Second Quarter 2016 / Office Research Report

Denver

Market Facts

42,800

Jobs added in the last 12 months ending in May, a 3.1% increase in employment.

3.3%

Unemployment in Denver, which is significantly lower than the national unemployment rate of 4.7%.

3.8

Million square feet of space now under construction, with 34% preleasing

9.9%

The Denver office vacancy rate fell back into the single-digits

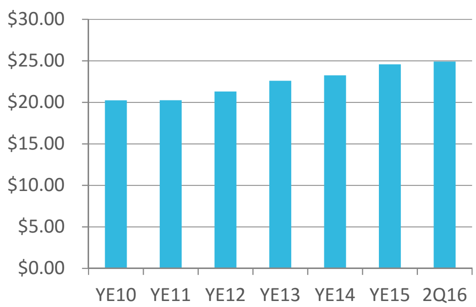
Market Overview

Denver's population has grown substantially in recent years, particularly from the in-migration of millennials who are drawn to the employment opportunities and quality of life that Denver provides. Even though Denver is benefiting from additional residents, the low unemployment rate of 3.3% indicates that recruiting and retaining a talented workforce will continue to be a top priority for employers. An emphasis on improved amenities, coupled with a reduced tenant footprint, continues to be the trend in the Denver office market.

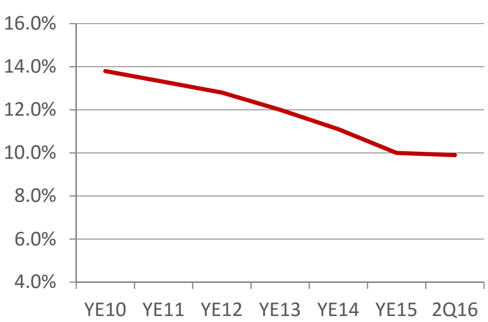
Additional projects have broken ground in the past year to address the growing demand. The current development cycle represents the most construction to occur dating back to the mid-1980s. Overall vacancy increased slightly throughout the past year, but dropped back down to 9.9% in the second quarter. Vacancy was also 9.9% at mid-year 2015. Demand is keeping pace with new supply coming online, and vacancy is expected to remain near historically-low levels throughout 2016. Although asking rates continue to increase, the growth has slowed to a more sustainable pace. However, average asking rates for Class AA space in Denver's CBD have reached a new high of $42.87 psf gross in the second quarter.

The energy industry, now entering into the third year of a downturn, is beginning to dampen absorption gains as oil and gas tenants continue to downsize. Energy companies occupy roughly 11% of office space in the CBD- enough of a footprint to have an impact on the market without derailing the positive momentum of downtown. The space left behind by energy companies is leasing quickly to tenants in thriving industries, including finance, healthcare, and technology. Aside from the effects of the energy downturn, the market is poised for substantial growth going forward.

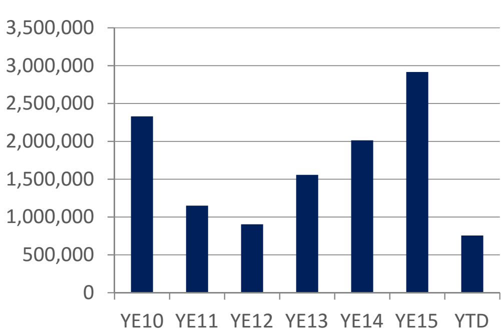
Asking Rates



Historical Vacancy Rate



Historical Net Absorption



Absorption & Demand

The Denver office market recorded 379,138 sf of positive net absorption in the second quarter, totaling 755,983 sf at the mid-year point. Absorption has slowed compared with 2015 due to oil and gas tenants vacating space in the Downtown market. Denver's CBD recorded a negative net absorption of 245,208 sf in the second quarter. Space losses this quarter were due to a number of small vacancies across the CBD's Class A buildings. Absorption gains in the Suburban market more than counteracted the negative absorption in Downtown. The Suburban market recorded 691,291 sf of absorption in the second quarter alone. Through the first half of the year, Denver recorded over 4.7 msf in leasing activity, which will translate into considerable space gains throughout 2016. Although the downturn in the energy industry is dampening activity, overall demand for office space remains high.

Vacancy & Availability

Denver's vacancy rate fell by 30 basis points from the previous quarter to 9.9%. Vacancy was 9.9% at this point last year. Avison Young includes corporate campuses in its data set to track the true expansion or contraction in the market. The delivery of additional corporate campuses, most notably Charles Schwab's campus in Lone Tree and FirstBank's new building in West Denver, have contributed in decreasing Denver's vacancy rate further. Although leasing activity has remained active throughout the past year, a good portion of speculative projects are expected to deliver in the second half of 2016. Demand is keeping pace with supply, and vacancy is expected to remain relatively stable in the coming quarters. The current vacancy rate will mean that tight market conditions will continue throughout 2016.

Asking Rates

Although asking rates continue to increase, the growth has slowed to a more sustainable pace. Average asking rates have increased by 2.8% from the previous year to $24.91 psf gross. At mid-year 2015, asking rates had increased by 6.8% from mid-year 2014. The majority of submarkets recorded growth in rental rates in the last 12 months, with the largest increases coming from Platte River, LoDo, Meridian, and Colorado Blvd/ Glendale. New construction deliveries, which demand higher rates, are also driving rental rate growth.

Construction

Denver's construction boom is in full swing. Large blocks of space continue to disappear from the market, and many tenants are turning to new construction to fulfill their real estate needs. In addition to fulfilling space requirements, office tenants in the Denver market continue to make real estate decisions based on recruiting and retention, with an increased emphasis on improved amenities that are provided in new construction projects. Nearly 3.8 msf is currently under construction. Along with the 1.8 msf that has delivered since the beginning of 2015 and new projects that are expected to break ground in the short term, the current development cycle represents the most construction to occur dating back to the mid-1980s. Five buildings broke ground in the second quarter totaling over 1.1 msf. Additional projects are expected to break ground throughout the remainder of 2016. Only two buildings have delivered this year. FirstBank delivered its 127,000-sf building at 12345 W Colfax and took occupancy of the space in the second quarter. 855 W 122nd Ave delivered 54,425 sf of Class B speculative space in the second quarter.

2Q16 Ground Breakings

16 Chestnut *(428,219 sf). Platte River*

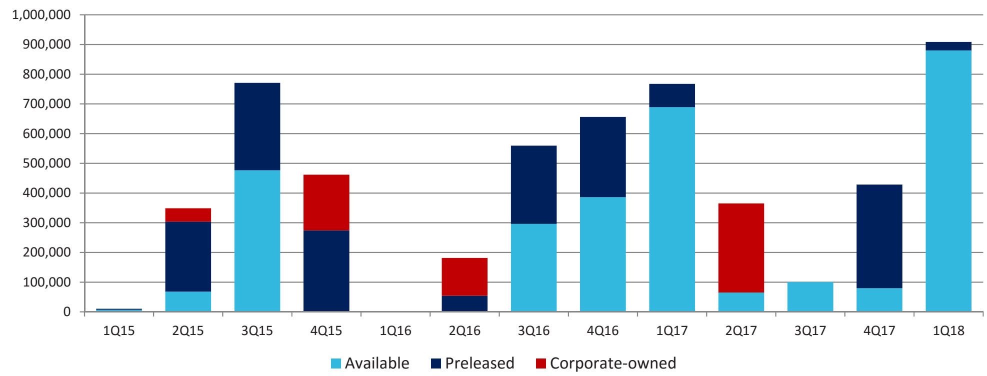
Denver Health Administration *(300,000 sf). Midtown*

Riverview at 1700 Platte *(210,000 sf). Platte River*

Gauge *(100,313 sf). Platte River*

Steam on Platte *(124,017 sf). West Denver.*

Construction Timeline



2Q16 Activity

- Comcast preleased the entire 211,579-sf INOVA Dry Creek building, which is set to deliver in late 2016. The INOVA development will eventually total 650,000 sf of mixed-use space. Developers are expected to break ground on the second office building, INOVA II, soon. It will total 235,800 sf.
- FirstBank completed its 127,000-sf building in West Denver and took occupancy of the space in the second quarter. It is the largest building to deliver this year.
- Biomet signed one of the largest leases in the first quarter at Westmoor Technology Park in Northwest Denver. The company occupied 104,000-sf of space in the second quarter.
- TIAA renewed its 346,081-sf lease at 1670 Broadway in Downtown Denver. Leasing activity in the CBD has topped 1.0 msf in the first half of the year.
- CoBiz Financial renewed its 67,279-sf lease at Colorado Business Bank in the CBD.
- SquareTwo Financial leased 61,153 sf at Legacy Cascades in Greenwood Village.
- Partners Group Holding, a Swiss investment company, announced plans to build a new North American headquarters in Denver. The company expects to have several hundred employees in Denver by 2018.

Trends to Watch

The price of oil averaged $45.59/bbl. in the second quarter, up from the first quarter's average of $33.38/bbl.

All economic sectors reported growth in the last 12 months, with Mining, Logging,& Construction (7.7%), Leisure & Hospitality (4.8%), Manufacturing (4.4%) and Financial Activities (3.1%) leading the way.

YTD residential building permits are up by 21.3% through May compared with last year.

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