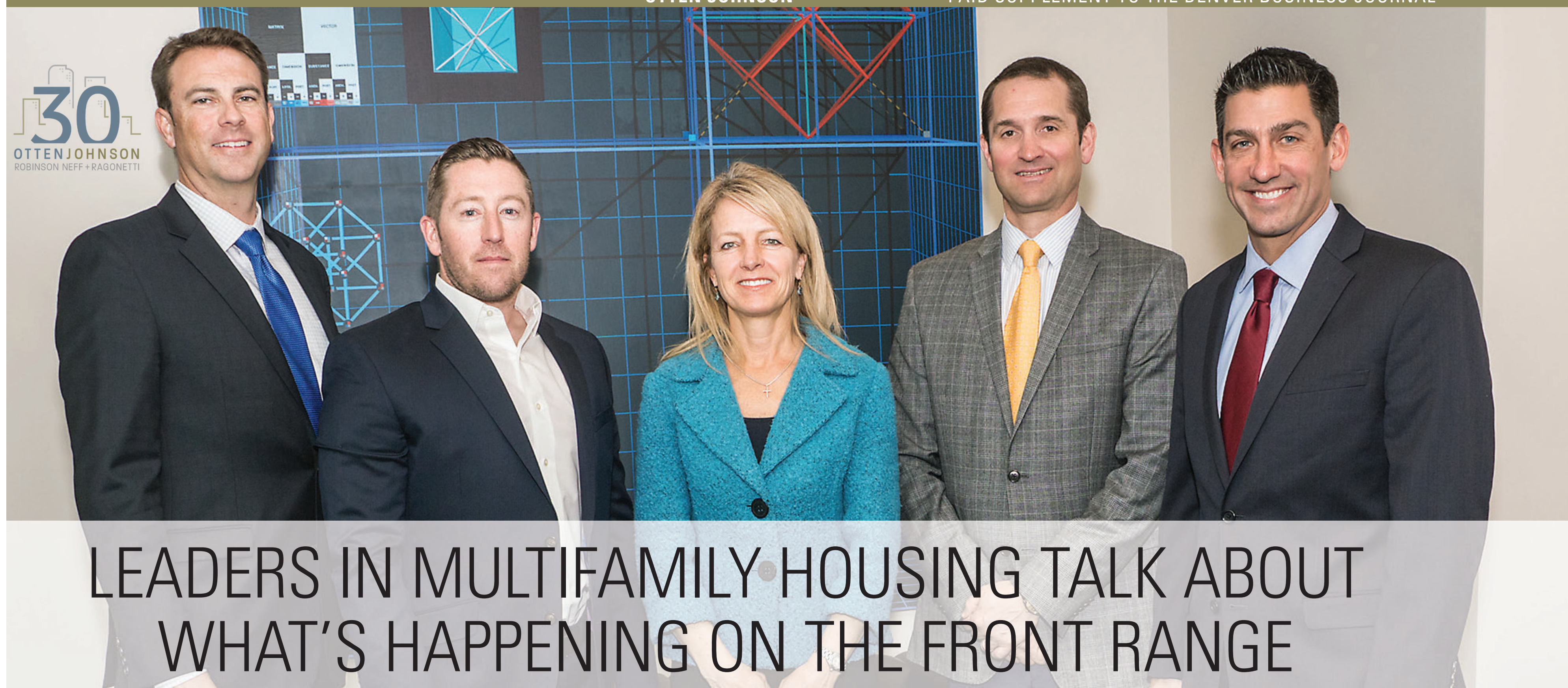

LEADERS IN MULTIFAMILY HOUSING TALK ABOUT WHAT'S HAPPENING ON THE FRONT RANGE

The cost of Denver housing seems to have skyrocketed in the past six months or so, as demand exceeds supply – despite all those new buildings that are going up around downtown. What's going on in the residential construction industry and what can we expect to see in the future?

Question: Housing costs are increasing rapidly in the Denver Metropolitan area as new and existing inventory of single family detached units is dropping to historically low levels. Are you seeing this same dynamic in the multifamily market?

ANDY CLAY, Alliance Residential Co.: We definitely operate differently than single family, where they have limited deliveries and longer turn schedules. We end up delivering larger chunks at one time, so I think that creates more of a lumpy delivery schedule for us, as we're delivering now, two, three floors at a time; it used to be we'd deliver one floor at a time. The city inspectors would rather we deliver the entire building at once … But obviously, absorbing 70 or 100 or 150 units at a time is challenging.

KIM SPERRY, Amstar: Demand still seems to be there. It's an interesting time of the year to measure it because historically, multifamily rental slows down during the winter season, but the pace has been reasonably strong, despite all those deliveries.

Q: What about housing affordability in Denver?

JIM JOHNSON, Otten Johnson: The unemployment rate has dropped, but the wages haven't increased. So you have these housing costs but no supply in single-family detached, and a very limited supply of condos. The apartment market is where it's at right now. If rents continue to go up, and the wages don't increase, it's just a perfect storm – we look no different than New York or San Francisco.

Q: Multifamily starts have reached record high levels in recent years. How long can the market sustain this level of development? Is it softening already?

DREW HYDE, US Bank: I'm a longtime Denver resident and I am very bullish on our city because of the macrotrends benefitting Denver, the natural environment, and the momentum of the city. You have a macrotrend environment that includes the fact that Denver never had a downtown resident population, unlike a lot of other major metros around the country. Denver also lends itself to the millennial population, so we are benefitting from a great in-migration relative to other cities in the country from the millennials. Then you have the national shift from owners to renters. You also have the natural environment itself that we all love and enjoy. That fits really well with the ideology of the millennials.

The biggest thing that makes me bullish about Denver is the momentum of the city. We have decades now of our leadership, and our citizens, making the right decisions – whether it's the 16th Street Mall, reclaiming LoDo and the South Platte Valley, the Highlands, DIA, the convention center, the light rail connecting them all, Union Station. The city has a long history of making the right decisions which has built its own momentum and supports multifamily.

CHRIS MURDY, Haselden Construction: The lifestyle and business climate hit this apex at the same time. It's been phenomenal to watch that all come together. If we can keep from trying to kill the golden goose here and maintain that business-friendly environment, we're going to continue to have companies move here from the coasts.

Q: Is the slowdown in the oil and gas fields reducing the labor costs for construction, and how will the slowdown affect the multifamily market on the Front Range? What's happening in the construction materials and commodities markets?

MURDY: We're not seeing a flood of job applications from guys who worked in the oil fields a month ago, and we don't think we're going to. I think we may see some labor come back to the Denver market, but we're so far short of what's needed right now, in the way of masons, framers, and drywallers in particular, that it's hard to imagine that we're going to put a dent in it in the near term. … The subcontractors are all stressed; they're being very picky about the projects that they want to work on … We are seeing stabilization in materials costs based on commodity pricing, but the supply and demand economics continue to drive some inflation in materials and labor.

JOHNSON: The clients that I've seen that are working with construction companies – and I typically represent the owners' side – they're actually not getting bids out of as many general contractors as they had been getting previously. And the reason is, these contractors are not staffing up, they're not hiring more people, they're just sort of hunkering.

Q: If S.B. 177 passes in a form substantially similar to its current state do you expect there to be an increase in the for-sale multifamily market? How much comfort do you believe the insurance market will obtain from it, and is it possible to predict when insurance rates may drop?

SPERRY: If S.B. 177 passes, it's going to create an environment where more people are going to step back in. … It only solves part of the problem. I think it makes the environment friendlier, but I don't think it makes everybody jump back in. There's certainly enough pent-up demand that I think some will.

JOHNSON: Many builders require anti-conversion covenants. It's going to be interesting to see – if this law passes and the condo market starts to come back – if some of these developers approach construction companies and say: "Hey, we have these anti-conversion covenants but we've got this protection now with S.B. 177 or whatever it is. What's it going to take for us to terminate this covenant and convert these apartments to condos?"

Q: Is there pent-up demand for for-sale multifamily units?

SPERRY: I think there is a pent-up demand … Denver is right there next to Dallas in terms of highest home appreciation in the country in 2014. Look at the price of housing, the shortage of the single-family stock, and I think there's got to be pent-up demand.

CLAY: I think the difference is, in the 2000s, the pitch was, oh, you need to buy a condo or a townhome because three years from now, you're going to have this much appreciation guaranteed. You bought, whether or not you were going to be in Denver for more than two or three years for a job. Now, they're either not believing it or it's not being explained to them you can own and remain mobile, so they're renting.

MURDY: If you talk to the brokerage community, they tell you that when a condo comes up for sale, they have multiple offers in 24 hours and it's sold. There's no inventory there.

Q: Do you anticipate that a significant number of apartment buildings will convert to condominiums, particularly among new construction?

CLAY: I don't know if it's S.B. 177 that's going to be the driver, but I totally agree with Drew. There are a lot of apartments that are being built right now … even though they're limited and excluding condo conversion as a possibility, many have every intent of eventually generating value as a condo, even if they sell to a converter or just convert themselves.

JOHNSON: What I see happening in the multifamily market in Denver right now, be it condos or apartments: we're finally building out a downtown resident population, a world-class resident population.

Q: How has the lending market responded to current market conditions in the multifamily segment? Are you aware of any new products that banks have developed, especially in light of today's regulatory environment?

HYDE: I think the lending market has done a very good job coming out of the downturn, in terms of getting with the program. Especially in this market and this city, we have an enormous amount of product that has been delivered and the bulk of that has been financed in some way.

Q: From the other side, how has the domain changed? Have you seen any changes to the tenor, any new products in particular that make your job of standing up apartment buildings any easier?

CLAY: In general, like the typical deals that we do, I think interests are best aligned when you have a sponsor that's guaranteeing the loan, because they're probably not going to underwrite trended rents, and if they do, they're going to be realistic and well-vetted. They are also going to lever down, because the risk is then on the sponsor if they're stretching leverage. We prefer to be lower leverage and stay in that risk tolerance.

SPERRY: We've also moved to lower leverage and typically pursue traditional bank debt and not those creative products because we tend to be more of a short-term holder.

Q: To what degree are Transit-Oriented Development (TOD) opportunities driving multifamily housing investment?

SPERRY: The Transit-Oriented Developments are definitely important to us as we move away from the core, if we're going to look out at the suburbs. For a while, coming out of the downturn, most of the product was in urban infill. You saw it next in the transit corridor, and now you're seeing more suburban product getting built. I think there's definitely a demand.

JOHNSON: This is the reason that Bob Murphy in Lakewood moved to spawn, for sale, condominium projects around TOD nodes. … Lakewood and other municipalities that surround Denver are going to be beneficiaries of these stops. They see these areas as locations to jump-start condo development in their jurisdictions.

HYDE: We're seeing a little bit of a shift from our local, Colorado clients doing TOD developments to out-of-town developers going to their local office and they're calling us and asking, "Hey, what about this site?" … One thing we're all benefitting from is that there's a national and international equity investment eye on Colorado, on Denver, that's focused on the central business district and TOD sites. That equity investment is not going to be here forever.

Q: What other factors make the Denver metropolitan market different from the other markets where you operate?

CLAY: I'd say affordability, believe it or not, even rents. When you look at people who have lived in Denver for 15 years, it may not seem that way, but when you have people looking at renting a penthouse apartment for $5,000 a month and they're coming from New York, they're coming from Manhattan, and that's like the cost of a studio there, and they come out here and it's great.

HYDE: One thing that I think is really unique, whether it's just people I run into or when we are hiring: people move to Denver without jobs, which is very atypical for U.S. population movement but speaks to the great attributes of Denver.

OUR PANELISTS

ANDY CLAY

Managing Director Mountain, Alliance Residential Co.

is responsible for identifying development opportunities throughout the Mountain Region. He has worked in real-estate development and property management for more than a decade, and has developed more than 2,400 units and managed more than 600 units in the Denver metro area.

DREW HYDE

Senior Vice President, U.S. Bank

is the Colorado Market Manager for U.S. Bank's Commercial Real Estate business line. In this role, Drew leads a team of commercial real estate professionals in the management of a $1.5 billion portfolio of acquisition, reposition, construction, bridge, and term loans.

JIM JOHNSON

Shareholder & Managing Director, Otten Johnson

assists real estate owners and developers in complex land use and development matters, including disputes regarding entitlement approvals and eminent domain. Prior to law school, he practiced as an engineer with an international environmental law company.

CHRIS MURDY

Director of Development, Haselden Construction

has been involved in the Denver development, design and construction markets for the entirety of his 22 year career. He is currently responsible for the Haselden Construction Real Estate Development portfolio in the residential markets of Denver and Phoenix.

KIM SPERRY

Managing Director, Amstar

is responsible for acquisitions of all property types on the West Coast and multifamily investments in Denver. Her responsibilities include acquisitions, joint venture structuring, construction and development, asset management and dispositions across multifamily, office and industrial properties.