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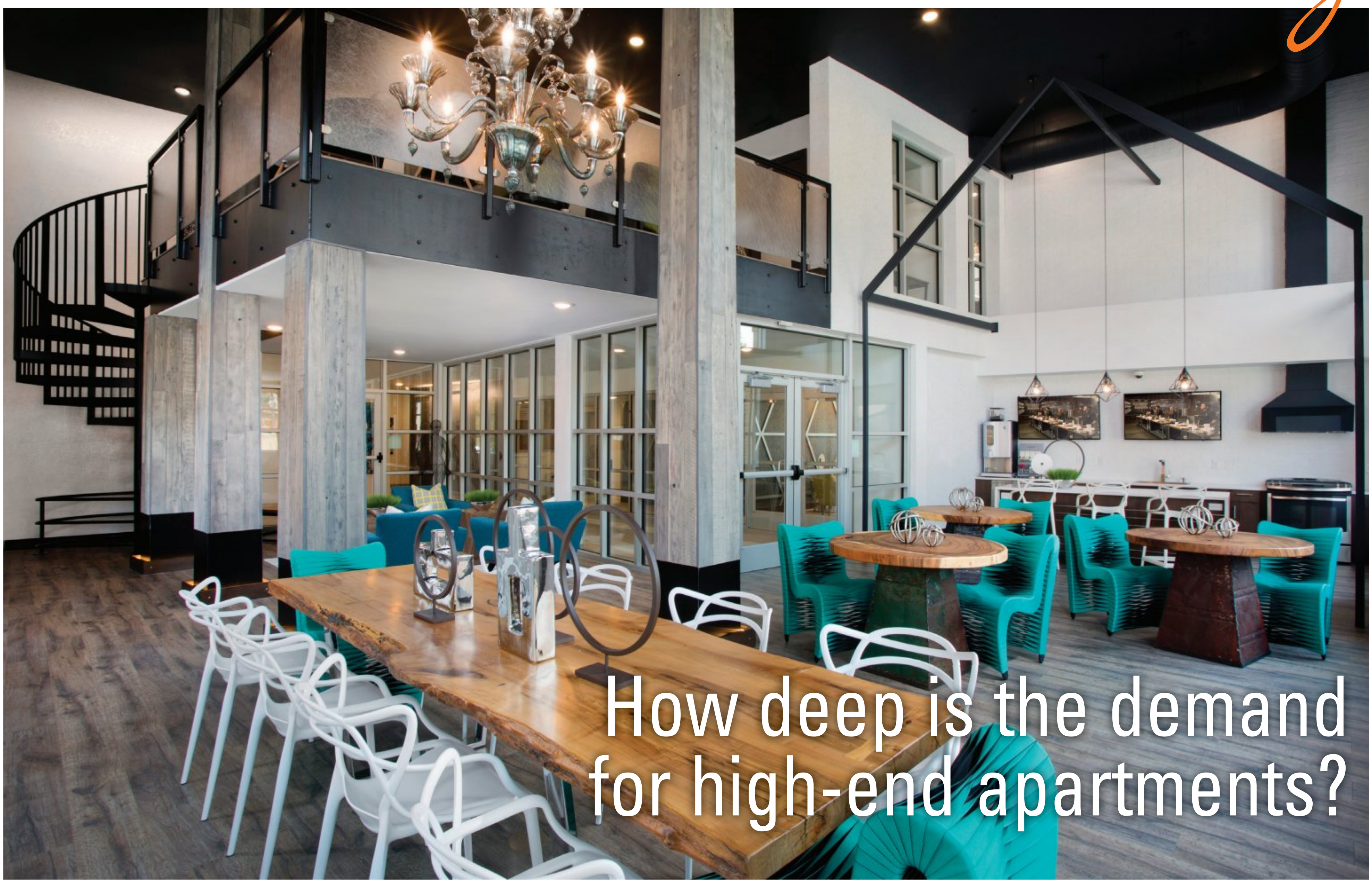

How deep is the demand for high-end apartments?

Adrian Tiemens Photography

Denver's Broadstone on 9th was completed in 2016, features 324 units, has a 92 percent occupancy rate and is considered a high-end apartment community.

One of the hallmarks of the current development boom has been the degree to which it has been focused almost exclusively on high-end apartments. Proponents say it represents a change in our housing preferences, with more and more higher-income households choosing to rent amenity-rich apartments. Critics point out that the nation is facing a near crisis-level shortage of affordable housing, yet the only properties being built are pricey Class A+ or luxury ones.

The apartment boom also has gotten more media attention this cycle than in the past. The homeownership count continues to edge downward, millennials are flooding into cities looking for the hip urban lifestyle, and baby boomers are downsizing and choosing to rent. Given the media headlines, it can be tempting to make this trend toward higher-cost, higher-rent infill construction seem like a new phenomenon. But it's not. Conventional wisdom has long been that the only new developments that pencil in most areas are either high-end or low-income housing tax credit properties.

But old trend or new, a common worry is whether the industry is in danger of overbuilding the high end of the market. At the National Multifamily Housing Council, we heard this same refrain a year ago, two years ago, even three years ago in some markets. Yet, in most cases, demand has held up better than many expected, resulting in good absorption of the new supply of higher-end units.

Consider that in Denver, we have added nearly 30,000 new units over the past four years and are expected to add another nearly 12,000 in 2017. It's fair to ask whether this can continue. After all, how many people can afford to rent these units? Mark Obrinsky, NMHC chief economist, recently looked at large, public microdata sets to see if we can get

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Kim Duty
Senior vice president, public affairs, National Multifamily Housing Council, Denver

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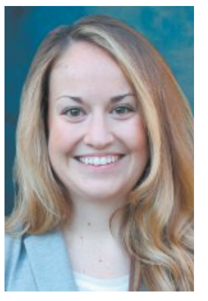
Multifamily in Denver

The Downtown Denver Partnership's 2017 State of Downtown Denver report allows us to dive deeper into one market segment to better understand the supply-and-demand balance.

Since 2000, the residential population of downtown Denver has tripled, according the report. A total of 79,367 people live in downtown Denver and the city center neighborhoods. The city averages 15,000 new residents per year, making it one of the fastest-growing large cities in the country.



In an attempt to keep up with this population growth, 3,817 additional residential units were completed between 2014 and mid-2017 in the downtown area, which was estimated to support 4,499 new residents. There are an additional 5,341 residential units in the pipeline, which will support 6,295 new residents once completed, according to the report.

Denver will need to keep a steady development pace even after these apartments are completed to accommodate the expected continued growth in the city center. By 2022, the report predicts that the population of downtown Denver will be 24,408, and the surrounding city center neighborhood will see a population of 87,345, which would represent a 56 percent growth rate from 2000 to 2022.

These downtown residents largely comprise nonfamily, white households, with an average size of 1.42 people. Males outnumber females, 56.2 to 43.8 percent, and the average age is 34.3 years old. The downtown population's average household income is $113,565 and 44 percent have a bachelor's degree.

These statistics are important, especially when you consider that the average rent for a one-bedroom apartment in downtown Denver is $1,574.

Obviously, the job market is crucial to maintaining a healthy multifamily market.

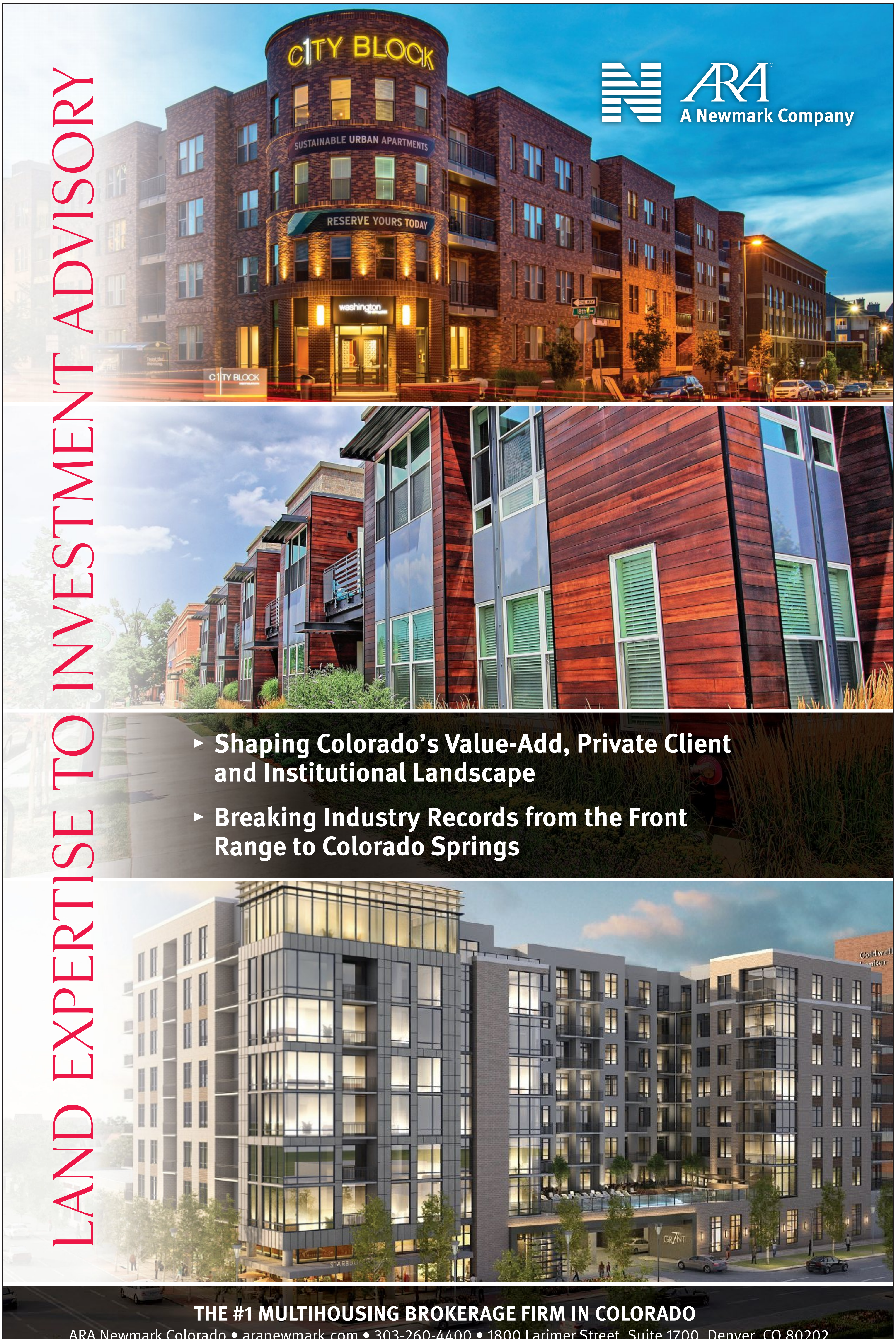
Denver's unemployment rate is 2.7 percent, metrowide. For comparison sake, the nationwide rate is 4.5 percent. This can be a double-edged sword when weighing the long-term vitality of Denver's in-migration as it becomes more difficult to find employment – time will tell how the market handles it.

Multifamily activity remains strong across the state, not just in Denver. This most recently was demonstrated by the record-breaking sale of Boulder's 17*Walnut, which sold for $600,000 per unit, or $654 per square foot.

Within this issue, you'll read about the market's solid fundamentals as well as a few areas to keep an eye on regarding affordability, condominium development, tax issues and regulatory challenges.

As always, thanks for reading.

Michelle Z. Askeland
maskeland@crej.com
303-623-1148, Ext. 104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Market Update

Denver settles into the 'new normal' market

Andy Hellman
Senior managing director, ARA Newmark, Denver

The Denver housing market's consistent double-digit appreciation culminated in 2016 with increasingly low for-sale inventory (3,878 residential properties available at the end of February, the lowest monthly total on record since 1985) and top honors in Zillow's list of "Top 10 Hottest Housing Markets" for the year, fueled by a surge of new construction in the area. Following the Great Recession, developers and investors kept a tight rein on new residential construction, hoping to avoid a glut of new housing. Both single-family and multifamily product were undersupplied by an average of 8,000 units per year from 2013 to 2015, as noted by Meyers Research.

This imbalance resulted in home price appreciation and apartment rent increases consistently averaging nearly 10 percent annually. It is not widely known that, beginning in fourth-quarter 2015, trailing vacancy rates for multifamily product increased for the first time since fourth-quarter 2009, marking the start of the Denver multifamily market's normalization.

What is the new normal for multifamily in Denver? For the first time ever, Denver's position has elevated from that of a tertiary city to a tier-one city, fueled by coastal and global investors' interest in Denver's lower-risk investing environment. Denver had two conventional multifamily properties trade over the $490,000-per-unit mark – the first time this was achieved in the market – and Boulder recently experienced the historic trade of 17*Walnut at $600,000 per unit. Investors are seeking opportunities and actively pricing lower yields in lower-risk investing markets like Denver.

Key fundamentals have contributed to Denver's multifamily investing environment over the past few years, including rising home prices, a lack of supply, high median household incomes, Denver's urban resurgence and its continued appeal to millennials.

The median home price for a single-family home in metro Denver increased 60.9 percent in nine years (2007 to 2016), while rents continue to rise throughout the metro area, up by 2.6 percent overall in the last year, according to the first-quarter Denver Metro Apartment Vacancy and Rent Survey. It should be noted that, compared to previous years, this rental increase is moderate. Some analysts thought these smaller increases – year-over-year rent growth in 2015 was 3.56 percent, then noted as the lowest increase since 2009 – indicated the end of the latest boom cycle when, in fact, moderate rent growth is the new normal as the multifamily market begins to stabilize.

Rising prices are indicative of increasing demand; in the case of housing, the undersupply of new product coupled with high migration produced the high prices and created a seller's and owner's market. As a result, the delivery of 3,246 new units in the first quarter was quickly absorbed without increasing the vacancy rate (at 5.7 percent overall) or lowering asking rents, which increased slightly to $1,383. This is impressive considering it was the largest delivery of units since 2002 during the early part of the year, normally a slower time for leasing. Much of the new multifamily product is comprised of luxury units positioned in prominent or up-and-coming urban and suburban markets, which can create a price barrier for the younger workers moving to Denver.

With such demand for entry-level, for-sale product, especially for value price points, why are so few condominium developments underway? Attached housing is an obvious entry-level product and, historically, played an integral role in Denver's housing market appeal. Certainly luxury apartment complexes are underway, and many of these units would be ideal condominiums. However, Colorado has had a hostile construction defects litigation environment since 2007 that has inhibited new attached housing development. This will hopefully change in the near future.

House Bill 1279 is making its way through the Colorado Legislature, recently passing a critical legislative vote. The bill allows for developers to address unit owners concerning any alleged construction defect and to make a voluntary offer to remedy the defect. Developers looking to build these entry-level condos are not immune to the associated costs. The average suburban-located, garden-style apartment community costs upward of $250,000 per unit to build. Given the necessary mark-up required for developers to profit, these units could cost upward of $300,000, not including related monthly homeowner association fees. In spite of the new legislation, condo development will continue to be slow, and completed units will be priced out of reach for many first-time homebuyers.

Denver's high quality of life, progressive laws, high median household income and low unemployment – reported as 3.2 percent in February, the lowest for large metropolitan areas in the U.S. – continue to attract newcomers, and it is reported that in-migration has added an average of nearly 30,000 new residents annually to the Denver/Boulder area from 2010 to 2015. Many of these new residents are millennials, as noted by the 2016 Mayflower Mover Study, which ranked Denver third in the nation for attracting millennials moving from another city. These newcomers are well educated, and Denver now boasts the second-highest percentage of college graduates in the country, with 40.5 percent of Denverites having degrees.

One area of concern with the younger generation is limited savings for the necessary down payment for homeownership. Denver's median home price has risen 88 percent since 2011, creating a prohibitive barrier to homeownership. Depending on education level and related debt, research indicates that new homebuyers will need to save for at least a decade to afford a 20 percent down payment. With this population unable to save, apartment demand continues to be high and that is not going to change anytime soon. Institutional money will continue to flow in the Denver metro area and, as a result, cap rates will remain competitive and investors will continue to view Denver as a low-risk market on the rise. ▲

Financial Market

Trends continue to signal growth, innovation

Multifamily development continues to surge across the Front Range, with a large amount of it being Class A. This trend stands, despite the sustained – and widening – gap in affordable product available, while the demand for Class B and C housing holds fast. A number of variables within the multifamily market, at the state and national levels, continue to be in flux. To gain some insights into current trends, as well as top opportunities and obstacles in this space, Jerry Green, with NCS Colorado, spoke with Ralph Lowen of Walker & Dunlop.

• **Green.** What do you see as some of the largest overall trends and opportunities within Colorado's multifamily space?

• **Lowen**. We see investors gravitating toward value-add deals and away from new Class A development. The market sure feels saturated at the top and returns are getting thin. There is opportunity in the affordable and moderately priced part of the market where demand is high and supply is tight.

The trouble has been in making the numbers work at today's construction costs, which have doubled over the last 10 years. Construction costs were a major catalyst for the recent boom in Class A development. Developers couldn't build at the higher costs without higher rents, so they all built Class A. Investors seem to like value-add deals because they can tap into pent-up renter demand and find attractive yield without biting off

Ralph Lowen
Senior vice president, Walker & Dunlop, Denver

too much costly construction.

• **Green**. What impact has the presidential election had on the real estate market?

• **Lowen**. We saw an immediate impact on federal low-income housing tax credits. The new administration has tax reform on the agenda and this turned the tax credit world upside down. If the corporate tax rate goes down, so will investor returns on tax credits. If investors are not willing to pay as much for tax credits, there will be less equity available for new affordable housing projects.

We are seeing huge equity gaps in affordable deals that were thin even before the election. Many of these deals are being abandoned. This is a tragic consequence that will slow new affordable development. The most frustrating part is that we don't even know if tax reform will be successful or where the ultimate tax rate will fall. But the uncertainty is too great and investors are pricing accordingly.

The good news, despite these challenges, is that there are still some affordable deals moving forward. They tend to be the stronger deals with various layers of subsidy. This makes the lender's job more important too as borrowers need debt with higher leverage and flexibility to offset reduced tax credit equity. Freddie

Jerry Green
Senior vice president, commercial sales, National Commercial Services Colorado, a div. of Fidelity National Title Group, Denver

Mac, Fannie Mae and the U.S. Department of Housing and Urban Development will play a significant role in the near term for affordable deals.

• **Green**. As the Denver area and Colorado region continues to experience explosive and consistent growth, what specific challenges are you seeing?

• **Lowen**. My clients are having a difficult time finding deals and many are temporarily on the sidelines. They just can't get a reasonable return at these lofty valuations. In the past, investors came to Denver to find value off the beaten path. Now Denver is very much on the national scene and local investors are going elsewhere because pricing and competition remains elevated. The trouble is that so many multifamily markets around the country are experiencing the same thing, so it is driving investors into even smaller markets to find yield.

• **Green**. At a broad level, what trends in financing are arising in response to these changes across the state?

• **Lowen**. Big picture – it is a great time to borrow from nonbank lenders. With banks still highly regulated and skittish about over building in Class A projects, nonbank lenders are open for business.

Truly, it's never been a better time to borrow Fannie Mae and Freddie Mac debt; they have available capital at aggressive terms. They've also rolled out various green programs that are driving much more bang for the buck, helping borrowers make their pricing more aggressive and lowering interest rates. Right now, nearly all of our borrowers are taking advantage of the green programs available through Fannie Mae and Freddie Mac.

The HUD business also is strong right now and it is a good time to be a HUD borrower. Although not the best fit for every deal, when the market, deal and borrower all align, HUD financing can bring the most aggressive terms available – 85 percent loan to value, 35- and 40-year amortizations and available construction debt. Here I would definitely say, where the bank door is largely closed in this area, HUD has available construction debt for developers.

• **Green**. That's interesting about the increased prevalence of green programs by nonbank lenders, what other products are on the rise?

• **Lowen**. Borrowers are looking for loan products that cater to value-add deals and prestabilization financing. There is a ton of new apartment supply and it will all need permanent financing. The prospect for rising rates makes the need even greater to exit variable rate construction debt. Some great options exist right now for newly built projects seeking permanent financing. Whether they are stabilized or prestabilized, we are getting these deals done with amazing terms.

Please see 'Lowen,' Page 32

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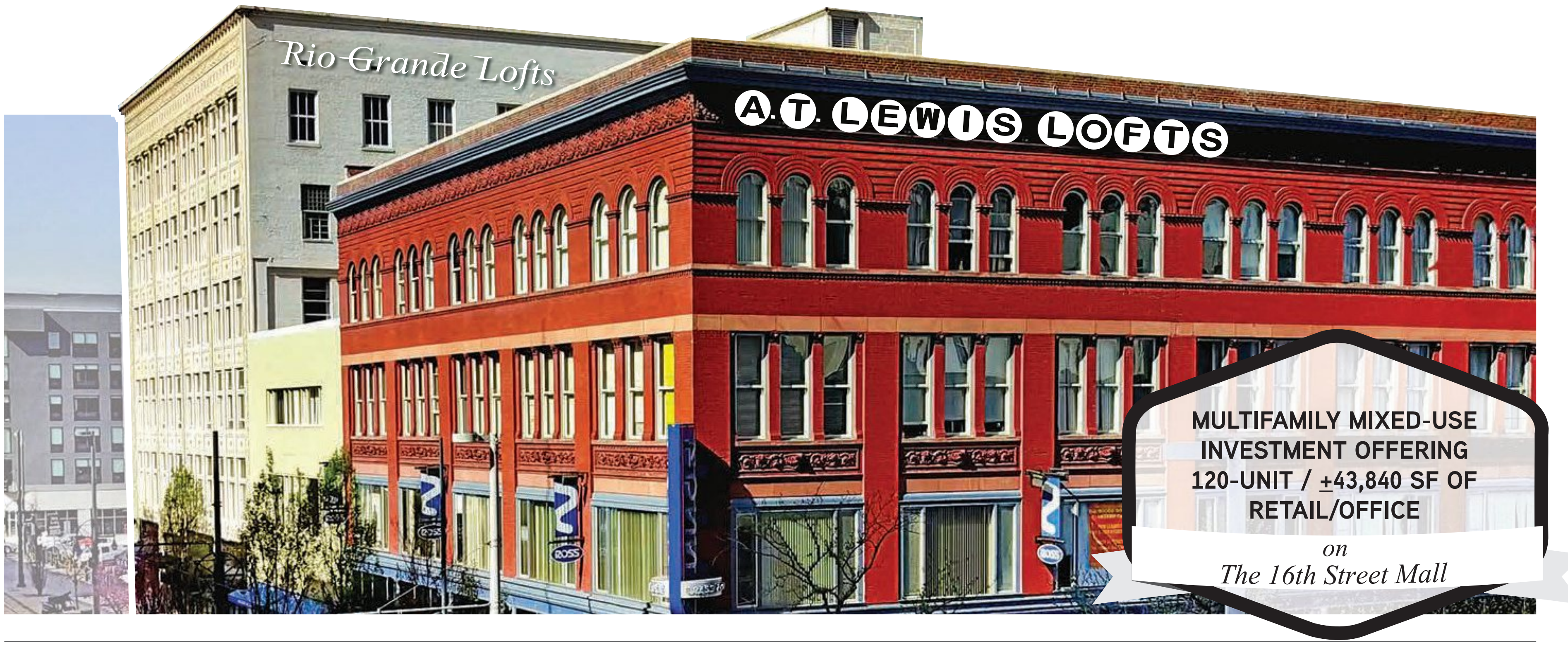
FEATURED LISTING*



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Lending

Agencies are helping preserve workforce housing

Michael C. May
Executive managing director, management committee member, Berkeley Point Capital LLC, Bethesda, Maryland

Charlie Haggard
Managing director, production, Berkeley Point Capital LLC, Irvine, California

The U.S. housing and multifamily market has been on an eight-year run that has seen values and rents exceed their prerecession peaks in most markets. The increase in single-family home values and the regulatory and lending practices that made it harder for Americans to qualify for financing, combined with demographic trends and a shift to renting versus homeownership, have fueled the rapid rise in multifamily rents. While that has been great for multifamily investors, it has created a squeeze on workforce housing as incomes, despite strong employment growth, have failed to keep pace. This disparity between rent growth and income growth has led to an increasing concern over the availability of workforce housing across the country.

There are few areas in the country in which this is more evident than in metro Denver, a clear leader in home appreciation and multifamily rents growth. Combine that with the metro's strong population growth, particularly with millennials, and the shortage of workforce housing becomes a real issue – potentially dampening future employment growth. Compounding matters is the severe lack of new condominium development, which typically helps to fill the gap between single-family homes and apartments, due to the state's stringent construction defects law.

All of these factors have led the apartment market to provide the bulk of the metro's workforce housing. Workforce housing is loosely defined as housing that is affordable to households earning 80 percent of the area median income, though most observers qualify workforce housing as affordable at 60 to 100 percent of AMI (see the affordable rent analysis chart for calculation). With multifamily rents skyrocketing in Denver, most projects now garner rents in excess of these thresholds.

A review of the metro multifamily housing stock, as shown on the permits chart, reveals that the largest portion of multifamily housing was constructed during the 1970s, with modest new development taking place until the recent construction boom, which consists almost exclusively of high-end, highly amenitized projects with rents not affordable to renters earning between 60 to 100 percent of AMI. With much of the vintage product of the 1980s and 1990s having undergone substantial rehab and landlords pushing post-rehab rents, the bulk of the area's workforce housing stock now is found in the vintage assets of the 1970s.

Freddie Mac and Fannie Mae, commonly referred to as government-sponsored enterprises, are keenly focused on this issue. One of the GSE's primary missions is to provide financing for affordable housing, including workforce housing. To that end, both have rolled out new products in the past couple of years that

AFFORDABLE RENT ANALYSIS

								Standard Cost Market			
State:	**Colorado**										
County:	**Arapahoe**										
AMI:	**$80,100**										
Market Type:	**Standard Cost**	Included Utility Allowance	Unit Factor Adjustment	Affordable Rent @ 100% of	# Qualifying Units	Affordable Rent @ 100% of	# Qualifying Units	Affordable Rent @ 60% of AMI	# Qualifying Units	50% of AMI	# Qualifying Units
Studio	0 Beds	$50	0.70	$1,402	0	$1,121	0	$841	0	$701	0
1BR	1 Bed	$77	0.75	$1,502	20	$1,202	20	$901	7	$751	6
2BR	2 Beds	$110	0.90	$1,802	50	$1,442	50	**1081 ***	**50 ****	$901	3
3BR	3 Beds	$149	1.04	$2,083	20	$1,666	20	$1,250	0	$1,041	0
4BR	4 Beds	$149	1.16	$2,323	10	$1,858	10	$1,394	2	$1,161	0
Total					**100**		**100**		**59**		**9**
% of Qualifying Units					**100.0%**		**100.0%**		**59.0%**		**9.0%**

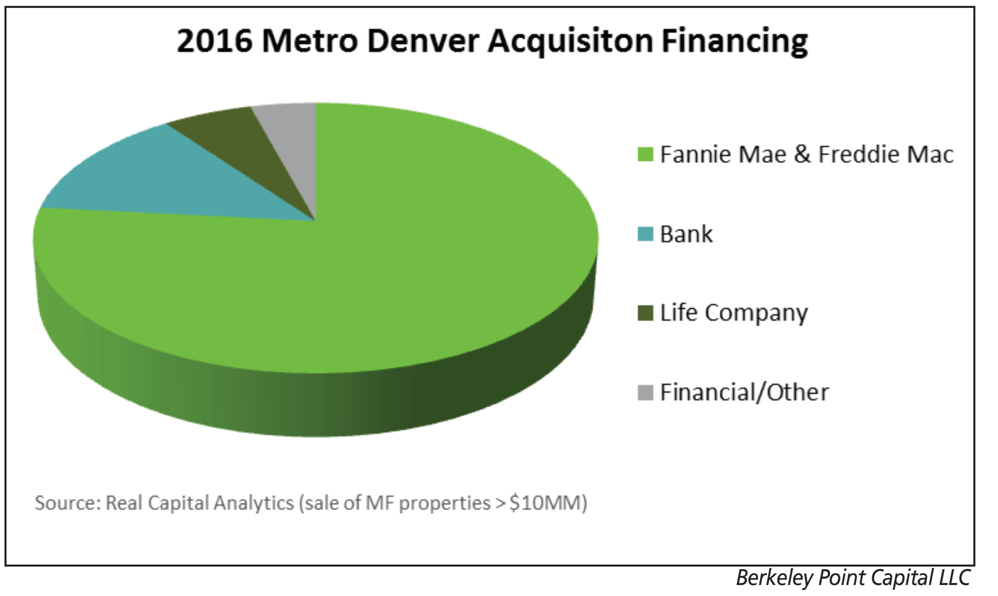
Key: AMI established by HUD; Market Type, Utility Allowance, and Unit Factor Adjustment are set by FHFA
* = (((AMI x .30)/12) x Unit Factor) x (60/100)
** Qualifying Units = # of units with actual rents + Utility Allowance </= to Affordable Rent calculated above

Berkeley Point Capital LLC

can help communities, like Denver, deal with the increasing shortage of workforce housing. These programs are aimed at preserving and enhancing workforce housing by providing more efficient capital to spur investment and capital investment into older multifamily assets. As shown on the acquisition-financing chart, both GSEs have been very active in financing new acquisitions in metro Denver – accounting for over 75 percent of new acquisition financing of properties over 100 units in 2016.

For properties in metro Denver with units that are affordable at 60 percent of AMI, both GSEs offer reduced interest rates based on the percentage of units deemed affordable at 60 percent of AMI. The rate benefit typically ranges from 15 to 30 basis points, depending on the percentage of units deemed affordable. For assets that do not have units affordable at 60 percent of AMI, but still are considered workforce housing with rents affordable at 80 percent or even up to 100 percent of AMI, both GSEs will provide improved pricing for those assets versus an asset commanding much higher rents.

In addition, both GSEs have developed "green" products that are designed to incentivize investment



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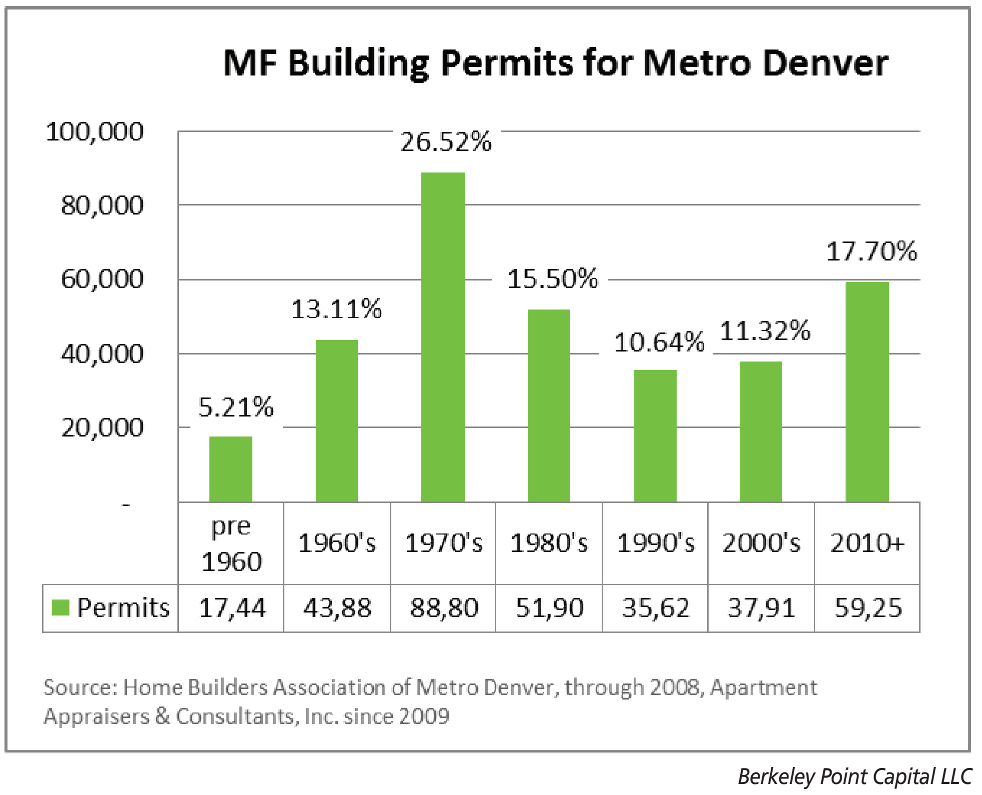


	pre 1960	1960's	1970's	1980's	1990's	2000's	2010+
Permits	17,44	43,88	88,80	51,90	35,62	37,91	59,25

Source: Home Builders Association of Metro Denver, through 2008, Apartment Appraisers & Consultants, Inc. since 2009

Berkeley Point Capital LLC

in older assets that generate utility/energy savings. These programs target capital improvements that generate minimum energy savings in the 15 to 20 percent range. Typically, the older the asset, the easier/less expensive it is to capture the required energy savings, making these products great options for investors and owners of older multifamily assets. The GSEs incentivize owners to "go green" through improved rates and pricing, typically ranging from 20 to 30 bps.

Finally, both GSEs have developed value-add products designed to provide investors and owners of older multifamily assets short- and long-term, cost-effective financing options for moderate and extensive property upgrades, providing updated housing and extending the remaining useful life of the asset. These programs are competitively priced and designed either to compete with the more traditional bridge lenders via short-term financing or to provide immediate mid- to long-term financing for assets that typically would require a bridge loan during the rehab stage.

While the GSEs continue to focus on affordable housing and housing for low-income families, their expanded product line will help maintain and increase investment in workforce housing across the country. Freddie Mac, for example, is working to develop a mezzanine product as well as a construction product for workforce housing that it hopes to launch this year. For a city like Denver, with an aging multifamily stock, and strong population and employment growth, these products could prove instrumental in maintaining and facilitating additional capital investments into the older assets – and who knows, perhaps lead to construction of new workforce housing.▲

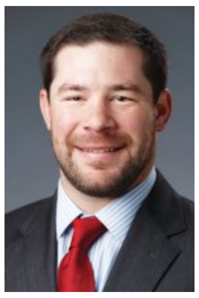
Taxes

RAR-appreciation imbalances signal trouble

When Colorado's Division of Property Taxation released its 2017-2018 Residential Assessment Rate Study, I knew that I wanted to write about it. But here's the problem: Constitutional amendments, taxes, math … not the sexiest content, right? I was pondering how to keep readers engaged when "Funny How Time Slips Away" came on the radio, and it hit me – just tie the article to something interesting, like Willie Nelson! Nelson wrote the song almost 60 years ago, but the song's message still can be applied to today.

First, some context. What is the Gallagher Amendment? Enacted in 1982, it established guidelines for determining the actual value of property and the value used for assessing such property. Spurred by homeowners' concerns over increasing property taxes, it divided the total property tax burden so that 45 percent would fall on residential and 55 percent on nonresidential. The solution was to fix the nonresidential assessment rate at 29 percent while adjusting the residential assessment rate to maintain the 45/55 split. When residential values outpaced nonresidential, the RAR would decrease.

• **"Well, hello there/My it's been a long, long time."** It's been a long time since the last RAR adjustment – 14 years, to be exact. In 2003, the RAR dropped from 9.15 percent to 7.96 percent and stayed there, until now. For 2017-2018 taxes, the RAR is expected to drop to 7.2 percent. It may not sound like a lot, but that's



Travis Hodge
Associate, Rocky Mountain Multifamily, JLL Capital Markets, Denver

a 9.5 percent year-over-year decrease. Beginning in 1987, Gallagher triggered seven RAR decreases in just 10 years. But in the 20 years that followed, just two. Why? The answer lies within the Taxpayer Bill of Rights.

Enacted in 1992, TABOR prevents state and local governments from raising tax rates without voter approval. In the early 2000s, Colorado entered into a mild recession. Total employment began to decline, apartment vacancies increased and home appreciation slowed. For 2003-2004 tax years, Gallagher triggered a decrease to 7.96 percent, but for the 2005-2006 tax years, the Division of Property Taxation estimated that the RAR needed to increase to 8.17 percent in order maintain the 45/55 split. In general, asking voters to self-impose additional property taxes is an unpopular request. When people are losing their jobs and home values start declining, it's a nonstarter.

While Gallagher can trigger automatic decreases, TABOR effectively prevents any rate increases. After 2005, the property tax burden that fell on home and apartment owners dropped below the required 45 percent, a trend that continued into the Great Recession. RAR estimates peaked at 9.13 percent in 2013, but nothing could be done to increase the rate from 7.96 percent.

• **"How am I doin'?/Oh, I guess that I'm doin' fine."** Indeed, practically any investment in a Colorado home or apartment over the last few years should be doin' just fine. Across the state, home values have increased nearly 60 percent since 2012 while the average price per unit for apartments has almost doubled. In 1982, residential properties made up 45 percent of Colorado's total property value; today, that number is closer to 80 percent. It's no wonder that the RAR has declined from 21 to 7.2 percent. According to assessors, total residential value increased by 20.8 percent between 2015 and 2017, while nonresidential value increased by only 13.1 percent. Absent any change in mill levy, the new 7.2 percent RAR means that if your house or apartment increased 20.8 percent in value, your property taxes are only increasing by 9.27 percent.

Nobody likes to see his tax payments increase, but it's an easier pill to swallow when it means your investment is increasing at the same rate. When the value of your investment increases at twice the rate of your tax bill, you won't hear any complaints. For apartment owners, real estate taxes can make up 10 to 20 percent of total operating expense, so the reduced RAR has a material impact on net operating income. For the most recent acquisitions, it's an even bigger windfall – the 9.5 percent decrease in taxes over a 10-year hold period ads up to a full year's worth of property taxes.

• **"Never know when I'll be back in town/But remember what I tell you/In time, you're gonna pay."** Gallagher has caused problems for local districts that rely heavily on residential property tax revenue. Before TABOR, districts could float the mill rate to make up for assessment rate decreases. Since 1992, the combination of TABOR and Gallagher has resulted in declining tax revenue. In 2000, after nearly a decade of budget cuts to school districts, Amendment 23 was passed requiring annual mandatory increases to school funding.

Well, when Gallagher and TABOR limit the ability to increase revenue, and Amendment 23 mandates increased funding, you have a problem. It's shifted the burden of school funding from local property taxes to the State General Fund, which now provides more than 60 percent of school funding, whereas it used to be less than 40 percent.

The 2017 Colorado Business Economic Outlook estimates the value of residential construction in Colorado this year to be $9.68 billion and estimates nonresidential to be $5.40 billion. Meanwhile, existing homes along the Front Range are continuing to experience double-digit appreciation. It's easy to imagine a future where total residential value continues to outpace nonresidential value, causing further RAR decreases and making statewide funding problems worse. The math doesn't work, and sooner or later, someone is going to have to pay. Until then, keep in mind, "It's surprising how time slips away."▲

Legal

The Vallagio case could impact development

For the last several years, the Colorado General Assembly has attempted to pass construction defect reform, especially for multifamily construction. When past efforts failed, numerous Colorado municipalities passed their own municipal codes and ordinances to address construction defect issues. Such local codes and ordinances primarily addressed construction defects associated with multifamily construction. There are unresolved questions about whether those local codes and ordinances are valid based on several legal issues, such as the home rule authority of municipalities to legislate on construction defects and preemption by Colorado statutes. While the Colorado General Assembly recently passed House Bill 17-1279 to address some aspects of construction defect reform, there are unanswered questions about its effectiveness to reduce construction defect actions and jumpstart condominium construction.

Without meaningful construction defect reform from the Colorado General Assembly and lingering questions surrounding local codes and ordinances, the case of Vallagio at Inverness Residential Condominium Association, Inc. v. Metropolitan Homes, Inc., becomes all the more important for multifamily construction.

In Vallagio, the defendant developer recorded a declaration that required mandatory arbitration for construction defect claims. The declaration also required the developer's consent to amend the mandatory arbitration provision. After the last unit sold, the developer turned the project over to the plaintiff association. At least 67 percent of unit owners voted to amend the declaration to remove the mandatory arbitration provision. The plaintiff association then filed a lawsuit against the defendant developer and general contractor for a number of construction defect claims. The defendants moved to compel arbitration based on the mandatory arbitration provision. The Arapahoe County District Court denied the motion, and the defendants appealed to the Colorado Court of Appeals.

Ryan J. Klein
Member, Sherman & Howard LLC, Colorado Springs

On appeal, the Colorado Court of Appeals primarily addressed whether the declaration's consent provision for the removal of the mandatory arbitration provision violated the Colorado Common Ownership Interest Act. One key CCOIA section over which the parties argued was C.R.S. § 38-33.3-217(1)(A)(I), which capped the percentage necessary to amend a declaration at 67 percent.

The Colorado Court of Appeals found C.R.S. § 38-33.3-217(1)(A)(I) only addressed permissible percentages and did not prohibit additional requirements for declaration amendments. Ultimately, the Colorado Court of Appeals upheld the consent provision as enforceable and consistent with CCOIA. The plaintiff association appealed to the Colorado Supreme Court.

Following briefing by the parties and many interested third parties, the Colorado Supreme Court heard oral arguments March 7. The Colorado Supreme Court asked many probing questions of the developer. For instance, Justice Brian Boatright asked whether developers could abuse the arbitration process specified in declarations. Justices Monica Marquez and Richard Gabriel were concerned about how their decision could be applied outside the context of an arbitration provision. Finally, Chief Justice Nancy Rice and Justice Gabriel inquired whether a consent provision in a declaration was an improper device for developers to control associations.

The developers were not the only party on the receiving end of the Colorado Supreme Court's questions. For instance, as to the argument about whether the 67 percent cap in C.R.S. § 38-33.3-217(1)(A)(I) prohibited a consent requirement, Justice Gabriel asked the association if it was an issue to be addressed by the Colorado General Assembly. Justice Gabriel also noted it appeared to be unseemly for homeowners to agree to a declaration that included a mandatory arbitration provision with a consent requirement, but later argue the provision is invalid.

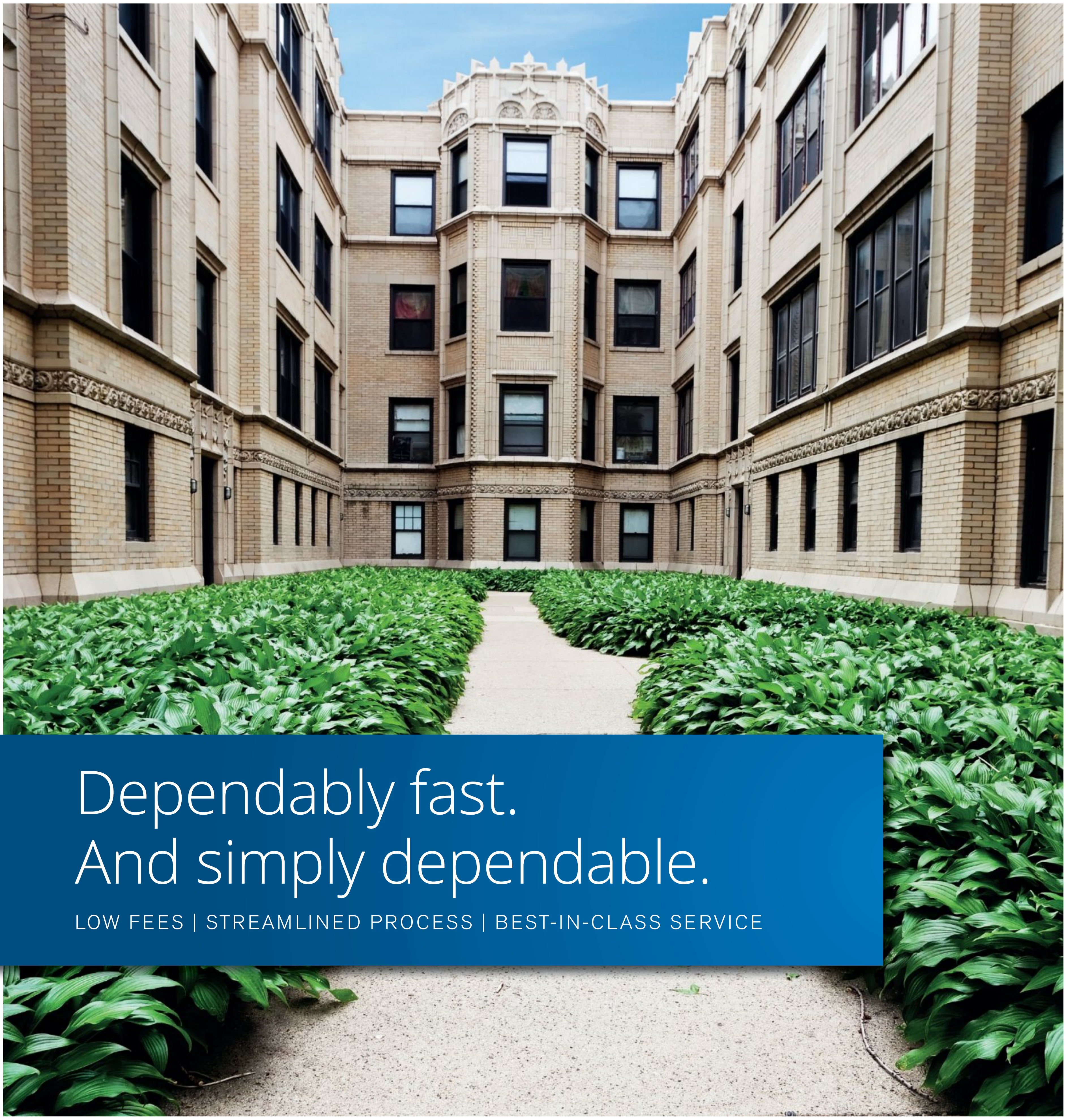
Whether one party receives more probing or difficult questions does not necessarily determine how the Colorado Supreme Court will rule. This author is not going to look into his magic eight ball and venture a guess as to whether the Colorado Supreme Court upholds or invalidates the consent requirement for the removal of a mandatory arbitration provision from a declaration. However, if the Colorado Supreme Court upholds the consent requirement, it likely will limit the decision to arbitration and may even put some limitations on the scope of a valid arbitration provision.

All this lawyering aside, Vallagio is an important case to the multifamily construction community. Senate Bill 17-156 would have codified much of the holdings in Vallagio. It passed the Senate, but was sent to the House State, Veterans and Military Affairs Committee. Some members of the construction community refer to this committee as the "kill committee." On April 20, Senate Bill 17-156 was postponed indefinitely.

The only way for developers to maintain their ability to include mandatory arbitration provisions is through a favorable ruling by the Colorado Supreme Court in Vallagio. The Colorado Supreme Court should rule within the next two to four months.

While waiting for the ruling, multifamily professionals should not avoid including mandatory arbitration provisions in declarations. The Court of Appeals' holding in Vallagio is still good law. However, multifamily professionals should be mindful of the Colorado Supreme Court's concern about expanding the scope of consent provisions outside of the arbitration context. Multifamily professionals also should not include potentially unfair procedures in mandatory arbitration provisions, such as where the developer selects the arbiter without any input from the association.

As the Colorado General Assembly wrestles with construction defect reform legislation, the best hope for assistance is from the Colorado Supreme Court.▲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Legal

Mitigate litigious risks for condo development

It's no secret that there is pent-up demand for condominiums in Colorado – and developers are starting to venture back into the market. There has been some legislative reform, but uncertainty is still the norm. Multifamily housing construction has been booming across Colorado's Front Range, but for-sale condominium construction is at near all-time lows, largely due to a legal framework that makes it easy for homeowner associations to bring expensive construction defect suits against developers and their contractors. This situation persists despite over five years of efforts by the Colorado Legislature as well as metro area municipalities and housing advocates to modify those aspects of Colorado's legal framework that discourage the construction of for-sale multifamily housing.

With the 2017 legislative session nearing an end, however, the Colorado General Assembly appears poised to pass at least one bill that may make condominium projects more attractive to developers. The leading bill, HB 1279, would require HOAs to go through stricter processes and follow tougher voting requirements before bringing construction defect claims against developers, contractors and designers.

Colorado courts also have struggled to balance the competing interests, and the Colorado Supreme Court has agreed to review a Court of Appeals decision involving the ability of developers to require arbitration of disputes in an HOA's governing documents. Developers and contractors are natural (and sometimes easy) targets for HOA boards, who all too often view a construction defect lawsuit as a no-lose proposition.

Jonathan G. Pray
Shareholder, Brownstein Hyatt Farber Schreck LLP, Denver

Once filed, construction defect lawsuits can last years, and the costs of defending them can be staggering – and, in the meantime, unit owners are frequently unable to sell their units. The current state of uncertainty means that developers must find their own tools to mitigate the risks associated with condo projects.

However, the risks can be mitigated. The following are a few things developers can do to reduce the likelihood of finding themselves on the wrong end of a construction defect lawsuit.

- **Design peer review.** Successful developers are investing in having the architectural and engineering drawings for their project reviewed by a second (or third) set of eyes. This process, often called peer review, gives an independent architect or engineer the chance to review the plans for errors as well as point out any room for improvement.
- **Construction inspections.** Another technique that is increasing in popularity is to rigorously inspect the contractor's work and create extensive photographic and video documentation of the construction techniques used. A developer might, for instance, photograph the waterproofing elements of every window and door before they are finished and covered up. These photos could be critical evidence in a defect lawsuit down the road.
- **Keeping the buyers happy.** On the assumption that a happy buyer is less likely to be litigious, developers also are focusing on ways to keep their buyers satisfied with their purchase. Options can include maintenance funds, aggressive warranty and repair programs, and financial incentives for buyers and HOAs not to sue the developer.

Andrew L. Meyers
Shareholder, Brownstein Hyatt Farber Schreck LLP, Denver

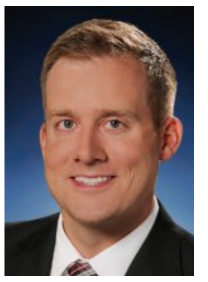
Keep in mind that, in addition to constituting modern best practices, many of these same strategies will be required by the insurance carriers underwriting the project.

OCIPs are Key

Speaking of insurance, perhaps the most important component of any defect mitigation strategy is the use of an owner-controlled insurance program, sometimes called a "wrap."

Traditionally, developers have relied on the general contractor and the dozens of project subcontractors to purchase their own liability insurance. The result can be a maze of insurance policies with varying limits, coverages and exclusions. Worse, when there is a claim, each carrier is incentivized to point the finger at other parties. Under an OCIP, by contrast, the developer buys a single package of liability insurance policies that provides coverage to all of the parties that enroll and perform work on the project. An OCIP can provide significant advantages to developers, including:

- **Control.** With an OCIP, the developer gains control over what is included in the insurance program for the project and how much insurance is available to respond to claims.



Benjamin Geiger
Insurance adviser, IMA Inc., Denver

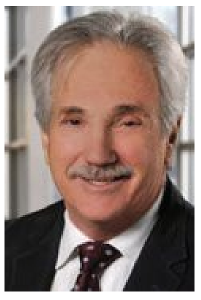
- **Longevity.** If structured correctly, an OCIP should provide coverage for the entire eight-year statute of repose, so developers don't have to worry about whether their contractor and his subs will have insurance after the project is complete.
- **Cost savings.** Rather than paying for insurance costs that are imbedded in contractors' and subcontractors' bids, by purchasing a single policy, developers can potentially negotiate less expensive coverage and higher limits.

Not all OCIPs are created equal, however, and it is critical to understand what is and is not included in a particular program. Common coverage exclusions can weaken the coverage provided by an OCIP. It's important to work with a skilled risk management team that can help you shape the right OCIP for your project. Getting started early is critical, and the sooner you can assemble your risk management team, the better.

There may not be a silver bullet for avoiding litigation on condominium projects, but developers who work to mitigate risks – and maximize insurance coverage – can be successful even in the current environment. Look for the second part of this series about mitigating condo development risks in the next issue of Multifamily Properties Quarterly.▲

Regulatory

Flat-rate fees are the wrong way to manage water



Carmine Iadarola
President, AquaSan Network, Glendale

There is tremendous value placed on water in the high desert. Every drop counts and as one public service advertisement suggests, people should "Use only what you need." The implementation of impact fees, however, has caused a mismanagement of this valuable resource for new buildings and has placed a burden on the affordability of new housing through flat rates and overestimating water demands.

Impact fees are fees charged by water and sanitary sewer providers on new construction. Few tenants, homeowners or occupants know these fees are a significant portion of their mortgages or rent. These impact fees are paid upfront before the occupant uses one drop of water and are costs the developer includes in the financing of the building and thus the rents and mortgages of every residence.

The Front Range of Colorado has some of the highest water impact fees in the nation. For example, according to Western Resource Advocates Study, Arizona's average impact fee for a single-family home is $5,200 and in Utah it is $2,900. The average for all of Colorado, according to the same study, is $12,400 per single-family home. In many parts of the Front Range, fees for a residence are over $30,000 per home, which is more than 10 times Utah's average.

Unfortunately, many water providers' impact fees are flat rates that do not measure water usage, and one cannot manage what one does not measure. Thus, the impact fees neither accurately reflect the cost of service, nor offer an incentive for water conservation for new construction. For example, a 600-square-foot affordable studio apartment often pays the same water and sewer impact fee as a 5,000-sf luxury penthouse.

As with most successful resource management tools, the market provides a very effective best management practice. Flat rates provide no price signal to the consumer and are the least-effective rate structure to manage water resources. In fact, the flat rates provide a disincentive for a developer to invest in water management devices when they pay the same impact fee, whether the building is using 15,000 gallons per month or 4,500 gallons per month. Flat-rate impact fees also negatively impact affordable housing, because an affordable studio apartment is subsidizing the high-impact luxury penthouse or home, often adding more than $200 per month in rent for water that is not needed.

The way impact fees are designed are ineffective in managing and conserving our water supplies. There often is no link between the amount of capacity used by a building and the amount paid for the water and sewer service. Without a market link, an opportunity to better manage water supplies by providing a price incentive to the builders to imbed water-conserving systems into their buildings is lost. The nexus between the amount of water capacity needed and the design of the building is lost.

The customers often don't know these fees exist, how many additional dollars are included in their mortgage or rent for these fees, or even how much water capacity they have paid for at their premise for water they do not need or use. If the consumer doesn't know how much water has been allocated to their residence, how can they appropriately manage their investment?

I believe the solution is the use of a market-based system for fees that are grounded in actual demands, which in turn, increases affordability in our water-efficient housing. First, the cost of providing water to a residence and a nonresidential building should be similar – no differentiation in the impact-fee schedule for residential and nonresidential.

Second, this fee should take into account the peak demand the building places on the system and the amount of estimated annual water consumption used. This can be ascertained from the estimates provided from a licensed engineer and can be calculated by the fixture unit method or the demand profiling method. The American Water Works Association for sizing water services recognizes both processes, but considers demand profiling more accurate.

Flat rates and broad generalizations regarding demands placed on systems need to be eliminated. The homeowner, renter or building owner should pay only for the amount of water and sewer capacity he anticipates using. Elimination of flat-rate impact fees sends a clear market signal that if a developer can reduce his water demand, the impact fee will be lowered and one can determine the value of investing in water conservation.

There is no question that flat rates do not manage resources and excellent opportunities are missed to reduce water demand that, in turn, would make our residences more affordable by including water management in the design of the building. The market system is the best way to send these signals. Water is too valuable in the Front Range for estimates, let's "use and pay only for what you need."▲

Regulatory

In multifamily, shrinking units equals growing liability

Denver's ever-growing population has spurred innovation and creativity in architecture, especially when it comes to apartment communities, but when could innovation mean breaking the law? New multifamily developments have been a staple here for several years and with that has come the escalation of construction costs, driving developers and architects to creative designs that maximize the use of space and minimize cost. Many times, in an effort for efficiency, room sizes shrink and critical accessibility considerations get overlooked. For developers, moving toward smaller layouts to increase unit counts also can mean a significant increase in liability.

The Federal Fair Housing Act is a federal law that was amended to cover the design and construction of multifamily projects built after 1991. It applies to multifamily properties, whether they are apartments or condominiums, and the design requirements apply to buildings with four or more units. It applies to all dwelling units if the building has an elevator. In buildings with no elevator, only ground-floor dwelling units are required to comply. Noncompliance with the Federal Fair Housing Act creates costly issues during construction and can heavily impact the project schedule. It also can create headaches down the road if the property is sold and a buyer finds accessibility issues, leading to additional expenses for the seller. Thoughtful strategy can help avoid those problems and decrease liability from potential complaints or lawsuits.

Compliance with the act translates into greater usability for everyone, not just those who are disabled. Fixture placement and clear-floor space are two requirements that can significantly impact the design and, in many cases, will limit how small a room can be. Efficiency units (studios) and micro units make heavy use of limited space, but rooms such as kitchens and bathrooms require thoughtful design and careful construction; otherwise, innovation may end up causing more problems than it solved.

Mari Lucci
Accessibility specialist, building ONE consulting LLC, Lakewood

Shrinking the size of the kitchen may seem like a cost-beneficial move, but consider if the required 30-by-48-inch clear-floor area is no longer provided at a sink or appliance – the unit may be noncompliant with the Federal Fair Housing Act. When designing kitchens or reducing the overall size of the space, favor linear kitchens rather than "L" or "U" shapes. This gives the greatest flexibility to meet accessibility requirements and minimizes dead space in kitchen corners. Another strategy is to shift appliances and fixtures away from kitchen corners, allowing for greater usability by providing centered clear-floor areas at each. There are myriad ways to ensure an efficient, accessible kitchen, but each approach will require ample attention to clearances and adjacencies.

Similarly, floor space in bathrooms is crucial for compliance with the Federal Fair Housing Act and future usability of the space. While relocating fixtures, omitting cabinetry or condensing the area overall are valid space-saving measures, the implication is that less space is dedicated to accessibility. In bathrooms, for example, the act requires a 30-by-48-inch clear-floor area outside of the door swing. If this area is not provided, the unit may be considered noncompliant with the act.

Kevin Harkins
President, building ONE consulting LLC, Lakewood

Fixture clearances are another consideration that easily can be overlooked when the intent is to tighten up a space. Being cognizant of accessibility spatial requirements during the design phase, especially in kitchens and bathrooms, can minimize headaches, avoid costly errors, reduce tearing out noncompliant construction and ensure a higher level of usability throughout the project.

Opting to design kitchens and bathrooms with slightly more space than is required is a strategy that can lower a developer's risk by allowing for required minimums and building in construction tolerance. This approach affords the developer more flexibility with product selection, such as appliances and cabinetry, commonly handled well after construction begins. A gas or electric range, for example, is a seemingly straightforward selection, but consider that the size and layout of the kitchen determines whether that selection will maintain or impede required clear-floor areas. The addition of spatial tolerance many times rewards developers with options where there otherwise may have been none.

There are many Federal Fair Housing Act requirements beyond clear-floor areas such as requirements that stipulate the minimum size of doors, how deep a closet can be or even the height of a threshold. There are seven requirements in total, all of which follow the philosophy of greater tolerance and higher usability for a variety of people. Further, there are laws and standards beyond the Federal Fair Housing Act that may apply to your project including the building code, state laws (Colorado Revised Statutes 9-5), accessibility laws based on financing (Section 504), as well as the Americans with Disabilities Act.

Taking a proactive approach to accessibility can help minimize the risk associated with efficiencies, micro units or any multifamily project. Such an effort also may appeal to future buyers. Maximizing a property's appeal and value is a consideration of any developer, and proactive compliance with the act could minimize price negotiations in the future.

There are great advantages to building efficient multifamily spaces, but with that comes great responsibility. As tighter spaces become more commonplace and as necessity leads to innovation, it is imperative that accessibility sits alongside creativity.▲

Community Spotlight

Multifamily activity is flourishing in Castle Rock

With nearly $500 million in new development already underway or about to break ground in Castle Rock, the multifamily housing market here is keeping a steady pace. In order to provide homes to a growing workforce that is finding ample employment opportunities, there are a variety of new multifamily housing developments already underway in this 56,000-resident seat of Douglas County.

The growth in Castle Rock and Douglas County isn't being ignored by developers, who have their sights set on building apartment and townhome projects that will provide a range of price points, from affordable to million-dollar-plus luxury units. The projects underway are creating plenty of momentum, which is inviting even more opportunities for commercial and residential development in this bustling and growing town.

Some of the larger multifamily projects are key elements of major mixed-use developments that will call Castle Rock home. One of these projects is the $60 million Riverwalk, being developed by Confluence Cos., which will include 228 apartments in addition to 30,000 square feet of office space and 10,000 sf of retail, located on two blocks of downtown real estate. The development will feature full underground parking and will abut Festival Park, an inviting urban amenity to the residents. Access to Philip S. Miller Park, a park that features 320 acres of activity is a short bike ride away.

Mercantile Commons is another sizable mixed-use development, providing nearly 29,000 sf of combined residential, office and retail space. Located in downtown Castle Rock, at 230 Third Street, and adjacent to Festival Park, the development offers studios, one-bedroom and two-bedroom apartments and has spectacular views from all sides. Units have moved quickly, proving that this market is ripe for this type of product.

Frank Gray
President and CEO, Castle Rock Economic Development Council

Just north of downtown Castle Rock, Venue at The Promenade, a Class A luxury apartment community by Embry Partners is underway. Venue will feature 312 units consisting of one-, two- and three-bedroom floor plans, designed with a contemporary Colorado mountain lodge theme, upgraded interior finishes, and interior and exterior amenities. Residents will enjoy unique connectivity to over 1.5 million sf of adjacent walkable retail via a terraced grand stairway. The property also benefits from outstanding western exposure to the Rockies' Front Range.

And while multifamily development is keeping pace now, there is little doubt that more will be needed in the near future. Construction of other developments throughout town are providing office, industrial-flex and warehouse space that the Castle Rock commercial real estate market has not seen in quite some time. Having available space for growing companies has proven impactful as scores of growing technology, pharmaceutical and light manufacturing companies are beginning to take residence in these spaces.

Craine Architecture

Riverwalk, a $60 million mixed-use project being developed by Confluence Cos., will include 228 apartments in addition to 30,000 square feet of office space and 10,000 sf of retail.

Additionally, the $200 million shopping center, The Promenade at Castle Rock, is nearing completion, and a $40 million Collaboration Campus is planned on 14 acres in The Meadows. The campus will include Arapahoe Community College, Colorado State University and the Douglas County School District. All entities will work together as educational partners to create a smooth pathway from high school diploma to associate's degree to bachelor's degree. The Castle Rock Town Council approved a $3 million infrastructure reimbursement to assist in the construction the Collaboration Campus.

This educational infrastructure is another step in our strategic plan to create a great environment and workforce pipeline for the attraction and retention of primary employers. It will have a significant impact as companies make location decisions – access to an educated workforce and ongoing training are critical to a long-term sustainable and vibrant community.

Anticipated projects that include additional office space, hospitality, light industrial and medical office buildings fill the development pipeline. We have been something of a secret for a long time, but with the combination of hard work to create a vibrant downtown, a growing employment base, a great location between the Denver Tech Center and Colorado Springs, and an increase in new development, we have become a great place for multifamily development.▲


WHAT IF...
You and your environment
became one?
A stunning synchronicity
of heart and soul
with space and place.
The perfect fit,
as comfortable and elegant
as your favorite silk shirt.
That's the power of great design.
Helping us to live
more
effortlessly.
Angela Harris
Pictured:
Angela Harris and "Highlands 32" by Alliance Residential
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TRIOENVIRONMENTS
BY ANGELA HARRIS

Affordable Housing

Addressing Denver's growing affordability issue

With both Colorado and Denver's unemployment rate at 2.9 percent (as of February), the state's economic growth is strong, especially compared to the national unemployment rate of 4.7 percent. While this statistic is worth celebrating, the state's housing market tells a slightly different story.

According to the Denver Office of Economic Development, half of Denver's renters pay more than 30 percent of their income for housing; nearly a quarter of those households pay more than 50 percent for housing. The high living costs can make it difficult for these households to save or invest in the future, potentially affecting the long-term economic vitality of the city. Denver Housing Authority has reported that the city needs about 21,000 more affordable units in order to meet demand – significantly more than are in the pipeline.

Once regarded as something that only affected the very poorest residents, affordable housing is affecting people with full-time jobs that would traditionally allow them to live comfortably – if not lavishly.

Take teachers, for example. A report from Trulia recently ranked Denver as the seventh-least affordable metro area in the U.S. for people trying to buy a home on a teacher's salary (a median of $53,400 a year). Less than 13 percent of homes on the market in late 2016 were affordable to someone earning that wage.

Cindy Harvey, AIA, NCARB
Associate principal, commercial market lead, RNL Design, Denver

Recognizing the need to address affordability from all angles, the public and the private sectors are committed to finding solutions. As architecture and design professionals, we approached our recent affordable housing projects – The Ashley at Union Station, Tapiz at Mariposa and Acoma Lofts – with an eye toward creating quality designs that promote equity, mobility and deep community connections. We also are watching closely how the city, nonprofits and developers are responding to this issue to partner where we can.

• **Public support.** Last year, the Denver City Council approved an affordable housing proposal aimed at raising more than $150 million over the next 10 years from property taxes and new development impact fees. The plan has the potential to preserve and/or create about 6,000 affordable housing units – far short of the 21,000 we need, but still a step in the right direction.

This came after Denver Mayor Michael Hancock announced the creation of a $10 million Revolving Affordable Housing Loan Fund. This financing tool is designed to support the development of multifamily rental units serving individuals and families earning up to 60 percent of the area median income, or $46,020 for a family of four.

According to the Denver Office of Economic Development, the fund will target housing projects that receive 4 percent Low-Income Housing Tax Credits through the Colorado Housing and Finance Authority. This fund will help bridge the gap because many affordable developments were unable to use the 4 percent credits because of a lack of soft funds and gap financing.

• **Private investment.** On the development side, there are a number of recently completed projects and several projects in the works, which aim to put a dent in the affordable housing issue.

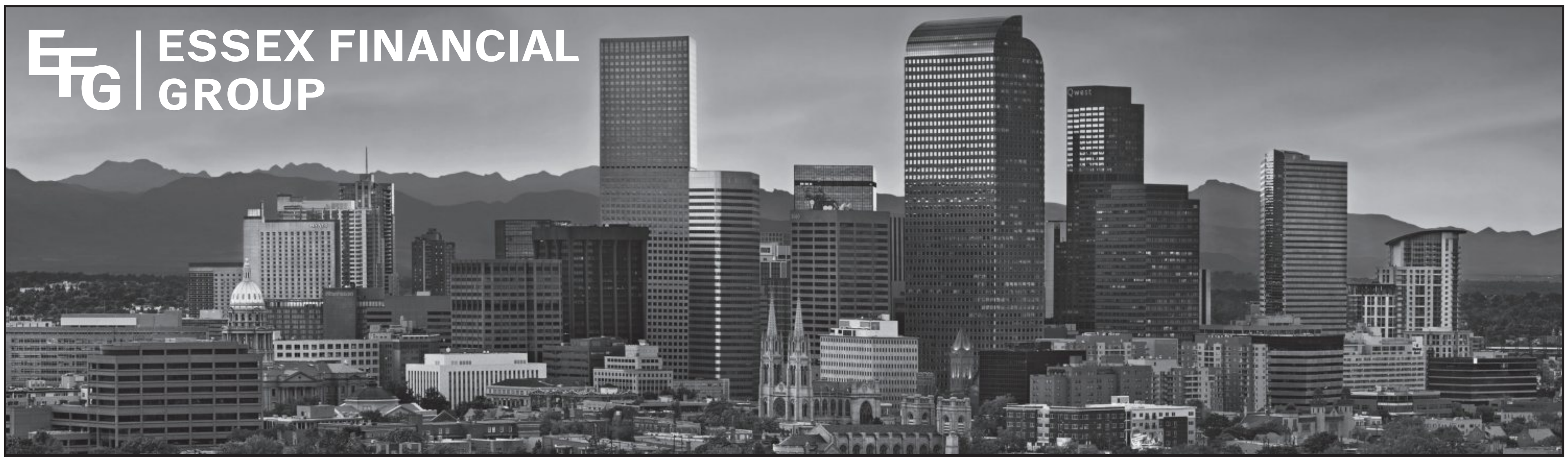
Last October, Welton Park affordable housing apartments started moving tenants into 223 units that are all income-restricted to people making 60 percent of the area median income. Likewise, Habitat for Humanity of Metro Denver recently completed a 51-unit, for-sale townhome development called Sable Ridge in Montbello.

In the red-hot River North area, Denver-based developer Zeppelin is building Redacted on the Taxi campus, a multifamily building with 314 apartments for renters who earn less than 60 percent of area median income. According to Zeppelin, adding affordable units to Taxi was appealing to many of the 150 businesses located there, and businesses wanted to align with them because of it.

In the heart of the Union Station neighborhood, we recently completed work on The Ashley, a 107-unit, mixed-income apartment complex. A truly mixed-income property, the property not only reserves 34 units for residents earning 60 percent of area median household income, but also it reserves another 34 units at 50 percent of area median household income and seven more for residents earning just 30 percent of area median income – a rarity, especially for a highly desirable area such as Union Station. Its proximity to the region's public transit hub further aids in the crucial area of mobility for residents.

For this project, our architecture, interior design, lighting and landscape design teams worked together to deliver a design that met the strict budget requirements typical of affordable housing projects, while also providing amenities residents would find in a higher-end complex – a rooftop deck, beautiful light-filled common areas and exterior architecture fitting of the area. The goal for the design was to create a space any resident would be proud to live in, regardless of income.

As Denver continues to grow, affordable housing will become more of an imperative. Between the public and private sectors as well as changing cultural attitudes, there is much we can do to address the problem and create a city that is livable for everyone.▲



Multifamily Properties Quarterly - Financing Sources Matrix

TYPE OF CAPITAL	SOURCE OF CAPITAL	EXPLANATION	RATES/SPREADS	LTV/COVERAGE	TERM	AMORTIZATION	FOCUS	TRENDS
LIFE INSURANCE COMPANY	• Insurance premiums • Annuity and GIC sales	• Non-Recourse • Longer-term fixed rate loan	140-200 bps over the comparable US Treasuries	• Up to 70% LTV • 1.25x Minimum DCR	5-30 Years	25-30 Years	• Market rate properties in major metro areas • B quality properties and above	• Many life insurance companies are ahead of plan for multifamily allocations and look to become more selective in 2nd half of 2017 • Most competitive at lower to moderate leverage with strong sponsor • Flexible prepayment penalties available for small pricing premium • At right leverage (~60%) lenders can do Interest Only • Best source for terms over 10 years
AGENCY	• Sales of mortgage-backed securities with implied government guaranty	• Non-Recourse • Longer-term fixed rate loan	210-250 bps over the comparable US Treasuries	• Up to 80% LTV • 1.20x Minimum DCR	5-30 Years	30 Years	• Market Rate • Age-Restricted • Affordable/Workforce • Major metro areas • Secondary/Tertiary Markets • C quality properties and above	• Operating through specially designated underwriters • Comparable pricing for affordable/workforce housing • Minimum investment is typically 750k with no maximum loan size • Agencies have expressed a desire for increased loan volume in 2017
CONDUIT (CMBS)	• Sales of mortgage-backed securities through public markets	• Non-Recourse • Longer-term fixed rate loan	225-275 bps over the greater of Treasuries or Swaps	• Up to 75% LTV • 1.25x Minimum DCR • 8.0% Minimum Debt Yield	5, 7 & 10 Years	30 Years	• Market Rate • Second tier properties • Secondary/Tertiary Markets • C quality properties and above	• Spreads have narrowed 25-75 bps since 4Q 2015 • Most competitive at higher leverage in secondary and tertiary markets • 10 years interest-only under 65% LTV • 5 years interest-only under 70% LTV
BANK	• Corporate Debt • Deposits	• Recourse (some non-recourse available) • Shorter-term fixed and floating rate loans	200-300 bps over bank cost of funds	• Up to 75% LTV for permanent loans • Up to 60% of cost for construction loans	Up to 7 Years Fixed	Interest Only to 25 Years	• Market Rate • Age-Restricted • Affordable/Workforce • Major metro areas • Secondary/Tertiary Markets • B quality properties and above	• Standards are tightening for Sponsors with no deposit relationship, and establishing a deposit relationship is becoming a requirement • Maximum LTC for construction loans has dropped to 55%-60% in last six months • Most competitive for Sponsors with established banking relationships and strong borrower history that are willing to accept recourse • Primarily recourse loans, with non-recourse available to strong sponsors at low leverage • More flexible (open) prepayment terms
DEBT FUND / BRIDGE LOAN	• Private Capital • Institutional Capital	• Non-Recourse • Shorter term bridge loans for acquisition and/or repositioning	LIBOR + 300-550 bps (some w/ floors)	• Up to 85% LTC • Going-in 1.0x DCR	1 - 5 (3+1+1)	Interest Only	• Market Rate • Secondary/Tertiary Markets • C quality properties and above	• Pricing depends on leverage level, property quality, and Sponsor strength

Essex Financial Group - Recent Multifamily Transactions

Decatur Point Apartments
Denver, CO
$39,000,000 Permanent Loan
Life Insurance Company

The Commons Apartments
Cincinnati, OH
$14,149,000 Permanent Loan
Agency

Gardens on Paris
Aurora, CO
$8,692,000 Permanent Loan
Agency

Jeff Riggs
President / Principal
(303) 843-0440
jriggs@essexfg.com

Peter Keepper
Managing Principal
(303) 843-6002
peterk@essexfg.com

Cooper Williams
Principal
(303) 843-4581
cwilliams@essexfg.com

Mike Jeffries
Principal
(303) 843-9220
mjeffries@essexfg.com

Ed Boxer
Principal
(303) 843-9256
eboxer@essexfg.com

Michael Salzman
VP of Loan Production
(303) 843-6015
msalzman@essexfg.com

Michael Lapporte
VP of Loan Production
(303) 843-4025
mlapporte@essexfg.com

Alex Riggs
VP of Loan Production
(303) 843-4027
ariggs@essexfg.com

Essex Financial Group | 1401 17th Street, Suite 700 | Denver, CO 80202 | www.essexfg.com

Design

Borrow from hospitality to preserve neighborhoods

With metro Denver's population growth continuing to outpace the national average, multifamily projects are springing up across the region to meet increased demand for housing. There are currently 21,000 units under construction metrowide, and another 24,000 units planned or proposed for construction.

With rapid building comes the risk of losing some of the character that makes each neighborhood special by settling on nondescript design templates for easy approval. Denver neighborhoods offer such unique and varying experiences; these new multifamily projects have the opportunity to add richness, not detract from it.

Denver is not alone in this struggle. The city of Seattle faced similar challenges and opted to create neighborhood conservation districts to help address the issue. While there may not be a formal movement in Denver, it's still a topic of concern.

We believe that the key to addressing this type of issue – and the key to any successful project, really – is to ensure that design reflects its context.

Take a look at the hospitality sector in Denver. The feel of The Crawford Hotel is entirely different than that of Halcyon in Cherry Creek or The Maven, our newly completed project in Dairy Block. Despite being within a few miles of one another, our designs were entirely based on

Liz McDonald, AIA, LEED AP
Principal, Johnson Nathan Strohe, Denver

the history and character of their specific neighborhoods.

Taking cues from hospitality design, we can help combat cookie-cutter multifamily projects, and preserve – even enhance – the character that makes each Denver neighborhood special.

• **Contextual design**. Exceptional hotels offer intentional experiences that can only be found where they are. The same is true of multifamily projects.

Designing for a multifamily project requires a cultural immersion into the character of an area. By accounting for both the needs of a client and respecting the history of the community, the final design will produce something that seamlessly blends into the neighborhood's fabric, reflecting the materials, structures, scale and details like window patterns of the area.

Take Denver's Lower Highland neighborhood as an example. With 10 multifamily projects either under construction or planned in the area, it's important to pay attention to what makes this place a local favorite – mainly, easy access to restaurants, bars and retail.

The 106-unit Alexan LoHi, set to open later this year, takes into account its historical urban setting. At just five stories, the project features a brick façade and first-floor restaurant and retail space that will add to the vitality of the neighborhood. The design also incorporates murals and artwork by local artists to make residents feel at home.

Taking cues from a different Denver neighborhood, Laurel Cherry Creek offers a taste of upscale hospitality fitting of the area. This 77-condominium project, set to open in 2018, will offer residents a porte-cochere, large balconies with sliding glass doors that blur the line between interior and exterior, and a resortlike rooftop deck with unobstructed views of the mountains and downtown.

• **Community connection**. One of the most powerful elements of hotels is their ability to create a connection with the surrounding community. As 24-hour, 365-day spaces, detailed attention is given to how they play a role in a neighborhood's daily life. Multifamily projects aren't all that different.

While there may not be unlimited access, the incorporation of mixed-use spaces including restaurants and retail adds to a community's connection to multifamily projects.

As one of Denver's up-and-coming areas, Sloan's Lake traditionally has been a residential neighborhood with a concentrated focus on the lake as a premier activity for those seeking an active lifestyle. While there are only a few multifamily development projects planned for this area, the redevelopment of the St. Anthony Hospital campus provides an opportunity to complement the area's active lifestyle with new offerings.

At Regatta Sloan's Lake, a 369-unit apartment community, which opened in the fall, the first floor of the west building offers restaurant spaces designed to attract residents and neighbors alike after a day on the lake or running around town.

• **Common spaces**. In the same way a hotel can create a great experience by facilitating connections to the surrounding community, it also can create memorable experiences with the strategic use of common areas for guests to interact, retreat and enjoy. This same type of amenity can make a difference in creating a thriving multifamily project.

The design for Alexan LoHi, for example, includes an interior courtyard that serves as an urban oasis and encourages residents to meet one another. Regatta Sloan's Lake features interior gathering spaces for residents that seamlessly connect to two interior courtyards. The project also uses Sloan's Lake Park as a common space, offering rentable paddleboards and kayaks to residents for use on the lake.

When done with intention and care, multifamily projects have the ability to both reflect and enhance the uniqueness and character of these special neighborhoods. These projects have a special opportunity to create a lasting impact on residents and the greater community for years to come.▲

Design

Design should connect and enhance communities

Stephen Dynia, FAIA

Principal, Dynia Architects, Jackson, Wyoming and Denver

Multifamily housing is a perpetual challenge met with a variety of strategies, from postwar rent control in New York City to the mega projects of the mid-20th century, and just about everything in between. We have gone through eras of centralizing and decentralizing, of density and sprawl. Heavy-handed systems in the former U.S.S.R. and now in China use housing as a form of collective control, whereas the American objectives focused on the pursuit of individual happiness while contending with the realities of managing post-industrial revolution migrations.

The historical examples tend to trend with prevailing urban planning thinking, from prewar garden communities to modernist towers in a park. We are in a new era of housing in cities, as cities regain favor as places to work and live. Multifamily housing projects include everything from single-lot prototypes and micro units, to large developments that explore new relationships with community. While there is much history to draw from, challenges continue to evolve with the complexities and variables of societies.

The architects' goal for all housing – multifamily and otherwise – should be to create quality living environments. Healthy societies grow from within and start with the conditions of habitation. The first priority in planning housing is location. Cities serve as vital amenities to individual neighborhoods and connect us as a community. With mass transportation making a comeback, connectivity is broadly addressed. Urban developments should focus on proximity to transportation and walkability.

Another critical objective is demographic diversity within housing developments and, by extension, within neighborhoods. The intermingling of people in different phases of life and in alternate modes of living adds richness to our daily lives. Economic diversity also is an objective – avoiding the creation of ghettos for singular economic categories helps soften economic castes. Although as a discipline, architecture has at times overstepped its boundaries regarding social engineering in the modern era, it is an inevitable component of social change, and it is our obligation as architects to inspire communities to move housing development in a positive direction.

As designers, we have a leadership responsibility to work with developers and municipalities to locate development sites and create housing that achieves these goals. The most-effective way of implementing change is through example, so I have included the recently completed Freight Residences project on the Taxi campus in River North to illustrate the following points:

Dynia Architects

Green space is a vital part of successful multifamily design. At Freight Residences, private garden patios are featured on the ground floor.

• Effective site planning should connect housing to the broader community as well as create collective and private amenity spaces within, such as private gardens. Although the amenities of the Taxi campus are extensive, a pedestrian bridge over the Platte River will provide access to The Source, The Source Hotel and Market Hall, and other business along the Brighton Boulevard corridor.

• Environmental considerations, such as sun and prevailing weather, inform a project configuration and enhance livability. Each unit features an operable glass garage door that opens the living spaces to the gardens on the first floor, generous private balconies on the fourth floor and to mountain views to the west from the third floor. In addition, the utilization of day lighting and natural ventilation has positive health benefits while reducing energy costs.

• Amenity spaces and programming play a key role in the social environment of a housing project. These spaces should go beyond the standard communal gym to include educational spaces with programs for and by the residents, community gardens with advisers to promote healthy eating, communal kitchens and outdoor cinemas. Unique to Freight Residences is a community recreation room, designed as a learning and play space.

• Innovative building design considers circulation strategies that go beyond the standard double-loaded corridors to create entry conditions with individuality and a sense of privacy, which can make an apartment unit feel like a private home. At Freight Residences, stacked,

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Management

Protect your property with the right recovery plan

Megan Dyk
National account manager, Interstate Restoration, Denver

Living in Colorado, we have many reasons to be thankful. As you run through your mental checklist of things you enjoy about living here, not having to worry about events like hurricanes and earthquakes may not even cross your mind. Because we aren't susceptible to many of the large-scale weather disasters like other areas of the country, there is a tendency to become complacent. However, we still need to be prepared for Mother Nature's curve balls. Flooding from rain or snowmelt, for example, or damage from tornadoes, wildfires and hail-producing storms are very real threats for this area. Consider last year's July hailstorm, which was the sixth-most damaging hailstorm in Colorado history. This storm alone caused approximately $352.8 million in damage to the Colorado Springs area.

Mother Nature isn't the only one throwing curve balls. Nonweather-related disasters are another concern. Accidents and disasters that take place on a property are commonly caused by people. Flooding from a bathtub, an overflowing toilet or a grease fire in the kitchen are all accidents that occur more often than you think. In fact, when we respond to a property that has fire damage, often the fire was either kitchen related or caused by a cigarette.

With these causes in mind, here are a few tips to help ensure a quicker recovery after an unforeseen disaster:

• **Ensure safety of residents and site personnel.** The No. 1 priority after an event is making sure everyone is safe in and around your property. Be sure to get an accurate headcount of residents, visitors and personnel so you can try to account for everyone who was on site when the event happened. Immediately notify emergency personnel of injuries or any unaccounted people.

• **Have a plan.** Having a plan in place before disaster strikes will not only help you to react quickly and improve safety, but also will help to minimize business interruption and speed-up recovery efforts. We recommend having a disaster recovery plan that is shared throughout your organization and is embraced by the on-site facilities team.

At minimum, this plan should include a list of key contacts like plumbers, electricians, public service companies and site-specific contractors who are familiar with the property and can get to work fast to minimize damage. This plan also should include procedures for how to handle reporting an emergency, locations of major property mechanics and unit floor plans. Site teams should hold regular trainings and drills to ensure staff remain calm and make the right decisions in difficult situations.

More often than not, fires are either kitchen related or caused by a cigarette.

Disaster plans should focus on the types of events that are most likely to occur year-round, as well as include special business considerations (i.e., if your property has undergone recent renovations). The plan needs to evolve as your business ages and should serve as a living, breathing document that's consistently updated. It's easy for your plan to become outdated, especially when considering employee and vendor turnover, so make sure it stays timely and remains a priority.

• **Communication is key.** Not only is knowing what to do important in an emergency situation, but knowing who to call is critical too. When disaster strikes, it's imperative for your on-site staff to know who they need to notify. It's a good idea to have an accessible phone tree in place and to routinely do a test call down to ensure contact information is kept current.

In addition to alerting employees, it also is important to consider how you're going to notify other residents, as well as respond to the media. Without a plan in place, it can be difficult to communicate effectively after a disaster. Ideally, you should establish an external communication protocol that includes the following details:

•Identify and mobilize a PR/communications spokesperson to be "out in front."

•Determine if and when your company will be providing inter-

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2017 fitness trends your amenities should offer

High-quality fitness amenities can drive apartment leasing and retention. As a key attraction in most multifamily apartments today, fitness amenities should not only include state-of-the-art equipment but also a plan to provide the best possible experience for the people who live there.

Ryan Conover
Business development manager, Sport and Fitness Inc., Littleton

• **Cardio.** Residents desire a variety of cardiovascular choices in today's multifamily fitness centers. Treadmills, ellipticals and traditional bikes are no longer enough. According to the American College of Sports Medicine's top fitness trends list for 2017, high-intensity exercise is No. 3. Residents want high-intensity machines including rowers, stair mills, motorless treadmills and indoor cycles.

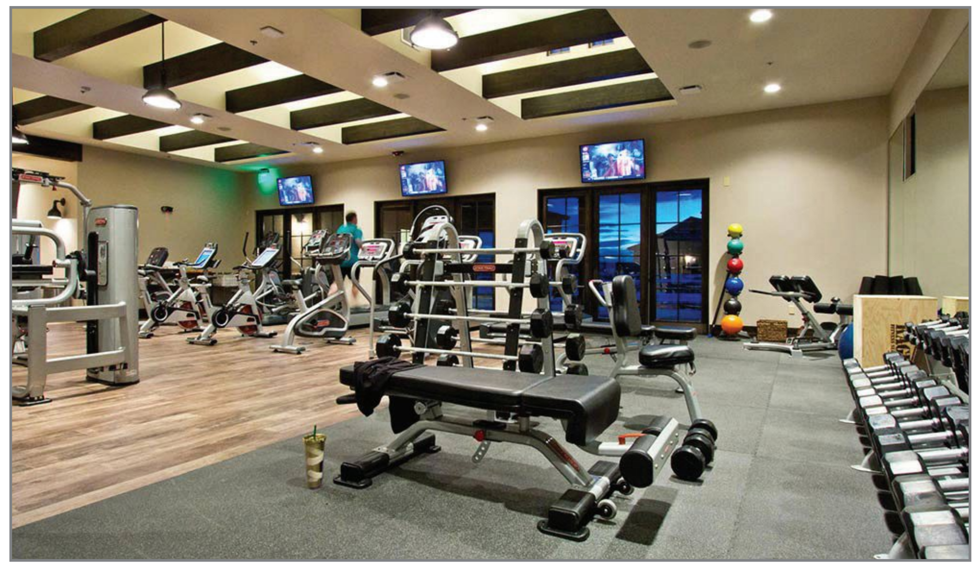
It's recommended that centers have at least five different cardio choices and duplicates of each unit. Attaching personal viewing screens or wall-mounted TVs is still the norm, while high-end facilities are embracing embedded cardio entertainment screens. Open-interface cardio systems now allow the users to link their smartphone or tablet to the cardio machine screen, creating a mirror image of the device. This allows for most wearable technology applications to be present on the screen. The American College of Sports Medicine's No. 1 fitness trend is wearable technology.

If there's space in the amenity for a studio, group exercise programs such as Fitness on Demand™ can be installed to provide virtual instructor-led classes including dance, yoga, Pilates and cycling. Boxing areas can be added if the noise doesn't detract from the other residents' experience. Group exercise programming is No. 6 on the list of trends this year and yoga is No. 8.

• **Strength.** At No. 5 on the top fitness trends list is strength training. One of the biggest complaints by residents can be a lack of free weights in the fitness amenity. To correct this, offer dumbbells up to at least 100 pounds and consider barbells from 20 to 115 pounds. Include at least one squat rack and some multiadjustable benches. If liability is an issue, a "freedom rack" can offer the movement of free weights with the safety of a guided track.

For strength machines, include a circuit that incorporates all major muscle groups: chest, back, shoulder, arms, abdominal, low back and legs. There are a variety of equipment options, and residents will notice if a facility has opted to purchase less than health-club-quality equipment.

If square footage is an issue, there are great options for smaller, dual-purpose machines that work more than one body part. For cable systems, a dual-adjustable pully can meet the needs of most multifamily centers. For more cable options and a wow factor, a larger five- or nine-station system can be explored.



Sport and Fitness Inc.

This apartment fitness amenity features premium floors, which look like wood, a small training area, strength equipment and cardio with onboard personal trainers.

• **Body weight exercises.** Body weight training scored No. 2 on the trends list. This includes isometric exercises like pushups, situps, planks and lunges. Most new properties offer a separate studio for these types of movements as well as for core work and stretching. If a dedicated space is not available, carefully planned small areas in between existing equipment can suffice.

• **Functional fitness.** Functional fitness was No. 12 on the list and is defined as using strength training to improve balance, coordination, force, power and endurance. The newest fitness amenities offer some form of functional training, which can include a larger functional trainer machine that accommodates multiple people at the same time with med balls, plyometric platforms and cable systems. Functional training accessories also can be placed in a separate studio and suspension trainers can be anchored to the walls or on a TRX multimount.

• **Other considerations.** It's important to remember that the fitness amenity represents the brand of the property. While rubber flooring is still acceptable, there are higher-end vinyl products that resemble hardwood flooring or carpet with a comfortable, cushioned rubber on the bottom. Keep the temperature of the center between 68 and 72 degrees Fahrenheit and consider ceiling fans for comfort.

The fitness amenity should be cleaned on a schedule. This entails regular cleaning of the treadmill hoods, displays and decks, and the

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Market Update

Continued from Page 1

some valuable insight into who's renting these high-end residences.

While a definitive conclusion is impossible, our analysis suggests that there are still many households – even many apartment renters – with sufficient income to rent new Class A apartments. Potential pullback in demand for these higher-end units in the future is more likely to reflect changes in resident preferences than affordability, with some residents perhaps choosing to spend less on their housing or opting for different types of housing altogether.

• **Many upscale renters downsize from single-family homes**. Identifying "luxury" apartments using public micro datasets turns out to be challenging because they lack class ratings (A, B, C, etc.) since there is no uniform agreement on how to define these class ratings. We could theoretically use the apartment characteristics that these data sources provide to try to create our own ranking system. But the data sets are missing one critical piece of information – namely, exact location.

Instead, we looked at apartments where the rent is at or above the 90th percentile of all apartment rents in the same metro area, which we'll call upscale apartments. While an imperfect measure – what qualifies as luxurious or upscale differs across diverse metro areas – it is, nonetheless, a useful proxy in gaining perspective on the high end of the market.

One of the first things the analysis showed is that there are some noticeable differences in who moves into upscale apartments. Data from the American Housing Survey on recent movers (those who moved within the past two years) showed that a slim majority – 51 percent – comes from other apartments. However, another 30 percent of upscale renters come from single-family, owner-occupied homes and 15 percent from single-family rentals.

In other words, 45 percent of those who moved into upscale apartments in the last year came from single-family houses. This is only a little higher than the 41 percent share in 1999-2001, suggesting this trend is not a temporary bump caused by the bursting of the housing bubble.

Clearly, existing apartment renters are not the sole source of demand for upscale apartments. The fact that just under a third of upscale apartment renters had previously been single-family owners/occupiers is noteworthy, particularly considering that single-family owners tend to move far less often than renters.

Recent movers to upscale apartments also are considerably less likely to live by themselves – just 31 percent of movers to upscale apartments are single-person households versus 43 percent of movers to other apartments. They are much more likely to have roommates (15 percent) than other recent movers (9 percent), and are a little more likely to be married.

These differences make sense. Roommates and married couples tend to have more income than single-person households, making such households more likely to be able to afford upscale apartment rents. In contrast, single parents are likely to have higher expenses relative to income than other households, so they may be less able to afford upscale apartments.

• **Many renters can afford expensive apartments.** Among apartment renters, the pool of potential upscale renters is substantially larger than the number currently living in upscale apartments, at least using the standard affordability metric that says housing costs should be no more than 30 percent of income.

In fact, in the top 45 metros, there are 1.5 million apartment households that could afford to pay the 90th percentile rent but instead pay rent rates between the median and the 90th percentile. This is especially true in New York and Los Angeles, where there are the most apartment households that could afford the 90th percentile rent but currently pay less.

Locally, in the Denver-Aurora-Lakewood metropolitan statistical area, there are 31,021 apartment renters who can afford rents at the 90th percentile but are renting between the 50th and 89th percentile, according to NMHC tabulations of 2014 five-year American Community Survey microdata. The rent used to represent the 90th percentile in Denver was $1,464.

The top 10 metro areas with renters who could afford to pay at the 90th percentile or more is noted on the table. Denver is No. 15 on the list of the 45 MSAs analyzed.

Most of the metro areas on the top 10 list also have seen considerable apartment development in recent years. This suggests that resident incomes might not be as large a governor on potential new development as some have suggested.

That said, the high cost of new development in many of these metros means that rents on new apartments may exceed, perhaps by a lot, the 90th percentile rents on the existing stock. In addition, many residents may be happy paying a good deal less than 30 percent of their incomes for rent, even if it means fewer amenities or inferior location.

• **The more educated, the more likely to live in upscale apartments.** We also analyzed the key economic, social and demographic variables available from the American Community Survey to identify any additional distinguishing characteristics of upscale renters. Only one stood out: education.

Among those who can afford 90th percentile rents, both nationally and locally, there is a strong relationship between the number of years of education and the rent they pay; the more schooling, the more likely they are to pay upscale apartment rents.

For example, among those who can afford 90th percentile rents in Denver and are living in upscale apartments, 45 percent have four years of college under their belts; another 26 percent have five or more years of college. By contrast, among those living in apartments with rents in the 50th to 74th percentile range, 33 percent have four years of college education, while 16 percent have five or more years.

It is unclear why greater education leads to a greater likelihood of living in an upscale apartment, even after taking into account income. There are likely other characteristics of an individual or household that play a factor. But it does suggest one additional element to look for when trying to estimate the size of potential upscale apartment demand.

Coming back to the question of whether the industry is in danger of overbuilding the high end of the market, our analysis suggests that, from a macro-market perspective, there is still a substantial reservoir of households who could afford upscale apartments.

The data shows that many high-end renters are essentially lifestyle renters or renters by choice. Many are highly educated and are married or living with roommates, making them more willing and able to pay higher rents for upscale apartments. Moreover, a good portion of them have had a single-family living experience, either as an owner or renter, prior to living in an upscale apartment. For whatever reason, an upscale apartment now makes more sense for their current needs.

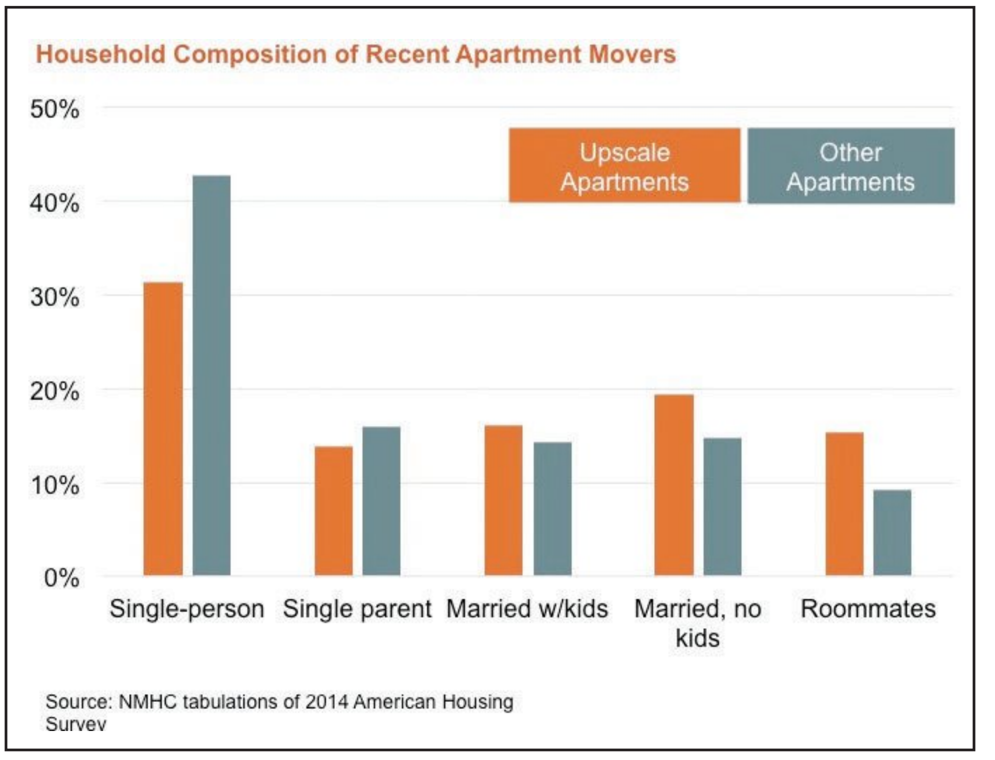
But arguably more important is the fact that there appears to be more depth to this market, as there are many apartment residents who could afford to pay upscale apartment rents but spend less. So the question is less about whether they can afford it and more about whether they see enough value in upscale apartment living to pay the higher rents.▲

Prior Tenure of Recent Apartment Movers

	Apartment	Single-Family Owned	Single-Family Rental	Other
Upscale Apartments	51%	30%	15%	4%
All Other Apartments	55%	21%	21%	3%

Source: NMHC tabulations of 2014 American Housing Survey

National Multifamily Housing Council



National Multifamily Housing Council

Renters Who Could Afford to Pay Higher Rents But Pay Less

Metro Area	Renters
New York	194,946
Los Angeles	125,857
Dallas	82,496
Chicago	70,725
Washington, D.C.	69,163
Houston	68,596
San Jose	54,441
Atlanta	50,120
St. Louis	43,781
Miami	39,679
Top 45 metro areas	1,486,062

Note: Totals reflect renters who could afford 90th percentile rents but are currently paying rent between 50th and 89th percentiles.

Source: NMHC tabulations of 2014 American Housing Survey

National Multifamily Housing Council

Renters who could afford to pay higher rents, but choose to pay less – based on the affordability metric that housing costs should be no more than 30 percent of a household's income

Lowen

Continued from Page 6

Other products, such as moderate rehab programs, have emerged recently in response to this investor shift to value add from Class A. Fannie Mae and Freddie Mac have acquisition/rehab programs that allow for greater flexibility during renovation.

• **Green.** If you had to characterize the themes and trends across the multifamily space in a few sentences, what would you say?

• **Lowen**. We will continue to see the delivery of high-end Class A units through 2018-2019. I do think we've hit the inflection point for high end so we will likely start to see this tapering off and lots of projects with construction debt in need of permanent debt. This will provide additional opportunity for nonbank lenders, who are not highly regulated and have greater autonomy, to handle these deals and get the construction debt off the bankbooks and into permanent financing. Lenders with experience in prestabilized and recently stabilized financing will continue to play a large role as this unfolds.

In my opinion, more critical and creative thinking, as well as a scrappier attitude, will be the names of the game in the multifamily market here in Colorado and across the country going forward. ▲

Dynia

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repeating modules of 18-foot sections are accessed through private gardens, creating a sense of a townhouse configuration. Innovation should extend to unit design to create flexibility. The unit designs are flexible, including spaces such as crib rooms that can alternatively be used as home offices. Only one hallway, the length of the four-story building, exists to access the one-bedroom apartments and top-floor units.

In most parts of the country, we are in the middle of a housing boom that hopefully will be used as an opportunity to repair community fabric and mend social ills. In concert with our development partners, we are committed to designing quality housing projects. We strive to enhance communities and promote social connectivity, while at the same time delivering timeless and innovative work.▲

Dyk

Continued from Page 28

views to the media (and who will be given the task), and how often your company will update social media streams and websites.

•Assign staff to reach out to public aid organizations, such as the Red Cross to assist residents affected by the emergency.

• **Expect surprises.** Even the best-laid disaster recovery plans aren't foolproof. There inevitably will be unaccounted for scenarios or circumstances. When this happens, take note and use the information to update your organization's plans so that everyone will be better prepared for the next curve ball thrown your way.

The more planning you do up front, the more competently you and your team will perform in the heat of the moment. If you don't already have a disaster recovery plan in place, don't let the idea of putting one together overwhelm you. Qualified disaster response partners with a proven history of working with multifamily properties should be aware of the nuances of the industry and can help you build a good basis for your plan. After all, knowing what to do and who to call after a disaster can make all of the difference in a speedy recovery.▲

Conover

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base of the bikes and ellipticals. Everything in the fitness amenity should have a storage place to keep accessories and clutter organized. Broken equipment should be repaired as soon as possible, so make sure equipment is purchased from a company that provides superior after-sale support. This is just as important, if not more important, as the initial equipment purchase.

Quarterly or semiannual preventative maintenance will not only extend the life of the equipment investment, but also prevent more equipment downtime and resident dissatisfaction. Careful daily inspection by the property manager can ensure that cardio TVs are working correctly and that all units are functioning properly. This includes plugging headphones into each cardio unit and trying each machine to ensure smooth movement.

When machines are broken, let the residents know by placing an out-of-order sign with the problem and anticipated repair date. To avoid dissatisfaction and costly repairs, and to remain competitive, cardio units ideally should be replaced about every three to five years depending on use and service history.

Consider a survey system or online comment box for residents to provide feedback on the fitness center and equipment. Act on these requests in a timely fashion and be responsive.▲