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commercial real estate services

DENVER METROPOLITAN OFFICE COMMERCIAL REAL ESTATE UPDATE
January 2020

Office Vacancy Rate Flat Since 2015
2020 Year of Deceleration

2019 Denver office market closed out strong but headwinds and dark clouds are a concern with high housing costs, significant building operating cost increases and high competitive labor market.

Denver's office vacancy at the end of 2019 remained flat at 10.1%. The vacancy rate has stayed between 10% and 11% since First Quarter 2015. Net absorption during 3rd quarter of 2019 was 300,199 square feet of space, significantly down from the 851,000 and 537,000 square feet during 1st and 2nd quarters of 2019 respectively. 3rd quarter 2019 had a small 45,000 square feet of net absorption of office space. Average asking lease rates for all metro Denver office space continued to increase by $.61 per square foot to $27.77 at the end of 2019, based on a full service lease. This represents a 1% increase in lease rates since the end of 2018. 4th quarter 2019 ended with Denver having over 3.2 million square feet of office space under construction. About a 1% increase from the end of 2018.

Office sector landlords have been investing in large scale renovations of existing buildings to modernize amenities necessary to compete with new construction and satisfy millennial talent. Tenants are showing clear preferences for office buildings that offer new amenities, higher functionality, walking distance to restaurants, bars, retail, entertainment, community spaces and convenient access to personal services near or on their employee's way to work. Location near transportation is also a big factor in office property selection. Every 100,000 square foot or larger office building constructed during this expansion cycle has been located within one mile of a light rail station. Tenants looking for the newest and best office space are willing to pay lease rates at an unprecedented level never before seen in the Denver, as some brand-new premium buildings have exceeded $50 per square foot asking lease rates.

Some of the headwinds we are watching in the market include an employer's inability to hire talent. Though Denver's population has grown significantly and mostly with millennials, the unemployment rate has hit its lowest in 44 years now at 2.5%. This forces employers to look at other markets where there is a bigger pool of talent. Changes in workplace norms, where employers are devoting less square feet per employee and adding more remote workers, lessens the need for office space. Additionally, office building operating expenses have become a significant challenge for both landlords and tenants. The 2019 property tax reassessments hit most owners with double or triple digit increases in valuations, which in turn raises the property taxes on the building. Additionally, the billions of dollars of losses in Denver from hail storms has property insurance companies squeezing building ownerships with significant increases in premiums and reduction of coverages. All of these increased costs will get passed down to the tenant through NNN charges, or expense stop pass throughs and push the necessity for higher lease rates at renewal time.

Expectations are for the office market to continue deceleration toward a more flat market through 2020. Potential increase in vacancies will make for more competitive market conditions for landlords. For right now, tenants with large space requirements will continue to find options limited and mostly within the higher rent and

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4th Quarter 2019 Metro Denver Office Market

↔ Vacancy Rates	↑ Average Lease Rates	↓ Net Absorption	↓ 4th Qtr. 2019 Deliveries
10.1%	$27.77RSF/Year	300,199/RSF	246,115/RSF

3 Year Market Comparisons
Average Quoted Lease Rate Per Square Foot Per Year

	4th Quarter 2016			4th Quarter 2019		
Class	**A**	**B**	**C**	**A**	**B**	**C**
CBD	$34.01	$26.61	$22.87	$35.22	$28.89	$22.33
Aurora	$18.30	$18.19	$12.42	$22.26	$20.04	$14.14
CO Blvd.	$30.82	$20.62	$16.34	$29.47	$20.70	$20.89
SE	$27.55	$21.20	$16.45	$29.60	$23.23	$18.07
NE	$20.25	$18.88	$16.18	$21.50	$23.69	$19.10
North	$21.00	$22.12	$16.66	$24.55	$25.65	$18.45
West	$25.84	$20.86	$15.47	$27.63	$23.04	$20.69
SW	$26.57	$17.39	$15.06	$28.64	$18.41	$17.72
NW	$25.87	$19.10	$16.61	$28.39	$21.00	$17.77

Vacancy Rates

	4th Quarter 2016	4th Quarter 2019
CBD	12.4%	11.6%
Aurora	6.9%	6.7%
Colorado Blvd.	7.8%	7.8%
Southeast	11.4%	11.4%
Northeast	5.7%	4.5%
North	6.3%	6.8%
West	10.5%	7.2%
Southwest	9.4%	7.7%
Northwest	9.1%	10.5%

Denver's average change in asking lease rates between end of 2018 and end of 2019
Class A 6.2% increase
Class B 3.3% increase
Class C 3.2% increase

Interesting Denver Office Market Tidbits
- Denver's office space consists of 40% class A, 48% class B, and 12% class C office buildings.
- The Northeast Denver submarket has the lowest vacancy at 4.5%
- The Meridian submarket has the highest vacancy at 16.4%
- The Platte River submarket has the highest average quoted lease rate at $40.82/RSF/year
- The Southwest Denver submarket has the lowest average quoted lease rate at $19.23/RSF/year

Average operating costs for Denver Metro office buildings
Class A $9.21 - $15.19/RSF/Year
Class B $7.56 - $11.41/RSF/Year
Class C $5.90 - $9.66/RSF/Year

Data source: Costar

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newly constructed properties. Smaller tenants have many options to choose from, as a significant amount of vacant office space in Denver is in suite sizes that are less than 15,000 square feet. These tenants can demand stronger incentives, such as more free rent, increased tenant finish allowances, moving and cabling allowances, and discounted or free covered parking. 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.

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. Tenants need this time to identify upcoming space options and gain the market knowledge on what other tenants have obtained for lease rates, tenant finish allowances, free rent, and other incentives. 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.

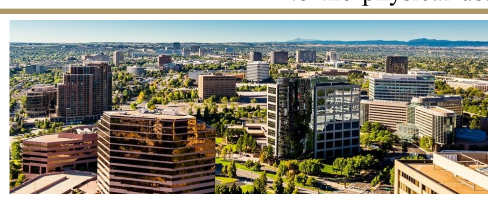
Hidden Costs of Signing a Lease Renewal

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!



Denver Technological Center

Commercial Real Estate Trends to Watch

Tenants renewing leases earlier: Tenants with highly customized space or in premier locations rarely want to relocate unless their space needs or configuration have changed. To make sure they have some leverage in the renewal negotiations, tenants are starting much earlier to negotiate and sign lease renewals, sometimes up to 2 years in advance of the lease expiration. Having options to renew in your lease is key to keeping your space "yours"!

Employers moving their companies to chase talent: Decades ago, employees were expected to relocate for a new job opportunity. Not so today. Employers are finding they have to move their company to secondary markets they might not have previously considered so they can attract the talent they need. Prospective employees are leaving high cost of living areas and expect their jobs to be where they live. Additionally, the workforce continues to prioritize work-life balance as they change how they shop, work, live and play. Employees want to work for companies that are located in buildings and areas that are amenity rich. Consumers are demanding convenient access to food, coffee shops, hair and nail salons, fitness facilities and health care on their way to and from work.

Concern about the environment: Wanting to reduce their carbon footprint, tenants are increasingly concerned about locating in environmentally friendly buildings. Awareness of the LEED certification program and other green building standards has tenants using this as criteria for location selection.

BOMA Revised Measurement Standards a Shocker for Tenants!

The Building Owners and Managers Association (BOMA) has updated its standard for measuring office properties for the purposes of leasing. Commonly known as the BOMA Rentable method (What the R stands for in RSF), the recent update favors only the landlord as a way to increase revenue for a property.

The new BOMA Rentable standard takes into account the newest building amenities we have seen being added to existing office properties, such as outside covered areas, rooftop terraces, game and relaxation rooms, and huddle rooms. Property owners that do install these amenities in their property can now include that area of space in their common area factor for the building, even if the space is outside or on the roof! The inclusion of these amenities allows the landlord to increase the rent to the tenants on the square footage of space they occupy by increasing the common area load factor of the building. In addition to these now allowed amenities, previously excluded vertical penetrations (stairwells, HVAC chases, elevators, etc.) are now INCLUDED and will even further increase the common area percentage of the property.

Tenants who occupy buildings where their landlord adopts the new BOMA standard could be facing a 3% to 5% increase in the Rentable square feet they have to pay rent on, without any change to the physical usable dimensions of their suite. So, if you and your employees are not going to use all of these amenities, it is best to choose a building that does not have them and has a lower common area factor.

Lease Rate Is Only Part Of A Tenants Occupancy Costs

Too many office tenants get wrapped up in lease rates when it comes time to renew or relocate. It may sound ridiculous to overemphasize the fiscal impact of square footage rates over a three- or five-year lease period, but tenants routinely do. They perceive the rental rate as the end-all without considering what other elements might be involved in the cost to occupy space, and there are always other elements. Here are six to look out for when reviewing the lease:

1) Building Operating Expenses

It costs landlords big dollars to operate and maintain their buildings. There are scores of recurring costs that factor into their profit models other than rent. Any one of these costs could be handed down in some part to tenants. These "pass throughs" can include taxes, insurance, landscaping, snow removal, security and utilities, among many others. Most landlords limit their financial liability by employing "expense stops." This is when the landlord agrees to pay an operating cost up to a specified threshold where it then passes all additional costs on to the tenant. The tenant better know at the front end exactly who is responsible for those costs.

2) Tenant Finish Allowance

This is usually a dollar per square foot amount used to improve the tenant's lease space. Tenant improvements can include construction, design and engineering costs, carpet, paint, millwork, doors, and hardware. The landlord already has an allowance built into its budget, regardless of whether or not the tenant asks for any of it. So for the tenant, it is a "use it or lose it" proposition. Every tenant should take full advantage of whatever the current market will bear when it comes to improvement dollars. And that includes renewing tenants as well.

3) Space Measurement

It is astounding how few tenants actually know how the space they rent is defined and measured. "Usable square footage," in essence, is the amount of space on which the tenant can set its furniture and equipment, and where people work each day. "Rentable square footage" is the usable square footage plus the tenant's pro rate share of common elements of the building, like lobbies, hallways and restrooms. Rentable square footage is specifically what tenants pay for each month. There are other methods of measurement that apply to full-floor and multi-floor tenants, and it can get complicated. Tenants should always know who is doing the measuring and what standard they are using. In fact, tenants would be wise to hire their own interior architect or other qualified expert to verify the landlord's documented square footage.

4) Holdover Provisions

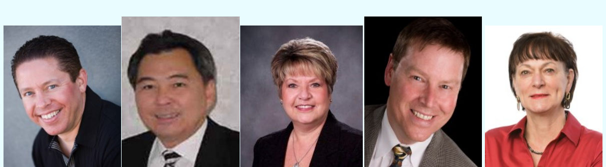
What happens to the tenant if it stays in its space after the lease period expires? In some cases, the landlord will allow for a month-to-month lease period to commence, but at dramatically inflated rates. This provision will also state how much notice the landlord will offer the tenant before eviction.

5) Right of Relocation

Any given lease may stipulate that the landlord can relocate a tenant to another space within the same building. This might not seem like an overwhelming inconvenience on the surface, but consider all of the hassles even a small tenant must endure during the relocation process. The disruption of an unintended move to another space, even within the same building, could be crippling to a tenant, not to mention the associated expenses.

6) Subleasing Provisions

Any given tenant's space requirements can change dramatically during the lease period. Sometimes subleasing becomes a fiscally attractive option, if the landlord will allow it. Can the tenant move out altogether and sublet its entire space, or will it be in default of the lease? Can it sublease just some of the space to another tenant? What would the rates be? What kinds of restrictions on the type of sublease tenant might be stipulated? How long is the approval process?



Eric Dan Mary Jo George Myra

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!