

Denver, Colorado

Multifamily Housing Update

April 2011

EXECUTIVE SUMMARY

The Denver economic recovery gathered momentum in early 2011, powered by stronger consumer spending and rejuvenated manufacturing activity. Orders for high tech devices, transportation equipment and raw materials surged, leading companies across the supply chain to rebuild depleted inventories and stockpile materials in anticipation of strengthening future demand.

Establishments in several industries accelerated hiring, most notably the hospitality and business service and retail trade sectors, which together added workers at a 9,900-job year-on-year pace in 1Q11, up from 6,400 jobs in 4Q10. Smaller gains were chalked down by wholesalers and durable goods manufacturers. Overall, payroll employment increased at a 9,900-job annual pace, up from 3,900- and 2,900-job gains recorded during 4Q10 and 3Q10, respectively.

Seasonally-adjusted figures also pointed to a faster rate of growth. Denver establishments created a net of 9,400 jobs from January to March, representing the largest single quarter advance since 2005. Consequently, the metro unemployment rate declined sharply in March, falling to 8.9% from January's 21-year record high 9.9% and 9.4% during February.

The **RED CAPITAL Research** payroll model suggests that the pace of progress will continue to accelerate over the next two years. The model foresees a 17,800-job, 1.5% advance this year, followed by a 29,800-job, 2.5% expansion in 2012. Economy.com are still more optimistic, forecasting 18,330- and 34,990-job gains in 2011 and 2012, respectively.

Apartment demand during the fourth quarter was commensurate. Reis report that metro property owners leased a net of 1,809 units, the second largest total for an October to Decem-

ber period in the 12-year Reis quarterly data series. Accounting for 520 new units added to metro stock, average occupancy increased 70 basis points from September to December and 250 bps year-on-year, reaching 93.6%, the highest rate since 2001.

Preliminary 1Q11 data from Reis indicate that further gains were made over the winter. According to this source, occupancy increased another 60 bps to 94.2% during the period, rendering the firm's cautious 93.7% year-end 2011 occupancy forecast published in February utterly moot.

The powerful demand conditions were not accompanied by comparable increases in average rents. Reis report that the average asking rent increased \$7 (0.8%) sequentially to \$904 during 4Q, while concession levels increased slightly, holding effective rent growth to \$6 (0.7%) to \$812. Asking rent trends slowed during 1Q11, rising \$3 (0.4%) December to March, according to a preliminary Reis estimate.

Property revenue growth was particularly strong in the Englewood submarket, where occupancy increased by 270 bps sequentially in 4Q to 93.3% while average effective rent surged 2.1%. Useful gains also were posted in the infill Central Denver submarket, perhaps at the expense of the newer, higher rent Downtown and Denver - North inventories, where both average occupancy and effective rent declined quarter-to-quarter.

Based on Reis's conservative February forecasts and a 5.25% generic cap rate assumption, **RCR** estimate expected 5-year holding period annual total returns of only 7.0%, well below the 9.0% **RED 50** average. But the Reis forecasts underestimate the potential for revenue growth in the Denver market. Fresh projections due in May are likely to form the foundation of a substantially higher return metric.

SNAP SHOT

	Y-o-y change	Projected 2011
Vacancy (6.9% - 4Q10)	↓ 2.5%	↓ 0.1%
Effective Rents (\$812 - 4Q10)	↑ 3.8%	↑ 4.5%
Cap Rate (5.6% - 4Q10)	↓ 0.8%	↓
Employment (1,199.4m - 4Q10)	↑ 3.9m	↑ 17.8m

KEY POINTS

- Denver households expressed some of the most intense apartment demand ever observed during an October to December period last year. Tenants net leased 1,809 units during the period, well above the approximate 520-unit 1999 - 2009 average.
- Occupancy increased 70 basis points sequentially in 4Q10 and 60 bps in 1Q11 to 94.2%, according to preliminary Reis data, the highest rate recorded since 2001.
- In contrast, asking and effective rent trends were only moderately stronger, rising 0.7% and 0.8% sequentially in 4Q10. Asking rents increased another 0.4% in 1Q11, the smallest advance posted since 1Q10.
- Payroll trends accelerated over the winter, transforming Denver's heretofore lackluster recovery into a fledgling boom. Seasonally-adjusted data suggest that metro employers created a net of 9,400 jobs in the first three months of 2011, the most in any calendar quarter since 2005. **RCR** expect growth to continue to accelerate over the next 2 years.
- Cap rates plunged over the past two quarters, falling to the low-4% area or lower for stabilized class-A assets.



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