

Class C apartment market is gaining momentum in 2008

As we all know, the foreclosure crisis has created a much stronger apartment market for the Denver metro area. Subprime issues bode well for apartment owners as would-be homeowners just three years ago are back to renting apartments. New construction for apartments remains at historically low levels. Colorado job growth continues to outpace the national average. The stock market has been no safe haven as of late. In short, demand for apartments is up and supply remains relatively low. So it is easy to see why so many investors are getting out of other commercial product types and moving their capital to apartment buildings.

Class A and B buildings, those that have amenities such as pools, fitness centers, business centers, etc., have been enjoying lower vacancy rates and increased rental rates for quite some time due to the aforementioned. However, the older and typically smaller Class C apartment buildings (those with no extra amenities) are just beginning to feel the effects of the strengthening rental market due to the classic trickle-down theory. As former homeowners are foreclosed upon, they tend to move into the newer and nicer apartment buildings with amenities (Class A buildings). Rents rise as demand increases and forces residents out of the Class A building and into a



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period as many had ever seen. In just the past six months, these owners have seen tenant quality improve and their buildings are now 100 percent occupied for the first time in years. However, due to fears that their building once again will become that same time- and energy-consuming problem they wrestled with for most of this decade, some owners remain hesitant about raising rents. Thus, there is real opportunity for investors to acquire Class C apartment buildings that are underperforming. And with rents moving north so rapidly, sometimes the gap between actual rent and market rent is astounding.

Class B property with less amenities and a bit older. The same occurs for Class B and C properties. This is why Class C buildings are now attractive to many investors – simply because we are in the infant stages of sharp rental increases for this class of building. Whereas the newer, nicer apartment properties around town have seen anywhere between 8 percent and 15 percent rental increases over the past year, many smaller and older buildings haven't started raising rents yet. More importantly, there are plenty of opportunities in this sector of the apartment market since it is, by far, the most inefficient of all three different classes of apartment building. Some smaller, Class C owners that may have only one or two properties are not coming to terms with and taking advantage of this strong rental market simply because their rents have not risen in six or seven years. During that time period, many of them were scrambling just to pay the bills as vacancies were vast and tenant quality was in the gutter. It was as bad a time

Fundamentally, all the ingredients are on the table for an incredibly strong run for apartment owners. Net operating incomes are improving as rents continue to rise. Capitalization rates are increasing across the board. Partially due to difficulty in the lending market, apartment values have not improved much – yet. Rest assured, as investor demand continues to build, prices will move north. Savvy investors will find massive opportunity and capitalize on the upcoming frenzy in the apartment market. There has rarely been a better time for investors to sell and exchange into a larger asset and/or acquire more apartment buildings before values rise.▲