MARKET REPORT

OFFICE

Denver Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

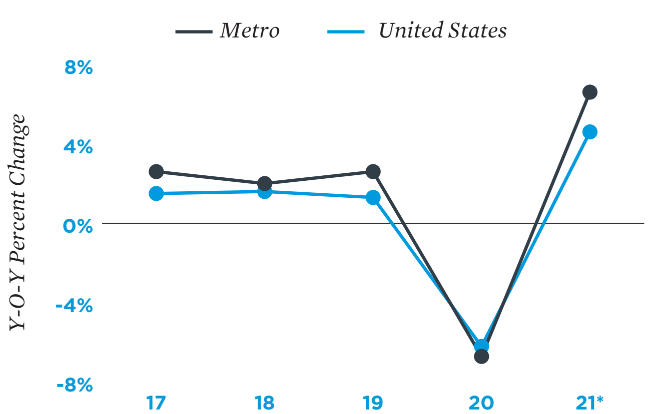
4Q/21

Offices Begin to Welcome Back Some Tenants; Investment Activity Continues to Steadily Improve

Companies commence reoccupying office space. The widespread release of vaccines in the spring and the related economic reopening paved the way for more employees to return to offices, lifting space demand. After 18 months of negative net absorption, the amount of occupied space increased in the second quarter. Organizations that took up large floor plans this year include Lockheed Martin and BP. Overall, leasing was most prevalent in suburban areas, particularly in the Colorado Boulevard-Glendale area as well as in North and Northeast Denver. The latter submarket was the only part of the metro where availability contracted on an annual basis. Vacancy is also below the market average in Aurora and Midtown, which has encouraged annual rent growth exceeding 5 percent in those areas.

Higher case count clouds outlook downtown. While the number of workers in traditional office-using fields has nearly recovered to a pre-recession level, the timeline for those employees to fully return to offices is less clear. Uncertainty is most prevalent within the central business district, reflected in softening demand and property fundamentals. Vacancy in Denver's CBD has steadily increased since the onset of the pandemic, topping 26 percent in June. Although the spread of coronavirus variants has delayed some office reopening plans, several firms remain confident in the future of downtown locations, including Deloitte and JPMorgan, which leased space in LoDo earlier this year.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.

Office 2021 Outlook

95,000 JOBS
will be created

EMPLOYMENT:

The creation of roughly 65,900 jobs through the first eight months of the year places the metro on track to record employment growth of 6.6 percent in 2021. Approximately 16,000 of those positions will be in traditionally office-using roles, a 3.6 percent gain.

2,100,000 SQ. FT.
will be completed

CONSTRUCTION:

The volume of office deliveries is anticipated to climb to a three-year high in 2021 with a 1.3 percent expansion to inventory. Downtown and Southeast Denver will welcome the most new space this year.

190 BASIS POINT
increase in vacancy

VACANCY:

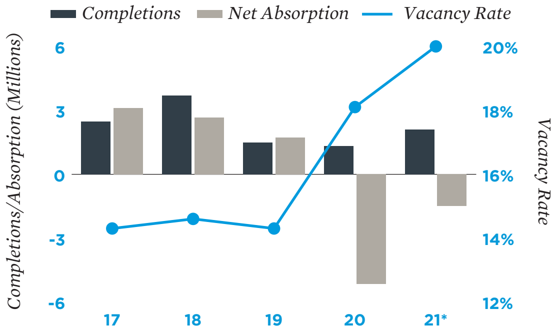
Less office space is expected to be vacated this year relative to 2020, which will lead to a smaller jump in the vacancy rate. At 20.0 percent, availability will nevertheless be at its highest point in at least 15 years.

1.5% DECREASE
in asking rent

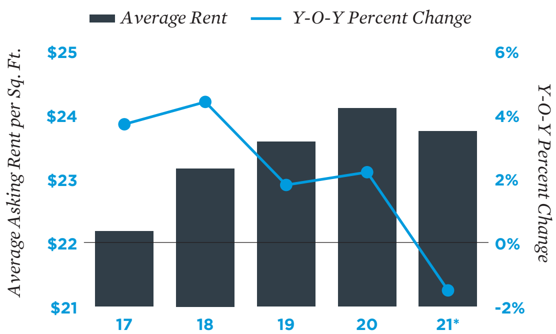
RENT:

Additional space available for lease, as well as some delays in office reopenings, will weigh on asking rents this year. By the end of 2021 the marketed average rate will have decreased to $23.74 per square foot.

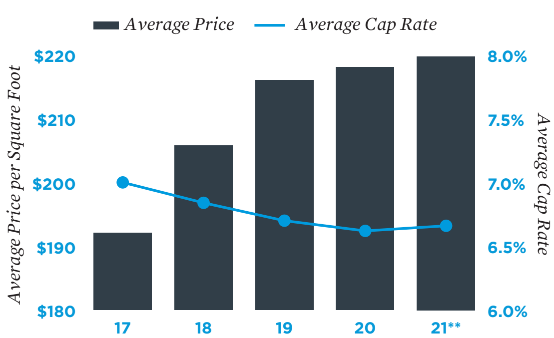
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 2Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

2Q21 — 12-Month Period

CONSTRUCTION

2,335,000 sq. ft. completed

- The pace of development more than doubled over the past year ended in June, driven primarily by the completion of about 1.3 million square feet in the second quarter alone.
- More than 900,000 square feet opened in Downtown Denver in the second quarter, led by the 606,000-square-foot Block 162 office tower.

VACANCY

450 basis point increase in vacancy Y-O-Y

- Vacancy has continued to trend up since the onset of the pandemic, although the quarterly pace of change has slowed. The rate rose 30 basis points between March and June to 19.8 percent.
- Availability is highest in the CBD, up 740 basis points year over year to 26.3 percent versus a suburban vacancy rate of 17.7 percent.

RENT

0.8% decrease in the average asking rent Y-O-Y

- Although the average asking rate initially rose during the pandemic, likely affected by higher-quality space coming to market, rents contracted in the second quarter of this year.
- The metro average fell to $23.77 per square foot, driven by a 3.2 percent annual drop in the CBD. Rates were about flat in the suburbs.

Investment Highlights

- More office assets changed hands in the second quarter than in any three-month period since the pandemic began. Overall sales activity for the past 12 months was about on par with the previous year.
- Despite uncertainty propagated by the health crisis, sale prices for assets traded over the past year modestly improved. The average sale price inched up 1 percent year over year to $220 per square foot in June, while the mean cap rate stayed the same at 6.7 percent. Yields did drop below 6 percent for some Class A and B trades.
- Investors continued to focus more on Southeast Denver relative to other submarkets. Entry costs were generally below the market average with first-year returns in the mid-6 percent to mid-7 percent zone. Several multi-property transactions also boosted sales velocity in Broomfield, which had seen little activity in recent years.
- Medical office buyers are looking most often in Southeast Denver, Broomfield and Aurora, keeping sales velocity about stable annually.

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