

MARKETBEAT

DENVER OFFICE REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION



3Q09

ECONOMY

Weakness in metro Denver's economy was evident at the close of third quarter 2009 as industry revenues fell and companies continued to layoff workers. Total nonfarm sales in the area were 6.2% lower (by over \$5.0 billion) through the twelve months ending June compared to the same period one year ago. Hardest-hit were retail- and industrial-oriented businesses, with aggregate sales down 9.8% and 7.9% respectively. And, although office-occupying sectors did report a 4.5% year-over-year increase in sales, receipts through the first six months of this year were down 4.7% from the same period in 2008. Meanwhile, year-over-year employment in metro Denver fell by 4.6% (down 58,000 jobs) through August with about one-third of these occurring in office-occupying industries. Most notably, the administration and support subsector contracted by 8,700 positions (a decrease of 9.5%), credit intermediation and related services employment fell by 2,000 jobs (down 7.0%) and architects, engineers and related firms cut 1,600 professionals from their payrolls (a 5.6% loss).

OVERVIEW

Overall office market conditions mirrored the economy with vacancy levels rising, rental rates falling and leasing activity remaining sluggish. Vacancy market-wide increased 400 basis points (bps) during the past twelve months, ending third quarter at 17.8% overall and 16.3% direct. Sublease offerings now account for 8.5% of all space on the market, compared to 7.3% one year ago. Rental rates quoted were down 5.9% from this time last year, at \$20.62 per square foot (psf) overall, and effective rents are estimated to be 10.0% to 15.0% lower than official asking rates in most submarkets. Meanwhile, new and expansion leasing activity of 4.4 million square feet (msf) year-to-date is off by almost a third from this market's historical average.

The biggest year-over-year vacancy increases occurred in the Aurora/East and Northeast submarkets, where several large blocks of space became available (including 207,960 square feet (sf) at 3190 South Vaughn Way in southeast Aurora which had been occupied by DEX Media, and 87,847 sf at one of ProLogis' global headquarter buildings at 4555 Airport Way in northeast Denver). Overall vacancy in this region increased 670 bps in the past twelve months to end third quarter at 27.0%. Denver's Central Business District (CBD) registered the second-highest vacancy rise, up 510 bps to an overall rate of 16.1% since September 2008 owing in part to the delivery of 572,720 sf of new construction in this time frame (a 2.3% inventory increase) as well as the release of 301,444 sf at the former Qwest Wireless Building (which accounts for a full 7.2% of all vacant available space in the downtown area, or 1.2% of total vacancy). The Southeast Suburban region also experienced above-average vacancy escalations, up 470 bps year-over-year to 19.3% overall. This area has been particularly impacted by the downturn in housing and financial services markets due to higher concentrations of these types of businesses within its boundaries. On the positive side, however, there is now a good amount of high-quality space available at extremely competitive rates in this otherwise sought-after market which should lease up quickly once the economy turns.

Eleven of the fifteen office submarkets tracked by Cushman & Wakefield reported year-over-year rental rate declines, ranging from a low of 1.4% in Cherry Creek (down to \$18.89 psf overall) to a high of 10.7% in the CBD (down to \$26.27 psf overall). The remaining four posted increases, from as little as 0.5% in the Arapahoe Road submarket (up to \$17.64 psf) to as much as 4.5% in Midtown (up to \$19.71 psf). By class, rental rates for lower-end C buildings have held up the best (down 4.8% market-wide to \$14.64 psf overall), as compared to class A facilities (down 6.2% to \$24.32 psf overall) and class B properties (down 8.8% to \$18.32 psf overall).

FORECAST

Recessionary forces will keep spending down, sales volumes weak, and job cutting efforts ongoing through 2010. Vacancies are likely to rise another 200 to 300 bps through the end of next year, while rents continue to fall. Tenants can find good opportunities to lock in low rates in the near-term, yet inflationary pressures could emerge once recovery takes hold and limit the window for savings. Nonfarm industry sales will be the harbinger of better times to come. Once growth resumes in these key local indicators, expect employment to follow which, in turn, will work to boost overall demand for commercial property with a lag of between two to three quarters.

BEAT ON THE STREET

"Even in the midst of this downturn, metro Denver continues to out-rank other areas in the country for its friendly business climate, high-quality workforce and above-average living standards, and these attributes are sure to help the area rebound quickly once recovery takes hold."

– Sherman R. Miller, Executive Managing Director / West Regional Manager

ECONOMIC INDICATORS

National	2008	2009F	2010F
GDP Growth	0.4%	-2.6%	1.8%
CPI Growth	3.8%	-0.5%	1.7%
Regional			
Unemployment	5.0%	7.7%	8.0%
Employment Growth	0.8%	-4.2%	-1.2%

Source: Moody's | Economy.com, US Bureau of Labor Statistics

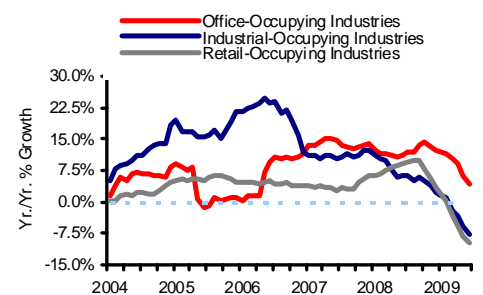
MARKET FORECAST

LEASING ACTIVITY is likely to remain weak, averaging 1.0 msf to 2.0 msf per quarter over the next four to six quarters. ↓

OVERALL ABSORPTION has been negative for the past four quarters and should remain so through 2010. ↓

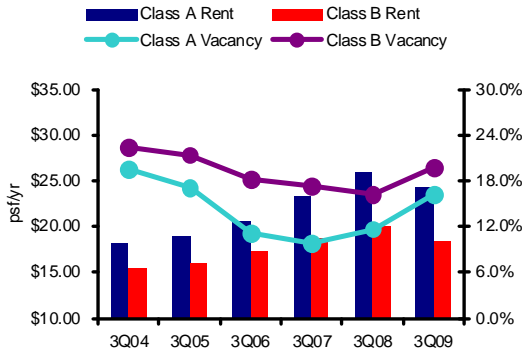
CONSTRUCTION deliveries are likely to be limited to the 1.4 msf already in the pipeline through 2011 as credit remains tight and declining rental rates fail to support cost of new development. ↓

NONFARM INDUSTRY SALES



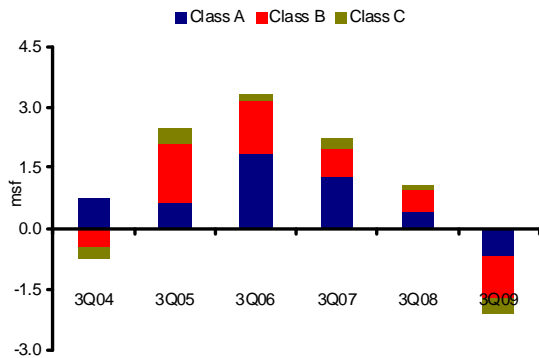
TOTAL MARKET

OVERALL RENTAL RATES VS. VACANCY



- Overall asking rents for class A properties appreciated by 42.0% from trough to peak between third quarter 2004 and third quarter 2008. They have since fallen 6.2% in the last four quarters, ending at \$24.32 psf in September of this year. Class B rents grew 30.6% during the same 2004 to 2008 time frame, but have since fallen 8.8% to end second quarter at \$18.32 psf overall.
- Class A vacancies rose 560 bps from a low of 9.1% overall at the end of 2007 to 16.3% overall at the close of third quarter 2009 as 2.1 msf of new product came online and demand weakened. Rising class B vacancies mirror the onset of economic contraction, now up 360 bps to 19.8% from third quarter 2008.

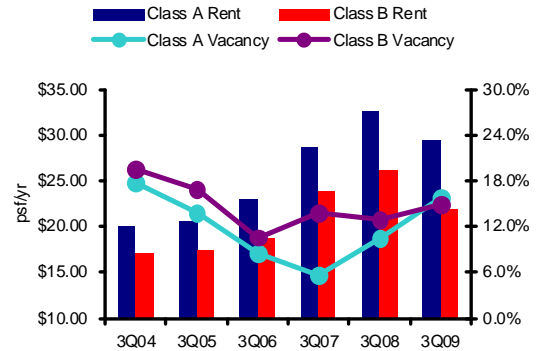
OVERALL ABSORPTION BY CLASS



- Overall absorption market-wide is decidedly weak, amounting to over 2.1 msf of negative space take-up since the start of this year. While new and expansion moves are still taking place, many more tenants are opting to downsize or seek short-term renewals as they wait to ascertain recovery prospects.
- Class A properties accounted for 33.0% of negative absorption recorded this year, while class B contributed 48.1% and class C added 18.9% to the overall total.

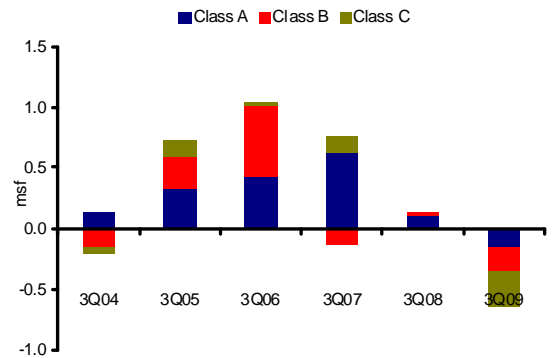
CBD

OVERALL RENTAL RATES VS. VACANCY



- The CBD witnessed a 62.1% spike in rental rates during its latest trough-to-peak cycle between second quarter 2004 and third quarter 2008. Yet, as economic troubles set in and vacancies started to rise, landlords were quick to give back some of prior-year pricing gains to remain competitive. Overall rents for all classes have fallen 10.7% in the past twelve months to \$26.27 psf, with class A rents down 9.8% in this period to \$29.38 psf and class B rents off 16.2% at \$21.95 psf.
- Class A vacancy jumped 530 bps from 10.4% in September 2008 to 15.7% overall in September of this year while adding 572,720 sf of inventory during this time frame. Class B vacancy rose 190 bps over the same period to 15.9% overall.

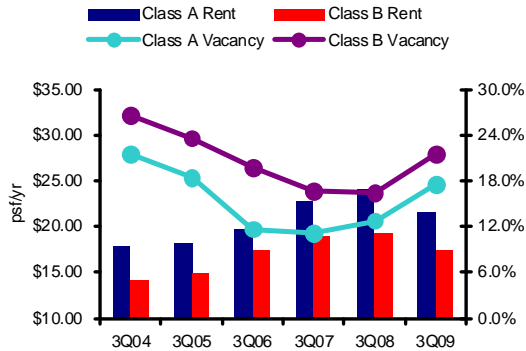
OVERALL ABSORPTION BY CLASS



- Class A represented a 25.4% share of the 641,745 sf of negative absorption in the CBD, while class B added 30.1%.
- Significant transactions closed this year that helped offset impacts of new construction and space give-backs include a 47,441-sf sublease signed by the Colorado State Judicial Department at 101 West Colfax, a total of 38,189 sf taken by law firm Polsinelli Shughart at Hines Tower, and a 13,000-sf expansion of Petroleum Development Corporation at Denver Financial Center I.

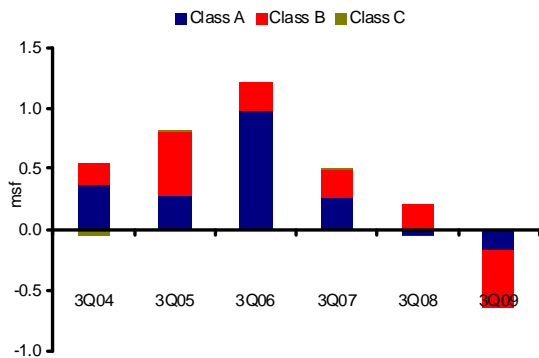
SOUTHEAST SUBURBS

OVERALL RENTAL RATES VS. VACANCY



- Overall class A rents in the Southeast Suburban region increased 37.7% in this area's most recent trough-to-peak cycle between year-end 2003 and third quarter 2008. They have since fallen 10.1% from a high of \$24.01 psf to \$21.59 psf today while overall vacancy for this property class rose 470 bps in this time frame to 17.5%.
- Class B rents experienced a 27.9% rental rate rise from a low of \$14.20 psf overall in third quarter 2004 to its last peak in third quarter 2008 at \$19.24 psf overall. Since then, overall class B rents have fallen 9.0% to \$17.51 psf and overall vacancy rates have risen 500 bps to 21.6% at the close of third quarter 2009.

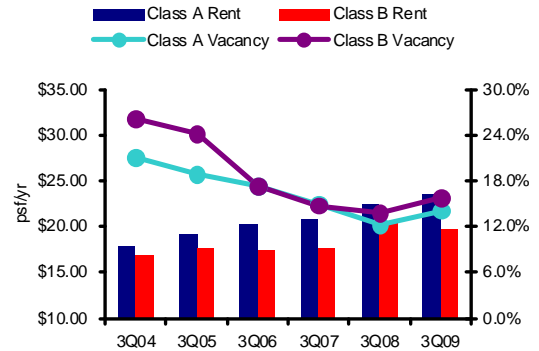
OVERALL ABSORPTION BY CLASS



- A full 72.1% of the 638,320 sf of negative absorption in the Southeast Suburban region is attributed to occupancy loss in class B properties. Class A contributed an additional 27.8% to this year-to-date total.
- Insurance company State Farm (taking 47,633 sf at Pyramid Pointe), law firm Holland & Hart (signing 24,012 sf at Village Center Station), engineering group Stanley Consultants (leasing 40,125 sf at Waterview III), and info-tech specialist IQNavigator (with 39,879 sf at Peakview Tower I) typify tenants currently active in this market.

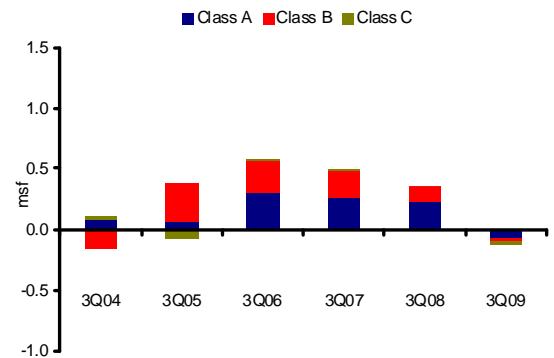
NORTHWEST

OVERALL RENTAL RATES VS. VACANCY



- The Northwest was one of two regions in the metro area to report increasing class A rental rates year-over-year (rising 4.6% in the past twelve months to \$23.49 psf overall), yet class A vacancies are beginning to rise in this area as well (up 190 bps from last year to 14.1%) and may lead to future rental rate depreciation as competition heats up.
- Class B rents have fallen 3.3% since September 2008 to \$19.71 psf overall, while class B vacancies jumped 200 bps higher to 15.7% overall. Although not immune from current economic pressures, the Northwest is expected to perform better than other regions in coming periods due to its mix of high-tech, manufacturing and energy-related industries.

OVERALL ABSORPTION BY CLASS



- Absorption has been weak for the past two consecutive quarters in the Northwest, amounting to negative 129,729 sf year-to-date. Almost 58.8% of this is associated with new class A vacancies.
- Tech, bio-tech, engineering, and research and development remain primary drivers in the Northwest. Leases signed by firms like Nellcor Puritan Bennett (with 47,380 sf at Corporate Place 2), General Dynamics (signing for 27,281 sf at Westmoor Technology Park), and Navarro Research (leasing 11,520 sf at Denver West) exemplify momentum.

MARKET/SUBMARKET STATISTICS

MARKET/ SUBMARKET	INVENTORY	NO. OF BLDGS.	OVERALL VACANCY RATE	DIRECT VACANCY RATE	YTD LEASING ACTIVITY	UNDER CONSTRUCTION	YTD CONSTRUCTION COMPLETIONS	YTD OVERALL ABSORPTION	DIRECT WTD. AVG. CLASS A GROSS RENTAL RATE*
Central Business District	25,789,200	127	16.1%	13.7%	946,609	848,822	474,884	(641,745)	\$30.48
Midtown	3,547,007	60	7.8%	7.5%	160,783	0	17,420	(18,554)	\$25.00
Urban Core	29,336,207	187	15.1%	12.9%	1,107,392	848,822	492,304	(660,299)	\$30.47
Southeast Denver	2,796,822	57	23.3%	22.9%	85,722	0	10,971	(100,989)	\$19.88
Cherry Creek	7,455,772	83	18.4%	17.6%	334,956	0	0	(148,404)	\$23.46
Southeast	10,252,594	140	19.7%	19.1%	420,678	0	10,971	(249,393)	\$21.86
Aurora	4,893,151	73	24.6%	24.6%	157,822	0	0	(111,372)	\$16.69
Northeast	2,505,498	38	31.7%	31.7%	87,082	175,155	0	(145,834)	\$24.54
Aurora / Northeast	7,398,649	111	27.0%	27.0%	244,904	175,155	0	(257,206)	\$20.44
Southwest	7,032,430	136	15.9%	14.9%	304,899	30,000	0	(87,788)	\$23.76
Union Square	2,141,044	31	17.2%	16.5%	122,802	0	0	(96,623)	\$20.09
Southwest	9,173,474	167	16.2%	15.3%	427,701	30,000	0	(184,411)	\$21.85
Denver Tech Center	9,109,253	67	19.2%	17.8%	550,992	0	0	(253,544)	\$21.90
Greenwood Plaza	7,932,434	64	16.7%	15.1%	486,493	0	200,174	(120,248)	\$22.94
Inverness / Panorama	6,389,797	72	22.5%	21.3%	348,300	0	0	(81,726)	\$21.93
Arapahoe Road	3,384,590	80	23.3%	23.0%	149,011	0	140,000	(95,794)	\$22.17
Meridian	2,589,178	25	14.6%	13.6%	83,395	0	0	(87,008)	\$21.34
Southeast Suburban	29,405,252	308	19.3%	18.1%	1,618,191	0	340,174	(638,320)	\$22.03
Denver-Boulder Corridor	8,119,104	119	16.5%	13.4%	394,726	350,948	0	(28,620)	\$25.53
West Denver	4,690,004	113	10.9%	9.8%	202,240	22,458	12,544	(101,132)	\$19.50
Northwest	12,809,108	232	14.4%	12.1%	596,966	373,406	12,544	(129,752)	\$24.87
CBD	25,789,200	127	16.1%	13.7%	946,609	848,822	474,884	(641,745)	\$30.48
NON-CBD	72,586,084	1,018	18.4%	17.2%	3,469,223	578,561	381,109	(1,477,636)	\$22.21
DENVER TOTAL	98,375,284	1,145	17.8%	16.3%	4,415,832	1,427,383	855,993	(2,119,381)	\$24.83

* Rental rates reflect \$psf/year

MARKET HIGHLIGHTS

SIGNIFICANT 3Q09 NEW LEASE TRANSACTIONS

BUILDING	SUBMARKET	TENANT	SQUARE FEET	BLDG CLASS
1515 Wynkoop Street	Central Business District	Policy Studies	75,474	A
11400 Westmoor Drive	Denver-Boulder Turnpike	General Dynamics	27,281	B
6380 South Fiddlers Green Circle	Greenwood Plaza	Holland & Hart	24,012	A

SIGNIFICANT 3Q09 SALE TRANSACTIONS

BUILDING	SUBMARKET	Buyer	SQUARE FEET	PURCHASE PRICE
The Greens at Inverness	Inverness/Panorama	Northstar Commercial Partners	63,653	\$3,880,000

SIGNIFICANT 3Q09 CONSTRUCTION COMPLETIONS

BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
The Streets at Southglenn	Arapahoe Road	N/A	140,000	8/09

SIGNIFICANT PROJECTS UNDER CONSTRUCTION/RENOVATION

BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
1800 Larimer Street	Central Business District	Xcel Energy	490,822	6/10
1900 16th Street	Central Business District	N/A	358,000	10/09
385 Interlocken Crescent	Denver-Boulder Turnpike	N/A	285,612	6/10