

James Real Estate Services, Inc.



# Apartment Perspective

## News and Analysis about the Denver Metropolitan Apartment Market

### Overview

Denver's overall economy continues to grow slowly but the 2006 apartment vacancy rate increased slightly to 7.0% at year end from 6.7% in the third quarter, a seasonal fluctuation. The vacancy rate is lower than 2005 at 7.9% and is near the lowest vacancy rate since 2000 at 6.7%. Rental concessions and incentives are still being offered to attract tenants to units with higher than market vacancy rates, such as communities constructed in 2005 with vacancy nearly 13.9%. Communities constructed between 1950 and 1959 have the lowest vacancy rate of 5.9%. Newer communities constructed since 1990 have vacancy rates from 6.5% to 7.0%. The 2006 year end average rental rate remained essentially flat from 2005 with only a 0.2% increase at \$850. The median rental rate is \$804.

Continued stabilization in the Denver apartment market is due in part to the continued high number of foreclosures in the single family market and rising interest rates both factors contributing to less movement to ownership, and the continued albeit slower new home construction. 635 units were added to the Denver area market in the fourth quarter for a total of 2,506 added during 2006. As of January 1, 2007, there are 1,796 units under construction. The number of units added during 2006 is nearly equal to the 2,517 units added during 2005. 2005 was a dramatic increase from 2004 when only 1,488 units were added. Many of the 1,796 units now under construction will be added in 2007. In 2003, 3,584 units were added and 9,123 units were added in 2002. Based on the number of units currently under construction with more in the pipeline to start in 2007, it appears that developers continue to anticipate strong recovery. There are nearly 4,900 units proposed for development. Developers of the 21 proposed communities anticipate commencing construction before year end 2007.

### Metro Denver Economy

The Colorado Department of Labor and Employment reports that the unemployment rate for the state fell to 4.0% for December of 2006, the lowest since August of 2001. This is down 0.8% from December of 2005 when unemployment was reported at 4.8%. Over 2006, the number of job holders increased by 106,200.

The Denver Regional Council of Governments (DRCOG) reports that employment increased 2.51% in the metro area during the second quarter of 2006 and the number of employing firms increased slightly more than 1.0% during the same time. According to DRCOG there are a total of 1,345,234 persons employed in the Denver metro area. Denver County has the largest employment base with 431,762 persons and Broomfield County has the smallest employment base with 29,503 persons. Douglas and Arapahoe counties ranked in the top 10 counties nationally in employment growth and weekly wage increases from June of 2005 through June of 2006.

Following is some of the major economic news in Denver during the fourth quarter of 2006:

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## Metro Denver Economy (continued)

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- A report of the Denver metro area housing market contends that the high foreclosure rate will not end until 2007. Conducted by Patty Silverstein on behalf of the Metro Denver Economic Development Corp., the study attributes an above-average share of adjustable rate mortgages in the state paired with job losses that occurred in 2002 and 2003 for the current foreclosure epidemic.
- More layoffs were made by Sun Microsystems in November at its campuses in Broomfield and Louisville, according to the Colorado Department of Labor. The layoffs, bring the total count in the local area to 577 since April.
- The creation of a turboprop subsidiary by Frontier Airlines will result in the creation of 300 to 400 new jobs by the end of 2007, reports the company. Frontier will place its office for the FrontierExpress service in Westminster but anticipates that the majority of those hired for the service will work at the airport.
- A recent ranking of U.S. cities in terms of prospects for commercial/multifamily investment and development placed Denver 16th on the list. Performed by PriceWaterhouseCoopers and the Urban Land Institute, the study places the major coastal cities of New York, Washington, D.C., Los Angeles and Seattle in the top four, with the cities of Austin, San Francisco, Orlando, Honolulu, San Jose, and San Diego completing the top ten.

## Metro Denver Apartment Market

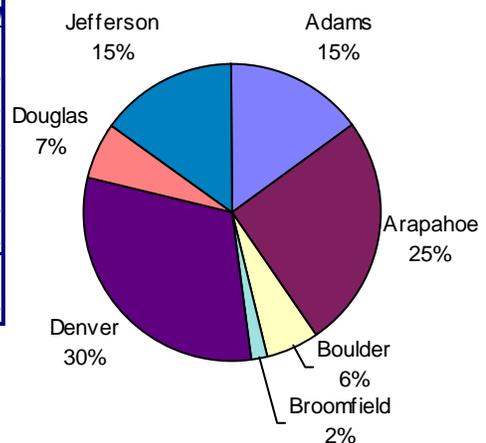
The metropolitan Denver apartment market contains a total of 166,361 existing units in buildings or communities of at least 50 units as of October 1, 2006. The United States Census Bureau defines the metropolitan Denver area as Adams, Arapahoe, Boulder, Broomfield, Denver, Douglas and Jefferson counties.

This inventory excludes public housing, on-campus student housing and apartments limited solely to senior residents. Changes in the total number of units occur due to the addition of new apartments and the removal of units from the rental inventory due to condominium conversions or demolitions.

In addition to the existing inventory, there were 11 apartment projects with 1,796 units under construction in metro Denver on January 1, 2007 including the recently started Dry Creek Village with 227 units. Another 21 projects containing 4,886 units have been proposed and all have been slated to start construction during 2007. Not all of those are likely to actually start construction or be developed as apartments. To put the amount of new construction into perspective, metro Denver experiences net absorption of about 5,000 to 6,000 apartment units in a "normal" year. According to the Denver Metro Apartment and Vacancy Survey, the market had a negative absorption of 487 during the 4th quarter of 2006 for a total net absorption of 2,709 for all of 2006, and in 2005 a total of 8,126 units were absorbed, the greatest amount

County	Existing
Adams	25,012
Arapahoe	42,463
Boulder	9,575
Broomfield	2,918
Denver	51,204
Douglas	10,928
Jefferson	24,896
<b>Total</b>	<b>166,996</b>

Apartment Units by County -- Existing



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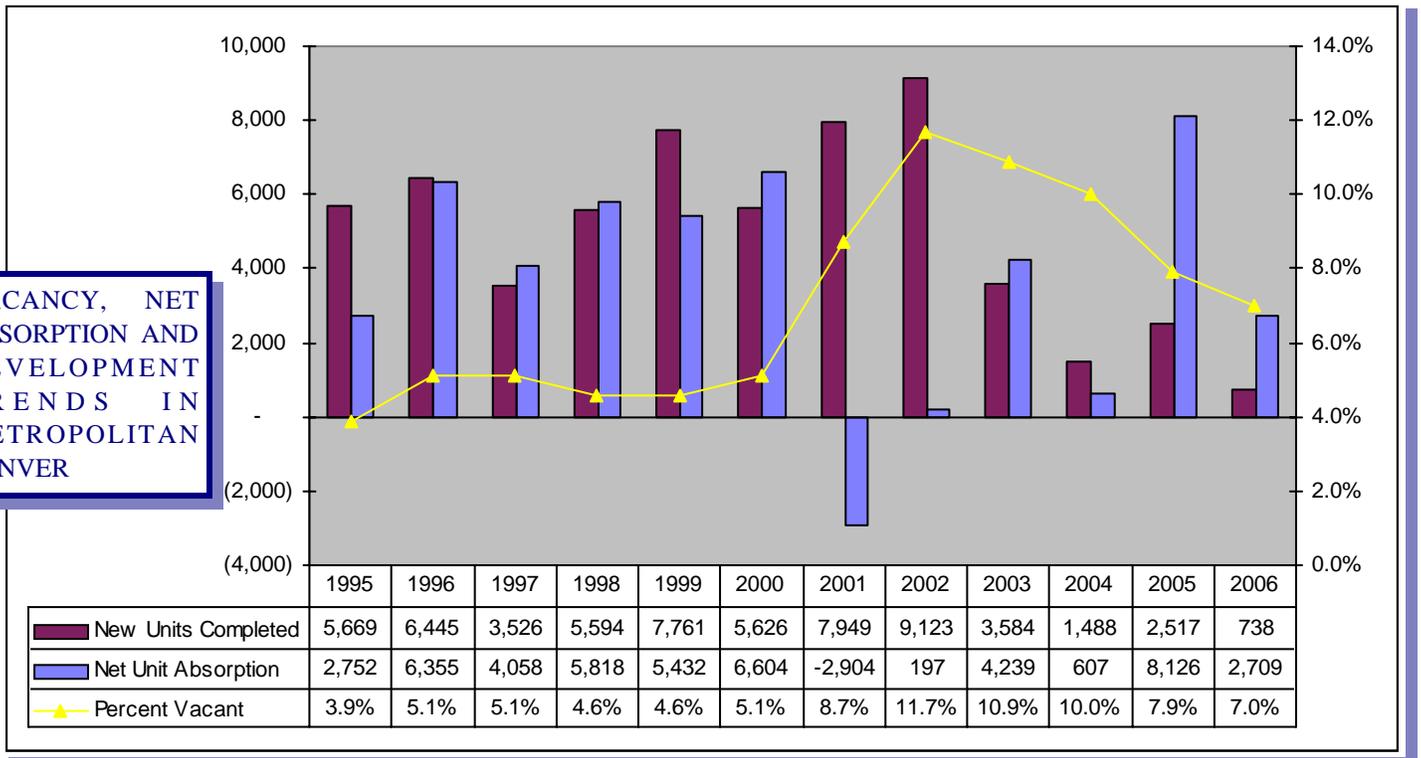
## Metro Denver Apartment Market (continued)

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since 1995. Absorption in 2006 is below the trend but is attributed in part to the slowdown in construction over the past few years.

From the early 1990s until early 2001, the vacancy rate in metropolitan Denver trended in a 4% to 5% range, allowing rental rates to increase and encouraging developers, investors, and lenders to start new apartment properties. As the economy slowed in 2001 and finally fell into recession, demand declined and the vacancy rate rose as new units came on stream.

According to James Real Estate Services (JRES) field work, developers completed 300 units in the fourth quarter of 2006 for a total of 2,171 during 2006 and a total of 3,768 units during 2005. This is in sharp contrast to the number of units reported completed by The Denver Metro Apartment Vacancy and Rent Survey, conducted by Dr. Gordon Von Stroh for the Apartment Association of Metro Denver (AAMD). The vacancy survey reports a total of 738 units were completed during 2006 and 2,517 were completed in 2005. JRES uses the survey's statistics of completed units in the table below for continuity. But, JRES field work completed since 2001 indicates a difference in the number of units completed than reported by the Apartment Association in the Vacancy Survey. JRES field work indicates that 2,398 units were completed in 2004, 7,018 units completed in 2003. JRES and the Apartment Association report the same number of units completed in 2002 with 9,123 units but JRES indicates fewer units were completed in 2001 with 7,095 units.



Note: Vacancy rates are as of the 4th quarter of each year.

In the fourth quarter, three new projects with a total of 322 units were started. During 2006 a total of 1,632 units started. This is a dramatic increase from 2005 when only a total of 494 units were started. In 2004, a total of 504 units were started. 2,685 units were started during the entire year of 2003. For all of 2002 developers started 4,926

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## Metro Denver Apartment Market (continued)

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units, well below the 11,427 units placed under construction in 2001. 2007 appears to be another strong year with a total of 4,886 units proposed to start during sometime during the year. With a total of 1,796 units currently under construction and another 4,886 proposed, the once emptying pipeline appear to be full again. Year end 2006 vacancy rate is also a positive sign with a drop of almost a full point since year-end 2005.

The excess of construction will not be eliminated until likely early 2008. This problem will be confined to some of the most active areas, such as Denver and Jefferson counties. Denver county currently has 740 units under construction and nearly 2,000 proposed for construction. Jefferson county has slightly more than 700 units under construction with an additional 62 units proposed. Arapahoe county has 259 units under construction with more than 1,600 proposed. Adams county has 71 units under construction and another 626 proposed. Boulder, Broomfield and Douglas counties have no units currently under construction and Boulder and Douglas counties each have less than 100 units proposed while Broomfield county has 358 units proposed.

The Central Denver segment has experienced the largest amount of growth over the past few years. There are four communities currently under construction in this segment which will add an additional 283 units when complete and 176 units were completed in the fourth quarter of 2006. Six proposed projects in Central Denver will add 905 units to this market segment.

Fourth quarter 2006 indicated an absorption of negative 487 units, but absorption for the entire year was positive with a total of 2,709 units absorbed. Historically, overall absorption has been positive. 2001 marked the only year with a total negative absorption rate of negative 2,904 units. 2005 had the greatest amount of absorption historically with a total of 8,126 units absorbed. The vacancy survey estimated that only 197 units were absorbed on a net basis during 2002. Net absorption improved during 2003, with the association's report estimating net absorption of 4,239 units. In 2004, a total positive net absorption of 607 units was achieved. An undercount of new units being completed, however, puts these numbers into question.

The divergence in the reporting of completed units between the AAMD survey of apartment managers and JRES field work may be due to recently completed buildings held unavailable for lease by management until previously completed buildings in the same project are fully leased up. Such buildings are not included in the AAMD study's measure of completed units. Of course, the AAMD net unit absorption may be overstated as well because of the difference in completions.

According to JRES field work, 2,171 units were completed in 2006. To date, 2,026 units have been leased indicating an absorption rate of 93%. The AAMD indicates a vacancy rate of 13.9% for units constructed after 2005. The 7% vacancy rate indicated by JRES is lower than the AAMD vacancy rate apparently due in part to the difference in measure of completed units. Douglas County indicates the strongest absorption during the year at 90% while Denver county indicates an absorption rate of 59% and Boulder county indicates a rate of 77%. The survey indicates that 65% of the units added to the market in Jefferson county were absorbed during the 4th quarter of 2006. No new units were added to the remaining counties during the year. Currently, Adams, Arapahoe, Denver and Jefferson counties are the only counties with active apartment construction but all counties have proposed projects in the pipeline.

Vacancy rates continue to trend downward. Year end 2006 vacancy rate was reported at 7.0% slightly less than year end 2005 vacancy rate of 7.9%, and 1.7% below 2001 year end data of 8.7%. While the apartment market continues to stabilize in metro Denver, there are wide ranges of conditions by submarket. Two submarkets report double digit vacancy rates for year end 2006. According to the Apartment Association's report, vacancy rates are highest in Denver—South Central (14.0%) and Aurora—Central Southwest (10.4%). It is not unusual that the Aurora Central submarket is experiencing vacancy rates higher than other markets. This market historically under performs due in part to new affordable single family home construction in the surrounding area and older rental product not able to compete with newer product in other areas of metro Denver. New student housing added to the Denver South Central

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## Metro Denver Apartment Market (continued)

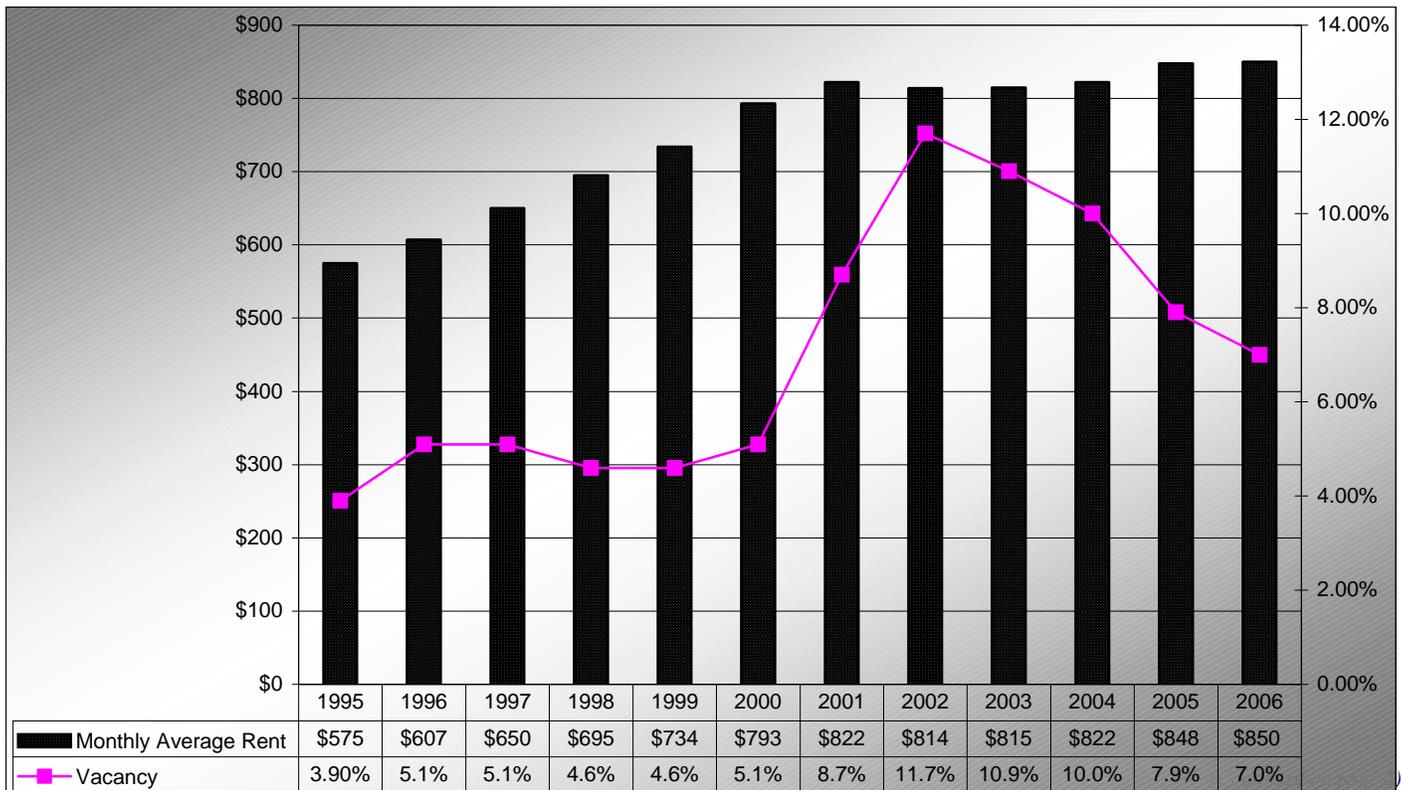
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market has increased the overall vacancy rate for the sector. Although the student housing does not compete with apartment units directly, the rental units vacated by students for student housing increased the overall vacancy rate. As these units are re-absorbed by the market this vacancy rate is expected to return to a normal rate. Other sectors to experience slightly more than normal vacancy rates include Aurora—North at 8.5% Commerce City/Brighton at 9.4%, Aurora Central Northeast at 9.6% and Glendale at 8.3%. Completion of new units and single family construction factor into the elevated vacancy rates in these markets.

Conversely, vacancy rates are still relatively low in several submarkets in which little new construction has occurred, including Denver Northwest (3.1%), City of Boulder—Except University Area (5.6%), Aurora South (5.6%), City of Boulder University Area (1.6%), Boulder County Other (5.5%), Broomfield (5.6%) and Littleton (5.8%) especially in areas with a concentration of low to moderate-income apartment communities.

In general, vacancy rates are lowest in smaller and older apartment properties and in those catering to low and moderate-income residents. Most of the overbuilding in Denver has occurred in suburban submarkets although the downtown submarket is also being affected as new units come on stream there and the new student housing competes with apartments.

While vacancy rates are highest in apartment communities with higher rents, demand is steady for “affordable” apartments, especially those using tax credit or bond financing. Developers are delving more deeply into this segment, especially in middle-income areas like Brighton, Commerce City and Longmont. However, due to the overall softness of the market HUD still has metro Denver on its “market watch” list, limiting the opportunities for funding from that source to only projects oriented to residents with the lowest incomes.



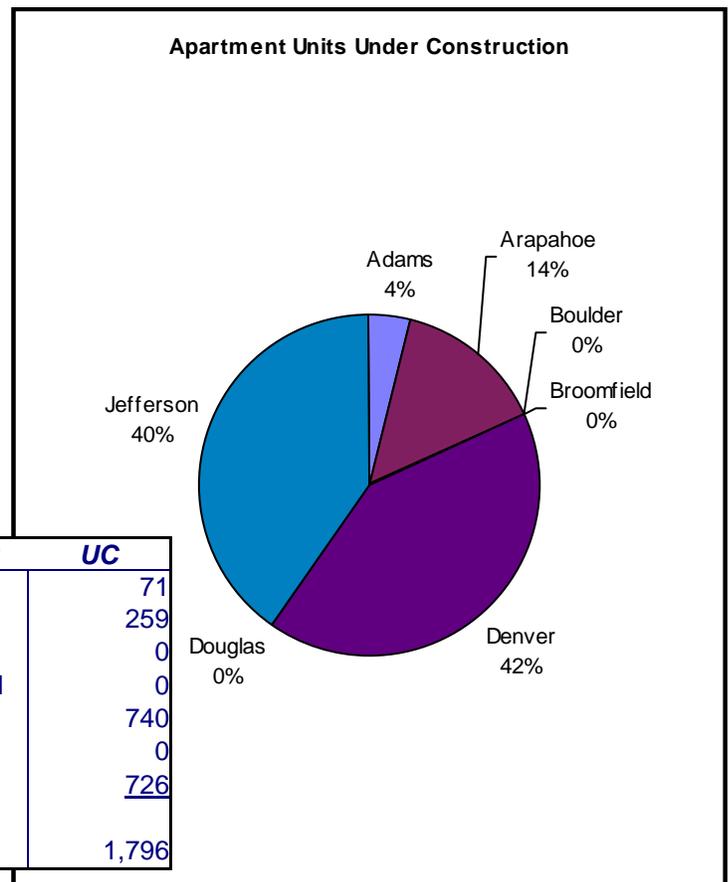
## Apartment Development Activity In Metro Denver

Rising interest rates have helped contribute to the stabilization of the apartment market. Much of the poor net absorption for apartments in Denver in the past was attributed to residents buying houses, townhouses and condominiums. Historically, investors bought new apartment communities and converted them to condominiums. This trend is slowing as the traditional new and resale condominium and townhome markets are becoming saturated. This trend has not created a large impact on the market. As the surplus of condominium and townhome units are absorbed developers might once again consider conversion a feasible option and possibly help eliminate some of the excess of rental units should more conversions occur, especially in well-constructed communities near major employment centers.

The stabilization of the market is also evident in the essentially level average rental rates. The 2006 average rental rate of \$850 is relatively unchanged from \$848 in 2005. The average rental rate increased from \$822 in 2004 following stagnant rates in 2002 and 2003. The quoted rental rates do not take into consideration the value of specials and concessions being offered by many apartment communities. The median rental rate is also stable at \$806 in 2005 and \$804 in 2006. The average rental rate should once again increase as the vacancy rate remains flat allowing for rents to increase.

The average rental rates quoted in the Apartment Association report may be somewhat inflated due to the periodic addition of new communities upon their completion, most of which have rental rates above the metro average. Unaccounted in these averages is the increasing effect of special deals, reduced or eliminated security deposits and other concessions meant to retain or attract residents. Rental rates are usually quoted with water and sewer costs included but with the tenant paying for electricity and natural gas. Effective rental rates are lower due to incentives such as free rent.

As of January 1, 2007, a total of 1,796 units were under construction in metro Denver including Dry Creek Village with 227 units which began construction during the quarter and 4,886 units were proposed. The amount of new construction was led by Denver County at 740 units, followed by Jefferson County with 726 and Arapahoe County at 259. The following charts and tables show apartment units, by county, under construction and proposed (most likely to start during early 2007) as of January 1, 2007.

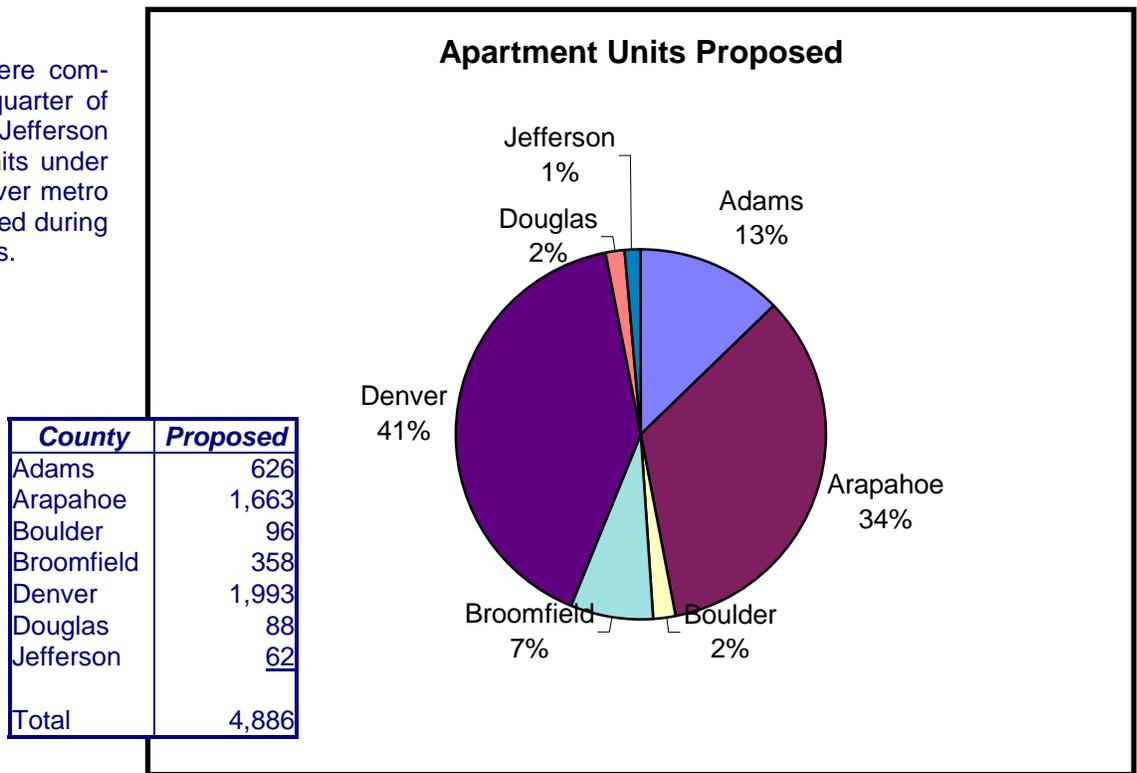


## Apartment Development Activity In Metro Denver (continued)

Even if the economy were to suddenly recover and once again generate strong demand for apartments, the amount of units currently vacant, plus those coming on stream this year, will probably cause the Denver apartment market to experience moderately high vacancy rates for at least another 12 months. With a strong economic recovery not likely to occur until at least mid to late 2007, the softness in the Denver apartment market could remain into 2008. Differences will occur, of course, by submarket and product type; even in a soft market opportunities will exist for the savvy developer.

Addenda following this report list apartment communities that were under construction or proposed in metro Denver as of January 1, 2007. In addition, tables are provided to show which apartment communities had units completed or started during the 4th quarter of 2006.

300 apartment units were completed during the 4th quarter of 2006 in Denver and Jefferson counties, with 1,796 units under construction in the Denver metro area. The number started during this period was 322 units.



## Apartment Sales During 4th Quarter 2006

According to CoStar, investors bought 12 apartment communities in metro Denver with 50 or more units during the 4th quarter of 2006 for a total dollar volume over \$343.6 million with an average sale price per unit of \$107,346. The largest sale during the 4th quarter was the Boulevard Apartments in Denver with a sale price of \$75,500,000 for 290 units equivalent to \$260,345 per unit. Parc Belmar, a recently renovated apartment community with 512 units sold for \$73,150,000 equivalent to \$142,871 per unit. Denver again topped the market with sales over \$120.1 million. Arapahoe county was second with slightly more than \$91.0 million in sales and Jefferson county was third with sales over for \$76.8 million.

## Apartment Sales During 4th Quarter 2006 (continued)

According to Marcus and Millichap, out of state buyers have accounted for 71% of the apartment sales volume. Investors are looking to take on properties that are under-performing with strong upside potential. The Aurora Central market is an area with a large amount of under-performing properties demonstrated by historic high vacancy rates compared to other segments. This segment is expected to benefit from the large Fitzsimons redevelopment currently nearing completion. Benefits to this sector include new jobs with the completion of Children's Hospital, University of Colorado Hospital and supporting medical offices. As workers relocate from the areas around the existing hospitals, they will look for housing closer to the new facilities increasing demand for rental units in the area.

During the first three quarters of 2006, a total of 57 communities were purchased for a total dollar volume over \$1,221.7 million with an average sale price per unit of \$80,178. Denver topped the market with sales over \$611.2 million followed by Arapahoe county with \$232.2 million and Jefferson county is third with sales over \$62.5 million.

In 2005, 52 apartment communities with 50 units or more sold in the Denver metro area totaling \$1,250.6 million with an average sale price per unit of \$80,183. The highest sale prices and per unit prices were recorded in Adams, Broomfield, Denver and Douglas counties.

It is anticipated that investment in apartments in the metro area will continue into 2007 as the annual vacancy rate of 7.0% is at a five year low and annual absorption of 8,126 units in 2005 was the highest recorded. Rental rates will gradually increase with fewer concessions offered to fill vacant units.

During 2004 there were 66 communities sold totaling over \$512.2 million. Jefferson County led the way followed by Adams, Douglas and Denver counties. The average sale price per unit was \$73,560

For all of 2003, investors had acquired 349 apartment properties for a total cost of \$986.9 million. Arapahoe County led the way followed by Denver and Jefferson Counties. The average sale price per unit was \$77,639.

Information about sales and conversions is obtained from published sources, including Comps.com, RealComps, CoStar and from buyers, sellers, or converters and should be verified for accuracy.

## Forecast 2007

Overall, the apartment market will continue to stabilize through 2007 with reduced but growing construction activity, job growth, and population in-migration levels slowly returning to pre-recession levels. The overall vacancy rate is at a level not experienced since 2000 and rental rates have remained flat but are expected to increase slightly into 2007. There is a large amount of new construction currently underway and developers indicate commencing on several additional communities before mid-year 2007. Although decreasing median home prices indicate possible over building, the increasing mortgage rates will add increased pressure to the single family home market aiding in stabilization of the apartment market. Also, the increase in foreclosure rates will aid in increasing demand for apartment units. Construction costs have begun to decrease might cause some developers to start construction.

Over the long term Denver is an excellent market for apartment investment and development. Out of state investors continue to look at Denver as an investment opportunity continuing to spur the sales market. However, the current market conditions will remain soft well into 2007, putting pressure on rental rates. Increasing home mortgage interest rates for sale of new condominium and townhouse communities and the continued but slower conversion of some apartments to condominiums continue to reduce additional competition for apartment residents.

## Methodology

Information provided in this report is obtained from published sources such as the Colorado Department of Labor and Employment, CoStar.com, RealComps, and the Apartment Vacancy and Rental Survey, which is conducted for the Apartment Association of Metro Denver by University of Denver professor Dr. Gordon Von Stroh. James Real Estate Services, Inc. also conducts independent research, including public records, conversations with planning and permitting officials of the various cities and counties in the metropolitan area, developers, and regular visits to development sites.

James Real Estate Services, Inc. makes every attempt to ensure accuracy but information cannot be guaranteed. Comments, suggestions and any corrections should be directed to Bill James, editor of the Apartment Perspective, at 303/316-6768 or [bjames@jres.com](mailto:bjames@jres.com).

## Addenda

The following lists include:

Apartment communities:

- Started during the 4th quarter of 2006.
- Completed during the 4th quarter of 2006.
- Under construction as of January 1, 2007.
- Proposed and most likely to start construction during 2007.

### Apartment Communities Started—4th Quarter 2006

NAME	STREET	SUBMARKET	COUNTY	UNITS	DEVELOPER
Burgwyn - Malik Project	420 West 12th Avenue	Denver Central	Denver	63	Burgwyn & Company
Dry Creek Village	SEC Dry Creek & Inverness	Englewood	Arapahoe	227	Fairfield Residential
Village @ Aurora City Center	NWC E. Exposition Ave/S. Fraser St. Aurora		Arapahoe	32	Northstar Development
			Total	322	

### Apartment Communities Completed — 4th Quarter 2006

NAME	STREET	SUBMARKET	COUNTY	UNITS	DEVELOPER
Benedict Park Place	240 23rd Street	Denver Central	Denver	124	Denver Housing Authority
The District at Southmoor	6300 East Hampden Avenue	Denver South	Denver	20	Pacific Properties LLC
Prentice Place Lofts	SWC Prentice Way & Valentia Way	Greenwood Village	Arapahoe	104	MBR Company
Retreat @ the Park	16th Avenue & Fillmore	Denver Central	Denver	52	Allied Realty Services
			Total	300	

## Apartment Communities Under Construction—4th Quarter 2006

NAME	STREET	SUBMARKET	COUNTY	UNITS	DEVELOPER
816 Acoma	816 Acoma Street	Denver Central	Denver	220	Hanover Company
Alexan @ Belmar (Blk 11)	Center Avenue & Saulsbury Street	Lakewood	Jefferson	307	Trammell Crow Residential
Botanica on the Green	7600 East 29th Avenue	Denver East	Denver	154	Forest City
Florence Square II	Emporia St N of Colfax Avenue	Aurora	Adams	71	Medici Communities
Senior Residences @ Creekside	17th Avenue & Pierce Street	Lakewood	Jefferson	119	Lakewood Housing Authority
Tevara	NEC Jackson St/E. Dakota Ave	Denver East	Denver	240	Fairfield Residential
Water Tower Village	Olde Wadsworth Blvd N. of 54th Ave	Arvada	Jefferson	300	Carmel Partners
Wolff Street	1551 Wolff Street	Denver Central	Denver	63	Parikh Stevens Architects
			Total	1,474	

## Apartment Communities Proposed

NAME	STREET	SUBMARKET	COUNTY	UNITS	DEVELOPER
1800 Market Street	NEC 18th Avenue/Market Street	Denver Central	Denver	318	Corum R.E. Group
Alexan @ Arista	SWC Wadsworth Blvd & Highway 36	Westminster	Broomfield	358	Trammell Crow Residential
Aurora Town Center	4th Avenue & Sable Boulevard	Aurora	Arapahoe	288	Embry Partners
Belmar Apts (Blk 7)	NWC W. Virginia Ave & S. Saulsbury	Lakewood	Jefferson	62	Continuum Partners
Bridlewood @ Saddle Rock	NWC 470 & Arapahoe Road	Aurora	Arapahoe	263	Embry Partners
Broadstone @ Ball Park Lofts	2101 Market Street	Denver Central	Denver	226	Alliance Residential
Broadstone @ Southlands	NEC Smoky Hill & Aurora Prkwy	Aurora	Arapahoe	340	Alliance Residential
Broadstone @ Thornton	SEC 104th Avenue & Marion Street	Thornton	Adams	386	Alliance Residential
Brownstones @ Inverness	Drycreek Road @ Inverness	Englewood	Arapahoe	309	Embry Partners
Clay Street Residences	SWC 28th Avenue & Clay Street	Denver Central	Denver	55	Burgwyn & Company
Colorado Commons	NWC 16th Avenue & Colorado Blvd	Denver Central	Denver	112	Trademark Communities
Englewood Senior Apartments	3578 South Pennsylvania Street	Englewood	Arapahoe	62	Englewood Housing Authority
Fairfield DTC III	NWC I-25 & Bellview Avenue	Denver South	Denver	398	Fairfield Residential
Fairfield DTC IV East	NWC I-25 & Bellview Avenue	Denver South	Denver	240	Fairfield Residential
Grandview Meadows Ph. 3	620 Grandview Meadows Drive	Longmont	Boulder	96	M. Timm Development
Lincoln Pointe Lofts @ Meridian Ph. 2	Mount Pyramid Ct & Meridian	Arphe Cnty SE	Douglas	88	Grand Peaks Property Mngmt
Park Ave Hope VI Ph 3	EC Park Ave West & Tremont	Denver Central	Denver	93	Denver Housing Authority
Platte River Lofts @ Sheridan	SEC S. Platte River Drive/Hampden	Sheridan	Arapahoe	318	Embry Partners
Renaissance @ River Front	SEC Park Ave West/Globeville Road	Denver Central	Denver	101	Colorado Collation for Hmlss
Reserve @ Gates	NWC Broadway & Mississippi Ave	Denver South	Denver	450	Trammell Crow Residential
Square @ Fitzsimons I	NEC & NWCs E. 22nd Ave & Ursula	Aurora	Adams	240	Pauls Company
Village @ Aurora City Center	NWC Exposition Avenue & S Fraser	Aurora	Arapahoe	83	Northstar Development
				Total	4,886