OFFICE REPORT

DENVER INVESTMENT SALES TEAM

2018 Q4 OFFICE REPORT

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CUSHMAN & WAKEFIELD

DENVER SUMMARY

Denver's economy had another robust year as we approach the longest economic expansion in U.S history. From 2013 to 2018, jobs increased by 14.3% in the Denver Metro area, outpacing the national growth rate of 7.8% during the same period. The unemployment rate finished the year at 3.5% - still below the nation's average of 3.9%. Additionally, the Centennial State by 80,000 people during the year, making it the seventh fastest-growing state in the country. Although population growth has started to slow in recent years, the 1.4% growth in 2018 remains much higher than the nation's rate of 0.6%. Looking forward, population is expected to increase by 5.8% between 2018 and 2023.

	JOB GROWTH	POPULATION GROWTH	UNEMPLOYMENT
DENVER THE MILE HIGH CITY	14.3%	14.3%	3.5%
	7.8%	7.8%	3.9%

COLORADO HAS THE **4th** BEST ECONOMY (2018) - BUSINESS INSIDER

#4 BEST PLACE FOR BUSINESS AND CAREERS FORBES, 2018

#3 BEST PLACE TO LIVE US NEWS, 2018

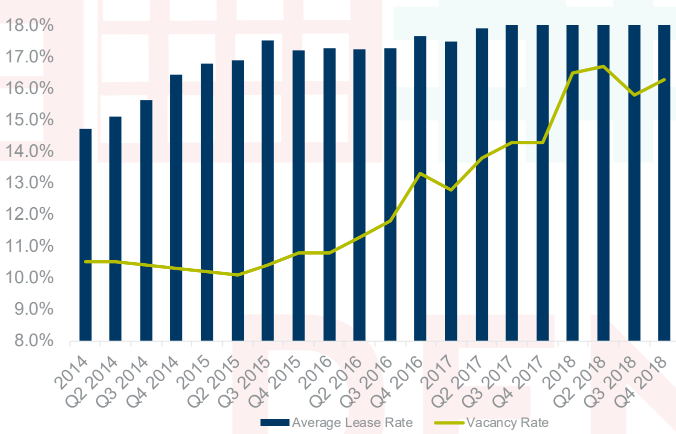
OFFICE SUMMARY

Direct vacancy continued to contract throughout 2018 in Denver's office market, closing out the fourth quarter at 13.9%. This represents a 50 basis point (bps) decrease from the third quarter 2018, while decreasing 30 bps from 14.2% one year ago. Large tenant expansions and tenants relocating operations to the Denver market have driven the vacancy rate back down while positioning Denver as the 3rd largest market in terms of net absorption.

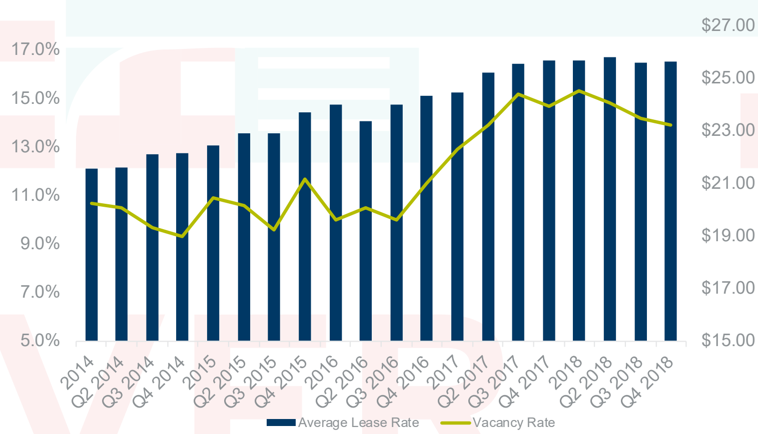
2018 was one of the best years during the current cycle, with approximately +2.7 million square feet (msf) of net absorption metro-wide, representing the first year since 2015 that metro-wide absorption eclipsed +1.0 msf and the first time since 2010 that net absorption surpassed +2.0 msf. This positive absorption is largely due to Denver becoming a more diversified economy with majority of absorption coming from technology, real estate, healthcare, financial and business services.

Year-over-year direct gross rental rate growth has remained moderate at $28.25, growing 4.2% from the previous year. Rental rate growth will continue at a moderate rate, largely due to the combination of new construction deliveries, rising real estate taxes and continued user demand looking to pull from one of the most educated workforces in the country.

CBD AVERAGE LEASE & VACANCY RATES



SOUTHEAST SUBURBAN AVERAGE LEASE & VACANCY RATES



INVESTMENT OVERVIEW

Denver's office investment sales volume finished the year at $2.79 billion. Denver's CBD took headlines with numerous high-profile transactions occurring throughout the year supporting the increased demand from institutional investors. These transactions continue to push past previous records with cap rates as low as 4.80% and sales in excess of $740 per square foot. Additionally, the SES suburban office market continued to show strong momentum as investors continue to acquire suburban office product. Cap rates for core investments continue to transact in the 5.00% - 6.25% range while the Southeast Suburban (SES) market is seeing cap rates between 6.75% - 7.50%.

PROPERTY	MARKET	SF	PRICE	PRICE/SF	CAP RATE	OCCUPANCY
1601 Wewatta	CBD	299,534	$222,254,228	$742	4.80%	97%
One Belleview Station	SES	318,057	$152,000,000	$478	5.75%	100%

Investors have recently expanded their focus towards the Colorado Springs market given it is one of the fastest growing economies in the nation – El Paso County is the fastest growing economy in Colorado. Supported by 3.6% unemployment and 5.2% job growth for 2018, Colorado Springs offers a low-cost alternative to Denver with a risk premium investors are willing to take on. For core investments, this translates to about a 100-150 bps spread over a core investment in Metro Denver. To support this premium, the Hendrickson Johnson Team facilitated three sales that tell the story of why investors should consider Colorado Springs as part of their portfolio.

PROPERTY	MARKET	SF	PRICE	PRICE/SF	CAP RATE	OCCUPANCY
Class A Office Portfolio	Colorado Springs	1,020,654	$125,250,000	$123	8.50%	77%
Tech VI	Colorado Springs	104,438	$12,115,000	$116	9.75%	90%
Chapel Hills Atrium	Colorado Springs	79,295	$11,075,000	$140	8.57%	92%

wework IN DENVER

WeWork signed their first lease in Denver at The LAB in Q3 2015 and occupied 580,986 sf throughout metro Denver as of year-end 2018. For the fourth consecutive quarter, WeWork continued to dominate leasing headlines, executing three new leases around the Urban Core for a total of approximately 163,000 sf in 2018. Coworking currently accounts for only 2.7% of the total Class A & B inventory throughout Denver's CBD, but 96.6% of that has been added in just the past four years. Estimates put the total amount of coworking space nationally at about 32.5 msf with Denver representing about 2.3% of the entire US coworking market.

A recent coworking study done by Cushman & Wakefield's Capital Markets Research looked at 17 office buildings across the country that traded since the beginning of 2016. The study found that properties with high WeWork occupancies (40% or more) traded at capitalization rates that were higher compared to the overall market rate for similar buildings – approximately 50 bps to over 100 bps softer. However, there are instances where quality product in the right location has been able to price through this softening.

Denver continues to tell the story of strong investor demand within the CBD, specifically Lower Downtown (LoDo) and Platte Street. The wave of new construction that the CBD has experienced in recent years can be attributed to these flourishing micro markets. Offering the best walkable amenities and surrounded by strong demographics, it's no surprise that these parts of town have attracted a diverse range of prospective tenants, particularly in the technology and coworking industries. The Triangle Building at 1550 WeWatta in LoDo delivered in 2015 and quickly secured a long-term lease with WeWork for 69,863 square feet or 31% of the building. After the additions of other high-profile tenants bringing occupancy to 98%, the asset traded for $154 million ($677 PSF) at a 5.34% cap rate in May 2017. A few blocks away from the Triangle Building is the first WeWork location at 2420 17th street, otherwise known as the LAB. Built in 2015, the property drew the attention of WeWork which signed the first lease for 49,484 square feet or 63% of the building. After carefully adding another 6 tenants which brought occupancy up to 86%, the property traded for a 5.15% cap rate in November 2018 which translated to a $45.5 million ($577 PSF) sale. While investors remain conscious of buying buildings with large coworking tenants, each of these transactions further support that Denver remains an attractive market due to the strong underlying fundamentals seen throughout the city and metro area.

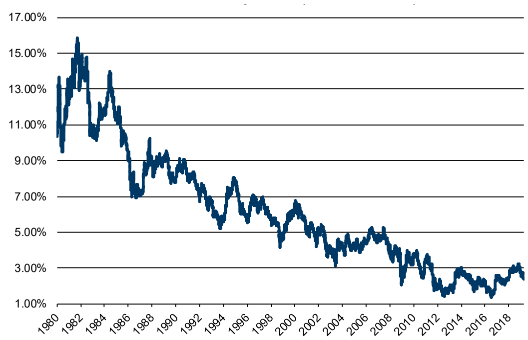
DEBT

The strength of the U.S. economy has led to an increase in interest rates throughout 2018. All signs point to the current expansion being the longest in history if we make it to July 2019. As of December 2018, the Fed increased the federal funds rate for the last time of the year to 2.50%. Contrary to what was previously said for 2019, current market pricing is that the Fed will not raise the target rate during the course of the year.

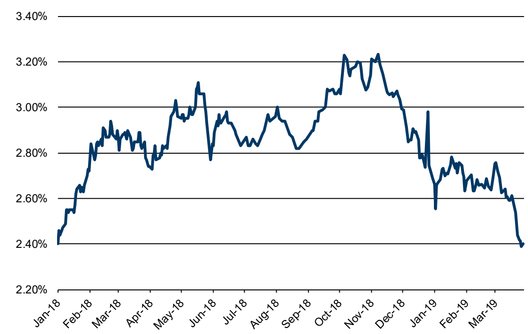
The 10-year treasury went for a roller coaster ride throughout 2018, reaching the highest rate the economy has seen over the last few years at the end of the third quarter. The 10-year interest rate begun the year at 2.40%, spiked to 3.24% in October and calmly ended the year up ~30 bps. As the first quarter of 2019 comes to an end, the 10-year treasury has decreased back to the start of 2018 rates, around 2.40%.

New construction, high-profile assets in core locations have received the most aggressive interest rates causing spreads to tighten compared to other inferior product types. CMBS issuance declined 4.3% in 2018, but as we get further into 2019, spreads continue to improve at a moderate pace with increased liquidity from all lending sources including CMBS, banks and Life Companies.

10-YEAR TREASURY YIELD (1980-CURRENT)



10-YEAR TREASURY YIELD (2018-YTD)

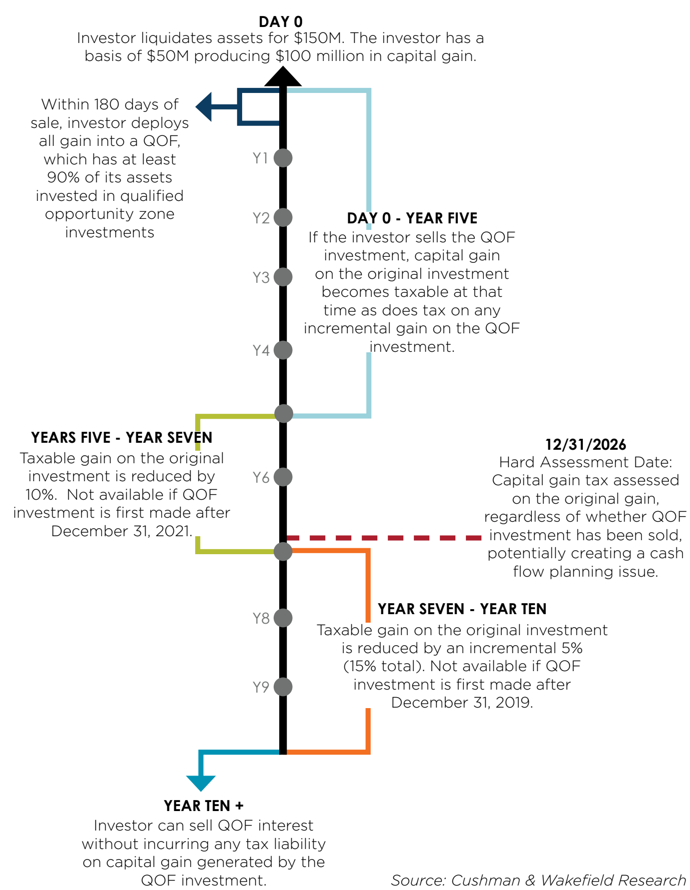


CRE HOT TOPIC

Opportunity Zones are a new community development program established by Congress in the Tax Cuts and Jobs Act of 2017 to encourage long-term investments in low-income urban and rural communities nationwide. The Opportunity Zone program provides a tax incentive for buyers to re-invest their unrealized capital gains into Qualified Opportunity Funds (QOFs) that are dedicated to investing into Qualified Opportunity Zones. The program is widely viewed as favoring CRE investments where eligible investments include ground-up development and asset renovations under some conditions.

The program allows for any capital gains realized after December 22, 2017 to be deferred provided those gains are invested in one or more "qualified opportunity funds" (QOF) within 180 days. QOFs are required to have at least 90% of its capital invested in qualifying investments in designated "opportunity zones." After reaching certain holding period hurdles – at least five and seven years – the basis for the original capital gain is adjusted upward, thereby not only deferring, but also reducing tax liability up to 15%. The balance of the deferred gain, unless the investment is disposed of earlier, will be recognized in 2026. Finally, if the opportunity zone investment is held for at least 10 years, there is no capital gains tax on the opportunity zone investment itself.

ILLUSTRATIVE EXAMPLE OF AN OPPORTUNITY ZONE INVESTMENT



Source: Cushman & Wakefield Research

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