

EMERGING SECTORS TO SUPPORT LONG-TERM DEMAND DRIVERS

Denver's weakening economy will drag on apartment fundamentals this year, though a diverse employment base should support a shallower downturn than the nation as a whole. The metro's growing alternative energy and biotechnology presence lends to a healthy outlook, with large employers such as ConocoPhillips and DaVita Inc. relocating to the area for its relative affordability and educated labor pool. Near-term conditions will soften, however, as supply growth and contracting demand push vacancy higher. Operators will struggle most in the eastern stretches of the metro in communities like Aurora, where overbuilding and job losses within lower-paying sectors are creating a supply/demand imbalance. To the west, Arvada and Lakewood will likely outperform due to minimal competitive threats and a dense renter base, while fundamentals in the downtown area are expected weaken in the coming months as a result of contraction in the professional and business services sector.

Fewer quality offerings and a disparity between buyers' and sellers' expectations have hindered sales activity over the past 12 months, as buyers continue to wait for further price reductions. A smaller proportion of out-of-area investors in the market also has contributed to the slowdown in velocity. Buyers who were anticipating a wave of distressed assets have found few such properties to date, and the number may increase only modestly in the quarters ahead, as the majority of deals in recent years were underwritten based on more conservative growth. Assets in core locations such as Central Denver and on the Westside will likely attract the most interest this year, with cap rates currently in the low-7 percent range, roughly 75 basis points below the metrowide average. In tertiary locations with more management-intensive properties, initial yields may need to approach 9 percent in order to generate bids.

2009 ANNUAL APARTMENT FORECAST



Employment: Continued economic weakness will result in elevated job losses this year. Local employment is forecast to contract by 3.4 percent, or 42,000 positions, following the elimination of 23,700 workers in 2008.



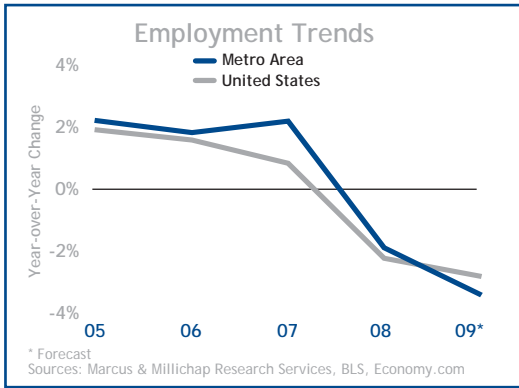
Construction: In 2009, apartment stock will expand by 1.6 percent with the delivery of 2,700 units, up from last year, when 1,800 units came online. This year's inventory growth is twice the metro's five-year average.



Vacancy: A rise in completions will be met with receding demand this year, as metrowide vacancy is projected to reach its highest rate in five years. Vacancy is forecast to jump 230 basis points to 9.9 percent, following a 70 basis point increase in 2008.



Rents: Weakened occupancy levels will place downward pressure on rents. Asking rents are forecast to retreat 1.4 percent to \$875 per month in 2009. Owners will widen concessions, causing effective rents to end the year at \$762 per month, a 3.7 percent contraction.

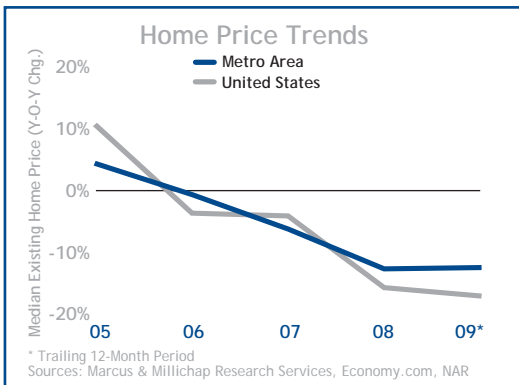


ECONOMY

- ◆ Local employers have eliminated 54,100 positions over the past year, a 4.3 percent decrease. Since the start of 2009, roughly 27,100 jobs have been cut.
- ◆ Falling consumer and manufacturer demand has been a drag on the trade, transportation and utilities sector, which has reduced head counts by 5.8 percent, or 14,200 workers, in the last 12 months.
- ◆ Despite job losses across almost all sectors, the education and health services and government segments remain relatively healthy, together adding more than 5,100 positions during the past year
- ◆ **Outlook:** Continued economic weakness will result in elevated job losses this year. Local employment is forecast to contract by 3.4 percent, or 42,000 jobs, following the elimination of 23,700 workers in 2008.

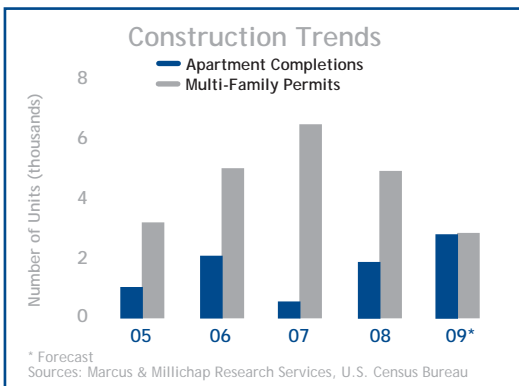
HOUSING AND DEMOGRAPHICS

- ◆ Over the last year, the number of single-family permits issued has fallen 50 percent to 2,800 units. The year-over-year decline in multi-family permitting activity was 45 percent, to an annualized 3,000 units.
- ◆ The median price for a single-family residence has dropped 12 percent in the past 12 months to \$193,800. Although the median household income has slipped 4 percent to \$65,200 annually in that time, it is still \$15,000 more than the minimum amount required to qualify for a median-priced home.
- ◆ Using traditional financing, the monthly mortgage obligation was \$80 more than the average Class A asking rent during the second quarter.
- ◆ **Outlook:** Above-average growth within the key renter cohort, or those ages 20 to 34, coupled with reduced permitting activity, should help to balance apartment supply and demand when the economy stabilizes.



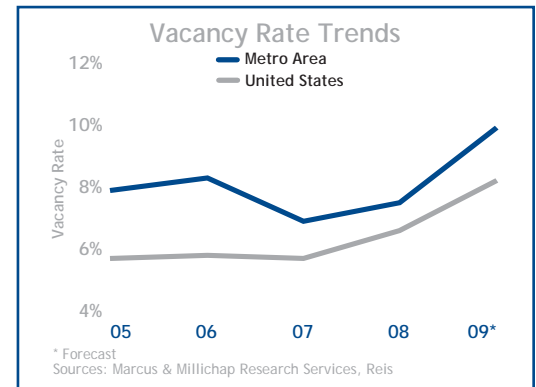
CONSTRUCTION

- ◆ Construction activity has more than doubled during the past year, as developers have brought 2,800 units online, a 1.7 percent inventory expansion. One year ago, 1,000 units were completed.
- ◆ Stock additions are expected to ramp up in the near term, as builders have 3,600 units under way, more than half of which are scheduled for delivery in 2010. The development pipeline is full, with roughly 9,100 in the planning phases.
- ◆ A large portion of future construction is concentrated in the Denver-North and Aurora-North submarkets, where close to 4,400 units are in the planning pipeline.
- ◆ **Outlook:** In 2009, apartment stock will expand by 1.6 percent with the delivery of 2,700 units, up from last year, when 1,800 units came online. This year's inventory growth is twice the metro's five-year average.



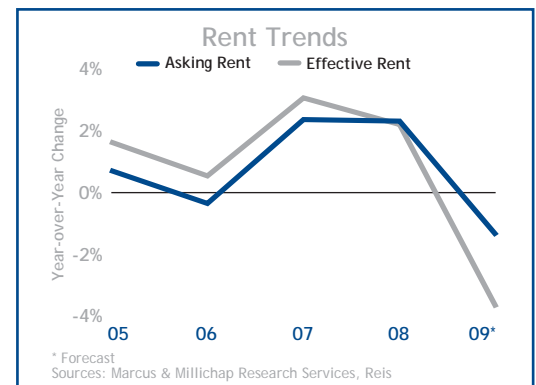
VACANCY

- ◆ Ongoing job losses and increased construction activity pushed metrowide vacancy up 220 basis points to 9.1 percent over the 12 months ending in the second quarter. Since the beginning of 2009, the vacancy rate has climbed 150 basis points.
- ◆ An influx of high-end deliveries has driven a 220 basis point year-over-year spike in Class A vacancy to 9.3 percent.
- ◆ In the lower tiers, elevated employment cuts, particularly in lower-paying industries, have dragged on renter demand. Vacancy in Class B/C properties reached 8.9 percent in the second quarter, a 210 basis point increase from one year earlier.
- ◆ **Outlook:** A rise in completions will be met with receding demand this year, as metrowide vacancy is projected to reach its highest rate in five years. Vacancy is forecast to jump 230 basis points to 9.9 percent, following a 70 basis point increase in 2008.



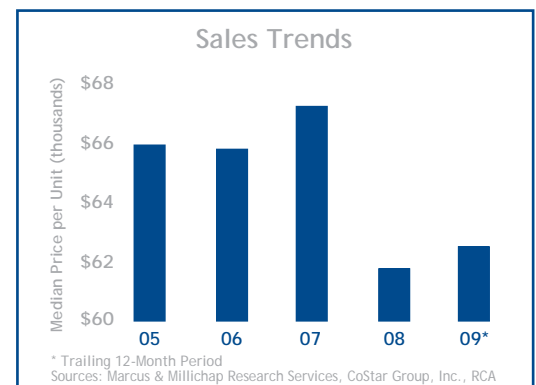
RENTS

- ◆ Asking rents have ticked up 0.1 percent year over year to \$885 per month, while effective rents have dropped 1.3 percent to \$780 per month. Since peaking in the third quarter of 2008, asking and effective rents have fallen 0.5 percent and 1.9 percent, respectively.
- ◆ Over the last year, Class A asking rents have slipped 0.5 percent to \$1,050 per month. Class B/C operators, meanwhile, were able to retain some of the gains recorded last year, despite recent softening, as asking rents reached \$735 per month, a 0.3 percent year-over-year uptick.
- ◆ Elevated vacancy levels have resulted in a 3.3 percent decline in average revenues during the past 12 months, compared with a 4.8 percent increase in the previous year.
- ◆ **Outlook:** Rising vacancy will place downward pressure on rents. Asking rents are forecast to retreat 1.4 percent to \$875 per month in 2009. Owners will widen concessions, causing effective rents to end the year at \$762 per month, a 3.7 percent contraction.



SALES TRENDS**

- ◆ Transaction velocity has slowed nearly 50 percent in the past year due to reduced buying activity from out-of-state investors. Trading has dropped off significantly in recent months, as transactions from the last two quarters account for less than 30 percent of all deals made in the past 12 months.
- ◆ The median price has slipped 6 percent in the last year to \$62,500 per unit, as buyer demand has waned.
- ◆ Metrowide cap rates have averaged in the high-7 percent to low-8 percent range recently, with some older, lower-tier properties trading near the high-8 percent area.
- ◆ **Outlook:** Investment activity is expected to remain measured this year, though solid prospects for an eventual rebound will maintain buyer interest in local assets. Despite near-term softening, properties located in downtown Denver will continue to attract investors, as demand from young professionals for in-city living supports the area's extended outlook.



** 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

- ◆ During the first quarter, multi-family mortgage originations were 61 percent below year-earlier levels and 79 percent lower than the late-2006 peak. Though considerable, the reduction in apartment originations remains less significant than declines among other core commercial property types, due largely to the availability of financing through Fannie Mae and Freddie Mac.
- ◆ Portfolio lenders are issuing apartment financing at all-in rates of 6.0 percent to 6.3 percent for three-year loans and up to 6.8 percent to 7.5 percent for a 10-year term. Loan-to-value requirements range from 55 percent to 75 percent.
- ◆ Agency lenders are offering five-year loans at all-in rates of 4.8 percent to 5.0 percent with 10-year mortgages available at rates averaging 5.35 percent and 5.7 percent, respectively. Maximum leverage among agency lenders ranges from 55 percent to 75 percent.
- ◆ Freddie Mac recently completed a \$1 billion securitization of multi-family debt, the first issuance to hit the market since last June. The securities, dubbed "K Certificates," vary from traditional CMBS in that buyers are provided a guarantee by Freddie Mac. In addition to the potential for another similar offering, government programs designed to increase credit flows into commercial real estate could be operational by late summer/early fall.

SUBMARKET OVERVIEW

- ◆ Investors should monitor the progress of the West Corridor light-rail project. Early work began in 2008, with construction set to start this year. Spanning from downtown Denver through Golden, the rail could spur demand for rental housing near boarding stations in the long term.
- ◆ Buyers looking for attractive deals may want to track properties in Arapahoe County. Cap rates in the area are hovering in the mid-8 percent range, above the metrowide average, while some recent deals have traded with initial yields pushing past 10 percent.
- ◆ Solid demand for rental housing, coupled with a lack of development activity over the last several years, has kept vacancy levels in the Littleton submarket tight and well below the marketwide average.

SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Littleton	5.0%	-50	\$761	-5.0%
2	Englewood/Sheridan	7.0%	20	\$734	-3.8%
3	Denver-Far Southeast	7.0%	100	\$663	-5.4%
4	Arvada/Broomfield	7.2%	20	\$737	-2.5%
5	Lakewood-South	7.3%	120	\$827	2.4%
6	Denver-Southeast	7.4%	-70	\$711	-0.8%
7	Denver-Downtown	7.5%	210	\$976	-1.9%
8	Douglas County	7.6%	0	\$949	-2.5%
9	Northglenn/Thornton	7.8%	100	\$745	-4.1%
10	Westminster	8.5%	230	\$715	-1.4%