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DENVER METROPOLITAN OFFICE COMMERCIAL REAL ESTATE UPDATE
February 2023

2023 Metro Denver Office Market

↑	↑	↓	↓	↑	↑
Vacancy Rate: 14.6%	Available Rate: 20%	Average Lease Rate: $29.03/RSF/Year	Net Absorption: Negative 393,000 SF	Sublease Space Availability: 6.6 million SF	Under Construction: 2.6 million SF

As the Denver office market gains clarity, major challenges are ahead, with large amounts of Denver office space probably remaining empty in 2023.

Overview

The Denver office market has faced several headwinds from the COVID pandemic, inflation, rising interest rates, and now economic uncertainty with a looming recession, all of which has made Denver a tenant's office market. The hybrid workplace environment is here to stay, and each company has its own different interpretation of what remote access in office work looks like. Companies are changing office designs to "we" spaces instead of "me" space, with heavy influence on multiple types of shared and hotel space options with less private offices. Tenants currently in the market for office space continue to reduce their size footprint and are reluctant to renew leases in older buildings, driving a flight to quality, with strong preference for newly delivered and under construction office buildings. Amenities are no longer an option, and the most important are connected to social interaction. Office landlords are focusing on common spaces, such as gyms with personal trainers, yoga studios, coffee shops, rooftop terraces, interactive golf simulators, and game lounges. Tenants are demanding their buildings be healthy environments, with building environmental sustainability ratings.

Vacancy & Lease Rates

Leasing activity improved throughout 2023, but the average lease size continues to trend downward. There is a continued emphasis on migration out of the CBD with office users favoring the Cherry Creek and Platt River submarkets. Vacancies still continue to remain high as demand for Denver office space remains depressed. Denver's overall office vacancy at the end of 2022 stood at 14.6%, up 1/10th of 1% from the beginning of 2022. Net absorption in 2023 came in at a negative 393,000 square feet. Due to Denver's concentration of tech companies who are more open to remote work, Denver now ranks among the worst performing office markets in the U.S. Smaller office requirements under 15,000 square feet in size have dominated leasing, with 60% of leases signed in 2022 being less than 15,000 square feet in size. Average asking lease rates at the end of 2022 for office space decreased by 9 cents to $29.03 per square foot compared to the middle of 2022. Year over year rent growth has slowed significantly in Denver and has dropped now to 0.7%. Lease rate pricing remains in the favor of tenants by commanding heavy concessions, such as significant free rent, generous tenant improvement allowances, moving and cabling allowances, and free parking. However, the tenants have to know what to ask for! Sublease space inventories are at historic record levels. Available office sublease space in Denver now totals 6.6 million square feet up from 5.1 million square feet in the middle of 2022. The amount of sublease space on the market solidifies a continued trend of downsizing or eliminating the need for office space. The current availability rate of office space in Denver is 20%, up from 18.8% at the middle of 2022. The difference between the vacancy rate and the availability rate is the sublease space, which is currently not vacant, but is being marketed as available. The effects of the sublease space are largely felt in the Downtown Denver submarket, where the vast amount of sublease space is listed, however recently a few blocks of 100,000 square feet of space have been put on the market for sublease in the Southeast Suburban Denver market. Sublease space puts downward pressure on overall lease rates, as these spaces are typically offered at a deep discount relative to direct lease space. The difference between average direct lease asking rates and average sublease space asking rates reached its widest disparity in 4th quarter 2022 and now stands at $8.00 per square foot!

Interesting Denver Office Market Statistics

- The Northeast Denver submarket has the lowest vacancy at 3.2%
- The CBD submarket has the highest vacancy at 24.8%
- The Platte River submarket has the highest average quoted gross lease rate at $44.03/RSF/Year
- The East Hampden submarket has the lowest average quoted gross lease rate at $21.08/RSF/Year

Data source: CoStar

Market trends we are watching

- Space reallocation: downsizing
- Location migration: to the suburbs
- Lease terms: short and flexible
- Work environment: flight to quality and amenities
- The U.S. Economy will fall into Recession in 2023
- Investment property CAP rates will rise
- Office vacancy spread between newer and older space will widen
- Smaller office spaces, under 15,000/sf will dominate leasing activity

New Construction and Outdated Buildings

Denver's office construction pipeline has pulled back and is no longer one of the top markets in the U.S. However, development remains active in Denver as developers continue to take advantage of tenant's desire for quality. Currently, there are 19 properties totaling 2.6 million square feet of new office buildings underway, expected to deliver in 2023. The pandemic has spelled the end for office properties that were already on their last legs. Finding new uses for these structures will become the focus for obsolete older office buildings. Many cities and ownerships are looking at conversion of these properties, through adaptive reuse, into industrial, storage, or affordable housing. Denver is no different, with numerous applications into the city from owners looking for permits to convert large central business district office buildings to residential use.

Sales

Office building investment activity slowed during the 2nd half of 2022 with $2.1 billion in sale transactions closed, down from $3.4 billion in 2021. Vacant value add assets have fallen out of favor as office vacancies continue to climb to record levels. Market average CAP rates for investment office properties came in at 7.1% for 2022 with an average sale price of $258 per square foot, up 4.5% from the previous year. The Cherry Creek market achieved the highest average sale price at $420 per square foot. With remote work still defining itself and a looming recession that would further lower demand for office space, U.S. property Values could drop by 20% in 2023. ***See update page 2*** *update from page 1*

Tenants of all sizes who desire to lease space should be able to command significant incentives that have not been seen in decades. Property owners continue to look close at tenant credit and ability to fulfill the lease term. Tenants with lease renewal options should make sure they have expert advice on market lease rates and not just accept a lease renewal rate proposed by their landlord. Without a market expert consultant, the tenant has no clue what incentives they may be leaving on the table because they didn't know to ask. With the office market in the tenants favor, don't be fooled into thinking you can secure a lease space on short notice! You will need significant time to accomplish space design, obtain construction permits, and complete construction of new space. For most tenants, starting the process 12 months in advance of your lease expiration is appropriate. For large tenants, starting 2 years in advance is necessary. Identifying upcoming space options and gaining market knowledge on other tenants negotiated lease rates and incentives is necessary to achieve the best economics on your lease decision. Retaining an experienced commercial real estate consultant to represent your company is imperative to navigating our "new normal" and accomplishing your goals.

It's a tenants market!
Don't make these common leasing mistakes

Tenants typically make three 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. The third most common mistake tenants make, is not knowing what leasing incentives they should be asking for, thus, leaving a lot of money on the table!

All three of these pieces of leverage for the landlord can be mitigated 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, moving allowances 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 company's top 3 financial commitments without having proper market knowledge and guidance. Eliminate the landlord leverage, protect your company's finances, all at no cost to you. Retain a commercial real estate tenant representative to be your advocate!

Celebrating Our 38th
Year in Commercial Real Estate
Over 143 Years Combined Experience

Lenders offering 100% SBA financing!
Stop buying a building for your landlord;
Start building equity for yourself!

The interest in ownership of one's own office or warehouse building/condominium continues to increase. In most situations, you can own your office space for the same or 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 adds a corresponding asset to the company balance sheet instead of just the liability of a lease.

Both SBA and Conventional loans are readily available now with ZERO down payment on some SBA loans and with as little as a 20% down payment requirement on conventional owner occupied loans. 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 purchase a property, and the company's credit, size fluctuations, and the potential risk of the purchase all need to be considered. The purchase, once under contract can take 2 to 6 months depending on the type of financing the buyer wants to achieve. Owner user commercial properties are in high demand, and thus, you should start your property search about one year in advance of when you want to be in the space. **Ownership is the Future of Leasing!**

The Sublease Space Flood!
Your Reward & Risk of Signing a Sublease

A total of 6.6 million SF of office sublease space is available, representing a record for the Denver market. The sublease space on the market represents 3.4% of the entire office inventory in the Denver metro area. Companies that do not have upcoming lease expirations are looking for options to offload space, due to a fundamental shift in where employees work. Deciding to take a sublease space offers both rewards and risks:

Rewards:
- Very attractive lease rates
- Quick move in times
- Sometimes, "plug and play" with furniture & equipment included
- Shorter term leases if that is what you are looking for

Risks:
- Don't like that tenant's lease? Don't take the space. You have to agree to everything in the lease that the tenant currently has.
- Don't like the carpet, colors or layout? You will have to reach into your pocket to change these. Typically, there is no tenant improvement allowance available from the tenant trying to sublease.
- Qualifying the tenant you are subleasing from is as important as them qualifying you! That tenant is your landlord and most likely, the rent you are paying them does not cover the full rent they are obligated to pay to the property owner. This means that the tenant must pay the deficiency each month. If they don't, YOU are evicted from the space!

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