A Colorado Real Estate Journal Publication
February 2015

RETAIL PROPERTIES *Quarterly*

Retail is more than shopping, it's a destination

Matthew Morris Salon recently opened its second location at 27th and Walnut streets.

by Ryan Gager

As more and more retail and restaurants attempt to be as close to residential areas as possible through mixed-use developments, there is still a desire for shoppers to get out, explore and visit different areas and neighborhoods. These developments are creating a type of destination outing.

"Consumers want an experience whether they are shopping or dining," said Molly Bayer, associate broker with Zall Co. "Often these customers will travel to shop or dine at a unique place."

These destinations offer several experiences without having to drive to multiple locations. Trying to decide between going shopping and working out? Stores like Athleta, which recently opened another location in Park Meadows Mall, allow customers to do both by offering free fitness classes right in the store. Other retail stores have also jumped on this trend of offering an experience while you shop. Common Threads is a consignment clothing shop that contains a creative lab where the customer can take sewing and knitting classes. Large retailers like H&M attempt to keep shoppers repeatedly coming back to the store by moving goods quickly and rapidly addressing the latest trends and styles.

Major brand-name stores can sometimes even move into an area and become part of the community, making it a destination that attracts people from other neighborhoods. For example, Lululemon, a yoga-focused athletic apparel retailer, offers free yoga classes in the Cherry Creek North and Park Meadows Mall stores.

However, there are specific areas where the small shops are still thriving. "Millennials have spurred

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Retail experience

Shopping centers cater to consumers by providing an experience.

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RiNo neighborhood

Up-and-coming neighborhoods like River North are attracting shoppers.

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Restaurant expansion

The Kitchen family of restaurants' team discusses challenges of rapid expansion.

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Letter from the Editor

Colorado's retail scene features creative concepts

Whether you are looking for the latest in fashion or trying out a new restaurant, retail is incorporated into our daily lives. Bricks and mortar have been battling with online shopping for years and there are some interesting concepts that have come from it. Old neighborhoods are being redeveloped, while remaining true to their roots.

Colorado Real Estate Journal is excited about the launch of Retail Properties Quarterly, our fourth and final installment in the new quarterly publication series, which also features Office Properties, Multifamily Properties and Property Management. CREJ has long been known for providing the information our readers need to make the right decisions for their commercial real estate clients and growing their businesses.

Retail Properties Quarterly provides an in-depth look at retail, shopping centers and restaurants with features on shopping trends, neighborhood profiles, and developments and experiences that are driving the market.

Retail has evolved to the point that it is no longer just about driving to the store, picking up a few items and leaving. Retailers are making shopping about an experience, and some a destination where people want to spend time. It is a new culture with, of course, the millennials leading the way.

In the Retail Insider section, get the details on how a limited supply of new product has increased retail rental rates. And the Developer Spotlight focuses on how existing properties can upgrade their centers, making them more attractive to shoppers and tenants.

Thank you to everyone who contributed articles, or met for interviews and helped me understand the retail realm of real estate. Without the help of these industry experts, this special section would not be possible.

As you read this publication, please don't hesitate to contact me with thoughts or ideas for articles that you would like to see in upcoming issues of Retail Properties Quarterly.

Thanks for reading,

Ryan Gager
rgager@crej.com

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VILLAGE AT THE PEAKS

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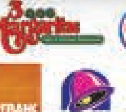

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All signs point to positive vibes for Denver retail

Retail is back on the scene in Denver with plenty of activity. Last year's activity was marked by declining vacancies, increasing rents and several new national retailers entering the market. A strong local economy, population and employment growth, increasing personal income and a booming residential market all contributed to the retail sector's resilience. 2015 will be another positive year in the sector, as the underlying fundamentals in the Denver metro area remain strong. Notable lease rate growth is anticipated to occur in the next 12 to 18 months due to space scarcity in A-trade areas such as Cherry Creek, Park Meadows, downtown and Boulder, along with moderate construction activity.

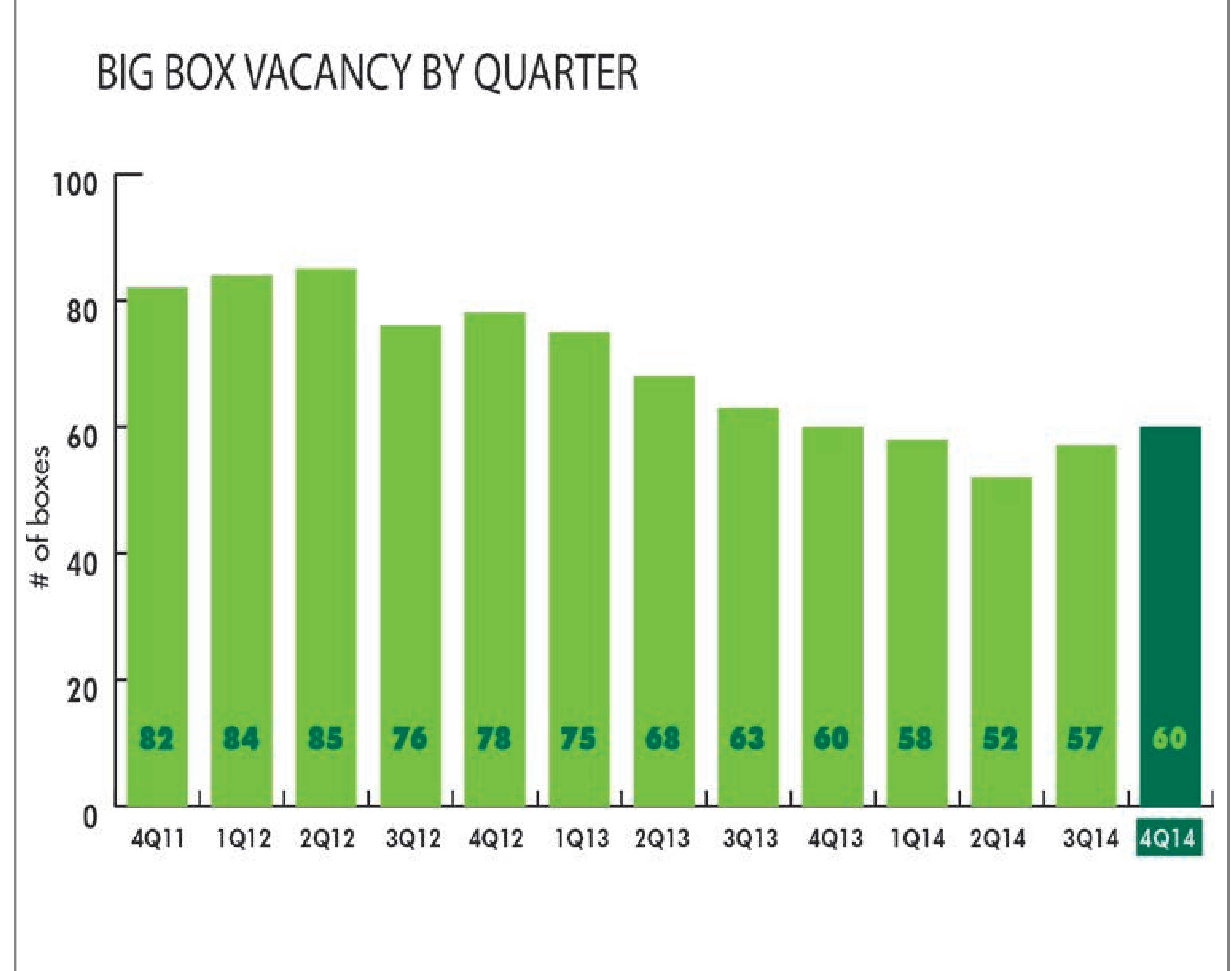
Jon Weisiger
Senior vice president, CBRE, Greenwood Village

Consumer activity was heightened in the metro area, Colorado and the U.S. during 2014, with retail sales increasing by 8.1 percent in the U.S. through October. Sales at the state level through May (the latest data available at the time of this article) were up 5.5 percent, and in Denver sales increased by 3.4 percent over last year. Consumer sentiment is also vastly improved, being pushed by cheaper gasoline and rising home prices in the area. As of December 2014, consumer sentiment in the region rose 19.4 percent over 2013, according the Mountain Region's consumer confidence index.

Twenty new national retailers entered the market in 2014, with more expected in 2015. New retailers are drawn to Denver for several reasons, including the above-average personal income levels, steady population growth and the region's solid residential market. Very few retailers are leaving the Denver market and business failures are still at a historic low.

Residential development, including a strong multifamily market, contributes largely to retail health because it amplifies consumption of home furnishings, appliances and accessories. For example, Conn's Home Plus, a home furnishings, electronics and appliance store, entered the market last year with six new stores in Colorado's Front Range.

The region's healthy retail market benefits from a flourishing restaurant scene. According to the National Restaurant Association, Colorado ranked fifth in the nation for projected restaurant sales growth in 2014. While national chain restaurants still seek opportunities in the market, some of the best growth has been in fast-casual concepts and chef-driven restaurants. Quick-serve restaurants posted a strong year in 2014 with several new QSR options added to the market, such as Protein Bar and Pizzeria Locale. We expect this trend to continue in 2015, along with the expansion of several proven national sit-down chains, like Del Frisco's Grille.



> Year-end vacancy in the market stood at 6.5 percent, which was the lowest level since 2008, when vacancy bottomed out at 6.4 percent.

Colorado is also the nation's leading craft beer producer, with over 175 breweries and counting. While the larger breweries typically are in industrial spaces, many smaller breweries seek space in key retail areas.

A very competitive grocery market will strengthen further in 2015. Some short-term vacancies and shifting are expected in the wake of the recent merger of Safeway and Cerberus, Albertsons' parent company, but new stores likely will absorb the extra space. While 2014 saw the entry of Trader Joe's to the market, there were also several new stores opened by Sprouts, Whole Foods, King Soopers and Walmart Neighborhood Market following residential growth patterns. Looking forward, the Union Station area of downtown will add two large grocery stores. A King Soopers is currently under construction and Whole Foods announced it will build a 56,000-square-foot store in the area as well.

Denver's urban core is now a place where people go to live, work, stay and play. Further redevelopment of obsolete space is expected in urban and infill areas in the near term as quality space becomes even scarcer and in higher demand. The market also will see mixed-use construction along transit lines following the substantial expansion of the region's commuter and light-rail network. For example, the city of Westminster is in the final stages of approving plans for the Westminster Center – a 105-acre transit-oriented, mixed-use development on the site of the old Westminster Mall, which includes a significant share of land planned for retail. Vertical construction may begin as soon as the third quarter.

Despite encouraging demand trends, local retailers will face new issues and ongoing challenges in 2015, ranging from big-box store consolidations to e-commerce. E-commerce sales account for an increasing share of total retail sales in the U.S., but remain a minor contributor overall. Total e-commerce sales increased 16.2 percent from third-quarter 2013 to third-quarter 2014, while total retail sales grew only 4.2 percent. However, third-quarter 2014 e-commerce sales represented only 6.6 percent of total retail sales in the quarter. Stores are increasingly incorporating omnichannel strategies to appeal to multidimensional shoppers and this trend is becoming increasingly present in Denver. For example, sporting goods store Sierra Trading Post, which made its Denver debut in 2014, offers customers an extensive online catalogue and an in-store pick-up option.

While big-box stores were expanding rapidly in the 1990s and early 2000s, a notable change in consumer habits led to smaller boxes becoming more desirable. Centers in key locations have repositioned or split their boxes to accommodate new users, thereby sustaining low vacancy rates in the A-trade areas. However, in secondary trade areas, the market is readjusting and nontraditional users are finding these leftover big-box spaces suitable for their product. Fitness clubs, churches, self-storage centers and entertainment venues like trampoline parks signed some of the largest leases in terms of square footage in 2014. Nontraditional use of these spaces will likely increase and the market will also see redevelopment of obsolete big boxes.

Year-end vacancy in the market stood at 6.5 percent, which was the lowest level since 2008, when vacancy bottomed out at 6.4 percent. Availability in the market reached 10 percent in fourth-quarter 2014, its lowest level in six years. These figures are reflective of an overall tightening of the market around high-quality space, a trend especially evident in the Colorado Boulevard/Midtown submarket, which has the greatest proportion of high-quality space and the market's lowest vacancy rate at less than 3 percent. Asking lease rates are reflective of these conditions, averaging $24.35 per sf triple net in fourth-quarter 2014. This submarket contains premium retail space in the Cherry Creek North area, which is at market-setting rates. A few highly anticipated mixed-use projects are under construction there.

The overall market experienced an average lease rate of $15.80 per sf triple net in the final quarter of 2014, with a 45-cent increase year over year and the highest rate the market has seen since 2011. In light of robust consumerism, as well as continued broad-based economic growth, ongoing construction and overall positive absorption, Denver retail likely will continue on a path of restrained expansion through 2015.▲

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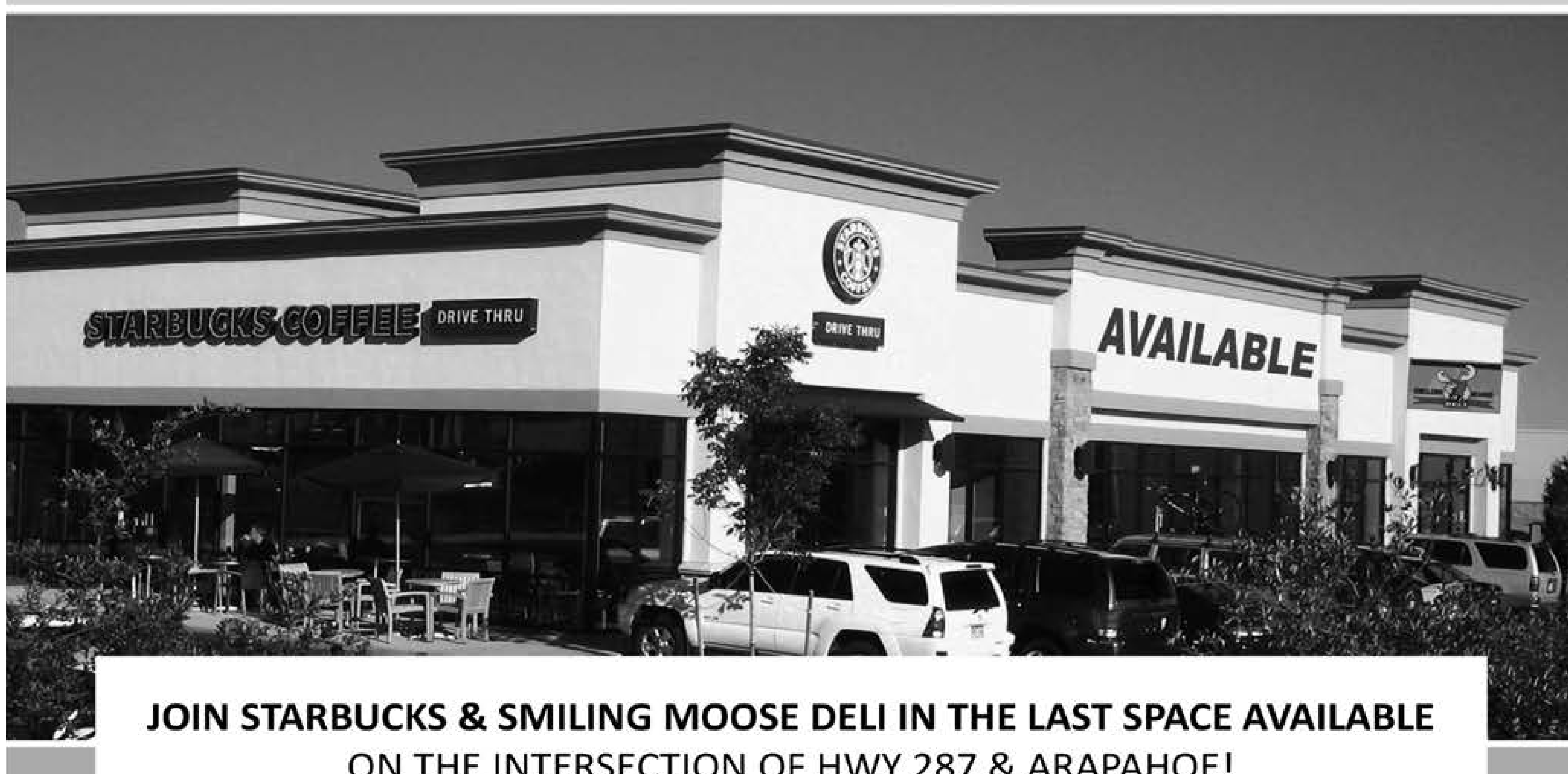

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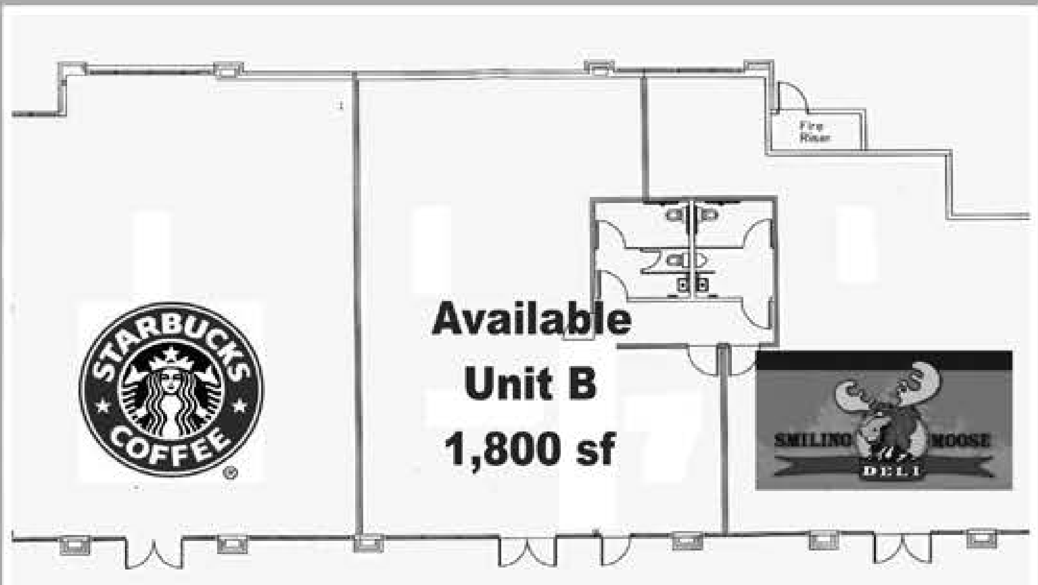

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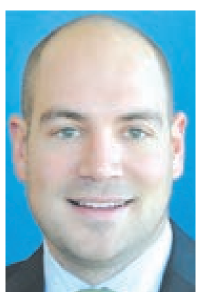
Northern Colorado Update

Secondary markets provide space demand relief

The new year is in full swing and established retailers are looking to execute on expansion plans following a strong holiday sales season. New ideas are ready to blossom into new stores. That means as a retail broker, I am spending countless hours searching for the next great opportunity, or pitching strong projects that have space available or that are coming out of the ground. Though time and time again, I hear from my colleagues and clients, "There isn't enough quality space available in the Denver metro right now." However, there are still strategies that can lead to retail success for those retailers looking in the right places.



Michael DePalma
Vice president, SullivanHayes Brokerage, Boulder

Retailers large and small, established or upstart, all want one thing right now – quality space. When looking at vacancy rates, you would think that quality space exists in the market, and that it's ripe for the taking. In reality, when focusing in on the 7 percent vacancy rate in Denver, you realize that most of that vacancy is not quality Class A space. Instead, vacancies are in Class B or C space that retailers just don't want.

The current vacancy is really conducive to demolition, or at least remolding and repositioning into a quality space that a retailer can sink his teeth into and have a high level of confidence in, which leads to strong sales projections. Unfortunately, that takes time and money, neither of which retailers want to waste. The most important factor right now seems to be time, because the quality space is not available. While owners and developers are trying to catch up to meet the current demand, retailers are competing for quality space.

Demand for retail space is coming from a number of segments, but restaurant growth has accounted for more than 40 percent of all total unit growth over the past four years, according to Garrick Brown, economist with ChainLinks. This is the largest market segment and the largest demand driver for good reason. Every fast-casual operator I spoke with had dreams of becoming the next Chipotle, and they all have their own concept or spin on some traditional offering. But what seems to get overlooked is how tough it can be to break through to consumers when you're surrounded by so many established names and other popular, emerging concepts. Denver is one of the hottest markets in the nation for emerging restaurant concepts, and is often called a foodie city, but that is not helping those who are trying to make an entrance.

The old adage "location, location, location" has never been more important for standing out as an operator; unfortunately, the quality space to plant a flag doesn't seem to exist. So what is a retailer to do?

I am encouraging clients to consider looking outside of the Denver city limits, and I have presented projects in secondary markets that could be huge opportunities for retailers. These opportunities for expansion exist along the entire Colorado Front Range and even in the Western Slope and mountain communities, which often are considered secondary markets. The clear and present advantage is the frequent lack of competition and, even more so at this time in the market cycle, additional space availability. I often use a pie analogy asking, "If you only have the opportunity to get a small slice of a big pie, wouldn't it be just as good, if not better, to get a bigger slice of a smaller pie? Or better yet, have the whole pie to yourself?"

The other factor that often leads to success in secondary markets is lower costs, whether it is lower occupancy cost, staffing cost or marketing cost.

Retail space is in demand for fast-casual restaurants.

Secondary markets like Lafayette may provide opportunities for retailers.

There are some great success stories in smaller markets and some concepts worth watching and duplicating. For example, Spoons, a soup kitchen of sorts, is one of my favorites and one of my stops any time I am in Fort Collins. Another is Post, a Big Red F Restaurant Group concept, based around a brewery and chicken menu in Lafayette. There is also ToGo's, one of California's largest sandwich chains, with over 325 locations, which just opened its first Colorado store in Colorado Springs. These retailer successes translate into developer and owner success stories as well. Over the course of the last 12 months, I have seen new projects preleased, and, in some cases, fully leased before delivery in markets like Castle Rock, Loveland and Lafayette – some had written these off as locations not worth the time and money. Rather than writing these secondary markets off, I am encouraging my clients to focus on them as some of the best opportunities of 2015.

Denver will continue to offer great opportunities, new projects, renovations, creative reuses and adaptions, but the secondary markets hold a lot of consumer dollars for those willing to go capture them. It will take some outside-the-box real estate searching and analysis, and some creative deal structure, but for a bigger piece of pie, it seems worth it to me.▲

Retail lagging but offers opportunity for investors

It has been said that the economy of Colorado Springs historically trails Denver by 12 to 18 months. When a downturn hits the economy, Colorado Springs may not feel the full impact for up to a year after the Denver market, and when the economy begins to recover, Colorado Springs does not see that recovery for 12 to 18 months. I have never heard a definitive explanation for this lag – maybe it is because Colorado Springs' economy is heavily influenced by the military (30-plus percent) and government spending does not follow the national or state economies, or maybe the companies that provide the primary jobs have different influences than those in Denver.

Jay Carlson
Principal, managing broker, Front Range Commercial, Colorado Springs

In this recovering economy, if Denver is Colorado Springs' older brother and they are in economic "school" together, Colorado Springs was held back a grade in 2014. Recovery of the Colorado Springs market is well behind the 12- to 18-month lag we have grown to expect.

Simply driving through each city provides proof of the longer-than-normal lag. In Denver there is new commercial construction in every quadrant. New homes are being built in creative new developments, and young people are attracted to Denver for careers with established companies as well as start-ups and high-tech. In Colorado Springs commercial construction is almost nonexistent, new home construction is stagnant at recession rates and well-qualified workers are moving to vibrant markets to the north. These factors all have an impact on the retail market in Colorado Springs.

Retail vacancy and absorption. Turner Commercial Research reports that overall retail vacancy rates reached a historic low in Colorado Springs in 2006 at 6.4 percent. Rates rose each year after that, to a high vacancy rate of 12.2 percent at the end of 2012. (2014 ended with a 10.2 percent retail vacancy rate.)

Absorption (the change in the amount of occupied space from one period to another) was negative in 2011 and 2012, meaning the amount of leasing activity could not surpass the increases in vacant space. Positive absorption numbers returned in 2013 and 2014, chiseling away at the vacancy rates. However, the vast difference in commercial construction activity between Colorado Springs and Denver is similar to that of each city's largest retail corridors, suggesting that Colorado Springs may have greater vacancy issues than the overall numbers indicate.

Colorado Springs has two main retail corridors – Academy Boulevard and Powers Boulevard. Academy Boulevard's retail properties were built during the 1970s and 1980s, while the retail on Powers Boulevard was built in the mid-1990s through today. To get the true vacancy numbers of what is apparent when driving through the two main retail corridors, I looked at the vacancy rates reported in Turner's year-end edition on individual shopping centers on Academy Boulevard and Powers Boulevard. The charts show my nonscientific findings. (The numbers do not include regional malls.)

From a visual inspection of each of these retail corridors, the vacancy rates on Academy Boulevard are in excess of the overall stated retail vacancy rate of 10.2 percent. However, it is more surprising to see high vacancy rates throughout the Central Academy area as well as for unanchored centers in the North Academy area. The other revelation according to these numbers is that the South Academy retail area, long considered the stepsister to all north locations, has much better occupancy than the Central Academy area in anchored shopping centers and has equal or better occupancy in unanchored centers than any other section of Academy Boulevard or Powers Boulevard.

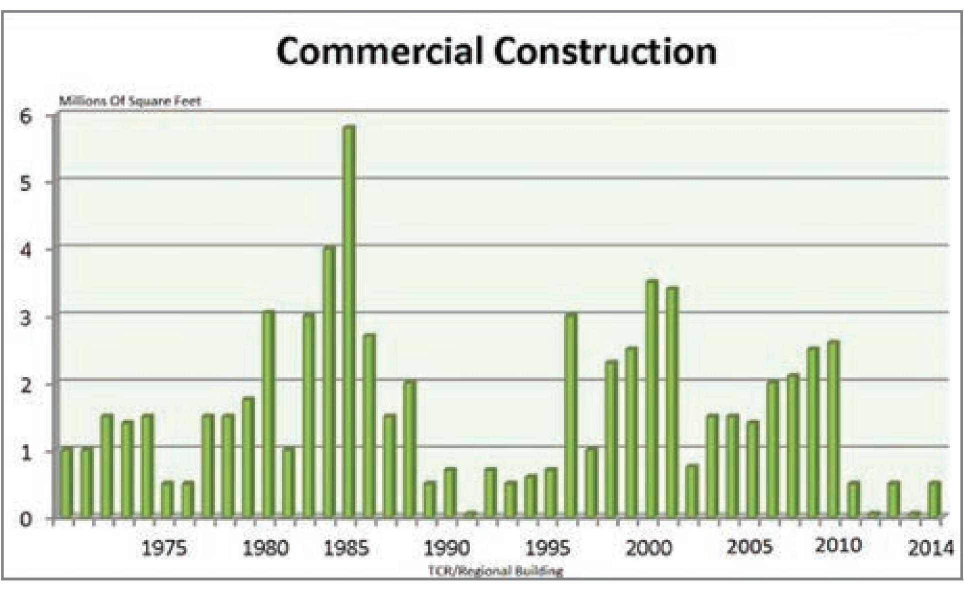
In general, the newer anchored retail centers throughout Colorado Springs, built with a much lower percentage of small retailer space, are very well occupied with strong national retailers. The older anchored centers, built with equal portions of anchor space and smaller tenant spaces, are struggling to find local or national tenants to fill their vacancies. Unanchored centers throughout the city are experiencing high vacancy rates as well.

Retail building sales. According to Turner, 57 retail properties were sold in Colorado Springs in 2014, the fewest number of transactions since 2010. Of the 57 sales, 29 were sold to investors (not owner/users). The average price per square foot of all sales was $92.72.

On a national basis, there is great demand for quality retail properties from investors. This has driven capitalization rates down to unheard of levels for quality properties (a low capitalization rate produces a higher sales price). While these ultra low cap rates are now the norm in the Denver market, Colorado Springs is still abundant in higher cap rate opportunities, getting investors more for their money.

There are bright spots in the Colorado Springs retail market: University Village on North Nevada Avenue continues to bring in strong national retailers. Some of the retailers are new to the market, like Trader Joe's and Bass Pro shops, which opened in 2014 at Northgate Road on Interstate 25. The development is expected to announce many new retailers soon. Walmart Express is in the process of opening five new stores in the market, helping to absorb several big-box vacancies. The First and Main development on Powers Boulevard continues to attract the highest-quality retailers to the market.

The overall story in the retail commercial real estate market in Colorado Springs is one of opportunity. The day is coming for Colorado Springs to catch up to the frantic economic pace of its big brother to the north. There are opportunities to purchase existing healthy retail centers and reposition them in the market. On the other hand, there are opportunities to purchase existing struggling retail properties, raze them and create entirely new mixed-use developments. Either way, there are several opportunities for investors to purchase retail properties at great prices relative to other markets. It's time to seize the opportunity.▲



Turner Commercial Research vacancy statistics year-end 2014

Shopping Centers	Size	Vacant Space	Vacancy Rate
53 (anchored)	12,064,000 sf	713,000 sf	5.9 percent
272 (unanchored)	7,603,000 sf	1,286,000 sf	16.9 percent
325 (total)	19,668,000 sf	2,000,000 sf	10.2 percent

Carlson's vacancy rate findings for the two main retail corridors

Academy Boulevard	Anchored	Unanchored
North Academy *(Interstate 25 to Union Boulevard)*	8 percent	23 percent
Central Academy *(Union Boulevard to Platte Avenue)*	35 percent	24 percent
South Academy *(Platte Avenue to Highway 115)*	21 percent	18 percent
Powers Boulevard	**Anchored**	**Unanchored**
Fountain Boulevard to Woodmen Road	5 percent	18 percent
North of Woodmen Road	5 percent	30 percent

The day is coming for Colorado Springs to catch up to the frantic economic pace of its big brother to the north.

Market Driver

Experience and attention are the new economy

The Great Recession had a tremendous impact on our economy, retailers, shopping centers and consumer habits. We have seen the impact of e-commerce and the ripple effect it is having on bricks and mortar. Consumers are savvier and demand more from their retailers, resulting in greater competition and reduced margins.

There is still much to be worked out with e-commerce, but I believe there is a force to be reckoned with that will influence the retail marketplace and it has nothing to do with Treasuries, oil prices or interest rate – millennials are rising!

Those born between 1980 and 1995 cannot be overlooked. Boasting a population of approximately 75 million, they are quickly becoming the most influential group of consumers. The Great Recession and technology have reshaped the marketplace, but I believe the next shift will be driven by the millennials who are looking for brands that are high quality, fit their personality and incorporate social responsibility.

Even if millennials have become accustomed to "window shopping" in an electronics store like Best Buy to find the laptop they want, then later buying it online at Amazon, thus delaying the instant gratification for two days, there is still a competitive advantage bricks and mortar offers – experience. The right experience can evoke emotion and spur loyalty. In order to offer this experience, retailers need to grab the attention of millennials.

Economic breakthroughs often are driven by real or perceived scarcity in the market. For a period of time during the industrial revolution, the scarcity was labor. We needed people to run machinery to keep up with the demand for goods. Then, as we began to produce incredible amounts of goods, the scarcity became knowledge. Our production was so good, now consumers had options and choices. We are inundated with choices, from deciding which car to buy or which food is the healthiest, to which smartphone can handle email updates, GPS needs, social network posts and take good selfies.

Today the scarcity is attention. Take a look around and observe how many people in our society have their head down focused on their smartphone. Our phones follow us everywhere, and with all the information we have available at our fingertips, our immersion in technology takes our attention away from the real world. Despite this, I believe that a desire for meaningful relationships and experiences still exist.

Luke McFetridge
Regional property manager, NewMark Merrill Mountain States, Fort Collins

So how do retailers capture the attention of the selfie-taking, Instagraming, Twittering, Facebooking millennials who are the next generation of shoppers?

Tenant mix. Give them what they want. The right tenant mix, as well as offering options that cannot be replaced by e-commerce, are key in creating an incredible experience. Retailers are realizing that they have to offer more to be competitive. Retailers like Whole Foods and REI focus on creating an experience while shopping. The staff is trained to take a typical shopping visit and transform it into an educational, inspirational and gratifying experience that creates value for and loyalty from the shopper.

Technology. Embrace technology instead of fighting it, and use it to your benefit. If millennials want to post photos and add hashtags, why shouldn't they be doing it at your shopping center? Technology has moved social media from a static place – either at home or office – to on-the-go where people can engage in real time. Beacon technology is one of the latest trends hitting the shopping center industry, which takes advantage of the signal a cell phone emits and collects data that can be used to optimize retail centers. Look for this technology to change how tenants and owners engage with their shoppers.

Third place. By encouraging shoppers to stay a while and come back frequently, retailers are creating a "third place," a place to go besides home and work (first and second places). In order for this to be successful, retailers must capture their attention and give them a reason to stay. Free Wi-Fi is not only expected, but also presumed at high speeds. It pays to be ahead of the curve when it comes to Wi-Fi speed. The next generation is going to expect Wi-Fi wherever they go, so retailers might as well offer it now. This also creates another opportunity to gather additional customer data, which can be used to benefit the store.

TENANT MIX:
GIVE THEM WHAT THEY WANT
TECHNOLOGY:
DON'T FIGHT IT
CREATE A 3RD PLACE:
ENCOURAGE THEM TO STAY A WHILE
GIVE THEM
SOMETHING TO DO
GIVE BACK

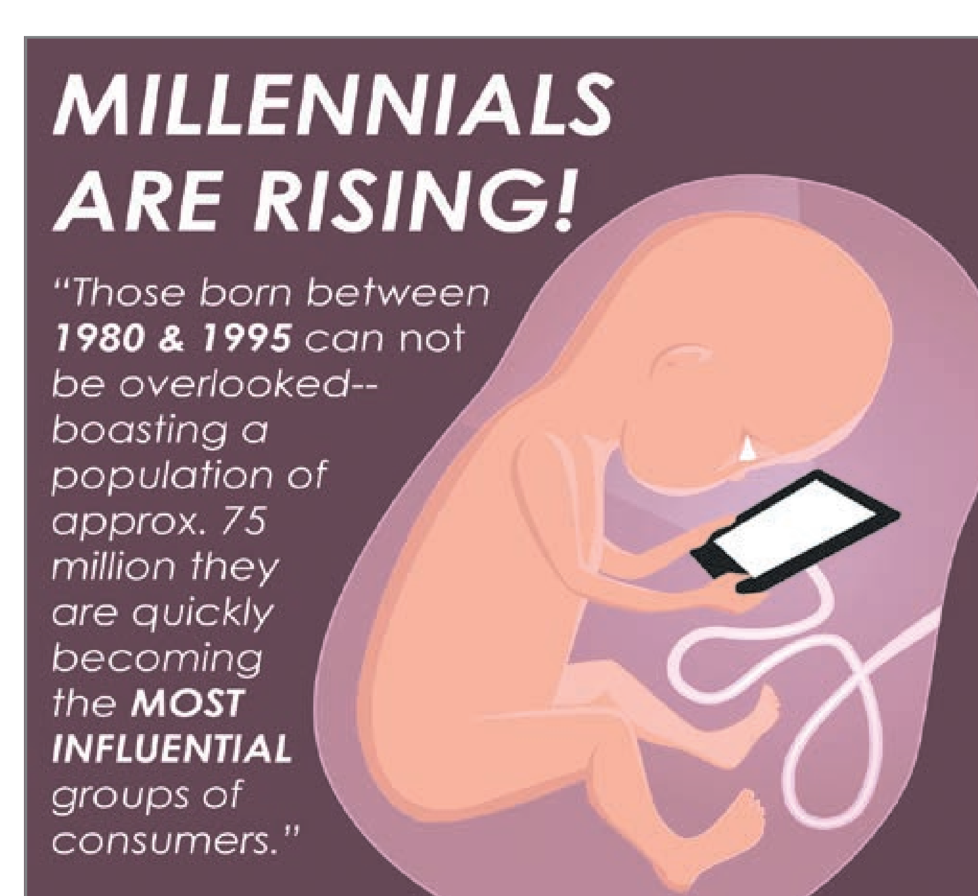
Simple things like charging stations help as well. Anyone who owns a smartphone can understand why this is important. Retailers shouldn't want potential customers leaving a store to go charge their devices.

Immerse the senses. Create a stimulating atmosphere to draw attention from the soft glow of phones. Lights, seasonal floral color, water amenities and music are simple additions that engage the senses. There are even technologies that exist today to infuse fragrances into an environment. Food retailers like Cinnabon have their ovens placed toward the front of the store so the aroma of freshly baked cinnamon rolls escapes into the shopping center every time the oven is opened.

Host events. Events are an incredible way retailers can generate experiences and create positive memories for shoppers. Low- and no-cost events, like a concert series, car shows, cooking exhibitions and action sport demonstrations, welcome the community to your center, promoting community involvement and camaraderie. Creating a diverse calendar of events can take a lot of thought and preparation, but the outcome can rally a community around your center and give customers opportunities to live experiences right in their own backyard.

Give back. Social responsibility is no longer just a trendy term that is thrown around. Get involved in the community you serve. Shopping centers have a tremendous impact on the sales tax base of a municipality, and they can also engrain themselves into the fabric of a community. Millennials are drawn to a brand that stands for something and, by doing so, shopping centers can do right by doing good.

To have a successful project, you need successful tenants. The days of passive ownership are over. As developers, we typically shudder at these ideas because they can drive up development costs, and the ongoing programming comes out of the bottom line. But with customer expectations continuing to evolve and the millennial generation representing shoppers of the future, retailers can't afford to ignore these trends.▲



Market Driver

California dreamin' for Colorado cap rates

When working at Trammell Crow Co. in the late 1990s, I led a group undertaking single-tenant, retail and build-to-suits all over the United States. We developed many projects throughout the country and even outside of the contiguous U.S., including Alaska and Puerto Rico. We would build the same building with the same lease for all of our clients in different markets. I always found it interesting how many almost identical properties we could sell, but the price would vary somewhat dramatically.

Greg Ham
Chief operating officer, co-founder, Cadence Capital Investments, Greenwood Village

We built an OfficeMax in Ponce, Puerto Rico, and the lease was in English. However, all the underlying documents were in Spanish. I have to admit, relying on a local lawyer to interpret and approve all of the underlying documents that were in Spanish was daunting. The location, language issue and the fact that you could not do 1031 exchanges in a U.S. territory at the time, pushed the cap rate and we were able sell the property up 100 basis points higher than what the same lease and building prototype sold for in similar locations in the continental U.S. This was in spite of proven high sales figures for retailers like OfficeMax in Puerto Rico. I decided after that deal to always factor in some of the more intangible factors that influence real estate investors.

Since 2002, we have been investing in and developing properties in Colorado and California. I am amazed at the special connection these two markets have and the benefits that Colorado gains from California investors' infatuation with our real estate.

Many elements go into property valuations. Factors include the quality of the improvements and the location, quality and length of the income stream, and, maybe most important, the amount of the income stream.

Colorado real estate generally gives California investors a slightly higher return, which, without a doubt, is a factor. However, the mountain resort image of our state and the lifestyle, along with a lot of direct flights are big differentiators that should not be overlooked.

In my experience, Kansas City, Missouri, from a cap rate perspective, is penalized for being flat, Minneapolis for being cold, and Cleveland for, well, being Cleveland.

We are blessed with beautiful mountains, great weather and a healthy lifestyle within which Californians connect.

Of course, as Coloradans we would like to pat ourselves on the back and say this infatuation exists because of the vibrant economy and quality communities that we have created. One might argue we have had little to do with it, but rather the landscape, proximity to California and weather are blessings we are fortunate enough to have.

We have an image created by the physical beauty, weather and lifestyle that attract real estate capital from other parts of the country, but especially from California.

Sprouts grocery store, part of a project completed at South Broadway and East Belleview Avenue, is a prime example of California capital investing in Colorado properties.

This strip mall was also completed as part of the project with Sprouts, which sold to an international company, represented by a California broker.

Most Californians are proud that they live in a state with beautiful mountains, beaches and very pleasant weather. The massive metroplex stretching from Ventura County north of Los Angeles, to the Mexican border in San Diego is one of greatest economic engines in the history of the world. The Bay Area in the north is not as large, but extremely significant. Add it all up and that is a lot of real estate worth a lot of money.

Real estate prices in these markets are high with low cap rates. I found that when an owner of a small apartment building in Los Angeles sells his property for a 4 cap, often the joy of selling is tainted by the fact that in order to buy something else in California, it's going to command the same crazy cap rate. To get an acceptable return, he would have to aggressively raise rents and drive net operating incomes up.

Many owners decide to look outside California for better returns. This is where the Colorado connection seems to flourish. Over and over again when selling retail assets, buyers from California step up to the plate and close on deals over local investors. Comments like, "I have always taken my kids skiing in Vail, so I would love to own property there," or "Colorado is such a beautiful place," are anecdotal comments I hear.

What I have not heard is, "I want to own real estate in Colorado because of the legalization of marijuana." Actually, I have heard statements to the contrary. And our neighbor to the west, Utah, is gaining more investor interest because of some of the high-profile decisions and events that may negatively affect Colorado's image.

In my experience, sometimes not many sophisticated economic metrics like demographics and employment growth are being applied. It is an image and a connection that Colorado has with California. These are investors buying assets under $5 million, and they are not institutional in nature. However, they are not short on real estate savvy and typically manage assets in a competitive California marketplace to get to where they are. They also have a lot of money to place when they sell even the smallest of assets.

If you own smaller retail assets, especially single-tenant, triple-net assets, you should make the California connection when you go to sell. In addition, we should all care about the image and perception of our state.▲

Ample capital sources available for retail properties

As we kickoff 2015, commercial real estate continues to display a healthy performance. While market strength alone may seem like a good enough reason for institutions to invest in commercial real estate, the capital market has created additional incentive. Much like last year, as interest rates remain low, institutional portfolio managers are finding commercial real estate yields attractive compared to other asset classes. With the supply of capital exceeding demand, commercial real estate lending is expected to be vigorous this year, and retail property owners are fortunate to have a wide variety of financing options available.

Even in this highly competitive lending environment, lenders remain selective. Appetites differ greatly from lender to lender, especially within the retail sector. Retail owners who seek financing in 2015 need to know what lenders are looking for. After all, the most competitive loan terms usually come from the lender that most wants to win the business.

Life Companies

Life companies are well known for being conservative lenders, and in exchange for lending on low-risk, stabilized properties, life companies offer the best available interest rates in the marketplace. Generally speaking, life companies prefer low-leverage loans, usually not exceeding 65 percent to 70 percent loan to value. Furthermore, many life companies will underwrite using internal, above-market cap rates to account for future market softness. Beyond seeking conservative deals, life companies don't all evaluate retail properties the same way. These are a few life company hot buttons:

Michael Salzman
Vice president, loan production, Essex Financial Group, Denver

Anchored centers. Many (but not all) life companies specifically seek grocery- or drug-anchored shopping centers. They will swing hard to win this business. Accordingly, retail owners should be armed with tenant sales figures so they can convey the strength of their anchor. For a grocer, lenders want to see sales figures that exceed at least $300 per square foot, and $400 per sf is considered good. Some lenders also evaluate a tenant's overall occupancy cost by calculating the ratio of total rent to gross sales. Ideally, this percentage should be in the low single digits.

Quality of tenant lineup. Life companies are always sensitive to lease rollover, however, they also pay more attention than ever to the types of retail users in occupancy (especially for noncredit tenants). As e-commerce continues to gain popularity, lenders strongly prefer tenants whose products and services can't easily be purchased online. For example, lenders favor restaurants, coffee shops, health clubs, and hair and nail salons, compared with clothing, shoe and bookstores. They generally like shop space ratios to be less than 35 percent of the total net rentable area, including the anchors.

Loan per square foot. Since life companies are conservative balance sheet lenders (meaning they tend to hold loans on their books for the entire term of the loan), aside from considering loan-to-value ratios to measure leverage, lenders also are focused on a metric called loan per square foot. Generally, life company lenders compete best if a requested loan per sf is $200 or less.

CMBS Lenders

Commercial mortgage-backed security lenders are the best option for borrowers who seek maximum leverage and the lowest loan constants. CMBS lenders underwrite using market cap rates, and they aren't afraid of 75 percent leverage. Additionally, although CMBS rates tend to be 20 to 50 basis points higher than life companies, CMBS lenders usually can offer longer amortization schedules, making their overall loan constants competitive. CMBS lenders also tend to be the best option for financing unanchored strip retail (because so many life companies are focusing on grocery- and drug-anchored centers), especially when a loan request exceeds $150 per foot. Here are a few important trends to know about the CMBS market:

Improvements to loan servicing. We've all heard horror stories about the frustrating inefficiencies of CMBS servicing in past years, however, retail owners who have avoided CMBS loans should consider taking a fresh look. The CMBS market heard these complaints and listened. Some CMBS lenders are looking for mortgage banking firms who can service the loans they originate. This allows mortgage bankers to provide better servicing and stand by their borrowers for the duration of a loan.

Focus on timeline. CMBS lenders are very focused on shortening the time it takes to close a loan, making them very competitive when it comes to financing acquisitions. Once CMBS lenders begin their process, they want to close and race to securitization. This translates to fast acquisitions for borrowers; CMBS lenders can close within 45 days. Also, as a side note, CMBS lenders won't shy away from low going-in cap rates (as long as the market justifies).

Banks and Credit Unions

Banks and credit unions deserve a mention, as they actively lend on retail properties. Because banks have a lower appetite for long-term, fixed-rate deals than life companies and CMBS lenders, banks tend to compete best for financing construction, short-term loans and transitional assets. Credit unions, on the other hand, still will entertain long-term, fixed-rate deals, however, they require full recourse to the borrower. Further, credit unions are not permitted to charge prepayment penalties, so they provide a very flexible exit for borrowers who don't mind signing recourse.

Nonrecourse Bridge Lenders

Nonrecourse bridge lenders are eager to finance transitional assets, and due to the low supply of value-

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OPTION	TYPE	EXPLANATION	REQUIREMENTS	USUAL SOURCES	AVAILABILITY	RATES/SPREADS	LTV/COVERAGE	LENDER FEES (POINTS)	TERM (YRS)	AMORT (YRS)	COMMENTS
PERMANENT LOAN	Debt	Fixed rate debt on stabilized centers	Stabilized Property Good Occupancy Good History Limited near-term rollover	Life Insurance Companies, Banks and CMBS Lenders	Excellent	150-250 bps over the comparable US Treasury	65% - 75% LTV; minimum 1.25x DCR	0 - 1/2	5 - 25	25-30	• Pricing dependent on leverage and tenant quality • Limited interest only period increasingly available; dependent upon leverage • Insurance companies are price leaders for terms 10 years or longer
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)
CMBS LOAN	Debt	Longer-term fixed rate loan	"A" to "C" quality property, Experienced multifamily 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
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	Debt/Equity	Equity source provides 95%+ of the capital stack, including third party debt	Experienced sponsor with a high-quality property ("A" to "B+") or development	Investment funds, life insurance companies, private capital and REITs	Good	Preferred return 8% - 12%	N/A	0 - 1	2 - 10	N/A	• Target IRR 10% - 15% + • Capital source usually controls major project decisions
PRESALE	Equity	Sale prior to start of construction; at a predetermined price	Substantial preleasing; better pricing for longer terms and stronger credit tenants	Investment funds, life insurance companies, private capital and REITs	Adequate	Presale pricing at 1.0% - 1.5% over the current market cap rates	0	0	0	0	• Cap rates continue to be compressed for quality deals due to high demand and lack of supply' grocery anchored retail and investment grade preferred

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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Revaluation of taxes in a strengthening economy

2015 could shape up to be an especially important year for property tax purposes for retail and commercial property owners. There is a strong likelihood that retail and commercial property owners could see significant increases in property tax valuations given the improving real estate values and general economic conditions in Colorado over the last three years. We have seen several indicators of an improving real estate market and strengthening economy. For example, according to the Colorado Secretary of State's Quarterly Business and Economic Indicators, state employment, wealth and building activity signal sustained economic growth; employment increased 2.8 percent year over year in second-quarter 2014 (reaching a new high of 2.4 million in June 2014); and annual foreclosure filings and sales decreased significantly in second-quarter 2014 (24.7 percent and 41.5 percent, respectively).

County assessors redetermine property values every two years. This two-year period is referred to as a reassessment cycle. Under Colorado law, county assessors are required to value properties based on data from an 18-month data collection period. County assessors will revalue properties this year using a data collection period of Jan. 1, 2013, to July 1, 2014. The valuations for both years of the reassessment cycle (2015 and 2016) will rely on the same data collection period. As such, property owners should pay particular attention to their 2015 property tax valuations when notices of valuation are issued in May because absent unusual circumstances, such as new construction, the valuations property owners receive in May will be used to determine their property taxes for the 2015 tax year and for 2016 as well.

Nickolas J. McGrath
Associate, Greenberg Traurig, Denver

County assessors may consider the income approach, the market approach or the cost approach to valuation for retail and commercial properties. The following is a brief explanation of these three approaches to valuation, and the impact of the data collected for each approach on 2015 revaluations.

The Income Approach

Using the income approach, the assessor calculates an operating income, expenses and vacancy; selects a capitalization rate; and divides the net operating income by the capitalization rate to determine the value of a property. Market rents increased while vacancy rates remained relatively low during the data collection period. According to the CoStar Group, the average rental rate across retail property types in Denver increased from $13.30 per square foot mid-year 2012 to $15.07 per sf as of first-quarter 2014, and the average vacancy rate across retail property types in Denver was 5.9 percent as of first-quarter 2014 (up slightly from an average vacancy rate of 4.9 percent mid-year 2012). In addition, cap rates continued to trend lower during the data collection period. According to CoStar, capitalization rates ranged from 6.96 to 7.86 percent based on approximately 14,500 retail sales nationwide between October 2013 and September 2014. Property owners should expect that higher net operating incomes and lower capitalization rates could result in higher 2015 valuations.

Neil B. Oberfeld
Shareholder, Greenberg Truarig, Denver

The Market Approach

Using the market approach, the assessor determines the value of a property by analyzing the sales prices of comparable properties sold during the data collection period. Generally, the market approach is the only approach to valuation permitted for vacant land and residential property. For 2015 revaluations, the assessor will be using purchase and sale transactions from Jan. 1, 2013, through June 30, 2014. There was a considerable up-trend in retail and commercial values through 2013 and moving into 2014. According to CoStar, the average sales price of office buildings 15,000 sf and larger increased from approximately $135 per sf at the beginning of 2013, to a high of approximately $235 per sf in third-quarter 2013, before declining and leveling off at prices of approximately $160 per sf, which is still higher than prices seen during much of the previous data collection period. As a result of the up-trend in real property values, the application of the market approach may result in higher 2015 property valuations.

The Cost Approach

Using the cost approach, the assessor determines the value of a property based on the anticipated development and construction costs of the property. Retail deliveries, construction and inventory grew during data collection. According to CoStar, a total of 772,057 sf of retail space was built in Denver between third-quarter 2013 and third-quarter 2014. There was an additional 379,028 sf of retail space under construction at the end of third-quarter 2014, and total retail inventory in the Denver market was 190.37 million sf in 14,065 buildings and 1,507 centers as of the end of third-quarter 2014. When the cost approach is applied, increased construction activity and construction costs during the data collection period may result in high 2015 revaluations.

Look Carefully at Your 2015 Valuation

So, what should you expect in the year to come? By May 1, 2015, county assessors will mail a notice of valuation indicating the valuation of your property for the 2015 tax year. Based on the discussion above, there are good reasons to expect that your valuation will increase this year, resulting in higher property taxes. Given the likelihood of increases, it will be particularly important to carefully consider the accuracy of your 2015 valuation and whether a tax protest is appropriate. For the 2015 tax year, the deadline to file a property tax protest is June 1.▲

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Retail Insider

The seller's market continues for Colorado retail

Strong job growth, a diverse and expanding economy, falling vacancy rates, increasing rental rates and a continued increase in demand from national and international investors made 2014 a good year to own a retail investment property in the Denver-Boulder metro area.

As we head into 2015, the following top four trends will shape retail investment results for investors in Colorado:

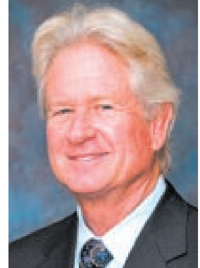
1. The desire for yield will continue unabated as financial assets continue to produce very low yields. This will result in continued cap rate pressure as demand for retail real estate remains strong.

2. The oil price "collapse," if sustained, will boost consumption, benefit retailers and increase retail sales, but will be a double-edged sword in some economies where energy employment is significant.

3. Continued improvement in job growth, reduced unemployment and increasing retail sales will result in increased demand for retail space, helping to reduce overall vacancy and increase rental rates.

4. A modest increase in new retail construction will result in positive net absorption and keep supply and demand for retail space in relatively healthy balance.

In addition to the strong fundamentals, the continued low interest rate environment has resulted in considerable investor interest in purchasing and owning retail properties. Investment yields on traditional financial assets, Treasury securities, corporate bonds and savings accounts are very low by historic standards, resulting in investors across all spectrums seeking real estate investments to achieve higher rates of return. The result has been downward pressure on cap rates, as buyers seek retail investments financed at historically low rates, making deals attractive at cap rates that only a few years ago would not have made any sense at all.



Garrette Matlock
Senior vice president, Investments, Marcus & Millichap National Retail Group, Denver

Post-recession investment sales of multitenant shopping centers in the Denver-Boulder metro area generally have seen the most velocity in grocery-anchored shopping centers and Class A power/lifestyle centers, which are heavily sought after by institutional buyers, on one end of the spectrum; and, distressed/value-add properties, generally targeted by more entrepreneurial investors, on the other end. In 2014, Class A properties generally sold at aggressive cap rates as interest rates fell (80 basis points over the course of the year), loans were available with increasing leverage at very low rates, and additional demand was created by an influx of national and international institutions.

Noninstitutional, private-party investors and investment groups, which had been active multitenant retail investors for years, generally have been disappointed at the small number of distressed or value-add opportunities with achievable upside available over the last few years, and either have withdrawn from the market or substantially reduced their transaction velocity. Some have begun targeting smaller redevelopment projects in densely populated, infill areas. Recently we also have seen these "upside" entrepreneurial investors attempting to acquire Class B and C properties for existing cash flow, without an obvious value-add angle, but these properties remain a small portion of the post-recession market due to a very limited supply.

Ryan Bowlby
Senior financial analyst, The Matlock Group, Denver

A part of the market that has seen a sizeable increase in demand recently is the market for smaller multitenant properties leased to high-quality tenants. The 1031 exchangers who flock to single-tenant properties with long-term leases in place increasingly have been discouraged by the low capitalization rates that these properties command. Many of these buyers have turned to small multitenant retail strips with two to five tenants, and have very low management requirements due to the discrepancy in capitalization rates. This increase in demand has put downward pressure on capitalization rates for these properties, but small multitenant strips still remain a good value in comparison. What remains true across all spectrums of multitenant retail properties is that the supply of such properties is limited relative to demand, and there is an abundance of buyers chasing the properties that are properly marketed. It is very much a seller's market.

A part of the market that has seen a sizeable increase in demand recently is the market for smaller multitenant properties leased to high-quality tenants.

The dramatic drop in oil prices (under $50 a barrel when this article was written) will result in an increase in disposable income. Consumers will have more money to spend on discretionary items, and the boost in overall spending is expected to benefit the retail industry and shopping centers in general.

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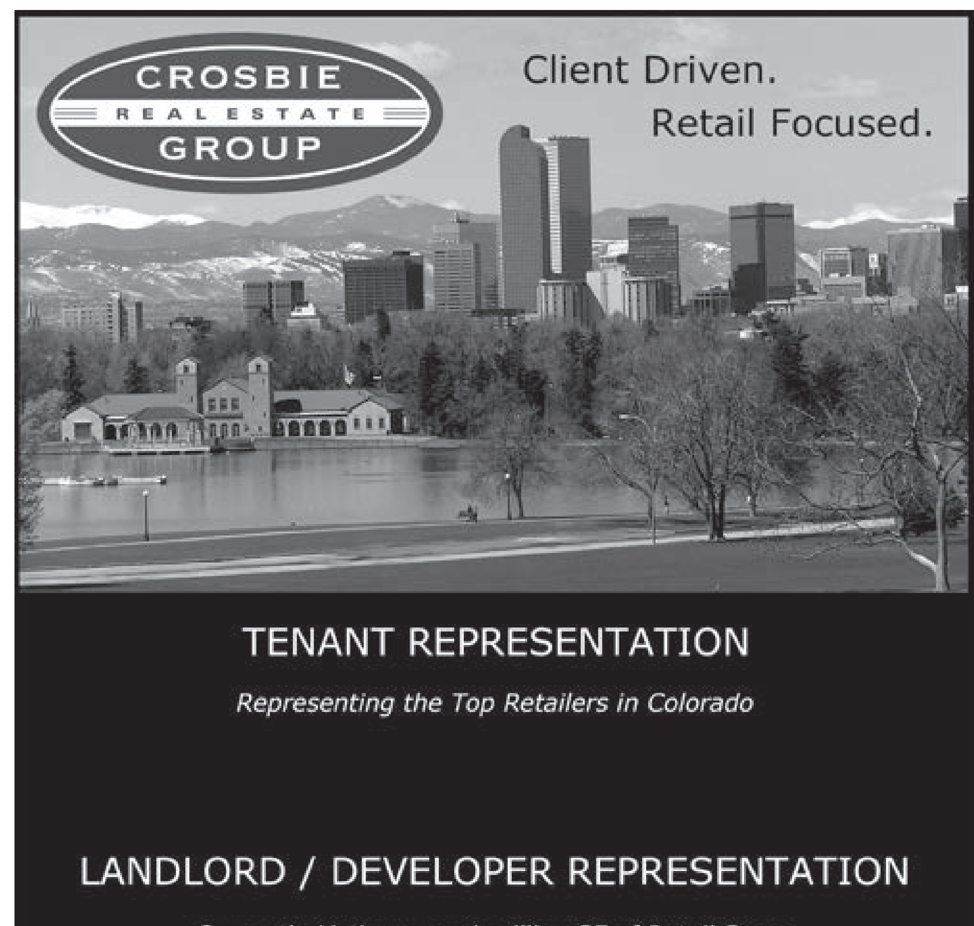

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Shopping Trends

Continued from Page 1

creative, independent stores that are doing really well, especially in the Lower Highlands, River North and Highlands areas," said Bayer. "Now national stores are taking a hard look at what makes these successful."

While malls remain one of the staples of the retail industry, there are several growing problems with them. One of the biggest is the fact that many malls and shopping centers are so similar in look and feel, said Stuart Zall, president of Zall Co. "I've been asked, what's my favorite mall and I don't have an answer because I can't differentiate that much between them," he said. "The big shopping centers don't have the creativity, and retail stores in malls lose their authenticity and 'real feel'."

Even though the traditional enclosed malls are not dying and won't be going away any time soon, Zall believes that some retailers in malls may start closing or downsizing. "Business models are changing and retailers are looking at other options for their stores," he said. "Putting a storefront along an active street is becoming more appealing than being in the middle of a large mall."

Many urban alley murals can be found in the River North area, which adds atmosphere to the shopping experience.

According to Zall, an issue that needs to be addressed is that Denver historically has not had great small-shop retail. Ari Stutz, a local developer and partner with Ken Wolf of Downtown Property Services, has properties in the RiNo neighborhood that are attempting to change that. Instead of a single store creating its own destination, Stutz and Wolf are redeveloping several buildings in RiNo with the hope of creating a central core for the community.

"We listened to the neighborhood and what they wanted was small retail spaces where creative, local businesses could thrive," said Stutz. "The difficulty we have here is trying to divide and break down large industrial buildings into small retail spaces."

Stutz said once they get over that hurdle and have the spaces ready to show, it is easy to encourage tenants to move in.

Jeff Osaka is one tenant who was easily convinced to move to the area and will be opening Sushi-Rama at the 2601 Larimer building, which was redeveloped by Downtown Property Services.

"It's like we're creating our own destination," said Osaka. "There's not really any competition here; instead each retailer helps out the other by bringing business to this area."

Osaka is not alone when it comes to opening retail in the RiNo area. Because there are many people who work and live in this area, with even more multifamily being developed, the neighborhood is transitioning and retail is trying to keep up with the growing amount of traffic. "It is an area that has been underserved for a while and it is great to see so much activity as retail tries to catch up," said Stutz.

For another retailer, Matthew Morris, owner of Matthew Morris Salon and Skincare, opening a store in the area was more about being original and groundbreaking. Morris is a renowned stylist, whose success with his first store, a 6,200-square-foot salon on South Broadway, encouraged him to look in similar locations to open another salon.

"We're known for having a luxurious place where it doesn't seem like it should be," said Morris. "So naturally, for store No. 2 we wanted to be in another area that needs pioneering."

These retailers believe there's a mindset that customers want to go somewhere unique and gritty. "The retailers moving into the area could drive some consumers away from areas like Cherry Creek North or the malls, and maybe even get them out of their comfort zone a little bit and create a new experience," said Stutz.

The previous two examples demonstrate that retail, no matter where it is located, is driven by what can't be done online – restaurants and services. This is also the reason why restaurants are paying the most rent. Whether it's casual dining or high-end, the restaurant industry is driving the retail rental market. And restaurants, like retail stores, are focusing on the consumer experience and bringing them to a destination, with breweries serving craft beer, farm-to-table locally influenced food and authentic designs intended to combine the food with the experience.

Whether it is an individual store creating a destination or a community of shops, retail is constantly evolving and inventing new ways to lure customers out from behind their computers and the world of online shopping, and into their stores. There is more thought put into where and when a store should be developed by using the increasing access to better data that provides breakdowns of who is shopping, at what time and what they are buying or consuming.▲

2601 Larimer is a mixed-used development with restaurant, retail and office space.

Jeff Osaka's Sushi-Rama will move into a store in the 2601 Larimer building.

Shopping Trends

Retail product takes different forms in Denver

Retail in central Denver neighborhoods is booming with strong job growth, new millennials arriving daily and a limited supply of real estate. This creates not only opportunities, but also several challenges for the central retail markets. All the new, young people downtown is driving demand for housing as well as places for these folks to eat, shop, socialize and recreate. Central Denver retailers are now defined as hip, progressive, artisan, foodie and trendy, which is what its young, rapidly growing population is looking for.

The growing demographic is just what retailers are looking for as well – young, employed and without kids, which means, unlike me, they have time and money to spare.

The challenge for landlords, developers and investors is how to balance the need for predictable, stable and creditworthy tenants with a track record that banks and investors desire, with the demand for hip and progressive entrepreneurs. Something new and exciting could be great for a property, but which cool new restaurant or retailer is going to have the long-term success that makes the bank and investors happy?

The other prevalent market dynamic in central Denver has been the new ground-floor retail opportunities that have come with the boom in multifamily developments. Though it has been great to have new product provided in mixed-use developments, it also has been a challenge for retailers to get comfortable with this product type. Retailers are used to single-story buildings with visibility, access and ease of parking as top priorities when choosing locations, and many of these fundamentals are tested in a mixed-use project.

My company is spending more time than ever helping landlords and tenants navigate these trends. Our experience with urban properties, as well as with retailers and landlords in traditional shopping centers, has given us an opportunity to help bring these two together. The landlords of urban properties take advantage of the hot market, and the owners of traditional shopping centers are able to attract new active tenants.

Mixed-use retail. Millennials are driving demand for urban housing and thus creating the multifamily construction boom we are currently seeing. The good news for retail tenants looking for space is that almost all of the new large multifamily developments include ground-floor retail, which is helping to balance some of the demand for new space. The challenge is that many mixed-use projects are built with the residential units as the primary focus, leaving ground-floor retail spaces struggling because they are not traditional real estate assessment models.

Access, visibility, parking and other key aspects that retailers typically are looking for are different in an urban setting than in a traditional shopping center, which makes it difficult for retailers to assess these sites. Since retail is only a small portion of the overall project, there is not a consistency in retail dynamics that one would find in more traditional retail settings, making it more difficult to prelease some of these projects. Because retailers have difficulty applying traditional formulas (traffic counts, ingress, egress, parking stalls) and their spaces can be less visible because they are a part of a large vertical building, they prefer to wait until projects are substantially complete, and physically walk the site to feel comfortable with it. These projects tend to lease up later into the development process than single-story retail, and a retailer who is not local has to be really interested in order to make a trip to walk the site. Working with landlords to help gain perspective on what retailers are looking for at these sites, and tenants to help them assess which opportunities are right for them, is key throughout this process.

John Livaditis
President, Axio Commercial Real Estate, Denver

From the developer perspective, it is important to know that not all ground-floor space has to be retail. There are other ways to use the ground-floor space if the correct retail dynamics are not there. However, it is enticing because it boosts the pro forma and activates the front door of the project, while empty ground-floor retail does nothing to help the bottom line or the appearance of a new development. For retail in mixed-use buildings to be successful, there has to be strong pedestrian traffic and a surrounding cluster of active retailers creating enough activity to overcome a retailer's traditional dependence on auto traffic, easy access and parking.

Restaurants. The central Denver restaurant market is hot, but beware of the revolving door. 2014 was a record year for restaurant openings in Denver, as Westword tracked over 300 restaurant openings throughout the year. (Almost one per day!) Compare that with 2013, when there were 200 restaurant openings. Hip, new restaurants tend to open with great fanfare and are quick to be touted as a smashing success, while restaurant closings seem to get lost in the noise created by all the grand-opening celebrations. Westword also reported 100 restaurant closings in 2014. This is still a very healthy restaurant market for landlords, with a net gain of 200 restaurants. The challenge is how to avoid being in the situation where your space becomes a revolving door of openings and closings, a trend that never seems to work out for anyone.

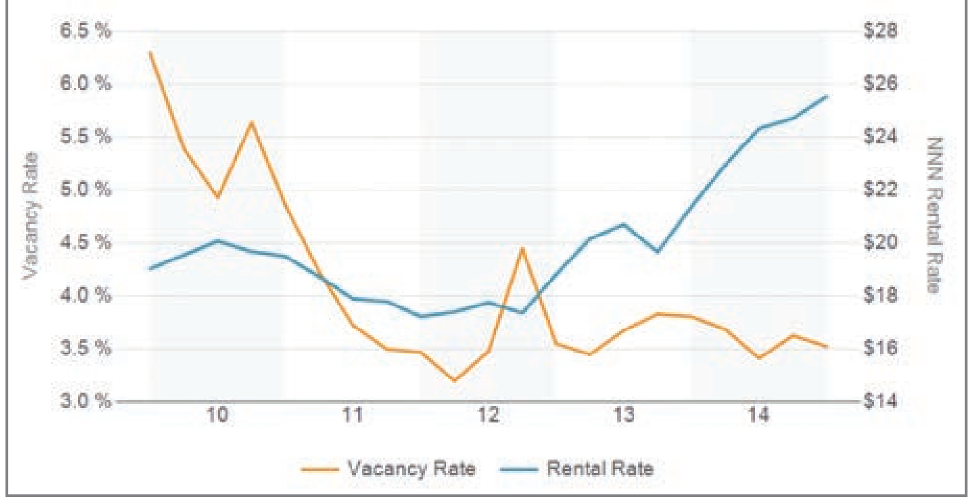
With demand high and a limited supply of restaurant space, the law of supply and demand says rents will keep pushing higher. With higher lease rates and new entrepreneurial restaurateurs who either overlook their occupancy costs due to the desire to get a space, or are inclined to inflate their potential sales, many restaurants are in trouble the day they sign their lease. Restaurants generally look to keep their rent plus triple-net expenses in the range of 6 to 8 percent of their total sales.

It is important for landlords to understand that the long-term success of their tenants is dependent on keeping rents in line with a restaurant's potential sales. Collecting the highest potential rent requires finding tenants that will achieve the highest sales in a particular location. This can be challenging because much of the current activity for restaurant space is coming from new one-off concepts. A look at the sales-per-square-foot numbers of national brands can help landlords understand what the rent-to-sales ratio looks like, since most are familiar with these concepts and the average unit sales are made public. Restaurant chains like Chipotle are attractive to developers not only because of their credit rating (or because their burritos are so tasty), but also because they have some of the strongest sales-per-sf numbers of any restaurant concept out there. A Chipotle store will average $2.17 million in sales out of a regular size space of 2,580 sf. This breaks down to $840.69 per sf at 6 to 8 percent, meaning this store can be profitable with gross lease rates in the $50 to $65 per-sf range for base rent plus triple-net expenses.

With rents plus triple net expenses in central Denver reaching record numbers, developers need to look at whether the tenants they choose can sustain high enough sales to stay in business and avoid the costs of the revolving door.▲

Restaurants are repurposing old, industrial spaces like Linger, which used to be a mortuary.

Many developments incorporate mixed-used elements with ground-floor retail space in apartment buildings, like at River Clay.



Over time vacancy rates have decreased while rental rates have increased for both retail and restaurants.

Average gross sales

Chipotle	$840.69 per sf
Panera Bread	$548 per sf
Noodles & Co.	$453.46 per sf

Neighborhood Profile

Merging art and development: The story of RiNo

by Ryan Gager

Customers inside The Source market hall can shop from local vendors and artists.

The saying goes, good things come to those who wait. Denver's River North neighborhood has been waiting, and now good things are coming. Tracy Weil, co-founder of the River North Art District, recalls a time before development and even before the area was RiNo. "When I moved here in 2000, our closest food sources were a 7-Eleven and Subway," said Weil. "So to see what is happening now is great."

What is happening is far from national chain development. Weil refers to RiNo as a maker's environment, a place for the creative entrepreneur. "What makes RiNo special is there's a high concentration here and they all feed off of each other," said Weil. "We're almost our own little town."

This momentum took several years to gain traction. In 2005, the art district started with eight members. Weil and the other members were determined to bring more people to the area, so they held a studio tour, built a website and distributed a press release. Introducing the area as RiNo, they also came up with a logo and a phrase, "Where art is made." Over 1,000 people showed up for the event.

"We went for it and had a great turnout," said Weil. "What I've learned over the years is that community building can spur economic development."

The art district has grown by leaps and bounds since its inception – from eight members to 170, and just last year RiNo earned the Creative District Certification by Colorado Creative Industries, a division of the Colorado Office of Economic Development & International Trade.

Many see retail in RiNo as an escape from corporate America and a chance to see and experience something different. "Instead of shopping at Walmart or Target, people come to RiNo to shop where they can often meet the person who made it," said Weil. "It's a different spin on retail and I think makes it more fun."

One place in particular that has embraced the maker's environment and attracted people to RiNo since opening in 2013 is The Source. The 26,000 square-foot brick building on Brighton Boulevard was a steel foundry from the 19th century. Today it is a marketplace, not only where people can eat at one of two restaurants, Comida and Acorn, or a shop at the various vendors including a butcher, baker, liquor store, florist, and art gallery and design store, but also a place where people come to meet up and socialize. The brewery and bar inside also enhances the atmosphere. The Source gives people a reason to stop and take a look around, which wasn't always the case in this area.

"Brighton Boulevard was always a street that people used to drive through to the highway," said Weil. "Now people are thinking they should stop and check it out."

The Source is one of several places in RiNo that brings the craft, manufacturing and retail together, giving customers a unique shopping experience.

Developers are finding ways to take advantage of the large industrial buildings in RiNo, once thought a hindrance to development in this area. Because there is not old residential or commercial to work with, Justin Croft, project manager with Zeppelin Development, said creativity was a tool that had to be used often throughout development. "It was basically a blank canvas," said Croft. "Mix that with the urban energy that this area had, and that is the recipe for the economic development that we are seeing."

As the last urban neighborhood near downtown, RiNo is experiencing lots of mixed-use, infill development. "Millennials want to experience the big-city atmosphere and in this area they are also getting the small-town feel," said Croft. "I think a lot of that is anchored by the local retailers."

Weil said it does not take too much convincing for retailers to move in. However, those who are interested must first meet with the members of the art district. "Developers see the vibrancy of the area and understand the cool edginess," said Weil. "They are the ones who ask, 'How can we help you maintain that?'"

Creating mixed-use developments and allocating space for performing arts, creative working or shared studios helps the art district maintain the culture in the area.

RiNo is in a phase of rapid development. Developers understand what consumers in this area want and are now providing it. Another market hall, similar to The Source, is in the works at the H.H. Tammen Building. Aptly named The Market, it will be on the corner of Larimer and 27th streets and will provide fresh and local produce, meats, cheeses, and dry and baked goods all under one roof.

The story of RiNo is not complete. This area has seen many changes over the last 15 years and will continue to progress. It will never be a clean, sleek, national brand-name retail area. Instead it is a raw, rough-around-the-edges, gritty art district – and it is becoming a popular trend.

"It's compelling when a housing development moves into the area," said Weil. "When people move in and want to fill their space with art, they are my customers. It is an all-ships-rise-together mentality."▲

The Source is a redeveloped iron foundry along Brighton Boulevard.

Several wall murals throughout RiNo represent the art and culture of the area.

The H.H. Trammen Building on 27th and Larimer streets will be redeveloped as The Market and will sell a variety of fresh and local food.

Neighborhood Profile

Exploring the possibilities along 38th Avenue

It should come as no surprise to retail brokers or developers that investors and prospective tenants have the Highland/Lower Highland neighborhood on their short list to buy or lease in.

This trend has not always been the case. Over 150 years ago, the mostly Protestant, church-scattered neighborhood was initially developed, but it wasn't until the turn of 19th century when many immigrants, mostly Italian, German and Scottish, discovered the neighborhood as a nearby escape from downtown Denver, and the population truly grew.

Gannon Roth
Senior broker, Unique Properties, Denver

The transformation of this area to the predominantly Hispanic and Italian neighborhood, as it is known to most longtime Denver residents, began in the 1920s and the population demographic remained largely consistent for 60-plus years.

In the 1990s, new bridges constructed over Interstate 25 improved connectivity between Denver and the Highland neighborhood, Elitch Gardens relocated to Platte Valley and the historic site on 38th Avenue and Tennyson Street was redeveloped. These changes provided the first signs of eminent rebirth for a now appealing neighborhood.

After the 1990s rebirth, most commercial and residential developers were focused on the Highland's Square area, roughly 32nd Avenue and Lowell Boulevard. Development in this area spread like wildfire as prices for all property types skyrocketed and inventory declined. As a result, many developers, tenants and buyers were forced to look for nearby alternative locations, such as LoHi, Sunnyside, Sloan's Lake, Berkeley and Jefferson Park.

Many Denver residents were attracted to the quaintness and character of those neighborhoods, yet 38th Avenue was seen as a major traffic corridor of less desirable uses and unattractive buildings, such as automotive repair, pawn shops and brown-bag liquor stores. However, over the past few years, many industry professionals and commercial real estate users set their sights on the still somewhat seedy 38th Avenue corridor.

While currently in its infancy of redevelopment and gentrification, this is quickly changing and numerous opportunities are opening up for property owners, developers and business owners.

Similar to the Highland's Square neighborhood, changes to 38th Avenue started with a concentration between Federal and Sheridan boulevards. The former Elitch Gardens site, now a 24 Hour Fitness-anchored, mixed-use development, brought in some of the first national retail center-type tenants and was an indication of what was to come. However, just like the surrounding neighborhoods, activity spread past the east and west boundaries, and as a result, we are seeing the rebirth of the 38th Avenue corridor, as it stretches from I-25 to Wadsworth Boulevard in Wheat Ridge. Because of the history of this corridor, it is no surprise that there are properties of all ages, types and sizes, and, as a result, urban renewal is taking on a similarly eclectic appearance.

The perpetual evolution of this corridor carries an underlying trend that cannot be ignored – the demographic shift is reflected in businesses catering to the needs of these new residents. Many restaurateurs are now considering the 38th Avenue corridor for new or additional locations and concepts, and while the types of restaurants vary greatly in price point and category, they appear to be competing for and appealing to the "trendy spot"– craving residents. Two examples are Denver Deep Dish, opening its second location at 38th Avenue and Kalamath Street, and Sunnyside Burger Bar, opening at 38th Avenue and Lipan Street. Both restauranteurs elected to remodel smaller properties that required significant construction to get them to the attractive caliber they are at today.

This trend can be seen in other nearby properties as well, like 2705 and 2709 W. 38th Ave., which are planning an overall update, according to Dennis McLin, principal of McLin Commercial. As a result, the tenants are considering a similar update to their existing business practices and products in order to entice local residents and appeal to the changing demographics.

Despite the popular upgrading and repurposing trend, not all new opportunities for business owners are following suit. A simple search of commercial listing websites shows there are many ground-up developments completed, under construction or proposed at this time. These development properties vary in size from smaller parcels, like the small-format retail center redevelopment of a single-family home site at 6690 W. 38th Ave. in Wheat Ridge to multilevel apartment and retail mixed-use developments, such as Highland Place at 3380 W. 38th Ave. The plethora of older buildings often in deteriorating condition, along with the increasing demand for retail and apartments in the area, make it unlikely this scrape-and-rebuild approach will slow down any time soon.

Even though opportunities exist for tenants to find affordable rents in the area, they will be in less desirable, and often less functional, older properties. With the high rates needed for new construction proving to be a hurdle for many tenants, some newer developments are not leasing as quickly or for the rates initially expected; however, rates on the corridor are still rising. One would be hard pressed to find rates lower than the mid-$20s per sf triple net for the newer or upgraded properties, and these quoted rates can go up to the $40s per sf triple net in some cases. While these rates and the desirability lag compare to the LoHi and Highland's Square areas for comparable spaces, they are a far cry from the basement prices expected a decade ago on 38th Avenue.

The Highland and surrounding neighborhoods have experienced exponential change over the last 150 years. For residents, developers, brokers and business owners alike, these changes are predominantly welcomed and are occurring at a pace not seen since the early days of the neighborhood.▲

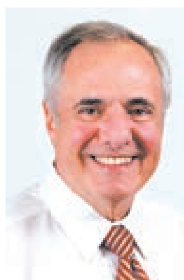
The former Elitch Gardens site is now a mixed-used development with a Sprouts, FirstBank and 24 Hour Fitness.

Sunnyside Burger Bar, at 38th Avenue and Lipan Street, chose to remodel an old, small property for their restaurant.

A small-format center development is taking place on a single-family home site along 38th Avenue.

Neighborhood centers and the grocery war

At the Rocky Mountain Commercial Real Estate Expo in November 2004, I delivered a presentation on the future of grocery store development in the Denver metro area. This article follows up on those predictions and what impact the merger of Safeway and Cerberus, Albertsons' parent company, will have in the continuing grocery war.



Howard Gerelick
Shopping center consultant, retired vice president of real estate, Safeway, Denver

Grocery store trends. Between 1989 and 2004, the growth of new grocery stores exceeded the population growth – the population during that period grew 37 percent, compared with the growth of new grocery stores at 42 percent. Albertsons' store count increased 52 percent, followed by King Soopers at 47 percent, then Safeway at 30 percent. Many of the new Safeway stores were on-site replacement stores, which increased its market share by 6.3 percent, while Albertsons, despite aggressive expansion, had its market share decline 14.6 percent, and the market share of King Soopers also decreased 8.7 percent. Cannibalization of existing stores, and having to compete with larger, newer Safeway stores, contributed to King Soopers and Albertsons losing market share despite building more new stores than Safeway.

National trends showed that market shares of conventional stores were projected to decline from 76 to 55 percent between 1997 and 2009, with price operators market share increasing from 21 to 39 percent and the market share of specialty stores increasing from 3 to 6 percent.

In 2004 I accurately predicted that conventional supermarkets would concentrate on remodeling and experiment with alternative formats to compete with the specialty stores entering the market. Based on current research and findings, I predict that specialty stores and super discount stores will be responsible for building most new stores, and fewer conventional stores will be built.

Historical perspective. A walk through the retail cemetery shows how the retail environment has changed over the years. The early grocery chains like Millers, National T, A&P, Furrs, Cub Foods and various Hispanic grocers are long gone. New food stores like Sprouts, Whole Foods, Trader Joe's, Vitamin Cottage, Save-A-Lot, Super Target, Super Walmart and Walmart Neighborhood stores have taken their place. King Soopers has had the most aggressive new store development in recent years, while Albertsons and Safeway have closed stores. And as these new supermarkets and discount stores got into the pharmacy business, drug chains like Skaggs, Osco, Eckard, Longs Drugs and Drug Emporium are no longer around. Looking at nonfood chains, Handy Dan, Mervyns, May D&F, Linens 'n Things, Woolco and Kmart, as well as major appliance stores have also disappeared – replaced by Home Depot, Lowes, Kohl's, dollar stores and outlet malls.

Redevelopment of neighborhood shopping centers also has been updated to accommodate new retailers or allow for expansion of existing supermarkets to include new formats. I was fortunate to be involved in the transformation of two King Soopers shopping centers that were redeveloped as Safeway-anchored shopping centers. The bottom line is retailers may come and go, but good locations are irreplaceable.

Albertsons and Safeway will merge, but continue to operate under both names.

> I think it is time for conventional grocers and shopping center owners to re-examine who their customers are, and develop shopping centers that offer the convenience, goods and services that consumers demand.

The merger could result in a grocery war for owners if two stores are close to each other.

The Safeway/Albertsons merger. How will the merger of Safeway and Albertsons change the dynamics of the grocery war and what role can developers, investors, landlords and city governments play to avoid becoming a casualty? In the short term, as the two companies complete their merger, I do not think capital spending will be high on the list of things to do. The companies suggest that they will continue to operate under both banners, but I believe this will be difficult to do. Albertsons has never had a shopper-loyalty card, it sold off its gas stations and, even when its stores were new, they felt plain, old and dated. Albertsons does have more nonfood stock-keeping units than a typical Safeway store, but, in my opinion, Safeway has better perishables and better facilities.

I suspect these stores eventually will end up operating under one banner, and it will be Safeway. After all, it is the oldest supermarket chain in Denver. For example, when Kroger acquired Smith's and Smitty's of Arizona, it eventually ended up operating them as Fry's Food Stores.

If you are an owner of a Safeway or Albertsons shopping center and there is a store with the other name close by, you need to decide if you want them to stay or have them leave. Now is the time to take control and, whatever the decision, aggressively pursue a deal that gives you control, otherwise you could become a casualty of the grocery war. Waiting for the other store to decide what it is going to do is not an option that will benefit you.

Appealing to the customer. Retail, particularly in the grocery sector, has become more difficult to find a format that is appealing to the fickle consumer. On one hand, you have examples like Costco, which requires the customer to buy a membership in order to be able to shop at its stores, and what you buy this week may not be available next week. The specialty grocer follows an opposing model, selling items you did not even realize you wanted to buy. The downfall of the specialty grocer is the lack of something as simple as Tide detergent, which is not available at these stores. Then there is the conventional supermarket, which is readily available in convenient locations. But the conventional supermarkets aren't without faults either. The model is based on trying to sell a little bit of everything, meaning inventory can run low and certain items are not available, therefore, these stores lose customers to the large membership retailers and specialty and discount stores.

I think it is time for conventional grocers and shopping center owners to re-examine who their customers are, and develop shopping centers that offer the convenience, goods and services that consumers demand. Often shoppers are willing to go elsewhere, rather than shopping at the most convenient location. Maybe this Albertsons and Safeway merger will provide an opportunity to develop a new format for both stores, and become co-anchors of the next generation of the neighborhood shopping center. ▲

Restaurant Update

Denver's restaurants have an appetite for variety

Kelly Greene
President, Urban Legend Retail Group, Denver

Last year, Denver welcomed approximately 300 new restaurants into the Denver metro area, and about 200, or maybe even more, are expected to open their kitchens in 2015. Needless to say, metro area diners have plenty of cuisines, neighborhoods and price points from which to choose. And before you begin to feel "stuffed," there are a lot of exciting new culinary ideas, ventures and trends that will keep you coming back for more.

One of the more interesting things occurring with small, chef-driven restaurants is the preference toward smaller spaces. These independents are more than happy to locate in a very intimate setting (2,000 to 4,000 square feet) and provide superior service and unique recipes to smaller groups of patrons. In addition to a small space, they are increasingly seeking locations that are tucked-away, and sometimes challenging to find, as long as they're in an urban setting. For these rebel chefs, being somewhat of a mystery – in an offbeat location – adds to the aura of their image, enhances the customers' experience and, some might say, makes them more in demand.

Perhaps people enjoy a sense of discovery and, for many serious foodies, the more unusual the trek to get a great meal, the more fun. As a result, small restauranteurs are on the hunt for the proverbial "hole-in-the-wall." Some of their target areas in Denver include old, traditional neighborhoods where small vintage buildings have been renovated (and have been home to the neighborhood tailor, barber or bar for countless years). Another surprising location that is in high demand is in the city's old, industrial zones (River North is a prime example), where a restaurant might set up shop next to a cement plant or a secluded art gallery. The many Denver neighborhoods that haven't yet reached their full potential in regard to development (Jefferson Park and Five Points are two examples) also are beginning to get a lot of attention from chefs with a "build it and they will come" approach.

The fundamental "rules of retail" have shifted for these culinary entrepreneurs. They do not require locations with the most auto and pedestrian traffic or highest incomes. And if they provide value, quality and are in step with contemporary trends and décor, people will find them. As an added benefit to their willingness to alter the rules of the game, they can obtain more affordable lease rates at the lesser-known commercial addresses that will help them to stay in the game long term.

This trend might concern the landlords of larger metro-area projects, but never fear, as many larger, multiunit operators' restaurants still want demand-only real estate. These restaurants understand that their customer base knows and appreciates their quality, consistency and service level, and will keep coming back for good food and added convenience. It's for this reason that the franchises want to be located in shopping malls and centers, along busy streets and in areas with great visibility. They often want large footprints (4,500 to 7,000 sf) so they can generate substantial volume and return on their investment.

The preference for chef-driven restaurants is toward smaller spaces.

Major, well-funded restaurant groups, particularly from other markets, are willing to pay top dollar for A locations, provided that they include the complete restaurant infrastructure and $100 per sf toward the build-out of the restaurant. These contributions often are in excess for larger restaurant groups. Their brand and reputation are already well known, highly respected and reliable for giving their customers exactly the experience they want. The landlords who can accommodate this formula for success likely will enjoy the value of having a strong restaurant-anchor tenant or tenants on their property for a long time.

In between the indie chefs and the large sit-down restaurants, there are numerous fast-casual restaurants, which continue to expand throughout the metro area. Customer favorites, such as Smashburger, Qdoba, Panera Bread, Modmarket, Potbelly, Noodles & Co., Einstein Bros., Hop Doddy, Chipotle and Dunkin' Donuts, are competing for new locations across the Front Range. They also have "prime" site criteria, and generally require 2,400 to 3,000 sf in order to serve their customers. In addition to new locations, this category of restaurants is actively updating the décor and design of their space. They want to appeal to a younger contemporary customer base, in addition to their base demographic, and stand apart from the competition.

If you're building up an appetite, the metro area's restaurant scene is as active as it has ever been and we are the beneficiaries.▲

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Restaurant Update

Lessons learned from opening new restaurants

2014 was a fast-track year for The Kitchen, with four new openings in less than nine months. The first opening was Next Door Glendale in March, followed by The Kitchen Fort Collins in June, then Next Door Union Station in July and finally, the first restaurant out of state, The Kitchen Chicago in October. Navigating the challenges of this level of accelerated growth was a new experience for the team, and it brought a commensurate amount of learning.

Aaron Mauck
Project manager, The Kitchen, Denver

Leila Schwyhart
Designer, Semple Brown, Denver

Reflecting on the whirlwind of activity and excitement that was experienced, the staff recognized there is no better way to improve an already well-honed process than to put new learnings and insights to work immediately. Thus, while new precedents for the future have been set, this information might also be useful to others embarking on a similar adventure. Here are a few good reminders, some surprises and a recommendation or two.

Good Reminders

Operator-designer relationship. A solid, trust-based operator-designer relationship is key to the success of each project with continuity among the development team critical to assuring that lessons learned on one project can be collaboratively applied to the next. Designs for each location will naturally evolve, making a team's collective knowledge and experience base extremely valuable, particularly when timelines overlap and converge. Further, a project is always more successful when the operator participates in the design process and offers input – in this case, the operator was Hugo Matheson, co-owner of The Kitchen.

Design and construction team. When the pressure is on and multiple openings are part of a long-term strategy, a strong, closely connected design and construction team that remains intact from project to project is crucial. It is incredibly important to thoroughly understand the scope of a project before moving forward. Bring in an architect early to help assess new spaces before committing to anything, and get a designer and contractor involved in the process right away to reduce changes once construction begins. Meet face to face on a weekly basis, maintain strong, longstanding relationships with vendors, consultants and subcontractors, listen for opportunities to better your design and visit the site often during construction to minimize surprises. Pre-coordination with base building teams also can reduce unnecessary headaches later on as core and shell buildings often are built (out) without consideration to future tenant needs.

Mechanical systems. Before beginning a project, a thorough, detailed understanding of the mechanical systems is imperative to avoid unexpected problems or added costs down

The Kitchen Denver is easily seen from 16th Street Mall and incorporates exposed brick in its design.

Next Door makes use of the newly renovated, historical Union Station building.

the road. This includes location, operability, potential for repurposing, level of efficiency and spatial needs of the infrastructure (i.e., electrical, heating, cooling and make-up air units, grease exhaust systems, distribution duct work and grease trap disposal).

Exhaust systems. Hood and grease exhaust systems can be particularly challenging due to their spatial and infrastructural requirements. Thus, they should be the primary consideration when determining the viability of transforming an existing space into a restaurant.

In Fort Collins, for example, the roof structure of the building had to be updated to support the needed rooftop ventilation equipment. This necessitated a surgical intervention to the existing structure, which involved peeling away a portion of the exterior walls and roofing.

Also, because grease exhaust must exit through the roof via a chase, restaurants located in multistory buildings present more complex issues. If a chase does not already exist, a vertical path to the outside must be found or created, which can be challenging in historic buildings because structural modifications are frequently required.

Lighting systems. Because lighting solutions are rapidly evolving, designing energy-efficient systems that are simple and cost-effective, yet allow for easy upgrading is key. The ability to take advantage of new technologies years before a space is ready for a complete remodel eliminates complex, costly retrofits and keeps operators happy.

Acoustics. Restaurant design is often about creating singular environments where sound quality is a critical factor in the success of the business, thus acoustical strategies and treatments must be carefully thought out early in the design phase. If treated as an afterthought, the addition of acoustical panels or other solutions can not only be unattractive, but financially prohibitive.

Historical buildings. Although renovating neglected historical buildings often can be a labor of love, preserving the character of the built environment within a city can be well worth the time and money investment (and the occasional headache!). Because the city approval process requires approximately four to six weeks, be sure to involve historic authorities and planning departments as early as possible to help align intentions and verify limitations in a timely manner. Making structural modifications to historic buildings can be challenging because they can severely alter the character of the space. However, if handled carefully, structural interventions can be cost-effective as well as visually compelling, even while retaining the charm of the original. Comprehensive evaluation of existing elements can also streamline decisions regarding what should be retained, modified or replaced.

A Few Surprises

Substrates. While assessing the quality of existing floor substrates is important, also be aware of unstable structures and unleveled floors in historic buildings. This will allow preparation for remediation strategies well in advance of construction, and budgeting for the appropriate solutions. In one of the locations, for example, the crew had to implement a number of structural upgrades to the substrate of the historical building, ultimately rebuilding the entire framing to level the floor.

Making structural modifications to historic buildings can be challenging because they can severely alter the character of the space.

Long distance. Opening restaurants in other cities (both in- and out-of-state) multiplies the complexities as well as the challenges. To resolve this, The Kitchen structured a flexible design and construction process to fit a variety of configurations and scales. Developing efficiencies and finding a balance between the priorities of budget, brand and what your design can accommodate is a natural next phase as more locations are added and geographical scope expands.

Tips and Recommendations

Delegate to focus on what you love. Because the operator of The Kitchen restaurants is very hands-on when it comes to design, finishes and materials, the team reached a point where a seasoned professional was needed to manage projects moving forward. While co-owner and chef Hugo Matheson is exceptionally talented in this area, it became obvious to him that opening four new restaurants in less than year, while fun and exciting, is also extremely time-consuming and takes him away from what he loves – being a chef!

Look for efficiencies. As growth accelerated and locations expanded, discovering how to streamline operations and seek out efficiencies in design and budgeting became increasingly critical. Lessons learned about how to implement these ideas at future locations helped to accomplish this, and allowed the development process and timelines to speed up enabling a quicker move in. An example of this involved the back-of-house spaces. While always striving to create unique dining experiences for customers and one-of-a-kind public spaces, streamlining kitchen operations is critical. Continually soliciting feedback regarding materials, adjacencies and systems from patrons and service staff helps designers create a better and more consistent template for the future.

Plan but be flexible. It is important to have a strong design in place prior to commencing construction, but be open to changing or evolving the design as unforeseen elements of the building are revealed or discovered during demolition. 3-D models allow for streamlining communications among team members before construction, therefore minimizing changes in the field. This was especially true for the first out-of-state project in Chicago. Once a high level of quality control was established, the design could evolve from one restaurant to the next while remaining true to its meaningful origins.▲

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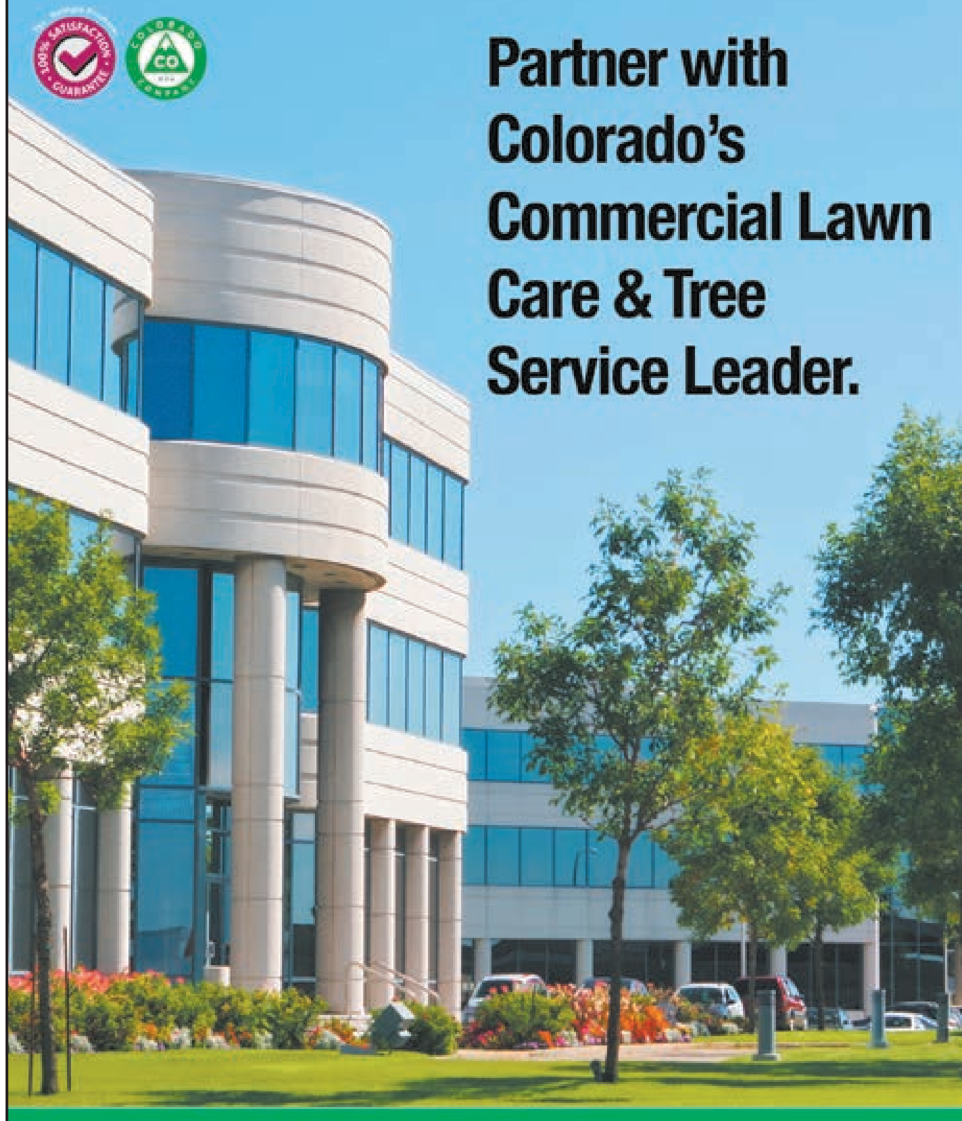

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Developer Spotlight

Shopping centers and big-box retail are adjusting

Chris Strom
Director of business development, Maxwell Builders, Denver

As I think about retail in Colorado, two specific trends come to mind – shopping centers have made an effort to upgrade and big-box retail is downsizing.

There has not been much new shopping center development, but there have been many redevelopments of existing centers. Shopping centers and strip malls provide an ease of use and single-stop convenience for a quick shopping outing. Usually, a stop at the anchor retailer is followed by a visit to a small shop next to it and then you are on your way. It is a great model that leads to success for all retailers involved. However, success for all is based on success for one, the anchor tenant. Time and time again, centers that lose the anchor tenant struggle to maintain business.

Courting a new anchor tenant can require extra work. In order to complete the deal, the anchor tenant may want upgrades. The request for a new façade for the anchor tenant, and the rest of the center, is becoming a typical scenario.

At centers like Villa Monaco in Denver and Westminster City Center, the new face-lifts are spurring development. The center becomes attractive not only to shoppers, but also to new retailers who want to get in on the action. The bottom line is having a successful anchor tenant and adding a new look can make or break a shopping center. Think about how many times customers shop at the anchor store, and then visit several of the small shops on their way out.

Speaking of anchor tenants, the grocery saturation is still ongoing with King Soopers leading the way. Walmart, Whole Foods, Safeway, Trader Joe's and Sprouts are following suit, and soon Winco Food also will have a presence in the Colorado market. Smaller footprints, which give the impression of a smaller local grocer, appear to be the focus of these stores. However, there are exceptions, such as the new King Soopers, built by Maxwell, at Broadway and Littleton, which is 20,000 square feet larger than its traditional stores.

The market also is busy with urban, mixed-use properties. Quick-serve restaurants and smaller users are very popular, and we are seeing lots of multitenant ground-up suburban projects. The sites with better visibility are in high demand, while the market in general is experiencing lower vacancy and higher rental rates.

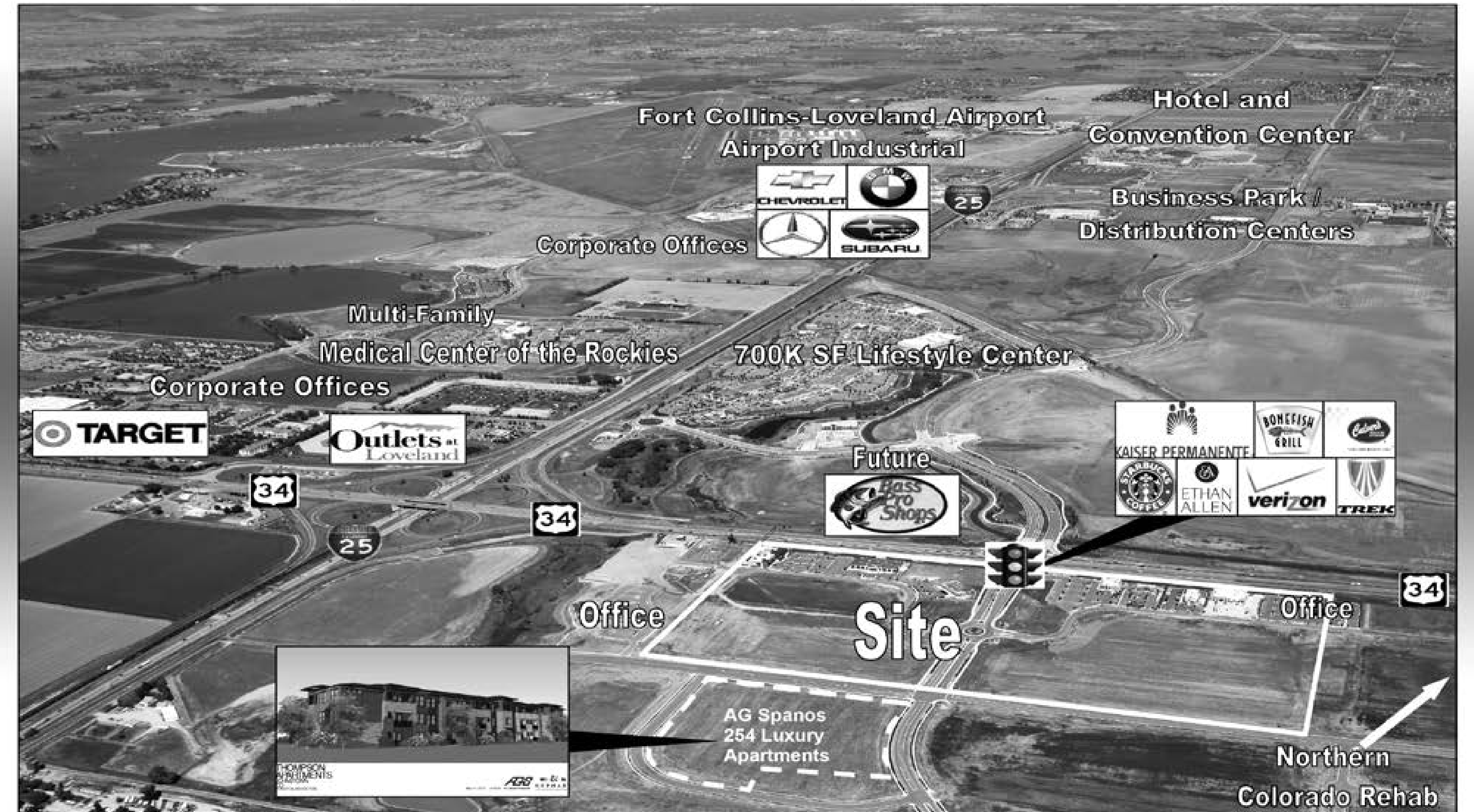
The larger developer/shopping center owners have a strategy of approaching underperforming big-box retailers, renegotiating leases and taking back some space. This approach allows those owners to lease smaller space to smaller users, therefore gaining more rent for their center.

The other theme we are seeing from large big-box retailers is subleasing space to retailers to sell their product inside of the main tenant. JCPenney has subleased space to Sephora, a skin care, makeup and fragrance retailer. Walmart has similar set ups with health care, tax filing and eyeglass stores located inside the large retailer. Subleases enable the big-box retailer to maximize return on investment – it costs space, but the stores are able to collect rent on it.▲

Renovation of Villa Monaco shopping center at South Monaco Parkway and Evans Avenue with anchor-tenant Walmart.

The Villa Monaco renovation continued throughout the center, providing a clean, updated look.

Outstanding Northern Colorado Retail, Office & Hospitality Sites



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Financial

Continued from Page 10

add retail properties in the Colorado market, they're forced to be aggressive in order to compete. Bridge lenders typically will fund 70 to 75 percent of an acquisition price, and also will fund 100 percent of future "good news capital" (capital for tenant improvements and leasing commissions) as leases are signed. Bridge lenders typically must be comfortable that the value-add business plan can get executed within 36 months. By the time a bridge loan is fully funded, often bridge lenders will have financed 80 to 85 percent of the overall capital stack.

Even though the real estate market is flooded with capital, capital sources each have their own specific lending appetites, and it's beneficial to understand where each capital source will be most competitive. For stabilized assets, life companies will continue to compete best on deals with low leverage, grocery or drug anchors, low tenant rollover risk and quality tenant lineups. They're also the best option for borrowers who seek forward-rate locks six to 12 months in advance. CMBS lenders consistently step up on higher leverage-deals, and their renewed focus on servicing and speed of execution has made them more competitive. Overall, it's a great time to leverage retail properties. Best wishes for a prosperous 2015!▲

Insider

Continued from Page 13

This silver lining for most, however, does have a potential downside in certain areas where "fracking," drilling and exploration make up a significant percentage of the employment base. Negative impacts could substantially outweigh the positive ones in areas such as Weld County and the Western Slope.

Between January 2008 and year-end 2014, the Denver metro area was among the top 10 metro areas in the nation for job creation. For 2014, the Denver-Boulder metro area is on track to create over 42,000 jobs, increasing employment by 3.2 percent (7 percent above prerecession levels). Moving forward, Leeds School of Business at the University of Colorado Boulder is projecting that Colorado will be among the top 10 states in 2015 with respect to job growth. It is projecting 61,300 additional jobs at the state level. Declining oil prices will negatively impact job creation in the energy exploration sector, which could be an issue particularly for communities heavily reliant on the recent energy boom.

New job creation and increased consumer spending, fundamental drivers behind retailer's demand for space, have spawned the reduction in vacancy rates. Metro Denver's vacancy rate peaked soon after the 2009 recession ended, and has been on a steady decline since then. Overall retail vacancy rates in the Denver-Boulder metro area have declined from 6.5 percent at the end of 2013 to approximately 5.8 percent by the end of 2014. Much sought-after retail space in the Denver-Boulder metro area, especially the Colorado Boulevard/Cherry Creek submarket, has a vacancy rate of 2.4 percent, while vacancy remains the highest in the northwestern suburbs, about 8.5 percent at the end of 2014. We are projecting an overall retail vacancy rate in the low 5 percent range at year-end 2015.

The number of new retail developments has been limited to a great extent by tightening credit requirements from lenders. Lenders are requiring developers to have some "skin" in the game, to have more signed leases from creditworthy tenants in hand and, in general, are not making loans on "spec" developments. Loan-to-value ratios are also more conservative. This has led to more disciplined decision making by developers, and an emphasis by a number of them to focus on redeveloping and rehabbing older, infill shopping centers. As a result, construction deliveries of retail square footage were limited to approximately 850,000 sf in 2014. In comparison, Denver metro area's historical average of retail square footage delivered annually over the last 32 years is about 3.6 million sf, according to CoStar.

Limited supply of new product coupled with declining vacancy rates have led to increasing asking rental rates. Average overall rental rates peaked in 2008 in the mid-$17 per sf range, and troughed in 2011 at close to $15. The 2014 year-end average rental rate is approximately $15.75, an increase of 2.5 percent over the previous year, and a 6 percent rise since bottoming out during the recession. While average asking rents remain lower than their prerecession highs, it appears asking rental rates have turned a corner after remaining relatively flat for several years.

To recap our 2015 Colorado retail forecast for the Denver-Boulder metro area, we believe that new construction will be muted, with very little spec space being built, and most developers will concentrate on infill redevelopment and upgrades to existing properties. Overall vacancy will decline 75 to 80 basis points to almost 5 percent, and rental rates will increase 3.2 percent to $16.33 per sf. On the transaction side, demand for properties will continue to outstrip supply, resulting in a seller's market; cap rates will continue under pressure, with cap rate compression in secondary and tertiary areas, as well as with B- and C-quality properties, so the difference in cap rates between top properties and others will narrow considerably. Demand will continue to be strong for larger, high-quality institutional properties and grocery-anchored centers.

One risk to our forecast is that if interest rates were to increase abruptly, the red-hot high end of the investment market likely will be tempered until sellers and buyers adjust to the new equilibrium the higher interest rates would create. Additionally, if the oil price decline is foretelling of a much softer economy than currently anticipated, employment, growth and retail sales could be affected.▲

UPCOMING 2015 MEETING DATES:

MARCH 19: General Membership Meeting @Wellshire Inn; Presentation TBA

MAY 14th: Happy Hour (location TBA)

JULY 23: General Membership Meeting @Wellshire Inn; "Creating Space" by Kristoff Kenton

SEPTEMBER 17: General Membership Meeting @ Wellsire Inn; Presentation TBA

Wellshire Inn located at 3333 South Colorado Boulevard, Denver, CO 80222

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*Star Award nominations are available online at www.RMSCA.net. The Rocky Mountain Shopping Center Association Mission Statement: To provide a forum for the mutually beneficial exchange of information among shopping center developers, owners, manager, brokers, investors, retailers and all professionals serving the Colorado retail real estate industry.

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TO STOREFRONT.
URBAN AND SUBURBAN.

Newmark Grubb
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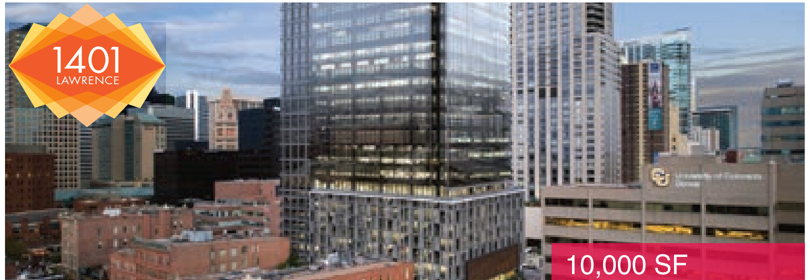

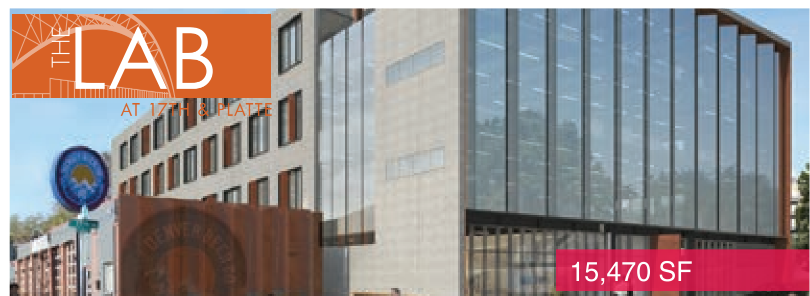

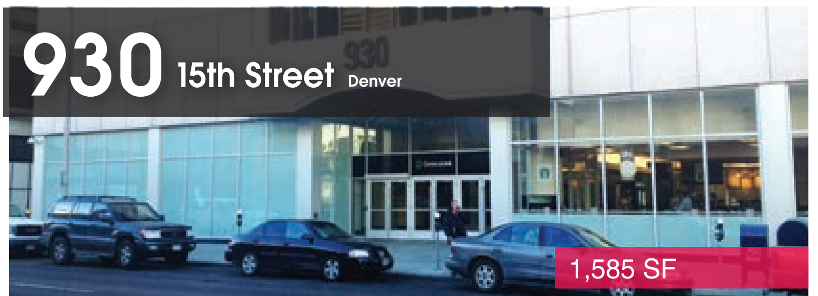

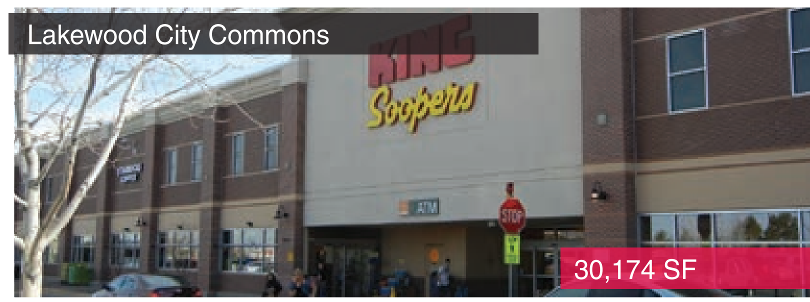

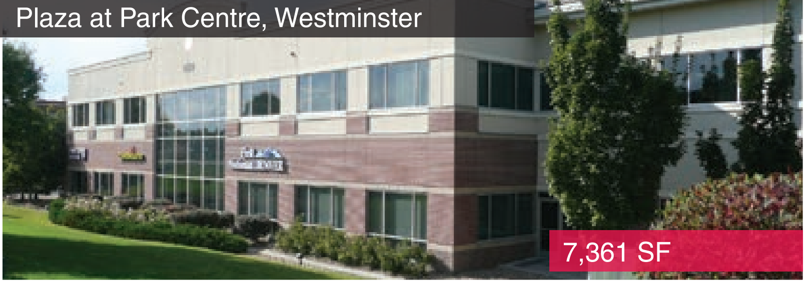

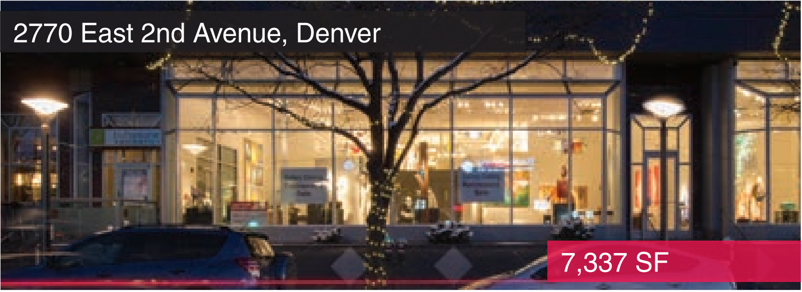

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