A Colorado Real Estate Journal Publication

December 2016

OFFICE PROPERTIES Quarterly

Denver's sublease market finishes 2016 high, but manageable

The amount of total sublease space – available and vacant – is up in downtown Denver. Oil and gas companies represent much of this space.

by Michelle Z. Askeland

As we wrap up 2016, the metro Denver sublease market is still up, but not earth-shatteringly so. However, experts are split on whether 2017 will bring relief.

Right now, downtown Denver has roughly 1.4 million square feet of available sublease space out of its total 26.7 million sf of office space, said Greg Holm, CBRE senior vice president. The suburban southeast Denver market has about 1 million sf available out of its total 34.5 million sf.

Any space that is under lease by a master tenant that is being made available to the market, typically at a discount below the current market rental rates, qualifies as sublease space, said Matt Davidson, managing director with Newmark Grubb Knight Frank.

It is also important to note that sublease space can be qualified in two forms – vacant and available, said Tom Lee, NGKF executive managing director. Vacant space is empty and physically available today. Meanwhile, available sublease space applies to companies that are occupying space, but if somebody would take their space, they would move out, he said. According to NGKF numbers, there is 890,000 sf of vacant sublease space in the total market, with 506,000 sf of that located downtown.

When discussing numbers, it's helpful to have historical comparisons. The sublease numbers are down when compared to the early 2000s, at the end of the dot-com bubble, said Lee. And in the southeast suburban, the amount of vacant space is half of what was available during the Great Recession, he said.

If you compare the numbers within the current cycle, they're a little high. Starting in 2010, the Denver metro has gone from around 2 million sf of sublease space down to 1½ million sf up to today's high of almost 3.5 million, said Holm.

"Right now, we have about 150 to 175 percent more sublease space than we typically have, based on the last seven years," he said. But it's important to keep in mind that there will always be some sublease space available. If the long-term average is somewhere in the range of 600,000 to 700,000 sf downtown and between 500,000 and 600,000 sf in the SES, and there currently is

Please see Page 26

INSIDE

CONTENTS

Letter from the Editor

Protect employment gains

Colorado's employment is expected to grow by 2.4 percent in 2017, adding a variety of jobs in almost every sector, according to the Colorado Business Economic Outlook Forum, put together by the University of Colorado Boulder's Leeds School of Business research division. The forecast calls for a gain of 63,400 jobs in Colorado in 2017. All but the state's natural resources and mining industry are predicted to see gains.

Leading this growth is construction. The industry is expected to see 5.7 percent growth. Employment for residential, nonresidential and nonbuilding (such as roadways, bridges and dams) construction will grow from 157,000 jobs to 166,000 jobs.

While many in the real estate industry are expecting to see a decrease in multifamily construction next year, following years of busy activity, the Leeds report predicts that single-family home construction will overcompensate for any fall in multifamily construction. In fact, single-family permit growth is anticipated to exceed the national average by 8 percentage points.

In terms of office construction, activity remains busy in the downtown area, but it is not limited to the core. Interestingly, metro Denver's suburban office construction activity is outpacing the development occurring downtown, CBRE's Hilary Barnett points out in her article on Page 4.

Other industries anticipated to enjoy three percent or higher employment growth include leisure and hospitality, education and health services, and financial activities.

"Colorado will continue to rank among the top 10 states nationally for employment growth in 2017, a six-year standing," said economist Richard Wobbekind with the CU Boulder's Leeds School of Business. "And it is poised for continued long-term growth, boasting a skilled workforce and high-tech, diversified economy; relatively low cost of doing business; global economic access; and exceptional quality of life."

While all of this bodes well for the commercial office properties market – a diverse employment base helps create resiliency in our marketplace – it is important to acknowledge that more must be done to maintain these successes.

Kelly Brough with Denver Metro Chamber of Commerce authors an article on Page 8 that highlights how Denver is succeeding in attracting employers. She also addresses some of the challenges the city needs to prioritize and fix in order to remain as competitive as it is now.

While JLL's Peter Merrion points out an alarming truth the must be reconciled – while we end up at the top of the list in terms of educated workers, a large number of those employees are transplants. Addressing this Colorado paradox will be critical in maintaining this reputation in the future, he writes on Page 18.

Michelle Z. Askeland
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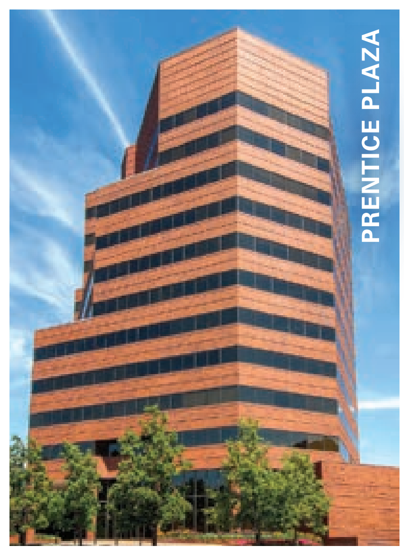

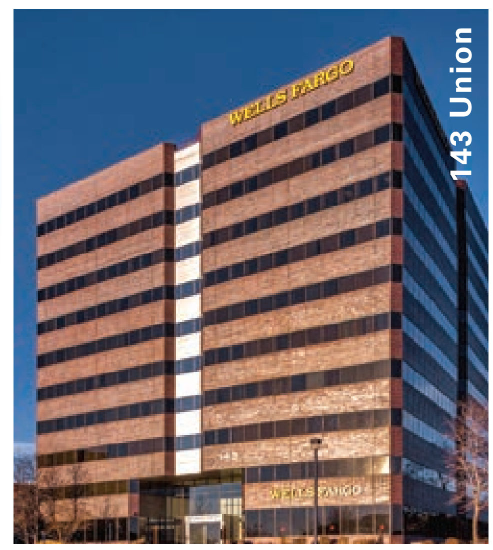

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Market Update

Suburb construction outpaces city activity

Denver's office market is in the midst of a construction boom the likes of which have not been seen in the past 25 years – over 5.6-million square feet of office space development is underway, according to CBRE Research. While urban submarkets like Lower Downtown and the Central Platte Valley have hosted a large portion of this growth, Denver's office space boom has not been limited to downtown. Strong construction activity is occurring in Denver's suburban markets as well, driven by robust demand from key industries and access to a deep and growing labor pool.

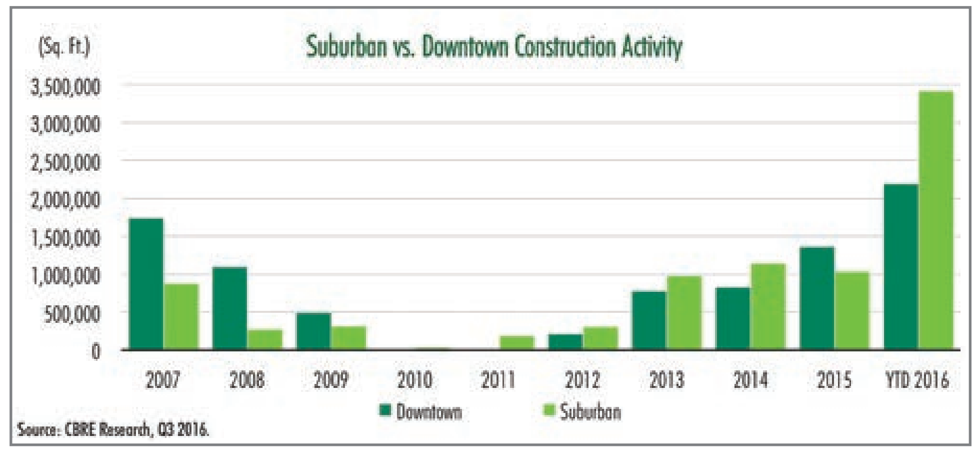
In fact, construction activity in suburban submarkets is outpacing the development underway in downtown Denver. These trends reflect the same urban revitalization efforts and subsequent economic developments that have transformed Denver into one of the country's most promising commercial real estate markets over the course of the last decade. A closer look at the state of office development across Denver's submarkets reveals how one of America's hippest urban cores has maintained and expanded its unique appeal to developers and employers alike.

Hilary Barnett
Associate, advisory & transaction services, CBRE, Denver

• **Union Station renovation sparks development.** It's not uncommon for urban revitalization to be anchored by iconic architecture. Union Station, located in the heart of LoDo, is playing such a role by piquing the interest of developers evaluating infill opportunities in Denver. Originally constructed in 1881, Union Station was once a major center of commerce prior to the decline of passenger trains following the end of World War II.

Major renovations completed in 2014 helped put Union Station back in the spotlight. Sections of the terminal building's upper floors were transformed into a 112-unit hotel. A light-rail station and underground bus facility were added to reposition Union Station as a transit hub. Additionally, 22,000 sf of ground-level expansion provided Union Station with more space to host independent retail stores and restaurants.

Concurrent with the completion of Union Station's renovations, the LoDo submarket began to experience an uptick in construction activity as office developers recognized the economic transformation taking place in Denver. Today, almost 2 million sf of mixed-use office building development is under construction in LoDo and the Central Platte Valley district. Major projects include 1144 Fifteenth (661,000 sf), 16 Chestnut (428,000 sf), 1401 Lawrence (311,000 sf), Dairy Block (235,000 sf) and Riverview at 1700 Platte (210,000 sf).



Construction activity in downtown Denver and the surrounding suburbs

Demand for new construction is driven by existing Denver companies placing greater emphasis on the office environment, meaningful amenities, access and building identity in order to better recruit and retain employees. Likewise, companies new to Colorado are drawn to the downtown market because of city's high quality of life, innovative culture, economic environment and an abundance of top talent.

• **Office spaces head to the suburbs.** While office development continues to ramp up in Denver's downtown submarkets, this growth actually was outpaced in 2016 by construction activity in suburban neighborhoods. Over 2.6 million sf of total construction activity is underway in Denver's suburbs, led by the submarkets in the southeast. Major projects underway include Village Center Station (306,000 sf), Granite Place at Village Center (300,000 sf) and INOVA I & II at Dry Creek (211,000 sf and 235,000 sf).

Several factors encouraged developers to shift more focus toward building office spaces in Denver's suburbs. Significant demand from key industry sectors such as financial services, telecommunications and health care, reflecting the market's deep and diverse labor pool, has allowed companies to support a wide range of business lines from one location. Additionally, as a result of improvements made to public transportation, Denver's urban core is better connected to suburban submarkets, allowing employers to access the region's available talent base of highly educated millennials.▲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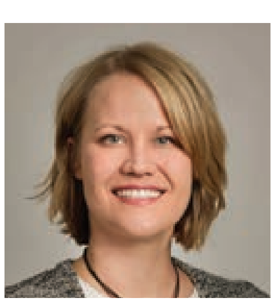


Market Update

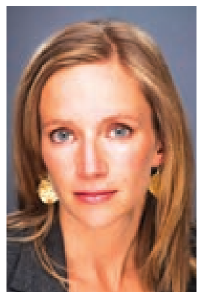
Boulder's office market continues in its own bubble

People joke that driving Highway 36 can make one feel as though he is entering a "bubble." This bubble encapsulates the city of Boulder and brings to mind the old saying regarding Niwot's Curse, which speculates that once someone has entered Boulder, he will be enticed by the natural beauty and will never want to leave. The truth is, Boulder has, in essence, created a mini Manhattan – a city surrounded by open space rather than water. Boulder is an island of land with no ability to sprawl outward and, due to the city-imposed height restrictions, can't expand upward.

With these conditions, Boulder has its own unique submarket, isolated in its bubble from the rest of the Denver metro market. Similar to the Denver market as a whole, over the last few years office vacancy has decreased to an all-time, single-digit low.

Due to the lack of supply, office rates also climbed to an all-time high. East Boulder office parks, located outside of central business districts, were signing leases in the $12- to $15-triple-net range a few years ago. Today, they are upward of $20 triple net. In the central business district and downtown, office rates were around $18 triple net. Today they generally average $28 to $32 triple net and have gone as high as $40 triple net in a few rare instances. Also worth mentioning, the average triple-net range in downtown Boulder is $15 to $16, bringing the all-in equivalent to $43 to $48 full-service gross. This market trend seems to support that the Boulder bubble of Niwot's Curse could be true.

Bullish Boulder developers started



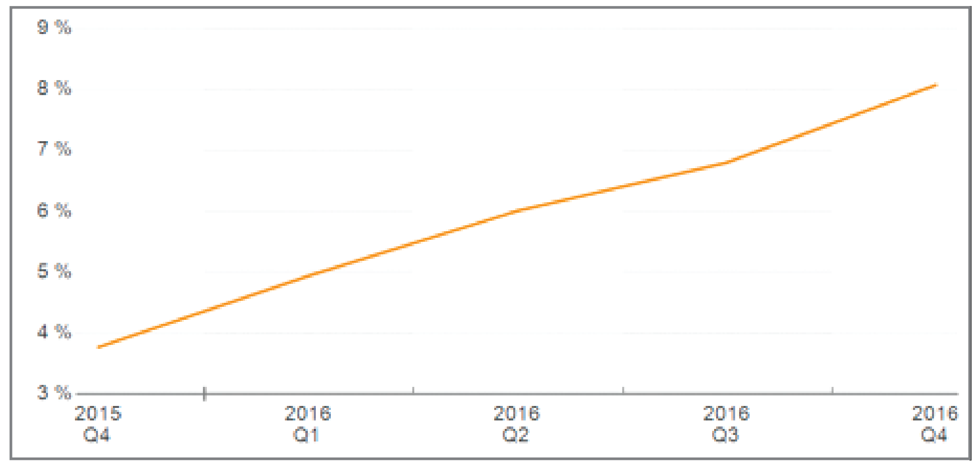
Angela Topel
Senior broker associate, Gibbons White Inc., Boulder

planning for new office product just out of the recession in 2010, which was well before the current low vacancy/high rental rate atmosphere. Developers delivered four additional office/retail buildings to the downtown market, which was orchestrated with perfect timing. These buildings – PearlWest on 11th and Pearl streets, The Wencel Building on 13th and Walnut streets, 909 Walnut and 1738 Pearl – totaling approximately 300,000 additional square feet, currently are a majority leased.

All this begs the question, will the Boulder bubble eventually pop, and can Boulder maintain this strong market with $50 all-in for office space? One must wonder, can Boulder keep absorbing additional office square footage?

With the change in the atmosphere and the strength of the Boulder market, we have seen many large companies occupying chunks of space in downtown boulder head elsewhere. To name a few, Bing, New Hope Media and Intermundo Media are moving east or completely out of Boulder for lower prices and easier accessibility for their workforces.

With the success of the earlier office projects and the high asking rental rates, developers have been flocking to Boulder to get in on the action. Currently there are about a dozen projects under construction or in the planning



CoStar

Downtown Boulder office vacancy rates for the past year.

stages for an additional 1 million sf.

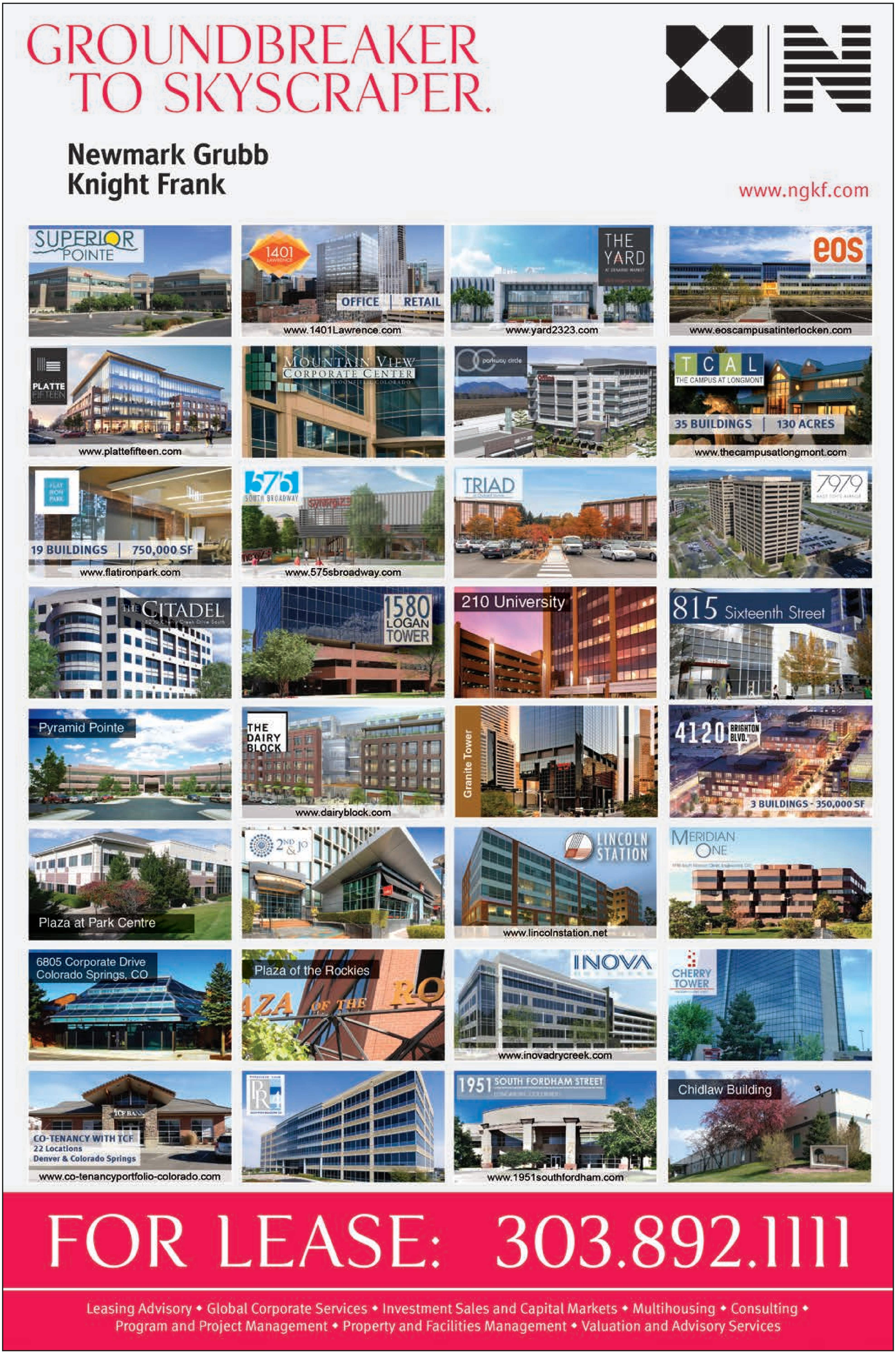
In studying current market conditions downtown, CoStar shows a continuing strong office market with an 8 percent vacancy rate – a 4 percent vacancy increase over the past year.

What CoStar doesn't show in its vacancy analyses is sublease space due to it being "still occupied" or "rent producing" space on the market. There is about 120,000 additional sf of office space being marketed as sublease space in downtown Boulder. This is another 5 or 6 percent of available office space. A 12 percent market vacancy tells a different story.

Although the office market continues to feel strong, there is a softening. If this vacancy level is maintained or increases, the likelihood is that the $28 to $32 triple-net asking rate will adjust downward somewhere between $5 and $7 per sf to entice those companies moving east to come back to the downtown business district.

The new product in other parts of town is underwriting the lower end of the downtown rates to make their construction numbers work. If downtown office prices decrease, will people choose to be in a new product in other areas of town for equal rent or will they move back downtown and will the 1-million-plus sf all be built?

Ultimately, Boulder is still a bubble; it is a mini Manhattan. Approximately one-third of the new 1 million sf of product is already spoken for by Google. Other companies, large and small, continue to seek out Boulder as a fun and "affordable" option for the same reasons as Google. If this continues to happen, this unique submarket will continue to flabbergast investors unfamiliar with this strong and bullish market, and companies will continue to pay $50 full-service gross for prime downtown office space. Boulder likely will become the Silicon Valley of the mountain region.▲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Market Update

Denver strong for business despite challenges

Throughout 2016, the Denver region received many accolades, perhaps most notably being named Forbes' Best Place for Business and Careers for the second year in a row. As someone who has lived and worked here for 30 years, it wasn't news to me but, clearly, the secret is out about our region.

Kelly Brough
President and CEO, Denver Metro Chamber of Commerce

Following are some of the factors that make our metro area the best place to run a business and to pursue a career.

• **A diverse economy.** From aerospace to agriculture, the Denver metro area has solid footing in a wide array of industries. Those businesses include sole proprietors (we're home to the fifth-highest concentration in the country) and Fortune 500 companies (10 are rooted in Colorado) alike, from startups to family owned businesses that have been around since the 1870s. And it's not just a strong business sector that makes us successful; we have outstanding research institutions, federal labs and educational institutions that also drive our economic success.

• **Location is everything.** The central location in the U.S. and the ease of travel out of Denver International Airport make Denver a no brainer for business and conventions. When you combine that ease of travel with Colorado's great outdoors, including 58 14ers and 25 ski areas, you get $19 billion in tourism and outdoor recreation each year in Colorado.

• **An educated workforce.** The state has the second-most-educated workforce in the country with 48 percent of our adults holding at least a two-year degree. This highly skilled workforce is what attracts so many companies to Colorado. We also have a higher median household income, $71,146, compared to the national median income of $55,775. Those salaries help create a great quality of life.

• **Millennials matter.** You've no doubt been talking about millennials in your own business and for good reason. Denver ranks third out of the top 10 cities where millennials want to move. Denver also ranks fourth for millennials with at least a bachelor's degree – that's 22.6 percent of people working – and they are helping keep our competitive advantage of a highly educated workforce.

• **Achievable work-life balance.** More than any other generation, millennials place work-life balance as the most important factor for choosing a job. That's no surprise, as the ability to enjoy the outdoors or discover the city has always been a selling point for people who live and work here. People care about health in Colorado. We are the leanest adults in the country and among the most active, proving that citizens take time to enjoy those great outdoors.

We also have a higher median household income, $71,146, compared to the national median income of $55,775.

Areas for Improvement

Our greatest strength may be that we are always looking at our weaknesses. At the Chamber of Commerce, we're working on ways to improve these challenges. We are as committed today as we were 150 years ago to help chart our course by continuing to work on some of the most critical issues of our day.

• **A place to call home.** The median home price in the Denver area this fall was $350,000, which is a 10 percent increase year over year. Our housing market continues to be the most expensive noncoastal market and is $127,000 more than the national average.

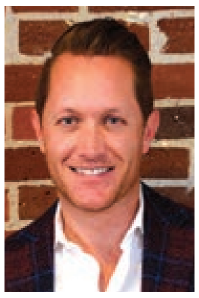
Workers earning the current median incomes can't afford to buy a median-priced home, leaving many out of the market. We will continue to ask the state Legislature to address this issue by creating a better process to resolve disputes between builders and condo owners. We also are working on strategies that can lower the cost of building condos and assist Colorado workers with down payments and loans.

• **Sitting in traffic.** When everyone has good jobs, traffic can be bad. Traffic congestion in Colorado costs drivers $1.35 billion annually in delays and fuel, which equates to an average of $913 per person in the Denver area. In 2014, Denver drivers lost 49 hours due to congestion. While we all agree this is a huge challenge, we haven't been able to get funding to address road and bridge maintenance for the entire state. We have brought together the public, private and nonprofit sectors to explore the investments we should make in transportation in the future.

• **Homegrown talent.** By 2020, 74 percent of our jobs will require some education after high school. The state is tied with Minnesota as the two states requiring the most-educated workforce. Today, only 28 percent of Colorado's students go to and through post-secondary options on time. We need to ensure our schools prepare our kids for these opportunities. In addition, we started our own workforce effort, the Denver Opportunity Youth Initiative to help prepare our community.▲

Investor Insights

Why we are not buying office product in Denver



Jason Shepherd
Co-founder, Atlas Real Estate Group, Denver

For many commercial real estate investors, the ever-evolving Denver market may appear to be in its prime for office properties. Topping the Forbes list of best places for businesses and careers for the second year in a row and still experiencing a surging tech boom, an investment in office properties seems likely to pay off. However, there may be cause for reconsideration. While the business climate in Denver remains strong, the market for commercial office properties does not.

• **New properties threaten investments.** The current supply for office properties in downtown Denver is rapidly outpacing the demand. In the first three quarters of 2016, we saw absorption of 61,486 square feet of new office space in the downtown area.

Parallel to that, there's currently more than 2.1 million sf of office space under construction, with 365,000 sf set to be delivered the fourth quarter. That means in the fourth quarter alone, almost six times the amount of office space absorbed all year will be delivered to market.

Even with numerous companies relocating headquarters to Denver, the forecast for returns for commercial office investors and developers does not look strong. Furthermore, the majority of new office construction in the downtown Denver area is Class A, oversaturating that asset class and market.

• **Sublease availability soars.** In addition to all of the new office construction coming on line, the amount of sublease office space available on the market cannot be ignored. Denver has long been a haven for oil and gas companies and, with the decline of this industry, it is unsurprising to see that a majority of the office sublease space available is from that sector.

What is surprising, though, is just how much sublease space is out there. Sublease availability remains above 1.3 million sf in Denver, with the energy sector accounting for over 900,000 sf of it.

While it is good news that many tech companies are moving to the Denver area, it is unfortunate that the space build out for a tech company differs greatly from that of an oil and gas company. Tech companies tend to favor large, open work spaces for their employees, while the oil and gas industry is known for a more traditional office setup with individual offices. While many subleases are offered at a discount of normal lease rates, the tenant improvements required to convert an oil and gas office into a tech office often offset any discount in rent.

Between the 2.1 million sf of office space under construction and the 1.3 million sf of sublease availability, it's hard not to see that the office market in downtown Denver is entirely oversaturated. This is good news for relocating companies who are hoping to get affordable lease rates, but for the Denver commercial investor – not so much.

• **What about co-working spaces?** In the midst of the growing office market in Denver, co-working spaces have established themselves as the latest trend in office space. Despite their recent popularity, an investment in co-working spaces is still fairly risky. Co-working spaces are a relatively new concept, making the long-term profitability of this asset class still unpredictable. As a real estate investor, vacancy is your biggest cost and co-working spaces are built around a short-lease tenant situation, which leaves a lot of vulnerability for vacancy.

Additionally, co-working spaces serve a niche population right now. That's not to say the market looking for co-working space might not grow and turn it into a stable asset class but, for now, it's too early to tell exactly what the demand will look like for the spaces in a few years.

Lastly, many new co-working spaces continue to try to "out cool" each other, sometimes resulting in making the space feel more like a frat house and less like an office. While these features might help garner initial interest, they usually do not help investors get a higher return on investment.

• **Growing business market, declining office value.** Colorado is deemed one of the best states for new entrepreneurs. Many might argue that absorption of vacant square footage will increase due to businesses relocating to or opening offices in the Denver area.

In the Denver market, third-quarter unemployment numbers were strong, sitting at 3.6 percent. While this is great news for residents and the economy, it's not necessarily good news for commercial real estate. With fewer people looking for work, there are likely to be fewer businesses relocating to the area. Combine this, along with the glut of new construction and sublease availability, and you can see why asking lease rates are on the decline, resulting in low profitability of commercial development for office spaces in Denver.

• **Not office space, not now.** With the business market and job market both strong, Denver certainly will continue to grow. While this paints a rosy picture for the future of office space, the reality is that the amount of product on the market already is outpacing the demand, without even including the office product under construction. You don't need to rely on reports and statistics to see this; it's right in front of your eyes in many of these gorgeous new office buildings without lights on and no tenants in place.

Next time you're driving through downtown, take a look around at these empty office buildings, factor in the new inventory coming to market and decide for yourself if investing in downtown Denver office space is a good idea right now.▲

Office Properties Quarterly - Financing Sources Matrix

TYPE OF CAPITAL	SOURCE OF CAPITAL	EXPLANATION	RATES/SPREADS	LTV/COVERAGE	TERM	AMORTIZATION	FOCUS	TRENDS
LIFE INSURANCE COMPANY	• Insurance premiums • Annuity and GIC sales	• Non-Recourse • Longer-term fixed rate loan	160-200 bps over the comparable US Treasuries	• Up to 65% LTV • 1.35x Minimum DCR	5-30 Years	25-30 Years	• Downtown, urban locations • Multi-tenant, traditional floor plates • Top tier tenants (local, regional & national) • Major metro areas	• Many of the life insurance companies will be more selective on office properties in 2017 • Most competitive at lower to moderate leverage with strong sponsors • Flexible prepayment penalties available for small pricing premium (5-10 bps) • At right leverage (~55%) lenders can do Interest Only • Staying away from single-tenant exposure
CONDUIT (CMBS)	• Sales of mortgage-backed securities through public markets	• Non-Recourse • Longer-term fixed rate loan	250-300 bps over the greater of US Treasuries or SWAPS	• Up to 75% LTV • 1.25x Minimum DCR • 8.25% Minimum Debt Yield	5, 7 & 10 Years	30 Years	• Downtown office • Class B suburban office • Single-tenant with structure • Secondary/Tertiary Markets	• Spreads have widened ~50 bps since 2Q 2016 • Most competitive at higher leverage in secondary and tertiary markets • 10 years interest-only under 60% LTV • 5 years interest-only under 65% LTV
BANK	• Corporate Debt • Deposits	• Recourse (some non-recourse available) • Shorter-term fixed and floating rate loans	200-300 bps over bank cost of funds	• Up to 75% LTV	Up to 7 Years Fixed	Interest Only to 25 Years	• All office assets • Value-add with repayment gauranty • Secondary/Tertiary Markets	• Standards are tightening for Sponsors with no deposit relationship • Most competitive for Sponsors with established banking relationships and strong borrower history that are willing to accept recourse • Establishing a deposit relationship is becoming a requirement • Primarily recourse loans, with non-recourse available to strong sponsors at low leverage • More flexible (open) prepayment terms
DEBT FUND / BRIDGE LOAN	• Private Capital • Institutional Capital	• Non-Recourse • Shorter term bridge loans for acquisition and/or repositioning	LIBOR + 350-600 bps (some w/ floors)	• Up to 85% LTC • Going-in 1.0x DCR	1 - 5 (3+1+1)	Interest Only	• Value-Add Transactions • Recapitalizations	• Pricing depends on leverage level, property quality, and Sponsor strength
MEZZANINE/ PREFERRED EQUITY	• Private Capital • Institutional Capital	• Junior financing secured by a pledge of, or participation in ownership interest	Mezzanine 8%-12%	• Up to 85% LTC • 1.10x DCR	2 - 10	Interest Only (in most cases)	• All office assets • Value-Add Transactions • Recapitalizations	• Preferred equity offers higher funding than mezzanine, but at a higher cost • Minimum investment is typically $5MM but can start as low as $1MM when paired with senior position

Essex Financial Group - Recent Office Transactions

100 St. Paul
Denver, CO
$52,000,000 Permanent Loan
Life Insurance Company

Civica Cherry Creek
Denver, CO
$33,700,000 Construction Loan
Life Insurance Company

200 Fillmore
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$10,700,000 Permanent Loan
Life Insurance Company

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Financial Market

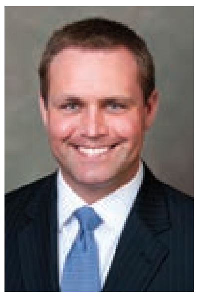
Insights into financing Denver's office market

The election of Donald Trump and signs that the country may be heading toward an inflationary environment have resulted in a massive sell-off of government bonds, creating a temporary (hopefully) disruption in the capital markets. As we've written in past articles, the reactionary nature of the capital markets to geopolitical events has been exacerbated by the real-time flow of information from all corners of the globe.

The selloff has driven yields on the 10-year Treasury from 1.83 percent on Nov. 7 to 2.39 percent on Dec. 5. The 50-plus basis point increase has sent interest rate coupons on commercial real estate loans skyrocketing with lenders scrambling to understand what will be the "new normal" for bond prices in order to benchmark spreads for the time being.

Denver's office market has performed well since 2011 with over 6.5 million square feet in positive net absorption and well over $10.5 billion in investment sales volume in the same timeframe. Lenders and investors alike view Denver as a solid office market due to low unemployment rates and the increasingly diverse tenant base. The majority of investors acquiring office buildings in Denver have utilized short-term, floating-rate loans from banks to execute their business plans, which involve value creation by repositioning and leasing up the asset.

Though lacking the interest rate protection of a fixed-rate loan, 30-day Libor – the most common index for these loans – has moved only about 40 to 45 basis points from +/- 0.20 percent to approximately 0.65 percent over the last couple of years. The result



Jeff Halsey
Vice president, capital markets, CBRE, Denver

has been effective interest rates in the low 2 percent to mid-3 percent range, typically with an interest-only component, which creates healthy cash-on-cash returns and helps to manage coverage ratios during transition.

Floating-rate loans also offer the ability to lend "good news" capital toward tenant improvements and leasing commissions that are accretive to the building's value on a capitalized basis. Banks have been the most abundant sources of floating-rate capital, although there has been a slight pullback due to increasing regulations and exposure issues as we move further into the current cycle. Banking regulations have introduced classifications such as highly volatile commercial real estate that aim to limit exposure to riskier projects. At this stage in the cycle, ground-up construction financing is as challenging as it has ever been to obtain without significant preleasing, lower loan-to-cost requests or personal guarantees.

The benefactor of the recent hurdles in the banking space has been the independent bridge lender category commonly known as debt funds. Similar to equity funds raised for the purchase of real estate, these groups raise capital from various sources to fund loans for transitional properties. The lack of regulations in this space allows these lenders to offer high loan-to-cost ratios (sometimes in excess of 80 percent), generous interest-only periods

Brady O'Donnell
Executive vice president, capital markets, CBRE, Denver

and the ability to pursue nonstabilized (sometimes vacant) properties, all on a nonrecourse basis. The premium is made up by charging spreads that typically are 100 to 175 basis points wide of banks with effective rates in the low 4 to 5 percent range. The typical structure, similar to bank loans, is a three-year term followed by two one-year extensions. Beyond the initial funding, debt funds typically lend additional dollars, covering up to 100 percent of the "good news" capital for tenant improvements and leasing commissions and, in some cases, will contribute to a capital budget. The sweet spot for these lenders typically is above $20 million.

Long-term, fixed-rate debt is much less common in the office space since hold periods for office typically range from three to seven years. The two main lender categories in this space are life insurance companies and commercial mortgage-backed securities.

Life insurance lenders generally are in high demand because of their favorable loan structures, low interest rates and prepayment flexibility. Most of the life companies have specific allocation targets each year and can afford to be picky, especially in recent years with an abundance of activity in a strong market. With more adversity to risk, life companies typically shy away from suburban office with the exception being Class A assets with strong, staggered rent rolls. Life companies favor core assets in high-barrier-to-entry markets like the central business district, specifically Lower Downtown/Union Station, Cherry Creek and Boulder.

CMBS lenders create opportunities for more leverage-sensitive investors and can offer lengthy interest-only periods that help maximize cash-on-cash returns.

The Denver office market has had a strong run over the last five years and is still a favored market for lenders. Some of the perceived threats in the market are easily overcome with an appropriate amount of research, especially when comparing present-day Denver to its past. Once considered heavily dependent on energy-related jobs, Denver's economy has diversified over the last 30 years to the point that oil and gas related jobs only use approximately 5 percent of metro Denver's office space. While a large concentration of this space is downtown, the recent turn in oil prices suggest that the worst is behind us.

Colorado's unemployment rate sits at a healthy 3.5 percent with an additional 63,400 jobs expected to be added in 2017, according to the Colorado Business Economic Outlook from the University of Colorado Boulder. In the wake of the Great Recession, people have focused less on following their jobs and more on location based on quality of life. Employers have followed suit, relocating and expanding in the Denver market to tap into an exceptional, highly educated and abundant labor pool. Denver's office market likely will continue to perform well over the next couple of years because of the improved fundamentals.▲

Lending

Is the co-working office space trend here to stay?

WeWork, Industry One, Galvanize and The Creative Farm are just a few of the co-working offices – shared working environments for entrepreneurs and businesses – that have taken the Colorado market by storm. And it's not stopping anytime soon.

More than 40 percent of American companies are using or considering shared workplaces, according to a recent CBRE Group survey. Global office sharing companies doubled their membership from 16,000 members to over 40,000 internationally from 2010 to mid-2016, according to WeWork.

Most recently, Bloomberg reported that co-working offices are no longer just for small businesses, freelancers and startups. Giants like General Electric Capital Corp., Pepsi and Heineken are joining the bandwagon and leasing space in co-working offices.

So this begs the question: Is it a good idea to invest in a co-working office space or to start one? If you're on the fence, there are a few important things to consider.

• **Weighing the unknown.** Many co-working offices have a unique business model and can charge by desk, private office or suite. They can charge tenants daily rates or monthly leases, allowing tenants more flexibility to come and go, which makes projecting occupancy rates difficult. This is what makes financing co-working office spaces a little tricky.

Adam Sands
Senior vice president of commercial lending, FirstBank, Denver

Banks have a better understanding of traditional office space. They understand what the lease rates should be, how much to allocate for tenant improvement and how much the expenses are. It also is easier for banks to predict occupancy rates in traditional office spaces, especially in buildings that have stood the test of time. With co-working, banks must consider if this concept is really here to stay and if it will always be in high demand. While some suggest it will be, but the truth is, we don't know.

• **Bigger net-operating incomes.** In many cases, the net-operating income per foot seems to be greater than traditional office space due to several reasons:

1. The load factor typically is less, creating more leasable space.

2. Amenities in co-working spaces are more desirable for today's workforce (e.g., outdoor patios, game rooms, cafés, etc.), so tenants are willing to pay a premium on a per square foot basis.

3. Tenants also share costs to have access to conference rooms, restrooms and waiting areas, reducing expenses for those operating costs.

4. Finally, in many circumstances, you won't need to invest in improvements or changes for new tenants.

• **Knowing the demand.** There's no shortage of co-work office spaces, especially in Denver. Some might even argue this market is saturated. Do your homework and find out if there's still demand in your community. Understanding if other co-work spaces have waiting lists or are fully occupied is a good way to start.

• **Location is everything.** To make solid income, you'll want a co-working office to be convenient, safe, easy to find and have access to parking and public transportation. Some great co-work office spaces work best in spacious warehouses or underutilized buildings that are in the midst of the hustle and bustle. Finding a good location is going to be strong determinant of your success.

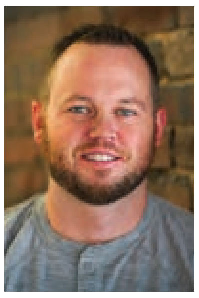
• **Bring something unique and desirable.** I once read an article about CoBoat, a floating co-working space that targeted techies and digital nomads, while it boated them around to some of the world's most desirable islands. That takes it a little too far, but you get the picture, right?

Some of the most successful co-working environments offer highly desirable items to their audience, whether it's access to equipment and tech courses for a nominal fee or ensuring they have fully staffed cafés, bars or in-house daycares for their tenants. Co-working businesses that do it right allow growing companies to attract new talent by offering a more social, relaxed or energetic work environment.▲

Owner Insights

Co-working space evolves to focus on community

In just a few short years, the co-working community in Denver has developed into one of the nation's most robust. There are co-working spaces seemingly around every corner with more popping up every day. When Thrive first opened its doors in 2010, the concept of co-working was rather different than the one seen today.



Chad Johnson
Co-founder, Thrive Workplace, Denver

While the concept of co-working remains communal at its core, co-working has developed to meet the growing needs of Colorado's co-workers. At first, traditional co-working centered on people; today, co-working centers on community. Increasingly, the city's co-working ecosystem is concerned about location, flexibility and community when selecting a shared workspace environment.

• **Location.** Location is crucial. We have witnessed that a co-working space's location has a sizable impact on the health of the community and affects where people actually want to get their work accomplished. A shared workspace's location needs to be accessible to where community members live, needs to have the right vibe and needs to supply access to eateries, bars and entertainment options.

While working from home can have its benefits – specifically, freedom and privacy – missing out on some of the most crucial psychological aspects of productivity poses a significant disadvantage. There are far more perks being offered by shared workspaces today than ever before. Cultivating a warm, motivating and productive atmosphere is crucial in meeting the needs of the modern co-working community. A co-working space with easy access to parking, public transportation and nearby restaurants, bars and other cultural offerings provides members with additional flexibility. Access and location play a sizable role in meeting the growing needs of the developing co-working community in Denver.

• **Flexibility.** Flexibility is a necessity for co-working spaces. Every co-working space has a different atmosphere, and the concept of co-working remains relatively unknown to a large percentage of the population. Often, people don't know what they want in a co-working space, so we offer the flexibility for them to grow through memberships or physical space. We have seen people take months switching from package to package before they know what option works best for them. And then once they're feeling comfortable, something happens – an employee moves on, they're forced to hire additional employees, sales don't go as well as planned or their company is acquired – and they are right back at square one, trying to figure out what works best again.

Offering flexible membership options and not being afraid to alter packages based on the needs of members benefits everyone in the co-working community. For example, walls and spaces can be designed to be modular for reconfiguration, expansion and contraction. We have a coffee shop area that can be changed into offices over the weekend and vice versa.

Thrive Workplace

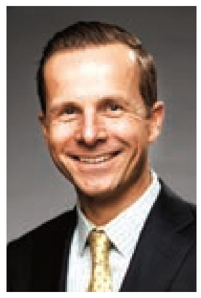
Flexibility is key for successful co-working spaces. Offering flexible membership options and not being afraid to alter packages based on member needs benefits everyone in the co-working community.

A co-working space should offer customizable packages that meet the needs of each business and supply a "work where you want" mentality. Even if members have private office space, ensure that they love to use the mobile workspace as well as offering a variety of conference room sizes and configurations. The ability to adapt to members' needs is crucial in the development of a co-working community. Whatever a co-working space can do to be flexible for its members will be beneficial in fostering a friendly, familial community.

• **Community.** Community is one of the most important values of co-working and it remains one of the hardest things to cultivate, because there are so many attributes that can impact the entire community. The location, feel of the space, other members, membership services and networking opportunities are all examples of the elements that make up the unique communities at each co-working space. We feel that you have to adapt to the surrounding neighborhood and members to cultivate a successfully community. Community is perhaps the most misunderstood value, as many co-working spaces have differing views on what

Please see 'Johnson,' Page 28

Education, engagement keys to keep CO 'sticky'



Peter Merrion
Vice president, JLL, Denver

We've all seen the numbers; Colorado's population grew by nearly 102,000 people in 2015. Denver is the fastest-growing major American city after Austin, Texas, and ranked No. 1 in U.S. News and World Report's 2016 Best Places to Live and No. 1 on Forbes' list of best places for business and careers in 2016.

Despite our booming population, our unemployment rates remain among the lowest in the nation at 3.8 percent, more than a point below the 4.9 percent national average, according to Bloomberg data. And the outlook remains rosy. The Mile High City is expected to add 130,000 net new jobs by 2020.

So how do we keep the streak alive and ensure that Colorado remains a great place to live for all of our residents, as well as a continued draw for business and investment? And from a real estate perspective, we must consider how we can keep pace and create conditions for sustained growth in the market.

As we look at market dynamics and metrics such as gross metropolitan product, population growth, net migration, unemployment, personal income growth and housing permits, there are a few key factors Colorado needs to address if we want to make the streak stick.

Address the "Colorado Paradox"

Denver consistently ranks among the top metro areas for attracting well-educated workers from out of state. We recently ranked 16th out of 150 large cities in the WalletHub's "2015 Most and Least Educated Cities" report.

The problem is, we're not doing a great job of supporting that educational attainment at home. While we are in the top for well-educated residents, we are 46th in terms of the percentage of those born in Colorado with bachelor's degrees or higher. The fact that we attract well-educated workers but few of them are actually educated in state is known as the "Colorado paradox."

The way we invest (or, more accurately, don't invest) in education starting at the earliest levels may have something to do with it. Colorado ranks 47th in the preschool poverty gap, according to stats from nonpartisan educational activist organization Great Education Colorado. We rank a dismal 43rd in per-pupil spending and 38th in spending on education overall.

It's not shocking then that the Denver Business Journal reported earlier this year that our state's public schools ranked 119 out of 150 large metro areas for school quality and enrollment levels.

At the college level, the picture is similar, and our booming economy doesn't seem to have translated into education funding.

In fact, between 2008 and 2015, per student appropriations fell 16.3 percent. Colorado currently ranks 46th in the nation in terms of state funding support for higher education, according to a study from the Colorado-based State Higher Education Executive Officers Association and Illinois State University. Additionally, Colorado's public colleges and universities retain and graduate students at below the national average rate, potentially indicating a problem with college prep and readiness among freshman.

Unless we address this paradox and the pipeline problem we're creating at home, it will be challenging to continue to attract and retain the educated millennial workforce, particularly as they look to raise families of their own. From a real estate perspective, this ultimately will impact office-using jobs and leasing volume.

- **Continue fostering engagement.** We all know Colorado's outdoor attractions are huge draws for tourists and locals alike, but you may not have guessed the state also ranks No. 1 in the nation for participation in the arts, according to data from the National Endowment for the Arts. The industry represented $1.8 billion in economic activity in 2015.

The impact of a vibrant arts culture can be hard to quantify in terms of direct impact on the overall economic vitality of a city, but we know that it can boost tourism, build a sense of community, elevate our national reputation and improve quality of life among residents.

There also is strong evidence that the young, well-educated workforce who is attracted to Colorado is more likely to value a vibrant cultural scene. People ages 18 to 24 participate in the arts at higher rates than older adults, according to the NEA study, and higher levels of education correlate with arts engagement.

Just as with education, in order to ensure continued vitality, it's important that we look at how we're supporting culture and arts engagement in the next generation. Children who visited art museums are about five times as likely to visit as an adult.

Supporting cultural engagement and activity is part of creating a great quality of life here in Colorado now and for years to come. We would be wise to remember that as our population grows and continue to support a robust arts and cultural community.

- **Invest in forward-thinking infrastructure.** Bloomberg recently cited Colorado as a success story for infrastructure spending. From Denver International Airport to FasTracks, from the National Western Center to Brighton Boulevard, the state has made and continues to make significant investment in improving infrastructure in Colorado.

Bottom line: If you build it, they will come. Take Union Station, for example. The initial $500 million investment in the Denver Union Station complex has yielded over $2 billion in private investment. That is a massive multiplier that has led to more jobs and an increase in commercial space from apartments to office buildings.

Recognizing the impact of infrastructure investment, Gov. John Hickenlooper recently said his administration sees it as the central element around which Colorado will build its new economy.

Please see 'Merrion,' Page 28

Denver shores up in the face of lower oil prices

Nicholas J. Pavlakovich
Vice chairman, Cushman & Wakefield, Denver

The remarkable Denver economy has been extensively charted over the past several years, with chronicles devoted to the influx of capital and talent. In 2016, for the second year running, Forbes named Denver as the best place for business and careers in the U.S. and attributed this recognition to the city's reputation as a hot spot for millennial talent.

Denver's boom has strengthened its commercial real estate market – from office and industrial to retail and multifamily – buoyed by a 3.6 percent unemployment rate, the lowest in the U.S., according the U.S. Bureau of Labor Statistics.

Today, over 75,000 people live in downtown Denver alone. Job numbers are at a historic high and are expanding across almost the entire spectrum – from leisure and hospitality to construction to professional and business services. The startup community is building and tech employment is growing; Moody's reports that 7.9 percent of the total jobs in Denver are in the core tech sector.

And all this growth has led to infrastructure improvements. The city has a dynamic and expanding transportation system (FasTracks) that recently opened a direct train line from Denver International Airport to Union Station, not only connecting the airport with the central business district, but also to the city's massive light-rail system already in place.

This multibillion-dollar transit expansion is one of the hallmarks of this city's exponential growth. Companies and investors alike have taken note of the investment Denver has made in itself, creating ease with which people can and will navigate the entire metro area.

The hub of this massive transportation system is downtown Denver. Currently, 88 total miles of rail connect into downtown Denver. This year alone brought transit from DIA, Westminster, Wheat Ridge and Aurora, all accessing the center of downtown Denver. The efficiency and mobility has permitted firms – for the first time in my 30-year career – to move from Boulder to Denver. Additionally, the abundance of labor provides employees the ability to live, work and commute into Denver's CBD.

Denver's sustained prosperity has mitigated the impact of the slowdown of one of its largest industries – oil and gas.

Rising oil and natural gas prices traditionally cultivated an active job market in our city but there are changes afoot. The plunge in oil prices of the world's major energy cities has had a net-negative effect on the world's largest energy-producing markets. As a group, these markets are experiencing slower economic growth, slower job creation and weaker office sector fundamentals.

The multibillion-dollar transit expansion of FasTracks is one of the hallmarks of Denver's exponential growth.

While office markets such as Moscow; Aberdeen, Scotland; Calgary, Canada; and Houston have faced significant headwinds due to the oil shock, our report "Occupier Research Report, Oil: the Commodity We Love to Hate," indicates that office markets in energy-centric metros with more diverse economies, such as Denver and Dallas, have held up much better in the face of lowered pricing.

In the United States, which is poised to surpass Saudi Arabia as the top-producing country globally, oil-centric markets led by Houston and Oklahoma City register some of the highest office vacancy rates in the nation.

Denver has seen its office vacancy rate improve from 12.8 percent mid-2014 (when oil prices were booming) to 11.4 percent mid-2016 (post-oil-price correction). Since mid-2014, the Denver office market has absorbed 3.6 million square feet and has seen rents grow by 13 percent.

Denver's oil and gas industry accounts for approximately 23 percent of the office market within the approximate 28 million sf of total office space in the Denver CBD.

Please see 'Pavlakovich,' Page 28

Leasing Trends

Leasing to federal agencies just got easier

In the coming months, Denver building owners will have the unique opportunity to do business with the federal government as more than 1.4 million square feet of leases are projected to expire, creating a significant need for office space in the downtown core and throughout the Denver area.

James Randle
Leasing division business center manager, General Services Administration, Rocky Mountain Region 8, Colorado Springs

General Services Administration's Rocky Mountain Region 8 leasing officials will start seeking those office spaces in early 2017 as several partner federal agency leases are ending. GSA works with partner agencies to identify and negotiate leases to assist in meeting their missions.

GSA's mission is to provide the best value in real estate to government agencies and to the American people. GSA currently manages a federally owned and leased inventory of more than 374 million sf of space across the country– more than 8.8 million of that in Region 8 and 5.5 million in the Denver metro area.

The upcoming lease expirations for GSA's Rocky Mountain Region are occurring over the next five years, with a bulk of that in the next two years. GSA wants to begin working with building owners who have leasable space in order to make the lease transitions as smooth and seamless as possible for the partnering federal agencies.

Providing cost-effective real estate solutions for federal agencies sometimes means constructing a new building or consolidating agencies in existing federally owned space. But often it means going to the market and soliciting for a lease. When GSA takes this route, the agency's goal is to seek ways to maximize competition, meet agency requirements and reduce costs to secure the best value in the marketplace.

One of the most-effective ways to secure best value is by soliciting for leases with longer terms, where appropriate. A longer-term lease often results in lower rates for the government and, ultimately, taxpayers. It also means the cost to make the space occupiable (furniture, IT, etc.) is partially contained within the cost of the lease and partially borne by the partner agency and is maximized since that investment can be used for a longer period of time. For these reasons, GSA has been working hard with partner agencies to identify requests where longer-term leases can be pursued.

To make it easier for building owners to conduct business with the federal government, GSA introduced a web-based leasing tool and acquisition platform called the Automated Advanced Acquisition Program. The AAAP was designed to consolidate and streamline the leasing process, making for a more efficient, transparent process that also secures the best value.

The program speeds up the leasing process by allowing building owners to submit available space in the database one time annually for consideration against multiple requirements each agency has, in place of every single leasing opportunity.

The AAAP will impact how the GSA Rocky Mountain Region conducts its leasing significantly by transitioning the traditional procurement approach to an electronic platform that will serve as GSA's primary vehicle to acquire office space. With such a significant amount of leases expiring in the Denver area, GSA believes this tool will be invaluable to its leasing business partners.

The AAAP allows building owners and their brokers to electronically submit lease offers through the website at https://aaap.gsa.gov. Awards are made through AAAP to the lowest-priced building that can accommodate the government's needs in terms of square footage, technical requirements, length of lease term and delineated area.

The program speeds up the leasing process by allowing building owners to submit available space in the database one time annually for consideration against multiple requirements each agency has, in place of every single leasing opportunity. GSA then matches federal agency office space needs to the inventory in the database to identify the lowest price, technically acceptable property and other factors. The efficiencies created by the AAAP are estimated to reduce procurement times by three to six months, delivering the needed space to federal agencies faster and initiating rent payments to building owners sooner.

GSA's Rocky Mountain Region leasing team will be hosting an Industry Day to inform the business community about the new leasing opportunities, describe the upcoming agency lease needs in detail and explain how the AAAP works. The event will be held Feb. 7 from 10 a.m. to 12 p.m. (MST) at the Byron G. Rogers Federal Building in Denver. For more information contact AAAP.Manager@gsa.gov or visit http://www.gsa.gov/aaap.▲

Design

Budgets drive how to 'millennialize' the office

Abbey Lyon
Senior project manager, Kieding, Denver

It's pretty easy to "millennialize" the office, at least when it comes to design concept. Why wouldn't it be? Millennials are the most studied and observed age group in American history. Besides, designers "ize" spaces for myriad office cultures and specialized industries every day. That's the essence of the profession, after all. A company's office design should represent the culture and drive the brand. Right?

Theoretically, yes. But the budget also drives the brand and drives it hard. Quite often, the bottom line supersedes design intent, and the challenge becomes not what the client wants, but what the client can afford. No news flash there.

So for those clients who don't have the luxury of huge tenant-improvement dollars, any type of "izing" can be a challenge. But there are ways to adapt a smaller budget to new space or existing space.

• **Yet another word about the open-plan office.** All matter of publications from the nation's preeminent daily newspapers to the design industry's most esoteric trade journals are still stuck on the notion that millennials thrive in a purely open-plan office.

Not so. The "boundary-less" workplace is as disruptive to millennials as it is to any other group. Indeed, studies show that millennials will use earbuds, seek refuge in quiet areas of the office and even leave the space altogether to fend off the relentless chatter of coworkers. In fact, The Journal of Environment Psychology points to several recent studies that claim as much as 40 percent of employees in open office environments – including millennials – clamor for more privacy, are less focused on their primary work and show higher levels of stress. Clearly, even millennials want barriers and boundaries that offer alternatives to the vastness of the office without walls.

The answer, not surprisingly, is a balanced office that provides wide-open workspaces with key areas of collaboration and enclosed quiet zones for individual work, one-on-one meetings and simple decompression. The challenge is getting there when money is most certainly an object.

Starting from scratch with bare space and a nearly unlimited design budget is surely the way to go when planning a millennial-style office. Of course, for the vast majority of businesses, this just isn't going to happen. What of the small firm with a modest tenant-finish allowance relocating to a new building? Or how about the company that's ensconced in an existing space, midlease, with an influx of new employees, all millennials? There are options for this majority that don't require grandiose design plans and the budgets that go with them.

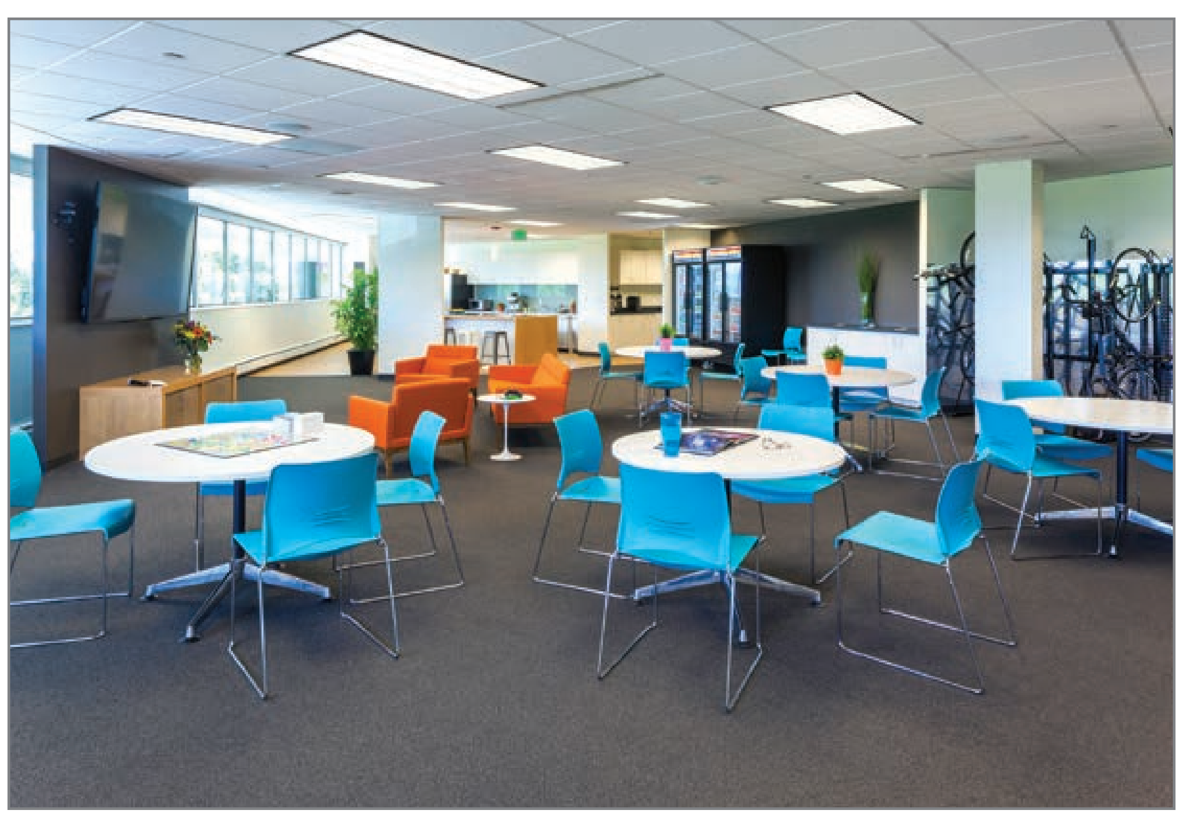
• **Open design is flexible design.** Open-plan spaces can take on any number of characteristics but, in general, the most coveted seem to consist of 12-foot ceilings (or higher), exposed ductwork, perimeter windows, if available, very low or no walls, and concrete slab or other hard-surface flooring. It costs approximately $20 per square foot to convert a 10,000-sf office suite with standard grid into what most of us would term an open-plan space. For tenants seeking space in a new building or in an existing building with a landlord willing to rip out the standard office grid, even a portion of open-plan design can suffice very nicely at a fraction of the cost of opening up – or building out – the entire suite.

Limiting the amount of open square footage without a suspended ceiling grid certainly will minimize noise from the suite's heating, ventilating and air-conditioning system and other sources while providing aesthetic appeal from varied ceiling heights. Adding accent and indirect lighting in a limited open-plan space can boost design appeal significantly while saving money on the overall infrastructure budget.

A human resources online magazine recently noted in a piece about millennializing the office that a "spare conference room" could be used as a "war room" or other gathering area in which to bounce around creative ideas. Spare conference room – who has those? It's a nice notion, but that kind of square footage is just too valuable to cast off as "spare."

A more likely scenario could involve the demolition

Please see 'Lyon,' Page 28



Ron Johnson

The design of this millennial-style Denver office space couples a small sit-down kitchen area with an expansive and colorful multiuse break room, including vending machines, flat screen, soft seating and bike rack.

NAIOP Colorado 30th Anniversary Awards of Achievement

THURSDAY, FEBRUARY 23, 2017

SEAWELL GRAND BALLROOM, DENVER CENTER FOR THE PERFORMING ARTS
14TH AND CURTIS STREETS | DENVER

4:00 pm	Doors Open! Registration and Networking
4:30 pm	Awards Program
6:30 pm	Awards Reception, After Party Begins!

Join NAIOP Colorado as we celebrate the 30th Anniversary Awards of Achievement event, honoring the "Best of the Best" in Colorado's Real Estate Industry for 2016 on Thursday, February 23, 2017 at the Denver Center for the Performing Arts in the Donald R. Seawell Grand Ballroom.

This year's awards event will include live music entertainment, diverse guest presenters, mixed media delivery, plus celebratory cocktail reception immediately following the awards presentation!

Award nomination forms are available on the NAIOP-Colorado.org website.
The deadline for all nominations in Broker, Developer and Other categories is Wednesday, January 11, 2017.

AWARD CATEGORIES INCLUDE:

- Industrial Broker of the Year
- Investment Broker of the Year
- Office Broker of the Year - Team
- Office Broker of the Year - Individual
- Land Broker of the Year
- Multi-Family Broker of the Year
- Retail Broker of the Year
- Legacy Broker
- Office Development of the Year
- Industrial Development of the Year
- Multi-Family Development of the Year
- Deal of the Year
- Innovative Project of the Year
- Capital Markets Team of the Year
- Sherman R. Miller Trailblazer Award
- Member of the Year
- Developing Leader of the Year
- James T. Brubaker Legislative Award
- Presidents Award
- Award of Excellence

Visit NAIOP-Colorado.org/Awards for more details and Nomination Forms.

TABLES AND TICKETS:

Individual Tickets, Half and Full Tables are NOW available for purchase! Registration includes pre-function refreshments, post-awards cocktail reception and after party with live music, heavy hors d'oeuvres and open bar!

- Upgrade to Premium Table, receive Cocktail Service throughout the Awards Program!
- Reserved Tables include pre-set Wine and Beer!
- Sponsorship and Marketing Opportunities Available—visit our website for details.

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Market Update

Continued from Page 1

1.4 million and 1 million available in these markets, respectively, that's the equivalent of 2.6 percent and 1.5 percent of the total respective space. "So it's material, but it's not earth shaking," he said.

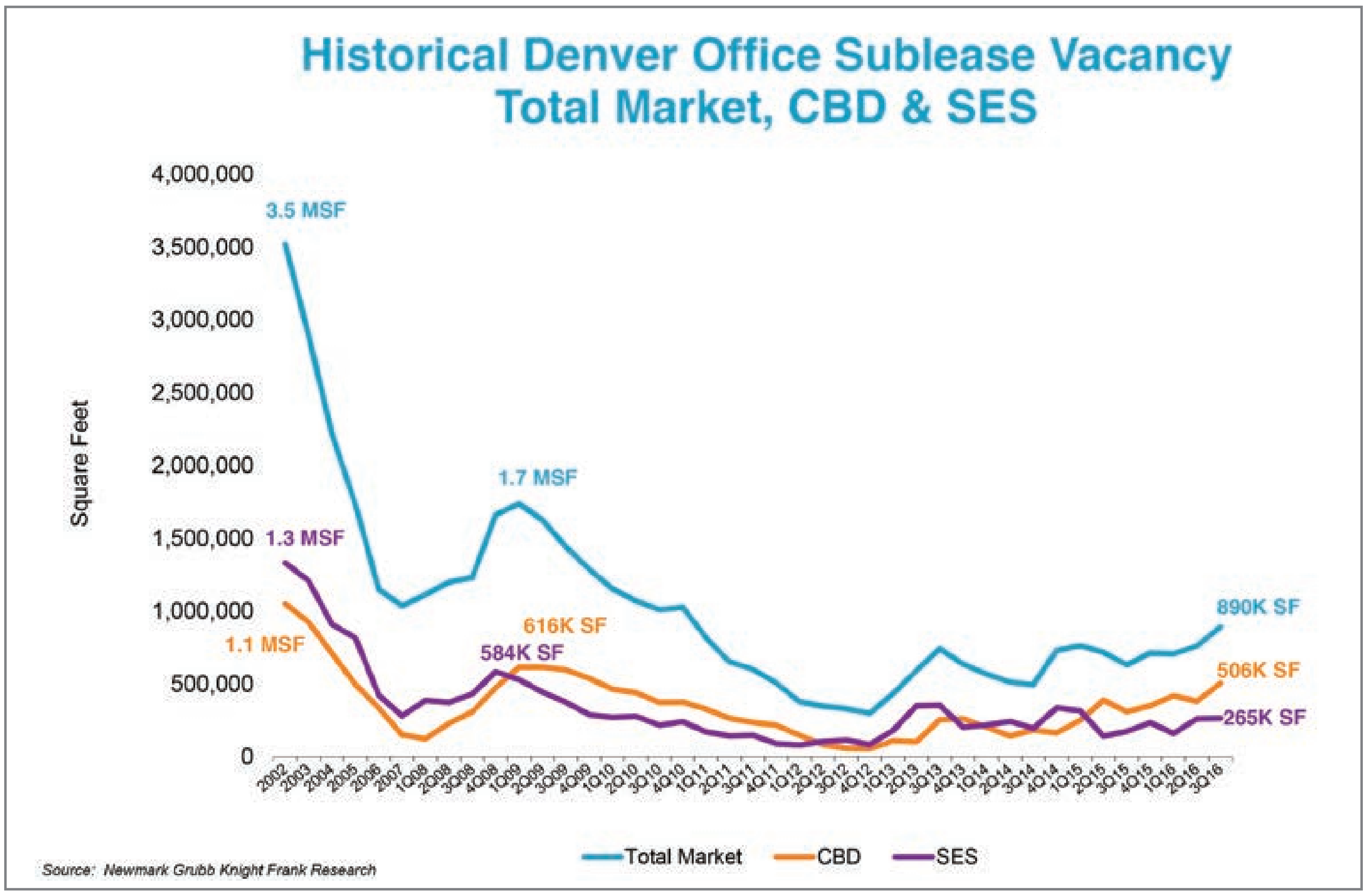
Another important key to understanding the current sublease market is identifying the main industry – oil and gas companies – subleasing space downtown. Unlike the previous oil bust of the 1980s, downtown Denver now enjoys a diversified business market, with oil and gas accounting for about 20 percent of downtown office market tenants. However, due to the drop in oil prices, these tenants now make up about 60 percent of the available sublease space in the downtown market, totaling almost 900,000 sf of available space, said Holm.

Further, of that sublease space, oil and gas firms make up four of the top five largest blocks of available space, which equals 52 percent of the entire sublease space available, said Davidson.

Of these four major sublease spaces – two are 100,000 sf, one is 230,000 sf and the last is 50,000 sf – all but one have four to five years remaining on their leases.

"The largest sublessors downtown, representing 60 percent of the oil and gas sublease space, are all credit users, so these are not people who are going to default," Holm said. "They're going to continue to pay the rent and landlords will continue to collect, and while those companies may sublease their space at a discount, the overall impact on the market is muted because they're not a risk of default."

The SES market's sublease space is spread across industries, which appear to result from a combination of factors without anything in particular leading the way, Holm said.



Source: Newmark Grubb Knight Frank Research

Potential Relief

There has been some activity backfilling this sublease space by a few oil and gas firms that are taking advantage of the current market and expanding. Law firms and professional services also are a natural fit for the space configuration, but it's hard to point to one specific industry that is gobbling up the spaces.

Thanks to Denver's diverse economy, there's a variety of potential tenants, ranging from tech to health care to finance and advertising to food services, that could be interested, said Lee.

"This is the best-valued space in downtown, because you're going to be in the $45- to $50-per-sf range on space in Central Platte Valley or LoDo for new construction," Lee said. "This space can come in at 50 to 60 percent of that cost, so it's really where the value is. The question is, is the fit appropriate?"

There are two major challenges when filling sublease space: configuration mismatches and timeline mismatches.

A user must be willing to use the space in its existing configuration. The sublessor does not want to invest more money into the space because he already is trying to mitigate a losing situation, Holm said.

"Finding a user who can use the space the way it is can be hard," said Holm. "If you have a tech firm and you're subleasing oil and gas space, which is all hard offices, that's a mismatch – it doesn't really work."

Aside from the floor-plan configuration, the type of building itself can present challenges. The majority of these spaces are found in traditional 1970s and 1980s vintage buildings that may not be appealing to every company, Davidson said.

Tenant improvement allowances from sublandlords can help get deals done as can in-building amenities, said Davidson. And the location is critical.

If you're a company subleasing 5,000 to 10,000 sf of open-planned, brick-and-timber space in Lower Downtown, your space will probably be picked up quickly and at rates north of $30 a sf because options are extremely limited, Davidson said. However, if it's a larger space that's office intensive, located in the downtown core, even at a price of $15 a sf, that space could sit vacant for a year or two, Davidson said.

The second common mismatch is in term requirements – i.e., a sublease space has three to four years left on the term, but the interested subleasee only needs it for a year and a half. Some of these deals get done, but it's challenging, Holm said.

With these two hurdles in mind, the ideal tenant must be a company that has a short-term need and can make the existing configuration work, such as a company that is moving to the market or needs to expand quickly, said Holm. For these reasons, it isn't surprising that much of the available sublease oil and gas space hasn't subleased.

"Some of these sublease spaces, these bigger blocks, have been sitting for a while," said Lee. "But that's going to change in 2017 for the following reasons: we've bottomed on oil and gas, where the price is right now; most of the space that's coming back to the market has come back in 2015 and 2016 – that doesn't mean that there couldn't be some more isolated situations – but most of the oil and gas space that's going to hit the market has; and I predict that by the end of 2017, the amount of sublease space downtown will be cut in half."

Additionally, relief will be aided by the fact that 1801 California is now 95 percent leased, which had been the gorilla of the downtown market for the last five years because it always had available space, he said. Many of the new builds are leasing up, and demand to be located downtown and the allure of downtown's amenities have never been stronger. This means that for tech or other growth-oriented tenants, there will be fewer options, he said.

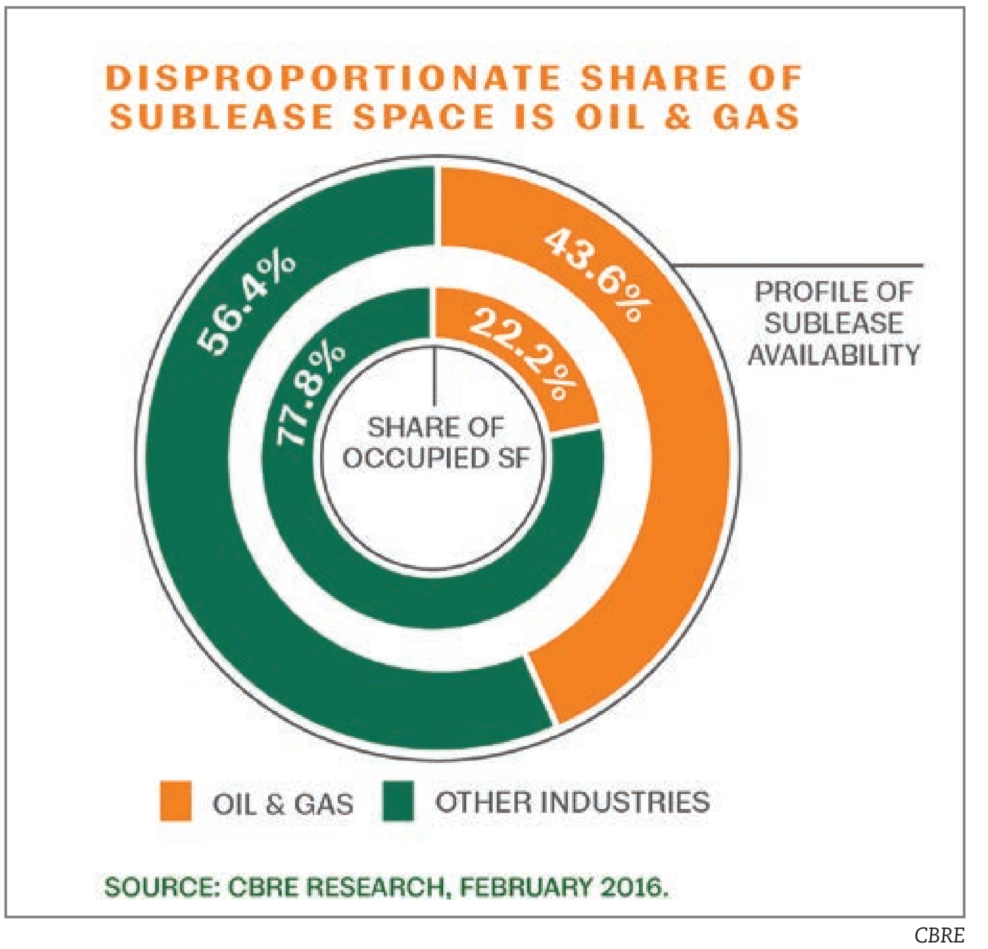
"Who are the next tech tenants that need 30,000, 40,000, 50,000 or 60,000 square feet?" Lee asked. "Where do they go? I think they go where there's value." They'll also be attracted to the flexibility and shorter lease term options. "The relief will be coming, for the most part, from value-oriented tenants who can't find growth in new product."

Holms disagrees about immediate relief coming in 2017. "I think it just takes time to work the sublease space down; you've got to go through the transition," he said.

He anticipates oil and gas firms are likely to remain static through the foreseeable future and wonders where we are in the overall business cycle, which has been enjoying expansion for about seven years. If something happens in the economy, the sublease space could get worse, not better, he said.

"I'm not saying that's going to happen – it's just a question, and I'm pretty sure I'm not the only one thinking about it because of where we are in the cycle," he said. The impact coming from the unpredictable political situation also adds to the unknowns.

"So no, I don't really see anything on the horizon that's going to all of a sudden fix the sublease situation," he said. "It's just going to have to work itself out over time and we all have to cross our fingers that something doesn't happen in the economy that actually makes it worse."▲



CBRE

Oil and gas firms make up disproportional share of downtown's sublease space.

Johnson

Continued from Page 16

formulates a great community.

Additionally, it's important to create a support system for your community through educational opportunities, partnerships and access to beneficial tools. For example, we recently partnered with the Founder Institute, a business incubator, entrepreneur training and startup launch program, and we partner with Rockies Venture Club and Venture Zone to offer entrepreneurs resources for funding, networking and collaboration.

In the end, the shift away from individuals and toward community has changed the concept of co-working in Denver. In order to meet the growing needs of this burgeoning community, co-working space managers and owners need to look toward ideal locations, formulate flexible workspaces and cultivate a supportive community to allow for a co-working space and its members to thrive and succeed.▲

Thrive Workplace

Community is perhaps the most misunderstood value, as many co-working spaces have differing views on what formulates a great community.

Merrion

Continued from Page 18

So what does that look like? What essential structure is Colorado or Denver still missing, and what does the next generation need and want in the way of infrastructure?

Evidence suggests that cities that attract and retain residents increasingly are going to be those that support multimodal lifestyles with multiple transit options. That means a greater focus on moving people vs. moving cars.

A 2013 American Public Transportation Association study found that nearly 70 percent of millennials use multiple travel options several times each week. This 18-34 age group cares less about how they get from A to B than the efficiency and practicality of the solution.

By supporting alternative transit options, such as biking – in which Colorado will invest $100 million over four years – car- and ride-sharing, and pedestrian-friendly streets, we can improve mobility and address traffic congestion (a major concern for any rapidly growing metro) for significantly less in the way of investment compared to traditional car-based infrastructure.▲

Pavlakovich

Continued from Page 20

In 1986, downtown Denver's oil and gas companies accounted for 47 percent of the office tenancy and most exited the marketplace overnight, creating a glut of office space and a virtual ghost town for a number of years. The price of a barrel of oil at the time was $9 and over 65,000 people moved out of Colorado that same year.

Today, oil and gas firms have put only approximately 924,000 sf of sublease space on the market. The oil and gas sublease space has been slow to move due to preferences for an open-plan layout within the very active, creative and tech-user market that continues to migrate to Denver's CBD.

The Occupier Research report states that, barring a production freeze or unforeseen event, oil prices are expected to remain below $60 per barrel through 2017, and most experts forecast below $70 through 2020. The impact of a protracted low-oil-price scenario is mixed: energy-producing regions struggle while consumers and nonenergy producing markets benefit.

While the positives from lower oil prices outweigh the negatives in terms of impact on global economic growth, the effects on the office market are more of a mixed bag, according to Kevin Thorpe, Cushman & Wakefield's global chief economist. Most energy-producing office markets have seen economic slowing and lower occupancy levels, while stronger consumer spending has boosted occupancy virtually everywhere else, he said. For occupiers, the prolonged oil price rebalancing will create efficiency and cost-saving opportunities in some markets, but rental pressure in others.

Layoffs within the energy sector were prevalent for a few quarters, but even that area has stabilized more recently. In spite of the recent pullback of oil and gas prices, the 924,000 sf of sublease space pales in comparison to the growth we have seen from other industries.

Denver is supported by several thriving industries – tech, tourism, professional services – that have seen year-over-year rent growth accelerate to 7 percent in the second quarter of this year.▲

Companies and investors alike have taken note of the investment Denver has made in itself.

Lyon

Continued from Page 24

of one or two existing hard walls that yield two or four multiuse "focus" or "huddle" rooms within the suite. The demo cost usually is manageable, and enclosed or even semi-enclosed spaces like these could accommodate small-group meetings or designated quiet areas.

The liberal use of color and alternative seating have been millennial hot points since the term was coined and, compared to major construction within the suite, these add-ons are both economical and effective. This could begin with paint and carpet, which are considered tenant finish basics, but also transformative with a low price tag.

- **Group spaces are happy spaces.**

The all-company or "all-hands" area is, by nature, an open zone in the office, which can see double or triple duty as work, play and break space. This type of area can act as an open canvas in which structure and organization are not primary issues. That is, all-hands space can define what a small company with limited resources can do to embrace the millennial culture, which prioritizes a spirit of community, collaboration, work, health and relaxation all happening at the same time.

This space might include a mix of hard and soft seating, lounge-style tables, stools, sofas and mobile soft-sided "bleachers" in vivid colors. With nifty design and smart furniture choices, even very small offices can adopt a space like this when both square footage and funds come at a premium.

Similarly, a company's commitment to a healthy workplace does not have to include a dedicated fitness room within a suite or even within a building. Sometimes a combination of healthy snacks, a break space and a bike rack, for example, are enough to assure all employees that an active effort is being made to support their collective wellness.

One metro Denver building owner is employing "bike labs" in its remodel budgets. In addition to the bikes themselves, the space is outfitted with tools and parts when on-the-fly repairs are required.

For tenant spaces, even as little as 150 sf of dedicated wall racks and vertical storage can satisfy the millennial preference for bikes over cars. Again, although sacrificing valuable square footage, simple bike racks and storage are cheap ways to advance one very important method of employee-based wellness. It's a relatively small dollar commitment on the part of the business owner that can reap significant benefits in good will.▲

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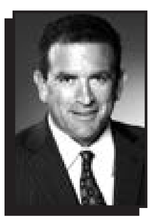

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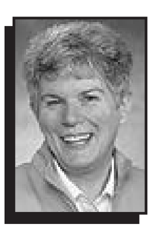

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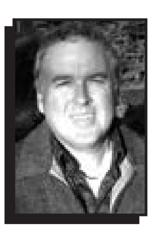

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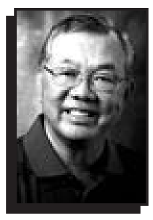

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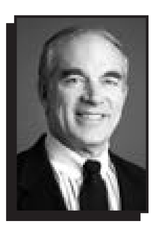

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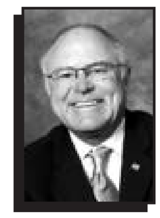

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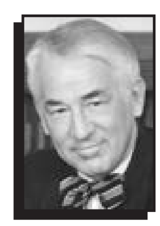

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