

# MARKETBEAT

## DENVER OFFICE REPORT

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION



4Q09

### ECONOMY

After twelve straight months of intensifying weakness, the pace of economic deterioration began to slow in fourth quarter 2009. Total nonfarm employment in the Denver-Aurora MSA contracted at a 3.5% year-over-year rate through November – down from the -4.7% trough reached in August 2009 – for a net loss of 43,400 jobs. Government and education & health remained the only two major industry sectors that continued to add jobs during this period. Government employment was up by 3,700 workers year-over-year, with the majority of this due to expansion in state and local government education. Private education & health payrolls grew by 3,200 positions, primarily owing to increased demand for nursing/residential care facilities and social assistance services. Meanwhile, weakness persisted in natural resources & construction, trade, transportation & utilities, and professional/business services, leading to a combined loss of more than 34,500 jobs in the past year. Nonfarm industry sales in the metro area's core seven counties for the twelve months ending October 2009 were 10.8% lower than the same period one year ago, amounting to \$79.7 billion.

### OVERVIEW

Job losses and sales declines have noticeably impacted metro Denver's office market, affecting every region and all property classes. Occupancy levels have fallen, driving vacancy rates up and rental rates down. Leasing activity has been sluggish, and new construction (with the exception of one build-to-suit and three speculative projects already underway) has virtually come to a standstill.

Overall vacancy rates are now 420 basis points (bps) higher than they were one year ago, ending fourth quarter at 18.9%. Denver's Central Business District (CBD) saw the largest vacancy rate rise (up 540 bps from year-end 2008 to 17.4% overall), owing in part to the delivery of 832,884 square feet (sf) of new construction in this time frame (a 3.3% inventory increase) as well as the release of 301,444 sf at the former Qwest Wireless Building (which accounts for a full 6.6% of all vacant available space in the downtown area, or 1.2% of total vacancy). The Northwest region registered the second-highest vacancy rise (up 470 bps to an overall rate of 17.2%), followed by the Aurora / Northeast region (up 460 bps overall to 28.0%). The Southeast Suburban region reported the lowest vacancy rate increase (up 330 bps year-over-year to 19.7% overall).

Part of the reason the Southeast Suburbs fared so well is that several large leases were signed over the course of the year that served to off-set new spaces coming on line. For instance Catholic Health Initiatives signed for 97,000 square feet (sf) at 198 Inverness Drive West, where it plans to move its headquarters and consolidate other operations into a single location. Similarly, Zynex Medical Corporation took 75,000 sf at 9990 Park Meadows Drive to relocate and expand its headquarters. Also, medical device manufacturer Baxa Corporation leased 63,824 sf at 9540 South Maroon Circle to consolidate administrative and executive operations housed in three separate offices into one location. Large tenants were also attracted to the CBD over the course of 2009, including the Colorado Judicial Department which subleased a total of 98,716 sf at 101 West Colfax in two separate transactions for a move from the Midtown submarket, and Black Hills Exploration and Production which relocated from the Southwest region to a 47,042-sf suite at the newly constructed Hines Tower development. Furthermore, moves and expansions by existing CBD firms like St. Mary Land and Exploration Company (which leased 75,713 sf at Denver Financial Center I), Policy Studies (taking 75,000 sf at Hines Tower) and the U.S. General Services Administration (signing 32,500 sf at the Colorado State Bank Building) show demand still persists in this submarket even though overarching economic fundamentals remain weak.

The weighted average of rental rates quoted has fallen 6.3% market-wide over the past year to \$20.40 per square foot (psf) overall. Southeast Suburban rents are now 10.9% lower at \$18.98 psf overall. CBD rents now average 9.4% less at \$26.30 psf overall, and Southwest rents are down 7.7% to \$18.15 psf overall compared to one year ago. On the plus side, firms that are in the market now can find exceptional value for their money with generous terms.

### FORECAST

Vacancies are likely to rise another 150 to 250 bps through the end of next year, while rents continue to fall. Tenants will 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. Look for an upturn in area business sales to signal rebound in employment markets and, in turn, improvement in commercial real estate conditions with a lag of between two to three quarters.

### BEAT ON THE STREET

"Once company balance sheets can sustain expansion, entrepreneurial momentum so characteristic of this market will revitalize commercial property demand. There is usually a lag between when hiring re-starts and space take-up accelerates, and another after that before rental rates respond. By 2011, Denver should be going strong again."

– Sherman R. Miller, IV  
Executive Managing Director

### ECONOMIC INDICATORS

	2008	2009F	2010F
National			
GDP Growth	0.4%	-2.5%	2.3%
CPI Growth	3.8%	-0.4%	1.7%
Regional			
Unemployment	5.0%	7.6%	8.0%
Employment Growth	0.8%	-3.9%	-0.7%

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

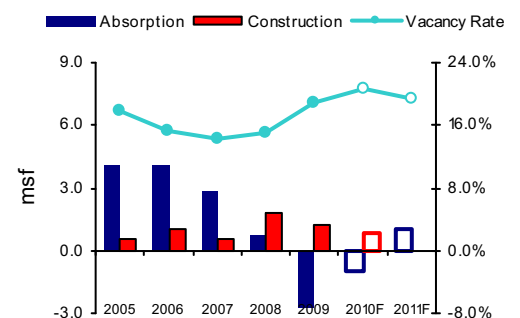
### MARKET FORECAST

**LEASING ACTIVITY** is down 37.3% from the long-run historical average for this market, but should pick up through 2010 as leases roll-over and confidence stabilizes. ↓

**DIRECT ABSORPTION** is likely to remain weak but should stabilize over the next several quarters. ↓

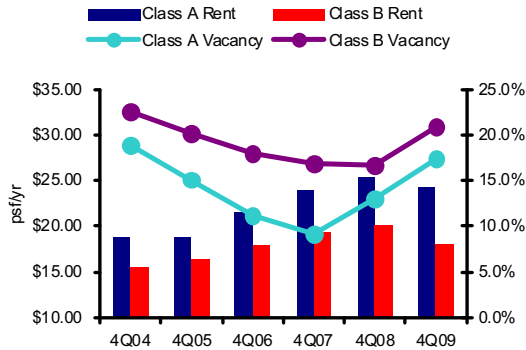
**NEW CONSTRUCTION** is brought to a standstill for the foreseeable future after current projects deliver. ↓

### SUPPLY & DEMAND TRENDS



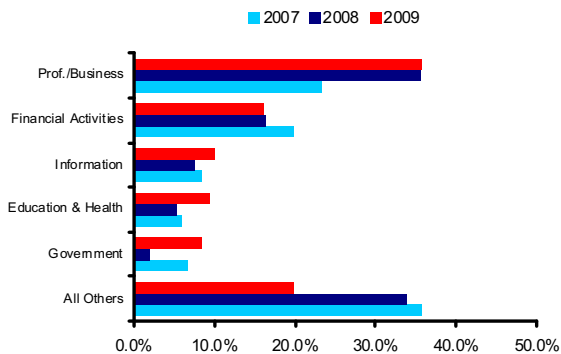
### TOTAL MARKET

#### OVERALL RENTS VS. VACANCY RATES



- Overall class A rents fell \$1.20 psf over the past twelve months to \$24.20 psf at the close of C&W's fourth quarter survey. During the same time frame the overall vacancy rate for class A property increased 440 bps.
- Class B overall rents were \$2.08 psf lower than year-ago levels at \$17.99 psf, while overall vacancy for this property class was up 420 bps from December 2008.
- Further depreciation in rents is likely through 2010 as vacancies continue to rise, but the rate of depreciation should slow as this market begins to stabilize toward the end of next year.

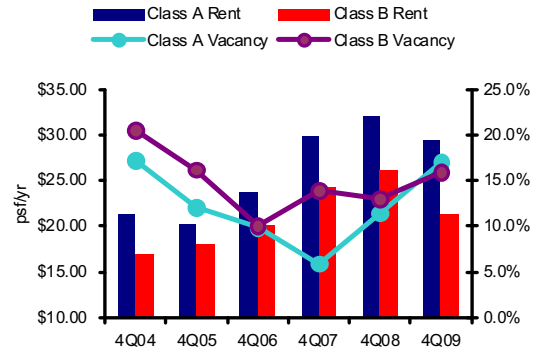
#### LEASING ACTIVITY BY INDUSTRY



- Year-to-date leasing activity in 2009 of less than 6.1 msf was down 37.3% from the long-run 9.6 msf per year historical average for this market, and this year's average lease size of 3,478 sf was 16.5% smaller than usual.
- The largest share of this space (35.8%) was taken by firms in the professional/business services sector, with law firms, engineers and scientific/technical consultants most active. Finance, insurance and real estate companies were the second-largest contingent of lessees, accounting for 16.2% of space signed. Firms engaged in information technology and education & health services were the next-most dominant, with 10.5% and 9.5% shares respectively.

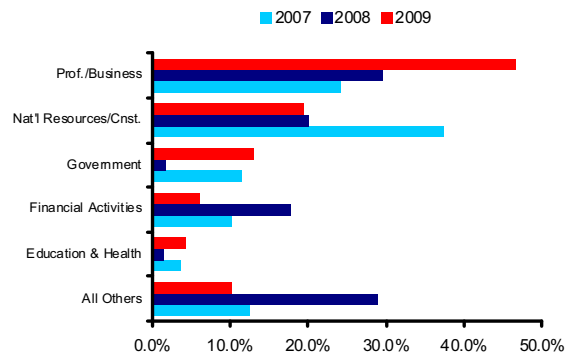
### CBD

#### OVERALL RENTS VS. VACANCY RATES



- Faced with some of the steepest rental rate increases in the market over a three-year period, downtown tenants found reprieve though 2009. Class A rates quoted were down \$2.53 psf to \$29.49 psf overall from fourth quarter last year. Class B rents fell \$4.85 psf year-over-year to \$21.32 psf.
- With 490,822 sf of construction still in the pipeline for 2010 and large move-outs scheduled to occur over the next several quarters, overall vacancy rates could rise another 250 to 350 bps through 2010, driving rents even lower. Concessions, however, are unlikely to be as generous going forward as landlords feel increasingly pinched.

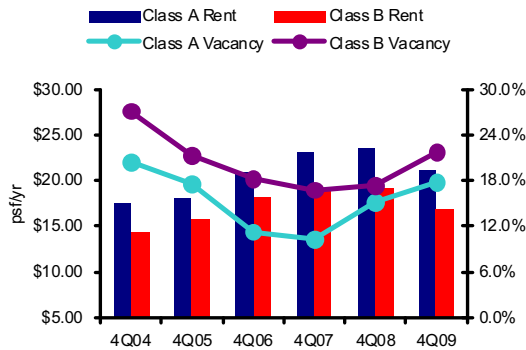
#### LEASING ACTIVITY BY INDUSTRY



- Leasing activity of over 1.3 msf was down 41.8% from the CBD's average of over 2.2 msf per year, and the average lease size of 4,679 sf was 18.6% smaller. The professional/business services sector accounted for 46.7% of this year's activity, as law firms (like Polsinelli Shugart, taking 38,189 sf at Hines Tower), management specialists (such as mortgage servicer Allonhill, subleasing 21,574 sf at Park Central), and consulting engineers (as David Evans & Associates, signing for 16,788 sf at the Guaranty Bank Building) remained in growth mode to service niche clientele. Natural resource firms were also on the move, leasing 19.5% of this year's space in the CBD.

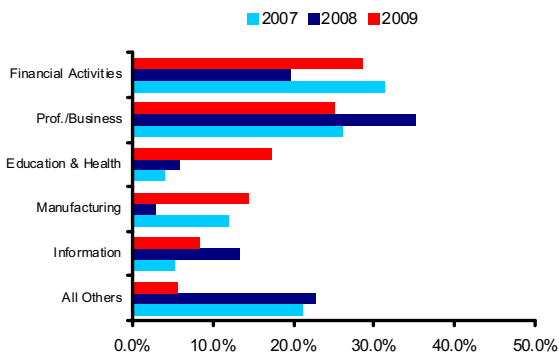
### SOUTHEAST SUBURBS

#### OVERALL RENTS VS. VACANCY RATES



- Southeast Suburban landlords quickly responded to financial- and construction-sector shake-outs due to above-average concentrations of these businesses in the region and, in some respects, may have benefitted from foresight. Posting the second-largest year-over-year decline in class A rents in the metro area, overall rates fell by 10.1% to \$21.16 psf. Meanwhile, overall class A vacancy rose only 260 bps in this period to 17.8% as value-seekers quickly back-filled availabilities. Overall class B rents fell more slowly, but ended up 11.8% lower by year's end at \$16.86 psf as class B vacancies increased 450 bps to 21.8%.

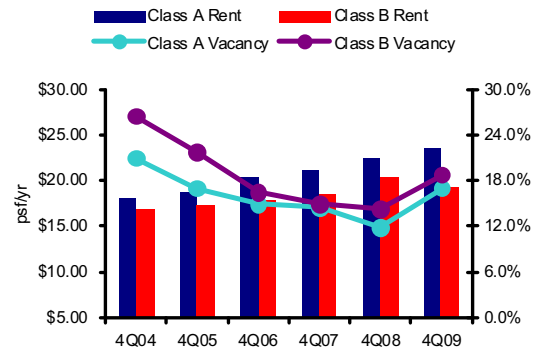
#### LEASING ACTIVITY BY INDUSTRY



- Financial services firms staged a little comeback in the Southeast Suburbs over the course of 2009, accounting for 28.7% of more than 2.3 msf leased in this region year-to-date. For the year, however, total leasing activity was still 30.9% lower than the 3.4 msf per year average while the average lease size of 4,462 sf was 10.7% smaller than normal.
- The professional/business services sector was the second-most active contingent in this market with a 25.2% share of all new and expansion leases signed.
- Other active sectors in 2009 included education & health (17.4%), manufacturing (14.5%) and information (8.5%).

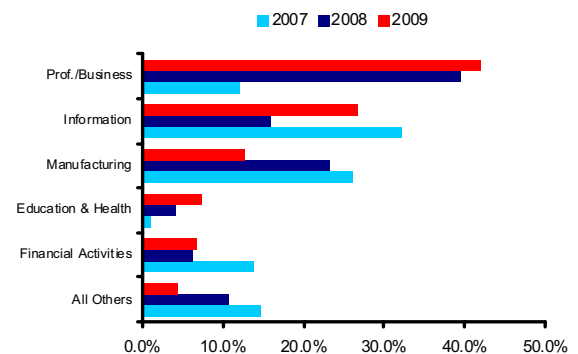
### NORTHWEST

#### OVERALL RENTS VS. VACANCY RATES



- The Northwest region was slower to feel effects of this current down cycle, but is now also reporting higher vacancies and softer rents – albeit still uneven in key respects.
- During the past year overall class A vacancy rates have jumped 520 bps to 17.0%, yet class A rents are actually 4.9% higher at \$23.58 psf. In contrast, class B rents have decreased 5.5% in the past year to \$19.29 psf overall while overall vacancies are up 450 bps to 18.8%. This discrepancy results from several high-end spaces becoming available that were priced in-line with historical scarcity and quality but have yet to synchronize with prevailing market conditions.

#### LEASING ACTIVITY BY INDUSTRY



- Amounting to just 727,868 sf for the year, leasing activity in the Northwest was off 41.3% from its historical levels, and the average lease size was 26.2% smaller than normal.
- Professional/business services accounted for 42.0% of regional leasing activity recorded in 2009. The information sector was also a notable presence (signing for 28.6% of transactions closed), as was manufacturing (with a 12.8% share). Some of the larger moves include ZOLL Data Systems (subleasing 67,250 sf at The Views II), Nellcor Puritan Bennett (expanding by 47,380 sf at Corporate Place 2), and Geomega Environmental Consulting (leasing 18,552 sf at the Centro Offices).

### 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	26,147,200	128	17.4%	15.3%	1,300,677	490,822	832,884	(606,656)	\$30.12
Midtown	3,664,810	63	10.5%	10.4%	208,726	0	17,420	(66,887)	\$26.00
Urban Core	29,812,010	191	16.5%	14.7%	1,509,403	490,822	850,304	(673,543)	\$30.06
Southeast Denver	2,796,822	57	26.4%	26.4%	128,966	0	10,971	(187,915)	\$18.40
Cherry Creek	7,455,772	83	18.9%	18.2%	436,475	0	0	(191,232)	\$22.80
Southeast	10,252,594	140	21.0%	20.4%	565,441	0	10,971	(379,147)	\$20.76
Aurora	4,893,151	73	26.3%	26.2%	192,747	0	0	(175,961)	\$16.40
Northeast	2,505,498	38	31.4%	31.4%	118,307	175,155	0	(136,605)	\$24.43
Aurora / Northeast	7,398,649	111	28.0%	28.0%	311,054	175,155	0	(312,566)	\$20.22
Southwest	7,052,430	137	17.0%	15.7%	385,313	0	0	(168,663)	\$23.10
Union Square	2,141,044	31	18.6%	16.8%	207,268	0	0	(126,223)	\$19.94
Southwest	9,193,474	168	17.4%	16.0%	592,581	0	0	(294,886)	\$21.53
Denver Tech Center	9,109,253	67	19.7%	18.3%	715,560	0	0	(296,736)	\$21.44
Greenwood Plaza	7,993,776	68	17.5%	15.3%	607,390	0	200,174	(164,562)	\$23.20
Inverness / Panorama	6,389,797	72	20.8%	20.3%	574,361	0	0	32,254	\$21.85
Arapahoe Road	3,402,279	81	26.5%	26.2%	223,862	0	140,000	(179,376)	\$22.72
Meridian	2,589,178	25	14.2%	11.8%	221,267	0	0	(2,307)	\$19.74
Southeast Suburban	29,484,283	313	19.7%	18.3%	2,342,440	0	340,174	(610,727)	\$21.78
Denver-Bldr. Corridor	8,645,758	135	19.7%	16.1%	474,683	285,612	0	(305,612)	\$25.10
West Denver	4,712,400	114	12.5%	10.7%	253,185	22,458	12,544	(180,633)	\$18.58
Northwest	13,358,158	249	17.2%	14.2%	727,868	308,070	12,544	(486,245)	\$24.42
CBD	26,147,200	128	17.4%	15.3%	1,300,677	490,822	832,884	(606,656)	\$30.12
NON-CBD	73,351,968	1,044	19.5%	18.1%	4,748,110	483,225	381,109	(2,150,458)	\$21.91
DENVER TOTAL	99,499,168	1,172	18.9%	17.4%	6,048,787	974,047	1,213,993	(2,757,114)	\$24.73

\* Rental rates reflect \$psf/year

### MARKET HIGHLIGHTS

#### SIGNIFICANT 2009 NEW LEASE TRANSACTIONS

BUILDING	SUBMARKET	TENANT	SQUARE FEET	BLDG CLASS
198 Inverness	Inverness / Panorama	Catholic Health Initiatives	97,000	A
1775 Sherman Street	Central Business District	St. Mary Land and Exploration	75,713	A
9990 Park Meadows Drive	Meridian	Zynex Medical Corporation	75,000	A

#### SIGNIFICANT 2009 SALE TRANSACTIONS

BUILDING	SUBMARKET	Buyer	SQUARE FEET	PURCHASE PRICE
1225 17th Street	Central Business District	HRPT Properties Trust	666,653	\$134,250,000
3190 South Vaughn	East / Aurora	Northstar Commercial Partners	300,000	\$4,759,000
5619 DTC Parkway	Denver Tech Center	Alliance Commercial Partners	241,211	\$18,400,000

#### SIGNIFICANT 2009 CONSTRUCTION COMPLETIONS

BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
1900 16th Street	Central Business District	N/A	358,000	11/09
1515 Wynkoop	Central Business District	Van Gilder Insurance	277,416	3/09
6380 South Fiddlers Green Circle	Greenwood Plaza	Cricket Communications	200,174	6/09

#### SIGNIFICANT PROJECTS UNDER CONSTRUCTION/RENOVATION

BUILDING	SUBMARKET	MAJOR TENANT	SQUARE FEET	COMPLETION DATE
1800 Larimer	Central Business District	Xcel Energy	496,359	6/10
385 Interlocken	Denver-Boulder Turnpike	N/A	285,612	6/10
7500 East 29th Avenue	Northeast	Federal Bureau of Investigations	175,155	1/10



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\*Market terms & definitions based on BOMA and NAIOP standards.

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