MARKET FORECAST

OFFICE

Denver Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

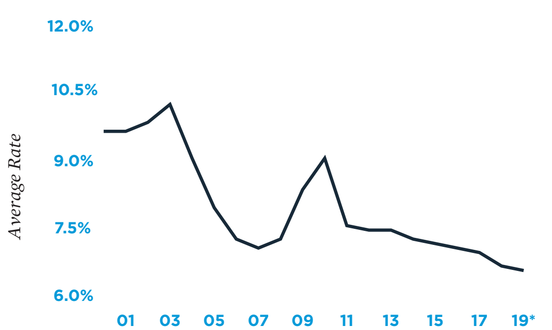
Q2/19

Urban Core at Forefront of Healthy Office Market; Vacancy Scheduled for Steep Drop

Downtown Denver becoming more attractive for Fortune 500 companies. As more high-profile businesses establish themselves in the Mile High City, the Denver office market continues to gain prominence. Luxury office space is being developed at a record pace, illustrating the persistent rise in demand. Availability of Class A office space remains on a downward trend as more corporations relocating from other parts of the country as well as local businesses transitioning from the suburbs vie for urban floor plates. In addition, coworking is beginning to play a significant role in space demand, headlined by WeWork, which is on track to grow its Denver footprint by more than 200 percent this year. Suburban submarkets are also performing well; however, space absorption is occurring at a more moderate pace.

Demand for urban space met with infusion of new supply. The bulk of office construction will again be concentrated in and around the core this year. Mixed-use projects headline development with The HUB containing roughly 280,000 square feet of office space and Platte 15 adding approximately 160,000 square feet. Prism Workspaces' new facility in downtown Denver comprises another notable development. Broomfield will also witness strong construction in 2019 as more employers fill the Northwest Corridor, further boosting the area's economic output and appeal to large-scale companies. Broomfield will add more than 200,000 square feet of office space by the end of the year, consisting of several small business parks.

Local Office Yield Trends



** Cap rates trailing 12 months through 1Q19*
Sources: CoStar Group, Inc.; Real Capital Analytics

Office 2019 Outlook

2.0 MILLION SQ. FT.
will be completed

CONSTRUCTION:

Office development declines almost 50 percent compared with last year, although the delivery sum is still aligned with the previous five-year average.

50 BASIS POINT
decrease in vacancy

VACANCY:

Denver is setup to log a significant vacancy drop after absorbing roughly 760,000 in the first quarter this year. The market rate will fall to 13.9 percent by year end.

2.3% INCREASE
in asking rents

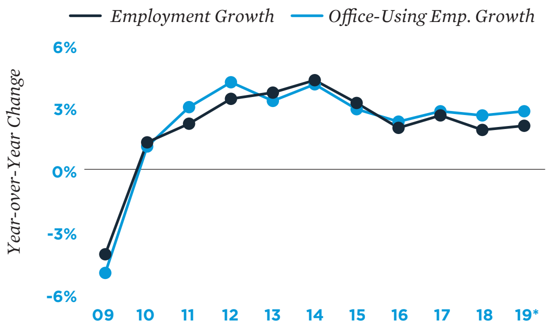
RENTS:

Asking rents will continue to steadily rise, pushing the average mark to $27.07 per square foot. In 2018, the figure climbed 1.8 percent.

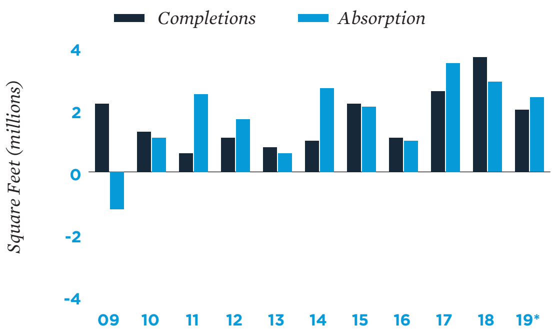
Investment Trends

- As Denver's secondary business hub, the Tech Center remained a highly targeted area for private and institutional investors. Numerous 1970s and '80s-built assets garnered considerable attention as cap rates for some of these properties extended into the low-7 percent range, up to 80 basis points above the metro average.
- North Capitol Hill provided many investors with value-add opportunities as they were able snag older assets adjacent to the CBD and renovate them to more closely compete with nearby luxury office space. Improved operations and more innovative amenities allowed these investors to adjust rents to market and significantly boost NOIs.
- Strong investor interest throughout Broomfield and Westminster continued during the past year, bringing a mix of domestic and foreign buyers. Properties that traded in this part of metro were relatively new spaces, generating cap rates in line with the market average. Sales prices generally ranged from $5 million to $25 million, resulting in varying sophistication levels of investors.

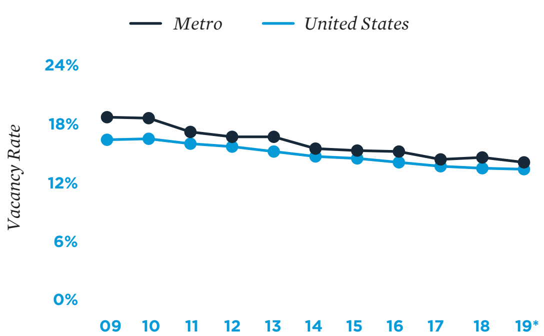
Employment Trends



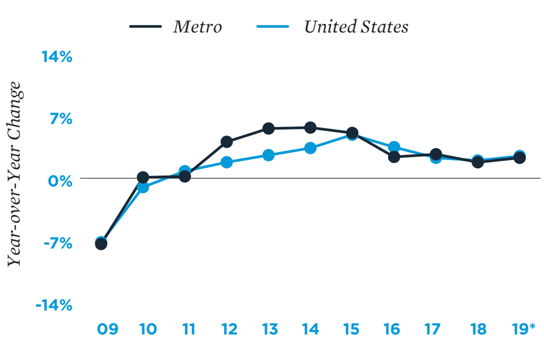
Office Supply and Demand



Vacancy Rate Trends



Asking Rent Trends



** Forecast*
Source: CoStar Group, Inc.

1Q19 – 12-Month Trend

EMPLOYMENT

1.3% increase in total employment Y-O-Y

- White-collar jobs continue to multiply in Denver, helping the metro's overall employment base increase by 20,000 workers year over year.
- Tech firms and healthcare companies hired at an accelerated pace; however, market unemployment rose roughly 50 basis points to 3.3 percent.

CONSTRUCTION

2.6 million square feet completed Y-O-Y

- A limited addition of Class B/C space relative to prior periods supported a 23 percent decline in construction since last March. Virtually all office development during the past 12 months consisted of luxury space.
- Downtown Denver remains the focal point for developers as the area received more than 1.2 million square feet. Southeast Denver also witnessed strong construction activity.

VACANCY

70 basis point decrease in vacancy Y-O-Y

- Market vacancy plummeted to 14.1 percent on an annual basis thanks to net absorption of nearly 3.2 million square feet. During the prior period, the reading decreased 40 basis points.
- Intense demand for urban office space pushed CBD vacancy down 180 basis points to 14.9 percent, while suburban vacancy declined more gradually, falling 20 basis points to 13.9 percent.

RENTS:

2.6% increase in the average asking rent Y-O-Y

- Rental growth remained steady, moving the average asking rent up to $26.70 per square foot. Class B/C space continues to lead rental gains as this tier has averaged 4.4 percent growth over the past five years, while Class A clocks in at 2.3 percent in that span.
- Expansive economic growth in Thornton and Northglenn has boosted demand for office space, supporting a 12.9 percent gain to North Denver's average asking rent.

Demographic Highlights

2019 Forecast Job growth

Metro **2.1%**

U.S. Average 1.3%

Population Age 20-34*

Metro **22.5%**

U.S. Average 20.6%

Sq. Ft. Per Office Worker*

Metro **317**

U.S. Average 215

2019 Office-Using Job growth

Metro **2.8%**

U.S. Average 1.7%

Population of Age 25+ Percent with Bachelor Degree+**

Metro **40.7%**

U.S. Average 29.9%

Office Square footage*

24.7% *Urban*

U.S. Average 32.0%

75.3% *Suburban*

U.S. Average 68.0%

**1Q19*
***2018*

SUBMARKET TRENDS

Lowest Vacancy Rates 1Q19

Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Average Asking Rent	Y-O-Y % Change
Parker-Castle Rock	6.8%	10	$26.18	1.5%
Midtown	7.5%	-120	$26.06	0.7%
Northeast Denver	8.5%	-120	$19.77	-3.1%
Aurora	10.0%	-70	$20.99	2.8%
West Denver	10.5%	-160	$23.80	5.9%
Southwest Denver	11.6%	60	$20.49	6.1%
Colorado Boulevard-Glendale	12.2%	-370	$27.44	0.8%
North Denver	12.3%	350	$25.05	12.9%
Broomfield	13.4%	120	$25.43	0.7%
Downtown	14.9%	-180	$33.99	2.2%
Overall Metro	**14.1%**	**-70**	**$26.70**	**2.6%**

SALES TRENDS

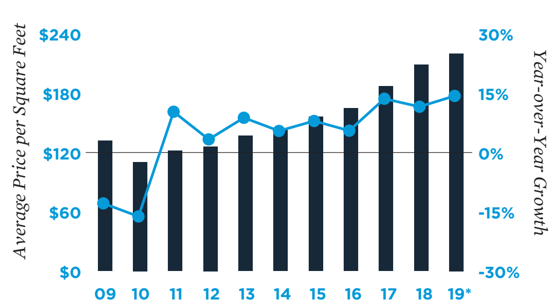
Favorable Yields Fuel Strong Investor Interest, Propelling Office Valuations

- With investor demand remaining strong in the Mile High City, transaction velocity increased roughly 10 percent on a year-over-year basis. In addition, the metro's average cap rate decreased 30 basis points to 6.5 percent.
- Price appreciation continued its strong run with the average price per square foot climbing 14.3 percent since last March. This measure has risen more than 60 percent since the end of 2015.

Outlook: Higher initial yields than other tech-heavy markets will attract more investors to Denver in the near future, particularly as space demand is further strengthened by business relocations from the Bay Area.

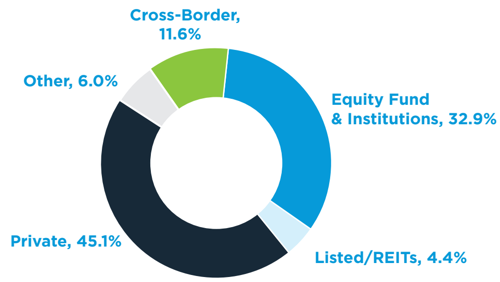
Sales Trends

Sales *Price Growth*

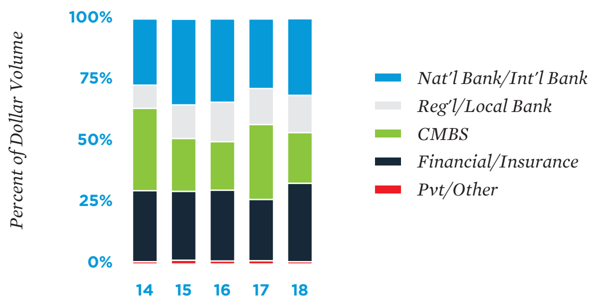


** Trailing 12 months through 1Q19 over previous time period*
Pricing trend sources: CoStar Group, Inc.; Real Capital Analytics

1Q19* Office Acquisitions By Buyer Type



Office Mortgage Originations By Lender



** Trailing 12 months through 1Q19*

Include sales $2.5 million and greater

Sources: CoStar Group, Inc.; Real Capital Analytics

Capital Markets

By DAVID G. SHILLINGTON, President, Marcus & Millichap Capital Corporation

- **Ongoing trade concerns weigh on growth outlook; Fed plots next steps.** Amid rising trade tensions between the U.S. and China and slowing global growth, the outlook has turned more cautious. Market volatility, along with a flight to safety trade, has flattened the yield curve dramatically, with the 10-Year Treasury trading below 2.2 percent. This has pushed the broader yield curve into inversion, a closely watched precursor to a potential recession. Meanwhile, many measures of the domestic economy remain buoyant, including continued job and wage growth, historically low unemployment and muted inflationary pressure. These conditions have prompted a dichotomy, with Federal Reserve officials signaling more accommodative policies. The impending end of quantitative tightening in September, coupled with potential cuts to the Fed funds rate in the second half of the year, highlight the shift in Fed policy. As a result, long-term interest rates are likely to remain subdued, with Fed policy leaning toward accommodation.

- **Conservative underwriting balances abundant marketplace liquidity.** While debt availability for office assets remains widely available from a wide range of sources including local, regional and national banks and insurance companies, sentiment surrounding the health of the economy has fallen somewhat in recent months. Lenders remain broadly cautious in underwriting, with loan-to-value (LTV) ratios typically in the 55 to 70 percent range, depending on the borrower, asset and location. The conservative approach has filtered into a focus on proven property results, with much less willingness to lend against pro forma rents. This has prompted investors to turn toward short-term mezzanine debt and bridge loans to cover capital improvements, while seeking long-term solutions once returns have been solidified. Construction origination remains muted, with lenders focusing on core locations with proven demand.

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Sources: IPA Research Services; Bureau of Labor Statistics; CoStar Group, Inc.; Experian; Moody's Analytics; Real Capital Analytics; TWR/Dodge Pipeline; U.S. Census Bureau