



**SHELDON • GOLD REALTY INC.**  
commercial real estate services

# DENVER METROPOLITAN OFFICE COMMERCIAL REAL ESTATE UPDATE

January 2018



## 4th Quarter 2017 Metro Denver Office Market

|               |                  |                |                        |
|---------------|------------------|----------------|------------------------|
| ↑             | ↑                | ↓              | ↓                      |
| Vacancy Rates | Average Rate     | Net Absorption | 4th Quarter Deliveries |
| 10.5%         | \$26.32/RSF/Year | 32,956/SF      | 11 Buildings           |
|               |                  |                | 482,174/RSF            |

### Office Market Flat for 2018, Continued Deceleration in Net Absorption, Occupancy and Rate Increases

2017 ended the year with Denver's office vacancy increasing to 10.5% for a total increase of approximately 1/2% for 2017. Net absorption was a positive 32,956 square feet of space during 4th quarter 2017, significantly down from the 257,755 square feet of absorption during 3rd quarter 2017. The amount of sublease space on the market in metro Denver continued to increase and ended 2017 at 1,906,860 square feet of space. Average asking lease rates for all metro Denver office space continued to increase and ended 2017 at \$26.32 per square foot on a full service lease. This represents a 1.3% increase in lease rates in just the 3rd quarter of 2017.

For 4th quarter 2017, Denver had 11 newly constructed office buildings deliver for a total of 482,174 square feet of space. Not all of these buildings were fully leased at time of delivery. Space that is not leased when a new building delivers is then counted as new market vacancy. At the end of 2017 there were new office buildings under construction totaling 5,233,168 square feet, all scheduled for delivery in 2018. The robust office building construction is being driven by higher than ever interest in newly constructed office buildings amid demand from companies that desire better office environments, amenities, access to transportation, better connectivity and identity. Newly constructed office space in Denver is leasing up very well and at historically high lease rates. Older buildings that lack amenities and the infrastructure for evolving technologies could begin to struggle to retain and attract new tenants.

Tenants with large space requirements will continue to find options limited and mostly within the higher rent properties. Smaller tenants under 15,000 square feet will have many options to choose from. For small tenants we are seeing an increase in incentives such as more free rent or tenant finish allowances, especially in class B and C quality office space. Asking lease rates however have not yet softened. In fact, the rise in lease rates in the CBD is pricing out many businesses and forcing them to seek out lower cost alternatives in the suburbs. Job creation is expected to continue demand for office space, but with the significant new construction, the office market vacancy and rent growth is expected to be flat in 2018. All tenants, especially ones with stronger credit, should find landlords offering more aggressive proposals to secure their tenancy in a property. Tenants with weak financials should be prepared for requests for personal guarantees and increased security deposits. With the office market still at a record low vacancy, tenants will find stiff competition for the more desirable properties and space locations within a property. Thus, tenants without options to renew in their lease should be focusing on their lease decision more than 1 year in advance of their lease expiration. Larger tenants may have to start the process up to two years in advance. In our current highly competitive market, tenants need the ability to quickly identify upcoming space options, gain the market knowledge on what other tenants have obtained for lease rates, tenant finish allowances, free rent and numerous other areas of the lease that effect a tenants cost of occupying space. Retaining an experienced commercial real estate consultant to represent your company is imperative to accomplishing this and keeping your companies occupancy costs as low as possible.

### 3 Year Market Comparisons

#### Average Quoted Lease Rate Per Square Foot Per Year

| Class    | 4th Quarter 2014 |         |         | 4th Quarter 2017 |         |         |
|----------|------------------|---------|---------|------------------|---------|---------|
|          | A                | B       | C       | A                | B       | C       |
| CBD      | \$33.49          | \$24.20 | \$27.99 | \$33.40          | \$26.85 | \$20.42 |
| Aurora   | \$21.69          | \$17.69 | \$11.89 | \$24.30          | \$17.35 | \$12.75 |
| CO Blvd. | \$26.58          | \$18.04 | \$16.02 | \$31.83          | \$22.32 | \$18.20 |
| SE       | \$25.25          | \$19.04 | \$14.40 | \$27.30          | \$22.03 | \$16.61 |
| NE       | N/A              | \$18.27 | \$15.17 | N/A              | \$21.88 | \$16.40 |
| North    | \$18.94          | \$17.61 | \$12.38 | \$20.50          | \$22.85 | \$13.93 |
| West     | \$28.37          | \$19.27 | \$14.73 | \$27.15          | \$21.53 | \$16.13 |
| SW       | \$25.92          | \$16.65 | \$13.34 | \$26.15          | \$18.72 | \$16.49 |
| NW       | \$24.41          | \$18.59 | \$13.87 | \$25.57          | \$19.74 | \$12.42 |

#### Vacancy Rates

|                | 4th Quarter 2014 | 4th Quarter 2017 |
|----------------|------------------|------------------|
| CBD            | 11.4%            | 15.2%            |
| Aurora         | 11.1%            | 8.6%             |
| Colorado Blvd. | 12.0%            | 14.5%            |
| Southeast      | 11.1%            | 12.5%            |
| Northeast      | 7.9%             | 10.6%            |
| North          | 14.7%            | 7.7%             |
| West           | 13.0%            | 10.6%            |
| Southwest      | 14.2%            | 8.9%             |
| Northwest      | 10.4%            | 9.4%             |

#### Denver's average change in asking lease rates between 4th Quarter 2014 and 4th Quarter 2017

- Class A 4.6% increase
- Class B 15.9% increase
- Class C 22.0% increase

#### Interesting Denver Office Market Tidbits

- Denver's office space consists of 34% class A, 53% class B, and 13% class C office buildings.
- Total Denver office inventory: 202 million square feet in 7,676 buildings of which 585 buildings (25 million square feet) are owner occupied
- The South Midtown submarket has the lowest vacancy at 2.6%
- The Platt River submarket has the highest vacancy at 23.1%
- The Platte River submarket has the highest average quoted lease rate at \$38.63/RSF/year
- The E. Hampden submarket has the lowest average quoted lease rate at \$17.91/RSF/year

Data source: Costar

## Tenants Get Breathing Room on Month-to-Month Tenancies, But Not by Much!

After two years of effort, the Colorado legislature passed Senate Bill 17-245 in 2017. The new law in Colorado now requires BOTH landlords and tenants to give the other 21 days notice before terminating a month to month lease or increasing rents.

Though this law more than doubles the previous time required, it is nowhere near enough time for a tenant to find and relocate to new space. Thus, a month to month lease is still problematic for a tenant to choose, putting their business at risk of being kicked to the curb with only a 21 day notice. Make sure you always have a window of 6-8 months to find and relocate to a new space for your company.

### Stop Making Your Landlord Rich Purchase and Own Your Office Space!

With office vacancy rates at their lowest and lease rates at their highest in the last decade, ownership of your office space should be at the top of your consideration. In most situations, you can own your office space for less than the cost of leasing. The incentives to ownership offer a tenant the ability to fix their occupancy costs long term and no longer be subjected to supply and demand pricing every time their lease renews. Ownership allows the tenant to build equity with their monthly payments instead of helping their landlord purchase a building for themselves. Owning your own property also provides stability and control over the costs of your occupancy and adds a corresponding asset to the company balance sheet instead of just the liability of a lease. Loans for the purchase of commercial owner user properties are very easy to obtain. Both SBA and Conventional loans are readily available and with as little as a 10% down payment requirement. Tenants as small as 600 square feet have the ability to purchase and own the office space they need. It takes forethought, knowledge and fast decision making to secure a purchase property and company's credit, size fluctuations and the potential risk of the purchase all need to be considered. The purchase process takes about four months longer than a lease. Thus, if you are going to consider a purchase, you should start about one year in advance of when you want to be in the space. Make sure you discuss purchase options with your commercial real estate consultant and find out what so many other tenants already know; Ownership is the Future of Leasing!

*Celebrating Our 32nd  
Year in Commercial Real Estate  
Over 135 Years Combined Experience*

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## Backlash Against Open Office, Shared Seating Spaces

With 2.5% unemployment in Colorado and continued job creation, demand for office space continues to be strong. However, office space occupiers have been reducing their footprint ratio of square feet per employee in an effort to do more with less space and reduce capital expenditures. This is a trend we expect to see continue as co-working and work from home options continue to evolve.

Over the last 10 years, companies that moved almost 100% from private office space to open offices with shared seating, in an effort to spark teamwork, have received criticism. Coworkers say that such workspaces bring distractions when one needs to focus on individual tasks. Though initially thought to be a good way for companies to reduce their real estate costs and create collaboration, the concept missed out on the fact that there needs to be a balance between private space for individual work and open space for teamwork.

The idea of open space is really a real estate play to save money and reduce occupancy costs. As such, expectations are that companies will move back to a mix of three types of available space; private offices, cubicle layouts, and bench or shared desk style areas. However, not everyone will have a permanently assigned space. Companies will continue to look at reducing their occupancy costs by "hoteling" and assigning work spaces on an as needed basis when employees come into the office.

### Hidden Costs of Signing a Lease Renewal Unrepresented

Tenants typically make two major mistakes when renewal time comes around. The first is folding their cards by asking the landlord for a renewal proposal. By doing this your landlord believes that you are only considering a renewal and not exploring any competing space with the assistance of a professional tenant representative to educate you on the market. Once a landlord thinks that you are committed to staying, he will most likely make you an offer inconsistent with market rates and terms. The second common mistake made by tenants, is not allowing enough time for the relocation/renewal process. Too short of a time gives your landlord the advantage, as he knows you won't have the time you need to relocate. Tenants occupying less than 10,000 square feet should begin the process one year in advance, larger tenants up to two years.

Both of these pieces of leverage for the landlord can be eliminated by engaging a commercial real estate tenant representative. While a landlord may tell you this will raise the lease rate, this is simply incorrect, as brokerage fees are already factored into the lease rates and agreed to in advance with the landlords listing broker. Additionally, just advising your landlord that you have retained representation tells him to put his best foot forward or risk losing you as a tenant.

- What tenant improvement allowance and free rent should you be receiving on a lease renewal?
- What is fair for a tenant, in the current office market, with regards to operating expense costs, parking charges, holdover provisions, relocation clauses, options to renew, and your ability to sublease?

You would never go to court without your attorney or through an IRS audit without your accountant. Don't make one of your companies top 3 financial commitments without having proper market knowledge and guidance. Eliminate the landlord leverage, protect your companies finances, all at no cost to you. Retain a commercial real estate tenant representative to represent you in your office lease decisions!