

## Concessions Start Disappearing! Landlord's Are Waiting To Gain Control In Recovering Office Market

Denver's office vacancy has decreased for the 6th consecutive quarter and now stands at approximately 13.0%, down from 13.9% at the beginning of 2011. The amount of vacant sublease space being offered has also continued to decline. During 4<sup>th</sup> quarter 2011, there was notable positive absorption of office space across all qualities of office properties. Average asking rates for Denver office space now stand at approximately \$19.78 per sq. ft. on a full service lease, remaining fairly flat for the last year. When we break down the rents by class of building we see increase in rents for Class A buildings while class B and C building rents have yet to stabilize.

The common trend we saw in 2011 was the flight to quality, where tenants move up in building quality and keep their rent expense about the same. Some have even renamed it as the "flight to value". Companies have shown they want to provide better work environments for their employees, better access to public transportation, better telecommunications and building infrastructure. Many tenants moved up to class A quality office properties while they could still take advantage of rates that were only slightly higher than class B quality office properties. This trend lessened by the end of 2011 as landlords reigned in the free rent and tenant finish concessions that were attracting the tenants to upgrade their quality of space.

Denver's commercial real estate market will continue in 2012 much like 2011, with incremental improvements in each submarket and quality of property, leading to continued gains in occupancy. The driving force behind the positive absorption is due to an increase in office related jobs and rising tenant demand for additional space, primarily in the energy, education, health care and financial services sectors. Denver has also seen an increase in companies consolidating to the metro Denver area due to Denver International Airport's central location and Denver's reputation as a place to do business. Denver did not overbuild like many other cities and the demand for space should continue to push lease rates up. Large blocks of space will become increasingly harder to find, prompting larger tenants to pursue build-to-suit opportunities. As momentum continues to build, we are starting to see new construction speculative office projects such as the redevelopment of Union Station, Opus' speculative office project in the Northwest market and Hines speculative project in Interlocken.

While some class A tenants are already experiencing a lease renewal premium to remain in their spaces, Class B and C tenants are likely to see rents remain flat for most of 2012. As the economy continues its momentum, the improvement of market fundamentals will set the stage for a stronger landlord's market. We expect the market to show us a jump in the office lease asking rates in the next 12-24 months. Tenants should act now to take advantage of what may be the last chance to benefit from these low market lease rates. The most cost effective way for tenants and buyers to protect themselves and reduce their occupancy costs, is to start early and retain an experienced commercial real estate consultant, even if it is just to renew their current lease.



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### Five Reasons to Consider Purchasing Property Now

By Eric J. Gold as Published in the Denver Business Journal July 29, 2011

A Theodore Roosevelt quote could be the guideline for those who sell real estate.

He said, "Every person who invests in well-selected real estate in a growing section of a prosperous community adopts the surest and safest method of becoming independent, for real estate is the basis of wealth."

Seems a bit long-winded, even for Teddy Roosevelt. While the core premise is sound, most owner-users of commercial real estate almost certainly would disagree with it — or should.

That's because the "investment" in one's business almost always creates higher rates of return than the investment in the real estate alone.

To put it another way, it's better for a business to own its own space — not as a safe investment, but as a means to increase its cash flow.

Here are five reasons why:

- **Tenants pay for buildings, not landlords** — That's the essence of leasing, of course. Tenants pay rent, and rent eventually pays for the landlord's building. It's a little more complicated than that, but not much.

Lease rates are always at the whim of the market, and the laws of supply and demand. Some leases even have clauses calling for increases based on annual consumer and cost-of-living indices.

While the owner-user does have to incur costs such as a down payment and perhaps capital improvements to the building, subsequent year-to-year costs for the life of the loan usually are both stable and predictable.

- **The window always closes** — Purchasing real estate is very much about timing. That's not a news flash. Still, far too many buyers fail to strike when prices hit bottom.

It obviously behooves a business owner to seek purchase options when market conditions are most favorable. In metro Denver, that time is now. Commercial real estate values have dropped 40 percent or more in the last two years. Replacement costs are still prohibitively high. The window is open, but it won't be open forever. Undervalued properties always will attract the attention of multiple buyers. Perhaps the biggest mistake an owner-user can make when considering a purchase is trying to predict the bottom of the market.

- **Financing just isn't what it used to be** — That's a very good thing, actually. After a slow and painful period of overcorrection, the credit markets finally have begun to prudently lend money, especially to lower-risk entities such as commercial owner-occupants. Favorable financing vehicles are just as available to a boutique-style user seeking 500 square feet as they are to a 500-employee, Class A office tenant. Smaller users may even have the upper hand.

A wide range of conventional loans are available with 20 percent down. The Small Business Administration will make loans for as little as 10 (continued on next page).

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percent down on a fully amortized 25-year note for users who will occupy 51 percent or more of the purchased property. And contrary to popular belief, most of those loans are being delivered with very reasonable approval and closing times.

• **An asset always will appreciate** — Yes, it's true. It will happen. Owner-occupants in it for the long haul — for at least 10 years — will see the property appreciate.

Writing off interest on the loan, depreciating the value and fixing occupancy costs are all factors that boost appreciation while locking in control of cumulative business expenses.

When the loan is paid off, those occupancy costs will drop significantly. Again, successful owner-users leverage the appreciation of their real estate as a means to increase cash flow while decreasing operating expenses.

• **Ownership offers options** — There's an argument to be made that leasing offers the most flexibility for any given small-to-midsized business. It's the best way for a company to stay nimble, stay ahead of market cycles, forecast volatility and avoid it.

The thing is, ownership offers similar options while stripping away the associated risks.

When an owner-user finds the right property in the right market at the right time, it instantaneously seizes control of its immediate and long-term facilities future.

After all, nobody can forecast, with any certainty, what this or any other market will look like in three, five or 10 years, when the typical lease expires.

At the very least, ownership removes that variable, that uncertainty.

Additionally, an owner-user can choose to jump into the real estate business by purchasing a space with ample room to expand its own operations or lease the surplus to one or more tenants.

In the latter instance, the owner-occupant, as landlord, controls both lease rates and tenant-finish improvements. The income from rent, of course, can be used to pay down occupancy costs.

There are countless models out there that analyze fixed/variable cost ratios, and other indices and matrices associated with ownership.

If you're a business owner considering buying, due diligence always should be your primary responsibility.

There's some risk, especially with a venture of this magnitude. But the long-term financial benefits and pride of ownership easily will outweigh any of those, especially in a market as favorable as this one.

## Negotiate Your Renewal From a Position of Strength & Knowledge!

Property owners negotiate leases every day and are keenly aware of the current market. Tenants represented by Sheldon-Gold Realty Inc. enjoy significantly better renewal terms on their lease when compared to tenants representing themselves. Why is this true? Because once you inform your Landlord you are represented by an experienced commercial real estate consultant, the landlord's risk for losing you as a tenant just significantly increased. Your landlord now knows that you are being properly educated on the market and thus he needs to offer you a fair deal if he expects to keep you as a tenant. Commercial real estate information is scattered among many different resources and a mountain of individual property marketing materials. Only a few of these resources are accessible to the tenant/buyer directly and it takes an excessive amount of time for the tenant/buyer to research, decipher and verify the various different information resources. The most important role of the commercial real estate consultant is to negotiate, advise and protect the tenant/buyer's interest. The knowledgeable consultant will present detailed, confirmed alternatives for your real estate decision and will add inside information, expanding the possible opportunities for you to consider. With the consultants's vast market knowledge, you are educated on the market and the many areas of the transaction where the buyer/tenant will have financial or liability exposure beyond the base costs if not negotiated properly. The commercial real estate consultant works to insure that you get a fair and equitable deal and eliminates surprises after the deal is closed. It is important to choose a consultant who is experienced in the type of real estate transaction you are contemplating, even for a simple renewal of a current lease obligation.

### Statistics - Selected Denver Office Submarkets

Average Quoted Lease Rate per Square Foot per Year

**BUILDING CLASS:**

SUBMARKET	VACANCY	A	B	C
CBD	12.9%	\$27.05	\$20.00	\$14.84
Aurora	15.3%	\$14.75	\$15.97	\$10.46
Colorado Blvd.	15.1%	\$21.48	\$15.72	\$14.82
Southeast Suburban	15.8%	\$21.92	\$17.29	\$12.64
Northeast	13.4%	N/A	\$17.44	\$14.06
North	15.6%	\$18.86	\$17.87	\$13.15
West	13.7%	\$21.37	\$18.27	\$13.02
Southwest	14.5%	\$23.83	\$17.04	\$12.43
Northwest	11.8%	\$22.74	\$17.28	\$13.63

### Interesting Denver Office Market Facts

- \* 58% of Denver's Tenants occupy under 2,499/SF of space.
- \* Once vacant, office space sits an average of 27.6 months before it is leased again.
- \* 44.2% of Denver's office space is occupied by business' in finance, insurance, real estate and business services industry.
- \* The average square foot of space per employee ranges from 131/SF (government uses) to 424/SF (communication firms).

### Month-to-Month Tenancies are Bad News for Colorado Tenants

Many tenants are unaware that a month-to-month lease could be detrimental to their business. Unless stated otherwise in the lease, Colorado state law only requires 10 days notice prior to the next payment period for the landlord to terminate or change the terms of a monthly tenancy.

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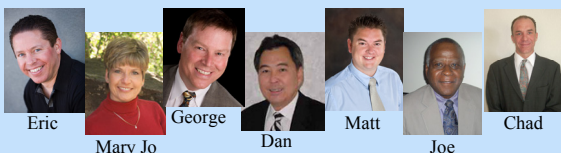
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