Denver has long been regarded as a one-industry city – mining in the 19th century, followed by energy and then telecom. But in recent years, the city developed a diverse economy that experts believe will fuel population and job growth for the next 20 years or more. Denver, today, is a prime example of an American city whose growth is driven by the work-live-play neighborhood dynamic that attracts young professionals and the companies that seek to hire them. The apartment market, often a leading indicator of market trends, is of particular interest to real estate developers, investors, and lenders.

Innovation That Matters, a recent report from the U.S. Chamber of Commerce Foundation, 1776 and Free Enterprise, ranked Denver third among U.S. cities – behind Boston and San Francisco – in terms of its “readiness to capitalize on the inevitable shift to a digital economy.” Among the 25 cities studied, Denver ranked first for quality of life, second for its well-connected ecosystem, third for its vibrant cultural foundation and fourth for its ability to attract college-educated millennials. Denver has figured out how to diversify its economy and is on a strong growth path. The economy here is where San Francisco’s was 20 years ago. Proof of this long-term stability is seen in Google recently announcing a $2 billion R&D campus in Boulder that can accommodate more than 1,500 employees.

One reason for Denver’s appeal is its business climate, with low taxes and incentives for job creation, employee training and infrastructure improvements. But the biggest reason is the city’s appeal to millennials as a desirable place to live, for its active lifestyle choices, such as hiking and skiing, and for a culture that values environmental issues.

Transportation is part of the appeal as well; Google executives note that a nearby transit hub was a major factor in choosing its Boulder site.

Denver also is benefiting from a demographic trend seen across the country – not only are millennials staying in apartments longer than previous generations, but also a record number of retiring baby boomers also are choosing the walkable lifestyle that work-live-play urban neighborhoods offer. Empty nesters are realizing that their wealth is tied up in their home equity, and they can enjoy life by selling the house and renting in an area with restaurants and shops. Plus, they don’t have to make repairs or do lawn work.

To accommodate the wave of apartment demand, developers have increased metro area inventory by 13 percent over the past three years and have seen average rental rates rise to 60 percent above their previous peak, according to a first-quarter report from Marcus & Millichap. Yet, multi-family vacancy rates are at historically low levels.

Affordability is the main concern in Denver’s apartment market today. Owners of B and B-plus properties have pushed rents 20 to 30 percent, and they are still 100 percent occupied. But renters are reaching the limit of what they can afford. As land prices and construction costs rise, new projects could have trouble making their pro-forma numbers. We are starting to see some concessions come into the market for Class A properties downtown. Capital sources that want a piece of today’s growth are becoming increasingly concerned about this downside risk.

Currently, however, apartment owners and developers still can get financing at favorable terms. Denver’s apartment market may be one of the most dynamic in the country, but the trend toward higher rent and occupancy can be seen in virtually every city.

The past year has seen increased volatility in the commercial mortgage-backed securities industry and a greater regulatory focus on underwriting quality of commercial real estate loans, resulting in a slowdown in the pace of lending. With hundreds of billions of CMBS loans maturing in the next two years, there is some concern that supply of capital will fall short of demand. But owners of existing multifamily properties will be able to refinance without too much difficulty, due to several relevant factors.

Money is flowing into the U.S. from around the world, because we are seen as a safe haven while most of the rest of the world is less secure economically. Foreign capital seeks assets that people in those countries understand – and everyone understands apartments. Capital inflows are helping keep interest rates low on a historic basis, a factor that helps borrowers gain greater proceeds when financing or refinancing properties.

The apartment market is shielded to some degree against the looming challenge of CMBS financing because Fannie Mae, Freddie Mac and the Federal Housing Authority are offering favorable terms on development and acquisition/refinance loans. For instance, FHA recently reduced the mortgage insurance premium on affordable and energy-efficient, market-rate apartment deals. In addition, early rate locks on forward-commitment options are coming back into the market, eliminating interest-rate risk for projects in lease up.

In short, the apartment finance market is on relatively solid ground to weather any volatility in the capital markets. As long as demographic and cultural trends are driving more people to choose apartments over homeownership, fundamentals like rent and occupancy will remain strong, and capital sources will continue to seek out opportunities to fund new and existing properties.

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