A Colorado Real Estate Journal Publication

June 2021

OFFICE & INDUSTRIAL Quarterly

Market faces strong resurrection potential following yearlong winter

For the time being, COVID-19 has flipped the market on its head and quickly turned a landlord's market in favor of tenants. This won't last long. The tides are changing, and the much-anticipated return to normal is coming fast, whether tenants are ready or not.

Thevin Campton, CCIM
Broker, office capital markets, Colliers International

Never in their lives have corporate real estate strategists faced such an extravagant global phenomenon. Unfortunately, those who don't learn quickly and fail to look ahead are now forcing their companies to be left behind.

The fact that normal life is once again resuming has shaken awake tenants "kicking the can" on major lease decisions. Conversations on corporate real estate strategy have only grown through 2021, particularly following Gov. Jared Polis' revocation of the mask mandate for most individuals in mid-May. We've seen the likes of Goldman Sachs, Google, Amazon and Wells Fargo announce nationwide plans to return to the office as early as this summer. The rising tide of consumerism and in-person spending is ushering in the necessity for all hands on deck. Insofar as office space occupancy goes, the much-anticipated return to normal (and not a "new normal" as many work-from-home zealots have prayed for) is coming fast, whether tenants are ready or not.

Following the yearlong winter of 2020, when much of the global office market struggled, quarterly metrics have since improved. Absorption in the Denver metro area, which saw a low of negative 1.7 million square feet in the fourth quarter of 2020, is dwindling quarterly to the upside. While large Class B commodity space continues to struggle, the market's quality Class A space has seen consistent interest. Today's lower current effective rates have been a boon for tenants seeking to affordably enhance the look and feel of their office space, especially in anticipation of their employees returning to work following many months of working from home. These spaces are being secured with above-market concessions, greater tenant improvement allowances and a generous amount of free rent – sometimes as much as 1.2 months per year of the lease term or

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Letter from the Editor

Rising construction costs boost decision-making urgency

In personal and professional conversations, I'm amazed at how frequently the topic of construction costs come up. While up until this issue, my references have been mainly anecdotal, several articles within this issue address the topic, which is causing headaches for both office and industrial properties.

Office tenant improvement projects are key to wooing tenants back into the workplace, as several workplace trend articles discuss within this issue. However, getting the timing right and the costs in line for projects requires a lot of careful work – as well as quick decision-making.

According to Nick Groeger with Taurus Builders, over a three-week period of contract negotiations, one tenant improvement project saw the budget increase 3% for metal stud framing, 9% for plumbing, 7% for HVAC and 5% for electrical, he writes on Page 10.

Meanwhile, rather than slowing things down on the industrial side, rising construction costs are prompting developers and investors to be more aggressive in order to expedite projects, Cara Stamp with Cushman & Wakefield writes on Page 28.

According to the two articles, prices have jumped for all of the following materials:

- Lumber,
- Steel/hot-rolled coil,
- Copper,
- Electrical wire,
- Gypsum and
- Aluminum.

Both articles share the view that the cost of these raw materials, and the overall cost of projects, won't be coming down anytime soon. Stamp references a report from Alcorn Construction that actually predicts prices may rise another 5% to 6% over the course of the year.

However, it's not all doom and gloom. This issue marks a noticeably more optimistic tone when discussing the future office market. Several articles stress that now is the time for tenants who have been hesitant to commit to space to do so, or lose out on the benefits currently being offered. The sentiment seems to be that office absorption and unemployment should be back to pre-pandemic levels by the end of this year or early 2022. Considering the roller coaster of the past 17 months and the historical timelines for past economic recoveries, it's a positive outlook indeed.

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OFFICE — MARKET UPDATE

Boulder rebounds as employees head back to work

Pre-pandemic, nearly 70,000 commuters came to Boulder each workday. COVID-19 forced remote-work strategies, which, in turn, have had a significant impact on Boulder's economy. As the vaccine is being distributed and as infection rates begin to drop, portions of the workforce are beginning to return to their places of business. For the last 12 months the majority of companies have been evaluating, and continue to evaluate, the best strategies that encompass productivity, culture, retention, recruitment and, of course, safety. With that in mind, what does that mean for the health of Boulder's office space as we head into the second half of 2021? On a positive note, the phone is ringing again in brokerage offices and people seem to be ready to go back to the office.

To restate the obvious, Boulder sits in a unique marketplace where developing is difficult and the supply chain is constrained. This historically has paved the way for Boulder's economy to recover faster than the rest of Colorado and, in turn, kept vacancies at a lower rate and lease rates stable.

In order to really understand where the office market is heading, let's start with what we do know. According to Leeds School of Business, at the end of the first quarter, total employment in Boulder was down to 185,700, compared with 200,700 in first-quarter 2020. Unemployment more than doubled from first-quarter 2020 (2.4%) to first-quarter 2021 (5.7%), and office vacancies jumped to almost 16% year-end 2020 from 9% year-end 2019. Every industry type is struggling to fill open jobs and the majority of companies polled by the Boulder Chamber of Commerce in May indicated only 50% of employees are currently back in the office. While the majority want to get back to the office, in all likelihood, the hybrid model is here to stay.

Beau Gamble
Broker associate, Dean Callan & Co.

While that information can be somewhat bleak, remember we are talking about Boulder, a city that some might say operates in a bubble. The reasons many companies want to work and be in Boulder have not changed with the pandemic – i.e., it is located at the base of the Flatirons, with hiking trails five minutes away, some of the country's best road and mountain bike trails, world-class skiing less than two hours away; it is home of the University of Colorado; and it offers a diversified economy that includes start-ups to Fortune 500s and the list goes on. Boulder will remain one of the country's best places to live, work and play.

For those reasons, there is good news about Boulder's office space. In April, Apple announced it was hiring an additional 700 employees to its Boulder engineering team and Google announced it intended to double its workforce. On the smaller scale, companies like Work In Progress, Trade Desk, Tecomet and Longpath expanded their footprints. Colorado (including Boulder in large part thanks to University of Colorado's reputation as a world-class research institution) is now one of the country's emerging life science markets. While this use does not typically occupy true office space, the growth of this industry certainly will attract other companies supporting those life science companies. Since existing life science space is very limited, the demand for smaller office space and converting to life science has increased dramatically for those landlords in a position to make that pivot.

> If you combine that human desire data point with the quality of life Boulder offers it certainly bodes well for a strong office market recovering to pre-COVID-19 numbers or even better by year-end 2022.

The end of the first-quarter indicated office vacancy was slightly increasing and rates were slightly decreasing. The market is not expected to see any significant changes to this trend until the middle of 2022, when companies will have returned to the office and are able to fully evaluate what a hybrid model will look like. While Zoom meetings might be convenient at times, we don't always love them. Humans crave connection and that connection cannot always be made through a computer screen. If you combine that human desire data point with the quality of life Boulder offers it certainly bodes well for a strong office market recovering to pre-COVID-19 numbers or even better by year-end 2022.

Consumer confidence cannot be overlooked when talking about the office market, and according to Leeds, 64% of the respondents believe the state economy will return to positive growth by year-end. Historically Boulder always has outperformed the rest of the state in the recovery process, and I don't think this time will be any different.▲

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OFFICE — MARKET TRENDS

How growing biz applications impact owners

The COVID-19 pandemic decimated small businesses around the country. By May 2020, nearly a third of small businesses in the U.S. had closed their doors, many citing a cash crunch and low demand, according to a report by Facebook and the Small Business Roundtable.

But amid tragedy and job loss, entrepreneurs found the opportunity to build back something new. More than 4.3 million new business applications were filed over the course of 2020, more than any other year on record, according to data from the U.S. Census Bureau.

■ **Colorado sees uptick in business applications.** The same trend held true in Colorado. More than 93,000 new small businesses filed applications in 2020, up nearly 8% from 2019.

The increase coincided with the highest unemployment rate in Colorado history, peaking at 14.4% in April. That's not a coincidence. New businesses helped Colorado dig out of the Great Recession of 2009, and it appears the same is happening with the coronavirus-related recession.

"It is a great opportunity for people to take that leap when people have lost their job," said China Califf, director of the Denver Metro Small Business Development Center. "In Colorado, we have so many makers."

Califf's organization helps new entrepreneurs develop business plans and get from idea to launch. She also noted that it has experienced an uptick in new clients and a rise in new businesses taking part in its startup consulting programs. There's been a particular increase in new businesses centered on sustainability, she said.

Melissa Wylie
Senior small business writer, LendingTree

Colorado's new businesses will be in good company: The state has among the highest concentrations of new businesses in the country. Over the past decade, Colorado has ranked No. 4 in the percentage of businesses 5 years old or younger and is No. 1 for number of jobs per capita created by businesses in their first year of existence.

■ **Things for commercial property owners to remember.** It's still unclear what impact these new businesses will have on the real estate landscape. But the market is changing dramatically, particularly for commercial real estate, as the nation continues to deal with the impact of the COVID-19 pandemic.

Don't expect the jump in new businesses to impact real estate – right away. This rise in new businesses is not likely to have a significant effect on commercial real estate, at least not immediately.

"New businesses generally do not hire a lot of staff to begin with, and many new businesses are sole proprietorships. So I would not expect any near-term impact on commercial real estate," said Tendayi Kapfidze, chief economist at LendingTree.

As they grow and develop, Colorado's new businesses may end up needing to buy property, but the impact likely won't be felt for several years.

Instead, demand for commercial real estate is likely to shrink. Companies responded to the pandemic by shifting employees to remote work if possible. This means they need less real estate. Economists predict that this trend won't reverse quickly, if at all. It might be a permanent change.

"A good analogy is the rise of online shopping and how that has reduced demand for retail space," Kapfidze said. This can be a good thing if you're in the market to buy a commercial property. Lower demand generally means lower prices. But if you're looking to sell or use equity in your property, this trend is not as positive.

Moving forward, instead of new office space or storefronts, Colorado might see more warehouses or other real estate that supports e-commerce, according to a forecast from the Colorado Legislative Council.

Denver may rebound faster. While the outlook for Colorado commercial real estate as a whole may be grim, its largest city may fare better. Denver was identified as a top five target for commercial real estate investors in 2021, according to a survey by CBRE. Real estate services firm JLL called Denver a "rising star" city.

Post-pandemic, there's room for improvement – the office vacancy rate was 13.1% in the first quarter, up from 9.8% the year before, according to the Metro Denver Economic Development Corp. That number may continue to rise. Office leasing in the first quarter was the slowest since the early part of the pandemic, according to a report from Avison Young.

With businesses continuing to downsize or keep employees working remotely, Avison Young predicts the vacancy rate will rise throughout 2021. However, construction activity is decreasing, too. Cushman & Wakefield predicts construction to decline through 2021 and into 2022, with no new projects breaking ground for a year or more. This will likely help push prices up if the economy rebounds.

■ **Now might be a good time to refinance.** Interest rates remain low by historical standards, meaning business owners may consider refinancing their commercial real estate loans. This might be able to help business owners survive in the new economy by lowering their monthly payments or using their equity to invest in their property or business. However, not all business owners will find that they are able to refinance. "Lenders are being more demanding in their underwriting criteria and risk assessment," Kapfidze said. ▲

OFFICE — MANAGEMENT

Strategies to address newly remeasured assets

In the first part of this series, I discussed how square footage is the foundational measurement in commercial real estate and provided real-life examples of situations where property value was added by remeasuring a building. Once your building is measured and new calculations are provided, compare them to the current rent roll. You might find that suites or overall building square footage have increased or decreased from the size you previously had referenced. Now that you have this accurate information, what do you do with it?

Becky Hanner
Principal, Commercial Asset Services

■ **Develop a square-footage tracker.** While you may be utilizing excellent property management software, an Excel spreadsheet tends to be the best solution to track variances in measurements for planning purposes. In Excel, identify each tenant suite, tenant name, the new square footage, the leased square footage and the lease expiration date. Make sure you have accounted for all building square footage, including vacant suites. With the building laid out this way, you can start to develop a strategic plan on how best to handle the variances.

■ **Review your leases.** Since the lease is a contract between the tenant and the landlord, it is paramount you review and understand provisions that address building and space size. What does your lease language state? Does it state the suite is a fixed square-foot amount or does it state the square footage is approximate? Does it outline that rent is a fixed price per square foot or does it outline a monthly rental amount based on an approximate square footage? Is there language to address changes to the building denominator or to the suite size? Understanding your leases should be a consideration as you develop your strategy.

■ **Develop a strategy.** Your strategy likely will depend on the outcome of the building measurement. You will want to consider how long each tenant has leased space at the building, when leases will expire, when the building might be placed on the market for sale, how many vacant spaces there are, how profitable the building is, what the goals and objectives of the ownership entity are, how open to a change in measurement the owner is and what kind of restrictions the lender may have placed for the loan to be secured.

■ **Options to consider if square footage increases.** If the overall square footage of the building increases, the most typical approach is to implement square footages over time. For example, it may be determined to immediately implement new square footages for vacant suites. A "dummy" suite can be added to the building in your property software to encompass the additional building square footage so that the building denominator will reflect the new, accurate amount on the rent roll. As tenants renew their leases you might add the square footage to their lease at that time and reduce the square footage of the dummy suite accordingly. Make sure the building denominator does not change with these adjustments. Using this methodology, eventually every lease will reflect the correct rentable square footage.

Another option is to change the suites all at one time and draft a lease amendment to reflect the adjustment with each tenant. This can be accomplished by adjusting the space square footage but keeping the tenant's monthly payment schedule the same through the lease term. That will lower the rental rate per square foot, but that

Tenant Name	Leased Unit	Usable Area	BOMA Remeasure with 16.2% Load Factor	OWNER RSF Using 15% Load Factor	Current Square Footage in Rent Roll	Variance (Re-Measured Square Footage vs Existing)	New Square Footage - Date Added to Rent Roll	Comments
Tenant #1	100	2,096	2,436	2,410	2,384	26	2,410	Increase at renewal
Vacant	110	937	1,089	1,077	1,077	-	1,077	Completed 12/17 when tenant vacated
Vacant	150	14,431	16,769	16,596	16,596	-	16,596	Completed with prior tenant, now vacant
Tenant #6	201	8,542	9,926	9,823	9,744	79	9,823	Increase at renewal
Tenant #6	220	1,197	1,391	1,376	1,401	(25)	1,376	Correct at renewal
Vacant	222	838	974	964	964	-	964	Completed sf upon remeasurement
Vacant	224	1,106	1,285	1,272	1,272	-	1,272	Completed sf upon remeasurement
Tenant #3	244	817	949	940	940	-	940	Completed upon renewal 11/16
Vacant	250	5,214	6,059	5,996	5,996	-	5,996	Completed sf upon remeasurement
Vacant	260	853	991	981	981	-	981	Completed sf upon remeasurement
Vacant	300	27,712	32,201	26,119	26,119	-	26,119	Completed sf upon remeasurement
Tenant #4	400	17,370	20,184	19,976	19,976	-	19,976	Completed with new lease 8/14
Tenant #4	405	3,693	4,291	4,247	4,247	-	4,247	Completed with new lease 8/14
Tenant #2	475	3,570	4,148	4,105	4,105	-	4,105	Completed with lease renewal 4/15
Tenant #2	500	24,330	28,271	27,979	27,971	8	27,979	Increase at Expiration
LF					88	(88)	-	
				Total Potential	Total at Present	Variance		Remeasured June, 2014
		112,706	130,964	123,861	123,861	-	123,861	

In the pictured example, the building has a 16.2% load factor, but the market can only bear a 15% factor. The vacant spaces and building denominators were adjusted immediately. A dummy suite was added to capture the difference in building square footage so that the building denominator is correct. In the "Comments" column, the strategy is outlined. Any suite that now reflects the correct square feet has a note as to when it was implemented. The suites that still need to be updated are noted as well.

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Office Properties Quarterly - Financing Sources Matrix

TYPE OF CAPITAL	SOURCE OF CAPITAL	EXPLANATION	RATES/SPREADS	LTV/COVERAGE	TERM	AMORTIZATION	FOCUS	TRENDS
LIFE INSURANCE COMPANY	• Insurance premiums • Annuity and GIC sales	• Non-Recourse • Longer-term fixed rate loan	3.00%-4.00%	• Up to 60% LTV • 1.50x Minimum DCR	5-30 Years	20-30 Years	• Downtown, urban locations or popular suburban office parks • Multi-tenant, traditional floor plates • Top tier tenants with good credit • Major metros & secondary markets (being more selective on secondary markets) •Diversified rent rolls with evenly distributed rollover	• Many of the life insurance companies have become more selective on office properties but that is starting to ease up • Lenders are digging further into the rent roll to understand each tenant business models and credit • Higher push for properties with credit tenants and term • Most competitive at lower to moderate leverage (50% - 55%) with strong sponsors • Typically targeting higher quality assets with better credit in the rent roll or assets with a staggered rent roll • Starting to target high-quality suburban office more due to impacts of COVID-19 on more urban areas • Interest reserves implemented on deal-by-deal basis
CONDUIT (CMBS)	• Sales of mortgage-backed securities through public markets	• Non-Recourse • Longer-term fixed rate loan	3.25%-4.25%	• Up to 65% LTV • 1.40x Minimum DCR • 9.0% Minimum Debt Yield	5, 7, & 10 Years	25-30 Years	• Downtown office • Suburban office • Single-tenant with structure • Secondary/Tertiary Markets	• Looking at office assets but being more selective with effects of COVID-19 •Higher emphasis on tenants' credit or loan structure around rollover • Interest reserve on a case-by-case basis; loans greater than 60% LTV will likely have a debt service reserve • Targeting acquisition or cash-neutral refinances in the current environment • Will consider full-term I/O on select office deals at LTVs of 55% or less
BANK	• Corporate Debt • Deposits	• Recourse (non-recourse becoming more available) • Shorter-term fixed and floating rate loans	3.25% - 4.25%	• Up to 65% LTV • 1.40x Minimum DCR • 9.5% Minimum Debt Yield	Up to 10 Years Fixed, Typical Max Term is 5-7 Years	25-30 Years	• All office assets • Value-add with guaranties • Secondary/Tertiary Markets	• Being more selective on asset quality given the current environment • Many banks focusing primarily on existing client relationships • Most competitive for Sponsors with established banking relationships and strong borrower history that are willing to accept recourse • Establishing a deposit relationship is becoming a requirement • Typically recourse loans, but non-recourse becoming more available to strong sponsors at lower leverage • More flexible (open) prepayment terms
DEBT FUND / BRIDGE LOAN	• Private Capital • Institutional Capital	• Non-Recourse • Shorter term bridge loans for acquisition and/or repositioning	L+ 300-500 bps spreads	• Up to 75% LTC • Going-in 1.0x DCR	1-5 Years (3+1+1)	Interest Only	• Value-Add Transactions • Recapitalizations	• Most lenders have a LIBOR floor of 25 or 50 bps • Being more selective on asset quality given the current environment • Pricing depends on leverage level, property quality, and Sponsor strength • Needs to have strong value-add business plan and story in place • Limited interest for non-cash flowing assets
MEZZANINE/ PREFERRED EQUITY	• Private Capital • Institutional Capital	• Junior financing secured by a pledge of, or participation in ownership interest	Mezzanine 8%-12%	• Up to 80% LTC • 1.10x DCR	2-10 Years	Interest Only (in most cases)	• All office assets • Value-Add Transactions • Recapitalizations	• Preferred equity offers higher funding than mezzanine, but at a higher cost • Minimum investment is typically $5MM but can start as low as $1MM when paired with senior position

DCR - Debt Coverage Ratio
DUS - Delegated Underwriter Servicer
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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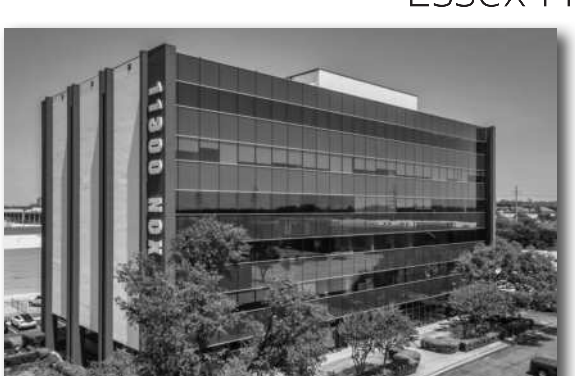

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OFFICE — CONSTRUCTION

Timing is everything in office construction right now

As vaccination rates climb and business restrictions loosen across Colorado, many businesses on the Front Range are eager to get their workforces back to the office after more than a year of remote work. With most companies planning a return to the office in some form by fall, the tenant improvement market is quickly gaining momentum.

The TI process always has been an important tool as it allows for the customization of a space to meet a company's specific needs and impacts everything from productivity to company culture. Now, with the potential need for health and safety upgrades like improved air filtration or increased social distancing, improving an office space is a crucial step for companies to move forward.

However, a set of market conditions, created in part by the pandemic and in part by the historic run-up in development we experienced on the Front Range before 2020, have made executing a tenant improvement plan more complex – and more expensive – than many businesses anticipate.

For companies ready to lease new space, expand or sublet, there are a few key efforts that can help mitigate the impacts of the market right now – and it starts with timing.

■ **Move quickly.** Timing is key in real estate, even under more normal circumstances, but with price increases in materials and

Nick Groeger
Principal, Taurus Builders

commodities driving up the cost of building at a breathtaking pace, the role of timing in the office TI process is more impactful today than ever.

The price of lumber, in particular, has more than tripled in some cases over the past year as sawmills across the country slowed production in 2020 – both as a result of pandemic shutdowns and in anticipation of a slowdown in demand (similar to what they experienced in 2008), which never materialized. As a result, the overall average price of lumber jumped to $1,188 per thousand board feet at the end of April, up from $349 a year prior. Materials like steel, copper and electrical wire have likewise jumped in price between 80% and 400% in less than 18 months. Unfortunately, we anticipate material availability will continue to be a challenge in the construction market for the foreseeable future.

Increases like this can be hard to stomach, and uncertainty about the future of the office market still abounds, making some companies understandably cautious. But prices are escalating at such a pace right now that hesitation of as little as a week can have dramatic impacts on schedule and overall project cost.

Prices are escalating at such a pace that hesitation of as little as a week can have dramatic impacts on schedule and overall project cost. Pictured above is a tenant improvement project for Kentwood City Properties' office.

■ **Negotiate a healthy tenant improvement budget.** The good news is that you may not have to bear the increased construction costs alone. While lease rates are showing signs of stabilizing following the pandemic, landlords still were facing a marketwide vacancy rate of 16.8% (in downtown Denver it jumped to 19.7%) in the first quarter, the highest it had been since 2010. Vacancy is expected to continue to rise as new product comes on line this year. All of this means that tenants are significantly better positioned than they were just a couple of years ago to negotiate a healthy TI allowance, with contingency to accommodate rising costs.

Working with an experienced broker, tenants should assess their situation, read their leases and determine their best-case scenario, in terms of concessions – whether that's timing, flexibility or support on costs such as moving and tenant improvement – then make requests knowing they're in a position of strength.

■ **Bring everyone to the table from the start.** Once you've secured a space, involving a general contractor early in the design phase will help with identifying potential budget and schedule impacts. If your landlord is not providing a general contractor, make sure you

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OFFICE — CONSTRUCTION

Design-bid-build project advantages & challenges

There are a number of construction project delivery methods used today. Each has a time and place.

Every construction project is unique. To determine the best construction project delivery method, owners must first evaluate their budget, design, risks and schedule, along with their own expertise in the design and construction process – for each project.

The five most common construction project delivery methods are:

- Design-bid-build (aka competitive bid, stipulated sum or hard bid),
- Construction management/general contractor,
- Design-build,
- Multi-prime and
- Integrated project delivery.

This article addresses the design-bid-build method.

■ **Design-bid-build.** This method is familiar to almost everyone in the industry as it has been used for decades. Its name describes the three sequential phases for this method. First, the owner and design team develop the design documents. This design is then sent to multiple general contractors to provide a bid. Bids are evaluated by the owner and design team for award, typically to the lowest bidder. A contract is agreed upon and signed, at which time construction (build) can begin.

There are two relevant points to note that affect construction starting immediately. The first is a building permit must be secured – if possible, the application for which might occur before contractor award. Second, materials must be ordered,

Laura Kingfisher
Senior estimator, Swinerton

mostly by subcontractors (trade partners). Orders cannot be placed and fabrication cannot begin until the general contractor has awarded contracts to the trade partners and material product data, samples and shop drawings are subsequently submitted by these trade partners for approval by the design team. This submittal process definitely has a time element to it. Special consideration should be given to the longest lead items being identified early. Construction cannot begin in earnest until materials have been fabricated and delivered.

Two factors can have the biggest impact on the success of a DBB project.

The first is to avoid tension among all parties; a successful DBB project requires meticulously thorough and accurate drawings and specifications to avoid potentially costly and contentious change orders and schedule delays. Drawings should be 100% completed and the specifications/details should be 100% applicable to the project before being released for bid. The drawings must have all comments by all authorities having jurisdiction incorporated and include all details and specifications.

The primary reason for releasing a set of drawings (permit set) before all details have been completed is the schedule. This is a commonly used strategy to mitigate the impact of AHJ approval backlogs. However, the hard-bid method works best with 100% completed documents. Giving the design team the time to produce coordinated, complete documents is incredibly beneficial to the bid and construction phase. The importance of this time cannot be stressed enough.

One major benefit includes more interest and engagement from trade partners in bidding the project. Incomplete project documents bring many questions from the contractors and trade partners during bidding. A project that begins the bid phase with incomplete information not only impacts valuable bidding time, but also leads to questions and doubts about the overall integrity of the project. Bidding on completed drawings and specifications protects the owner and general contractor from bids that are missing scope or have added contingency for unclear information.

The second factor impacting a project's success is the owner warrants the sufficiency of the drawings and specifications to the contractor. The contractor is responsible to build the project as designed. The designer is responsible to design to the professional standard of care, but the owner is responsible for any "gaps" between the construction documents and the owner's requirements. Allowing additional time during design will lessen the owner's exposure to this risk.

■ **Advantages.** There are many advantages to DBB projects. It is the most familiar method and there are well-defined roles for the parties involved. The owner has a significant amount of control over the success or failure of the end product. The owner has control of the design and owns the details of the design. The best-suited projects for this method have a defined scope of work, realistic schedule and are not subject to significant changes after bidding.

■ **Disadvantages.** With these projects, there is no opportunity for collaboration. The general contractor and trade partners may not assist with estimating, scheduling, drawing/specification coordination and constructability reviews during the design phase. The quality of the design has an impact on change orders and delays. Also, the owner generally faces exposure to change orders and claims over design and constructability issues since the owners accept liability for design in their contract with the contractor, and the owners do not know what construction costs are until after the bid process; the risk is that bids are higher than the budget after a large portion of the design money has been spent. Additionally, a construction contract typically is awarded to the lowest bidder, without consideration of qualification. There is a potential for adversarial relationships as well as a potential for redesign and rebid if the project comes in over budget. The projects also can see long lead times as materials cannot be ordered or fab-

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OFFICE — WORKPLACE TRENDS

3 considerations for planning your office return

Amy Aldridge
Partner, Tributary Real Estate

Metro Denver's economic engine is beginning to hum louder after more than a year of financial hardship for many companies, brought on by COVID-19. With more people getting vaccinated, infection rates declining and restrictions on businesses lifting, there are a lot of reasons to get excited about the next few months and the return of something closer to normal life and business operations.

Accordingly, many business leaders are thinking about their strategies for returning to their offices – or considering if they need to go back to the office at all. After months of remote work for most office workers, this topic is more complex than it sounds, with many new variables to think about as the reality of workplaces has shifted because of COVID-19.

The first step to assembling a plan for returning to the office is asking key questions that will serve as a guide. Here are three of the most common questions that business leaders should answer as they develop a return-to-the-office strategy.

■ **How will you ensure employees' health and safety in the workplace?** One of the most important aspects of returning to the office is ensuring there are systems and infrastructure in place to keep employees safe and healthy. Although masking and distancing guidelines have been relaxed generally, every county, city and even some office buildings can make their own requirements, and they can change with little notice.

Beyond governmental requirements, it's also important that employees feel comfortable in the office. Everyone has a different level of risk tolerance and comfort when it comes to the question of masking and social distancing, so business leaders need to listen to their employees to get a true pulse on how their workforce feels and act accordingly.

Many office buildings have upgraded their HVAC and filtration systems to pave the way for companies looking to return to offices with increased health and wellness practices. Companies should assess what improvements have been made in their buildings and if there's anything further that needs to be done.

Basic things like sanitizer and cleansers should be standard. Most offices kept these items on hand before the pandemic, but they are likely to be used more frequently now. Some companies are even thinking through space flow to help motivate hygienic practices. For example, employees may start entering the office through the break room so they can easily wash their hands before starting the day.

■ **Should you consider changing your workplace model?** "Returning to normal" is everyone's goal right now, but it's important to be realistic about the fact that we're looking at a new set of challenges when it comes to workplace models and office usage. There always will be a place for offices in American commerce, and they remain the best place to collaborate with colleagues, build company culture and morale, and provide crucial training and management functions that serve the pipeline of talent in any industry.

The marketing for Rev360 on Brighton Boulevard highlights the property's health, safety and wellness upgrades.

But many companies are learning that some of their workers enjoy working remotely, particularly for focused tasks, while others miss the office atmosphere and want to see their co-workers. Enter the office real estate topic du jour: hybrid working. This model simply involves some employees working remotely while others come into the office. In some cases, those workers may switch places depending on what kind of work they have to do or even the day of the week.

Another potential model is hub-and-spoke, in which companies maintain a central office, likely downtown, while establishing several smaller offices in the suburbs. This is popular among workers who either moved or have always lived away from the city center and have become accustomed to no longer having a commute.

Finally, the idea of coworking, which gathered significant strength before the pandemic, still is an option for many companies. Since so much is still in flux, companies that are unsure if or how their head counts will change over the next 12 to 18 months might appreciate having short, flexible lease terms that allow them to adapt to changing conditions.

■ **What kinds of changes will your office require?** Some companies will be able to go back to their offices

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For hybrid work plans, no 2 companies are the same

Martin Goldstein
Founder, Venture Architecture

After a long, often dark and largely lonely year, we all can finally see the light at the end of the tunnel. The vaccine is here and widely available, Denver is now at level "clear" and with return-to-work campaigns being led by groups like the Downtown Denver Partnership, we are on the precipice of some sense of normalcy.

On one hand, that's great news – certainly, for mitigating loss of life and supporting the well-being of people and businesses. But also it raises a lot of questions about the longevity of the new routines we fought hard to build – from the way we work to the way we interact with one another. Will we all head back to the office en masse now that we're free to do so? Will flexibility to work from home become the expectation from the workforce? Who will be able to work from home and for how long? What are the human resource implications?

Our perspective has been to look at the past year more like a traumatic event. On Sept. 12, 2001, no one was comfortable heading back into a big office building. We were deeply affected and rightly so. It was a horrible event, but we healed. Eventually, we headed back and got back to our lives. With nearly 600,000 dead in our nation alone as a result of the pandemic, this event should absolutely be considered a national trauma. And as before, we will heal again.

Ultimately, we believe that most companies eventually will resume completely full in-person work or something close to it. There is simply too much of the human experience that we can't replicate with virtual tools. But following the pandemic, we still have a rare opportunity if we choose to take it. We can evaluate what did work during this difficult time. We can make changes for the betterment of our organizations and our people in the short term and begin to reshape our approach to work long term.

By pulling insight from the folks working day in and day out with companies across the spectrum who are grappling with what comes next for their organization, we can get a clearer picture of the strategy that will work best for our own organizations.

■ **Predicting back-to-office timing.** Let's start with the short term. Most workplace strategists are coalescing around the idea of a hybrid office model – at least initially. Employees are certainly on board. Fully 92% of employees surveyed by Smartway2, a workplace scheduling company, said that they would prefer a hybrid arrangement of some kind.

While we're generally heading back to the office in some form, there are two large unknowns. First, is the timing – when and at what rate. The second is how – what will it look like, how will it work (and for how long).

The former is easier; albeit the answer will vary from company to company. In Colorado, as of mid-May, approximately 43% of the population was vaccinated. Assuming we continue to make progress toward herd immunity, and given the recent lifting of a majority of restrictions at the city and state levels, we can expect companies to resume a more normal office routine by summer.

While timing can be roughly figured out, the harder part is how we'll office when we get back.

■ **Who goes back and how?** Groups that are largely mobile, possibly sales-oriented or others that have culturally thrived out of the office prior to the pandemic finally may be compelled to shed office square footage. Conversely, collaboration-based, largely interactive or proprietary materials companies will flood back to the office.

There are some for whom the decision will be clear-cut. However, most will be less so. For those, the path will prove harder to forge. They will be facing a hybrid solution; but no two hybrids will be alike.

Denver workplace-solutions provider Elements recently came out with a research-based report, Hello Hybrid, along with a workbook to help organizations navigate potential changes.

Among the questions it recommend addressing are:

• What does "flexibility" mean to your organization?

• How much remote work will you allow?

• Do your facility and real estate needs change?

• Does the organization need to be trained to lead/manage differently?

• Do expectations for the organization change in a hybrid model?

The very different responses each organization will give to these questions illustrates just how challenging this process will be. There is no right or wrong way; it's about what will work for your organization.

The companies in this hybrid zone that are most in tune to their cultures will be most successful at carving out their response.

■ **Planning ahead for your office of the future.** Talking to the brokerage side yields further insights into both the challenges and opportunities.

For those companies in a lease transition, making major changes, particularly major downsizing, is a risk. With real estate expenses averaging 8% of a company's budget, the appeal is tempting. However, the result of locking into a five-, seven- or 10-year lease that substantially reduces square footage also may limit your options (and cost you) should the post-pandemic hybrid/remote work experiment ultimately fail.

Tributary Real Estate notes that some of its clients are starting to make more long-term real estate decisions, while others remain wary of making big changes. For companies that know an in-office presence (even in a smaller footprint) will continue to be a major part of their strategy, there is significant opportunity right now.

This is the best time to find and lease new office space, as rents are entering negative growth territory and will probably remain depressed for some time. Vacancy rates, particularly for high-quality product, are expected to spike in 2021 as new construction comes on line

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OFFICE — WORKPLACE TRENDS

Foundations of high-performing placemaking

While the full impacts of the COVID-19 pandemic on real estate remain to be seen, we do know one thing: Drastic changes in the built environment are needed to keep up with the way policies and human behaviors have shifted over the past year. Going to the office is no longer simply about getting work done; the office must now be a place where people collaborate with colleagues and fulfill their desire to be a part of a company's culture to drive positive social change within a working community.

For companies that are reimagining their workplaces through return-to-office strategies, there are four critical pillars that all organizations looking to evolve and thrive post-pandemic must prioritize. We see this as the "nexus of sustainability":

1. People: Promote the mental and physical well-being of employees.
2. Social: Create a long-lasting culture and strong community.
3. Environmental: Protect natural capital, maximize energy efficiency and eliminate carbon emissions.
4. Economic: Invest in early planning to build resiliency and optimize return on investments.

Together, this nexus of sustainability is reshaping how companies think about the future of workplace, and an integrated approach across this nexus is more relevant than ever. The question now is, what do commercial real estate professionals do about it?

Commercial real estate teams can

Emmy So
Vice president, real estate and workplace solutions, Stok

use these high-level, critical steps as an entry point:

■ **Prioritize health and well-being initiatives.** Now more than ever, the workplace experience has shifted to focus heavily on the health and well-being of employees. Teams will need to shift how they function in their shared space, and engagement strategies that foster employee buy-in and participation will lead to a thriving cultural evolution in the workplace that prioritizes employees' mental and physical well-being.

Companies should demonstrate a "day in the life of hybrid working" for individuals and teams to illustrate how and where hybrid work happens. They also should call on leaders and managers to establish and model social behavior standards that prioritize well-being to help the organization define workstyle effectiveness and adopt best practices.

■ **Redefine the working environment.** Fostering safe environments takes more than ensuring your mechanical systems are updated for better air quality. It's about creating a place of security and comfort that allows people to accomplish their best work. Companies will need to develop an experience framework that aligns business goals, asset

Adam Guli
Director of client solutions, Stok

management, sustainability goals and strategies that meet the emotional and physiological needs of occupants and visitors.

To do this, create settings within the work environment to foster social collisions while maintaining safety protocols. Define a hybrid workplace, because where employees work from will have major implications on asset management, protocols and future expansion plans for organizations at any stage. Think beyond "one" workspace. Instead, utilize a network of spaces easily accessible to individuals and teams. Also, expand the design of work environments beyond office walls and create programmatic and technological processes to shape a virtual place.

■ **Assess climate risk to build resiliency.** Commercial real estate professionals have a growing financial incentive to assess the climate risk on their portfolios. As they develop robust initiatives to drive sustainability and resiliency portfoliowide, organizations that transparently benchmark and document progress toward goals will be better equipped to answer market demand for environmental stewardship while building critical climate readiness across their portfolio.

Companies can use climate models to help inform long-term decision-making around real estate strategy. They also can work cross-functionally in the organizational hierarchy to develop achievable goals for resiliency initiatives and associated action plans, which may incorporate building certifications, life cycle assessments, sustainability guidelines and more at the portfolio scale.

■ **Establish a robust communication plan.** Clear and concise communications regarding how employers plan to accommodate a modification to behavioral norms should speak to the hybrid work/home structure and find a way to infuse these new norms while slowly integrating people back into the office. Ultimately, this will lead to an analysis of the impact of a company's real estate on business objectives to support employees' shifted workplace priorities.

Companies should prioritize thorough communication across the organization, which will be critical in supporting employee confidence in their organization. This should be a communitive effort across all business verticals within the organization to ensure transparency and trust. Consistent messaging from executives, business leaders and team leads is key.

Also, establish a multitiered communications platform (for example, identify "hybrid" champions, intranet, Slack, Teams, etc.). Define and communicate clear systems

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Wellness-based design and the future of real estate

Recent research has revealed that, between home and work, adults spend almost 90% of their time indoors. This means that interior spaces can have a powerful influence over an individual's health and lifestyle. Indeed, the majority of what determines human health is directly based on the physical and social environments where one lives, works and plays.

Through its design and functionality, a property can shape daily habits and activities, drive individuals toward healthy or unhealthy choices, and influence overall health through the quality of the surroundings. This connection between buildings and wellness also can impact business outcomes, potentially leading to lucrative gains. Properties that thoughtfully incorporate wellness models create a more productive, satisfied and healthy work environment. As such, real estate professionals are in a strongly unique position to support both public health and their clients by exploring the numerous benefits that wellness-based design can provide.

■ **What is wellness?** Understanding human health and its connection to real estate starts with understanding wellness holistically. Wellness encompasses more than just physical health, with most models recommending at least six dimensions to consider. In addition to this, research conducted by the World Health Organization and the Centers for Disease Control and Prevention showed that genetics are responsible for only 10%

Rami Vagal, LEED, WELL AP
Senior manager of sustainability, Mohawk Group

of a person's health. This, then, begs the question: If physical health is only one consideration of wellness and genetics contribute very little to a person's overall health, what exactly is wellness?

Most wellness models include six major dimensions: physical, mental, emotional, spiritual, social and environmental.

- Physical: Supports a healthy body through exercise, nutrition and sleep.
- Mental: Focuses on engaging the world through learning, problem-solving and creativity.
- Emotional: Being in touch with, accepting of and able to express one's feelings (and those of others).
- Spiritual: The search for meaning and purpose in human existence.
- Social: Emphasizes connection and interaction with others.
- Environmental: Underscores the role we play in bettering the natural environment.

The most desirable real estate properties, especially post-pandemic, will embrace many, if not all, of these dimensions and positively contribute to public health. However, recognizing a multifaceted picture of wellness is only the first step. The second step is to build an understanding of how and why a healthy environment can support a client's bottom line.

■ **The business benefits of healthy environments.** Today, sustainability conversations are expanding to address building occupants' overall health and wellness, seeing clear data that a healthy workplace with happy employees is good for business.

A physical space can affect people and relationships. The space we inhabit has a certain energy, a feeling that affects our mood. If we are unhappy in a space, that can carry over to other parts of our lives. Our relationships, both personal and professional, will reflect it.

Various factors influence the quality of a space, including color, light and materials. An environment with poor lighting, awkward design and a dreary atmosphere can negatively affect an occupant's mental and physical well-being. When a business occupies that space, negative moods can damage company morale and hinder opportunities. As a result, poorly designed and constructed spaces can create tense interactions, stressed relationships, poor communications and low productivity.

On the other hand, properties that promote health and wellness provide vital benefits. Employees prefer green buildings that make them feel healthier and more productive. A building's asset value increases the greener and healthier it is. Indeed, a recent report by the World Green Building Council showed that employees are happier in a green space, such as one that reduces energy consumption, greenhouse gas emissions and air pollutants. With natural light, access to nature and other mood-enhancing attributes, these buildings also improve occupant well-being, satisfaction and productivity. In one case study, a net-zero carbon office showed 94.5% staff satisfaction and better health reported by 72% of its employees. Yet another office experienced a 68% reduction in reported respiratory problems, with staff sick days almost halved.

The companies that own or occupy these buildings also experience strong financial returns. These companies realize economic savings through resource-efficient designs and operations while also seeing reductions in staff turnover, absenteeism and presenteeism.

The WGBC report further revealed that the most significant benefits occurred when environmental considerations were rooted in the initial design phase. In other words, the companies that experienced the largest economic benefits were also the companies that weighed potential impacts on people and the environment from the start of building design. This early consideration helped establish a clear path to achieving key goals, such as improving air quality without sacrificing energy efficiency.

■ **The results are clear.** A successful wellness-based building reflects the multiple dimensions of wellness, providing remarkable benefits to all. Employees prefer and work best in green and healthy buildings.

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OFFICE — MARKET OUTLOOK

Continued from Page 1

greater. For the time being, COVID-19 has flipped the market on its head and quickly turned a landlord's market in favor of tenants. This won't last long.

Across the nation, sophisticated businesses took advantage of mandated lockdowns and stifled business velocity to strategize long-term corporate real estate strategies. Since the first quarter of 2020, there have been over 25 announcements of firms either relocating to or expanding in Denver, many of which are coming from high tax, high cost-of-living coastal cities, such as HealthPeak Properties (formerly Irvine, California), Palantir Technologies Inc. (formerly Palo Alto, California) and DAT Solutions (formerly Portland, Oregon). Investors, privy to evolving sentiment and seeking to enhance their own value strategies, have aggressively sought intel into the do's and don'ts of the Denver office capital market space. Anecdotally, our office has not experienced a greater surge of interest from out-of-state investors and companies looking into Denver than during the prior 12 months. A tsunami of new capital, new residents, new businesses and, most importantly, new jobs is entering Denver at an unprecedented rate in a post-crisis environment. Denver arguably out-competes the majority of U.S. cities in balancing a strong quality of life, overall tax liabilities and the accessibility of a true live-work-play atmosphere. Even when companies don't choose Denver, their employees do. Approximately 8.6% of workers in Colorado are remote workers, according to a 2020 FlexJobs report. And, with Denver consistently ranked as a No. 1 best city to live in with approximately 20% of its population comprising millennials, it is extremely well positioned to recover coming out of COVID-19.

COVID-19 accelerated many workplace trends that we did not anticipate seeing until several years into the future: workforce mobility; greater square-foot-per-employee and hybrid workspaces; the movement of millennials from the urban core into suburban and other remote areas; and a slow, steady push toward greater employee privacy. Prepandemic, employees were reporting fatigue from 100% open office plans. If these employees are returning to those same spaces, they are likely to struggle to achieve the same level of privacy (and noise control) that they've since become accustomed to at home. Individualistic health and wellness are likely to be emphasized moving forward, allowing landlords the ability to dust off their office gym amenities and flip on the lights. ▲

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Groeger

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have a good sense of the contractor's project load and subcontractor availability. Given the vital role of timing right now, ensuring your general contractor has the resources to move quickly is essential.

Once you're into the construction process, quick decision-making remains crucial to keeping projects on track financially and with respect to schedules. The sooner contracts are signed, the sooner the general contractor can lock in prices. On a recent office TI project, for example, we saw a project budget increase by 3% for metal stud framing, 9% for plumbing, 7% for HVAC and 5% for electrical – all within the three-week period of the prime contract negotiation. As a result of current market conditions, many subcontractors on projects right now will only guarantee bids for one week, underscoring the importance of quick decision-making.

In spite of the challenges within the market right now, a successful TI project within a reasonable budget still is absolutely within reach for those who act decisively and engage with an experienced, well-connected general contractor.▲

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So

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to support bilateral communication flow. Receiving feedback and input from employees is just as essential as feedback coming from the executive level.

Commercial real estate professionals are being challenged to rethink the future of work and workplace. Addressing the four pillars of the nexus of sustainability through an integrated approach is critical to answer the big questions commercial real estate teams are faced with today. By reimagining the workplace to maximize human, social, environmental and economic opportunity, leaders can turn their commercial real estate assets into tools for innovation, community building, climate resiliency and financial gain. This is the foundation of high-performance placemaking – and the future of commercial real estate. ▲

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Vagal

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With this enhanced productivity also comes drastically improved employee satisfaction and staff engagement rates, making workplaces even more functional and stable. Maximizing the potential of a property and incorporating the most ideal solutions demand that all environmental impacts are considered and addressed as early as possible, even at the start of building design. Of course, an additional benefit to a wellness-based building is also perhaps the most notable – an overall improved relationship between people and the environment. Together, all of these benefits deliver actual value to both real estate professionals and their clients as the world emerges out of a pandemic and looks for spaces to support healthy operations. ▲

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Targeted Industries: Downtown has a strong and diverse concentration of industries, including: legal services, accounting, energy/natural resources, finance/insurance, engineering/architecture and broadcasting/telecommunications

FIRESTONE, CITY OF

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Targeted Industries: Retail Trade, Accommodation and Food Services, Residential, Business & Professional Services, Sports & Outdoor Recreation, Health & Wellness, Technology

FOUNTAIN, CITY OF

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www.furaco.org
Targeted Industries: Manufacturing (*specialized "niche" advanced, food/AG*) - Transportation & Logistics - Homeland Security (*military, law enforcement*) - Entrepreneurialism - Renewable Energy - Motorsports Economy (*tourism & entertainment*)

GRAND JUNCTION ECONOMIC PARTNERSHIP

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Targeted Industries: Aerospace and Advanced Manufacturing; Agriculture; Energy and Renewables; Health and Medical Care; Outdoor Recreation; Technology and Entrepreneurship; Opportunity Zone projects.

JEFFERSON COUNTY ECONOMIC DEVELOPMENT CORP.

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Targeted Industries: Aerospace, Aviation, Adv Manu, Beverage Prod., Bioscience, Energy, Engineering, IT/Telecom

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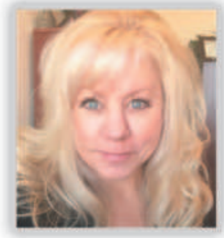
WINDSOR, TOWN OF



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Hanner

Continued from Page 8

rate can grow quickly upon lease extension.

■ **Options to consider if square footage decreases.** If the overall square footage of the building decreases, understandably, this is the most difficult problem to address. No owner wants to make a good tenant disgruntled if they feel they have been overcharged, yet it is doubtful the landlord will desire to refund any rent collected over the lease term. This is a situation in which lease review is most crucial. Calculating the amount of rent that was collected based on the inaccurate square footage is a useful tool in determining how best to address the issue. Findings may be discussed with the tenant and square footages adjusted accordingly if the lease states rent as a flat monthly fee for an approximate amount of square feet. Perhaps the landlord will consider providing some rent abatement in lieu of a refund. Communication and transparency are paramount.

Some landlords elect not to inform tenants that the lease states a greater amount of square footage than what the verified measurement truly is. They may prefer to wait until the current tenant moves out of the building to change the suite measurement. Be aware that it is not proper practice for a landlord to lease out more area than exists in the building.

Whatever option might be chosen, this is an owner business decision that requires research, review of options and financial implications of each, thoughtful strategy and good tenant communication when implementing.

Once you have determined the strategy to implement correct floor measurements, track your progress by color-coding your tracker accordingly. Use one color for suites that are using the new square footage and another to indicate the strategy as to when the adjusted square footage will be implemented.

In the pictured example on Page 8 the building has a 16.2% load factor, but the market can only bear a 15% factor. The vacant spaces and building denominators were adjusted immediately. A dummy suite was added to capture the difference in building square footage so that the building denominator is correct. In the "Comments" column, the strategy is outlined. Any suite that now reflects the correct square feet has a note as to when it was implemented. The suites that still need to be updated are noted as well. Using a tracker such as this will help you roll out your implementation strategy.

In conclusion, implementing updated building measurements should not be performed without having first analyzed factors such as leases, expiration dates and lending requirements. An implementation strategy should be developed with the property owner and the leasing/management team. This strategy will determine if the measurements will be revised immediately or if they will be applied over time. A tracker should be utilized as this process evolves. When future changes are made to the building, include the measurement professional who provided the new computations so they can maintain in their records for future use. ▲

Kingfisher

Continued from Page 12

ricated until a contract is executed.

The challenges with the DBB method helped birth other project delivery methods to increase trust and collaboration among project teams and address quality issues that were becoming more problematic. It is important that a project owner understands the advantages and drawbacks of each delivery method before selecting a project delivery approach. ▲

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Aldridge

Continued from Page 14

almost exactly as they left them in early 2020, but most will have to make some kind of change, whether it's staffing plans, technological infrastructure or an entirely new office space.

Shifting to a hybrid approach, for example, probably means upgrading technological capacity for file transfer and virtual private networks, while reduced staffing numbers could mean moving to a smaller office. The combination of fewer people, but each needing more space for social distancing, however, might balance out in your current space without having to increase or decrease your footprint.

And then there are the lease options to consider. COVID-19 has increased office vacancy, particularly in downtown Denver. The availability of space for sublease nearly doubled year over year to 5 million square feet in the first quarter.

Whether looking for sublease space, renewing an existing lease or exploring new options, now is the time for companies to make their move before being back in the office becomes the norm once again. Once that happens, the opportunity to secure more favorable lease terms, including multiple concessions, will be harder to come by.

Regardless of how companies choose to navigate the next several months, one thing is certain: We're all in a new frontier for the office and Denver's economic growth will be all the better for it. ▲

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Goldstein

Continued from Page 14

and is met with lower-than-average demand. Tributary notes that this should help companies that are in a position, and know what they want, to get into a nicer space at a better rate than would have been fathomable a little more than a year ago.

There are as many possibilities as you might imagine. The unknown of it all is unsettling, but also these times offer opportunities to revisit your strategy, increase flexibility and fine-tune operations in a way that simply never existed before. Taken in steps, and by being authentic and true about your culture and its challenges, this a wonderful opportunity to improve your organization and take it to new and exciting heights.▲

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A Colorado Real Estate Journal Publication

June 2021

INDUSTRIAL PROPERTIES

Recent sales activity highlights Colorado's robustness

As the cost of construction continues to rise, investors are purchasing assets in shell condition, taking on the lease-up risk just to capture quality new build product. For example, KKR recently purchased Park 12 Hundred for roughly $173 per sf with only 36% of the space currently leased.

Denver industrial activity continues to perform in dramatic fashion with no pause in sight. Investors, developers, builders, lenders, occupiers and owners remain bullish on the sector, resulting in one of the most remarkable industrial markets on record for construction, deliveries, absorption and sales in Denver.

Asking rents closed the quarter at $8.02 per square foot, up 3% since December and 5% year over year for the first quarter. Even an overall vacancy rate that rests at its highest level since 2012 has not curbed the appetite for new product.

The torrid pace of expansion for Denver's industrial market over the last expansion cycle is inextricably linked to what were the metro's concurrent years of net migration averaging 36,000 new residents annually. While that growth has slowed since 2017, the rise of e-commerce stepped in to lift the development pipeline. It's no secret that construction is booming here.

Larry Thiel
Managing director, capital markets, JLL

Carmon Hicks
Managing director, capital markets, JLL

There currently is more than 9.4 million sf of industrial product under construction along with the growing trend of national developers moving deliberately ahead with large projects metrowide. With Denver being on the radar for developers and institutional capital, we will continue to see a strong industrial push.

The positive outlook extends beyond the Denver metro area. Industrial expansion is occurring from Fort Collins to Colorado Springs; from Loveland and Brighton; south through Castle Rock and Monument and extending down Interstate 25 toward Colorado Springs. Secondary markets increasingly are being targeted by builders eager to discover the next "it" submarkets that allow for more affordable and feasible development opportunities. New construction will continue to pop up in areas stretching outside the "traditional metro."

As the cost of construction contin-

Please see Page 37

INSIDE

INDUSTRIAL — MARKET UPDATE

Denver sees record-high deliveries, strong metrics

Sam Dragan
Associate, Industrial & Logistics, CBRE

The industrial market shows no signs of slowing after recording 44 consecutive quarters of positive net absorption both nationwide and in the Denver metro area. Nationwide, asking rents rose in the first quarter to a record $8.44 per square foot, up 2.2% from the end of 2020 and 7.1% year over year. Rates likely will continue to rise from the increased demand from e-commerce and the need for safety stock to safeguard from supply chain issues experienced from COVID-19.

The effects of e-commerce. The pandemic caused a surge in e-commerce activity, which for the first time in history accounts for just over 20% of total national retail sales. In 2020, retail saw a 32% increase in online sales, spurring on a new wave of industrial demand. A CBRE research study estimates that for each incremental $1 billion growth in e-commerce sales, an additional 1.2 million sf of distribution space is needed to support the growth. While online sales growth is expected to slow in 2021, CBRE expects online sales to account for up to 25% of all retail sales by 2025, furthering the demand for additional warehouse space across the country.

Reaching the consumer. While there will continue to be some retail-to-industrial conversions, it still remains a niche area with large barriers to entry such as zoning restrictions and building design. Instead, many retailers are taking an omnichannel retail approach to meet the shifting needs of their consumer. This constitutes flexibility with sampling, ordering, pickup/delivery and returning items. Brick-and-mortar retail will continue to retrofit their stores to support the growing online sales and customer returns while they continue to expand distribution networks to better reach the customer. With this, last-mile locations will continue to evolve and be in high demand as companies want to get closer to their consumer to assure quick delivery times.

Denver continues positive trend. In the first quarter, the Denver metro area recorded positive total net absorption of 976,255 sf, more than twice the absorption volume year over year. The airport submarket was the primary driver for activity, recording 923,519 sf of positive net absorption.

Record-high deliveries. Nineteen projects totaling just under 3 million sf were completed in the first quarter, a record high. The airport submarket accounted for two-thirds of the total delivery volume, adding 2 million sf of warehouse space in Ascent Commerce Center's new Buildings 1, 2 and 3, and three other

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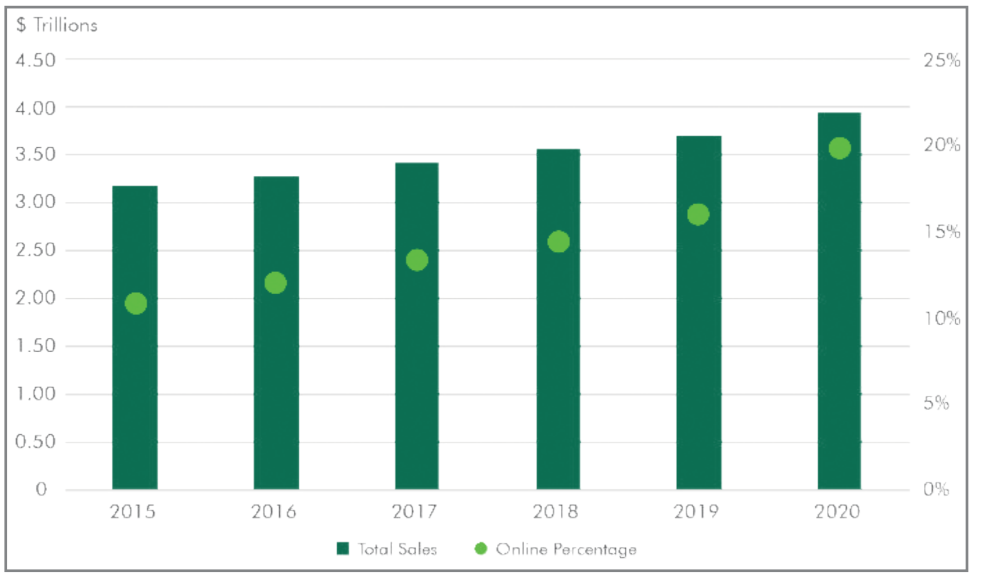
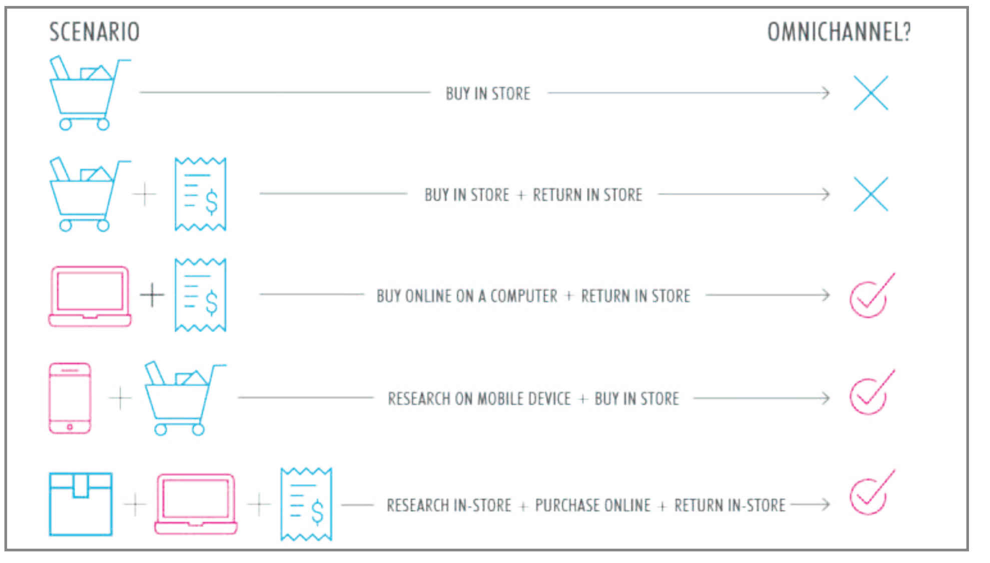


Source: U.S. Census Bureau, CBRE Research, February 2021
Total retail sales and online sales, excluding auto/gas/food services and drinking places.



CBRE
Omnichannel retailing is becoming a common retail approach.

INDUSTRIAL — FINANCE

Financing themes revealed by common questions

It's starting to become old news to say it, but industrial properties continue to be the most desired product type among investors and lenders. As logistics, technology, e-commerce and construction services companies continue to be such important parts of our economy, the industrial real estate markets continue to flourish. We have worked on a wide range of industrial property financings this year, and we would like to share some frequently asked questions and key financing themes that have come up on recent deals.

Paul Donahue
Assistant vice president of loan production, Essex Financial Group

Cooper Williams
President, Essex Financial Group

■ **Question: We recently completed a Class A industrial development and already are 75% leased within six months of delivery. Is it too early to explore the permanent capital markets and consider refinancing our construction debt?**

No, it is not too early to explore a refinance. In fact, stabilized property lenders are getting more aggressive on pre-stabilized assets in order to increase their overall exposure to the asset class. Most of the balance sheet lenders – life insurance companies and banks included – are underweight in an industrial property exposure, and creativity is a recurring theme to win good business.

While demand certainly is high, there are sizing constraints and parameters being used to consider funding pre-stabilized deals. Lenders have been requiring a minimum 1.0x debt service coverage ratio at closing and are solving to a minimum 7% debt yield upon stabilization. Typically, these pre-stabilized loans have minimal structure with holdbacks only for unfunded tenant improvement/leasing commission dollars on signed leases (no interest reserves or recourse required, so long as there is a 1.0x debt coverage ratio in place). Furthermore, there is so much liquidity in the debt markets for industrial product right now that pre-stabilized loans do not come with pricing premiums.

We are seeing fixed rates range from 125-150 basis points over the corresponding United States Treasurys, which puts all-in 10-year fixed rates around 2.75%-3.25%. We also are seeing floating rates between 150 and 175 basis points over Libor. Elevated demand and strong liquidity in the industrial space continues to make it a borrower's market with various financing options available.

■ **Question: What types of construction loans are available for speculative industrial development in today's market?**

More and more lenders are actively seeking speculative industrial construction loans for several reasons – speculative construction loans give lenders more exposure to the asset class, and speculative construction loans generate marginal additional yield compared with existing, stabilized industrial loans. Depending on a borrower's objectives, there are several options for speculative construction loans. For lower-leverage financing with minimal guarantees, life insurance companies are a great option and will fund up to 60% of cost. Current pricing is in the L+325-350 basis points range with a 25 basis points Libor floor. Local and regional banks, which have long been a dependable source for construction lending, also can execute in the 60% loan-to-cost range with completion guarantees only. Banks can push leverage up to 70% LTC with partial or full recourse, but with pricing that is very attractive in the L+250 range. Lastly, debt funds are continuing to make a push in the construction lending environment and have been winning deals by providing higher leverage options up to 75% LTC, with pricing around L+400. We have been seeing several spec industrial construction loan requests and there are various options available in the marketplace. Borrowers can be confident that they will find attractive terms for spec projects with a great location in thriving markets like Denver.

■ **Question: How should I finance a vacant industrial building acquisition?**

Financing execution on vacant, value-add properties really depends on the borrower's objectives – recourse, business plan, absorption timeline, etc. Several lenders are actively financing vacant industrial assets in well-located markets with an executable business plan sponsored by a seasoned borrower. The general financing terms for vacant properties are in the 60%-65% LTC range with pricing at, or better than, the construction terms outlined in the previous paragraph. These deals typically fall under the debt fund category, but certain banks and life insurance companies with strong value-add lending platforms will consider this profile as well, leading to a broader pool of capital, more competition and better economic terms.

■ **Question: Are lenders interested in higher-finish "flex" industrial assets?**

Historically, lenders have shied away from high-office-finish industrial assets (40%+). In the current environment, lenders are actively pursuing this product type and are comfortable with higher exposure to higher office finish. Why are lenders interested in this product type now? It mostly stems from the fact that these assets typically have smaller tenant sizes, which leads to better rent roll diversification. A lot of these properties tend to be located in infill areas and benefit from a higher demand for last-mile functions, service-oriented businesses and proximity to densely populated areas. Lenders will want to drill into replacement rents, reusability of second-generation space upon lease expiration, location and surrounding like-kind product, and historical performance before making a loan investment, but this asset class certainly has gained attraction from the capital markets community. Pricing on both long-term fixed-rate and short-term floaters has been very competitive.

Please see Donahue, Page 38

INDUSTRIAL — MARKET OUTLOOK

Will rising construction costs impede development?

Since the beginning of the pandemic in March 2020, experts across various disciplines have too often relied on the word "unprecedented" when discussing COVID-19's disruption of modern life. While this could be considered an accurate – if somewhat reductive – way to describe many of the challenges the Denver commercial real estate industry has faced over the past year, one challenge, at least, isn't new: rising construction costs.

According to Rider Levett Bucknall's Quarterly Cost Report, published in January, nonresidential construction costs were up 1.29% in Denver year over year. Denver-based construction firm Alcorn Construction also predicted prices may rise an additional 5-6% throughout the balance of the year, translating to a $1 to $3 per-square-foot increase in ground-up construction costs.

Though current pricing increases cannot accurately be described as "unprecedented," considering Denver experienced similar price-percentage increases in 2018 and 2019, the most recent uptick in costs is nevertheless a result of the pandemic. Supply chain disruptions and transportation issues caused by the pandemic – including shortage of shipping containers – caused a surge in the cost of raw materials, particularly steel, in the early part of 2021. The United States also drastically slowed its domestic steel production at the start of the pandemic in response to plummeting economic activity and an anticipated global recession, creating a

Cara Stamp
Senior research analyst, Cushman & Wakefield

further shortage in supply when demand rebounded more quickly than anticipated.

Unfortunately, though the threat of the COVID-19 virus has begun a slow but steady retreat in 2021, the pandemic's economic aftershocks are slower to fade. The price of domestic hot-rolled coil – the type of steel most often used in welding and construction – has risen 210% since August 2020, with the Bureau of Labor Statistics reporting that U.S. steel prices are currently 70% higher than the global average. Given predictions that it may take 12 months or more for global steel supply to catch up to the backlog of demand, it is unlikely there will be much – if any – decrease in cost of raw materials in the foreseeable future.

With these factors in mind, the question for the Denver industrial sector becomes: How will construction costs affect the market's development pipeline? Even before the onset of the pandemic, there was some debate in Denver over whether the supply of new industrial development was beginning to outpace demand. Despite strong leasing activity both before and during the pandemic, vacancy in Denver has been on a slow but consistent rise since the third quarter of 2019, due in large part to speculative projects delivering vacant.

Given decreased preleasing activity over the last several quarters and the current construction pricing outlook, one might have expected to see projects being scaled back or delayed indefinitely as 2021 progresses, but, thus far, that has not been the case. Far from a wait-and-see approach, many developers in Denver seem keen to finalize plans and order the necessary materials to avoid further price increases or delays.

"Our clients are pushing forward and doing everything possible to expedite their development schedules," said Bryan Fry, a director of industrial at Cushman & Wakefield. "Between the delays that currently exist throughout the supply chain and uncertainty over where construction pricing may go, the overwhelming sentiment in the Denver market is that now is the time to strike."

Far from a slowdown in construction activity, the Denver market actually may experience an uptick in land sales as developers and build-to-suit tenants race to secure sites and procure the necessary materials to compensate for extended project timelines. With dwindling land supply in the northeast submarket and redevelopment sites pushing toward $40 per sf in the urban core, development activity likely will begin shifting northward along the Interstate 25 corridor toward Fort Collins.

Furthermore, while industrial vacancy has increased over the last several quarters, the market's overall vacancy rate remains at a lean 6.3%, an indication that the market's pent-up demand has yet to be fully depleted. In fact, the extended construction timelines for current projects likely will provide an opportunity for some of the speculative space that delivered vacant in 2019 and 2020 to be absorbed, driving vacancy down and maintaining the need for a robust development pipeline into 2022 and beyond.

Finally, it is worth noting that the cost for existing space build-outs/improvements – while still less expensive than ground-up development on a per sf basis – also have increased as a result of supply chain disruptions. Similar to steel, materials like lumber, gypsum, copper and aluminum also have been subject to price increases and order backlogs in recent months, lowering the margin on existing space compared to new construction.

Much like the virus itself, it is impossible to know precisely how long the pandemic's supply chain disruptions will last, making it difficult to predict how construction costs may be affected long term. However, it is clear – at least in the short term – that material shortages, delays and increased pricing aren't going away. While this may translate to a severe drop-off in development activity in some of the less active industrial markets, developers and tenants in Denver seem determined to forge ahead. ▲

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OUR ENERGY SOLUTIONS.
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INDUSTRIAL — MARKET OUTLOOK

E-commerce, migration fuel metro industrial market

While most commercial real estate sectors have languished over the past year, the industrial market has experienced the most promise for post-pandemic success.

We know what a gut punch the office sector has absorbed. The same has been true for restaurant, hospitality and a large chunk of retail space. Predictably, health care has remained robust and, after an especially bumpy 2020, multifamily fundamentals have rebounded nicely with demand outpacing new supply in this year's first quarter. Those other distressed markets are rallying as well, albeit more deliberately than consumers would like. But it is the metro area's industrial sector that has proven to be the rock star quarter over quarter in the 14-plus months under the thumb of the pandemic.

Justin Rayburn
Principal, Fountainhead Commercial

In fact, all of 2020 and 2021 year to date have generated nothing but positive metrics for industrial space here.

According to statistics compiled by CoStar Group information services, Denver recorded 1.2 million square feet of positive net absorption with vacancy hovering at 6.9% in the first quarter of this year. Twelve-month rent growth ticked up 2.2% with overall rental rates settling at $10.20 per sf, the most ever recorded for this sector.

Construction activity broke another record with 8.3 million sf in process.

Aberdeen Construction

Denver's industrial sector continues to soar as e-commerce and positive migration reshape the marketplace. This building will feature up to 10% office spec space for a user on the fast track.

Lowrey Burnett
President and principal, Fountainhead Commercial

These and other stable fundamentals coupled with a lack of available space are driving up industrial sales prices.

There are three main types of industrial space with many more subsectors: logistical, specialized and flex.

Logistical space is designed to accommodate e-commerce-related distribution. Typically, wide open spaces with high ceilings and cross docks define this model used to receive and ship goods into one dock and out the other.

Specialized industrial space may include cranes and other heavy equipment for manufacturing, storage and distribution. These types of spaces also may require beefed up power, reinforced concrete flooring and other infrastructure improvements to accommodate heavy operations.

Flex industrial space is the hybrid of the group. This model features warehouse space, and may accommodate light manufacturing, research and development, bioscience, laboratory and a host of other purposes.

Those are the broad strokes, and there is significant variance among these industrial property types. All of them can include a percentage dedicated to office space, the size and design of which may vary according to the type of business, as well as who will be inhabiting the space at any given time.

Though market watchers are careful not to overuse superlatives, it is clear that industrial space takes the lead as a current preferred investment asset, and the pipeline does nothing to dampen that sentiment. But why? What do key historical indicators reveal? What are the primary drivers, and will they prove sustainable through the rest of 2021 and beyond?

"The vast majority of Denver's industrial space is multitenant," said Doug Ressler, manager, business intelligence, with Yardi Systems, a provider of software solutions for the real estate industry. "Denver is a transfer point for those larger cities that have huge, single-tenant fulfillment and distribution centers in towns like Indianapolis and Kansas City." In fact, about 42% of all industrial properties across the Front Range are multitenant, according to CommercialEdge, one of Yardi's subsidiaries that produces broker-based software.

Granted, Denver does have a small cadre of single-tenant mega-players in the market like Costco, Lowes Home Improvement and, of course, Amazon, among others. Those companies typically require 500,000 sf and up, and eventually, they'll get it here. Smaller, multitenant companies, on the other hand, fuel economic growth faster by requiring a broader base of industrial real estate for their operations. After all, small businesses – those with fewer than 500 employees – anchor the Colorado economy, accounting for a staggering 99.5% of the state's commercial operations, according to the U.S. Small Business Administration. Those people with dreams of hanging out their own

Please see Rayburn, Page 38

Industrial Properties Quarterly - Financing Sources Matrix

TYPE OF CAPITAL	SOURCE OF CAPITAL	EXPLANATION	RATES / SPREADS	LTV/COVERAGE	TERM	AMORTIZATION	FOCUS	TRENDS
LIFE INSURANCE COMPANY	• Insurance premiums • Annuity and GIC sales	• Non-Recourse • Longer-term fixed rate loan	2.25%-3.50%	• Up to 65% LTV • 1.35x Minimum DCR	5-30 Years	20-30 Years	• Established industrial corridors or properties with superior access, last-mile product very popular • Vintage and new product, will compete aggressively for new construction • Single-tenant with long-term lease (credit preferred) or multi-tenant with staggered rollover • Major metro areas & secondary markets (being more selective on secondary markets)	• Industrial is seen as one of the most attractive asset classes for insurance companies given the current risk environment associated with office, retail, and hospitality assets • Competing on value-add light lease up deals with floating rate programs and hybrid bridge programs • Newly constructed or well-maintained product is in high demand with additional interest for construction financing from select life companies • Full-term interest only to be considered for 50% - 55% with strong sponsors • Sensitivity around loan basis on older product, especially at higher leverage • Lender sensitivity to deals with a large cash-out component, especially for newly constructed assets • Properties with CBD or marijuana tenants are still challenging, despite the continued changes in legislation
CONDUIT (CMBS)	• Sales of mortgage-backed securities through public markets	• Non-Recourse • Longer-term fixed rate loan	2.75%-4.00%	• Up to 70% LTV • 1.25x Minimum DCR • 7.0% Minimum Debt Yield	5, 7, & 10 Years	25-30 Years	• Secondary/Tertiary Markets • Large transactions or portfolios that are tough for other lenders to pursue alone	• Strong B-piece buyer demand for stabilized industrial • Leasing capital reserves or cash management incorporated for large rollover events • Will consider full-term I/O on select deals at LTVs less than 65% • Can be more competitive on larger one-off deals or portfolios that may be too large for other lending sources
BANK	• Corporate Debt • Deposits	• Recourse (non-recourse becoming more available on case-by-case basis) • Shorter-term fixed and floating rate loans	2.00% - 3.50%	• Up to 65% LTV • 1.30x Minimum DCR	Up to 10 Years Fixed, Typical Max Term is 5-7 Years	25-30 Years	• All industrial assets • Value-add with guaranties • Secondary/Tertiary Markets	• Very strong appetite for construction or re-position on assets with strong sponsor and good location • Most competitive for sponsors with established banking relationships and strong borrower history that are willing to accept recourse • Establishing a deposit relationship is becoming a requirement • Primarily recourse loans, with non-recourse becoming more available to strong sponsors at lower leverage • More flexible (open) prepayment terms
DEBT FUND / BRIDGE LOAN	• Private Capital • Institutional Capital	• Non-Recourse • Shorter term bridge loans for acquisition and/or repositioning	L+275-400 bps spreads	• Up to 75% LTC • Going-in 1.0x DCR	1-5 Years (3+1+1)	Interest Only	• Value-Add Transactions • Recapitalizations • New construction	• Most lenders have a LIBOR floor of 25 or 50 bps • Competing on ground up construction at higher leverage than banks are considering • Pricing depends on leverage level, property quality, and Sponsor strength • Needs to have strong business plan and attractive location
MEZZANINE/ PREFERRED EQUITY	• Private Capital • Institutional Capital	• Junior financing secured by a pledge of, or participation in ownership interest	Mezzanine 8%-12%	• Up to 85% LTC • 1.10x DCR	2-10 Years	Interest Only (in most cases)	• All industrial assets • Value-Add Transactions • Recapitalizations	• Preferred equity offers higher funding than mezzanine, but at a higher cost • Minimum investment is typically $5MM but can start as low as $1MM when paired with senior position

DCR - Debt Coverage Ratio
DUS - Delegated Underwriter Servicer

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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Essex Financial Group - Recent Industrial Transactions

Garrison Business Park
Lakewood, CO
$6,000,000 Permanent Loan
Life Insurance Company

Norwood Flex Portfolio
Littleton, CO
$7,430,000 Bridge Loan
Debt Fund

Denver Airport Business Park
Denver, CO
$9,000,000 Permanent Loan
Credit Union

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INDUSTRIAL — MANAGEMENT

Don't turn a blind eye to what tenants are storing

Industrial development and leasing are happening at breakneck speeds throughout the metro area as property owners try to keep up with staggering demand among all types of users. In most instances, industrial space is being used for common business practices that are risk averse. However, industrial property owners and managers can't afford to turn a blind eye to what may be filling their available spaces. Doing so could result in very costly, and sometimes criminal, outcomes.

Patty Gage
Principal, RE | Solutions LLC

Mary Hashem
Principal and co-founder, RE | Solutions LLC

While it's said that "ignorance is bliss," that can't be the maxim of an industrial property owner. There is too much potential for hazardous materials and environmental threats to be brought onto your property and quietly stored away if you and your property manager aren't asking very direct questions and establishing specific rules and requirements as part of a lease agreement. Following are some of the steps you should be taking.

■ **Hazardous materials.** If a tenant intends to store hazardous materials, it doesn't need to disqualify them as a tenant, but it must provide a full disclosure regarding what the materials are and what quantities will be present at any given time. There are new and emerging chemicals that are newly regulated by state and federal environmental agencies and it's your responsibility to maintain a safe property for all of your tenants. Make sure the potential tenant is in compliance with all of the regulations it is required to meet. This can be done by consulting with environmental specialists who are well-versed in current regulations. You also should have a provision in the lease that guarantees that you and your environmental consultant will have the right to access the tenant's space for regular inspections and updates on how it is maintaining compliance.

■ **Environmental permits.** There are numerous types of environmental permits that you need to be aware of as they relate to your property. For example, you and the tenant will be subject to Toxic Release Inventory reporting if there are chemicals or other forms of hazardous materials being stored on your property above threshold quantities. Request TRI reports from the tenant so that you can become aware of any compliance issues that might become a problem of your own. Other permits and compliance reports to be aware of include the Resource Conservation and Recovery Act generator registrations, biennial reports and any inspections. Be sure to obtain copies of any required permits and associated reports and reserve the right to conduct audits and inspections.

■ **Emerging chemicals.** There are new and potentially troubling chemicals and materials that have recently "emerged" as health and safety hazards that experts still are studying and gathering information about. Obviously, these unknowns present risks that you may not be comfortable with. It's your responsibility to do your due diligence and investigate what a company intends to bring onto your property. Some examples of these new problem areas include poly- and perfluroalkyl substances and perfluorooctanoic acid substances, such as those used in making Teflon coatings. A sudden and unintended release of this substance not only presents an immediate health and safety hazard but will result in damage to the property and expensive removal and cleanup efforts. It's important to be aware of the new chemicals and materials that are becoming more prevalent.

■ **Marijuana risks.** As the marijuana industry in Colorado continues to maintain a significant foothold on the local economy, these owners, operators and growers have become a sizable tenant for industrial properties. There are hazardous chemicals associated with marijuana that could become a nightmare for your industrial property. For example, fertilizers and sulfur compounds present considerable risk if they're being stored in large quantities, not to mention molds that could become evident if plant materials are being stored. Marijuana is a huge and profitable business, but there are risks associated with it that could bring harm to your industrial property and other tenants. In addition to heavy power loads and significant water use, fertilizers, pesticides and growth-enhancing agents can cause contamination in, under and around buildings if there is a spill or release.

■ **Are you doing enough?** That's not a question you want to respond to with a "No," especially if there is an incident or accident. In order to be prepared, research and purchase the best insurance to cover the damage that might be caused by hazardous materials being stored or used on your industrial property. Work with professionals to be sure that your property has taken adequate steps to contain any leaks or spills. Make sure that you are following best practices and have the permits and reports in place that you might need in the future. There are obviously a tremendous number of considerations and guidelines you need to follow if you're allowing hazardous materials and environmental risks onto your property.▲

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INDUSTRIAL — CONSTRUCTION

Industrial construction along the Front Range

The industrial market is booming. Everywhere you look there's another warehouse popping up, and it's especially true along the Front Range in Colorado. From Colorado Springs to Fort Collins, there's a fairly rapid increase in industrial builds. But where is the need coming from?

■ **Population growth.** Denver has been a hot spot for population growth, and as the U.S. population growth has slowed overall, Denver has seen a 17% increase in population since 2010. With its high employment growth and booming technology market, the Denver area is attracting residents from all over the country.

This same population growth has helped Denver land in the top five nationally for investors, according to CBRE, which placed Denver at No. 3 on the list of locations where large investors are enthusiastic about investing. This, coupled with the steady demand for additional capacity, means the area is ripe with opportunity for new developments.

With this tremendous growth comes the need for improved logistical infrastructure for shipping and distribution. This need has fed the industrial market sector along the Front Range. In fact, 2020 saw more than 6 million square feet of construction in the area, which followed a record year in 2019.

According to Lee & Associates, developers who already had a strong presence in the Front Range saw major success leasing their speculative buildings, all while new developers entered the Denver area, making the market even more competitive.

Dan Feagans
Vice president, Brinkmann Constructors

■ **COVID-19 pandemic.** The already-bustling warehouse market was given an unexpected boost from the COVID-19 pandemic, which pushed people online for their shopping needs. From food to retail, and from electronics to commodities, these items need a place to live before getting shipped out to the end user. And the high demand for products has led to an even higher demand for fast shipping, which means these products must be stored close to accessible transit lines.

Lee & Associates reported an increase in large retailers and food manufacturers expanding to satisfy the incredible demand, a trend that is expected to continue throughout this year. The need for more supply also may increase the size of the industrial warehouses being constructed, giving retailers and food manufacturers more space for storing their products before satisfying that demand.

Also likely to increase? The number of big box and last-mile distribution facilities.

Since opening its Denver office location in 2008, our firm has built more than 7.3 million sf of industrial warehouse projects for a variety of clients, with almost 6 million sf of that built in just the last two years.

Lincoln Property Co. selected a Commerce City location for its Ascent Commerce Center because the company wanted to attract tenants whose top priority is easy access to transportation and workforce.

Locations like Fort Collins, Longmont, Mead, Thornton, Broomfield, Brighton, Commerce City, Aurora, Denver, Englewood, Colorado Springs and Monument are seeing robust business when it comes to industrial builds.

Examples of recently completed projects that focused on prime locations include Colorado Logistics Park from Brennan Investment Group and Lincoln Property Co.'s Ascent Commerce Center. Meanwhile, under construction projects that are further exemplifying these trends include Falcon Commerce Center in Monument, two industrial buildings from Scannell Properties on Zeppelin Road in Colorado Springs and two new warehouses at 40th Avenue in Denver from Confluent Development. ▲

INDUSTRIAL — CONSTRUCTION

Data centers are opting to use precast concrete

Rachel Schiebout
Marketing administrator, EnCon United

In this age of ever-increasing technology usage, data centers are in high demand for the storage and services they provide. As this market segment continues to grow in Colorado, build schedules are tightened, lumber prices increase and shortage of quality labor continues to grow, prefabricated solutions have become an attractive and rapid option.

Precast concrete construction reduces detailing and construction trades with year-round erection and fit-out for faster occupancies, which are important factors, especially given construction labor shortages. Precast concrete is prefabricated off-site, providing the ability to meet a fast-track construction schedule and a condensed duration. The speed at which precast can be manufactured and erected complements these aggressive schedules. This allows the structure to be occupied by other trades faster, supports earlier completion dates, and eliminates trade overlap of the core-and-shell system and similar trades. Systems can be installed concurrently, reducing the amount of shoring and bracing required during this construction cycle.

These components easily span large distances and provide an efficient floor depth required to fit equipment and wiring. Open spans are extremely cost-effective, providing column-free areas to allow for installing or removing equipment. These long-span precast floor members are strong, stiff, heavy and offer a method of minimizing vibration transfer from equipment and personnel. High ceiling requirements are supported by prestressed load-bearing systems and meet interior space requirements ranging from single to multiple stories. Using a precast wall panel system can result in achieving building heights up to 50 feet or more with one panel, and without the need for interstitial floor connections. Typical design and construction of stacking server components over mechanical components is achieved through this high-bay construction technique. The precast design process is a detail-oriented step in the delivery process of a total precast data center. To facilitate the prefabrication process, a precast design team can prepare shop drawings concurrently with contract drawing development, and work closely with the owner, architect, structural engineer and general contractor. The design phase of the delivery process can be performed alongside the development phases of schematic design, detail design and construction documentation.

A precast solution easily accommodates future expansion planning and future loading demands if needed. Non-load-bearing wall panels can be removed from one end of the building, with new panels added to the sides and the original panels reattached to add space. This is quite common and simple, and precast is easily matched to existing building colors and finishes.

Often, data center exteriors include wall panels with a layer of insulation sandwiched between two layers of concrete. It is this construction method that generates the greatest thermal mass benefit of the enclosure system.

Data centers typically are designed with large façade areas and panels. Precast provides a wide array of affordable aesthetic advantages, from multiple mix and finish options to maintenance-free finishes, which can be integrated into a single panel. This type of exterior panel design creates a functional load-bearing architectural panel and reduces additional framing members, eliminating redundancy in the structure.

Often, data center exteriors include wall panels with a layer of insulation sandwiched between two layers of concrete. It is this construction method that generates the greatest thermal mass benefit of the enclosure system, which is a key benefit of a precast concrete. Since concrete has high specific heat, a high product density and conductivity, a large amount of heat energy can be absorbed and released in the surrounding environment, reducing indoor temperature fluctuations. The high thermal mass of the concrete wall panels provides thermal storage and reduces energy requirements through the ability of the concrete to absorb, store and release heat as needed. This natural release to the interior of the structure will dramatically shift the energy demands of HVAC equipment. This shift reduces peak demand as well as the duration of the peak requirement.

Nearly all data centers require stringent structural load requirements in an effort to keep the facilities operational in the case of a catastrophic event. Precast structures are able to meet the rigorous demands of highly specialized data center and warehouse structures and have the advantage of being able to transfer these forces through proper load paths down to

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INDUSTRIAL — MARKET TRENDS

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ues to rise, we see investors purchasing assets in shell condition, taking on the lease-up risk just to capture quality new build product. For example, KKR recently purchased Park 12 Hundred for roughly $173 per sf with only 36% of the space currently leased. KKR struck gold again by purchasing Edge 470 from Etkin Johnson for roughly $180 per sf for two buildings that were 50% leased.

The trend continues with the sale of Potomac Park to Westcore Properties from Opus Development in Centennial for approximately $146 per sf. Westcore also purchased Dove Valley II as part of a forward commitment with Brennan Investment Group at roughly $133 per sf. Other similar trades are rumored to be occurring in the Denver market as capital is rushing in to gain exposure to Denver's growing population.

When we look at the numbers, more than 4 million sf of leases were signed in the first quarter of 2021 – a threshold passed in only two other quarters on record and led by a 1 million-sf lease for a build-to-suit in the Interstate 70/East submarket. At 2 million sf, deliveries far exceeded the longer-term trend.

Investor appetite for industrial assets has never been hotter and that demand is causing fundamental shifts in pricing worth noting. Investors are no longer solely focused on high-bay, bulk distribution assets and are willing to venture into more flex assets with higher office buildouts. In the first quarter, Etkin Johnson sold its CTC portfolio to Starwood's real estate investment trust for $393 million, which equated to $236 per sf. This 16-property portfolio has varying levels of office finish and also demonstrates how investors are willing to acquire industrial buildings for prices above replacement cost.

Denver also is experiencing a significant compression in cap rates having a profound impact on developer returns. The Tower Business Center and Enterprise Business Park transactions were each just north of a 4% cap rate. Additionally, there is a 4% forward commitment sale on a long-term net-leased industrial asset. This trend, along with land repositions, will continue as developable land sites become scarce. Lastly, Denver is joining the approximately 25 markets nationally that are experiencing sub-4% cap rates with a transaction set to close in the second quarter. And there will be more.▲

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Dragan

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sizable projects.

■ **New construction.** Denver currently has 9.5 million sf under construction with over half of the space dedicated to build-to-suit projects. These build-to-suits offer a healthy diversity of industry type ranging from e-commerce, food and beverage, auto and building supply/home improvement.

■ **Leasing activity.** Total leasing volume in the first quarter reached 2.8 million sf, up 6.3% year over year. New leases accounted for over two-thirds of the activity. The warehousing/storage industry claimed the largest portion of leasing activity over the past four quarters, representing 21.1% of total activity. The transportation/distribution industry accounted for the second-largest share of overall activity at 20.3%. The life sciences industry has continued to see its share of activity grow over the past year.

■ **Investment sales.** Fifty-five properties traded hands in the first quarter, recording an overall (investment and owner-user) sales volume of $437.3 million – 6.5% higher than the total this time last year. The overall average price per square foot showed slight growth year over year at $138.68. Quarterly owner-user sales numbers recorded the highest volume since second-quarter 2020, posting $87.5 million with an average price per square foot of $141.21.

■ **Looking ahead.** After a tremendously positive 2020, the Denver industrial market started the new year off strong with record high delivery volume, the 44th straight quarter of positive net absorption and a construction pipeline that again reached new heights. With continued occupier demand and considerably strong leasing activity, achieved rates are expected to see sustained growth throughout 2021. As indicated by a diverse economy, strong fundamentals and healthy investor demand, the Denver region is positioned to remain a highly sought-after destination. Carrying strong momentum into 2021, elevated leasing activity, robust sales volume and a record-breaking development pipeline all indicate a vibrant and dynamic market. ▲

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Schiebout

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the foundation. Testing and demonstration have shown that impact from airborne debris from high wind loads, seismic events and tornadoes are effectively resisted by an insulated wall panel system. Precast concrete is designed for structural stability, is water and weather resistant, and provides resiliency features to acts of nature and fire with high fire ratings for floor, roof and wall members. All precast members can be designed and constructed to meet a four-hour fire rating. In addition, progressive collapse requirements can be accommodated in the early stages of connection design and product placement.

As Colorado continues to experience data center demand and construction labor shortages, prefabricated products will continue to be a major factor in the build process by providing structural systems that meet the high-performance demands required. This durable material inherently provides versatility, efficiency and resiliency needed to meet stringent requirements and long-term demands, and to ensure a data center's strategic value now and in the future. ▲

Donahue

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■ **Question: I am acquiring an older, infill industrial property that is well occupied, but the rents are way below market and the entire rent roll expires within the first 30 months. How much can I push the leverage to reposition the asset?**

We recently financed several of these types of deals and have seen a variety of structures based upon borrower preferences. For borrowers looking for maximum leverage and short-term floating-rate options, up to 80% loan to cost is available. Pricing is very attractive in the 4.5% to 4.75% range, and the lender will fund 100% of the future capital expenditures, tenant improvements and leasing commissions. The traditional structure is a three-year interest-only term with two one-year extensions. Debt funds have been very competitive in this space. Most debt funds have a minimum loan size of $15 million, but there are several national groups that now are competing in the $5 million to $15 million space. Borrowers also can benefit from a short-term exit with minimal prepayment penalties. With debt funds, these penalties range from 12-18 months' minimum interest.

■ **Question: Are lenders comfortable with large cash-out refinances in this environment?**

This topic historically has been a sensitive one that can vary lender by lender but also is driven by the general dynamics of the capital markets, as well as product type. For high-quality industrial assets with stable, predictable cash flow, lenders are very comfortable with large cash-out refinances, subject to strong debt yield and debt coverage metrics. Lenders will ask about the borrower's basis, how much capital has been invested into the property, the age of the buildings and years of ownership. All these factors play into the ability to provide a borrower with proceeds to return equity, and the general rule of thumb is that lenders like to be less than 85% to 90% of total cost. There are exceptions to every rule, however, and we have seen 100% LTC loans in this environment. Given the pending impacts of new tax reform, we expect this question to become more important and more frequently asked as the return of equity from loan proceeds are non-taxable dollars.

The overall theme here is that lenders want more industrial assets on their balance sheets and are willing to go outside the box in order to win deals and increase their exposure. Just as equity investors are getting aggressive to purchase these types of assets in large quantities, lenders are just as aggressive and have the same intentions. ▲

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Rayburn

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shingle keep coming to Colorado.

"Denver is in the top five of in-bound net positive migration," Ressler points out. That's another way of saying way more people are moving here than leaving, and the demographic skews younger, which proved to be the catalyst for the industrial market's overall health since the outset of the pandemic.

That is, the younger demographic groups already here and those on their way from somewhere else have been using e-commerce almost all their lives. These "digital natives" are the first American demographic groups born into the Internet age. It's always been more natural for them to purchase goods online as a viable alternative to the brick-and-mortar option. The pandemic amplified this practice for millennials and younger while baby boomers and older generations were forced to adapt virtually overnight as the lockdown dragged on. This is not to say that boomers and senior citizens were digitally illiterate. It's been a mixed bag for those demographic groups, but they have adapted very quickly. This "flight to digital" is now a standard across most American demographic groups. The pandemic brought e-commerce to the fore as the preferred method of obtaining goods and services with low-touch and no-touch delivery. Subsequently, the industrial landscape began to swell in order to accommodate the new normal. Suffice it to say, good industrial space became hard to get in metro Denver. It's still hard to get. This has not been lost on investors already bullish on that sector.

Land is a finite commodity even in the expansive northern and eastern suburbs of Denver. But Denver has more of it available than most other cities of its size, and certainly more than larger metropolitan cities on or near the coasts. Much of that land zoned for industrial use has been falling off the market for years. Investors keen on that advantage are now reaping stellar profits as developers scramble for more product.

Again, the pandemic is not solely responsible for this most current development wave, but it hasn't hurt. Quite the contrary, in fact. Much of that available space is preleased or specified for build-to-suit, both of which have spiked as the pandemic has worn on. Even within those packaged options, new methods of adaptive creativity have made the sector more attractive to users with virtually no time to build.

"How do you move a 50,000-square-foot industrial tenant next week? The answer is you can't. You just can't do it in this market. There's no space left," said Peter Brumley, project manager for Denver-based Aberdeen Construction.

Aberdeen for years has been touting the versatility of specification space, or "spec space" for industrial properties, which goes outside the traditional methods of design, construction and leasing. Although industrial spec spaces or spec suites have been around for a few years, the pandemic has pushed this option to the front of the line for users on the fast track.

The practice is rather simple and has been used extensively in the office market for decades. The essence is that a portion or all of the space is built out with finishes before a tenant even sees the overall property. Up to 10% of industrial buildings are adaptive for spec suites. Since the core and shell of the building already is standing, the spec suite can forego the back-and-forth design process, thereby saving valuable time for the tenant to begin operating much more quickly and, usually, more economically.

"Tenants are becoming much more sophisticated," Brumley said. "If the design aesthetic doesn't include high-end finishes, they realize what a huge benefit the spec space can be, as is."

Everybody has become much more sophisticated since last March. It's been a necessity. A pandemic will do that. And let's face it, despite the reopening of America, nobody knows what impact COVID-19 will have on commercial real estate in the near future. As far as e-commerce as the principal driver for industrial real estate growth here, don't expect consumers to go back to pre-pandemic purchasing levels. There is too much mutual benefit for that to happen. ▲

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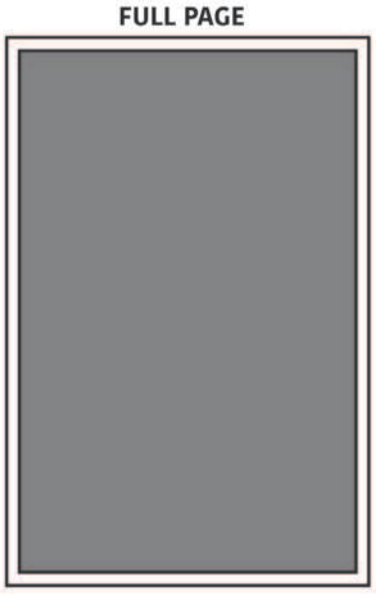

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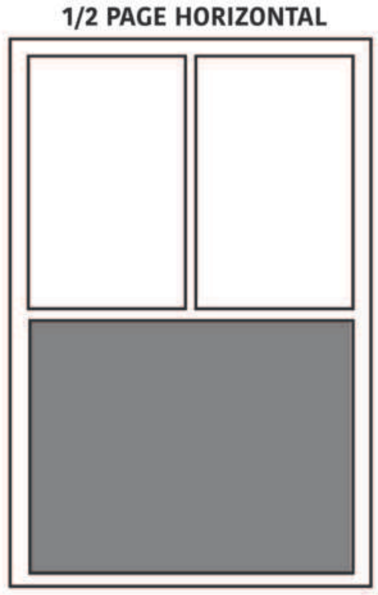

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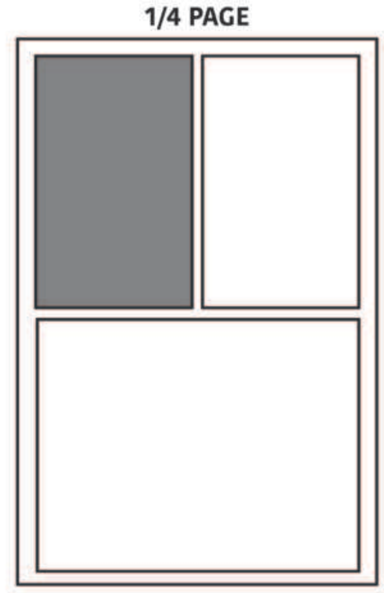

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