May 23, 2016

$154 Million Deal is a Sign Owners Hold the Cards in Union Station Property Sales

The May 3 sale of the Elan Union Station apartment complex for $154 million is an indicator of the institutional sales potential of the area surrounding Denver Union Station, industry experts say -- if owners are willing to let go of the prime real estate they've built there. It's not the first building stemming from the flurry of development around the restored historic train depot to sell, but it is a meaningful gauge of what a completed, stabilized apartment project in the area can get in terms of sales price, said Matt Barnett, first vice president with the multifamily investment properties team at CBRE Group Inc.'s Denver office. Cadence Union Station, a 13-story, 219-unit apartment complex developed by Denver's Zocalo Community Development Inc., was the first property in the area to trade, selling when it was just 20 percent leased in 2014 for $70 million. Later in the year, Verve, another apartment complex, was sold for $94 million, according to public records, also before it was leased. Both properties were purchased by entities associated with Dallas-based Invesco Real Estate. Elan Union Station was the area's first stabilized apartment property -- meaning it was leased up beyond the initial leasing period after a building is completed, usually considered a risk-mitigating factor for buyers -- to trade hands since the redevelopment of the Union Station area began. And it was a meaningful sale for Denver, Barnett said. "It was a very good sale for the market," he said. "It helped gauge what a stabilized asset in the Central Platte Valley can get." In addition to the apartment portion of Elan Union Station being stabilized, the property has one other very attractive asset in its ground floor: King Soopers, Barnett said. King Soopers parent Kroger Co. (NYSE: KR) is the kind of long-term, high-credit retail tenant that investors like, Barnett said. Having the ground-floor grocer in place ensures a steady stream of baseline cash flow into the property regardless of what the apartment rental market is doing. California-based American Realty Advisors picked up Elan Union Station from its developer, a partnership between Greystar and Goldman Sachs, in a quiet deal earlier this month. No details were released about the sale, but public records confirmed the $154 million sales price. And more buyers are likely to come, Barnett said. "What you have there is one of the more unique investment opportunities in the U.S. because the redevelopment is happening in the center of Denver," he said. "Over the next three to five years, demand is going to continue." There are plenty of desirable properties already complete near Union Station, but some development, including about 5,000 apartment units, is still underway. And as more projects are completed, the area will only get more attractive to buyers with lots of capital to place. But it takes two to make a real estate sale, and sellers might not be so willing to come to the table. The kinds of properties in the Union Station and Central Platte Valley areas check a lot of the same boxes as coastal assets and are scarce in Denver, said Jeff Haag of HFF, which represented the seller in the Elan Union Station sale. That scarcity will drive investor demand, but not all owners in the area will have the appetite to sell. "There will be tremendous investor demand, and that demand might drive some sales, but for some the intent is to hold," he said. Barnett agreed, adding that especially in the current rental climate in Denver, owners might choose to enjoy the cash flow rather than sell. In the metro area, average rents are up 9 percent year-over-year and the average rental rate for an apartment downtown is nearing $1,700 per month, according to the Apartment Association of Metro Denver. "On the seller side, the majority are leaving their options open," Barnett said. The story is similar for office properties located near Union Station, said Mike Winn, vice chairman of institutional properties at CBRE. The north-wing building at Union Station, located at 1705 17th St., sold in 2014 for $68 million, a relatively modest overall amount for a downtown office building, but the price broke records in terms of per-square-foot price at $600. Similar to the way the Elan Union Station sale sets a benchmark for the multifamily market, the sale of the wing buildings indicated what kind of capital the right asset can attract, said Jason Schmidt, executive vice president at Jones Lang Lasalle. The north-wing building and the south-wing building at 1625 17th St. were both acquired by GLL Properties, a subsidiary of Munich, Germany-based GLL Real Estate Partners Gmbh. Now, potential buyers that want to grab up something equally well-placed might be looking to buy other office assets in the area, Winn said, but again, the sellers may not line up to let go of their prize properties. "No developers of current projects have made overtures toward selling," Winn said. "They're working on leasing up." Basically, reasons why buyers want to keep the properties are the same reasons why owners want to hold them, said Patrick Devereaux, also executive vice president at JLL. But sell or hold, one thing is certain: Those that did the developing near Union Station are going to reap rewards. "Developers are in a very desirable position," Winn said. "Either they can collect the cash flow or sell for a good profit." **(Denver Business Journal)**

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Is the CRE Lending Environment Improving?

Off to a wobbly start in 2016, the lending landscape for commercial real estate is expected to bolster as the year progresses. Yet investors and lenders remain uncertain about the extent of improvement, as the industry faces looming loan maturities and regulatory measures. The CMBS market has been on shaky ground recently, as concerns about the stock market, China and the global economy dampened lender and investor confidence. “In the first two and a half months of this year, CMBS was virtually broken,” says Michael Riccio, senior managing director in the capital markets group of real estate services firm CBRE. In May, CMBS delinquencies rose for the first time in 10 months, to 2.92 percent, from 2.90 percent in April, according to Fitch Ratings. (The firm expects delinquencies to remain below 3.0 percent this year.) According to a recently released report by New York City-based research firm Real Capital Analytics (RCA), “Into the second half of 2015, the price of commercial real estate debt increased in line with turmoil in the corporate bond markets. RCA calculates that the average interest rate on commercial property loans (office, industrial, retail and hotel) came in at 4.4 percent in June 2015. By January 2016, this figure had increased to 5.0 percent.” Late March brought some stabilization, with spreads recovering, at least partially. “Sixty to ninety days ago CMBS was all but dead, spreads widened out and borrowers were being re-traded on most deals,” says Gerard T. Sansosti, executive managing director at financial intermediary firm HFF. “AAA-rated CMBS bonds widened out to 173 basis points, with BBBs widening to over 850 basis points. This was the bottom of the market. Since that time (in the last 30-45 days), pricing has come in significantly. The latest securitization priced at 117 for AAAs and BBBs were in the 625-725-basis-point range.” In the interim, alternative sources of funding have risen to the occasion to fill the demand gap—and they don’t plan on going away any time soon. One example of this is EB-5 funding. "For new construction and/or rehab projects in the Midwest and other locations, many borrowers are utilizing alternative sources of debt and equity, such as historic tax credits, new market tax credits and EB-5 funding," says Jim Doyle, senior vice president at Bellweather Enterprise, a commercial and multifamily mortgage banking company. Bank and life insurance companies have also positioned themselves to gain market share should CMBS issuance not return in a significant way. "During the market volatility [in the first quarter], a number of our borrowers avoided the CMBS market and went with debt funds or bank financing, even if it required some level of recourse. They were willing to put in more equity or take on recourse to avoid a CMBS execution," Sansosti says. For their part, banks are becoming increasingly more comfortable with longer loan terms, now going up to 10 years, and funding higher leverage deals if recourse is on the table. They are also increasingly funding new construction loans. In its April 2016 Lender Forum report, CBRE notes that life insurance companies are competing with CMBS lenders by structuring loans at 75 percent loan to value ratios (LTV) for higher mortgage rates. "Life companies want to be at 60-65 percent LTV or below and are pricing deals below 200 basis points," says Sansosti. "CMBS lenders are really only competing with life companies on higher leverage transactions (65 percent-plus LTV) and larger single asset deals ($200 million-plus loan size). With the recent tightening in the market, we have begun to see CMBS lenders competing with life companies on some of the lower LTV opportunities (i.e. 50-60 percent LTV)." "Life companies continue to be aggressive this year after a record year in 2015," he adds. Insurance lenders accounted for 13.0 percent of all lending across commercial property types in 2015, according to data from the Mortgage Bankers Association (MBA), an industry trade group. Banks held the most market share last year, accounting for 41 percent of all lending, while CMBS lenders accounted for 16 percent of the market, down from 27 percent in 2014. That downward trend continues in 2016. Owners and developers who can avoid using the CMBS market right now are doing so, with Simon Property Group being a prime example. Should CMBS not perform up to par, the REITs are quite comfortable going to life insurance companies, according to Steven Marks, managing director for corporate finance and REITs with Fitch Ratings. "REITs generally endeavor to have as many different sources of capital as possible, such as unsecured debt, bank capital, preferred stock, joint ventures, asset sales, and even through the secured market if they really need it," Marks says. This year brought an increase in assets sales, for example, to raise equity across several REITs, he adds. Looking ahead through 2017, industry insiders are generally optimistic, pointing to solid property fundamentals, a stable market and good discipline from lenders. "Lenders are comfortable, but thinking about where we are in the cycle," Riccio says. With the wave of loan maturities coming due this year, it will take about 18 months to clear loans made in 2006 and 2007, industry sources say. The market will also have to adjust to Basel III bank reserve requirements and the Dodd Frank risk retention framework that are scheduled to take effect later this year. "When they figure out what they will do about risk retention, then CMBS spreads should stabilize, and that engine will pick up again," Doyle says. **(National Real Estate Investor/Diana Bell)**

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Oil and Gas Woes Finally Catching up to Denver Office Market

After more than a year of low oil and gas prices and bankruptcy and merger news for energy companies, Denver office real estate is finally feeling the effects of the energy market's suffering. In the first quarter of 2016, the office market had negative absorption of 349,535 square feet, according to the latest data from commercial real estate firm Jones Lang LaSalle. Absorption rates refer to the net amount of space that was either taken off or put on the market in a given time period. Trouble in the oil and gas sector was a big part of the negative absorption, said Mandy Seyfried, senior research analyst at JLL, particularly in the central business district, where many oil and gas companies have regional offices or corporate headquarters. Subleasing activity and diversity of office tenants has helped keep Denver office space filled even as energy companies with a presence here have laid off thousands of workers in Colorado, sold assets, filed for bankruptcy and merged with stronger companies. But some big leases were vacated in the first quarter, Seyfried said, contributing to the overall negative vacancy. In particular, Newfield Energy and WPX Energy's leases in 1001 17th St. resulted in 240,000 square feet going back to the market. Outside of energy issues, CoBank's move also contributed to the negative absorption in the office market. CoBank relocated to a new build-to-suit office space in December, simultaneously vacating 225,000 square feet at its old headquarters at 5500 S. Quebec St. that hit the market in the first quarter. But in spite of the newly empty space on the market, both lease rates and vacancy rates for office space remained steady in the first quarter, according to JLL's data. Average asking rent in metro Denver in the first quarter was $26.19 per square foot, up slightly from $25.95 in 2015, and the vacancy rate metro-wide was 13.7 percent in first-quarter, down just slightly from 13.8 percent in first-quarter 2015. And with several office relocations and expansions in the works, expectations are that absorption rates for office space will be back in the black later in 2016, said TJ Jaroszewski, research manager for Denver and Salt Lake City at JLL. There's also plenty of office construction in the works in the metro area, Jaroszewski said. Nearly 2.7 million square feet of office are under construction in metro Denver, and more is scheduled to break ground this year, which will create a dynamic in the office segment that hasn't been seen in a long time. From the beginning of 2016 to the end of 2018, there is more office real estate in the works than in any three-year period since the mid-1980s, Jaroszewski said. Vacancies and lease rates in the retail segment also remained steady, according to Newmark Grubb Knight Frank. The retail vacancy rate in the first quarter was 6.1 percent, about flat from the same period in 2015, and the lowest in memory for Justin Kliewer, managing director at NGKF. Median rents were about $21 per square foot. Low vacancy in retail is especially apparent in Class A space, which is in high demand among regional and national retailers looking to locate or expand in metro Denver, Kliewer said. That demand may start to drive more speculative development this year. Even with low vacancies sticking around through the first part of the year, retailers absorbed 181,447 square feet of space in the first-quarter, according to NGKF's report, with six of the submarkets studied by the company's research team posting positive absorption and four, including the central business district and Cherry Creek, staying flat. Cherry Creek and downtown Denver are still among the best places to be a retail landlord, with some spaces able to bring in rents of $60 to $70 per square foot in those areas, Kliewer said. But one looming factor in the retail market has yet to be resolved. The bankruptcy of Englewood-based retailer Sports Authority has already closed three stores in metro Denver, and could ultimately mean more vacant retail space hitting the market, depending on how the company's liquidation plays out. Sports Authority has 16 stores around the metro area, Kliewer said, and the fate of those stores remains to be seen. Industrial real estate in metro Denver posted another strong quarter, continuing its long streak of increased rents and low vacancy. Rents increased 11 percent year-over-year to $7.98 per square foot in the first quarter, up from $7.18, according to a report from Colliers International. More than 120,000 square feet of new industrial space was delivered to the market in the first quarter, the result of developers seeking to meet the high levels of demand for warehouses and manufacturing space. The new space was quickly taken up, with the vacancy rate increasing nominally from 4 percent a year ago to 4.1 percent in the first quarter of 2016. First-quarter deliveries were also just a drop in the bucket for new industrial construction in Denver. More than 4.8 million square feet are currently under construction in the metro area, according to Colliers. That level of new construction in the pipeline could drive up vacancy rates later in the year. Industrial absorption in the metro area reached 254,183 square feet, led by the Longmont submarket, where 106,570 net square feet of industrial space was leased up during the quarter. While leasing activity for industrial space remained strong, institutional sales of industrial properties decreased year-over-year, with $154 million in sales volume transacting in the first quarter, 15 percent lower than in the first quarter of 2015, according to data from CBRE Group Inc. Office sales also saw a decline, from $552 million in the first quarter of 2015 to $520 million this year. The decreases are due mostly to the fact that 2015 was a record year for institutional sales, said Geoff Baukol, executive vice president of investment properties at CBRE. Because so many large core assets have traded in the last two years, more transactions are taking place in the suburbs, where real estate is cheaper and the buildings are smaller, leading to smaller dollar volumes. Retail institutional sales had a strong quarter, with three major sales driving $674 million worth of transactions. Cherry Creek's Clayton Lane retail building sold for $169 million in February and the recapitalization of Flatiron Crossing and 29th Street shopping centers in Boulder accounted for 77 percent of the quarter's transaction volume, said Brad Lyons, first vice president at CBRE. "Institutional capital is trying hard to find core profile assets, and it’s hard to find, so pricing is getting near records levels," Lyons said. Capital markets overall remain active, and Denver remains an attractive area to place that capital for both American and international investors, Baukol said. **(Denver Business Journal)**

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Colorado's Jobs Streak Breaks: Unemployment Rate Up for the 1st Time in 5 Years

Colorado's unemployment rate saw an uptick in April to 3.1 percent and the state broke its 53-month steak of adding jobs, the Colorado Department of Labor and Employment reported today. The state’s total nonfarm payroll jobs declined 2,000 from March to April. The state had been on the longest stretch of adding jobs since the 1990s. However, in April, private sector payroll jobs decreased 2,800 and government increased 800, according to a survey of the state's employers. But the numbers should not be taken as alarm, said Alexandra Hall, CDLE's chief economist. They still could be revised up, as they were in the previous month. In March, it was initially reported that the state added about 5,500 jobs but the numbers were revised to 7,000 jobs. It means it's possible that the state could grab back onto the job-adding streak when the revised numbers come in, she said. But for now, according to a separate survey of households, unemployment increased two-tenths of a percentage point in April to 3.1 percent, which is the first increase in the state's unemployment rate since January 2011, according to recently revised data from the U.S. Bureau of Labor Statistics. The number of people actively participating in the labor force increased 11,300 over the month to 2,888,800 and the number of people reporting themselves as employed increased 6,100 to 2,799,900. The larger increase in the labor force than in total employment caused the number of unemployed to increase 5,200 and the unemployment rate to increase to 3.1 percent. But with all the news about job losses in the oil and gas industry, shouldn't the unemployment rate be higher? In Weld County, for example, where oil and gas job losses are the talk of the town, the unemployment rate remains the same in April at 3.7 percent as last month. Hall says there are two reasons why the unemployment rates have remained the same:

▪One is that the oil and gas labor force can be migratory. If a person loses a job in Colorado, he or she may move to another state, thereby not sticking around to make an unemployment claim, she said.

▪But also, the state has a diverse economy and labor force. Fort Collins, for example, is showing strength economically. "Greeley has easy access to that area and it may have allowed those who were displaced to find jobs in other sectors," Hall said.

The national unemployment rate remained unchanged over the same period at 5 percent. The largest gains in jobs in April were in education and health services and construction. The sectors the lost the most jobs were in professional and business services, trade, transportation, and utilities, and leisure and hospitality. Over the year, nonfarm payroll jobs increased 67,700 with an increase of 57,900 in the private sector and an increase of 9,800 in government and the unemployment rate is down nine-tenths of a percentage point from 4 percent. **(Denver Business Journal)**

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	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED TARGET RATE	.50	.50	.25
3 MONTH LIBOR	.63	.64	.28
PRIME RATE	3.50	3.50	3.25
10 YEAR TREASURY	1.85	1.77	2.24
30 YEAR TREASURY	2.63	2.58	3.04