A Colorado Real Estate Journal Publication

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OFFICE PROPERTIES Quarterly

Trends in action:
Union Station wing buildings

Courtesy JC Buck

by Michelle Z. Askeland

The Union Station wing office buildings – often referred to as One Union Station and the IMA Building – exemplify many of the trends the Denver office property market is witnessing. A large part of both buildings' success – each sold for over $600 per square foot to GLL Real Estate Partners, a German-based international asset manager in 2014 – can be attributed to the old adage that real estate is all about "location, location, location."

"Because of its reinvention as an intermodal transit hub with rail, light rail to Denver International Airport and buses, Union Station has really become the "new center" of Denver and the two buildings that we purchased sit directly adjacent to that transit hub; there are no two other buildings that can boast the location that these buildings enjoy," said Eric Ramm, acquisition officer for GLL Properties, the U.S. subsidiary of GLL Real Estate Partners Gmbh. Ramm said the renovation of Union Station is one of the most appealing transit-focused developments in the country.

Across the city, most Class A office properties are experiencing record prices, however the price paid per sf for the two wing buildings set Colorado office property records by nearly $160 per sf, said Chris Frampton, managing partner for East West Partners. East West Partners was one of the master developer partners for the whole project, and developed One Union Station (the south wing building).

Frampton said he believes the entire Union Station area will move in the same price direction. "The train station has made us attractive to foreign capital, and foreign capital is a huge deal," he said. "We are getting compressed cap rates as a result of it. People view this submarket as a core market, or close to it, so we're getting a great value of our land

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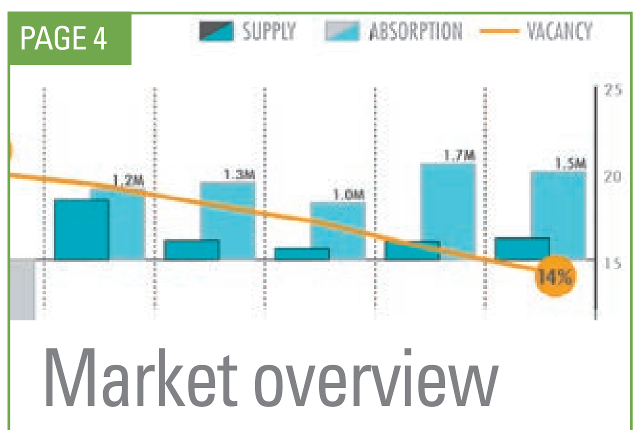

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A recap of the past five years and expectations for 2015, including submarkets, building classes and more

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Promoting craft and authenticity are important when transforming the corporate environment.

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Finding the balance

Collaborative spaces and private, focus areas are equally important in the workplace.

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Letter from the Editor

Colorado's strong employment helps market

As we wrapped up this issue, several reports came out about the office market. One area in particular stands out, and that's the employment numbers in Colorado.

Employers in Denver are forecasted to add 43,000 workers during

2015, and office-using payrolls will increase by 14,000 jobs, according to the Marcus and Millichap 2015 National Office Report. Denver is ranked the sixth-healthiest employment market in the country, according to the report.

The Denver area currently has 3.6 percent unemployment, according to CBRE's Denver 2015 Market Outlook. Make sure to read Patricia Silverstein's article on Page 16 to learn more about the employment pool and its effect on the office market.

With these numbers, one thing is consistently mentioned – the Denver office market is not reliant on the oil and gas industry. While the energy industry and its peripheral businesses are a large presence in Denver, there is a well-balanced blend of industries.

In addition, we have a great generational blend. Millennials continue to pick Denver as the top location they'd like to live, and employers are taking note.

"Denver continues to attract businesses due to its highly educated workforce," said the CBRE outlook. "In 2013, 42.1 percent of the Denver region's workforce had obtained at least a bachelor's degree, compared to the national average of 29.6 percent. Further, Colorado is the second-most educated state in the nation."

These positive trends undoubtedly are affecting the office market. At the end of 2014, the average asking lease rate was $23.15, the office market vacancy rate was 12.5 percent and there was 2 million square feet of office property under construction, according to the CBRE outlook.

In response to this influx, there are 2.2 million sf of office space that will be brought on line this year, mainly downtown and in the Denver Tech Center, according to the Marcus and Millichap report. However, developers are cautious not to overbuild the market, which Tom Lee discusses on Page 9.

I want to thank all the authors who took the time and energy to research and write for this issue. Please reach out to me if you have any thoughts on the issue, are interested in contributing or would like to make sure we cover something important in an upcoming issue.

I look forward to hearing from you, and thanks for reading.

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Finance Market

Financing for permanent office building loans

Following are some insights regarding the current financing environment for permanent loans for office buildings.

■ Overall, how receptive are permanent lenders for office building loans?

Over time, life insurance companies tend to vary widely relative to their interest for office building loans, depending on their perception of the economy and the respective loan exposure to that property sector or local market. Since the Denver office market is quite strong, office building loans are candidates for all life companies and commercial mortgage-backed security lenders, as well as banks and credit unions. CMBS loans may be the best option for longer-term nonrecourse financing for office product, especially for higher-leveraged transactions.

■ How does a central business district location compare with a suburban location for lender preferences?

For life companies, there is some bias toward a CBD location or infill areas like Cherry Creek, where there are higher barriers for development. Nonetheless, there are many strong suburban office parks or concentrations of office development in the Denver area that have demonstrated consistent market occupancy levels over the years. Lenders are more cautious about generic office product, where buildings can compete only with rent levels.

■ How would you define a "generic" office building?

A building built in the 1970s or 1980s that has lower ceiling heights, limited common-area amenities, older mechanical systems, narrow hallways, challenging floor plans or bay depths, and low parking ratios (3.5 spaces per 1,000 square feet or less). Most of these buildings possess permanent functional obsolescence that is difficult to cure.

■ How are generic buildings best financed?

Generally a life insurance company lender will require a very conservative loan structure or personal recourse. Banks or credit unions are logical candidates. CMBS lenders are the best option for a nonrecourse loan for generic buildings, especially where higher leverage is needed.

■ Why is a CMBS loan worth considering?

Many borrowers have indicated that they would never use a CMBS lender again after dealing with loan administration and defeasance nightmares over the past few years. However, the main reason for an owner to consider a CMBS finance execution is to achieve a nonrecourse loan with highest possible leverage level, say 75 percent. In addition, the loan amortization likely will be 30 years or could include a few years of interest-only payments. The debt constant will be lower compared with a life company option, even though the interest rate may be higher. For example, a full-leverage CMBS 10-year fixed-rate loan at 4.5 percent with a 30-year amortization has a debt constant of 0.061. This compares with a life company constant of 0.065 using a rate of 4.25 percent with a 25-year amortization for the same property.

The downsides of a CMBS loan include funded reserves for tenant finish, leasing commissions and capital expenditures; a two- to three-year lockout period for any prepayment option; and a defeasance prepayment structure. There are also covenants for minimum debt coverage of approximately 1.10 that trigger a requirement for the tenants to remit rents to a lender-controlled lock box. Lender legal fees for closing the loan are much higher than for other lenders. There are myriad loan administration issues for lease approvals, loan assumptions, and other property or borrower issues that are subject to master or special servicer review, which can have lengthy time delays.

Stephen P. Bye
Executive president and senior managing director, NorthMarq Capital, Denver

At some point in the future, defeasance may be a valuable option when interest rates are normalized again. In the example above, if at the time of prepayment the treasury rates are more than 4.5 percent for the matching maturity date of the loan, the loan would be paid off at a discount.

■ Can you discuss how life companies approach office building underwriting?

First, they tend to be more conservative regarding capitalization rates for defining value regardless of an actual purchase price or Member of the Appraisal Institute appraisal value. Second, their loan-to-value ratios tend to be 65 percent or less, based on their internal value. Third, they will be more selective than CMBS regarding the sponsor and the cash investment in the transaction. Fourth, a 30-year amortization or interest-only payments are exceptions. A typical amortization schedule will be 25 years.

One distinct advantage that life companies can offer is with regard to options for prepayment flexibility, although there always will be some element of call protection for a portion of the term. Life companies can offer fixed-rate terms anywhere from three to 30 years, although at least one lender started offering a 40-year term.

There is a significant lender competition for low-leverage loans (sub-60 percent), for core or core-plus asset quality, for properties in "A" locations and for a strong financial ownership group. With the 10-year U.S. Treasury yields currently hovering around 2.25 percent, an interest rate of 3.5 percent is likely for a 10-year term. (There has been a spike in the 10-year Treasury rate from 1.65 percent to 2.25 percent as of March 6, and the all-end rate in this example would have been closer to 3 percent on Feb. 1). Interest-only payments for part of the term can be expected for leverage levels closer to 50 percent.

■ What are some other office building finance challenges?

The greatest challenges are related to single-tenant buildings. In addition to the lease maturity event risk, there is also a tenant's credit background, as well as its competitive business sector to evaluate. As a general rule of thumb, most lenders will require a funded reserve account via a cash flow sweep in order to accumulate a sufficient amount of funds for re-tenanting costs and possibly an interest reserve of one years' debt service. This reserve easily could exceed $30 per sf in most cases. Some lenders try to mitigate the default risk with a "springing" personal recourse covenant.

Single-tenant buildings with a noncancellable long-term lease (15 years or more) with an investment-grade credit tenant can be easily financed using a fully amortized loan matching the lease term or with a small residual loan balance "hang-out" (amortization extending three to five years beyond the lease term), provided the estimated building value or land value will provide a refinance cushion at the time of the loan maturity.

Another problem to address is office properties that have a significant exposure to large tenant leases that rollover during the loan term, or those leases expiring a few years beyond the loan maturity. The normal solution is to have funds reserved for those events.

A multitenant building with a staggered lease rollover schedule is what most lenders prefer. Since the CBD and primary suburban buildings have a mixture of lease terms anywhere from three to 10 years, these examples fall perfectly into the strike zone. Generic buildings typically will have one- to five-year lease terms and noncredit tenants. These situations will require more conservative underwing and perhaps personal recourse.

■ What advice do you have for a typical office building owner regarding financing options?

Every borrower has a unique strategy that he wants to explore. All of the property characteristics, including legal and title issues, will dictate a distinctive approach to solving the financing priorities. Every loan request needs to be exposed to a wide array of lenders, as many as 25 in most cases. There are so many variables and risk perceptions that only can be qualified after a lender has dug into the background of a transaction.

To sort out the lender alternatives, a borrower should work with a financing intermediary that has the ability to network with a diverse group of portfolio lenders. In addition, an experienced intermediary will be able to recommend various aspects of a loan structure that borrowers may not know are available. Even CMBS lenders can differentiate from one another, although they ultimately must adhere to industry standards regarding loan underwriting rules with some small pricing variance. In summary, every loan transaction is analogous to a puzzle and office buildings have a lot of pieces that need to be connected.▲

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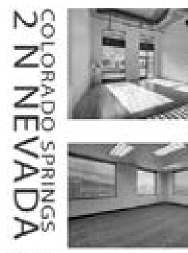

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Market Overview

2014 year-end Denver office market overview

The Denver office market enjoyed a five-year run of robust expansion from 2010 to 2014. Fourth-quarter 2014 vacancy fell to 14.4 percent, the lowest level since the boom year of 2000 and a 560-basis-point decrease from year-end 2009. Quarterly absorption stood at 208,682 square feet, bringing the year's total to 1.5 million sf. From 2010 to 2014, a total of 6.7 million sf were absorbed.

Lauren Douglas
Research manager, Newmark Grubb Knight Frank, Denver

Submarket highlights. The central business district and Northwest submarkets posted the strongest performances for the year, with total absorption of 453,266 sf and 386,255 sf, respectively. Vacancy in the CBD is 12.6 percent, which is down from 13.3 percent in the previous quarter and down year over year from 13.6 percent. Lower Downtown has the lowest vacancy rate of the CBD's three micromarkets, a drum-tight 7.3 percent.

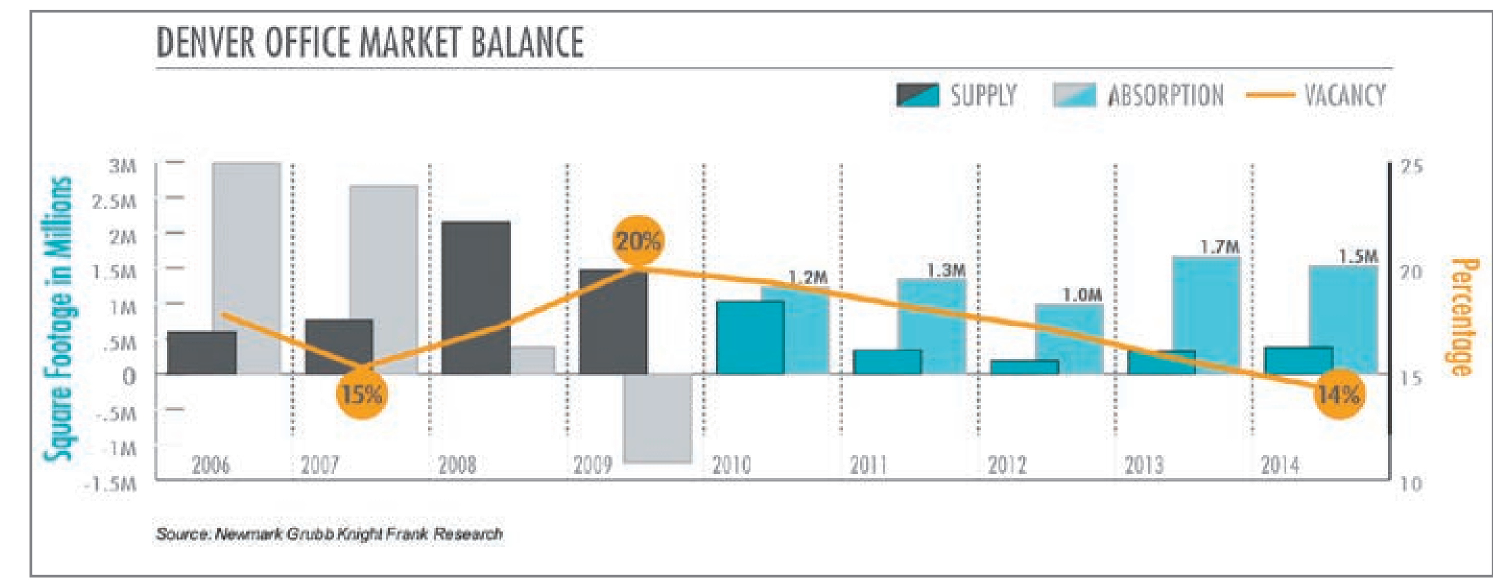
The NW submarket posted a strong performance in 2014, driven by vigorous corporate expansion, new business lines opened by existing tenants and tenants new to the market, culminating in the lowest vacancy since 2000. Vacancy plummeted 481 bps year over year to 14.3 percent.

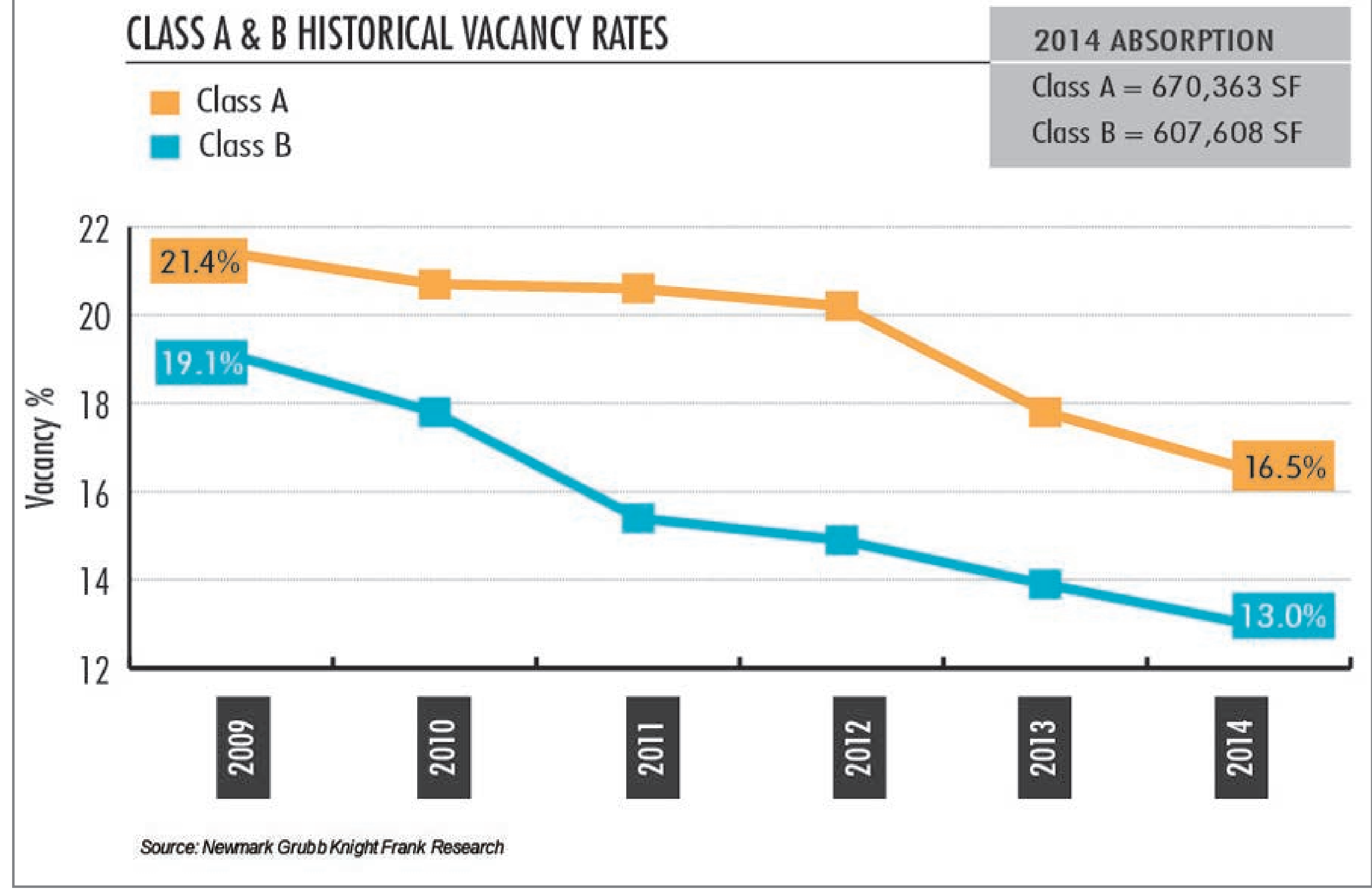
The southeast suburban submarket ended the year in the red, with full-year absorption of negative 218,819 sf. This loss, an anomaly, was due to significant downsizing by First Data, from 330,000 sf to 99,000 sf, and the first wave of migration of Charles Schwab's 1,900 Denver-based employees to its new owned campus, which left two vacant buildings. Although the latter move was a driver of more than 250,000 sf of negative absorption, Schwab's commitment to Denver promises substantial positive economic impact. The financial services firm plans to add up to 480 high-paying jobs over the next five years, and its 47-acre site has the space to accommodate 4,000 employees.

Class A and B dynamics. The Denver office market's Class A and B office sectors both continued to improve. As is typical in a recovery cycle, the Class A sector was the vanguard as tenants took advantage of relatively low Class A rates to upgrade space. After several years of flight to quality, recovery then trickled down to the Class B product due to the widening lease rate delta and lease up of the desirable Class A spaces.

Class A vacancy plunged 610 bps from a cycle high of 19.1 percent at year-end 2009 to end 2014 at equilibrium (the point at which neither landlord nor tenant has a clear advantage) at 13 percent. Class B vacancy fell 490 bps during the same period to 16.5 percent. In 2014, Class A and Class B were neck and neck in terms of absorption with both sectors absorbing more than 600,000 sf.

Rental rates. Upward pressure on asking rates continued in the CBD and NW submarkets. CBD Class A rates increased 7.9 percent year over year to $34 per sf, and NW Class A rates rose 7.5 percent to $25.54 per sf. These rates represent historical highs.





Development. Denver's strong economy and market fundamentals opened a development window: 11 office projects, totaling 2 million sf, are under construction or renovation. Development is concentrated in the LoDo micromarket of the CBD, and the SES and midtown submarkets.

Investment. In 2013, Denver's office investment market enjoyed its best year since 2007 with 11.8 million sf valued at $2.2 billion trading hands. In fourth-quarter 2014, sales totaled 5.7 million sf valued at $598.6 million, which pushed 2014's totals past those of 2013, to 14.3 million sf valued at $2.3 billion. During 2014, Denver continued to be a hotbed for equity placement, with an influx of new institutional and international equity to the Denver metro area driving core pricing.

Of particular note were the sales of the new Union Station "wing buildings," which traded to GLL Properties, the U.S. subsidiary of GLL Real Estate Partners Gmbh, for a record-shattering $600-plus per sf. Suburban office sales led transaction velocity in the latter half of the year. Spreads between Class A and Class B rents have become significant and will affect investment patterns in 2015, prompting capital sources to move down to Class B product in order to chase yield.

Outlook

Metro Denver has outperformed the nation in terms of job growth since February 2010. As of December 2014, job growth increased 3.3 percent year over year, compared with the U.S. rate of 2.3 percent. Unemployment stood at 3.9 percent, almost 2 percentage points lower than the national rate. Denver's record-breaking housing market, which is ranked sixth in the nation, is another example of its economic strength. According to the S&P/Case-Shiller Home Price Index, metro Denver home prices rose 7.5 percent year over year in November, the tenth consecutive month in which prices reached all-time highs.

The future looks bright for Denver's economy and office market. The University of Colorado's Leeds School of Business forecasts that Colorado will gain 61,300 jobs in 2015, a level of growth that will place the state among the top 10 in the nation for job creation. The professional and business services sector, one of the top office-occupying industry sectors, is also projected to grow by a robust 3.3 percent this year, adding 12,800 jobs.

Denver was ranked fourth among U.S. markets to watch in 2015 in the prestigious Emerging Trends in Real Estate report, which cited its popularity with millennials, concentration of technology and energy firms, strong local economy and active development community.

The stage is set for continued expansion in 2015. Newmark Grubb Knight Frank research forecasts this momentum will continue in 2015 with:

- Positive absorption in most submarkets meeting or exceeding 2014 levels;
- Positive absorption returning to the SES, with space vacated by Charles Schwab being backfilled;
- Rental rate increases continuing in the CBD, NW and SES submarkets;
- Class A and Class B asking rates in the CBD, NW and SES continuing to achieve new highs;
- Strong absorption in the core CBD, SES and NW submarkets with continued trickle-down to the midtown and southeast submarkets;
- Speculative transit-oriented development breaking ground in the SES;
- Increased sales of Class B product due to the spread between Class A and Class B rental rates; and
- Continued job creation and falling unemployment driving expansion in 2015.

Market Overview

Oil Prices

The wild card in 2015 and beyond is the effect of plunging oil prices on Denver's CBD office market, which, of course, will be dependent on how long prices stay depressed. Drops in production lag price decreases. Operating rigs are under lease, typically for two to four years, so they would not be shut down immediately, and many companies have hedges that lock-in above-market prices. Oil trading at lower prices is better than no production at all, but new exploration and production would be put on hold in the face of sustained low prices.

This type of slowdown would be felt acutely in the oil patches but would have a more muted effect on oil company tenants in the CBD. Many CBD employees are petroleum engineers who are in short supply and would be retained except under the direst of conditions. Large oil companies, who are in turn the largest occupiers of office space, have the ability to hunker down and wait out the cycle, but some smaller firms, especially those burdened with debt, may fold or be ripe for acquisition.

> In 2014, Class A and Class B were neck and neck in terms of absorption with both sectors absorbing more than 600,000 sf.

OFFICE SUBMARKET COMPARISONS 4Q14

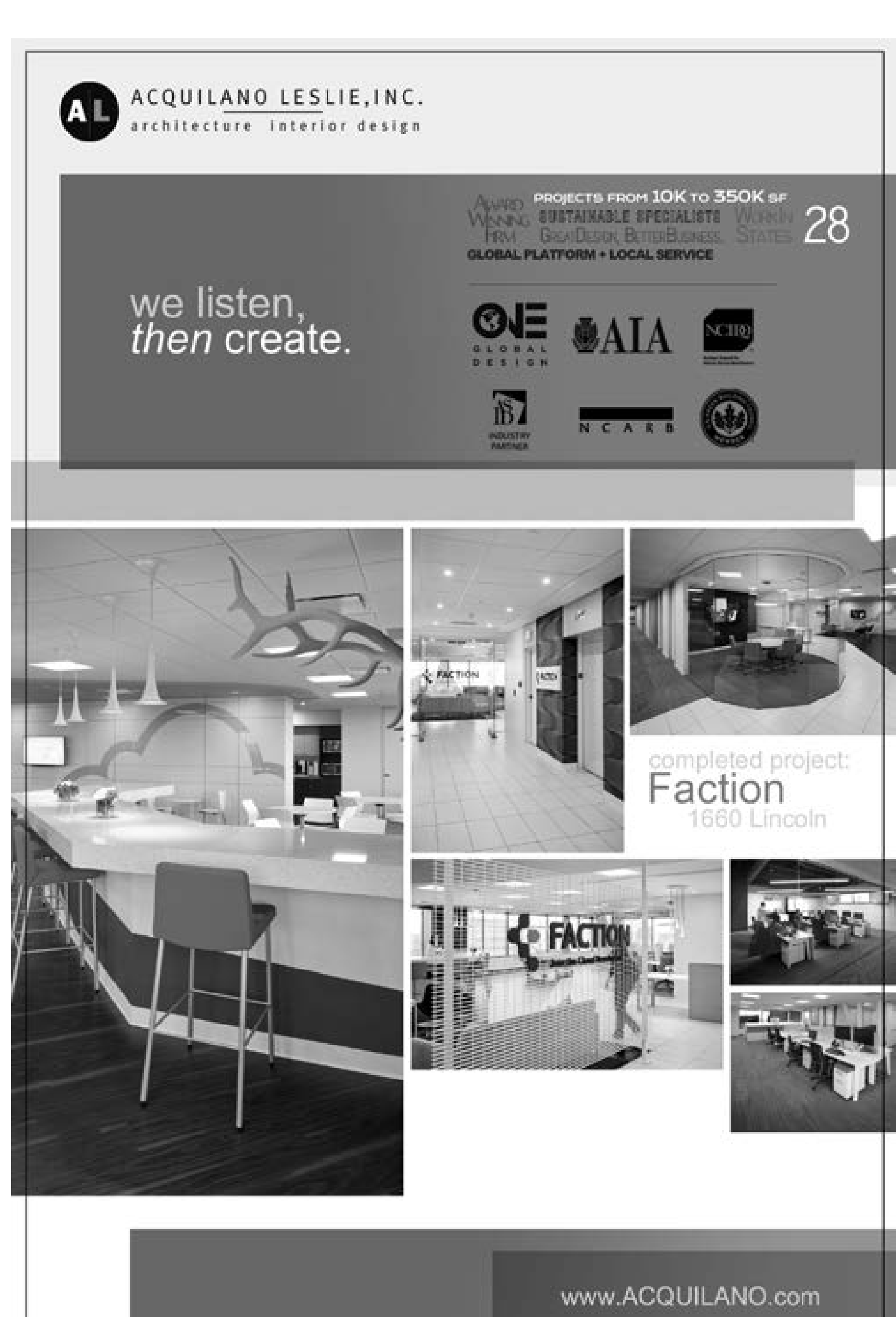
Submarket		Total SF	4Q14 Vacancy %	4Q13 Vacancy %	4Q14 Absorption	YTD Absorption	Rental Rates Median FSG
AURORA		4,618,312	21.32%	24.87%	47,969	163,752	$14.00
CBD		25,818,535	12.62%	13.63%	167,031	453,266	$30.00
MIDTOWN		5,995,089	7.40%	9.50%	18,247	273,197	$22.25
NORTHEAST		2,096,300	15.99%	17.88%	-1,058	39,594	$16.85
NORTHWEST		8,043,673	14.30%	19.11%	297,055	386,255	$21.33
SOUTHEAST		6,316,770	18.21%	22.30%	35,583	257,822	$18.45
SES		27,971,850	13.91%	13.13%	-331,860	-218,819	$21.00
SOUTHWEST		2,893,810	10.23%	11.32%	-1,741	31,427	$17.25
WEST		8,628,211	20.63%	21.84%	-22,544	138,195	$18.50
TOTALS		**92,382,550**	**14.38%**	**15.64%**	**208,682**	**1,524,689**	**$23.63**
	Class A	**46,057,585**	**12.99%**	**13.93%**	**304,742**	**670,363**	**$28.87**
	Class B	**36,384,786**	**16.48%**	**17.80%**	**-132,276**	**607,608**	**$19.60**
	Class C	**9,940,179**	**13.19%**	**15.76%**	**36,216**	**246,718**	**$15.96**

Source: Newmark Grubb Knight Frank Research

Finally, the CBD is not overbuilt and, reportedly, tenants committing to or looking hard at new and planned products are most exclusively technology, law and financial services firms – not oil and gas. Many experts project that oil prices will recover in the next 15 to 18 months and, if this is accurate, the effects on Denver's CBD will be minimal. In any case, the CBD's diverse tenant mix will prevent a reprise of the devastation wrought by the oil bust of the 1980s.

"Denver has reinvented its economy since the dark days of the late 1980s and early 1990s when massive overbuilding, tax law changes and a plunge in oil prices conspired to send the local real estate market into the tank for the better part of a decade," said Bob Bach, NGKF's director of research, Americas.

A recent study by the Brookings Institution ranks Denver in the top quartile of the nation's largest 100 metropolitan areas for employment in advanced industries that depend on highly educated research and development, and scientists, technology professionals, engineers and mathematician workers, said Bach. The study notes that these industries will play an outsized role in powering regional and national economic success.▲



Taxes

The often overlooked value in your office building

Every year in Colorado there is the opportunity to protest a property's assigned value as determined by the county assessor, potentially saving money by minimizing your Colorado property tax liabilities and enabling a fair and just ad valorem valuation.

Property owners and managers are sensitive to rising expenses, and managers often audit energy and maintenance costs looking for ways to operate their buildings more efficiently. Property taxes are the single-largest fixed-expense item. However, many overlook a possible expense reduction that requires no change to current business operations. An inappropriate valuation for ad valorem purposes cuts into the net operating income and the property value.

While management styles vary, all property owners and managers are wise to implement a strategy for protecting against paying more than their fair share of property taxes. Experienced property managers are keenly aware of the occupancy costs when negotiating rents with potential tenants. An accurate ad valorem valuation is essential in remaining competitive in today's marketplace. This strategy applies not only to office buildings but also to all real estate investments.

By lowering the taxable value of a $10 million commercial building by 10 percent, in an area with a mill levy of 100 mills, the property taxes can be lowered by $29,000 annually. With any tax reduction, net operating income is increased, thus enhancing the value of the property.

Kendra L. Goldstein
Vice president, Sterling Property Tax Specialists Inc., Denver

As Colorado assessors reappraise all real property every two years, a reduction to the taxable value in one year often will capture that tax saving in the following year (also known as the intervening year).

Ideally, the valuation for ad valorem purposes should be monitored every year for unfairly assessed values. Possible grounds for an appeal include general overvaluation by the county assessor or improper classification of a property. Other circumstances that may impact value include chronic underperformance, occurring situations of excess vacancy, high maintenance costs associated with aging and dated buildings, or erroneous application of market factors by the assessor. Assessor valuation errors also can occur during times of property transition, such as during development and new construction, at the end of economic life of an improvement or at the time of redevelopment. On occasion, an event causing significant damage to the property will impact value.

While many property owners attempt to appeal ad valorem valuations themselves, most quickly learn they do not have the time or expertise to navigate the complex ad valorem valuation rules and statutes, often leaving valuable tax dollars on the table.

Ad valorem laws and valuation rules are ever-changing and differ from an appraisal for other purposes. Many owners of office buildings do not understand the difference between their valuation for ad valorem purposes and a "fee" appraisal.

Appraisals can be done for many purposes, such as asset management, estate purposes and, most often, used in lending decisions. Appraisals can provide an opinion of value for various types of ownership interests and typically will reflect the value at the time of the appraisal.

By law, ad valorem valuation in Colorado must be retroactive to a specific date in the past, using a specifically defined data collection period and can only value the fee simple estate. Further, due to the enormity of the task of valuing thousands of commercial properties, most county assessors use a computer-assisted mass appraisal system to value many properties at once. This process can make it difficult to properly consider all attributes of individual properties.

Professional property tax consultants are knowledgeable in ad valorem valuation as well as the many specific ad valorem distinctions that the typical property owner may not be aware of. The benefit of using a tax consultant extends beyond that of a single appeal of a property's ad valorem valuation. A tax consultant can analyze the property and recommend which properties should be appealed as well as recommend filing abatement petitions for real property valuations for up to two years of past valuations, if no protests were previously filed for those years. Further, a property tax consultant can educate the property owner regarding the appeal process and the financial feasibility of pursuing an ad valorem valuation appeal.

Although appealing an ad valorem valuation can be complex and time consuming, hiring a professional who is skilled and knowledgeable at negotiating the multiple levels of appeal will increase the opportunity for a successful appeal, and most likely increase the amount of any realized tax savings.

Most property tax consultants offer a variety of fee options. Some consultants offer the ability to negotiate a contingency fee based upon the tax savings. In many cases, if an appeal does not result in a tax savings, there is no cost to the property owner.

It is important to seek a professional tax consultant with strong local market knowledge and a longstanding exemplary reputation (especially with the local assessors) to advocate on behalf of the property owner.

By Colorado statute, the current year ad valorem property values can be appealed during the month of May. Be prepared to file an appeal in a timely manner. Now is the time to consider how your property tax liability affects your bottom line, and what you can do to lessen your burden. Engaging a property tax protest specialist is the best way to ensure your assigned values are fair and accurate.▲

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Taxes

IRS presents a gift to landlords … Really!

Tax professionals recently have been bombarded with questions about the new(ish) Internal Revenue Service rules, effective for 2014, relating to a boring part of tax accounting that is, for better or worse, central to real estate tax planning – capitalization policy.

As a review, capitalization policy concerns whether money spent on a property should be posted to the balance sheet and the cost recovered through depreciation over a term of years, or expensed to the income statement and deducted in the current year. This is obviously quite a distinction in result for tax-planning purposes.

The IRS concluded in 2006 that there was too much confusion in this area and it has been working feverishly since to compound the confusion under the name of "simplification." As is often the case with new tax rules, the germ of this idea made perfect sense – to introduce some order to an area that was fraught with controversy. I am not going to say that the IRS screwed this up (but I wouldn't necessarily argue with someone who did), but I recommend we taxpayers try to make lemonade from the lemons we were handed.

My approach is to emphasize that the changes are truly a paradigm shift in how your accounting team should view your capitalization policy. I think the best way to illustrate the change is with examples; but first, a brief review. Most accountants judge an item that must be

Zane Dennis
Tax partner and real estate practice leader, Richey May & Co., Denver

capitalized on two factors, its useful life and its cost. If something has a long useful life and costs a significant amount it is capitalized; if not (on either count), it is expensed. (For example, a trash-can may last longer than a computer, but it is expensed and the computer is capitalized).

Now this has changed. Here are four examples:

1. An office building with a bank of four elevators replaces one elevator, which was nearing the end of its useful life, at a cost of $100,000.

• Traditional approach – Capitalize – It is expensive and long-lived.

• New approach – Expense – The building component is not enhanced by the change.

2. A hotel lobby makes flooring and other upgrades to refresh the look of the property at a cost of $150,000.

• Traditional approach – Capitalize – It is expensive and long-lived.

• New approach – Expense – Only 10 percent of total hotel surface is affected, and the lobby has no more utility than before the upgrades.

3. A large office building replaces bathroom sinks in 40 percent of its bathrooms at a cost of $100,000.

• Traditional approach – Capitalize – It is expensive, long-lived and sounds like a program of improvement.

• New approach – Expense – 40 percent of the building's sinks is not substantial relative to the total plumbing system. After all, what has changed? A sink is a sink. The building utility is the same.

4. A grocery store upgrades and replaces older equipment, dresses up the interior and offers new features, including a coffee bar and sushi bar, at a cost of $1 million.

• Traditional approach – Capitalize – It is expensive, long-lived and a major upgrade.

• New approach – Expense (or a good case to do so) – Nothing has changed; a grocery store before and a grocery store after.

And there is more. Even if you have to capitalize a change or addition, you likely can write off the undepreciated cost of the item that is replaced, which can be established based on estimates, and you don't need a cost-segregation study to support the position. You should also question whether you have to capitalize tenant improvements related to retenanting a leased space (renewals or a new tenant).

Another important point here is that you take advantage of the new rules with your 2014 tax return, and you have an opportunity to look back as if these rules had always been in effect. This means you can take a deduction now for the undepreciated remaining cost of items that was capitalized, but that could have been deducted under the new rules. (In fact, I would say if you don't do that, you are not really in compliance with the new rules.) To

> My approach is to emphasize that the changes are truly a paradigm shift in how your accounting team should view your capitalization policy.

accomplish that, you have to file for a change of accounting method (IRS Form 3115), but you should be doing that for 2014 anyway. (Also note that you can do that for free for 2014, but going forward it is likely to cost you at least $7,000 in filing fees per form filed.)

My point here is not to educate you on the ins and outs of these rules, as they are extensive and still not as well defined as they should be, but to give everyone in the real estate industry pause. The new rules are different and, in many ways, turn capitalization policy on its head, so you owe it to yourself to verify that your accounting team gives that area of your business a fresh look.▲

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Investment Market

Office investment market continues to thrive

Denver's office market and economy continues to thrive in 2015. Colorado's 2014 year-end unemployment rate was 4 percent. Denver was the No. 1 city in the nation for millennial population growth in 2014, and it is estimated that 22 percent of Denver's population is made up of millennials.

Colorado had approximately 1.65 percent population growth in 2014 (fourth in the nation) and is now ranked the No. 2 city for number of bachelor degrees per capita. The 2014 year-end job growth was approximately 60,000 jobs. These dynamics resulted in Urban Land Institute ranking Denver the No. 4 market for commercial real estate investment in 2015, and Business Insider Magazine ranks Denver as the most comprehensive city for economic growth.

Denver's office investment market started rebounding in 2010. Some of the investors that were willing to make acquisitions early in the recovery are now harvesting profits. Two examples of this are The Triad at Orchard Station and Offices at The Promenade.

M&J Wilkow purchased The Triad in 2012 for $63 per square foot at 72 percent occupancy. The asset was retrofitted and rebranded by the ownership over a two-year period. At the time of purchase, market rents were $16-$17 per sf; today they are $21-$22 per sf gross. The Triad is back on the market for sale and will prove to be a case study on market timing and value enhancement execution.

There are currently several office listings that were purchased between 2006 and 2008, and the holding periods were extended due to the Great

Patrick Devereaux
Executive vice president, capital markets, JLL, Denver

Recession. Denver weathered the downturn better than most markets. Numerous office owners were successful in holding through the recession, and they can now exit with upper-teen returns. Occupancies are nearing 90 percent, and rents are at levels exceeding past cycles.

Upside potential today in Denver is rolling existing leases to market in an improving rental market. It's typical today to see rents in place at $3-$5 per sf below current market rents in the primary suburban markets. Core-plus capital is aggressively pursuing assets in Denver, and they target 60 percent roll or more in the first three years of the holding period.

Cap rates continue to compress as new capital pursues Denver office listings. There were 18 office trades above $15 million in fourth-quarter 2014; 11 of them sold to new investors to Denver. The capital pool spans from New York to California domestically, and Canadian capital is the most active foreign capital. Cap rates continue to compress as the depth of buyers increases. The 10-year bond has been below 2.25 percent since the end of November. At the time of this article, the 10-year is at 1.94 percent; it was as low as 1.67 percent on Feb. 2 (volatile). This has resulted in interest rates for long-term debt being plus or minus 4 percent.

Jason Schmidt
Executive vice president, capital markets, JLL, Denver

Most conduits and life companies are offering between two and 10 years of interest-only rates, depending on the loan to values and the creditworthiness of the borrower. Bank or fund bridge debt can be in the mid-3 percent. Hence, a 6 percent cap results in a positive leverage return of 10 percent during the interest-only period. Commercial real estate is the preferred investment vehicle as the risk and reward can provide higher returns than alternative investments.

Denver's most preferred core and core-plus markets are the infill locations of Lower Downtown, Cherry Creek and Boulder. There is about 1.25 million sf of new construction underway in LoDo and the west central business district. LoDo has a vacancy rate under 4 percent, and leases that were signed in 2008-2009 can be $7-$8 per sf below market today. Cap rates can be in the upper-4 percent for trophy assets constructed during the last cycle to mid-5 percent for redeveloped historic brick and timber properties. Prices per sf can range from $300 per sf for core-plus properties to mid- or upper-$500 per sf for trophy and core opportunities in LoDo.

Cherry Creek is transforming from a dominant retail destination to a live, work, play environment. Cherry Creek is becoming a LoDo/millennial environment that caters to adults with some of the highest incomes in Denver. Due to the recent zoning change, there are two office assets, two multifamily properties and a hotel under construction. Leasing activity is strong and rents for new office product are in the mid-$30s per sf triple net. First Avenue Plaza (55 Madison and 44 Cook) recently traded for $285 per sf and under a 5 percent cap rate.

Boulder is in the midst of a transformation due to a significant amount of value-add capital being infused into the market over the past three years. Unico and Goff Capital Partners both made significant investments into portfolios of older assets in Boulder's core and eastern markets. With the repositioning of these properties, Boulder became even more attractive to technology and biotech companies. Office rents are increasing significantly, and the downtown core of Boulder can be in excess of $40 per sf triple net.

Due to the lack of opportunities in Denver's CBD and the low yields of assets in LoDo, investors are fully engaged in pursing core and core-plus listings in the southeast suburban market. Twelve office sales occurred in the fourth quarter above $15 million. Prices ranged from $66 per sf for a vacant call center facility to $210 per sf for a core-plus Class A multitenant building.

Overall, Denver continues to be one of the most preferred locations in the nation for office investment capital. Transaction flow continues to increase as new domestic and foreign investors pursue upside in a rising rental rate environment. The Denver office market is experiencing benchmark prices per sf as lease rates exceed peak levels of previous cycles, and cap rates continue to be at historical lows.▲

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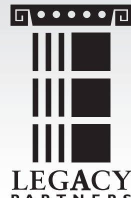

Developer Market

Boom-and-bust cycle squarely in the past

Denver has a long history of boom-and-bust cycles – or cycles of rapid expansion followed by crushing retraction – created in part by the once heavy emphasis of the oil and gas industry in our economy. But the metro area is moving away from this trend, with a more diversified market, including strong activity in the finance and technology sectors. While Denver currently has nearly 2 million square feet under construction or renovation, this represents a less than 2 percent increase to total supply. Market forces are encouraging restraint so the market is not overbuilt.

Denver's central business district is one example of restrained development – despite what appears to be major activity in the market, especially in Lower Downtown and Central Platte Valley. New development projects underway include 1601 Wewatta, the Triangle Building, 1401 Lawrence, the LAB at 17th and Platte, and Z Block, which is located along Wazee and Blake streets between 18th and 19th streets.

For the first time in the history of many development cycles, Denver's market is experiencing significant preleasing success – each of the buildings are 30 to 40 percent preleased prior to completion with substantial activity on the balance of each property.

The market diversification is evident by the strong activity in the finance and technology sectors, providing additional insulation from potential downsizing while

Tom Lee
Executive managing director, Newmark Grubb Knight Frank, Denver

oil prices remain low, and producing a vibrant, active and heterogeneous market. At year-end 2014, the CBD reported overall vacancy of 12.62 percent, well below the 35-year historical average. This activity resulted in strong full-year absorption of 453,266 sf, leading the metro Denver submarkets.

The office market is a barometer of the health and vitality of the overall market.

Office rental rates are rising steadily throughout the metro area, with an average increase of 21 percent over the last four years. Part of this increase is due to the restraint in development – scarcity of high-class product is creating a strong demand, which pushes rents upward. Landlords are upgrading assets to maintain market relevancy, also driving rates upward.

This trend is so powerful in some markets that Class B buildings are now experiencing strong occupancy and accelerating rates. Southeast suburban Class B properties in many cases are achieving over $20 per sf, a new high for Denver. Even Class C buildings are feeling the impact, achieving lease rates that reach former Class B prices.

Many factors are encouraging this shift away from the severities of boom and bust. The Metro Denver Economic Development Corp. spent the last 12 years diligently working to make history for Denver, consistently recruiting new industries and companies, expanding the area's international draw, and growing the Denver metro area. As a result, Denver is now recognized as a top city, ranking fourth among U.S. markets to watch in 2015 in the prestigious Emerging Trends in Real Estate report, which cited its popularity with millennials, concentration of technology and energy firms, strong local economy and active development community as reasons for the ranking.

Additional positive influences include very high in-migration for the metropolitan area, with a growth rate ranked ninth in the nation by Forbes magazine. The Denver metro area's emphasis on mass transit is also a game changer, and encouraged suburban and CBD development. Through the challenging years of 2008-2010, transit-oriented development provided the only real wins in the metro area – as Palazzo Verde, Village Center Station I, Panorama IV and Lincoln Station highlight. Finally, market diversification created a positive impact, insulating Denver from the fluctuations of one industry.

Technology industries, in particular, have been a growth engine for the area, with Denver ranking third in the nation (for the sixth consecutive year) for high-tech workers per capita. Corporate and regional headquarters are expanding; recent announcements include Arrow Electronics, Nationwide and CoBank. Additionally, companies are in growth mode, with many insurance, health care and engineering companies expanding, such as Allstate Insurance and Kiewit Construction. The CBD, SES and Northwest markets have seen the most expansions and corporate relocations. In particular, companies are looking again at the CBD as a vibrant and positive location, as evidenced by recent announcements by Liberty Global and Transamerica.

It is expected this trend will continue, and many economists predict the future looks bright for Denver's economy. The University of Colorado's Leeds School of Business forecasts that Colorado will gain 61,300 jobs in 2015, a level of growth that will place the state among the top 10 in the nation for job creation. The professional and business services sector, one of the top office-occupying industry sectors, is also projected to grow a robust 3.3 percent next year, adding 12,800 jobs. The stage is set for continued expansion in 2015.

Newmark Grubb Knight Frank Research forecasts the momentum achieved in 2014 will continue in 2015, with positive absorption in most markets meeting or exceeding 2014 levels; rental rate increases continuing in the CBD, NW and SES submarkets; speculative TOD development breaking ground in the SES; and continued job creation and falling unemployment driving expansion.▲

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Finding value in vibrant southeast suburban Denver

Southeast suburban Denver is proving to be a dynamic and highly sustainable submarket for owners and tenants. Opportunities abound across more than 40 million rentable square feet of office space, with abundant options for tenants and significant movement among spaces. And it's always easy to find a parking spot.

Since recovery from the Great Recession began in June 2009, 17 of the 22 quarters have seen positive absorption. In a few cases, tenants have exited the Denver area or moved to a different submarket, but what is perceived as a setback for the landlord community only generates opportunity for tenants.

Investment activity in SES is fascinating. Transwestern's Investment Services Group tracks sales activity, and watched a compression of capitalization rates from 2012 to 2014 of more than 100 basis points for stabilized Class A product, and over 65 bps for stabilized Class B product. For this purpose, "stabilized" is defined as 85 percent occupied or greater. The practical application of this scenario for tenants is that the owners' bases have risen dramatically, commanding higher rent for recently acquired product.

Class A asking rates climbed an average of 4.78 percent year over year since 2010, while Class B asking rates followed with an average climb of 4.17 percent during the same time period. Given the customary 50-cents annual rental bumps, tenants that executed leases in 2010 will see a disparity of $2.32 per sf increase (in favor of the owner) in market asking rates compared with the ending contract rate for Class A space, and compared with

Preston Dunn
Vice president, Transwestern, Denver Tech Center

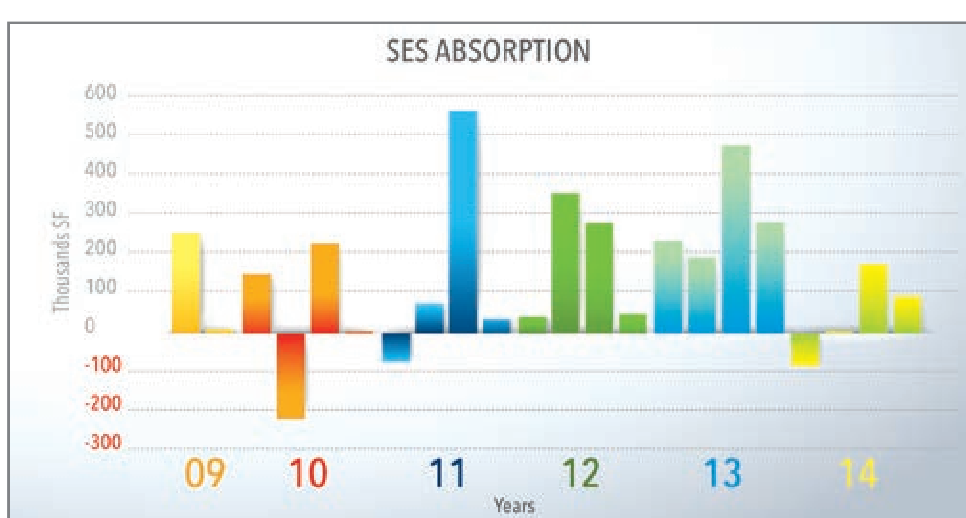
Chaise Schmidt
Associate, Transwestern, Denver Tech Center

$1.10 per sf disparity for Class B space.

Another recent phenomenon is the rise in construction costs since 2012. Today, $45 per sf is the new $30, and $65 per sf is the new $40. In a build-out situation, it is becoming obligatory for owners to expend greater amounts of capital, which either will affect their margin or be amortized into the rental rate. This rise in construction cost contributed to increased rental rates, and made it more valuable to salvage existing infrastructure when planning new office space.

With over 30 large-block tenants (30,000 rentable sf or greater) currently in the market, representing over 3.4 million rentable sf of space, turnover is unremitting. This statistic is intriguing because the large-block tenants in the market represent approximately 8.5 percent of the overall inventory. Typical users in the SES submarket include professional services firms, communications companies, financial services firms and engineering firms.

Among the development community there is a clear direction for "urbanization" of the SES Denver market. For new developments to be successful, proximity to light rail and walking-



Southeast suburban absorption rates from 2009 to 2014

distance amenities are key. There are more than 30 proposed office projects in various development stages across the SES Denver.

Here is a practical application to tenants confronting an office-leasing situation:

Start early. Time is your friend. Forward-thinking companies that want to uncover all opportunities to drive value from real estate should approach the market well in advance of the renewal-option notice date.

Trust your adviser. Interview multiple tenant representation specialists to ensure the right fit for your requirements and your business. Cross-examining multiple groups will give you access to several perspectives and ensure you are engaging the best team to handle your transaction.

Don't settle for the status quo. Many real estate professionals can point to comps and trends in the market, but few look for ways to deliver outlier results that disrupt the norm. Assembling a team of real estate professionals with diverse skill sets leads to the best solutions. Every lease is an opportunity to drive value, not only economically, but also emotionally by creating a physical space that will attract and retain employees.

Understand why. Building ownership structures all have different goals and objectives. Negotiating with a real estate investment trust, private owner, institution or foreign entity presents different challenges that require insightful audience analysis.

Cover the bases. Understanding the basis and financial structure of the asset in question can pay dividends in your negotiation strategy. Focusing on buildings with low amounts of debt and low bases can add substantial flexibility to the owner's abilities.

Recognize the details. Office leases are complicated financial instruments that require acute attention to every detail. Buildings will trade owners, but the lease documents will remain in place, commanding tenants' outcome.▲

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Why is Boulder's office market soaring?

If Boulder is 25 square miles surrounded by reality, then the Boulder office market is similarly surreal. Dramatic changes in ownerships and prairie fire demand have conjoined with municipally limited development to produce the prospects for a massive price upheaval. This change in lease rates moved by as much as 45 percent in certain suburban pockets in the last three years alone, with the majority of the increase coming in the last six months. Let's walk through the reasons this is now taking shape by exploring some catalysts.

First, in 1967 Boulder voters approved one of the first open-space tax initiatives in the country for the purposes of limiting growth and creating buffers within and around the city. This set the stage for Boulder to become one of the more unusual communities in the nation.

Jump to 2006 when three random events prepared Boulder to take off in terms of office space demand. An unassuming former motocross rider turned advertising genius, Alex Bogusky, gets a wild hair down in Miami and decides he wants to pick up most of his entire 800-person advertising agency, Crispin Porter + Bogusky, and move it to Boulder. It's hard to overstate the impact this move had on the Boulder business community. The major advertising player redesigned a 60,000-square-foot indoor soccer arena into one of the hippest and most unusual office environments Boulder has ever seen. Articles in AdDesign, Wired and the Wall Street Journal created a deafening buzz.

Design firms, public relations firms and advertising agencies across the country took notice and opened satellite offices. These people were collectively known as "creatives," and create they did. People left larger firms to open new firms, and existing design and advertising groups found themselves more "on the map" than ever before. Demand for space surged. All of the sudden Boulder had a whole new kind of cool associated with it.

Around this same time, Brad Feld and David Cohen, a pair of high IQ venture capital nerds, formed TechStars, a business incubator and accelerator to coach and grow inchoate technology startups. Their motto is, "Do more faster." They have succeeded and then some by plowing over a billion dollars, along with their venture capital partners, into over 500 new businesses, most of which were located in downtown Boulder. Filtrbox, Graphicly, Socialthing, Sphero and hundreds of others are actively working, changing everything from our social media applications to toilet technology in developing nations.

Google built its presence in Boulder through the purchase of @Last Software, also in 2006. What was it about 2006 – solar flares? The Googlers now number almost 200 in Boulder and plan to grow into a large campus at Pearl and 30th Street that has Boulder's antigrowth doomsday cultists positively soiling themselves.

Add to the witch's brew LogRhythm, Kapost, Sendgrid, Quick Left, Albeo and so many others that have flourished in this educated and cutting-edge environment and it's no wonder why we're running out of office space options. Collaboration spaces started to manifest in less desirable basement spaces, and do-it-yourselfers joined with other small businesses to fill even more vacancy.

Paul Whiteside
Managing partner, NewOption Partners, Boulder

In 2011, longtime owner of most of the buildings in Flatiron Park, Larry Frey, sold his assets to – cue the scary organ music – a big national real estate investment firm, Goff Capital Partners. Other than Swedish Pension Fund Alecta, which owns three buildings in downtown Boulder, very few national players had ventured here because most felt safer investing in larger metropolitan areas. And why wouldn't they? This community seems to take special pride in being antibusiness, but the more antibusiness they project, the more businesses thrive. Go figure. So our quiet little debutant of a town has come out, exposed to the national real estate investment community as worthy of their serious courtship.

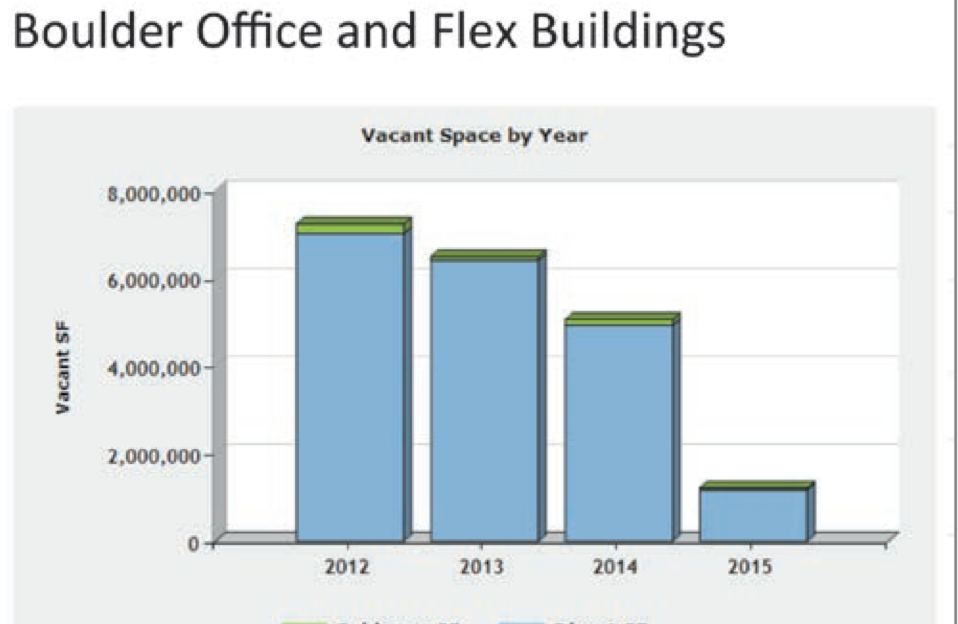
In 2012 another national investor, Unico Properties, bought into J Midyette's downtown Boulder portfolio and became his partner in the 20 or so buildings that he developed with the late Don Rieder. Unico almost immediately began to court Bill Reynolds, the patriarch of Boulder office space development and builder of millions of feet of commercial real estate.

So, with a sizable measure of Adam Smith's invisible hand, all of these events slowly marinated over the next few years, quietly boiling in the pressure cooker of market dynamism and limited-growth local politics. Predictably, the vacancy rates plunged lower and lower, from 10 percent to 8 percent, to 5 percent …

Meanwhile, in the last few years our little berg was recognized by all categories of national media (thanks Wikipedia):

- The 10 Happiest Cities – No. 1 – Moneywatch.bnet.com
- Top Brainiest Cities – No. 1 – Portfolio.com
- Ten Best Cities for the Next Decade – No. 4 – Kiplinger's Personal Finance magazine
- Gallup-Healthways Well-Being Index – No. 1 – USA Today
- Best Cities to Raise an Outdoor Kid – No. 1 – Backpacker Magazine
- America's Top 25 Towns to Live Well – No. 1 – Forbes.com
- Top 10 Healthiest Cities to Live and Retire – No. 6 – AARP magazine
- Top 10 Cities for Artists – No. 8 – Business Week
- Lesser-Known LGBT Family Friendly Cities – No. 1 – Wearegoodkin.com
- America's Foodiest Town – No. 1 – Bon Appetit magazine
- Queerest Cities in America 2015 – No. 10 – Advocate.com

All of which brings us to what is supposed to be the point of this tangential mess of a column, the Boulder office space market, circa 2015. In a move that rocked the city, Bill Reynolds finally sold all of his suburban office space, over a million sf, to Unico in the largest sale in Boulder's history. Upon closing the transaction, Unico immediately raised the rates by some 35 percent across the board for virtually all renewal and new lease transactions. This amounts to a near cornering of the office space market due to the increasingly finite supply of this scarce commodity.



Office & Flex Market	24,373,326
Occupied SF	23,256,094
Total Vacancy	4.58 %
Total Vacant SF	1,117,232
Direct Vacancy	4.38 %
Direct Vacant SF	1,068,168
Sublease Vacant SF	49,064
Total Available SF	1,403,671
Direct Available SF	1,244,918
Sublease Available SF	158,753
4Q 2014 Net Absorption	96,290
Net Absorption YTD 2014	629,666

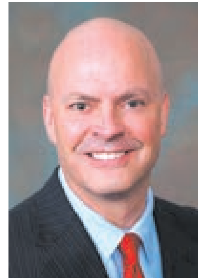
Even now, tenants that exceed 20,000 feet have distressingly few options, countable on one hand. This information is so new that most of Boulder's tenant base has no idea what is coming down the turnpike.

This will have a muscular influence on the rest of the office space market, and the pricing and values of Boulder office buildings will certainly jump. Outlying communities including Broomfield and Louisville also will feel the impact.

It's fair to say that Boulder's office market is in for a precariously wild ride in the next couple of years as tenants shift and try to make sense of the extremely low vacancy market. More than ever, sound and clever real estate representation will be critical to helping tenants navigate responsible office space decisions.▲

Leasing Market

RiNo's office market has found its place



Darrin Revious
Broker, NAI Shames Makovsky, Denver

The official slogan for Denver's River North Art District should be "Up and Coming." It seems to be the phrase of choice whenever the burgeoning neighborhood is referred to in almost any context. And why not? It is a perfectly fitting description of the commercial growth going on in the area across virtually all property types.

While RiNo is most notable for its profusion of artists, designers, architects, art galleries, studios and other things creative, it does, in fact, have an office presence. It certainly bears no resemblance to the central business district's sparkling towers or Cherry Creek North's upscale shops and café. It is not as universally appealing or accessible as Lower Downtown's brick-and-lumber charm. But RiNo doesn't need any of that, nor would its residents and employers stand for it.

The area's identity was forged decades ago by location and industry. It is nestled just north of downtown Denver, with Interstate 70 and Interstate 25 to its north and west, respectively, Arapahoe Street at its eastern border and Park Avenue North to its south. When connected on a map, those boundaries take on the rough shape of a bowtie, which is what much of the real estate community calls it.

RiNo's history is as uneventful as its location is isolated. Until the resurgence began at the turn of the last century, RiNo was sparsely populated with warehouses, small factories, industrial shops of various types and a smattering of residences. Abandoned rail yards and the Platte River accounted for the balance of the area.

It wasn't until 2000 that Zeppelin Development decided to gamble on what the district could offer by converting a former Yellow Cab central office into the aptly named "Taxi 1." The 25,000-square-foot brick office building proved to be the cornerstone on which RiNo would expand unabated, save for a brief period during the recession. Today's office market numbers are no less impressive.

Predictably, vacancy reached its peak of 19 percent during midrecession in 2008. Quick to rebound, RiNo showed positive absorption in every year since, as vacancy rates fell by 12.6 percentage points, according to CoStar Group commercial real estate services. Average rental rates ticked up by 22 percent over the same period, which is a clear indication that developers believe in the long-term potential of office space among an admittedly offbeat collection of urban mixed-use properties. And those existing office spaces continue to perform well amidst significant new growth.

RiNo's current office building inventory stands at 863,585 sf in 48 buildings, with 123,000 sf of that being new product, and a net absorption of 119,131 sf. Percentage of vacancy, quarter to date, is 6.4, the lowest since 2011.

Average rental rates have stabilized at $28.80 QTD, a 1.8 percent drop from 2014's year-end mark, which can be traced to 183,000 sf of new product delivered since summer 2014. Lease rates have risen and vacancy rates have fallen steadily since 2008, even with the recession's lag and nearly 256,000 sf of new space added to the market over that period. RiNo is nothing if not resilient.

This is not to say that the district doesn't have issues. Despite its central location geographically, it is still very much a "destination" area, slightly off the beaten path, although transportation improvements are ongoing, including the expansion of light rail to the area.

Income demographics are low – about 49 percent earn less than $50,000 a year – but expect that to change as commercial growth continues to stimulate housing construction. The whole of RiNo is often referred to as gritty, which is what attracted people there in the first place. That industrial lineage won't be compromised.

Strength of the current fundamentals will continue to spur office space growth on its own, as will the fixed market drivers surrounding the area. RiNo is surrounded by LoDo, the central business district and the National Western Complex. There is still vacant land to be developed there, and a number of existing properties to be rehabilitated.

RiNo's current office building inventory stands at 863,585 sf in 48 buildings, with 123,000 sf of that being new product, and a net absorption of 119,131 sf.

Sustainability is critical to the district. Reuse of materials from within RiNo and other areas of metro Denver lend credibility to the sustainable movement as a whole, cut construction costs and preserve the authenticity of the district's roots. Rust can be a good thing, and there's no shortage of it in RiNo.

As the nation's economy strengthens and the metro area continues to stimulate job growth, new office space will find a place in RiNo. It's already there, and the demand is real. The look and feel of the place might not be for everyone, but suffice it to say, it's way beyond "up and coming."▲

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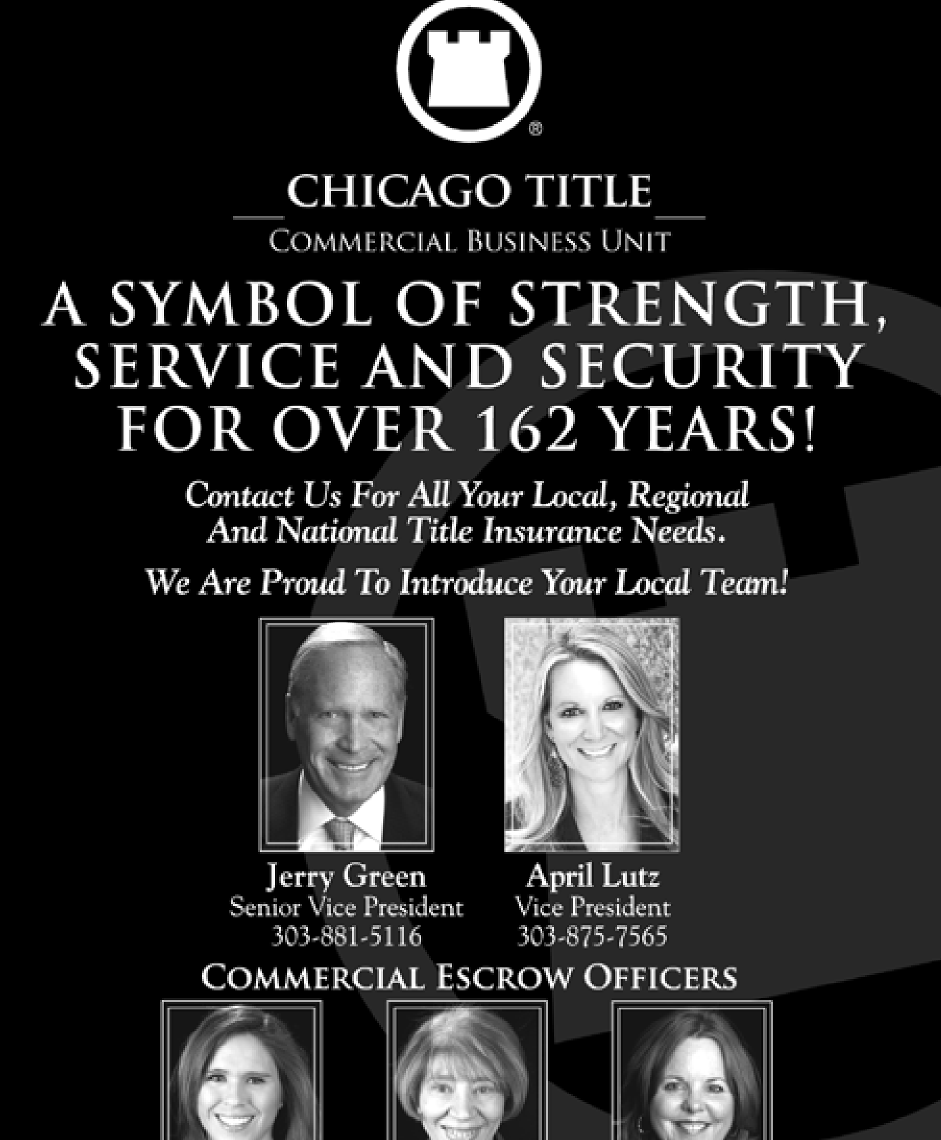


Leasing Outlook

Creative office alternatives found in periphery

Denver's growth is changing the city's culture and energy – a change rivaling the great cities of the world. Within the next few years, downtown will continue attracting people of all ages and companies of all sizes, boosting demand for office space. Recently, many companies decided to relocate or open offices in Denver to access the educated workforce offered in the Mile High City. The central business district is only 11.2 percent vacant, and Lower Downtown and the Central Platte Valley market are even lower at 6 percent direct vacancy. Downtown is tracking 831,005 square feet of new office construction underway with the majority coming in large, traditional office blocks.

Technology, advertising, media and information companies account for a large portion of Denver's office market. Where are these companies choosing to office and what is driving their decision?

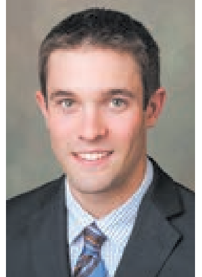
It is no secret that LoDo provides TAMI companies with the best of all worlds. LoDo's proximity to downtown provides great access to public transportation, commerce, entertainment and density of workers. However, if you are looking to move a business here, these amenities will cost you. The high demand for creative office space coupled with the redevelopment of Union Station drove the vacancy in the area to an all-time low, while rents continue to sky rocket. Does this mean there is no hope for a creative company that does not want to break the budget?

Hadley Cox
Vice president, CBRE | Brokerage Services, Denver

The answer is no. Areas such as River North and South Broadway, made up of predominately infill redevelopment properties, offer perceived value while staying connected to the amenities and culture that TAMI companies cherish. Neighborhoods like Ballpark, Five Points, Curtis Park, Highlands, Lower Highlands, Golden Triangle, Santa Fe Arts District and the Baker Neighborhood are experiencing tremendous growth.

Working with these creative companies every day, our tenant representation team has seen a shift in the type of space companies want to occupy. Companies are now searching for more diverse office space, ranging from quiet, individual work environments to large ad-hoc collaborative meeting spaces. Creative space is the intersection of innovation and collaboration, and converted warehouses and renovated office buildings support these types of build-outs.

For instance, the RiNo area has creative office concepts popping up all over the place, turning historically industrial areas into a burgeoning tech environment. Restaurants, breweries and bars are anchoring neighborhoods and providing local flavors that draw a healthy mix of people.


Drew Thomas
CBRE | Brokerage Services, Denver

Stepping into the Periphery

In competitive business environments, companies need to attract and maintain a high-quality workforce. Today's workers, especially the millennials, demand more than a desk, computer and phone, which drives management to look beyond the status quo to find inspirational spaces with character. Employees want access to amenities that help them create a healthy work-life balance. These amenities include bars, restaurants, yoga studios and proximity to quality housing. Companies are expanding outside traditional markets that offer lower-cost, cutting-edge spaces.

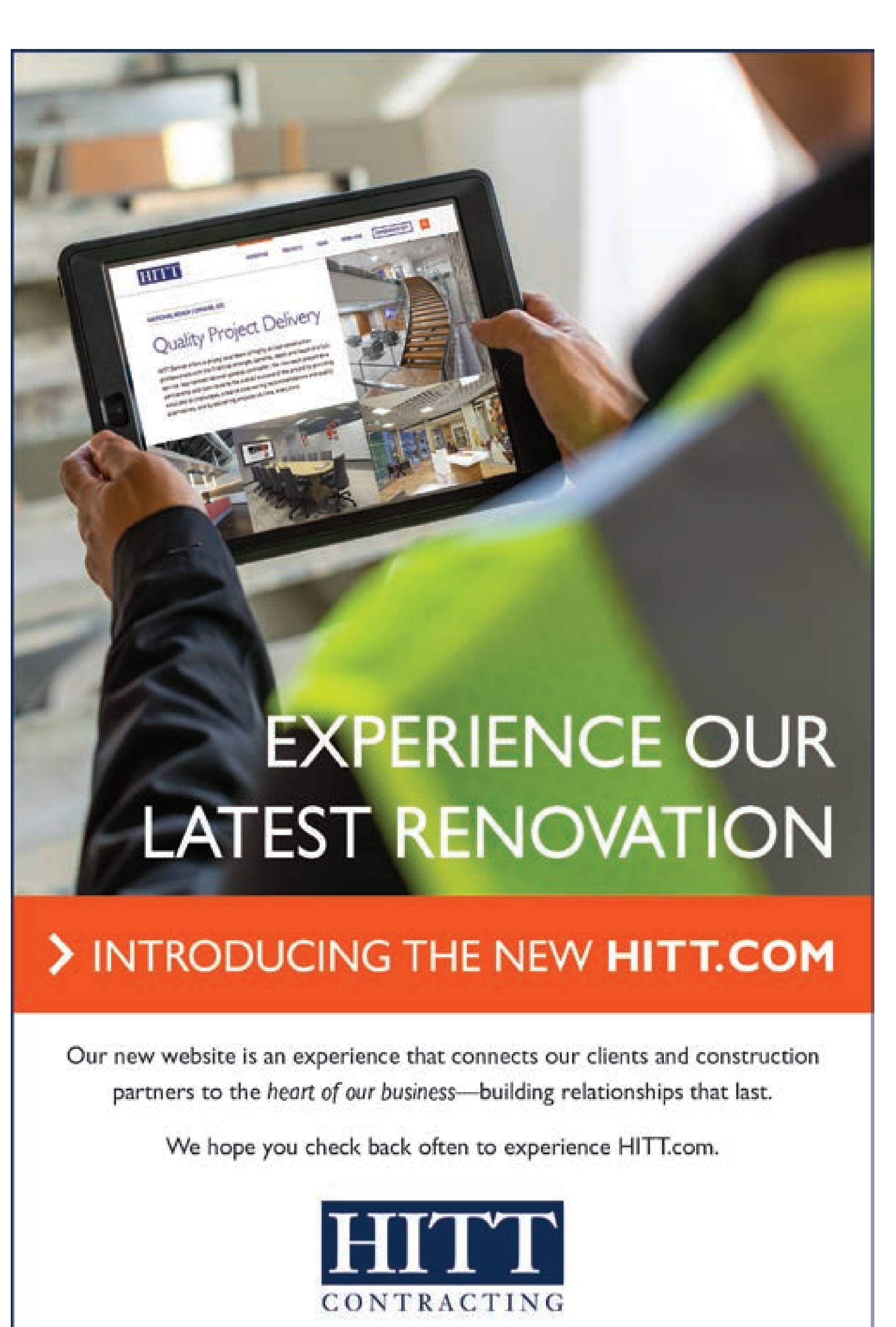
Several companies that have bet on these locations include Mersive (RiNo) and Sprocket Design (Golden Triangle). According to both companies, walkability, lifestyle and access to transportation are key elements to providing their employees with a healthier work-life balance. Sprocket Design Build Principal Bill Moore said he believes buildings in these areas are blurring lines between traditional classifications of office buildings.

Companies like Mersive, which has a large number of employees who bike to work or ride public transportation, love areas like RiNo because of the proximity to bike paths, bus lines and the highway.

When Sprocket Design Build needed space, it was looking for value in a cutting-edge space. Moore said he wanted to be near the Golden Triangle and purchased a former nightclub building at Ninth and Lincoln. After modest renovations, the building is a prime example of adaptive reuse.

While these buildings offer character, culture and charm, they are not without drawbacks. Some of these older buildings still have problems, but as long as you can make an informed decision and know how to navigate the realm of a creative office, these types of spaces can offer immense value to companies.

If approached correctly, companies willing to look outside traditional markets can access the lesser-known market of inspirational, creative space in a price range that will not break the bank. While these spaces are not for everyone, they provide ample access to amenities desired by today's workforce and can provide an added advantage when competing for top talent.▲



Nonprofits facing space crisis in strong market

Katie Edwards
Membership and technical assistance associate, The Nonprofit Centers Network, Denver

The Colorado nonprofit sector soon will face significant increases in operating costs due to rising real estate expenses in the Denver metro area and beyond. The 2014 Colorado Nonprofit Facilities Survey Report, released in November by Denver Shared Spaces and The Nonprofit Centers Network, shows that 26 percent of Colorado nonprofits will renegotiate their leases in the next 12 months. With the current booming commercial real estate market, these organizations may face a $5-per-square-foot cost increase to retain current office space. The average nonprofit surveyed required approximately 3,500 sf for operations. Renegotiating a lease at today's prices could mean nonprofits would be paying an additional $15,000 per year in occupancy costs.

"Our organization has an office in the Ballpark area of downtown Denver where there are many services for the homeless population," said Laura Thompson, executive director of the Denver Voice. "We have been informed that the building will eventually be torn down. As a nonprofit, we are very concerned about finding another space in this area that is easy for our vendor to access and that is affordable.

"My organization currently has two offices, and our lease is expiring in early 2015," Thompson said. "Since we need to be close to downtown Denver to serve our clients, it has been next to impossible to find adequate space in our price range."

For many organizations, the increase to their overhead costs may be even more substantial. Approximately 70 percent of survey respondents stated that their workspace would not meet their organization's needs in the next five years.

When asked why their current space will be inadequate in five years, most nonprofits responded that their offices are bursting at the seams – they are not leasing enough space to accommodate current programs, administrative staff or storage needs.

As nonprofits of all types see the demand for services continue to increase, even those who currently have adequate space may need to expand to accommodate their stakeholders' needs. The Nonprofit Finance Fund's 2014 State of the Sector Survey reported that nonprofits nationwide are experiencing increases in demand for services for the sixth year in a row.

"This information is very useful for nonprofits, policymakers and funders," said Renny Fagan, president and CEO of the Colorado Nonprofit Association. "The market is changing and nonprofits need information like this to stay on top of trends."

More Nonprofits Lease than Own

While leasing can be advantageous in down markets and can preserve flexibility for growth, it also can expose organizations to additional risk when high-market demands increase rental rates. Nonprofits that lease space are paying an average of $10.50 per sf, the survey found. These favorable rates negotiated during the recession may no longer be available. Some organizations may be fortunate enough to find a benevolent landlord willing to donate space or provide below-market lease terms; however, as prices rise, many once-donated spaces for nonprofits will be reintroduced to the market.

In today's market, nonprofits are more subject to price fluctuations than before, as more organizations are leasing. In 2002, a funder-led Denver/Boulder Nonprofit Facilities Needs Study conducted by the Rose Community Foundation and The Daniels Fund found that 43 percent of nonprofits in the metro area and Boulder leased their space. Today this number has increased by 10 percent.

What are Colorado's Nonprofits Looking For?

Although budget restrictions are significant when it comes to finding space for the nonprofit sector, many also have specialized needs. One of the most desired amenities revealed by the survey was warehouse space, which has become difficult to find at an affordable rate since the legalization of marijuana.

Additionally, nonprofits need access to large training spaces, event space, commercial kitchens and performance space. Storage space, conference rooms and small meeting rooms were also highly desired.

Opportunities for Nonprofit Organizations

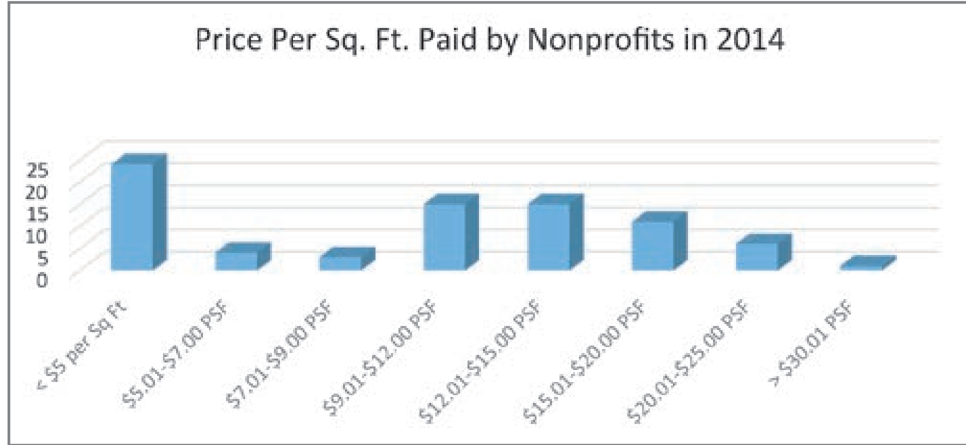
The traditional solution for many nonprofits facing rising rents would be to move outside the traditional service area in pursuit of affordable space; however, the growing movement of nonprofit shared-space models provides new options. Denver is home to one of the largest concentrations of intentional shared spaces for nonprofits in the United States with over 20 nonprofit centers currently operating and more coming on line each year. Colorado nonprofits and social entrepreneurs are driving the movement toward collaborative, creative workspaces that meet the needs of employees, clients and community members.

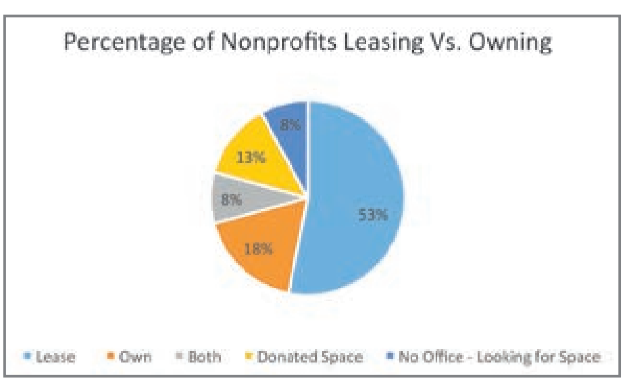
Nonprofit centers are most often categorized as "social purpose real estate" – buildings focused on the triple bottom line of people, planet and profit. Sharing space allows nonprofits to economize on office space as well as shared services like IT, bulk purchasing, cleaning, security and sometimes shared staffing, while the landlord receives a modest return on investment. Additionally, these shared spaces allow for organic collaboration among like-minded organizations, increasing their impact on the communities. The growing trend has resulted in over 350 mission-driven shared spaces across the U.S. and Canada, with another 250 centers in some stage of development.

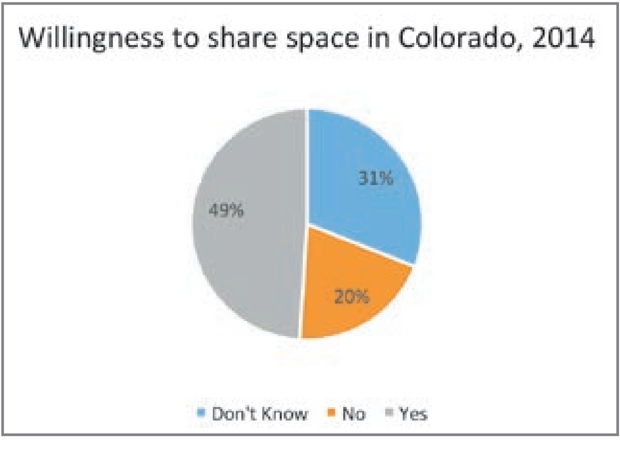
Attitudes about sharing space in Colorado have shifted substantially since 2002, when nonprofit shared space was a novelty and few mission-driven models existed. Nonprofits are more familiar with the concept now, better understand the advantages and disadvantages, and are more sophisticated about how shared-space models can support their mission. While shared space isn't for all organizations, it is increasingly being considered as an option to expand impact and efficiency.

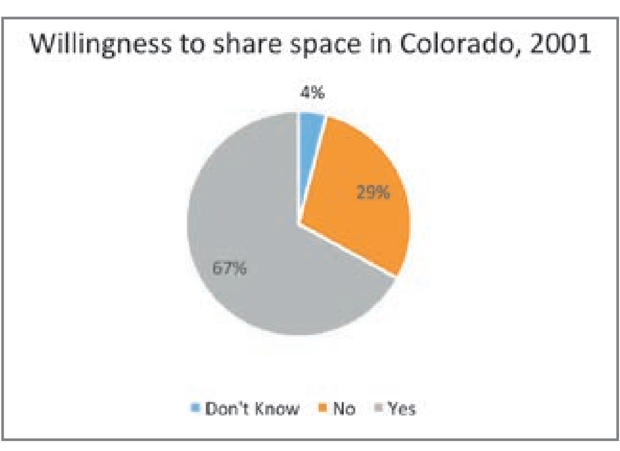
Thompson said she sees shared space as a potential option for Denver Voice. "We are working with a number of partners who serve the same population to see if there are spaces that we could share as an alternative to having our own separate space," she said.

Source for all charts: The Nonprofit Centers Network









There's a bigger number of nonprofits now that don't know if they are willing to share space, which indicates that more nonprofits understand the challenges of sharing space, but are still open to considering it.

What's Next?

The Nonprofit Centers Network and Denver Shared Spaces chose to issue the Colorado Nonprofit Facilities Survey in mid-2014 to fill a 13-year data gap around nonprofit facility needs and to better understand how nonprofits are using buildings to meet their missions. The intent was to analyze today's space needs and to capture the size, scope and state of nonprofit space use in metro Denver and throughout Colorado.

The electronic survey tool was distributed statewide via a variety of partners, collecting 249 unique responses. This represents only 1 percent of the potential pool of eligible organizations.

As such, DSS and NCN are planning a second phase of the research that will increase the geographic and subsector representation of respondents. In order to have a more robust data set that reaches cities and towns outside of the Denver metro region, a listening tour is being planned to convene nonprofits and create a forum for discussion of space-related issues. These space summits will be held in a diverse set of counties statewide selected to capture the fullest range of nonprofits.

Nonprofit workspace and infrastructure is important, because workspace is an integral component of how nonprofits serve communities. Organizations facing space challenges can reach out to local experts such as DSS and NCN for support not just around shared spaces, but also referrals and broad advice regarding commercial real estate.▲

Case Study

Continued from Page 1

and we have great tenancy too. For foreign buyers who are looking for good, safe investments, they look at the train station and think this is a safe, valued investment."

However, while the location is an important part of the buildings' success, other elements also contributed to the top-dollar price tag. The buildings, like much of Denver, are 100 percent leased and occupied.

"I think there's a lot of other intangibles that created value in these two products," said Robert Cohen, chairman and CEO of The IMA Financial Group Inc. "Yes, another building two blocks from here can be just as beautiful and just as classy and have long-term tenants, but its not on the 50-yard line of Union Station. Or it could be right across the street at the 50, but not have a long-term tenant. I think for the buyer to get all of that, and to have a buyer who's not in the market who wanted to come into it, helped accelerate the price."

GLL entering the Denver market is an example of the increased interest from domestic and foreign capital that now views Colorado as an ideal market. From January to November 2014, there were 27 office transactions above $15 million. Of those, 14 acquisitions were with new investors to Colorado, and nine were with a foreign capital source, according to Patrick Devereaux, executive vice president, capital markets, JLL.

"Denver is a market that we've been interested in for a long time," said Ramm. "A component of our overall investment strategy includes employment growth and, by all measures, the Denver metro market clearly has been performing well."

The submarket location of the two buildings – defined by Cherry Creek and Speer Boulevard to the west, Platte River to the north, Coors Field and 20th Street to the east, and traditional historic Lower Downtown product to the south – is relatively compact, said Ramm.

"There is 1.5 million square feet of office and retail existing or planned for that submarket and all the land is spoken for; once it is fully built out, that's it," he said. "Additionally, we are one of the only places in the LoDo submarket where tenants can get brand new, energy-efficient product with larger floorplates and everything else one would expect from a new building, because much of the LoDo product is older, historic buildings with functionally challenging space."

The two office buildings – designed to look like cousins, rather than identical twin sisters – are part of the historic landmark district development. When designing the buildings, it was important that they complement, rather than contrast, their surroundings – the historic Union Station, the brick warehouses of LoDo and the contemporary redevelopment with the high-tech transit solutions, said Andy Nielsen, the principal in charge of the projects with AndersonMasonDale Architects.

"We tried to pick those up and meld them together so the buildings could mediate between the historic station and the historic warehouse context but also be contemporary in their expression," he said.

One of the major aspects of the master development plan for the Union Station project was to create an urban environment in which employees feel like they have everything at their fingertips. This desired city vibe goes beyond the classic definition of a mixed-used environment that offers retail on the bottom and office above.

Courtesy Frank Ooms Photography 2014

The wing buildings were designed to complement, rather than contrast with, their surrounding buildings, a nod to the historical elements while staying contemporary.

"It's a perfect symbiotic relationship," said Frampton. "It's truly a neighborhood and truly a city. We do have retail on the bottom, but we have a true urban setting on the bottom. It's well beyond just having Subway. You can drive down Arapahoe Road, and you'll see that all the office buildings have retail in them. It's not that. It's an authentic urban experience."

This new take on a mixed-use environment is a trend that Denver is seeing more and more. Large warehouses in the River North district are embracing the community aspect with large success.

"I certainly hope the projects that develop will have some of the same characteristics that make the whole Union Station development work, and that's the use of pedestrian active areas on the ground plane," said Nielsen. "Making sure there's a sense of amenities along the street that give people a reason for being there, and keep people coming and going so there's vibrant activity – that urban feel – there's lots going on and lots of choices."

The desire to embrace the urban environment is often associated with the influx of millennials moving to Denver and joining the workforce. More than 25 percent of Denver's population growth since 2000 has been millennial, said Devereaux.

"These two buildings are in a very strong submarket (LoDo), which is definitely on the upswing as a live-work-play neighborhood attractive to millennials (and therefore to employers) and which has some unique characteristics that make it very appealing from an office investment point of view," said Ramm.

"Everybody is moving to cities, and it's partly for jobs, but it's also partly for the appeal," said Frampton. The ability and desire to have a true community experience, rather than the suburban experience, is attractive to many. "People, for whatever reason, more than ever, want that," he said. "That's why you see so much growth around here."

This communal aspect of the development is in large part attributed to the Wynkoop plaza area. To incorporate the plaza into the buildings, the IMA Building features indoor-outdoor areas, which are a highly sought-after amenity for new office buildings. The idea of bringing the indoors outdoor is very much part of the Colorado lifestyle, Cohen said.

Courtesy Frank Ooms Photography 2014

A lot of the buildings' value is in their proximity to the transit-oriented development of Union Station.

The building features balconies on each floor, as well as a private plaza area on the ground floor connecting to the public plaza and a terrace on the top floor. "When you're downtown working, you rarely get outside in the middle of the day to have a meeting, and now we can do that," he said.

Additionally, both buildings offer many of the considered must-have office amenities – a third-space environment, collaborative areas, workout facilities, security, parking, and convenience for employees who bike or use public transit to get to work.

Another feature all generations are demanding more from Denver properties is a conscious effort toward sustainability and the importance of LEED certification. "It was very important to us," said Cohen. "We have an environmental department here, we have a younger millennial workforce here, and I would say that to most of them, that matters."

Both wing buildings are LEED Gold certified. Nielsen said there is mandate for state projects that buildings meet LEED certification, which is driven by public's demand for it.

"Developers are finding that there's a benefit, at least for certain LEED certifications," he said. "People like the idea of supporting sustainable design. If you're going to put your name on the outside of a building, you like the idea that it's got a LEED plaque that goes along with it."▲

Market Drivers

Employment growth and the downtown market

Patricia Silverstein
President and chief economist, Development Research Partners, Littleton

Colorado maintained its ranking as a top 10 state for employment growth during 2014 and is expected to post a strong 2.7 percent increase in employment in 2015. The employment base is expected to reach 2.5 million workers in 2015, representing the addition of over 66,000 jobs.

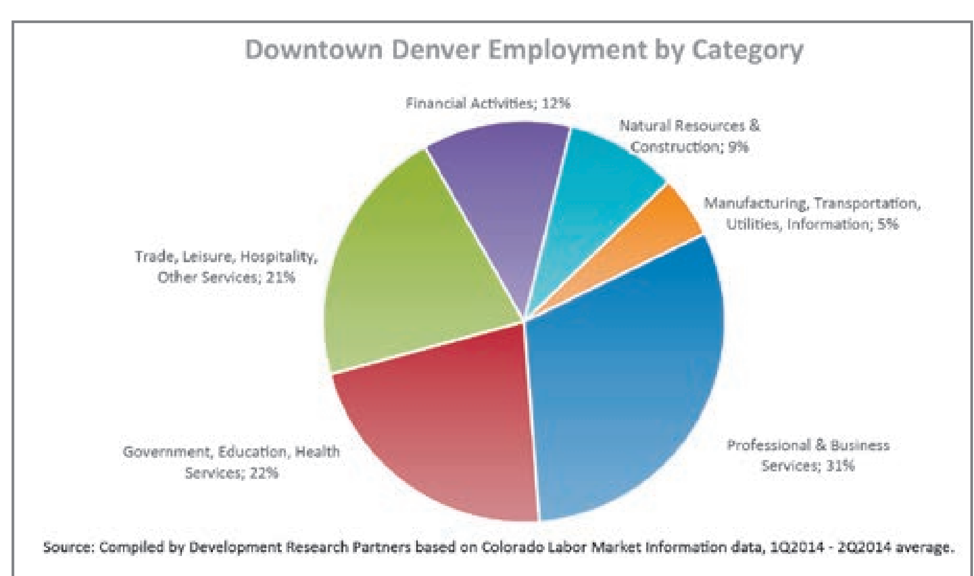
More than 60 percent of employment in Colorado is located in the seven-county metro Denver region. Metro Denver job gains accelerated during 2014, finishing out the year stronger than expected with the addition of 46,200 jobs. An additional 45,000 jobs are expected to be added in 2015, representing a 3 percent growth rate. Metro Denver will experience particularly strong employment growth in the education and health care services, professional and business services, and leisure and hospitality supersectors.

About 120,000 workers were located in downtown Denver during the first half of 2014, based on the boundaries defined by the 2007 Downtown Area Plan. Using data from CoStar Realty Information, this region includes about 20 percent of all office space in metro Denver, or about 35.1 million square feet. Employment data often is discussed in terms of 11 supersectors, or combinations of employment sectors. To simplify the discussion, employment in downtown Denver has been further combined into six categories. When viewed in this manner, a picture of the major users of office space begins to emerge.

Nearly one-third of downtown Denver's employment falls in the professional and business services category. This category includes the whole array of business services, such as legal, accounting, architecture, engineering, computer systems programming and design, business administration and management, and advertising. These companies tend to be office users, so the expected strong growth in this supersector bodes well for downtown office occupancy.

About 22 percent of downtown Denver's employment consists of federal, state and local government workers, as well as education and health care providers. This category is also a large user of office-type space in the central business area, although much of the space occupied by these workers is in landmark buildings such as the Colorado State Capitol and the Denver City & County Building. Sustained economic growth and increases in tax collections provide a positive outlook for employment in this category in 2015.

The third-largest category, representing 21 percent of the employment base, includes all of the retail, leisure and hospitality workers. These workers are found in the hotels, museums and performing arts spaces, as well as the 3.3 million sf of retail space in downtown Denver. Only about 4.4 percent of the downtown retail space was vacant at the end of 2014. Leisure and hospitality also is expected to be one of the fastest-growing supersectors in metro Denver in 2015, so downtown Denver employment in this category should remain robust.



The remaining roughly one-quarter of the workers fall into three categories: financial activities (12 percent), natural resources and construction (9 percent), and information, transportation and utilities (5 percent).

Financial activities consist of banking and finance, insurance, investments and real estate. These office users have experienced mixed results with generally decreasing employment in metro Denver's banks, but increasing employment in investment services. About 60 percent of investment services employment in metro Denver is located in Denver and Arapahoe counties, with much of the Denver employment found in the Cherry Creek area. Based on these mixed trends, minimal change in financial activities employment in downtown Denver is expected.

About 78 percent of the natural resources and construction employment in downtown Denver comes from oil and gas companies, which tend to occupy office space. Although the natural resources sector represents just 1 percent of metro Denver employment, direct oil and gas employment represents about 7 percent of the downtown Denver employment base, or about 8,300 workers. As oil prices have plunged from $106 per barrel in June 2014 to $47 in January 2015, oil and gas companies are responding by decreasing exploration and extraction activity. Depending on how long oil prices remain low, a decline in oil and gas employment in downtown is likely.

The smallest employment category in downtown Denver, representing about 5 percent of total employment, consists of manufacturing, transportation, warehousing, utilities and information companies. Information was

Please see 'Employment,' Page 30

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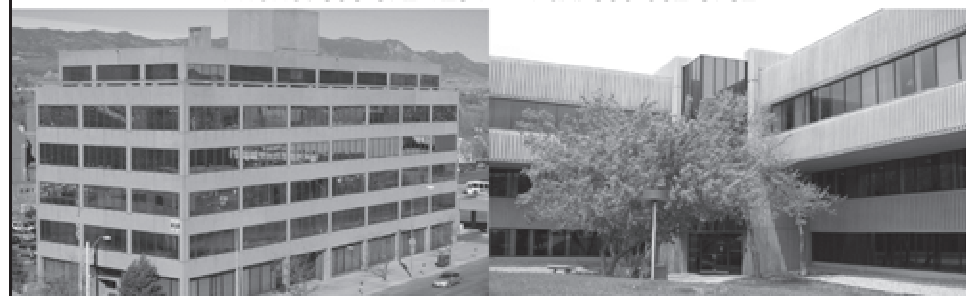

Market Drivers

The evolution of office space utilization

In today's rapidly changing office climate, it is often difficult to determine how much space a tenant will need when they are relocating. With the rise of telework opportunities and alternate office arrangements, it is not always as cut-and-dried as a specific square footage per person. This evolution presents a unique challenge for commercial real estate brokers and tenants alike, and they must work closely to determine the most effective course of action.

Denver Market Space Utilization Study

Through phone surveys of Denver office tenants and U.S. General Services Administration data, the current prevailing standard average workspace is between 175 and 200 sf per person, with the smallest reported space at 64 sf. This is down from recent years. In 2010 the average size per person was between 225 and 250 sf. On the current trajectory, this average could be down to as low as 150 sf in a few years.

Local survey respondents typically fall within the nationwide norms, with law firms reporting the highest average space per sf per employee, followed by engineers, financial institutions and architects. Many Denver companies are embracing telework opportunities, with 60 percent of the study group reporting that a portion of their employees work from home on a regular basis. While many employees have the opportunity to telework full time, they often choose to come to the office for a portion of the day and still require desk space.

Unsurprisingly, the industries in the Denver market that tend to telework the least are those requiring more space per sf per employee. These organizations often need face-to-face time with clients, have shared storage space and require regular contact with coworkers.

Industry shift. Certain industries stand out as most likely to make a shift in office space use. Technology companies were among the first to embrace densification of their space, said Joe Sigdestad, principal at Avison Young. Tech companies have the ability to telework and use established telework centers, and shared office space is very common. Even traditionally space-hungry users are making moves to decrease their space use. "Efficient space utilization has even crossed into the legal field," said Sigdestad. "Historically, law firms have had the highest utilization ratio per attorney of over 1,000 rentable square feet per attorney. Today the goal is much closer to 750 rentable square feet per attorney."

Other industries that have a reputation for being old-fashioned are slowly making a shift as well. The government, for example, mostly uses the private office setup for upper level associates, however, steps are being made to reduce their footprint and increase efficiency. Manufacturing companies are also finding they can operate in much less space than before.

Key motivators for tenants. As rents increase in Denver, brokers see clients reevaluate their space needs more and more. Companies are required to do more with less space to lower overhead costs and increase efficiency. Not only do open-office concepts save rent money, but also they reduce utility and maintenance costs.

Aside from financials, companies are driven to remain an attractive place to work. Retaining top employees is critical to a company's success, and a flexible work environment and teleworking is very attractive. Additionally, open space plans with natural light encourage collaboration, and allowing every employee to enjoy views is better than a select few.

Sarah Carver
Research manager, Avison Young, Denver

Strategies for the effective broker. The evolving concept of office space utilization presents certain challenges a tenant rep broker must face early in the process to determine the size needs of their clients. In initial conversations, it is best to keep the conversation simple to determine how much space they are currently using per employee. One suggestion is to find the gross sf of the entire office and divide it by seats, said David Hurtado, Avison Young principal project manager. By evaluating this baseline square footage, you have a solid starting point for your future conversations. Next, it is key to determine how the tenant envisions their space and to involve a project manager and architect for best results.

There are also ways to aid in the evolving space trend as a landlord rep. It is important to educate the landlord on the changing face of office space and make the advantages of leasing to open-plan users clear. A building owner who embraces densification and prepares their building for these users will easily set himself apart from the competition. Being viewed as a progressive owner will speak volumes for the property and attract tenants who desire better amenities.

There are many ways brokers can use the shifting office space trend to their advantage.

"A big area of opportunity is to assist companies 'right-size' their existing space by becoming more efficient and effective at using it," said Justin Rayburn, principal at Avison Young. "Right-sizing also allows us to help our clients put more money to the bottom line."

> 'Historically, law firms have had the highest utilization ratio per attorney of over 1,000 rentable square feet per attorney. Today the goal is much closer to 750 rentable square feet per attorney.'
>
> *– Joe Sigdestad, Avison Young*

By showing tenants the many ways brokers can assist, in addition to negotiating a lease, a broker's value is evident and the tenant is more likely to come back again and again for various real estate needs.▲

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Market Drivers

Recruitment and retention bodes well for Denver

Like a coach evaluating the depth of skill on his team up and down the bench, I have been struck lately by all the strengths that Denver is bringing to the game. If economic development recruitment is a championship tournament amid grueling competition, Denver has shown that it has the stats, the gifts and the drive to go all the way toward its ambitious goal of being the next truly great world-class city.

Paul Washington
Executive director, Denver Office of Economic Development, Denver

Denver's lineup of assets includes the following:

Our workforce. Denver's labor pool is deep and wide; we are second to none in concentrated talent. Our workforce strength is created when you start with an exceptionally well-educated population, and then overlay the fact that this is a top-ranking place where people all over the country would choose to live.

Our startup climate. Our state boasts the fourth-highest concentration of sole proprietors in the country, and consistently ranks in the top five for entrepreneurship. A 2014 report on Colorado's fertile climate for entrepreneurs estimated that we're seeing one new startup company in the state every 72 hours. Small wonder that here in Denver, the percentage of small business jobs as a subset of all employment is a robust 44 percent.

Our rankings. Virtually every community in the country has at least one thing that they can point to that propels them to the top of some real or perceived hierarchy or competition. The factor that makes Denver's rankings enviably distinctive is that we have so many right at the top of anyone's list of just about anything that matters. Top place where people want to live? Magnet destination for emerging professionals aged 25-34? High rate of college graduates; low rate of adult obesity; high level of venture capital; low rate of corporate tax? Yeah, we've got all that.

Some days the aggregate strength of all that Denver brings to the field makes it a little hard to be humble. We've posted some very strong wins in recent months that have confirmed that our game plan is a tough one to beat.

A "Go-To" Destination

Our current winning streak started when WorldRemit, a London-based financial services firm, announced in December that it would be opening its North American headquarters and operations center in Denver in early 2015. We competed with several other cities for this deal, which will grow rapidly to a staff of 100 this year and more than double within a few years.

WorldRemit offers an online money transfer service with a global reach of more than 110 countries. In 2014, the company added 15 Latin American countries. In addition, Accel Partners – an early backer of Facebook, Spotify and Dropbox – invested $40 million in WorldRemit.

"Denver offers the perfect combination of a highly skilled workforce, supportive local authority and idyllic location," said WorldRemit Founder and CEO Ismail Ahmed. "The city is already gaining a reputation as a go-to destination for the burgeoning financial tech sector and stealing the thunder of New York and Silicon Valley."

The firm is leasing 11,126 square feet of downtown office space at 600 17th St. The Denver office had barely opened its doors when WorldRemit landed a $100 million round of additional venture financing, which may speed up the hiring in Denver.

The Colorado Office of Economic Development & International Trade approved incentives for WorldRemit totaling up to $3.4 million. Our office pledged more than $110,000 of incentives, which includes support from the city's Business Incentive Fund, business personal property tax credits and workforce development support.

Riding the Rail

A second and significant win for Denver arrived when Panasonic announced that it would build a hub for its fast-growing business solutions operations adjacent to Denver International Airport. The campus will create about 300 jobs, incorporating both the new operations base and an assembly facility, said Jim Doyle, president of Panasonic Enterprise Solutions Co.

The project, which is expected to be completed by mid-2016, will allow Panasonic Enterprise Solutions to further expand its rapidly growing large-scale audiovisual and ecosolutions business.

Attracting Panasonic as the anchor tenant for this new transit-oriented development is one of the biggest economic development wins for Denver and the entire region in the past several years. Also, it marks a giant step forward for the "Corridor of Opportunity" between downtown and DIA. It reinforces that our culture of ingenuity and incredibly talented workforce continues to make Denver a magnet for industries of tomorrow, delivering new opportunities and connections to further strengthen our economy for decades to come.

Doyle said the firm intends to drive global attention to the importance of sustainable community development. Denver's deep commitment to sustainability and quality of life makes the city and the state of Colorado the perfect place to do this, he said.

A Major Downtown Decision

The economic development game isn't merely scored by flashy recruitment wins, of course. Behind the scenes and out of the headlines, myriad factors and smaller deals are playing out weekly as firms of all sizes consider specific and often unique factors that drive location and leasing decisions.

Meanwhile, no less important than firms that relocate here are the existing ones that Denver can keep happy and thriving. These aren't the thrilling home runs exactly, but a steady run of singles and doubles – maintaining relationships, building trust, listening, ensuring lines of communication, solving problems and reducing barriers. We work hard not merely to retain employers, but also to encourage them to grow their operations and employment base.

Such was the case recently with the announcement that Transamerica, one

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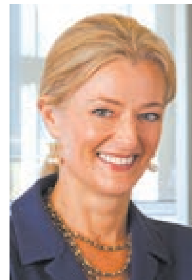
Design

Craft and authenticity transform the workplace

In today's real estate world, a beautiful transformation is subtly taking place with corporate interior design. In simple terms, this transformation is driven by a growing need for the workplace to express personality and individuality in order to flourish. The concept of craft and the infusion of authenticity into design is an effective way to deliver this personality and, as such, it is a high priority for companies to manifest those concepts into their workspaces.



Gillian Hallock Johnson
Principal, BurkettDesign Inc., Denver

To that end, companies are taking great care in teaming themselves with skilled designers to differentiate their culture and validate their image. In the past, the human element slipped away as workspace took on a more standardized environment due to an emphasis on quick technology and trend-driven design solutions. This eroded the human element, which in turn led to personal disconnection and loss of workplace identity.

As the pendulum swings away from depersonalized space, a renaissance of human-centered design focused on craft and authenticity is emerging. With it comes a celebration of diversity, individuality and increased collective thinking.

The best models of individuality and diversity are found in nature and animals, and designers are referencing nature more than ever before. They are employing the inherent geometries of divine proportion found in plants, bringing the outdoors in, and introducing organic shapes to soften and humanize office space. The joy we experience when we see the cerulean blue feet of a blue-footed booby, the brilliant red feathers of a cardinal or the skin pattern of a lizard validates how we emotionally react to genuine originality. The pattern, color and ingredients that identify and define certain species in nature can be reinvented in interior design to identify and characterize a company's personality and corporate DNA.

Because collective thinking is driving new business solutions, reconnecting people to people through the workplace versus the computer is in itself a transformational concept that needs attention. I believe that how this is accomplished has more to do with how powerfully a company's personality can attract the best-suited people, and less to do with adopting the latest workplace trend when laying out a space.

To that end, interior designers are stepping back from their industry's saturated landscape of workplace trend buzzwords, and considering them as thought-provokers to initiate the desired changes. While trends are effective benchmarks for metrics and establishing social history, it is important that they not become overly prescriptive or inhibitive manifestos. Designers have a responsibility to understand the genesis and the trajectory of workplace trends, but it takes a skilled designer to distill the ideas and forecast which aspects of a trend best fit the ideology of a company's work space. Looking at each client more carefully and individually will peel off any stereotypes and reveal the company's most relevant core values. The expression of these core values is where "craft" can have a substantial impact. Craft implements the realization of image and authenticity.

Craft is an art or trade that requires skill in execution. A high level of skill and execution of details within a space can convey a very positive message about a company and its product or service. Conversely, poorly detailed materials will demonstrate a lack of thought or ingenuity and will deliver a negative message.

A simple example of craft is the straightforward and powerful use of millwork in a space because it lends a warm familiarity and a tactile quality, as well as a calming effect. Taking a natural material like wood and applying it in broad, unexpected ways inside a space is a modern approach that shows artistry and advancement. The details surrounding the joinery and transitions to other materials can provide a sense of discovery and appreciation by the people inhabiting the space, and the osmosis of this environment pervades the minds of the people and the attitude in the workplace. In this way, it silently creates and reinforces the company's brand.

The outward-oriented culture and balanced lifestyle in Colorado is the perfect stage for human-centered design, and Denver firms with satellite offices in nearby regional cities such as Boise, Idaho, and Salt Lake City are leading the way through example. With every new lease, companies are capitalizing on the opportunity to design space that engages a new set of values and taps directly into the inherent cultural and contextual qualities of the city. In doing so, they are also tapping directly into the hearts of their employees.

Design authenticity draws people to other people, places and ideas. In particular the expression of craft in corporate interior design is one of the most powerful conveyors of brand in which a company can invest. A well-crafted working environment can psychologically promote higher standards, heighten the self-image of the people working there, bring people together and increase productivity.▲

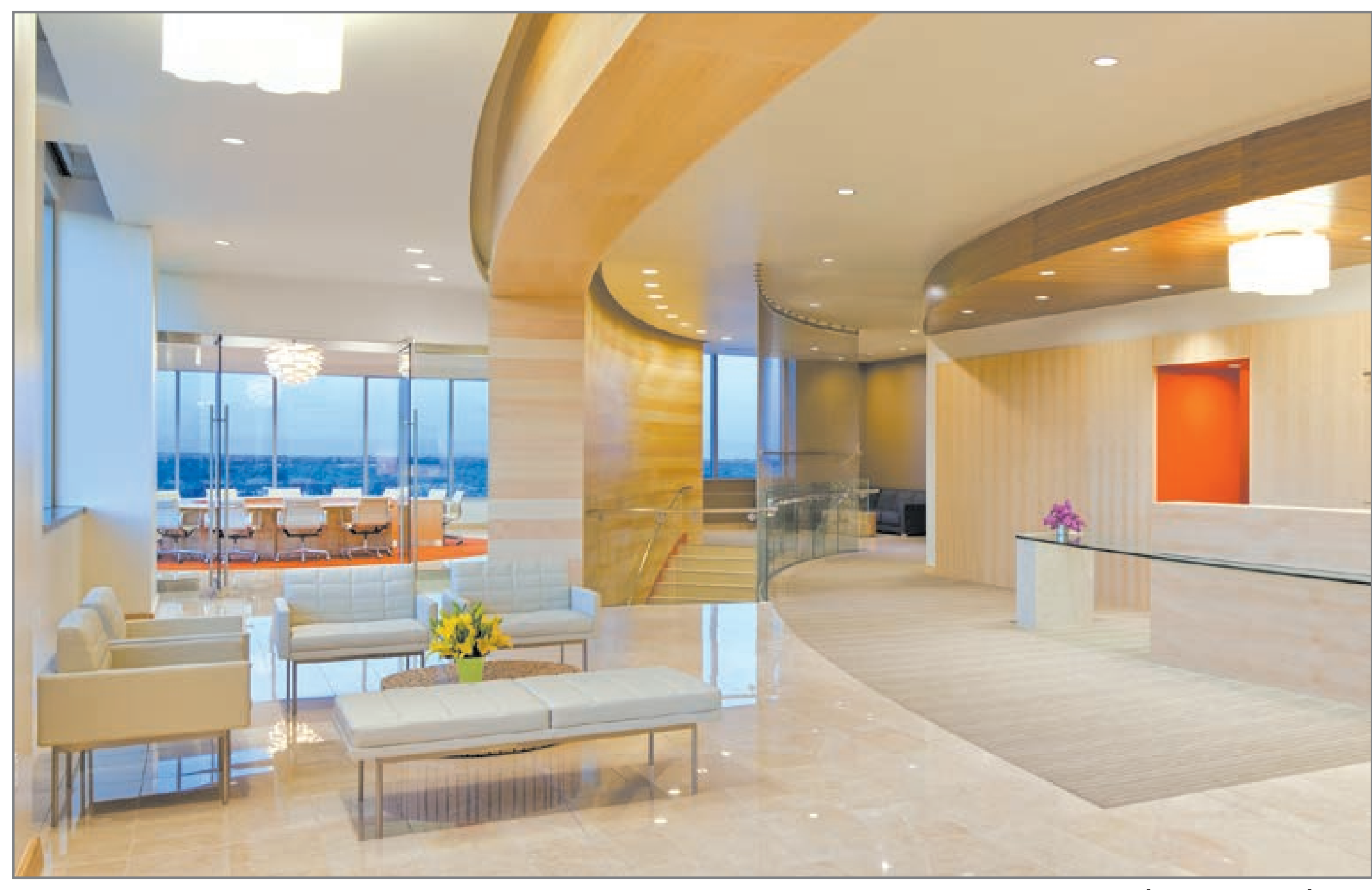


Photo courtesy Frank Ooms

The broad sweeping wood spine wall floats through the reception level to create a circulation gesture, lending a warm familiarity, tactile quality and artistry to the space.

Photo courtesy Frank Ooms

The handcrafted reception desk at the entry is layered with woven wood, steel and concrete to create a statement of the importance of the human element.

Inspiration often comes from nature. The pattern, color and ingredients that identify and define certain species in nature can be reinvented in interior design to identify and characterize a company's personality.

Design

Collaborative spaces thrive best with balance

by Michelle Z. Askeland

Embracing a work environment that offers a variety of choices to encourage collaboration is now a staple in the workplace. However, while it is important to promote collaborative areas, the need for a balance between collaboration areas and focus areas is crucial to create a successful workplace environment.

"I think the key is to understand why clients want a collaborative space," said Michelle Liebling, senior associate, design director, Gensler. "There's a lot of discussion about innovation and how to foster innovation in the workplace, and a lot of that can be through collaboration."

The term collaboration might be too general a phrase to encompass the many aspects of creating a social environment.

"By its very nature, collaboration is not easily managed," said Mary Kay Sunset, principal, Semple Brown. "Groups tend to form spontaneously, thus participation is a self-motivated choice. The designer's role is to help their client foster conditions that encourage collaboration and a sense of community to flourish."

This ad-hoc engagement is represented in a variety of ways, said Joy Ramsey Spatz, studio director, senior associate, Gensler. People may have the expectation that a conference room satisfies this need for a collaborative area, but the conference room alone does not, she said. Collaboration can be learning, meetings, one-on-one connections or focusing on something together. "Collaboration does not only happen in one room," she said.

The benefits of collaborative workplaces are a topic of a variety of studies and research. All three firms interviewed cited research to support that these environments foster worker satisfaction, innovation and productivity.

"Our own research has shown that top-performing companies actually collaborate more and socialize more," said Liebling. "The idea is to provide opportunities for people to do their best work, because when people are doing their best work, they're satisfied, and when you have satisfied people, you have higher levels of engagement and this is a positive chain reaction."

"Its been fairly well substantiated at this point that collaborative environments tend to be more dynamic, creative and innovative," said Amy Tabor, director of facilities planning, RNL. "They are also the norm for younger generations who grew up in educational environments that stress project-based teamwork, and a technological environment where they are always connected socially and professionally."

Almost all of the clients of Gensler, RNL and Semple Brown are embracing some form of collaborative workspaces – however the environment in which they do so varies.

"All of our clients are embracing better support of collaboration," said Tabor. "Not all of them are doing it in the same way. For some, it's an effort to increase designated spaces where collaboration can occur and be supported. For others, it's an effort to make sure that collaboration can occur anywhere."

In order to create the best solution for the company, it's important to understand that each corporate culture is different. Needs and desires vary from client to client and from one industry to another, said Sunset. "There is no set formula."

"Creative" professions, including advertising, marketing and sales, may embrace a community-based environment more enthusiastically than law firms or financial services, the designers agreed.

"Defining what collaboration means to the specific organization is important," said Tabor. "One company's collaboration is not necessarily another's."

Courtesy David Lauer Photography

Shared conference and lounge-style meeting rooms serve as building amenities for all tenants at the Alliance for Sustainable Colorado, designed by Gensler.

Courtesy David Lauer Photography

The Railyard multipurpose room at IMA Financial Group, designed by Semple Brown, includes a complimentary Starbucks barista, healthy food choices, a foosball and pingpong table, and outdoor patio to increase interaction.

Focus-Time Areas

To identify the needs of a company, a design team must investigate how the company operates – who the employees are, what are their needs, how do they work, what in the current workplace isn't helping them, etc. They also must understand what the employees do throughout the day to determine if they're spending a majority of their time collaborating or focusing at their desk, said Liebling.

"If you're going to have an open office, you must also provide private areas," said Sunset. "Executive and employee needs and desires are not universal. While marketing and sales departments generally work best in more flexibile and open environments, legal, accounting and human resources may still need and desire more private workspaces. Hitting the sweet spot in terms of balance is the key."

Gensler has four workplace profiles to classify work modes, which are focus, collaborate, learn and socialize. "In top-performing companies, survey results and feedback from employees rank those modes high," Spatz said.

"More recently, however, there has been recognition that paying attention only to the collaborative side of a work environment can have some pretty detrimental downsides," said Tabor. "One cannot collaborate effectively unless you also have time to focus, reflect and concentrate."

When visiting a client's space, Spatz said she might notice a collaborative space right next to workstations. This location leads to many potential conflicts if rules are not established about when to collaborate and who can use the area, she said. "They have this condition they're fighting – and they didn't realize they were fighting it – that the collaboration area is actually disrupting the people around it," she said. "A lot of our clients don't know that. The people sitting there know it, but sometimes those people aren't the squeaky wheels. Squeaky wheels get replaced."

All four designers also stressed the importance of a variety of spaces. Sunset said she likes to vary the type of seating to provide options for usability, including bar-top-height tables with bar stools for quick meetings and casual meeting rooms with upholstered furniture to embrace a living room feel for longer, informal conversations.

"There's a series of different needs for an organization," said Spatz. These needs must embrace different postures

to escape the continuous position of sitting at one's desk, and must provide options for employees to choose where they feel comfortable, she said.

When enabling choices by creating a variety of spaces, it is important to recognize that not everyone will use all the areas, said Liebling. "It isn't a one-size-fits-all solution," she said. "Not every single person is going to use every single space. But it's about being the most efficient and productive with the space that you have."

Technology's Impact

The integration of technology is also important to collaborative spaces. The introduction of laptops and smartphones helped blur the line between work and home, as has the increase of millennials in the workforce. Both of which lead to a massive paradigm shift in terms of what the workplace is, said Liebling. "It's no longer this place that people show up, push their papers, hit their numbers and leave," she said. "It's really this more knowledge-based, collaborative environment."

While collaborative work environments have been around in various forms for a long time, the movement seems finally to have found the needed balance to thrive.

"I believe each design trend is unique unto itself and driven by corporate culture changes," said Sunset. "Trends grow out of a need or change in corporate operations, systems, new technologies, etc. They happen when the design of our office spaces need to support a change taking place within the workplace."

The mid-1990s saw the beginning of the virtual worker, said Sunset. By the end of the 1990s, the dot-com era had led to a craze in unconventional spaces, said Tabor. And 10 years ago, many thought that to have collaborative space one had to sacrifice other essential components of the workplaces, which led to an imbalance, said Spatz.

"I'm going to say that human behavior has not really changed, ever," said Spatz. "But our awareness of how we can shape and impact the space in order to make it better for people, that's really what this is all about."

"Open, collaborative work environments are likely here to stay," said Tabor. "The success and effectiveness of those, however, is dependent upon providing the right spectrum and distribution of spaces that provide something other than just that. Some people thrive in that kind of environment 100 percent of the time, but not very many. There needs to be a much greater emphasis on providing a healthy work environment."▲

Courtesy Paul Brokering

A headquarters building in the Denver area, designed by RNL, features open and enclosed collaboration spaces that are integrated into the workstation areas.

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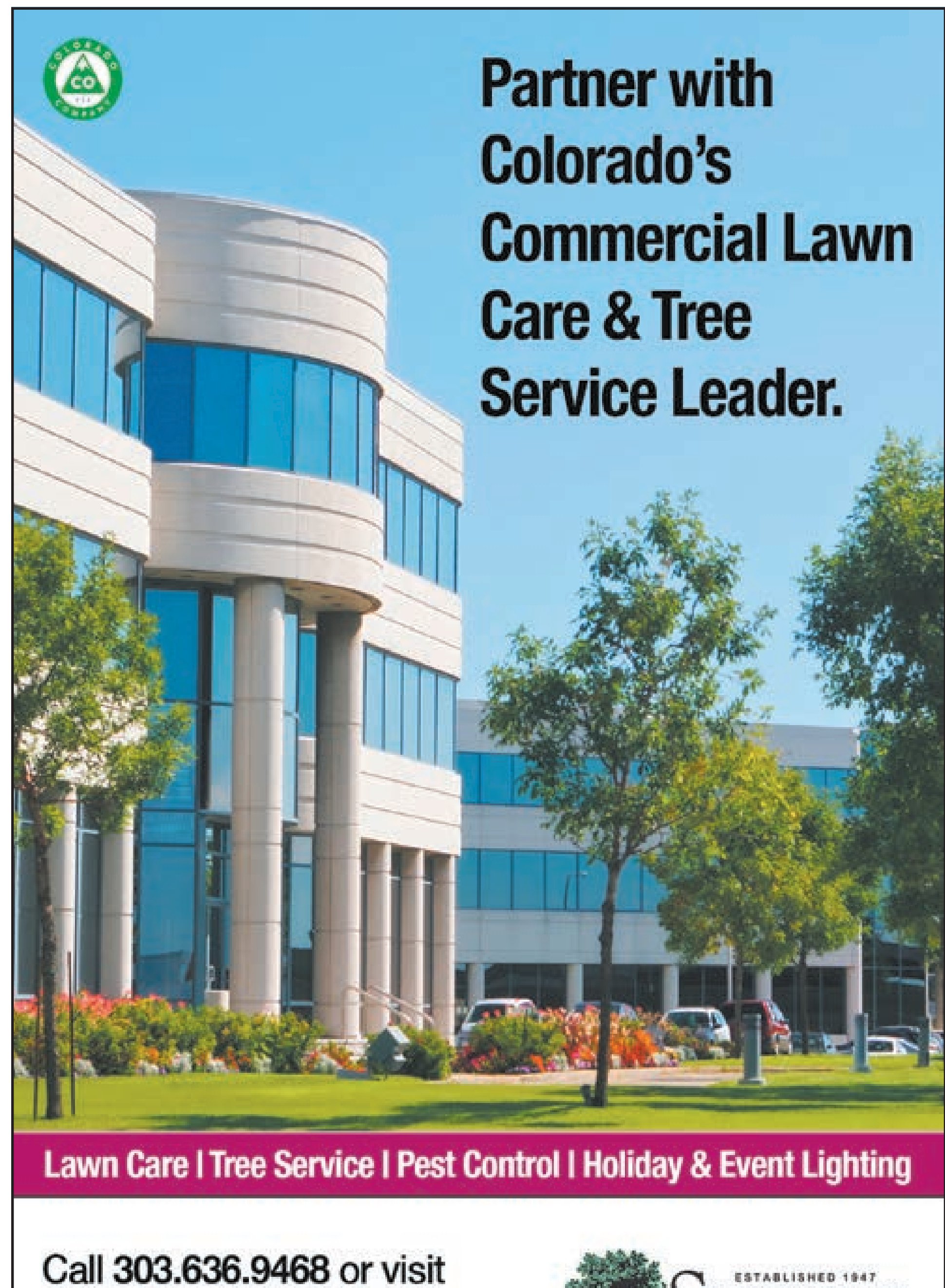

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Design

Speculative suites are low on the sexy scale

Given the choice, about half of all office users would prefer a "sexy" workspace. Sexy is color and texture. Sexy is new technology. Sexy is in. Sexy interior design is about branding and corporate culture fused together in a package that brings the wow factor into sharp relief. Sexy is also pretty pricey in a cycle where construction costs are out of control.

Tia Jenkins
President and architect, Kieding, Denver

You know what's not sexy? Spec suites. They're designed to be rather pedestrian, basic, utilitarian. So why are they gaining so much notoriety in an office market that seems to want something different?

By definition a spec or speculative suite is an office space built out by the landlord without a prospective tenant in the mix. That is, landlords prepare office suites as a way to shorten the entire search-to-lease process that tenants traditionally must navigate. The design and construction is done on the front end before a lease is negotiated. This might mean that suites are move-in ready, including fixed or demountable perimeter offices, furniture, lighting, paint, carpet, window treatments and more. Or they can be in "white box" or "vanilla box" condition with tenant improvements limited to bare bones heating, ventilating and air conditioning, electrical, finished ceiling, restrooms and a concrete slab floor.

The variations between these two options can be virtually limitless, depending on the trends of a particular market. But generally, the more restrictive a given spec suite appears, the less notice it will attract from prospective tenants. In any event, landlords must pay for improvements to these suites whether a tenant ultimately leases the space or not, so there is some risk. The safe bet, at least in theory, is for landlords to stay on the "generic" side of the design path, if there is such a thing in today's office market.

By casting as broad a net as possible with a clean, basic design, landlords attract a wider range of tenants and mitigate the risk of sitting on spec suites either too stripped down or too exotic to attract tenants with a fairly traditional business model.

What that means, essentially, is that most prospective tenants need to "visualize" themselves in a space before they would commit to any kind of custom design completed through traditional channels. Spec suite leasing can forego that step by offering a staged option, not unlike a home residence, except that whatever is in that space stays in the space after the lease is signed, with little or no additional costs incurred by the landlord or the tenant.

Spec suites are usually smaller in size – between 1,000 and 5,000 square feet – so that factor alone eliminates large users with contiguous space requirements. On the other hand, some landlords will dedicate larger vacant blocks of space to a spec suite "program" by improving many suites at once in a single building or many buildings, with the goal of finding tenants on a rapid growth curve with flexible requirements for space and lease terms.

In this case, landlords control the astronomical cost of construction through economies of scale by building out multiple spaces simultaneously. These spaces are typically high quality and move-in ready with a variety of finish options and layouts. Similarly, tenants can enjoy the option of expansion more quickly than traditional methods of design, construction and leasing will allow. There are no rules here, however, so landlords and their leasing representatives are continuously hustling to apply the right strategies to the right markets at the right time.

Typically, it is a distressed market that stimulates more spec suite activity. At the very least, spec suites are almost always in a landlord's discussion when trying to combat high vacancy. But that's not the case right now, at least not along the Front Range.

The sector as a whole is in an extremely low-vacancy cycle – about 10 percent, according to CoStar Group commercial real estate services. In fact, metro Denver's office market is among the healthiest in the nation with similarly rosy projections on the horizon. Fundamentals will remain particularly robust, and although new product continues to come on line in the central business district and southeast suburban submarkets – the metro area's largest – much of that space is already leased. Consequently, there is no significant "flight to quality," a clear indication that an ailing market is struggling to correct itself. On the contrary, this market is firing on all cylinders.

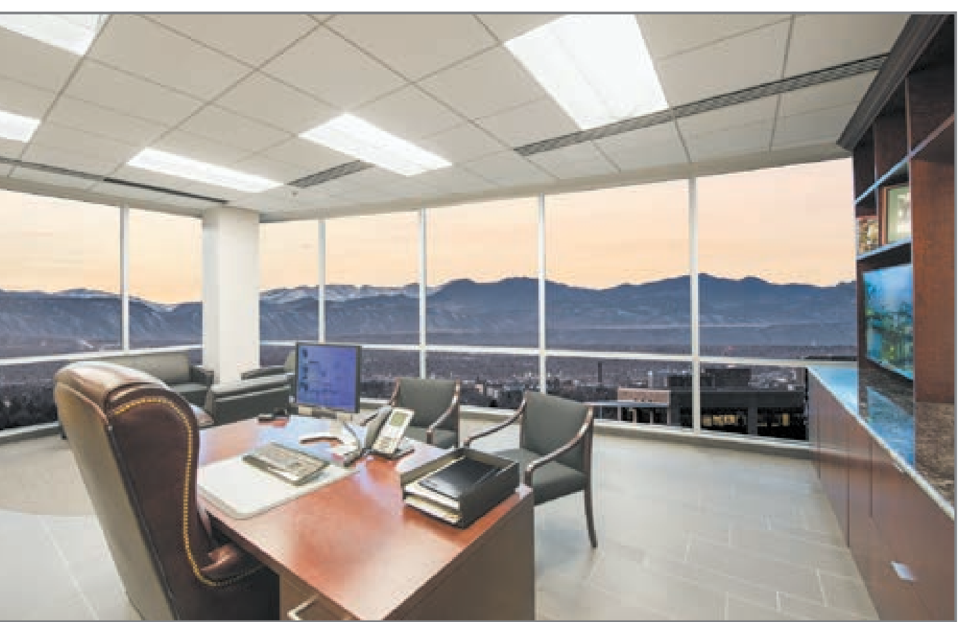
Sure, some Class B properties are still lingering and landlords are keen to apply the spec suite model to a good percentage of that type of vacancy when conditions are favorable. But on balance, rental rates in premium Class A and AA properties will continue to tick up over the next several quarters while Class B space continues to be absorbed. Additionally, most landlords have stopped offering heavy incentive packages and major concessions, such as extended free rent. They don't need to do that anymore to remain competitive.

But no market is ever 100 percent leased. There is always turnover, and there are always spaces that will not move for one reason or another. In a low-vacancy market like this one, maybe a large tenant leaves "leftovers" of a few hundred or a few thousand sf, oddly configured or unfavorably located over multiple floors or even multiple buildings. Maybe the suite has a less than stunning view or less than desirable neighbors. It happens.

The point here is that landlords are always leasing, and still have to seek creative ways in which to market those stubborn spaces that won't budge. Spec suites often can meet those challenges and prove to be the better choice when all other factors between competing properties are relatively equal.

Those same spec suites often can prove invaluable when looking at office properties through a sales prism.

It's obvious that investors are bullish on metro Denver across all property types and almost all submarkets. Office buildings are trading at near record rates, which usually advance a good-news-bad-news scenario for landlords. The good news is that interest rates are still low and both sales volume and sales velocity are red hot. The bad news is that everybody already knows this. Competition to attract buyers is no less fierce than it is to attract tenants. It's all about value for both sides of the deal, even after exhaustive analytics reveal the marrow of any given property.



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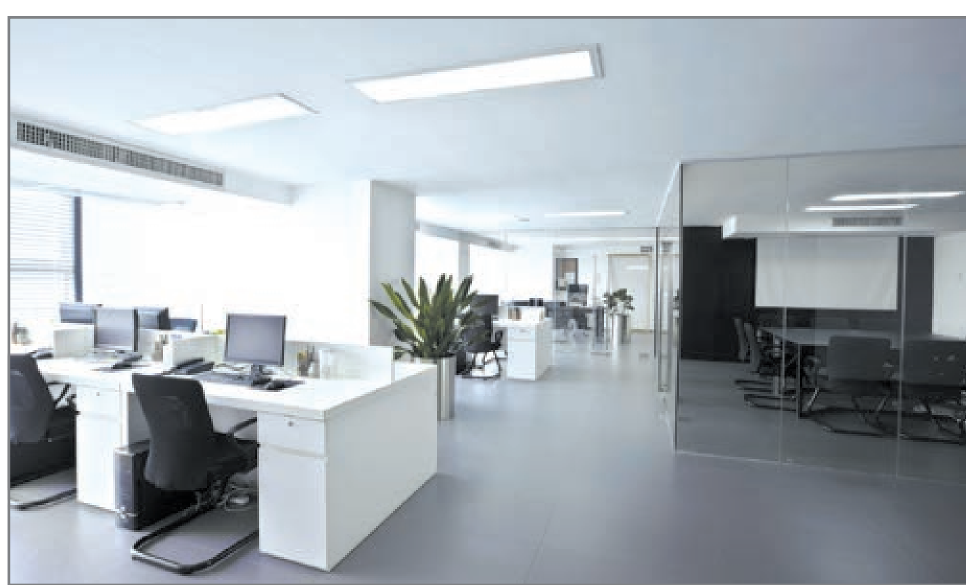

The safe bet, at least in theory, is for landlords to stay on the generic side of the design path, if there is such a thing in today's office market.

Well-designed spec suites can, and often do, swing a deal to the landlord with the vision and funding to invest at precisely the right time. Value is always going to transcend design, regardless of how well or poor an unimproved suite might look. It's finding that value that can be a tricky business.

Like any leasing strategy, or micro strategy as spec suites are known in some markets, landlords must strive to stay ahead of the curve or at least on top of it. That can be a tall order when obsolescence in interior design and technology outpace the traditional planning and construction timeline. It's one thing for landlords to build out a space with a custom open plan to satisfy a single tenant with a sharp eye on keeping its millennial workforce productive and happy. It's another thing altogether to build out a full floor of spec suites with similar requirements that appeal to a relatively small percentage of users. But it's happening now, and coming soon to a submarket near you.

The rather literal new moniker for these units is "tech-suite," or "tech-spec," but the basic leasing strategy is the same. The design is not. It's sort of an open-plan-gone-wild proliferation, especially in the major U.S. tech hubs that are seeing good to very good results. Designs can range from plug-and-play industrial-style open ceilings and concrete floors to more refined models with paint and flooring in shockingly vivid colors and textures embraced so passionately by the Google crowd. That's because it is a Google-like crowd that will inhabit these spaces.

Granted, landlords are not going to shell out top dollar for the additional tenant improvements typically demanded by this group. But they may offer more than what a generic spec package would, if the numbers make sense. The jury is still out on that one for metro Denver. But not for too long.

The war between the open office and its many detractors is still raging, though widely misunderstood in most major markets. But that's not a landlord problem. Spec suites of any size, shape or level of finish are designed to offer the landlord some measure of inventory cost control in a largely uncontrolled market.

Spec suites almost always increase the overall value of an office property. And with good timing and solid design and construction, the return on investment is usually worth the risk for landlords and tenants. In that respect, spec suites are doing the job they were created to do decades ago. That's not sexy. But it certainly is sensible.▲

Design

Examining myths, realities of workstations

It's time to debunk the myths about current workstations and address the workplace realities. First, let's reflect on the current state of office workstation furniture. Through the combination of a few large projects, we have directed two very different clients through the process of procuring more than $10 million worth of office furnishings. That volume exposes one to everything the office furniture industry has to offer.

Our two clients came from different orientations – one wants to be leading edge and push the envelope in terms of creating the ultimate open, collaborative, energetic workplace. The other, unfortunately, believed it was an innovator in its marketplace, but was rooted in old-school values and myths when it came to the workplace environment. Juggling two perspectives and providing both with the best consulting was a challenge.

Part of our responsibility is to educate our clients about what is out there that may be outside their wheelhouse. The resistance for some to accept where the evolution has taken us is embedded in some myths about workstations. Those myths, realities (at least my take on them) and some solutions follow:

• **Myth No. 1:** Employees need privacy that the workstation doesn't provide.

Reality: On average, employees may need privacy for a small part of their workday while the rest of the time could be spent collaborating and interacting with colleagues.

Solution: The evolved workplace provides huddle rooms for those private times.

• **Myth No. 2:** Higher panels create the impression of visual and acoustic privacy.

Phillip A. Infelise
National director, project and facilities management, Cresa, Denver

Reality: Yes, but they also restrict collaboration and management oversight.

Solution: Moderate panel height with glass panels above can achieve both.

• **Myth No. 3:** Higher panels absorb noise, so the workplace is quieter.

Reality: Not really, because the noise bounces to the ceiling and back down.

Solution: Sound masking and cultural adaptation do a better job quieting an area.

• **Myth No. 4:** Lower panels create a noisier workplace.

Reality: Just the opposite – research shows an incredible natural adaptation of workers to lower their sound volume when in a more open environment.

Solution: A modern sound-masking system and cultural adaption create a workplace that is quieter with low panels than without.

• **Myth No. 5:** Size is everything – more gross size equals more productivity.

Reality: Those passé 8-foot-by-8-foot stations are huge, cost serious real estate dollars and are wasteful, especially in light on old monitors taking up 9 square feet in the corner.

Solution: Try a 6-foot-by-7-foot option with narrower surfaces that offers as much room as the old 8-foot-by-8-foot station with deep surfaces and corners.

• **Myth No. 6:** Managers can't work in workstations; they must have offices.

Reality: The modern workstation can provide everything a manager needs to do his job most of the time.

Solution: Create an adequate number of huddle rooms, as well as collaborative and quiet areas.

• **Myth No. 7:** Managers can dictate workstation configuration even though they don't ever work in them.

Reality: Mangers tell us what their workers want, but it might be better to let the workers tell us themselves.

Solution: Educate management and let the younger generation occupying those workstations have a voice in their development.

• **Myth No. 8:** Workstations are impersonal and create an Orwellian group of workstation gnomes.

Reality: Workstations can be 100 percent adaptable and often are personalized with individual choices of layout, work tools and accessories.

Solution: Drop preconceptions and look at what is offered today.

It is not just about the workstation. Most clients are now warming to the notion that the most functional, flexible and economic workplace is created when the same components are used in both the workstations and the private office. Minimizing the "kit of parts" while maximizing the available configuration options is a win across the board .▲

The workstation evolution from the 1960s to today

To provide a bit of historic background, the following is a (very) general timeline in the evolution of what most of us know as the "workstation":

• 1960s: First freestanding steel-divider panels surround steel desks and file cabinets in long, monotonous rows of 6 feet by 6 feet standard sizes.

• 1970s: Softer monolithic fabric panels and first connected work surfaces, but the area maintained highly regular, boring "cube" farms still in a standard 6-foot-by-6-foot station.

• 1980s: Integrated deep corner surfaces accommodated large monitors, along with components hung on panel systems as sizes grew to 8 feet by 8 feet.

• 1990s: Stackable panel systems are front and center; and many more storage and work tool options are introduced to the standard 8-foot-by-8-foot configuration.

• 2000s: "Belt-Line" integrated voice, data, power management and glass view panels; flat screens brought shallower work surfaces and some hotel or touchdown stations; and the standard size moved toward an economical 6 feet by 8 feet.

• 2010s: Lower panels are introduced as sound masking improves acoustics; free-standing components, benching and desking systems are introduced; mobile pedestal seating allows guest visits, even in the standard 6-foot-by-8-foot footprint; and the same components are used in the office to minimize the kit-of-parts and maximize flexibility.

• 2020s: "Panel-free systems" are on the way, with all possible storage options; standing surfaces, teaming and collaborative stations in a 6-foot-by-6-foot standard – perhaps workstations as a concept are a thing of the past.

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Design-Build

Office developers win big with design-build

While the design-build approach is often associated with small, fast-track projects or large, complex government projects, it is just as beneficial to office building projects where speed to market is critical to developers. Nowhere is this truer than with Colorado's white-hot office market with its extreme competition for top-tier tenants.

In a design-build project, teams are responsible for the entire office undertaking, from design to estimating to construction. This approach produces efficiencies that result in higher-quality buildings that are free of cost overruns and schedule delays. Moreover, the design-build approach eliminates the inefficiencies of the traditional design-bid-build approach and gives developers a competitive advantage by bringing projects to market faster.

A good design-build team views the project from a developer's perspective, knowing that a successful project requires a responsible design solution. In the design-build delivery model, architects and engineers collaborate with the preconstruction and construction team, from the concept stage of the project onward in order to meet the developer's pro forma objectives.

In the conventional delivery model of design-bid-build, project team members assume they will have access to developer contingencies to cover change orders as the project progresses. These unforeseen problems increase the developer's cost and competitive risk and put them in the middle of the conflict resolution, between the architect and the contractor. Conversely, design-build teams focus on target-value design and strive to complete the project without dipping into contingencies through early and ongoing collaboration.

Doug Spuler, AIA, LEED AP
Principal, The Beck Group, Denver

The overarching benefit of the design-build approach is centered on the concept of maximizing value through a collaborative model. It's a developer-oriented approach that maximizes project pro forma opportunities to produce a high return on investment and to make it easier to obtain financing and early tenant commitments.

The approach to building office complexes provides clear benefits for developers. These include reduced schedules, higher building quality, greater tenant flexibility and results in few (if any) project-delaying change orders.

Building Better Quality on Tight Schedules

Now, more than ever, it's critical to secure tenants and quickly develop rent roll. With the stakes high, schedule slippage can dissuade potential tenants and kill a project. Developers who choose a design-build approach will build their rent roll earlier and avoid the schedule-crippling churn of design, estimate and redesign that can cause serious delays that result in losing tenants and financing.

The approach is especially beneficial to the success of fast-tracked office projects because project estimating happens in tandem with the design. Generating and locking in the guaranteed maximum price early in the project produces trustworthy estimates with lower contingencies for projects that are buildable as designed.

Contrast this to the design-bid-build approach where the architect designs the building and hands the design to the estimator, who produces a price estimate that includes a sizeable contingency to cover unknowns. If the estimator determines that the building cannot be built within budget as designed, it triggers a redesign, followed by another estimate. This design-estimating cycle can take substantial time, effort and money to resolve and it can completely derail the schedule.

Instead of designing in a vacuum and requiring the contractor to figure out if the design is buildable within the developer's budget and schedule constraints, architects and engineers in design-build teams design the building with quality and construction top of mind, using the target-value approach. Using 3-D modeling and other advanced building information modeling tools, they can quickly evaluate design alternatives and material options for the budget. This collaborative process also ensures that it can be designed and built on a compressed schedule.

Tenant Flexibility

When developers are building to attract high-value tenants, the tenants often request changes to the design. The design-build approach accommodates tenant design changes more easily than the design-bid-build process, because making these changes likely involves a cumbersome communications loop that includes the tenant, broker, architect and contractor. The design team evaluates whether the change can be achieved. Then it goes to the contractor, who may push back or request a change order, either of which will delay the schedule.

With design-build, design and construction team members address the requested changes together to find a workable solution to the tenant's request. Because there is no back and forth between the architect and contractor, the changes usually can be absorbed within the original schedule and with minimal cost impacts. The results are happy tenants and signed leases.

No Surprises

Change orders can have a major negative impact on a project schedule and budget, especially when the changes are a result of problems discovered during construction, which are more expensive and take longer to rectify. Because the design-build team collaborates in the constructability of the design from the beginning, the architecture and engineering team can analyze and alter the design to eliminate the types of conflicts that often crop up in the field, alleviating most change orders.

Developers who use these teams find great success meeting pro forma requirements and achieving a higher return on investment with increased speed to market. The office buildings are arguably the highest quality for the budget and win desirable tenants with the promise of design flexibility and on-time occupancy.▲

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Office Quarterly - Project Financing Overview

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OPTION	TYPE	EXPLANATION	REQUIREMENTS	USUAL SOURCES	AVAILABILITY	RATES/SPREADS	LTV/COVERAGE	LENDER FEES (POINTS)	TERM (YRS)	AMORT (YRS)	COMMENTS
LIFE INSURANCE COMPANY	Debt	Non-Recourse, longer-term fixed rate loan	Creditworthy borrower and a stabilized, well-maintained property of "B" quality or better	Life Insurance Companies, Pension Funds	Excellent	125-200 bps over the comparable US Treasury	Up to 70% LTV; minimum 1.25x DCR	Typically limited to a processing fee	5-30 Years	25-30 Years	• Non-Recourse • Excellent source for long-term debt • Flexible prepayment penalties available
CONDUIT	Debt	Longer-term fixed rate loan	"A" to "C" quality property, Experienced Owner	Investment Banks and/or specialty lenders	Excellent	190-250 bps over SWAPS	Up to 80% LTV (75% with cash out); minimum 1.25x DCR	0	5 - 10	I/O up to 10 years, then 30	• Full proceeds in secondary/tertiary markets • 3 or more years interest only
BANK	Debt	Shorter-term, fixed and floating rate loans	Strong borrower and personal guaranty	Banks	Excellent	225-250 bps over bank cost of funds	Up to 75% LTV	1/2 - 1	Up to 7 Years Fixed	Interest Only to 25 Years	• Recourse (non-recourse available at low leverage, 60% and less) • More flexibility with shorter term and second source of repayment
CONSTRUCTION PERMANENT LOAN	Debt	Floating Rate construction loan can be converted to fixed rate permanent loan at borrower's option	Well located Property, significant pre-leasing and creditworthy borrower	Banks, some insurance companies depending on deal size and credit worthiness of pre-leasing	Good	LIBOR + 150-250 bps	70% - 75% 1.25 - 1.30x DCR	1/4 - 1	5 - 20	I/O up to 3 years, then 25 - 30	• Typically recourse during construction term • LTC generally may not exceed 85%
BRIDGE LOAN	Debt	Shorter term for acquisition and/or repositioning	1.00 - 1.10 DSC at closing	Specialized finance companies, banks, some insurance companies and opportunity funds	Excellent	LIBOR + 250-600 bps (some w/ floors)	70% - 75% 1.25 - 1.30	1/2 - 2	1 - 5	Interest Only	• Pricing depends on leverage level, property quality, and strength of guarantees (if required)
MEZZANINE/ PREFERRED EQUITY	Debt / Equity	Junior financing secured by a pledge of, or participation in ownership interest	Experienced sponsor and good quality property / development	Investment funds, life insurance companies, private capital and REITs	Adequate	Mezzanine 7%-12%	Up to 85% - 90% of cost 1.10	1 -2	2 - 10	In most cases, Interest Only	• Preferred equity offers higher funding than mezzanine, but at a higher cost
JOINT VENTURE	Equity	Equity source provides up to 95% of the total equity	Experienced sponsor with a high-quality property / development in good locations	Life insurance companies, pension funds, REITs and opportunity funds	Good	Return and yield requirements vary by property	N/A	0 - 1	Up to 10 Years	N/A	• Various structures available • Sponsor's equity pari passu with JV equity
PRIVATE EQUITY	Equity	Private capital seeking ownership positions in leveraged projects	Experienced sponsor and project with attractive cash flow & upside	Individual investors pooled through a fund manager or syndicator	Good	Vary Widely	N/A	N/A	N/A	N/A	• Becoming more and more available with the lack of high yields on alternative investments

DCR - Debt Coverage Ratio
DUS - Delegated Underwriter Servicer

IRR - Internal Rate of Return
CF - Cash Flow

LTV - Loan to Value Ratio
LTC - Loan to Cost Ratio

LIBOR - London Interbank Offered Rate
REIT - Real Estate Investment Trust

This information is intended to illustrate some of the lending options currently available. Other options may exist. While Essex Financial Group strives to present this information as accurately as possible, no guarantee is made as to the accuracy of the data presented, or the availability of the terms at time of application. Rates and terms are subject to change. Please contact one of our mortgage bankers for up to date rate and term information.

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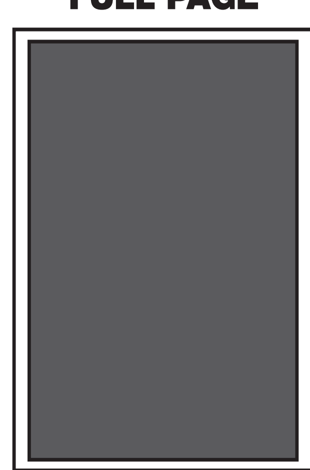

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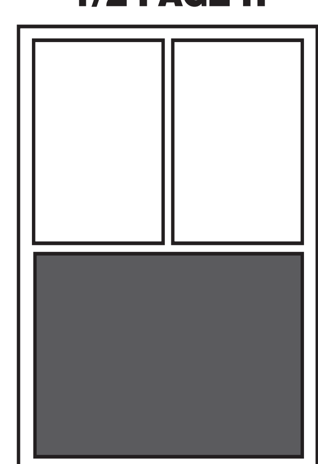

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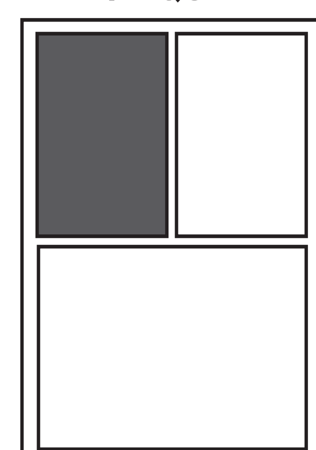

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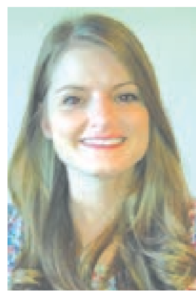
A look at Colorado's robust office construction

The Southwest Energy Efficiency Project recently published a set of fact sheets that examine commercial construction activity in the Southwest. As a whole, the six-state region has a relatively low population of about 20 million, yet in 2013 investors poured $11.3 billion into commercial construction projects.



Lauren Smith, LEED AP BD+C
Program associate, Southwest Energy Efficiency Project, Denver

Wyoming, Colorado and Utah experienced the biggest increases in commercial construction projects in the region. In 2013, the total value of all commercial construction projects in Colorado was about $3.2 billion.

Looking specifically at office projects in the private sector, the total value of all new construction and renovation projects in Colorado was just over $220 million in 2013. Note that, in the CMD database, office buildings do not include medical, military or warehouse offices. When governmental offices are included in the calculation, the total value of all new construction and renovation projects in the state was over $342 million for the same year.

In the private sector, the proportion of renovation projects to new construction projects has grown since 2009, but new construction projects still account for the bulk of total project value. This means that the total number of office renovation projects is increasing, but project costs are much higher for new construction projects because they comprised 90 percent of the total private project costs in 2013. When public-sector office buildings are included, the proportion of renovation projects increases significantly in all years from 2006 to 2013, and most significantly from 2009 to 2013 (renovations make up 86 to 92 percent of projects in these years). In fact, 92 percent of all office projects constructed in 2013 were renovations when governmental offices are included.

In terms of cost, new construction projects comprised about 68 percent of the total office construction value in 2013 when governmental offices are factored into the analysis. In this case, renovations are driving the market more so than in the private sector.

This means that the total number of office renovation projects is increasing, but project costs are much higher for new construction projects because they comprised 90 percent of the total private project costs in 2013.

The CMD data also classifies commercial projects by county so that trends in construction by geographic area can be evaluated. This begs the question: Where in Colorado is the most office building construction occurring?

Well, that depends on how you look at it. Regarding the number of project starts or the total number of projects, the top counties in descending order are: Denver (24 percent), Arapahoe (10 percent), El Paso (9 percent), Boulder (8 percent) and Larimer (7 percent). This means that more office projects are constructed in these counties than other counties in the state.

Regarding the total sf constructed, the top counties in descending order are: Denver (44 percent), Broomfield (26 percent), Arapahoe (7 percent), Eagle (5 percent) and El Paso (4 percent). This means that more office space is constructed in these counties than other counties in the state. These statistics were generated using years 2005 to 2013, and square footage estimates are available for new construction projects only.

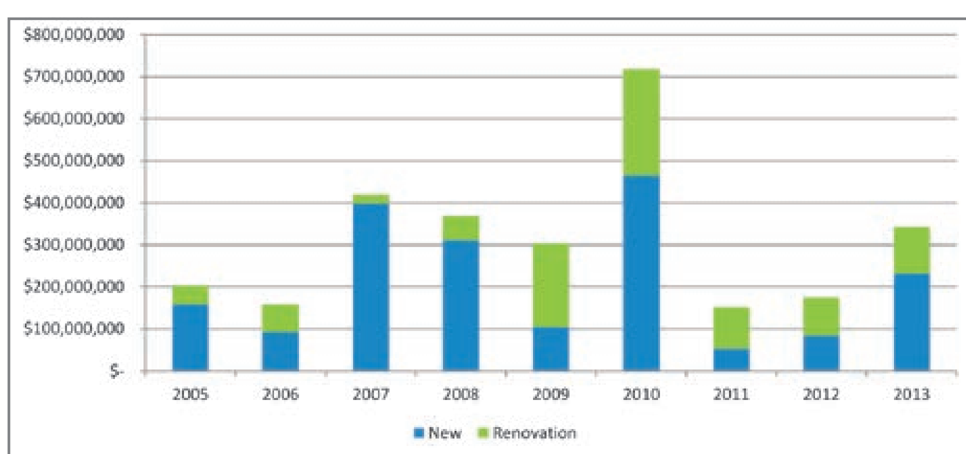
Overwhelmingly, and perhaps not surprisingly considering its population, Denver surpasses all of the other counties in Colorado when it comes to office building construction. This is also true by total project cost for years 2005 to 2013, during which Denver represents about 52 percent of the total project value in the state for office buildings.

There is not considerable variance in the top counties for office construction when governmental offices are included, except that Jefferson County (and not Arapahoe County) is in the top five counties for number of projects, and Boulder County (and not Eagle County) is in the top five counties for total project value or cost.

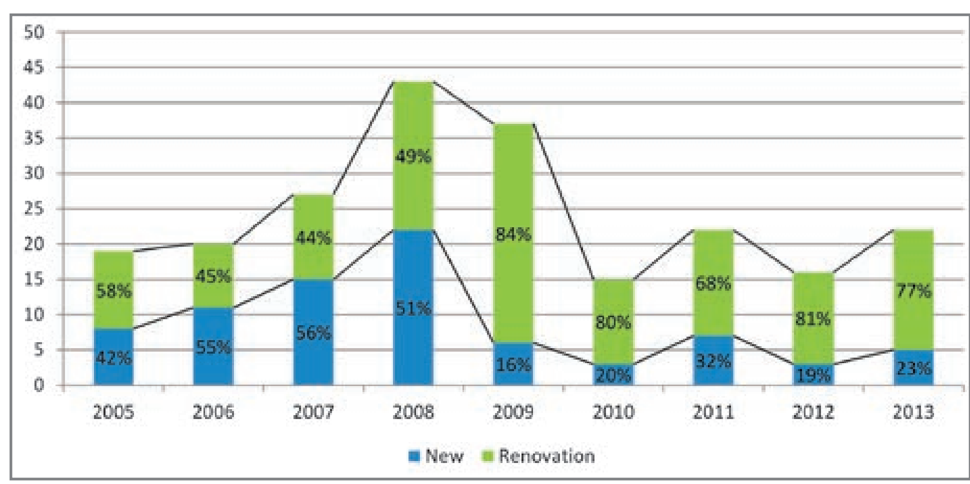
As to private office building size, the trend in Colorado is similar to that of the region. There is a high number of small office projects being constructed, but the largest office buildings comprise a high percentage of total sf constructed. Almost half of the private sector office projects in Colorado are less than 25,000 sf (41 percent), but buildings in the 500,000 sf to 1 million sf range represent the largest portion of total sf. These statistics were generated using years 2005 to 2013, and sf estimates are available for new construction projects only.

In summary, 2013 showed:

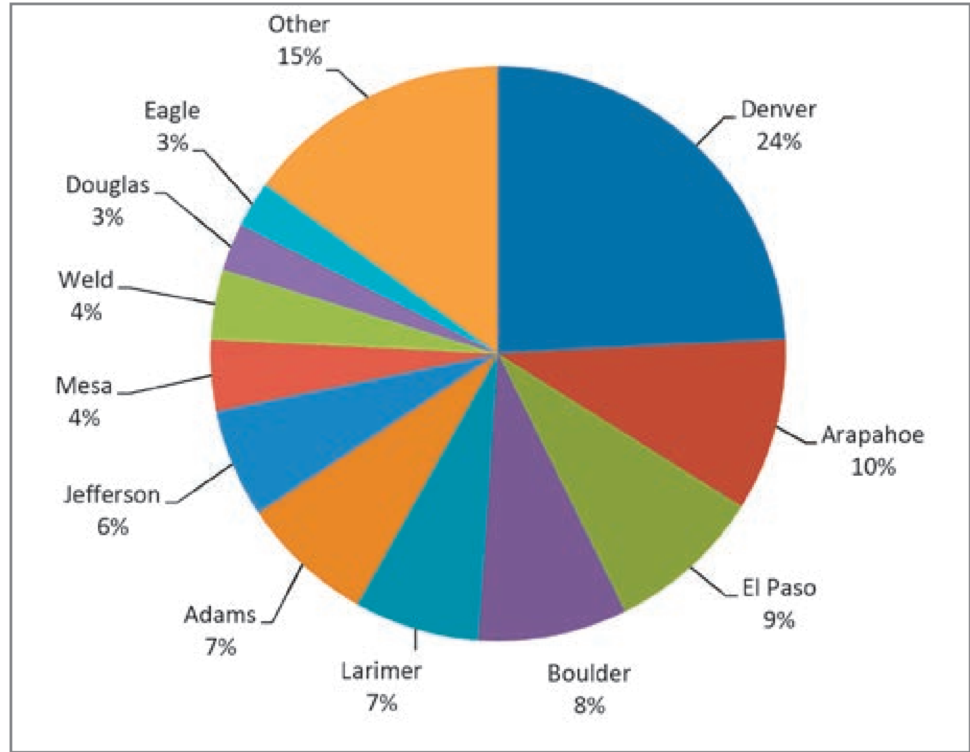
- An increase in total project value when looking at office construction (new construction and renovations);
- A high percentage of office projects are renovations, especially in the public sector;
- Denver is the top county in Colorado for office building construction, and Broomfield office buildings account for a considerable percentage of office building construction in terms of sf;
- Most office buildings constructed are 250,000 sf or less (86 percent); and
- The largest buildings of 250,000 sf or more comprise about 70 percent of the total sf constructed from 2005 to 2013.▲



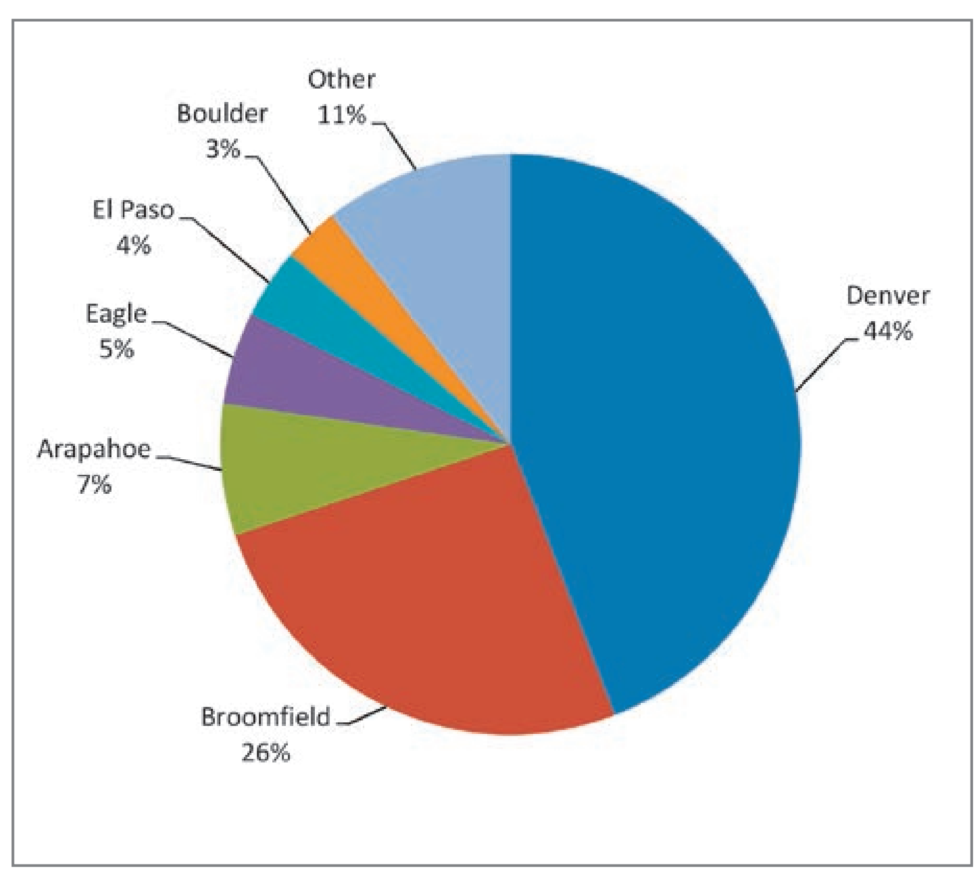
Total office project cost by year (private and public sectors)



Number of office projects by year (private sector)



Top counties by number of projects (2005-2013)



Office building size in square feet by number of projects

Development

The impact of an aging office inventory

As more people move to Denver for employment opportunities, the region's aging office inventory presents both a challenge and an opportunity for developers and brokers, who often say the market isn't overdeveloped, just underdemolished.

But demolishing old buildings would tarnish the region's reputation as a hub for sustainability, and there are plenty of examples of older buildings that have been successfully redeveloped to meet the needs of today's workforce.

Take The Alliance Center in Lower Downtown – the first historic building in the world to receive two LEED certifications. The old warehouse became a hub of sustainability that moved the needle in terms of creating collaborative workspace aimed at increasing the productivity of its tenants.

Collaborative workspace is the trend as millennials take over the workforce, and The Alliance Center isn't the only example. In the River North Art District, developers converted a distressed warehouse into Industry, a 120,000-square-foot creative office space that anchors the revitalization of the Brighton Boulevard corridor.

The move to develop modern office space comes with the expectation that about 45,000 jobs will be added to metro Denver this year. The majority of those positions will be filled by millennials – people reaching young adulthood around the year 2000.

But more than 76 percent of metro Denver's office buildings were built before 1985 and can't meet the demands of increased efficiencies and amenities that companies say are crucial for attracting talent. With employment growth expected to continue, the expectations that companies have for office space will keep evolving.

Katy Sheehy
Vice president, Colliers International, Denver

Accommodating the rapid growth of the region's population with an aging building inventory is critical. The simple answer is to demolish the old buildings and build new ones. The alternative is to repurpose and substantially renovate the aging inventory.

There is room for both options. A shining example of new construction is DaVita's headquarters in LoDo. The state-of-the-art work environment with collaborative workspaces throughout the building, including the Town Hall on the top floor, creates a progressive work environment for the kidney dialysis company's employees.

DaVita's headquarters is steps from Denver Union Station, the epicenter of the metro area's FasTracks system. The voter-approved transit expansion program will build 122 miles of commuter and light rail, 18 miles of bus rapid-transit service and add 21,000 new parking spaces.

With growing traffic congestion and rising parking rates, millennials are demanding a "live, work, play" environment – whether it's in an urban or suburban location – that has easy access to transit. That's sparked an increase in the use of Denver's easily accessible public transit system. Since 2012, the average weekday boarding of the Regional Transportation District's buses and trains has increased 5 percent from 328,109 to 344,381.

Abby Vollmer
Broker associate, Colliers International, Denver

This growing demand is also causing a shift to higher-density use in buildings near transit centers, which typically are in older neighborhoods. The concern is whether the old structures can withstand the surge in density growth. Metro Denver's aging buildings have been forced to accommodate the highest capacity they can, causing deterioration in performance ability. Outdated building systems, deferred maintenance, inadequate parking and failure to meet the regulations required under the Americans with Disabilities Act are just a few of the characteristics that contribute to the functional obsolescence that can cause a property's value to depreciate.

But companies demand these things, so there's been a flight to quality that resulted in increased rental rates across the metro area. Over the last 12 months, Class A rental rates in Denver's central business district increased 5.3 percent. That trend is metrowide, with the southeast market reporting a 4.8 percent increase in Class A rents. Rents in Class B buildings also are rising. Class B lease rates in the CBD rose 8.3 percent and rates were up 6.1 percent in the southeast market.

Developers are trying to meet the demand for office space. They've recently delivered 442,954 sf of office space to Denver's CBD and 397,285 sf to the southeast market. There also is nearly 1.5 million sf of new office space proposed in the CBD and 2.8 million sf in the southeast market.

Still, the supply isn't enough to meet the demand for contemporary office space. So tenants are adjusting their real estate requirements to fit the space that's available, and it's affecting the reliability of metro Denver's office statistics.

There was about 9 million sf of office vacancy reported at the end of 2014, but it's difficult to determine how much of the vacancy is in buildings that are not competitive in today's market. The question now is whether there is a future for aging buildings. In most cases, as evidenced by the repurposing of older buildings in Denver's core, the answer is yes.

If owners are willing to spend the money to bring a well-located property up to current market standards, even the most outdated buildings have a shot at competing with newly built next-generation office space.▲

Project Management

The new definition of a project manager

The definition of a project manager is ever-changing, and a new definition exists that requires the role to be nimble and flexible in its project approach to office construction. Often, a project manager is also referred to as a PM, owner's representative, construction manager or process manager. While varying definitions and unique identifiers come into play, one thing remains the same: A project manager, when scoped correctly, is the grounding point and conduit for an office project, and progressive adaptation of the project management role is underway.

While there are changing and varying titles to the role itself, the differentiating factor in a project manager's profile is the scope of services that a project manager is asked to orchestrate in any given project's lifecycle. The resultant changing workload affords the opportunity for clients to custom tailor their needs and ensure not only no duplication of efforts within their project team, but also to strategically source what they need from a project manager.

Determining the scope is critical to a project's realization and ultimate success, as is fully acknowledging and understanding that construction and nonconstruction workstreams play an equal role in the project. From architecture and engineering to general contracting and strategic partners encompassing sustainability, audiovisual, low-voltage cabling, security, furniture, soundmasking, artwork and move management – each workstream plays a mission-critical role in the success of the project. In addition, the specific workstreams can have project managers within their teams leading the efforts. While the industry has many definitions of "project manager" and strategic partners within any given project have project manager titles, the definition of the term can be defined depending on the role within the project team.

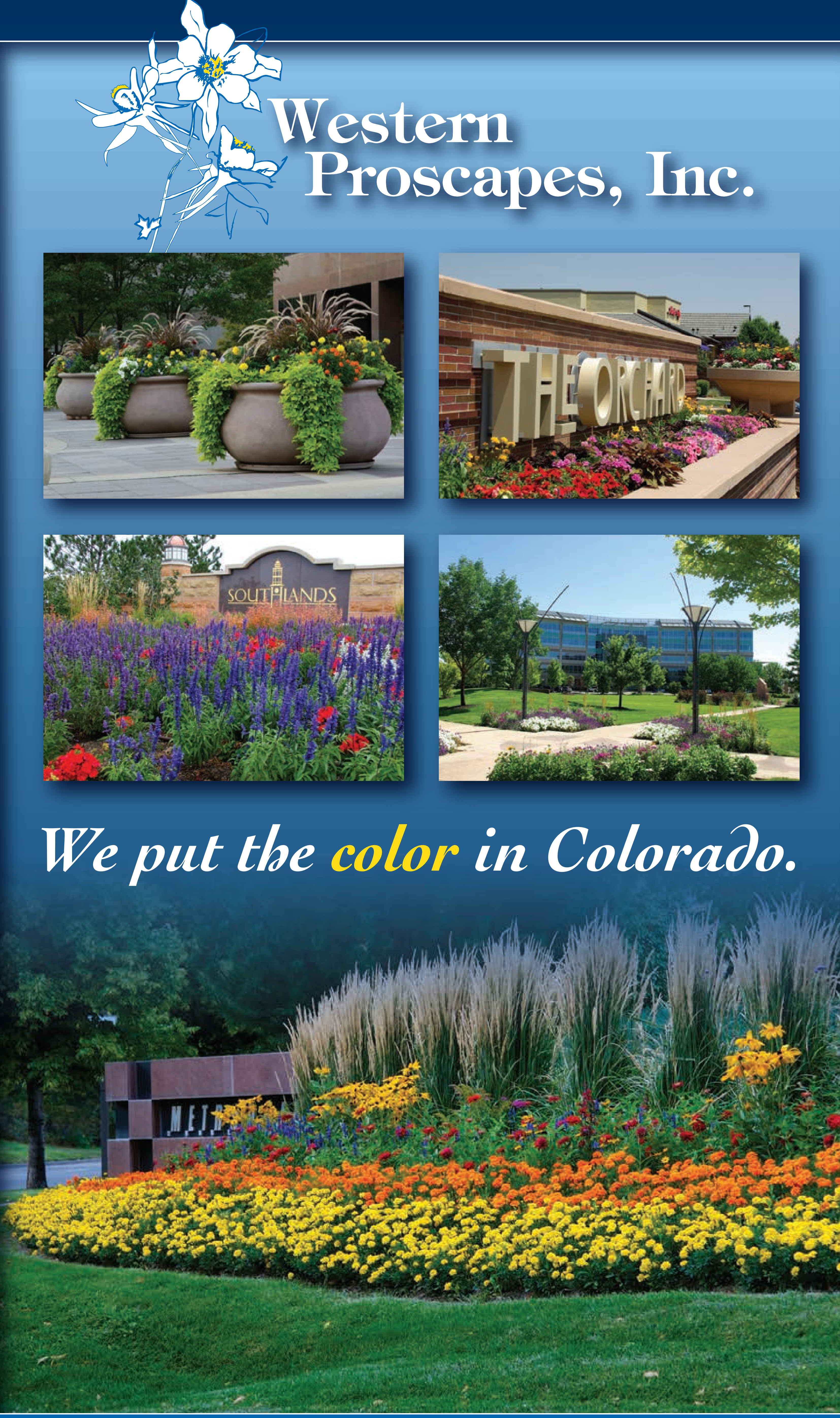
Megan Walsh, LEED AP BD+C
Principal, Catalyst Planning Group, Denver

When onboarding a project manager, step back and assess the distribution of workload internally and externally within your organization. Ask yourself the following questions: Are there deliverables that can be managed in-house or does a current job description not support the time and dedication needed to focus on a one-time real estate effort? Does trying to allocate internal resources to a project distract the internal team from their day-to-day role or efforts in a way that would adversely impact your operations or business? Can an external project manager augment or support in a hybrid role in partnership with an internal team member or team? Or does an internal team not exist for this one-time project effort and full outsourcing is required? The ability to strategically structure your specific need is key.

The value of a project manager can be realized at varying stages of a project. While typically hired early, project managers can join a team at varying intervals depending on the scope of services needed. Changes to the current project management profile are underway. While often clients onboard a project manager for full project support, variations can occur. There are times when a client may only need move-management support to help orchestrate the client's relocation from point A to point B. Likewise, there may be instances where a client only needs construction-management support and can internally handle the logistics of a move on his own.

In addition, a ground-up or build-to-suit project requires a different project management scope of services and has differing scope complexities than a tenant improvement project. You should know the nuances of a turnkey versus tenant improvement project when scoping a project manager's role. It is also important to understand the variance of a landlord-managed tenant improvement project as a tenant-based project manager – while the landlord may be managing the construction aspects of the project, a tenant-based project manager can be the link between landlord and tenant, while maintaining oversight of the nonconstruction workstreams on behalf of the client. In addition, when a client is taking a subleased space, there are varying degrees of project management that are needed from oversight of furniture reconfigurations to low-voltage cabling and security adaptations for the space, with move coordination to follow.

Regardless of the project manager's scope and whether he is contracted for full service or a la carte, menu-based selections, project managers are being asked to take on a more consultative-based approach versus a task-based approach. Checking the boxes is easy for any manager, but fully engaging in a project as the project manager requires creativity, strategy, problem-solving and people skills. The art is in the ability to understand the clients' needs and expertly be exactly what they need, when they need it.▲



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Employment

Continued from Page 16

the only supersector to post a decline in employment in metro Denver in 2014. Minimal growth in the other sectors in this category will result in little change in employment in this category in downtown Denver.

Changing demographics also influences office space needs. Just as metro Denver historically was known as a magnet for the baby boomers, the region is now a choice location for the millennials. The millennials are the largest population group in metro Denver, numbering just over 730,200 in 2015. While the generation X and baby boomers dominate the labor force today, the millennials are making their mark on the workplace and will represent the largest component of the labor force within 10 years.

Some key trends that influence the labor force and employment potential in metro Denver are emerging with the shifting generational groups, such as more telecommuting, flexible work schedules and locations, and more interest in co-working space. These trends are arising due to our entrepreneurial environment, as well as millennial demand for greater work-life balance.

The diverse employment base in downtown Denver and throughout the Denver metropolitan area means that employment declines in one sector may be offset by increases in other sectors. In addition, a vibrant entrepreneurial community bolsters the metro Denver economy. Forbes ranked Denver as the second-best city to launch a startup business and NerdWallet ranked Denver the fifth-best city in the U.S. for millennial-aged entrepreneurs. The solid business fundamentals in Denver ensure that the region will continue to expand in 2015 and beyond.▲

Recruitment

Continued from Page 18

of the world's leading financial services companies, signed a lease at 1801 California for 121,000 sf, effectively doubling the size of its current space in the Denver Tech Center and bringing 650 jobs downtown when the move occurs later this year.

Brookfield Property Partners L.P. announced the leasing agreement with Transamerica, a milestone that reaffirms that Denver is clearly a top city not just for business overall, but also the financial services industry in particular. Transamerica's choice to remain in Denver and grow significantly here is a great move for the century-old company, as well as a broader boost to Denver's next-generation workforce and climate of innovation.

"We are delighted to establish a notable footprint for Transamerica in the heart of Denver's financial district," said Blake Bostwick, chief marketing officer of Transamerica's Investments and Retirement division.

The property's premier amenities as well as the overall urban environment downtown were cited as supporting Transamerica's plans to attract professionals from throughout the metro area and the southern and northern corridors, he said.

The Transamerica decision reinforces that Denver's active, vibrant workforce seeks an urban environment with easy access to booming residential units in and around the city center, a thriving retail and dining scene, theatre district and sports venues, and convenient transit options including bike lanes and walkability.

Each recruitment or retention announcement showcases Denver's core strengths but is invariably due to a unique mix of specific factors. I suppose that's what keeps economic development work exciting and rewarding. Speaking for myself, it's hard to imagine playing in this league without the deep talent of Denver's tremendous, competitive assets.▲

2015 SPECIAL SECTIONS CALENDAR

January 7
Office Properties Quarterly

January 21
Multifamily Properties Quarterly

February 4
Property Management Quarterly

February 18
Retail Properties Quarterly
Top Commercial Brokers

March 4
Health Care and Medical Office Buildings
BUILDING DIALOGUE

March 18
Leading Developer: Profiles & Current Projects
Senior Housing

April 1
Office Properties Quarterly

April 15
Multifamily Properties Quarterly

May 6
Property Management Quarterly

May 20
Retail Properties Quarterly

June 3
Industrial
Data Centers & Mission Critical
BUILDING DIALOGUE

June 17
Economic Development Across Colorado

July 1
Office Properties Quarterly
NAIOP

July 15
Multifamily Properties Quarterly

August 5
Property Management Quarterly

August 19
Retail Properties Quarterly

September 2
Land & Development
Transit-Oriented Development
BUILDING DIALOGUE

September 16
BOMA Supplement
Commercial Properties For Sale

October 7
Office Properties Quarterly
Corporate Real Estate
Association Spotlight: CoreNet Colorado Chapter

October 21
Multifamily Properties Quarterly

November 4
Property Management Quarterly

November 18
Retail Properties Quarterly

December 2
Hotel & Lodging
BUILDING DIALOGUE

December 16
Hall of Fame

For more information on these sections, please contact Jon Stern at 303-623-1148 or e-mail jstern@crej.com

AVISON YOUNG

AVAILABLE PROPERTIES

OFFICE ● INDUSTRIAL/FLEX ● LAND

4690 TABLE MOUNTAIN DRIVE SUITE 200, GOLDEN
Asking Price: $1,850,000
Suite Size: 10,668 SF
Marc Lunde | Howard Schmidt | Chris Sharp

1930 W. 41st AVENUE, DENVER
Asking Price: Contact Broker
Land Size: 18,740 SF
Lowrey Burnett

970 YUMA STREET, DENVER
Asking Price: $2,095,000
Building Size: 21,027 SF
Ross Ethridge | Jonathan Schneider

1275 W. 124TH AVENUE, WESTMINSTER
Asking Price: $2,032,000
Building Size: 17,672 SF
Dawn McCombs

7201 S. BROADWAY, LITTLETON
Asking Price: $995,000
Building Size: 9,137 SF
Jonathan Schneider | Ross Ethridge

19201 E. MAINSTREET, PARKER
Lease Rate: $13.00 - $20.00/SF FSG
Space Available: 580 - 3,500 SF
Justin Rayburn | Howard Schmidt

1900 16th Street, Suite 1300, Denver, CO 80202
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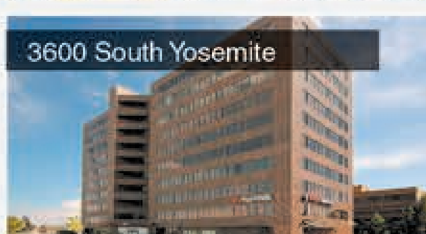

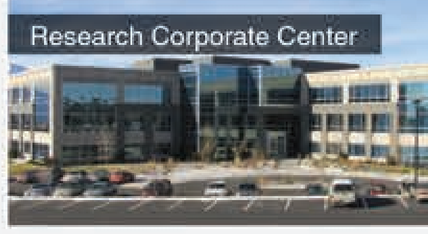

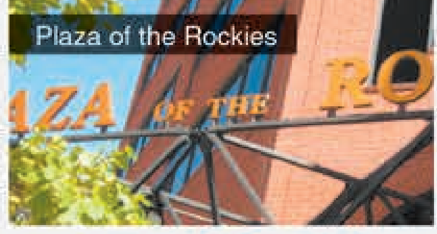

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