# MARKETBEAT

# Denver, Colorado

## Office Q2 2017

CUSHMAN & WAKEFIELD

CELEBRATING 100 YEARS

STATS ON THE GO

### Economic Indicators

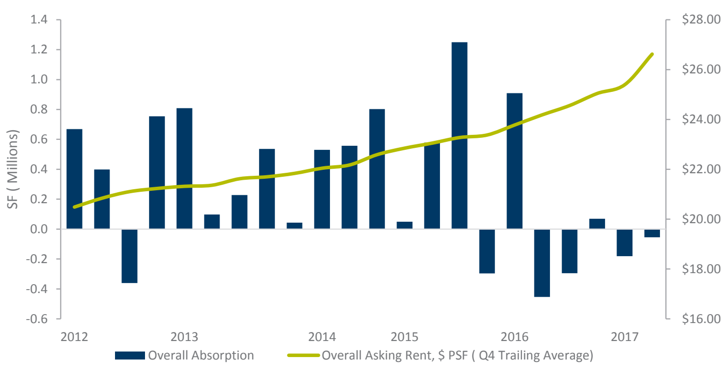
| | Q2 16 | Q2 17 | 12-Month Forecast |
|---|---|---|---|
| Denver Employment | 1.42 M | 1.45 M | ▲ |
| Denver Unemployment | 3.1% | 2.3% | ▬ |
| U.S. Unemployment | 4.9% | 4.4% | ▬ |

### Market Indicators (Overall, All Classes)

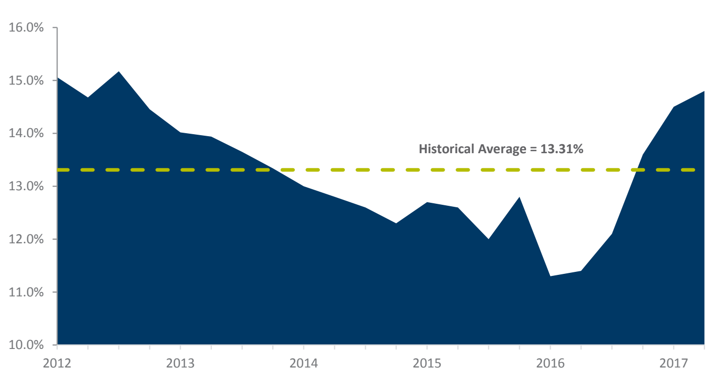
| | Q2 16 | Q2 17 | 12-Month Forecast |
|---|---|---|---|
| Overall Vacancy | 11.4% | 14.8% | ▲ |
| Net Absorption | -453,355 | -55,086 | ▲ |
| Under Construction | 2,811,227 | 4,216,959 | ▲ |
| Average Overall Asking Rent | $24.80 | $26.62 | ▬ |

*Rental Rates reflect gross asking $psf/year

### Overall Net Absorption/Overall Asking Rent
**4-Qtr Trailing Average**




### Overall Vacancy




## Economy

Denver's economy continued to flex its muscles in the second quarter of 2017, further decreasing its unemployment rate from 2.8% in the first quarter of 2017 to 2.3% at the mid-year point, one of the lowest figures in the nation. The one threat is that the market is at full employment making it more difficult to fill all positions available. Thus far, the ongoing in-migration of a highly educated and talented millennial population has boosted an ever expanding global business community desperate for workers. If that can be maintained, Denver, with its dynamic quality of life metrics, will maintain its healthy growth rate.

## Market Overview

Denver's office market recorded an increase in the direct vacancy rate in the second quarter of 2017, rounding out with an 80 basis point (BPS) increase to 13.4% metro-wide, while overall vacancy recorded a marginal 30 BPS increase to 14.8%. One driver to this increase in vacancy was the delivery of new construction that occurred throughout the market including Tower III at 2000 S. Colorado Boulevard, which delivered fully vacant. All classes saw an increase in direct vacancy with Class A products recording the most significant increase of 150 BPS quarter-over-quarter to 13.4%, thanks to the impact of relocations, downsizing and new product coming on line. The downsizing is due to tenants utilizing workplace strategy to reduce their overall real estate footprint through densification and efficiency strategies.

Absorption was down compared to the first quarter of the year with approximately -55,000 square feet (SF) of net absorption. The Denver market is expected to show stronger absorption figures throughout the latter half of 2017, as more large users occupy already leased blocks of space. Leasing remained steady through the second quarter, with over roughly 1.6 million square feet (MSF) of activity. The bulk of that figure market-wide was leased by smaller users; meanwhile full-floor tenants were less active in pursuing blocks of space. Notable leases signed in the second quarter of 2017 included Northrop Grumman's renewal for 104,136 SF at 17455 East Exposition, Sierra Nevada's 85,935 SF short term renewal at Executive Center I and Air Methods 62,124 SF new lease at Landmark Corporate Center, which will be their newly dedicated headquarters.

The direct gross average asking rate increased again in the second quarter of 2017, closing at $26.83 per square foot (PSF). Year-over-year rental growth increased approximately 7.8%, continuing its upward trajectory throughout the current economic cycle. One major factor helping to push rental rates up was the delivery of new construction at record high pricing. Another contributing factor to the increase in rental rates was rising real estate taxes that continue to escalate gross occupancy cost for tenants, though net returns to landlords have remained flat at best. On average in the Central Business District (CBD), real estate taxes increased 15% from 2016 to 2017, with the suburban markets seeing marginal increases compared to its downtown counterparts. Lastly, with concession packages continuing to propel deals, landlords are helping to compensate expenditures through higher asking rates.

We continue to see a gravitational shift in demand towards new office developments due to reasons such as higher parking ratios, larger floor plates, and building and surrounding amenities. With this product offering superior efficiency, it has helped alleviate tenant concerns when making real estate decisions, even with the elevated occupancy costs associated with new construction. For example, 16 buildings (3.2MSF) have delivered within the CBD alone during the current development phase that began in 2009. These buildings are collectively 85% leased, signaling the strength and demand for new product by users.

The Denver market delivered four buildings in the second quarter, totaling approximately 869,000 SF of new Class A office product. New construction continues to experience strong leasing activity compared to the aging product, with both Granite Tower at Village Station and A-Block being 100% leased. One Belleview Station experienced activity from large users, attracting tenants looking for high-end space in the Southeast Suburban (SES) market.  Colorado Center Tower III was the fourth building to deliver during the second quarter of 2017, with all of its 218,000 SF still available.

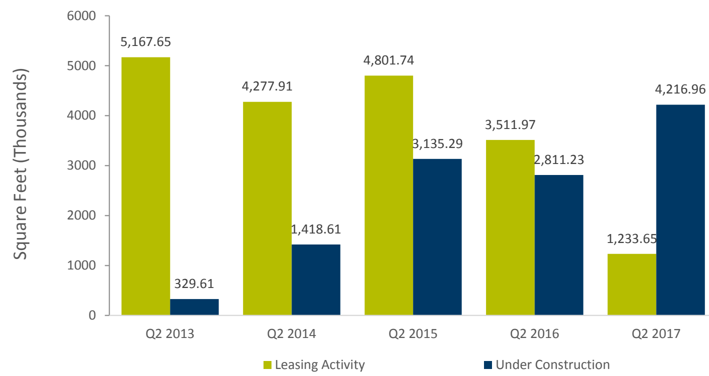
Currently, the Denver Metro area has just over 4.2 MSF under construction, with most of the development activity occurring in the urban core. River North (RiNo) remains a hot neighborhood for new and adaptive-reuse development, initiating a frenzy amongst developers snagging older industrial properties, hoping to ride the wave of the ever-changing dynamics in this submarket. With infill sites scarce in the CBD, the wave of new developments continue to expand outward into the surrounding areas, apparent by the seven buildings currently under construction in the outlying portions of the urban core.  Suburban office developments have also recorded healthy activity for new product that offers superior amenities, a strong transit-oriented location or an abundance of parking.

Denver will remain a market leader in this ongoing U.S. economic expansion as long as it can continue to attract the workforce needed by ever-expanding businesses. As larger users begin to occupy recently leased space during the second half of the year, expect a positive swing in net absorption. Rental rates will remain steady in the near-term, but as new construction delivers over the next two to three years, there will be an uptick. Space users will continue to focus on isolated prime sites, whether in the CBD or suburban locations, leading landlords in secondary locations to become creative and competitive in order to draw tenant prospects from outside their geographical focus.

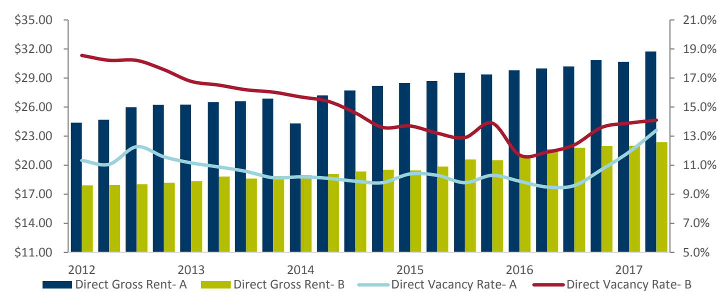
## Outlook

- Tenants will continue to focus on new construction.
- Older office buildings that are not spending capital to renovate and amenitize will see higher vacancies and eroding rents.
- The high cost of tenant finish will impede  relocations.

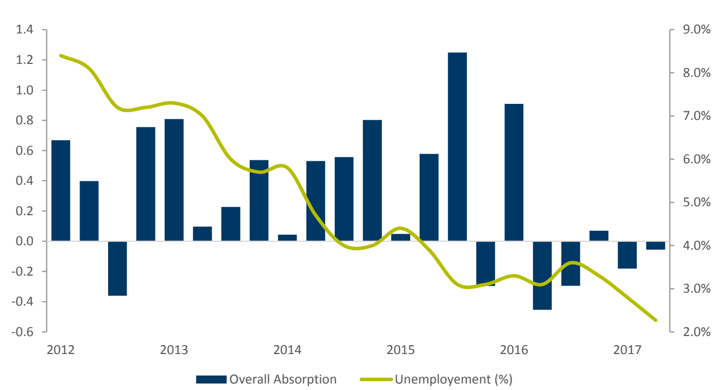
### Leasing Activity/Under Construction




### Class AB Rate/Vacancy




### Overall Absorption/Unemployment



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### Office Q2 2017

CUSHMAN & WAKEFIELD | CELEBRATING 100 YEARS

| SUBMARKET | INVENTORY (SF) | SUBLET VACANT (SF) | DIRECT VACANT (SF) | OVERALL VACANCY RATE | CURRENT QTR OVERALL NET ABSORPTION (SF) | YTD OVERALL NET ABSORPTION (SF) | YTD LEASING ACTIVITY (SF) | UNDER CNSTR (SF) | OVERALL AVERAGE ASKING RENT (ALL CLASSES)* | OVERALL AVERAGE ASKING RENT (CLASS A) |
|---|---|---|---|---|---|---|---|---|---|---|
| Boulder | 5,141,609 | 138,642 | 572,006 | 13.8% | 17,699 | -20,806 | 271,506 | 372,200 | $32.20 | $38.42 |
| Midtown | 4,243,305 | 8,915 | 352,876 | 8.5% | -28,902 | 23,408 | 115,384 | 756,385 | $26.55 | $31.47 |
| **CBD** | **28,494,538** | **624,471** | **4,156,427** | **16.8%** | **-29,504** | **34,961** | **1,118,265** | **1,358,358** | **$33.65** | **$36.14** |
| Southeast Central/ Cherry Creek | 11,053,493 | 139,006 | 1,529,196 | 15.1% | -94,104 | -207,628 | 266,840 | 99,774 | $26.46 | $31.26 |
| Northeast/Aurora | 7,612,142 | - | 1,069,745 | 14.1% | -14,932 | -95 | 153,698 | 43,586 | $16.55 | $21.99 |
| Northwest | 13,904,687 | 201,320 | 1,393,904 | 11.5% | 34,307 | -32,496 | 487,671 | 248,914 | $22.98 | $25.40 |
| Southeast Suburban | 31,747,934 | 380,058 | 4,419,626 | 15.1% | 103,123 | 107,166 | 1,186,163 | 1,337,742 | $24.85 | $26.84 |
| Southwest | 10,077,970 | 72,918 | 1,598,196 | 16.6% | -42,773 | -140,043 | 290,085 | - | $19.73 | $23.66 |
| **DENVER TOTALS** | **112,275,678** | **1,565,330** | **15,091,976** | **14.8%** | **-55,086** | **-235,533** | **3,889,612** | **4,216,959** | **$26.62** | **$30.98** |

*Rental rates reflect gross asking $psf/year

| CLASS | INVENTORY (SF) | SUBLET VACANT (SF) | DIRECT VACANT (SF) | OVERALL VACANCY RATE | CURRENT QTR OVERALL NET ABSORPTION (SF) | YTD OVERALL NET ABSORPTION (SF) | YTD LEASING ACTIVITY (SF) | UNDER CNSTR (SF) | DIRECT AVERAGE ASKING RENT* | OVERALL AVERAGE ASKING RENT |
|---|---|---|---|---|---|---|---|---|---|---|
| Class A | 56,849,133 | 1,122,162 | 7,618,445 | 15.4% | 136,174 | 76,304 | 2,240,908 | 3,985,943 | $31.74 | $30.98 |
| Class B | 43,548,109 | 411,039 | 6,151,711 | 15.1% | -128,234 | -257,583 | 1,225,653 | 231,016 | $22.38 | $22.38 |
| Class C | 11,878,436 | 32,129 | 1,321,820 | 11.4% | -63,026 | -54,254 | 423,051 | - | $20.22 | $20.18 |

*Rental rates reflect gross asking $psf/year

## Significant Construction Activity Q2 2017

| PROJECT | SF | DEVELOPER | COMPLETION DATE | SUBMARKET |
|---|---|---|---|---|
| 1144 Fifteenth | 627,861 | Hines | Q1 2018 | CBD |
| 16 Chestnut Building | 428,218 | Continuum Development | Q3 2018 | CBD |
| Village Center Station - Building 2 | 306,053 | Shea Properties | Q1 2018 | Southeast Suburban |
| 9151 E. Panorma Circle | 227,000 | Miller Global Properties, LLC | Q3 2017 | Southeast Suburban |
| 3601 Walnut Street/HUB | 220,000 | Beacon Capital Partners | Q4 2018 | Urban Core/RiNo |

## Key Lease Transactions Q2 2017

| PROPERTY | SF | TENANT | TRANSACTION TYPE | SUBMARKET |
|---|---|---|---|---|
| 17455 East Exposition Avenue | 104,136 | Northrop Grumman Space & Mission Systems Corp | Renewal | Aurora/Northeast |
| Executive Center I | 85,935 | Sierra Nevada Corporation | Renewal | Southeast Suburban |
| Landmark Corporate Center | 62,124 | Air Methods | New Lease | Southeast Suburban |
| Church Ranch Corporate Center II | 55,004 | Staples, Inc. | New Lease | Northwest |
| Two City Center | 51,377 | Marketo, Inc. | New Lease | CBD |

## Key Sale Transactions Q2 2017

| PROPERTY | SF | SELLER/BUYER | PRICE | SUBMARKET |
|---|---|---|---|---|
| The Triangle Building | 227,000 | Starwood Capital/Union Investment Real Estate | $154,000,000 | CBD |
| Inova I | 211,675 | Principal RE Investor/Capri EGM | $67,500,000 | Southeast Suburban |
| The Citadel | 130,652 | KBS Realty Advisors/Amstar | $37,000,000 | Southeast Central |
| Parkway Center | 61,717 | W.W. Reynolds Companies/Boulder Orthopedics | $20,744,800 | Bolulder |
| One Environmental Way | 154,616 | Staples Inc./Elevations Credit Union | $16,500,000 | Northwest Corridor |

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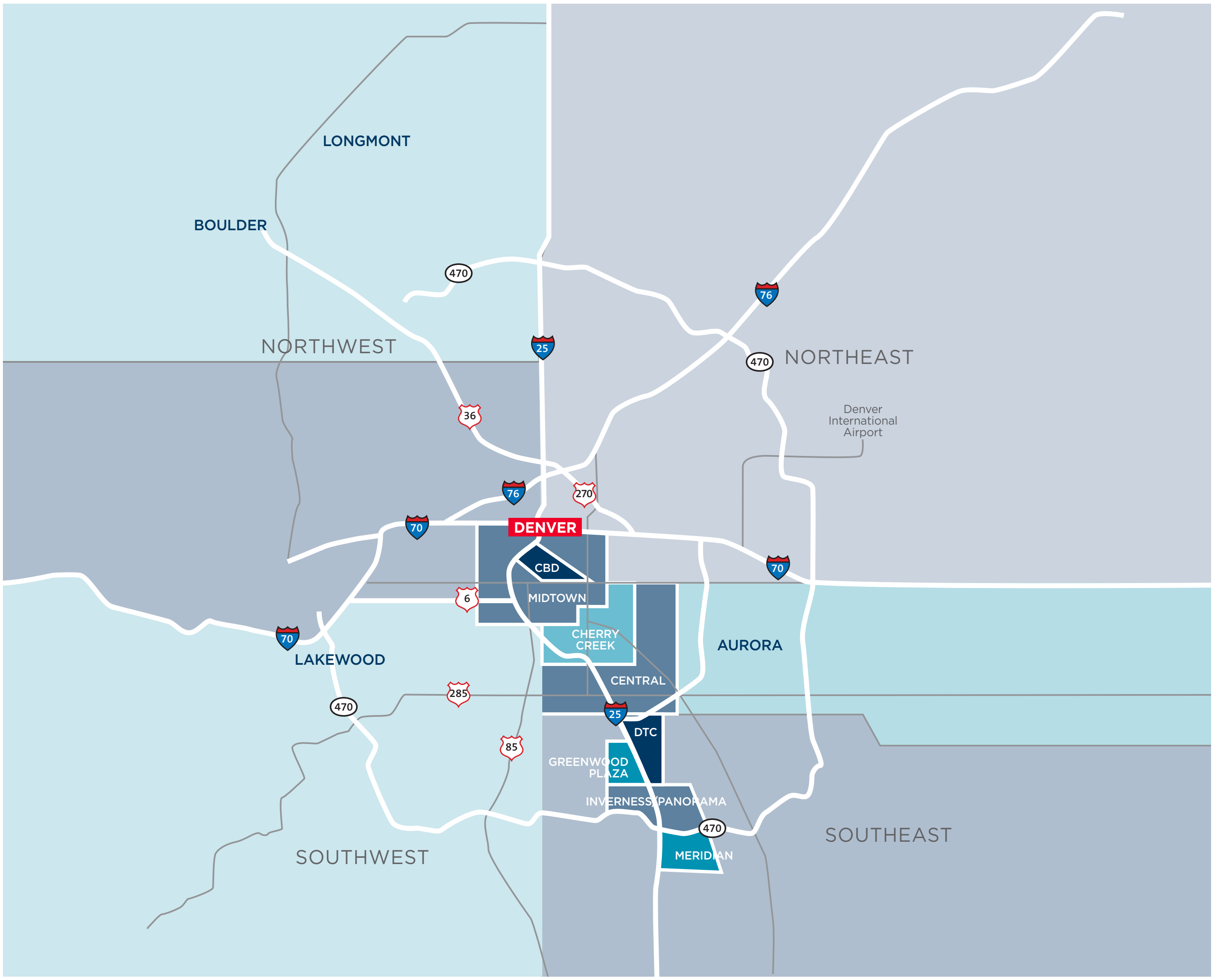
### OFFICE SUBMARKETS

DENVER, COLORADO





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