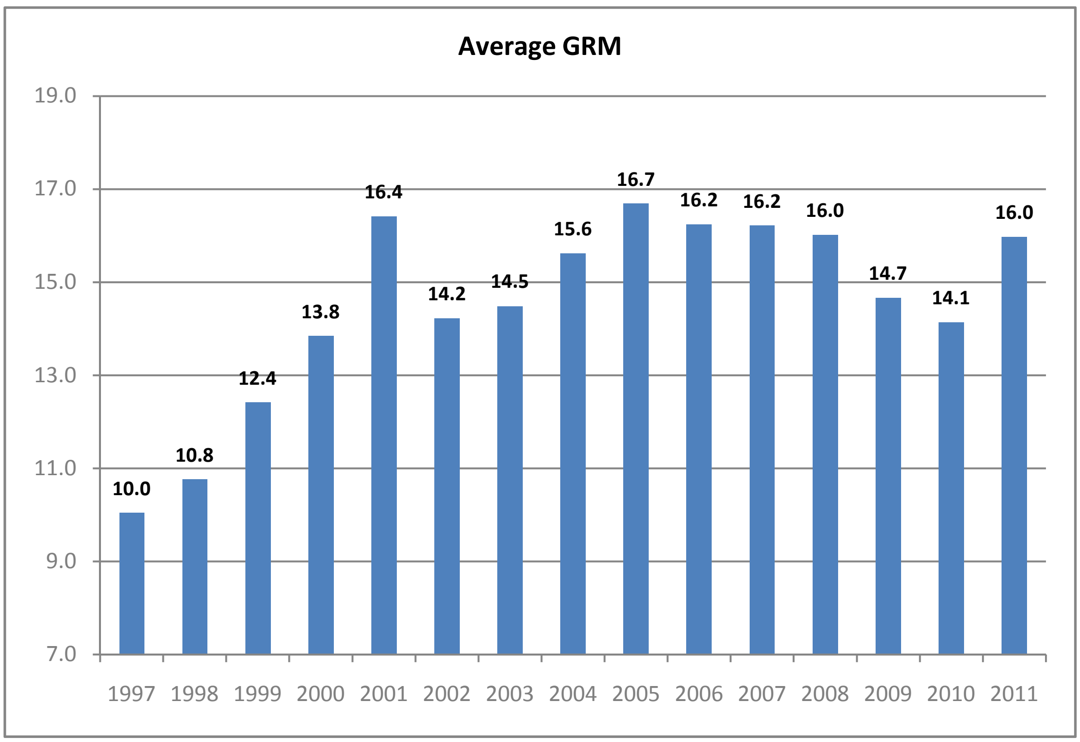
Boulder, Colorado

Multifamily Housing Market

Overview

When we look at the multifamily market in Boulder over a long stretch of time, say fifteen years, we can read statistical stories that tell us valuable lessons about today's market…and also glean some clues about what the future may hold in store. It should be noted that all the data we used for this report came from IRES (Information and Real Estate Services), the Multiple Listing Service that dominates Boulder's marketplace.

Gross Rent Multipliers



GRMs: These statistics were taken from the multifamily units, two units and larger, that *sold* between January 1997 and March 2011. These were not inflated listing prices, but were actually what multifamily investors paid.

We all know that, in large measure, income properties increase in value as the income increases or the expenses decrease. In other words, in relationship to an increasing net operating income. After all, investors will pay more money for an investment that yields more profit. True? Demonstrably so. However, this graph also illustrates that in the five years between 1997 and 2001 if rents had stayed the same the property value would have increased 60% anyway! Investors in 2001 were willing to pay 60% more for the same income than 1997 buyers were. Although it is not reflected in the graph, we all know that, in fact, rents also increased dramatically.

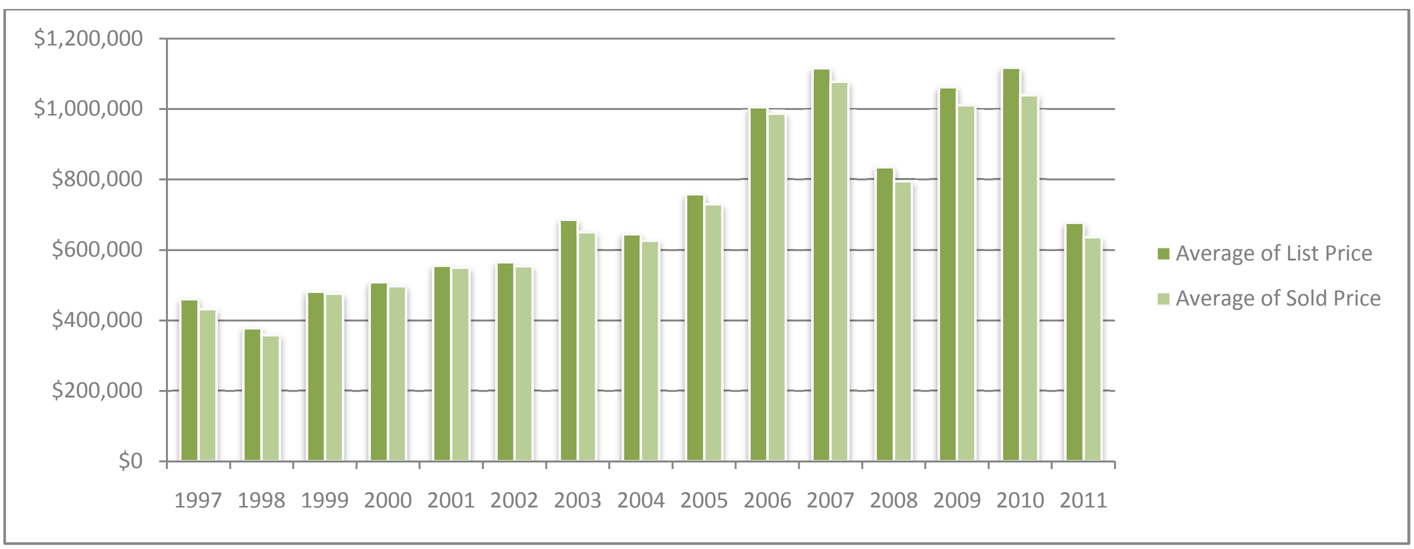
We have all heard about the huge decline that has occurred in real estate since 2008. We have also been told that Boulder maintains its values much better than the average Colorado town. Well, the multifamily decrease from 2008 to 2009 in Boulder was only about 13%, *and prices have* *tended upward since*. Yes, it appears to be true that Boulder is, in fact, stubborn in the face of economic woes. Boulder continues to be a darling for investors; a safe harbor during economic storms.

What about the GRM's trend in the next year or two? It is interesting to note that since 2004, GRMs have been more or less steady, hovering around 15. Perhaps all the bad news and apprehension in the world will bolster the GRMs at this level or higher. We think so. We're anticipating GRMs north of 15.5 during 2011, but in 2012 our crystal ball remains hazy with scattered fog.

A clear message for investors: with GRMs at this level, cash flows will continue to bobble along the bottom of the income stream…or diminish. It looks like a contrarian move to solid venues poised for upside that would yield major increases in cash flow may be in order. Can this be done with no discernable increase in risk? You bet. It is a matter of fundamentals. Let's talk.

Market Activity

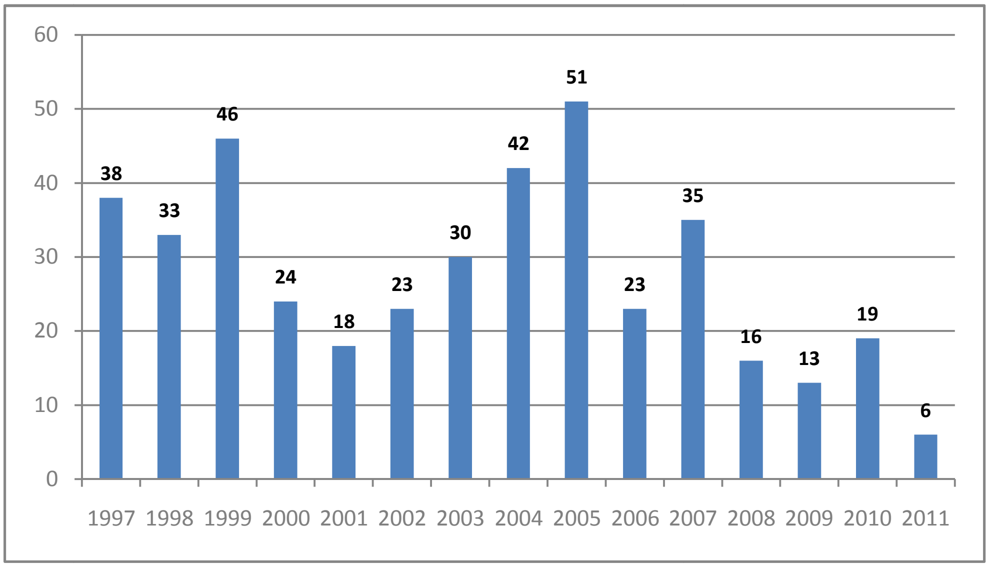
List Price to Sales Price: With all the noise given to the bath that sellers were taking by bottom feeding buyers squeezing equity from their every pore, it is interesting to note the facts don't really support that. Not surprisingly, two of the three biggest variances between listing prices and sale prices were in 2009 and 2010. However, the huge discounts that sellers were being forced to take averaged only 6.88% in 2009 and 6.19% in 2010. The multifamily market in Boulder has really been somewhat of a yawner; not nearly so dramatic as the moaning and wailing in the press would have us believe. In fact, we had to go back to 1997 to find another percentage decrease over 6%; then it was 6.2%, actually higher than 2010.



The average variance between listing and selling prices over the past fifteen years has been 3.7% for Boulder's multifamily buildings. Consistently over the years, good times and bad, Boulder's multifamily market is remarkably taut.

With the single exception of 2008, since 2006 the average sale price has been hovering around $1,000,000 or more. It might appear that 2011 will be dramatically lower than any year since 2003 or 2004. That may turn out to be the case, but we doubt it. One quarter does not a full year make.

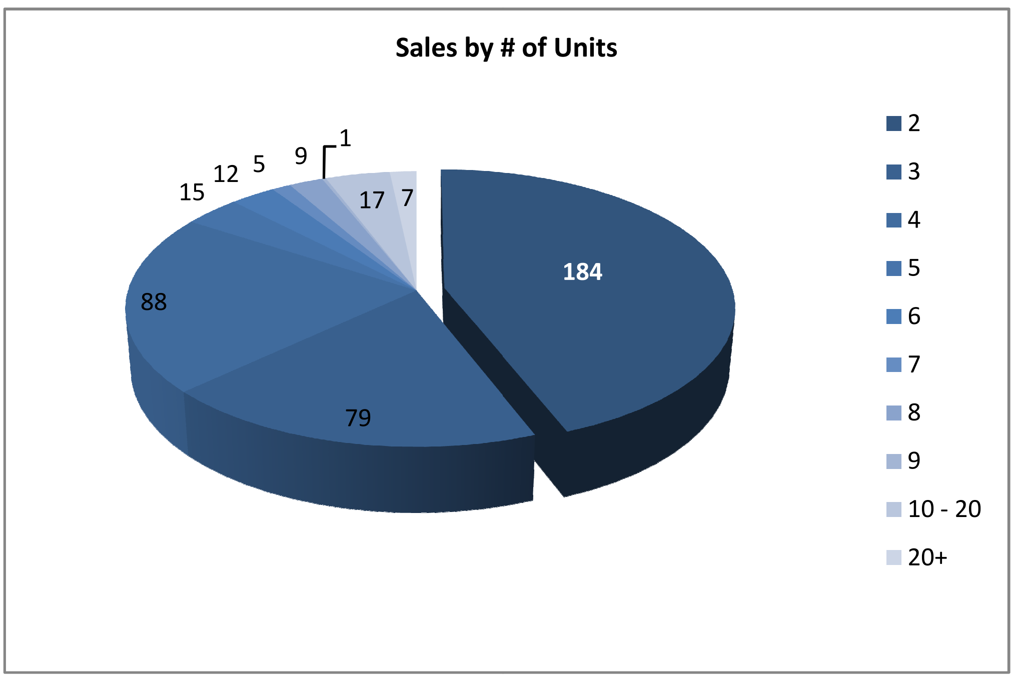
There have only been six sales in 2011 so far. We believe the total sales will be 30 or so by year's end so there is still plenty of activity left in the old girl ('11) yet.



<u>Total Sales:</u> If we are right about our total sale projections (above), 30± multifamily sales will be the biggest year since 2007.

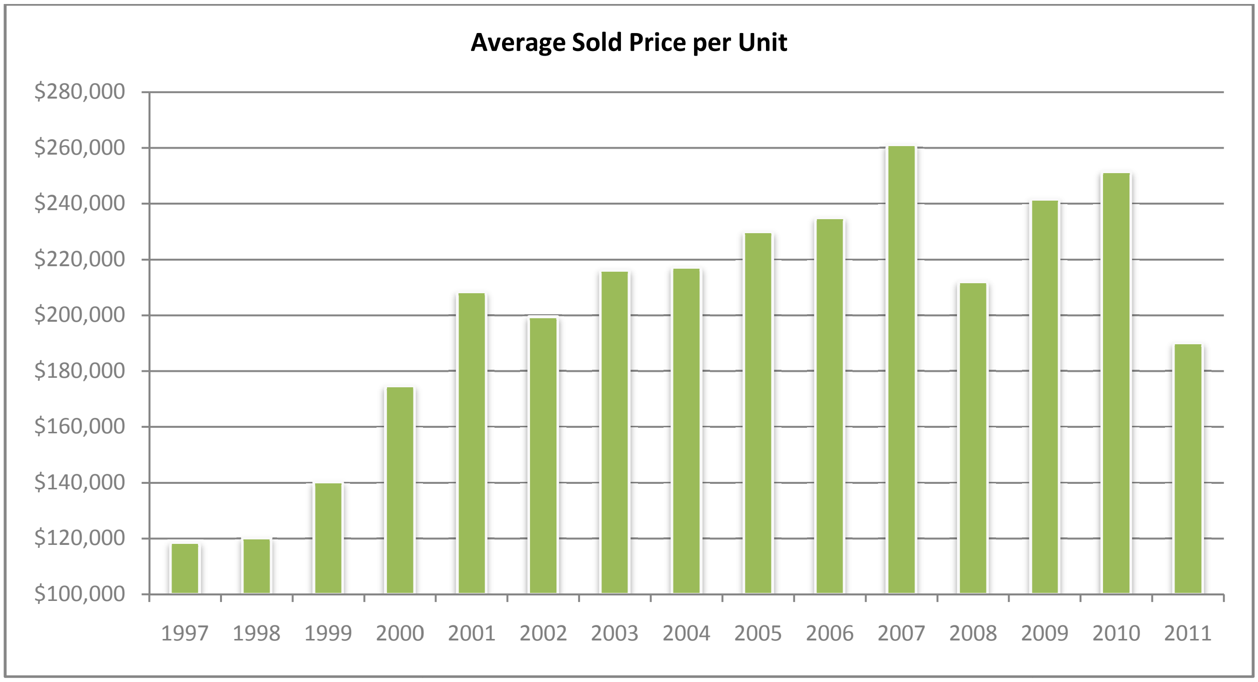
While this will be a banner near-term year for activity, let's not get all giddy. After all, the average number of annual sales in the past 14.25 years is very nearly 30. We are just looking forward to an average year. There has been subpar activity in four of the past five years. We are betting that the sales reservoir is fairly saturated.

<u>Multifamily Makeup:</u> No, this title has nothing to do with putting lipstick on a pig. Grasping the distribution of the number of units in Boulder's multifamily market, is vital to an understanding of these various statistics. It may quicken your reading of the graph to know that of the 417 buildings sold in the past 15 years, 184 – fully 44% – have been duplexes. Once we add the 79 triplexes and the 88 fourplexes, we now have 84% of the multifamily inventory of sales being commanded by buildings with four or fewer units.



Simply because of the greater demand for smaller buildings, this preponderance of 2 to 4 unit properties tends to increase the average unit price and GRMs while decreasing the Cap Rates and cash flow. So, if you happen to be among the 1% of investors considering a 16 unit building, you may have reason to be more skeptical about the averages than if you are among the 44% who are making determinations about a duplex.

<u>Average Price Per Unit:</u> In the eleven years between 1998 and 2009 the average price per unit sold, doubled; that's a compounded rate of 10.3% per year. Now let's see, if you have leverage of just 3:1 that's an annual increase on your initial investment of…oh my…and you have cash flow, debt reduction and depreciation on top of that! Remind me, please, why is it that some investors just can't understand investing in real estate?



At first blush, the 2011 unit price looks like the market for nuclear reactors in Japan. Then you remember we are only 25% of the way through the year and the statistics seem much less important. Will we top $240,000 per unit this year? I am unwilling to predict that, but my hesitancy probably has more to do with my memory of prices five, ten and fifteen years ago than it does with a rational assessment of the market today. Not only could it happen, I don't think we should be surprised if it does.

Summary

In summation, let me just add that the Boulder multifamily market is a niche market, a boutique market, a Tiffany's market. Its main attraction has been investor security. Many investors just feel financially warm and cozy within Boulder's horizontal growth-restricted borders, its plethora of trust supported families and its lure to the smart and trendy. However, it is also a heavily regulated market and the regulations, once thoroughly understood, have opened it to some very profitable opportunities. This combination of strong upside with low risk is the hallmark of InSight Brokerage's target markets.

The weakness in Boulder's market is the natural result of its popularity with investors…demand keeps pressure on high values which tend to depress cash flows into a range from limited to thin. However, cash flow is just not a major priority for many Boulder investors. For those whose investment parameters include cash flow as a moderate to high priority along with extremely low risk and strong upside there are several options in select metropolitan areas…but they will not be found in Boulder.