

# DENVER OFFICE MARKET

## DENVER OFFICE MARKET ENTERS A NEW PERIOD OF UNCERTAINTY

After similar absorption was posted in the first quarter of 2020, vacancy and rental rate growth to the prior three quarters, the Saudi Arabia/Russia oil price war and the COVID-19 pandemic propelled the real estate market into uncharted territory as the first quarter closed and the second quarter began. Intermittent concerns about the longevity of this mature cycle were suddenly usurped by a “black swan” that brought a swift shock to the economy and service sector job losses, resulting in unprecedented contraction in the global and local economies, although the duration remains to be seen.

Quarterly net absorption was negative 568,944 square feet, producing year-to-date absorption of negative 257,895 square feet. Vacancy rose to 14.1%, up from 13.5% in the prior quarter and down 32 basis points from 15.0% one year ago. The Class A sector managed to avoid the large loss of occupied space, with quarterly absorption of 84,679 square feet and year-to-date absorption of 353,061 square feet, benefiting from a strong first quarter. The Class B sector was the most affected, with quarterly absorption of negative 485,252 square feet, while the Class C sector posted more moderate negative absorption.

Two of Denver’s nine submarkets posted positive net absorption for second-quarter 2020, the Northwest and Northeast submarkets with 121,569 square feet and 14,468 square feet, respectively. The Downtown submarket was the most affected by the downturn, posting quarterly net absorption of negative 312,319 square feet. As a result, the Northwest and Northeast submarkets led the market with year-to-date net absorption of 173,773 square feet and 61,962 square feet, respectively, and only the Southeast Suburban (SES) submarket also maintained positive year-to-date net absorption. Direct asking rates decreased year-over-year in six submarkets, as the additional space that has come on the markets has spread the range of rental rates, especially on the lower end.

The Downtown submarket led the market in both 2018 and 2019. This continued through first-quarter 2020 but the oil and gas troubles, paired with the COVID-19 pandemic, brought this trend to an end. This submarket was the most heavily affected, with quarterly absorption of negative 312,319 square feet and year-to-date absorption of negative 181,220 square feet. Activity was down in all classes, including the historically strong Class A sector, which posted year-to-date absorption of negative 73,557 square feet. The Class B and Class C sectors were only slightly better, with absorption of negative 65,311 square feet and negative 42,352 square feet, respectively. Overall vacancy stood at 16.1%, up from 14.9% in the prior quarter but nearly unchanged from one year ago.

## CURRENT CONDITIONS UPDATE

Quarterly net absorption of negative 568,944 SF, ending the streak of 41 consecutive quarters of expansion

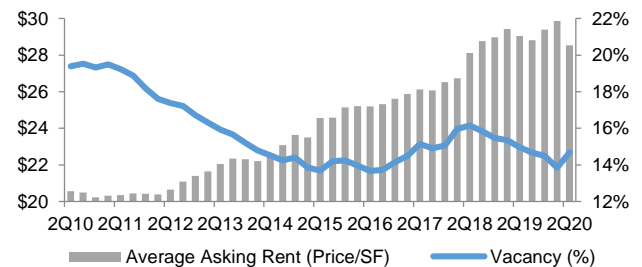
Vacancy rate of 14.7%

Loss of occupancy is mainly focused in the Class B sector

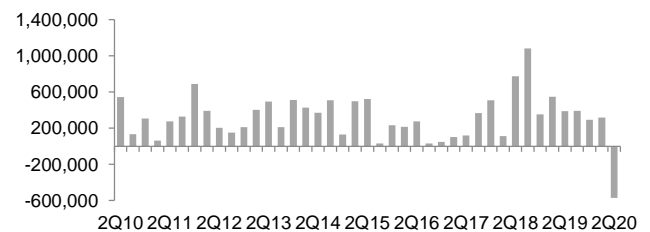
2.2 MSF under construction

## MARKET ANALYSIS

### Asking Rent and Vacancy



### Net Absorption (SF)



## MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	12 Month Forecast
Total Inventory	99.5 MSF	99.3 MSF	99.3 MSF	↑
Vacancy Rate	14.7%	13.8%	15.0%	↑
Quarterly Net Absorption	-568,944	317,263	414,002	↑
Median Asking Rent	\$28.53	\$29.87	\$29.04	↓
Under Construction	2.2 MSF	2.2 MSF	2.1 MSF	↓
Deliveries	205,783	0	0	↑

In 2018, the SES submarket posted annual net absorption approaching 1.0 million square feet. This strong performance was the product of vigorous corporate expansion that slowed in 2019, which posted annual absorption of 106,327 square feet. Although organic growth resulted in the market's strongest performance in the first quarter, the second quarter was characterized by large corporate move-ins in Class A being offset by small and medium sized tenants vacating largely from Class B buildings, posting quarterly net absorption of negative 54,960 square feet and year-to-date absorption of 58,739 square feet.

## PIPELINE STILL ACTIVE, DESPITE COVID-19 JITTERS

After no projects were completed in first-quarter 2020, three building delivered in second-quarter 2020: 777 Grant Street (a 73,123-square-foot renovation project) in the Midtown submarket; 3060 Brighton Boulevard (a 70,000-square-foot renovation project) in Downtown; and 9th & Colorado (62,660 square feet) in the Northeast submarket. Thirteen projects totaling 2.2 million square feet are currently under construction or renovation.

Eight projects are under construction in the Downtown submarket: Block 162 (595,000 square feet), One Platte (250,402 square feet); the Link (the renovation/ conversion to multi-tenant of a 229,287-square-foot former CenturyLink building); McGregor Square (190,000 square feet); Revolution 360 (134,000 square feet); HUB North (97,698 square feet); Market Station (the 95,000-square-foot office portion of the mixed-use redevelopment of the former RTD bus hub); and 3501 Blake Street (34,099 square feet).

## COVID-19 LEAVES INVESTORS WITH FEW GUIDE-POINTS

The investment market finished 2019 strong with annual totals of 12.4 million square feet, valued at \$2.5 billion, but activity slowed in second-quarter 2020 as investors have struggled to find meaningful data points to use as guides amongst the unprecedented real estate environment brought on by the COVID-19 pandemic. The top transaction of the quarter based on sale price was Matador Equity Partners' acquisition of the Citadel in Cherry Creek from Amstar for \$33.0 million.

## LOOKING FORWARD

The Denver's office sector deal flow was greatly disrupted by the statewide stay-at-home orders, as well as the following "safer-at-home" staggered reopening. Leases that were already close to the end of the process were almost exclusively the deals that continued forward during most of the quarter. As this pipeline empties, it is expected that businesses with term on their leases or with short-term renewal options will continue with a watch-and-wait approach. Although Denver does have exposure in the vulnerable sectors of tourism and energy, there is optimism that Denver's diverse economy and a decade of robust market fundamentals will mitigate long-term economic effects and pave the way for a rebound and a return to growth.

### LEASE TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
Lockheed Martin	10475 Park Meadows	SES	Sublease	167,000
Ball Corp	10955 Westmoor Drive	NW	New	98,500
Facebook	1900 16th Street	Downtown	Expansion	47,000
Robinhood	2373 15th Street	Downtown	New	35,000

### SELECT SALES TRANSACTIONS

Building	Submarket	Sale Price	Price/SF	Square Feet
3200 Cherry Creek S Dr- The Citadel	Midtown	\$33,000,000	\$253	130,652
1115 Acoma St- Evans School	Midtown	\$4,830,000	\$104	46,467
3570 E 12 <sup>th</sup> Ave- Monroe Professional Building	Midtown	\$3,830,000	\$290	13,200
7955 E Arapahoe Ct - Arapahoe Plaza East II	SES	\$3,530,000	\$121	29,140

**SUBMARKET STATISTICS**

	Total Inventory (SF)	Under Construction (SF)	Total Vacancy Rate	Qtr Absorption (SF)	YTD Absorption (SF)	Direct Asking Rent (Price/SF)
<b>Overall (Classes A, B &amp; C)</b>						
Aurora	4,492,438	0	14.0%	-51,967	-51,428	\$18.65
Downtown	30,402,195	1,640,486	16.1%	-312,319	-181,220	\$39.66
Midtown	5,923,160	173,322	11.5%	-144,945	-107,530	\$27.75
Northeast	2,0124,874	0	11.8%	14,468	61,962	\$21.25
Northwest	8,343,932	0	13.1%	121,569	173,773	\$24.30
Southeast	6,534,871	0	14.5%	-44,084	-98,141	\$24.00
Southeast Suburban	30,444,533	362,366	15.3%	-54,960	58,739	\$25.00
Southwest	2,836,519	0	9.0%	-25,840	-4,669	\$20.50
West	8,410,915	0	14.4%	-70,866	-109,381	\$21.00
<b>TOTAL MARKET</b>	<b>99,513,437</b>	<b>2,176,174</b>	<b>14.7%</b>	<b>-568,944</b>	<b>-257,895</b>	<b>\$28.53</b>
<b>Class A</b>						
Aurora	349,208	0	56.8%	0	17,850	\$22.00
Downtown	19,895,246	1,606,387	13.5%	-269,347	-73,557	\$47.48
Midtown	2,769,037	64,000	9.2%	-56,778	-18,406	\$38.76
Northeast	827,779	0	3.2%	23,746	38,209	\$28.00
Northwest	5,223,108	0	13.7%	171,598	147,624	\$25.51
Southeast	2,658,600	0	15.0%	-40,835	-23,599	\$28.89
Southeast Suburban	17,485,765	362,366	13.2%	237,757	236,146	\$28.00
Southwest	1,046,425	0	12.8%	-21,083	-19,383	\$30.25
West	1,255,301	0	8.5%	39,621	48,177	\$26.50
<b>TOTAL CLASS A</b>	<b>51,510,469</b>	<b>2,032,753</b>	<b>13.3%</b>	<b>84,679</b>	<b>353,061</b>	<b>\$30.01</b>
<b>Class B</b>						
Aurora	3,297,326	0	10.8%	-33,293	-55,275	\$19.88
Downtown	8,524,682	34,099	22.0%	-9,642	-65,311	\$34.14
Midtown	2,082,635	109,322	16.5%	-63,381	-60,962	\$26.50
Northeast	873,070	0	20.2%	-13,948	17,011	\$21.50
Northwest	2,626,550	0	13.4%	-32,826	43,433	\$20.91
Southeast	2,451,493	0	16.9%	-848	-82,838	\$23.85
Southeast Suburban	10,990,422	0	19.2%	-250,341	-151,041	\$23.50
Southwest	1,204,414	0	4.6%	10,557	21,377	\$18.50
West	6,105,370	0	16.4%	-91,530	-142,261	\$21.00
<b>TOTAL CLASS B</b>	<b>38,155,962</b>	<b>143,421</b>	<b>17.5%</b>	<b>-485,252</b>	<b>-475,867</b>	<b>\$23.50</b>

## ECONOMIC CONDITIONS

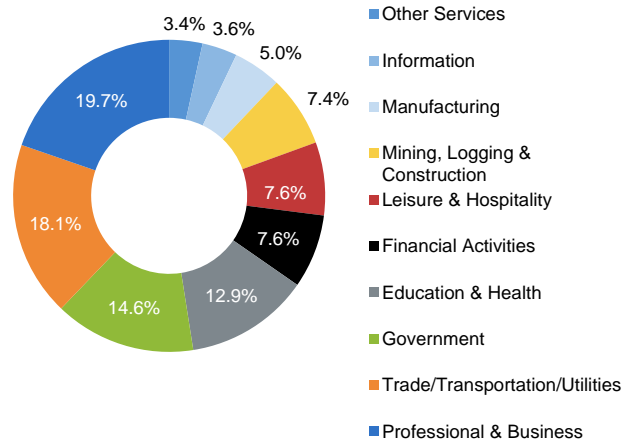
Preliminary average annual job growth for the Denver metro area for the 12-month period through May 2020 was 0.4%, and the average rates for 2017, 2018 and 2019 were 2.1%, 2.6% and 2.2%, respectively.

Nine of ten industry sectors logged job loss in May. The information sector posted moderate job growth of 1.0%. The leisure & hospitality, other services and trade, transportation & utilities services sectors logged the largest year-over-year losses at negative 39.1%, negative 18.2% and negative 7.5%, respectively. The important office-occupying professional & business services sector and the trade, transportation and utilities sector remain Denver's largest employment sectors, accounting for 19.7% and 18.1% of total nonfarm employment, respectively.

Denver's preliminary May 2020 unemployment rate stood at 10.4%, a number that would have been unthinkable at the beginning of the year; except for a small spike at the end of 2018 and in January 2019, Denver unemployment has been around 3% or below since April 2016.

## EMPLOYMENT BY INDUSTRY

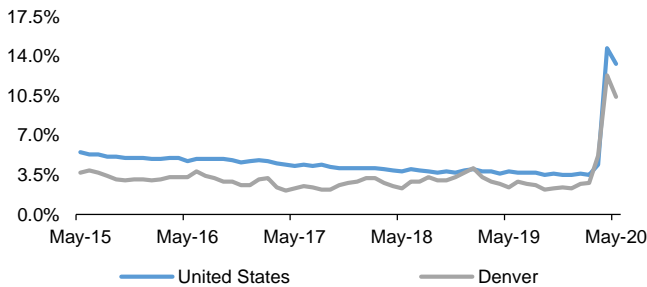
Denver, May 2020



Source: U.S. Bureau of Labor Statistics

## UNEMPLOYMENT RATE

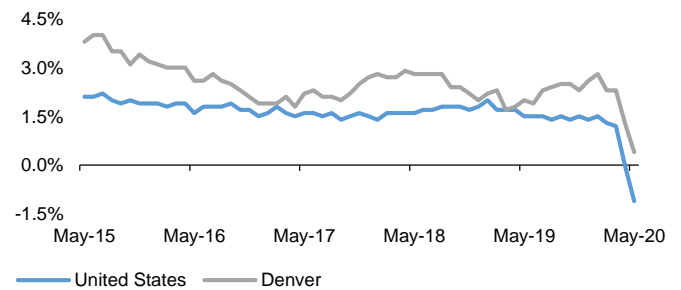
Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

## PAYROLL EMPLOYMENT

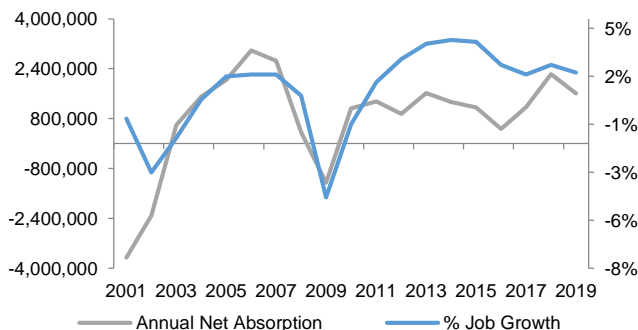
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

## EMPLOYMENT GROWTH AND ABSORPTION

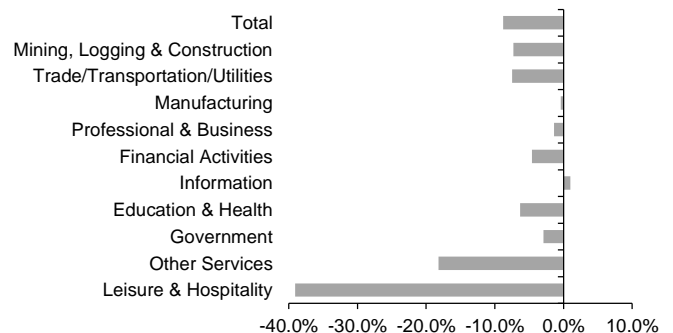
Denver YOY Employment Growth and Office Annual Absorption



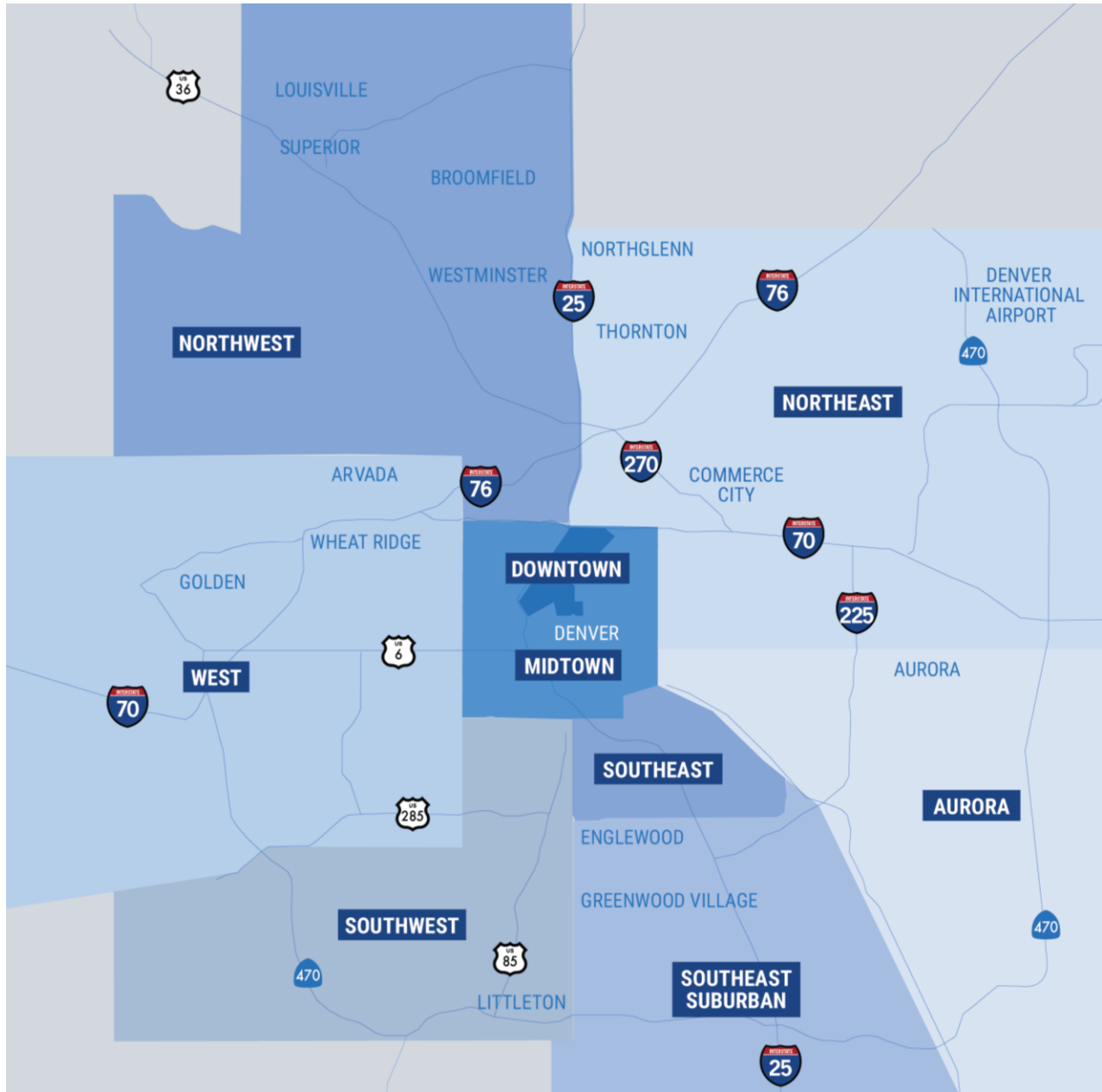
Source: U.S. Bureau of Labor Statistics/NKF Research

## EMPLOYMENT GROWTH BY INDUSTRY

Denver, May 2020, 12-Month % Change, Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics



**MANDI JOHNSON**

Research Analyst  
303.260.4433  
mpjohnson@ngkf.com

**DENVER**

1800 Larimer Street, Suite 1800  
Denver, CO 80202  
303.892.1111

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