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DENVER METROPOLITAN OFFICE COMMERCIAL REAL ESTATE UPDATE
January 2022

Signs of Recovery in Metro Denver's Office Market
Strongest Leasing Demand since 2019
Flight to Experience; Amenities No Longer Optional

Overview

Over 2 years since the beginning of the COVID pandemic, the commercial real estate office market is now seeing the strongest leasing demand since 2019, rebounding to pre pandemic levels in just the 2nd half of 2021. However, Denver is still a tenant's office market. Office space will continue to play a critical role for companies, but the way employees use the office will change. Offices will become hubs for collaboration and culture with more square footage dedicated to "we" spaces instead of "me" space. The office of the future still remains very uncertain. How much space companies will occupy and what a post pandemic office layout will look like remains unclear. Tenants currently in the market for office space are driving a flight to quality, with strong preference for newly delivered and under construction office buildings. These companies are able to afford the higher quality office properties by shrinking their leased footprint due to remote work environments. Tenants with larger office space requirements are demanding their buildings be healthy environments, with building sustainability ratings, and top notch amenities such as: fitness centers, food service, outdoor spaces, meeting areas, rooftop terraces, bike storage, golf simulators, game rooms, mountain views, and access to transportation, which are now considered necessities instead of optional. Smaller companies are embracing low-rise buildings, (recently coined as "groundscrapers"), with the ability to reach offices via stairs rather than elevators and a shift to smaller suburban locations closer to where their employees live. The commercial real estate industry is very optimistic about tenant's desires as we see office landlords rushing to upgrade their buildings health, sustainability and amenities.

Vacancy & Lease Rates

Office vacancies have continued to rise, but at a slower pace. Denver's overall office vacancy at the end of 2021 increased to 14.4%, up 1.9% from one year ago. Net absorption in the prior 12 months came in at a negative 1.8 million square feet, much less than the 4.7 million square feet of negative absorption one year ago. The pace of sublease space coming to market has finally slowed with metro Denver ending 2021 with 4 million square feet of available office sublease space, having hit its peak of 4.7 million square feet early in 2021. The current availability rate of office space in Denver is 18.1%, down from 19.2% a year ago. 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. Sublease space puts downward pressure on overall lease rates, as these spaces are typically offered at a deep discount relative to direct lease space. Average asking lease rates for office space decreased ever so slightly in the last 6 months from $28.67 per square foot to $28.60 per square foot. Though the asking lease rates have not changed significantly throughout the pandemic, the concessions a tenant can command have. Tenants that know what to ask for can achieve significant concessions such as free rent, increased tenant improvements, free parking, and moving allowances.

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4th Quarter 2021 Metro Denver Office Market

↑	↓	↑	↓	↓
Vacancy Rate: 14.4%	Average Lease Rate: $28.60/RSF/Year	Net Absorption: Negative 1.8 million SF	Sublease Space Availability: 4 million SF	Under Construction: 1.4 million SF

Interesting Denver Office Market Statistics

- The Northeast Denver submarket has the lowest vacancy at 4.1%
- The CBD submarket has the highest vacancy at 28.7%
- The Platte River submarket has the highest average quoted gross lease rate at $43.89/RSF/Year
- The East Hampden submarket has the lowest average quoted gross lease rate at $21.17/RSF/Year

Data source: CoStar

Demand for office ownership increases!
Control your entrance, control your occupancy costs and build equity!

Since the beginning of the COVID pandemic, the interest in ownership of one's own office building or condominium has increased tremendously. Many companies are making the move from large office buildings with elevators, large common lobbies and many people, to a property they can control the entrance and avoid the use of elevators. 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.

Financing for the purchase of commercial owner user properties is 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 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. 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!

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New Construction, Tenant Finish & Outdated Buildings

Denver's office construction pipeline is thinning, with only 1.4 million square feet of new office buildings currently underway, a decrease of more than 50% from the previous year. Tenants, working on leasing new office space, continue to see significant time delays in occupancy dates, due to challenges with long construction permit times, rising tenant finish costs, supply chain issues, and labor shortages. The pandemic has probably 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. This may be their only remaining lifeline.

Sales

Investors have returned to the Denver market after retreating in 2020, following the initial outbreak of the Coronavirus. Roughly $1.65 billion in office building sale transactions closed in the second half of 2021. Over the past decade, Denver has become a destination for both corporate relocations and small startup expansions, due in part to the city's relatively lower prices, diversified economy, and educated workforce. While the pandemic momentarily dampened this momentum, Denver's historically low vacancy rates and strong cumulative rent growth have heightened the metro's profile as an investment market. Investors have demonstrated confidence in the Denver's long-term viability as evidenced by $2.7 billion in office building sales in 2021, a 38.4% increase over the prior year. The sale of 1551 Wewatta, which sold in August 2021, for nearly $800/SF, set a new record for price per square foot in downtown Denver. Investors also continue to target assets located in Denver's suburban submarkets as well. The market CAP rate for leased office investments was averaging around 7.2% in 4th quarter 2021, and the average sale price per square foot in 2021 was $244, up from $236 per square foot in the prior year.

Summary

Tenants of all sizes who desire to lease space should be able to command lower lease rates and significant incentives that have not been seen since the 1980's. Property owners will be looking closer at tenant credit and ability to withstand another round of a COVID variant. 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. 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 significantly more time than in the past to accomplish space design, obtain construction permits and complete construction of new space. For most tenants, starting the process 12 to 15 months in advance of your lease expiration is appropriate. For large tenants, starting 18 months to 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.

Denver Technological Center

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 only asking the landlord for a renewal proposal. By doing this you make your landlord believe 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 free rent and moving allowance 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 lease decision!