October 31, 2016

The Big Shift: Apartment Vacancy Rates in Boulder County Rising

The tide might be turning in Boulder's crazy rental market, as vacancy rates hit highs not seen since the Great Recession and property managers say apartments are sitting empty through several price drops. Boulder's vacancy rate (not including the university area) rose to 7.2 percent in the past three months in the city, according to the Apartment Association of Metro Denver (AAMD.) The last time it was that high was 2009. In fact it's only been over 7 percent twice in the past decade: third quarter '09 and today. Vacancy rates have been trending up all year, and rents dipped slightly in early 2016. But they rebounded to new and historic heights in the following months, and landlords reported no trouble filling high-priced units. Now, though, the picture appears to have changed. "We've started noticing properties sitting longer than usual, and actually needing some lower rental rates in order to attract tenants," said Simon Heart, owner of All County Boulder Property Management. "We target to lease properties within 30 days, but within the last month or two, there are properties that have been sitting for 30-60 days that we've had to lower the rent several times" to fill. Heart said it's "hard to tell" if the situation is indicative of a larger trend or more short-term, since vacancies always rise in the fall. While that's true, third-quarter vacancy rates have been in the three percent range historically for Boulder, according to Christopher Dean with the AAMD. Dean said the rising rates are likely due to the addition of new apartments to the city's housing stock. Boulder added 635 apartments last year, according to data from the city's division of housing. Vacancy rates of 6-7 percent (where Boulder has been all year) are considered to be indicative of a balance in supply and demand. How many more units would have to be added to start driving down rents is unclear. The data is encouraging: Rents have fallen 8 percent since the beginning of the year, from $1,799 to $1,649 on average. But a recent report from the Wall Street Journal found that major cities struggling with affordability — San Francisco and New York among them — would have to construct more new units than during the 2000-2010 national building boom to make a real dent in prices, due to the overwhelming demand. In Boulder, new units have been absorbed rapidly. In early 2014, for instance, the addition of 3,085 units the previous year pushed the vacancy rate to a temporary 22 percent. But the next quarter, the rate was back down to a more typical 4.2 percent. Other parts of the county are even farther away from a balanced market. Boulder County (which includes everything but Boulder and Longmont) has a 5 percent vacancy and a $1,572 average rent. Longmont is at 4.4 percent vacancy, with rent averaging $1,285. The 12-month average vacancy rate in the county is the highest its ever been, reflecting a surfeit of new development. Longmont, too, has a 12-month average (4.6 percent) not seen since 2010, though property managers there say the market remains brisk. "None of my clients have had more than a couple-day vacancy," said Chrissy Smiley, who owns rental agency Smiley & Associates. Of 50 units, she has no current openings. But, like others in her industry, she did note having a "harder time" renting properties that, in the past few years, would have been snapped up immediately. "I just feel there is some kind of sea change happening with the rental market," she said. "Part of it is that rents are going up and people's incomes aren't going up at the same rate. "I get this sense that's something's about to flip." **(Daily Camera)**

2.5%: The Average Vacancy Rate in Higher-Quality Retail Centers

The vacancy rate for higher-quality retail centers was just 2.5 percent in the third quarter of 2016, according to real estate management firm Heitman. "Occupancies at 'A'-quality centers are at or near all-time highs, and market rents in such centers are increasing despite lackluster retail sales growth. A historic lack of new supply growth remains a key driver of retail fundamentals," says Andrew McCulloch, managing director of real estate analytics for Green Street Advisors. "Additionally, the healthiest retailers continue to seek out strong locations to establish brand recognition and awareness and are therefore migrating to the better centers. Because of their omni-channel strategies, retailers at 'A' centers are increasingly willing to pay rents not necessarily justified by sales out of the physical location. "A sea change is occurring in consumer behavior, and e-commerce will continue to capture market share from physical retail," says McCulloch. "E-commerce consumes about 20 percent of retail sales for malls and 10 percent for strip centers. The e-commerce drag on mall sales growth could be as much as 300 basis points annually in the coming years, which could essentially wipe out sale growth. Strip centers, on the other hand, are a little more protected as they have less exposure to threatened retail concepts and more tenants that are service providers," he says. "You can't buy a haircut online—not yet, at least. "Better-quality retail outlets are adapting to the changing environment and should be fine, but lower-quality centers have been struggling and will continue to face increasing headwinds," McCulloch says. "Operating fundamentals continue to bifurcate between the haves and have-nots. "Tenant bankruptcies and closures of both individual stores and anchor stores have been a dominant concern for retail property owners, but for the best centers. the current levels are not overly problematic. Some landlords at better-quality retail outlets will even pay to get prime space back from a struggling tenant because oftentimes getting space back allows landlords to bring below-market rents to market. "This divergence in property fundamentals between high-quality and low-quality centers is especially evident when looking at changes in asset values. For example, Green Street's Commercial Property Price Index for high-productivity malls is about 50 percent above its prior peak, whereas values for low-productivity malls are not much different than their prior peak," says McCulloch. "The operating environment for retail properties is far from uniform." **(ULI)**

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Making Real Estate 'Future Ready'

The future of commercial real estate is bound up with its adoption of technology on a macro scale, i.e. fitting in with the "smart city" concept now on the radar of urban policy makers, Deloitte says in a new report. Urban planners are responding to the "significant demographic shifts" underway, as well as the issues of "security, climate change and resource scarcity concerns" that are pressuring government budgets and the physical infrastructure. "Naturally, the built environment plays a pivotal role and is an integral part of urban planning," according to Deloitte's report, titled "Innovations in Commercial Real Estate: Preparing for the City of the Future." Given the forwarding-looking focus, the report says, "the question you need to ask yourself is: as developers and owners of the built environment, are your buildings future ready? Are you deploying technology innovatively and effectively to prepare and respond to the rapidly changing ecosystem?" Deloitte's report notes that many commercial property owners might view "cities of the future" as a concept too far ahead on the horizon to make an impact on existing building stock. However, the report quotes Rupert Murdoch as one illustration of its theme that the time to prepare for the future is now: "The world is changing very fast. Big will not beat small anymore. It will be the fast beating the slow." The report cites five key trends that CRE owners should incorporate into their business strategies. They include:

Future of Mobility. Self-driving cars are poised to transform the entire mobility ecosystem, the report says. For CRE, the implications extend to both use and supply-and-demand dynamics, reducing the need for large parking structures in CBDs and freeing up space for additional retail and entertainment uses. For example, "sidewalks will likely be freer as the new mobility options would reduce curbside parking, and street widths could be reduced based on more efficient management of auto traffic," the report states. "As a result, CRE owners will have access to large tracts of space in prime areas that can be put to use in different ways—space that commands very high prices."

3D Printing. The most immediate relevance, in Deloitte's view, is to engineering and construction firms, with 3D printing set to reduce construction costs, drive operational efficiency and enhance construction quality. However, the implications are more far reaching: 3D technology may result in more on-demand production and delivery, thereby reducing the need to hold inventory in large warehouses or retail stores.

Occupant Health and Wellness. "Millennials, now the largest cohort of the US population and labor force, have a particular lifestyle pattern, as the 'live/work/play' mantra holds center stage for them," according to Deloitte's report. This pattern is now extending into the workplace, as Millennials place significant importance to well-being at the job site. Accordingly, the report notes that while CRE players to date have focused mainly on sustainability initiatives relating to resource conservation, "companies will now take their efforts to the next level by considering occupant health and wellness, with equal emphasis on mental, social and physical within the built environment." The reasons for owners to pay attention are numerous, according to Deloitte's report, not least of which is the impact on pricing. "Health and wellness features may impact CRE prices, especially for class A properties, as sustainability measures such as energy conservation have now become a norm," the report states. "There is the potential for an erosion of value for those buildings that do not offer the appropriate conditions for occupiers/users to be healthy and productive."

Internet of Things. An IoT building management system offers higher-order management systems compared to existing automation efforts, potentially allowing landlords to improve margins through costs savings and operational efficiency, according to Deloitte. Industrial CRE owners can likewise use IoT to enable faster and more accurate shipments using robots and sensor tracking.

Demographic Data and Predicative Analytics. Data captured through internet, satellites and sensors has brought new levels of nuance to demographic profiles, and CRE owners can benefit from the use of predictive analytics tools to predict future valuations and potential redevelopment needs for existing properties. "For instance, it will be useful for companies to know the unique and detailed future demographic profile of a region in which they are either present or plan to invest in the future," the report states. "Once companies get an idea of the needs and preferences of the prospective inhabitants of a region, they can potentially assess whether the existing CRE infrastructure will align with the requirements of those inhabitants." **(GlobeSt.com)**

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Commercial Real Estate Money Going to the 'Burbs

Since the end of the recession, many of Denver's highest-profile pieces of commercial real estate, including offices, hotels and apartment complexes, most of which are located in the central business district, have traded hands as investors sought to enter the market. As the expansion of Denver's economy goes on, however, suburban properties are becoming more likely purchases for investors. Eighty percent of the office inventory in downtown Denver has traded hands one or more times in the last 10 years, said Mike Winn, vice chairman of capital markets at CBRE Group Inc. Immediately after the recession, investors were only investing in the very top-tier markets, Winn said, but as they became more confident, they started investing in smaller markets like Denver. Downtown was the safest place to put money. "But most of the core investment deals are already done," Winn said. "There's not a lot of value-add opportunity. That's why most of the money that is downtown now has gone into development. Other dollars have moved to the suburbs." Equity funds and other investors with capital to place still see Denver as a healthy market and a low-risk place to spend money, Winn said. They're also counting on the economy here experiencing more job growth and appreciate the fact that the office market hasn't been decimated by the oil and gas downturn, although there are some vacancies in the central business district stemming from consolidations among oil and gas companies. The downtown office market has enough other office uses that it hasn't suffered the same kind of high vacancy rates as cities such as Houston, but the Denver suburbs are even more insulated by tenant diversity. Downtown, Winn said, about 5 million square feet of office space is oil and gas related, while in the suburbs, only 500,000 square feet are occupied by such tenants. From 2012 to 2016, energy companies accounted for 28 percent of new leasing activity downtown, according to CBRE data, but only accounted for 3 percent of new leasing activity in the suburbs. Overall, the suburbs are home to more tenant diversity than downtown, with sectors like bioscience and aerospace taking up small slices of office space in addition to more common uses such as business services and government. However, suburban investments aren't for everyone, Winn said. Some funds have minimum deal sizes and many suburban properties aren't priced high enough to meet those minimums. Pricey assets can be found in the suburbs, although they're more rare than downtown. In 2016, for example, two nine-figure office deals closed. First, the CoBank building sold to a South Korean investor for $113 million in January, and in September the headquarters of engineering firm CH2M sold for $122 million. In the hotel market, deals of such size are still limited to downtown, although the recent sale of the Hyatt Regency Denver Tech Center came close, clocking in a $96 million, paid by Columbia Sussex Corp. "Downtown is still the preferred market for private equity," said Mike Cahill, CEO and founder of Greenwood Village-based Hospitality Real Estate Counselors (HREC). "But Denver as a whole keeps getting better. The trajectory keeps going up. People realize Denver's recovery is real." The 2015 sale of the Embassy Suites Denver Downtown Convention Center for $170 million set a new record of $421,000 per key, and suburban properties have a long way to go before they reach that level. The Hyatt DTC went for $212,000 per key. "Hotels are subject to idiosyncrasies that other properties are not," Cahill said. Namely, hotels downtown benefit from the fact that the area is a tourist destination that attracts festivals and conventions that keep people in the rooms 24 hours a day, seven days a week, while suburban hotels, particularly in the DTC, do well during the week with business travelers, but don't have the same weekend business. The fact is, according to Cahill, downtown hotels simply make more money per-room than suburban ones, making them more attractive - and higher-priced - opportunities for many investors. Apartment investment sales have been the most prolific in metro Denver in recent years, bringing in about $4.4 billion in sales volume in 2015 and produced record-breaking deals, particularly in the suburbs and on the outskirts of Denver, said Terrance Hunt, vice chairman at ARA, A Newmark Company. Most recently, The Breakers Resort, which is located in Denver but very near Aurora, sold for $350 million, leaving behind previous record-holder. Horizons at Rock Creek in Superior, which sold for $255 million in 2015. The biggest difference between the suburban and downtown markets for apartments, Hunt said, is that downtown has a much larger quantity of new apartments than the suburbs. That means that investors seeking "value-add" properties, or those that need improvements that will increase cash flow in the future, are more likely to look in the suburbs. **(Denver Business Journal)**

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Denver Falls out of Urban Land Institute's Top 10 Markets to Watch

Denver has fallen out of the nation's top 10 markets on a prestigious list of U.S. "markets to watch." The Urban Land Institute's annual list of 'markets to watch' for real estate trends sees Denver at No. 11 this year, down five spots from a year earlier. Austin, Texas was ranked No. 1 on the annual list, which ranks U.S. cities for best overall real estate investment and development opportunities. Dallas was No. 2, followed by Portland, Seattle and Los Angeles. "Denver has seen particularly strong growth in the leisure and hospitality, construction, and professional and business services sectors," this year's report read, adding that "Denver has not been able to completely escape the downturn in the energy-related business services sector." The 38th "Emerging Trends in Real Estate" was conducted jointly by the Urban Land Institute and PwC, and surveyed more than 1,500 professionals in the real estate business. **(Denver Business Journal)**

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED TARGET RATE	.50	.50	.25
3 MONTH LIBOR	.89	.85	.32
PRIME RATE	3.50	3.50	3.25
10 YEAR TREASURY	1.86	1.59	2.15
30 YEAR TREASURY	2.62	2.31	2.95