median household income increased 1.5 percent to \$61,500 annually, just over the amount needed to qualify for a mortgage on a median-priced residence.
- The monthly payment on a median-priced home in the metro, assuming 20 percent down and payments for taxes and insurance, is nearly \$1,340 per month. Renting is the slightly more affordable option as the average asking rent for an apartment built after 2005 is \$40 cheaper.
- **Outlook:** While the difference between owning and renting is slim, young professionals seeking the live-work-play lifestyle will choose to rent in areas near public transportation. Young households are attracted to the amenities of rentals, the ease of mobility, and low-maintenance responsibilities.



Construction

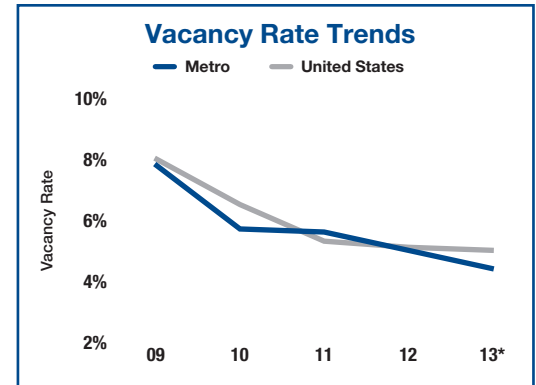
- Developers expanded metrowide inventory by 1.3 percent during the last 12 months with the completion of nearly 3,400 units. Half of all completions during the year were delivered in the second quarter, the largest quarterly delivery in over five years.
- Construction was completed on Arvada Station in the second quarter, adding 378 units to inventory near the future Arvada Ridge Station along the RTD Gold Line. The light rail line is expected to open in 2016.
- Nearly 13,000 apartments are under construction in the metro with completion dates scheduled through 2015. Approximately 3,500 of these units are underway in the CBD and the area surrounding Union Station.
- **Outlook:** Builders will complete 4,600 units during 2013, increasing inventory in the metro by 2 percent. Just over 1,900 apartments were completed last year.

*Forecast

**Trailing 12-month period through 2Q

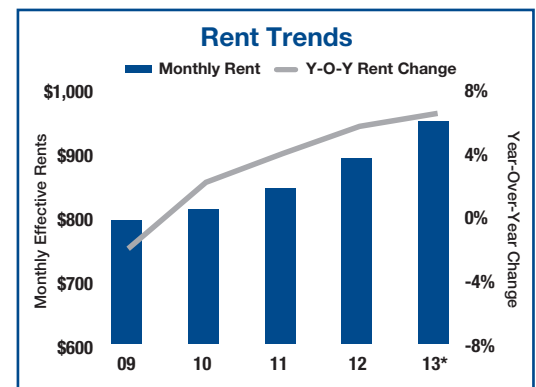
Vacancy

- Strong demand for apartments in the metro pushed vacancy down 30 basis points year over year to 4.6 percent. Over half of the 33 submarkets in the metro have vacancy below 5 percent.
- Vacancy is lowest in the Aurora-Central NE and Denver-Central submarkets, both falling below 3 percent in the last 12 months. Rents in both submarkets are in the bottom half compared with other areas, and this affordability and proximity to business districts and major thoroughfares contribute to their popularity among renters.
- Vacancy in the Denver-Downtown submarket is one of the highest in the metro at 9.4 percent, up 450 basis points from the second quarter of 2012. Large amounts of new inventory coming online in the area have contributed to vacancy rising; however, this shift is expected to be temporary as demand for apartments in the submarket rises.
- **Outlook:** Job and population growth will spur additional demand for apartments through the year and vacancy will fall to 4.4 percent, down 60 basis points from 2012. Vacancy also dipped 60 basis points last year.



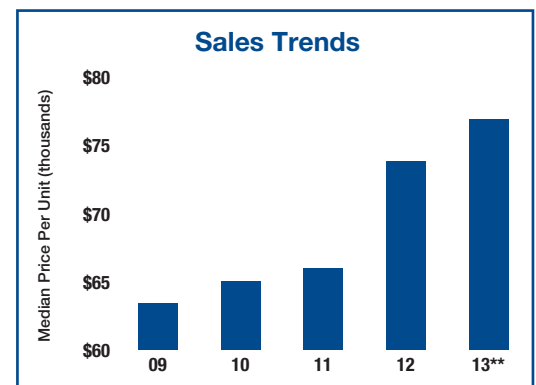
Rents

- Strong demand and tight conditions are encouraging owners to lift rents, and average asking rents grew 4.4 percent in the last year to \$1,011 per month.
- Effective rents continued on an upward trend during the last 12 months, rising 7.3 percent to \$937 per month.
- At complexes offering leasing inducements, the average concession fell to 7.3 percent of annual rents. Concessions in the metro peaked at 11.3 percent of annual rents in mid-2011.
- **Outlook:** Average asking rents will rise to \$1,028 per month while average effective rents reach \$948 per month, increases of 5.8 percent and 6.5 percent, respectively. Last year, asking rents rose 5.2 percent while effective rents climbed 5.7 percent.



Sales Trends**

- Increased buyer demand for assets in the metro contributed to a 27 percent jump in transaction velocity during the last 12 months. Sales in the Capitol Hill area nearly doubled during the period, while Aurora, West Denver and Northwest Denver also experienced increased interest.
- The median price of assets sold during the past year climbed 11 percent to \$76,900 per unit. Strong interest in assets selling below \$20 million contributed to a 15 percent rise in pricing in this segment, largely affecting the overall median price for the current period.
- Cap rates averaged in the mid-6 percent range for properties traded during the last four quarters, compressing approximately 20 basis points from the prior 12 months. First-year yields for institutional-grade assets started near 5 percent.
- **Outlook:** Well-capitalized, private buyers in search of larger assets will find opportunities near public transportation in suburban markets. Many of these assets can be upgraded, providing owners the opportunity to increase rents.



*Forecast

**Trailing 12-month period

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Capital Markets

By WILLIAM E. HUGHES, Senior Vice President, Marcus & Millichap Capital Corporation

- The rate on the 10-year U.S. Treasury rose to the mid-2 percent range after comments from Fed Chairman Bernanke were interpreted to mean that the central bank would start tapering stimulus sooner than expected in late 2013. Subsequent statements from Fed officials were intended to reassure the markets that the winding down of bond purchases would be neither preemptory nor severe. The immediate reaction of multifamily lenders was to hold rates firm on transactions in the pipeline, but quote higher rates on new inquiries.
- Cap rates will be affected by higher interest rates, although the two will not move in a one-to-one relationship. Most immediately, cap rates will rise on Class A assets, where spreads were already quite narrow before the Treasury re-priced. With long-term rates well below historical trends, however, opportune conditions exist for borrowers to either get acquisition financing or refinance.
- The 10-year CMBS loans will re-price as interest rates settle, and other lenders will follow. Local and regional banks were issuing loans of \$3 million and more for 10 years from 3.75 percent to 4.25 percent this year, but are likely to price 75 basis points higher. Competition remains keen as new sources of capital emerge. Five-year loans, meanwhile, will price from 4.25 percent to 4.625 percent.
- Government agencies Fannie Mae and Freddie Mac continue to assume leading roles in multifamily finance and account for most of the debt placed in the sector. The agencies will underwrite deals at up to 80 percent LTV and rates 2.75 percent over the seven-year Treasury.

Submarket Overview

- Target will open a new store at Tamarac Square in July, offering produce, meats, and baked goods, as well as a Starbucks and a pharmacy. The store will employ 200 workers and serve residents in southeast Denver.
- The Platform at Union Station is underway and the 21-story apartment project will add 287 units to stock once completed in late 2014. The project is located west of the rail platforms at Union Station and will cater to young professionals.
- Developers broke ground on an 18,000-square foot Trader Joe's, the brand's first store in Denver. The grocery store is expected to open in the fourth quarter of this year and will also contain the company's only liquor store in the state.

Submarket Vacancy Ranking

Rank	Submarket	Vacancy Rate	Y-0-Y Basis Point Change	Asking Rents	Y-0-Y % Change
1	Aurora-Central NE	2.2%	-360	\$813	6.6%
2	Denver-Central	2.8%	-90	\$935	0.1%
3	Lakewood-South	3.1%	-150	\$1,046	9.6%
4	Wheat Ridge	3.1%	-50	\$759	8.5%
5	Denver-North Central	3.2%	90	\$1,401	13.3%
6	Arapahoe Co-South	3.3%	20	\$1,162	6.2%
7	Northglenn/Thornton	3.4%	-190	\$951	6.3%
8	Littleton	3.4%	-50	\$989	-5.6%
9	Golden	3.6%	-100	\$1,094	7.8%
10	Aurora-Central SW	3.7%	-420	\$849	1.9%

The information contained in this report was obtained from sources deemed to be reliable. Every effort was made to obtain accurate and complete information; however, no representation, warranty or guarantee, express or implied, may be made as to the accuracy or reliability of the information contained herein. Note: Metro-level employment growth is calculated using seasonally adjusted quarterly averages. Sales data includes transactions valued at \$500,000 and greater unless otherwise noted. Sources: Marcus & Millichap Research Services, Bureau of Labor Statistics, CoStar Group, Inc., Economy.com, National Association of Realtors, Real Capital Analytics, 1st Quarter 2013 Vacancy and Rent Report, Apartment Association of Metro Denver, Apartment Insights, TWR/Dodge Pipeline, U.S. Census Bureau.