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OFFICE & INDUSTRIAL Quarterly

Office is the new alternative asset class for lenders

Essex Financial Group sourced a permanent loan for the Wheeler Block Building at the height of the pandemic. Lenders were attracted to the diversified rent roll with smaller tenants.

The delta variant has proven to be a major curveball for office tenants who optimistically planned for a post-Labor Day return to the office. While some companies have stayed the course and welcomed employees back to their cubicles, others have prolonged their work-from-home policies indefinitely. For now, a hybrid plan is keeping the office market in limbo. Investors and lenders remain hesitant on the asset class as a whole, so much so that office is the new alternative asset product.

With capital flooding the market, lenders have flocked to COVID-19-era darlings, industrial and multifamily, driving competition up and yields way down. The year has been anything but slow on the financing side and, as a result, insurance companies have invested billions of dollars into what is largely only industrial and multifamily mortgage. Now that we're in the third quarter, several life insurance companies are looking to pivot their existing strategy and diversify their production by investing in some higher-yielding debt. The quest for higher yields is leading them back to office. For example, a recent loan opportunity on a 50% loan-to-value stabilized multifamily asset that typically is catnip for lenders saw several groups pass due to overproduction in low-yielding multifamily loans year to date. Many lenders found themselves at 80% of their year-to-date production in low-yield multifamily loans, and have to shift focus for the remainder of the year, chasing higher-yielding loans. On the flip side, albeit not the majority, we've seen select insurance company players get more

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Principal, Essex Financial Group

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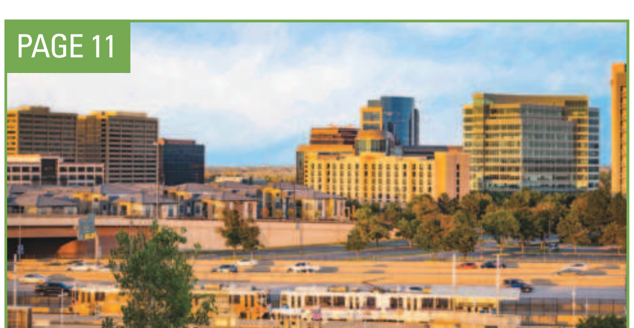

Back to work

Denver South launches an initiative to help employees return to office buildings

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Industrial section

As demand grows, community development plans keep industrial on the back burner

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Another round of wait and see

As the pandemic battle rages on, it seems we're in another critical quarter of the wait-and-see game. Wait and see what will be the result of the expired federal unemployment benefits; wait and see what will come from the new federal vaccine/testing mandates that will impact nearly 800,000 Coloradans; wait and see what will come from the new COVID-19 variants and schools being back in session; wait and see how rising construction costs are going to impact the pipeline; the list goes on.

With so much in limbo, it's clearly not the time to make major proclamations about the future of office, and yet there are positive market indicators highlighted within this issue to offer glimmers of hope for the remainder of the year and beyond.

For example, those active in the office investment market across the Front Range had busy summers and are finding interest in unlikely places. While deals are being scrutinized more than ever, there's capital on the sidelines looking to diversify after focusing heavily on industrial and multifamily earlier in the year. If an office property ticks the right boxes, there's an audience for the deal. And it's not just from the big money sources. Businesses looking to own their own properties are active as well, Jeremy Reeves writes on Page 8.

Additionally, pre-pandemic, office design seemed to be fluctuating between open floor plans for all with a pushback for private space. It seems the pandemic ushered in some clarity on the need to fine-tune both approaches to match the melding of a hybrid worker. A space needs to capitalize on the collaboration people longed for while out of the office, but also recognize the necessity of providing "quiet space" some can't achieve at home.

On the industrial side, the general proclamations of a thriving market are easily stated and strongly supported by the statistics from the articles within. However, even the thriving market is not immune from the wait-and-see game this quarter brings.

While Colorado's industrial development activity is robust, rising project costs, limited land and complicated project timelines all present challenges. As the section's cover story on Page 21 states, consumer behavior has shifted and it won't be going back. People expect quick delivery of all things purchased online – making last-mile distribution, fulfillment centers and freezer storage prominent market players. The problem is these assets by their very nature need to be near the population centers, yet the mentality of many city planners that industrial is a less-than-ideal land use is creating hurdles to finding land, and the rezoning timeline can halt a project altogether. We'll have to wait and see if community planners can recognize the importance of the shift and make these projects easier to green light.

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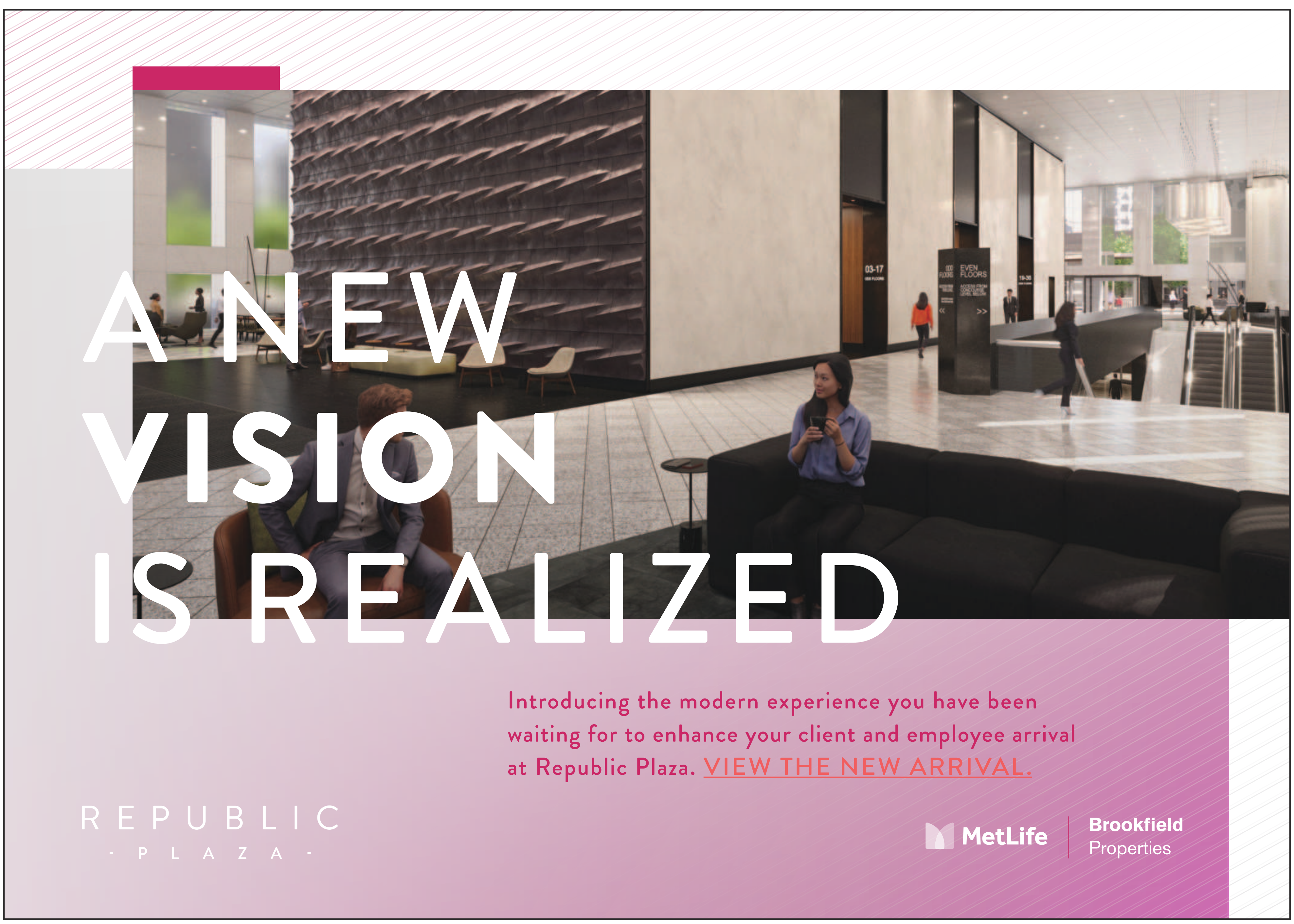


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OFFICE — MARKET UPDATE

Office investors can't get enough of Denver area

Denver is proving to be one of the most resilient office markets in the country. Last spring, we anticipated that Denver would be a bright light coming out of the pandemic and that capital sources would favor Denver's fundamentals, which are driven by job growth, population growth and several corporate relocations of varying degree. Fast-forward to August and the story of Denver continues to get better.

We've noticed a lack of seasonality traditionally seen in the summer months, as investors try to make up for lost time by deploying some of their dry powder. June was a great month for Denver office investment as we tracked 10 transactions totaling over $760 million, an improvement from the $301 million in 10 transactions in March, April and May.

Larry Thiel
Managing director, capital markets, JLL

Value-add and opportunistic investors are not waiting for the distress seen in the last cycle and are finding compelling pricing in suburban office. The southeast suburban office submarket – Denver's largest submarket – is ripe with opportunity to reposition assets, increase occupancy and mark-to-market existing leases. Some of its most well-known Class B buildings traded at extremely compelling pricing, ranging from the mid-$90s to mid-$110s per square foot, setting up the opportunity for an investor to compete heavily on rate.

Jason Schmidt
Managing director, capital markets, JLL

Any office building between downtown Denver and Boulder/Longmont is in the crosshairs of a significant number of investors who view the northwest corridor as the optimal environment for tech, life science and corporate relocations with its breathtaking views, boundless open space and recreational outlets.

Denver's largest landlords are staking their claim in Boulder, evidenced by Pearl East, an 11-building, 453,424-sf portfolio in Boulder that recently traded hands at $410 per sf to Beacon Capital. Interlocken assets also are highly in favor, with Central Park Tower and the rebranded Mountain View Innovation Campus recently selling. Pricing is so strong that it has prompted some owners to accept off-market offers, such as Church Ranch Corporate Center and Globe 4Hundred, two deals the JLL team orchestrated.

Investors targeting single-story office and flex asset classes also are finding opportunities throughout the Denver metro area. Although not traditional office, investors love the functionality and versatility of the space. The newly built Atria traded hands in March to Kennedy Wilson, a portion of The Campus at Longmont with Front Range Community College sold for $150 per sf in the northwest corridor, and a recently vacated flex asset in Longmont sold to a developer for just under $100 per sf.

The market is rewarding owners who have completed their business plans and are delivering stabilized, core-plus assets. We have tracked $698 million in transactions spread across 10 core-plus office assets in the past six months. Investors craving the highest-quality properties also are finding opportunities throughout the metro area, with trades involving Peakview Tower in Greenwood Village, 200 and 250 Columbine in Cherry Creek, and Signature Centre in Golden at compressed yields.

Denver will continue to thrive through the end of the year as a top-performing and resilient market. Moody's ranked Denver as the No. 2 best large city to recover from the pandemic, and, according to JLL research, Denver gained 72% of jobs back since 2020. Our state's population growth continues to soar with 60,000 new residents to Colorado in 2020, and Denver is in the top five cities for population gain in 2020. Investors will continue to see Denver as a beacon of light and a major target for capital deployment. ▲

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The market is rewarding owners who have completed their business plans and are delivering stabilized, core-plus assets.

OFFICE — MARKET UPDATE

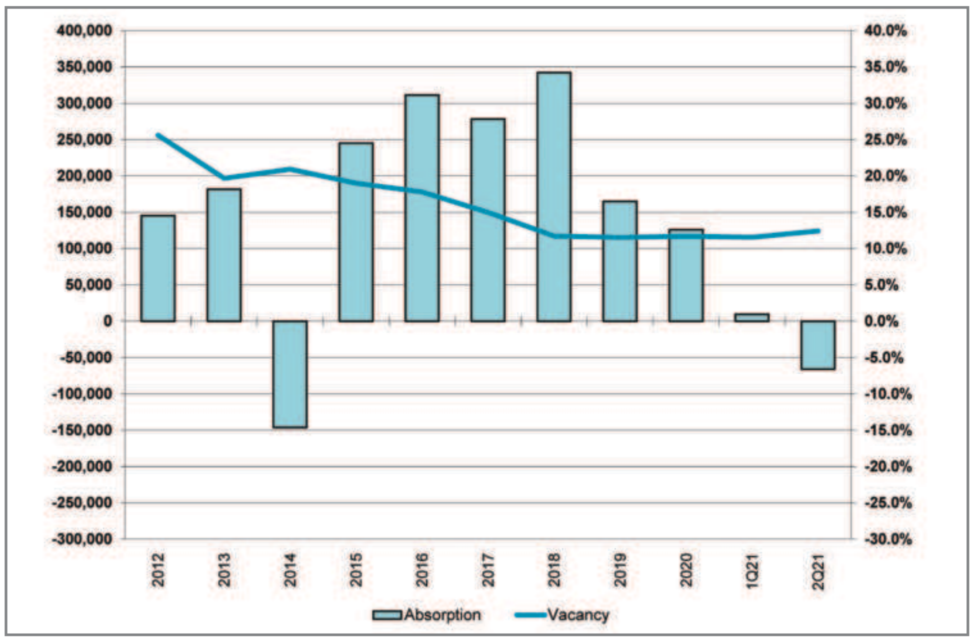
Excitement throughout Springs office market

The first half of 2021 in the Colorado Springs office leasing and sales markets has been nothing short of exciting. In January the horizon was extremely uncertain and the indecisiveness in the marketplace was pervasive. There were some sales transactions, but in most cases underwriting was conservative by most groups and the buyer pools were mostly those historically familiar with the Colorado Springs market. That said, the smaller tenants (5,000 square feet and under) in almost every sector remained active in their space needs.

Peter Scoville
Principal, Colorado Springs Commercial, Cushman & Wakefield

Greg Phaneuf
Principal, Colorado Springs Commercial, Cushman & Wakefield

By June, the overall feel of the market was significantly different in several ways. First, Colorado Springs has maintained tremendous momentum in the past 36 months with rapid population growth, a shift to a younger demographic, the construction of thousands of apartments both in the central business district and suburbs, and the completion of city-changing projects such as the U.S. Olympic & Paralympic Museum and Weidner Field, to name a few. In short, Colorado Springs seems to be truly "on the map" for national investors and users like it never has been historically. The capital interested in investing in the city seems to increase daily, and with a number of high-quality assets coming to market in the second half of the year, we anticipate very active third and fourth quarters.



Class A and B vacancy vs. net absorption in Colorado Springs from 2012 to second-quarter 2021.

A second shift in the market in recent months has been a number of larger spaces (greater than 30,000 sf) coming on the market, either as direct space or sublease space, as corporate users continue to define what the new-normal work environment will be. This has caused the overall vacancy rate to increase from 11.69% at year-end 2020 to 12.41% year-to-date 2021, with an increase in vacancy anticipated throughout the rest of the year. While on the surface this seems like the market is going in the wrong direction, based upon all of the interactions we have had with many of the major employers and companies, we anticipate this to be a temporary market shift. There is limited supply of quality assets in the market and a general (and evolving) sentiment that most companies will be near or above pre-COVID-19 occupancy levels by the first quarter of 2022.

The overall market has a very positive outlook as we forecast into the next 12 months with anticipated continued rent growth and increasing demand in a market that has not been overbuilt.

■ **Vacancy.** Vacancy rates for the first half of the year posted at 12.41%. This represents a modest increase over year-end 2020 vacancy of 11.69% and year-end 2019 of 11.52%. The increase in 2021 generally can be attributed to three tenants in the north Interstate 25 submarket that vacated a total of 70,000 sf. The north I-25 market noted the largest swing, with vacancy rates rising from 15.09% for year-end 2020 to 16.28% year to date. Both the airport and CBD submarkets remained fairly steady but noting a very minor increase. We do anticipate additional space being vacated in the second half of the year. Leasing activity, particularly in the sub-5,000-sf range, remains healthy; however, larger requirements remain limited, although we anticipate those to pick up in the latter part of the year. Overall, the market remains tight, and we forecast this slight increase in vacancy rates to be short-lived.

■ **Lease rates.** Lease rates continue to escalate throughout the market, and despite the slight increase in vacancy rates we do not expect that to stop. Perhaps more significant

Please see Scoville, Page 18

OFFICE — MARKET TRENDS

Owner-user office sales represent a bright spot

While Denver's office leasing fundamentals have been jolted by the effects of COVID-19, the owner-user office building and condo sales markets have weathered the storm with increased demand and pricing reaching all-time-high levels.

Owner-user office buildings and condos generally are defined as properties owned and occupied either solely by the owner's business or in conjunction with other tenants to whom the owner leases. The benefits for tenants to own their own office space are numerous. Instead of being tenants subject to volatile and increasing lease rates during lease renewals, they can take advantage of the opportunity to provide their businesses with clear, fixed occupancy costs through locking in a long-term commercial mortgage. Coinciding with this idea is the concept that owners pay themselves rent instead of making their landlord wealthy. Additionally, the money put into an owned property has the potential to add value when selling versus that value benefiting the landlord when the space is leased again. Many owners associate owning their office space with retirement savings as history shows their property will appreciate over time while the loan balance is being reduced. Lastly, a business can leverage tax advantages such as depreciation and interest deductions.

The COVID-19 era has brought on additional benefits and opportunity for buyers. Low interest rates, aggressive owner-user financing and

Jeremy Reeves
Vice president, office division, Colliers

U.S. Small Business Administration incentives have provided the opportunity for buyers to own at a lower monthly cost while taking advantage of long-term fixed interest rates.

Landlords of multitenant office buildings implemented various levels of protocols during the height of the COVID-19 lockdowns. These protocols often restricted tenants on how and when they could access their space along with imposing elevator capacity limits, mask mandates and other safety measures, oftentimes beyond the state's or Centers for Disease Control and Prevention's recommendations. While this often was appreciated by most, there is a loss of control that concerned some business owners. Additionally, while businesses can control how they operate in their own space, there is no controlling how other tenants in the building function. This has spurred a desire by businesses to own their own space in order to achieve autonomy. Whether seeking a building that is occupied solely by the business with its own entrance to offer complete control or an office condo where there is a greater say in establishing the building's protocols, the desire not to be subject to others' rules has motivated a significant number of recent buyers.

Attractive financing and the desire for autonomy, coupled with the more traditional reasons for purchasing an office building or condo, have spurred demand – contrary to what the work-from-home narrative would suggest. This demand plus a lack of inventory, specifically for smaller properties, have created a robust seller's market. Similar to the leasing market, the fundamentals are better in the suburban markets than the urban core.

Suburban office buildings and condos have seen near average or better sales volume, prices-per-square-foot and sales-to-asking price differential metrics in 2020 and year-to-date 2021. The owner-user sales volume in 2020 was $145 million, just off the yearly average of $153 million over the last five years. Sales price per sf averaged $151 per sf and is $163 per sf year to date, just below the average of the prior year and well above the previous five-year average of $137 per sf. The sales-to-asking price differential, a key market indicator, was 8.7% in 2020 and 6.6% year to date, near the all-time low of 5.5% in 2017 and well above the worst differential, which occurred at the tail end of the Great Recession in 2012 at 17.7%.

While the average historic suburban office owner-user sale is approximately 9,000 sf, the average office condo sale is 2,400 sf, which caters to a much larger pool of buyers. The sales volume of suburban office condo sales hit $24 million in 2020, a peak since 2008-2009. The sale price per sf also hit a new record at $229 per sf, 17% higher than the previous high in 2008 and well above the average over the previous five years of $163 per sf. The sales-to-asking price differential was only 4.3% in 2020, near the all-time low of 2.7% in 2018. For comparison, the worst sales-to-asking price differential was 16% in 2009.

While pricing for urban owner-user properties continued to rise overall, the sales volume in 2020 took a big plunge. There was $31 million in sales volume in 2020, compared with an average of $51 million for the previous five years. Urban office condos sales suffered in particular with an average sales price of $250 per sf in 2020 as opposed to an average of $266 per sf over the previous five years. The sales-to-asking price differential sky rocketed to 13.7% on average.

History provides a cautionary tale. During the Great Recession, a soft leasing market and conservative business strategies stunted demand for owner-user properties. Today, threats of a prolonged shift into a tenant's market, potential rise in interest rates, work-from-home initiatives gaining greater adoption, and COVID-19 or economy-related delayed decision-making could broadly quell demand and affect owner-user office sales at some point. Until then, owners with changing space needs or business objectives, those nearing retirement, or those just wanting to be opportunistic should consider their exit strategy and capitalizing on a hot market. ▲

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OFFICE — MARKET TRENDS

Relevant indicator tracking provides market pulse

Zain Jaffer
CEO, Zain Ventures

When a vaccine rollout became a conceivable reality, outspoken employers began singing a different tune. Some of remote work's biggest champions – J.P. Morgan, Goldman Sachs, Apple, Facebook – were forthcoming with their plans to make their way back to in-person operations. Whether a full-return or a hybrid approach, the changed sentiment among industry giants reflected a COVID-19-era revelation: Our in-office space offers more than we think.

It's not to say that the remote work experiment didn't go well, or even better than we'd planned. Technology vendors and cloud computing capacities made the transition to at-home work almost seamless. When it comes to onboarding, networking, brainstorming and simple socialization, the on-screen interaction did leave something to be desired. Sentiments regarding a return to the office have changed. But have changed sentiments translated into market action?

■ **Return of the tour.** Action in the commercial real estate segment doesn't hold a candle to the world-record price race that's happening in the residential space. But throughout the last few months, signs of reprieve have surfaced, including but not limited to an uptick in tour requests. Of course, tour numbers can't be extrapolated with any certainty to indicate signed contracts or long-term lease relationships. But in a recent report by the experts at UBS, it released a figure that shows tour requests for dense and coastal markets including New York City, San Francisco and Seattle. Around March of this year, a long-standing downward trend begins to pick back up. Cities like New York have seen twice the amount of interest in about a three-month period. A chart that takes into account the previous month's numbers might even stretch to resemble a smile.

Another important factor influencing the office real estate market is the rebound in office-using jobs that came toward the end of 2020. Faster than originally predicted, office-using sectors recovered from the dip in unemployment in second-quarter 2020. Compared with the top 15 markets, Denver kept pace, recovering between 50% and 100% of lost office jobs between August and December of 2020.

■ **The market as it stands.** A popular PwC survey came out at the beginning of this year that demonstrated the expectations of 133 C-suite executives; 75% expected their employees to be back in office by now. The current state of the market, and the accuracy of those predictions, depends heavily on the region in question. Dense cities with a high dependence on public transport for commuting remain slower to return, and states with more restrictive policies have seen diminished capacity. But according to UBS, the national office vacancy rate for the first quarter of this year was 16%. That represents little to no deviation from the national average.

There's also been a uniform trend toward quality as a main determiner of leasing decisions. As predicted, the return to office has exaggerated the preference for modern buildings. Built environments with air filtration, automation, proper spatial design, hands-free controls and integrated building management applications have been rewarded by post-COVID-19 tenants. This is a trend that's been consistent across all segments and is expected to continue.

■ **Colorado office real estate: The rule or the exception?** Looking at Denver specifically, market research shows a 14.8% vacancy rate across all market classes for direct office real estate (excluding sublets). Compared with Fort Worth, Texas, (21.8%), Houston (23.6%) and Atlanta (17%), that's at a manageable rate, still lower than the national long-term average. Denver's vacancy for Class A space is similar, hovering at 14.2%. Further, Denver experienced a declining rate of negative net absorption at the end of 2020, meaning the amount of new supply entering the market being bought by landlords and investors was on an upward trend.

Sublease vacancies also are an important area of focus to understand how the market is performing as a whole. When ample subleasing space is available, it has a negative overall effect on rents across the market. For Denver, sublet vacancies represent about 15% of all office vacancies, which is about the midrange for the market – San Francisco is at a high of 30% and Miami is at a low of 0%. However, new supply entering the Denver market indicates that vacancies in the subleasing space could continue to grow even with some return to leasing activity.

Since June, Colorado has seen a 150,000-plus increase in nonfarm payroll jobs. Those roles are spread out over many sectors, but tech companies, absorbing 247,000 square feet, and companies in the energy sector, 215,000 sf, are driving most of the spatial uptake.

The past many months of market observation have reinforced the truth that markets move without any regard for our expectations. Soaring prices in the housing market are a good example. The contributing factors can be understood through a market analysis, but no one would have predicted a boom of that size to follow on the heels of a pandemic-induced recession. Similarly, it's too early to understand exactly how a hybrid workplace will actualize and what its effects will be on office real estate. While Denver's vacancy level is slightly below the national long-term average, new supply, delayed returns or shifts in office-job employment could continue to change. Keeping an eye on relevant market indicators, we'll be able to watch the story unfold in live time. ▲

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OFFICE — LENDING

State of office financing: Denver 2021 midyear

Mark Jeffries
Vice president, NorthMarq

After enduring five consecutive quarters with growing vacancy in the metro Denver office market, things appeared to level off somewhat in the second quarter. Asking lease rates have stabilized, as have the increases in vacancy seen in late 2020/early 2021. Much of the second-quarter new vacancy is due to new Class A product delivering. Sale transaction volume picked up in the second quarter, mainly in the suburban markets as there still is a big question as to what will happen with the central business district going forward. Lenders are as active as they've ever been in commercial real estate this year, but, at the same time, office buildings are met with more scrutiny than they have been in the past. Lenders are zeroing in on tenants' likelihood of renewing after their current terms, the current actual physical occupancy levels of their employees and what's specifically happening in the submarket. Rates have remained historically low throughout the year, and the availability of capital has made more debt financing for office buildings possible than would have been otherwise. Denver's economy has rebounded well from the pandemic, and it seems few companies are completely switching to remote work, indicating things will improve from here.

Now that employees are returning to offices, combined with school being back in-person for most students, it seems that at least physical occupancy in offices is starting to normalize to what it will look like going forward. This seems to vary based on different business sectors. For example, the professional service industry seems to be coming back to the office more than tech, which has adopted remote work to a larger extent. Anecdotally, this seems evident in what I see every day in our building in the CBD. The majority of our employees are regularly back in the office, but the other tenants (many of which are in the tech business) seem to be at 10%-15% physical occupancy even now.

Lenders are extremely focused on what that actually looks like in any specific deal, as it is an indicator of which tenants are likely to renew or potentially look to downsize at the end of their current lease terms. We have noticed with the office buildings we have financed recently that the smaller-tenant-oriented buildings seem to have larger physical occupancy than larger buildings, likely due in part to these companies not having the same resources to set up a robust work-from-home system. It is positive, however, that many companies and individuals continue to move to Denver, as many certainly will prefer an in-person office setting.

Lease signing activity improved in the second quarter. With the vaccine rollout, companies that are expanding or had given up space began to actively explore options. Vacancy across the metro area did increase from the first quarter, mainly as a result of very little leasing activity in the prior 12 months combined with major new Class A office deliveries primarily in the CBD. Very few new office buildings are in the development pipeline at the moment, with less than 250,000 square feet scheduled to deliver per year in 2022 and 2023, which also should help normalize vacancy going forward. The 12 months leading up to the second quarter saw a climb in vacancy greater than anything in the past 12 years, with direct vacancy approaching the 18%-19% levels last seen in 2009. Surprisingly, however, asking lease rates do not seem to have dipped overall. In some submarkets more concessions are being offered, but so far asking rents have not taken the dive we might have expected. It has been encouraging to see sale activity pick up during second quarter, although much of this has taken place in the suburban markets where the future of office needs seem more certain. Vacancy is perceived to have hit bottom in most suburban markets, especially in the southeast. As a result, lenders are much more willing to lend the suburban markets than downtown, although they are being very careful, and leverage from nonrecourse sources of capital typically is less than 60% at the moment. There also seems to be more capital chasing debt deals than at any time since the Great Recession, so lenders are incentivized to really look hard at office deals that make sense in order to pursue more yield than they can get typically with multifamily or industrial deals.

Much of the direct and sublease space available is in Class A buildings, which should be quick to gain ground as companies are actively looking for space. Lenders generally are bullish on Denver as a place that will continue to attract out-of-town companies and residents, which makes them more willing to situationally look at office deals with strong characteristics. With the metro Denver office market appearing to have hit bottom over the past few months, lenders are more open to considering local office deals. With the vaccine rollout well underway, many folks back to work and extremely little office product scheduled to hit the market over the next two years, it seems like we've finally turned the corner and the overall Denver office market as well as available financing will only improve from here. ▲

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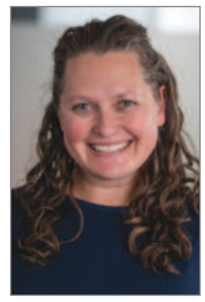
OFFICE — WORKPLACE TRENDS

Denver South launches back-to-office initiative

Looking forward to having employees return to an in-office work environment as we navigate today's complex world of COVID-19 and the aftermath requires much more than opening the doors of an office building and turning on the lights. It demands a great deal of time and attention to health and safety measures, as well as creative work schedules and models that provide a balance to those who can and want to return to the office.

Denver South serves six jurisdictions (Arapahoe County, Douglas County, city of Centennial, city of Greenwood Village, city and county of Denver and the city of Lone Tree) and comprises more than 48 million square feet of office space, serving approximately 15,000 businesses and 240,000 employees. Needless to say, finding ways to support local businesses and help them transition their employees back to work is imperative for every economic development organization in the state and across the country.

Sheryl Machado
Director of communications and public affairs, Denver South



Erin Schneiderman
Director of marketing, Denver South

Denver South recently implemented a back-to-work initiative to help companies better understand and address the hybrid workday as businesses continue to face the realities of an ever-evolving pandemic.

As a result of this necessity, we recently implemented a back-to-work initiative to help companies better understand and address the hybrid workday as we continue to face the realities of an ever-evolving pandemic. The initiative also is helping to maintain occupancy levels in our office buildings in a safe, healthy and responsible manner, providing a work environment for employees who thrive in an office setting.

As part of the initiative, Denver South worked with some of our best resources – our local companies – to learn more about their plans for helping businesses find the best hybrid work conditions possible. Among ideas we discovered were companies looking to create collaboration spaces for employees as they return to the office for those in-person meetings. Other organizations are responding to employees' requests to maintain some semblance of working from home and in the office (survey results from Global Workplace Analytics reveal over 80% of employees polled want some type of a hybrid return to the office work plan). The initiative provides employers and employees with valuable resources and templates they can use to formalize a hybrid concept.

While not all job types have the ability to work from home, many employees have discovered during the pandemic that they are happier and more efficient at their jobs in a home office setting. Denver South is addressing this as well by helping companies find the most efficient and effective ways to provide the work-from-home option in a more formal way. We've developed policies and programs, determined technology components, established ways to educate employees and identify participants, and created a way for companies to evaluate and report on results.

Our sample guidelines for implementing a hybrid work approach include resources for companies to consider such as:

- Eligibility requirements for an employee to work from home.
- Setting limits to the number of days an employee can work from home.
- Schedules and hours.
- Workspace requirements.
- Workers' compensation and liability.
- Insurance and additional expenses.
- Tax implications.
- Equipment and supplies.
- Employee access and availability.
- Inclusion process.
- Evaluations.

Employers also can access sample employee agreements that provide structure and examples of some of

Please see Machado, Page 18

OFFICE — WORKPLACE TRENDS

Zoning an office space for hybrid worker success

Tia Jenkins
President, Kieding

The concept of working remotely has been creeping into the office environment for years. Some employers just couldn't get comfortable with the idea of work being accomplished without seeing the work being done. Introduce a pandemic, and we had very little choice but to accept that a lot of work could be done outside an office. Assuming you had the internet infrastructure, and computers at home, the staff could work independently or with little interaction – it was possible to keep the office clicking away without physically being in the office.

With the introduction of a workable vaccine, social distancing and some hygienic measures, it is becoming possible to create a new hybrid work environment: one that allows people to quarantine when required or work remotely to accommodate personal schedules or to avoid unhealthy situations. The question becomes: How do we meld the two environments of remote and on-site working into an efficient and flexible office environment that offers safety and necessary collaboration? One method is to introduce zones within the office for: information, focus, communication and collaboration.

First, recognize that the internet of your office is the primary "information zone." If you have not established a state-of-the-art internet system with cloud-based backup, apps and the required platforms for remote working, then the flexibility of remote and on-site work will not run smoothly. It may be necessary to rework your internet capabilities to provide the highest level of security and internet speed possible. Unfortunately, employees who have poor internet service at home soon become a liability to the work product and easily become frustrated when the technology doesn't cooperate. It also is important to invest in training the staff to use new software, such as Bluebeam, Teams, Zoom or other industry-specific applications.

Second, in all office areas, is it critical to establish physical and acoustical zones within the office. These are not unlike the privacy zones that we have in our homes: the quiet zones for focused activities, the slightly more occupied zones for conversation, and the highly occupied zones for group interaction and communications.

Quiet focus zones require concentration and minimal noise or visual distraction, especially for "heads down" and private tasks. The standard office workstation still can provide this area – but to provide some protection from germs and to minimize the visual and auditory distraction, clear or solid dividers work best. These panel dividers provide protection and block distraction at seated heights (about 45-52 inches) or higher. While private offices provide the most social distancing benefits, some private workstations can be effective tools to provide the necessary isolation. The acoustical and auditory benefits of the higher panels are added bonuses to the work areas that still are smaller than private offices.

Fred Winter, Shadow From The Sky

Collaboration zones are more ad hoc, as they tend to be noisier and have more energy for group meetings. These are the areas that many miss most when working remotely.

Communication zones are established for video or telephone conferencing. This type of conferencing zone is not limited to outside clients; it also works well for traveling staff, remote workers, part-time workers or independent contractors who don't require a full-time workstation. The best environment for this activity is an individual room that provides a work surface, controlled lighting and, in some cases, a wall or table-mounted video monitor. The acoustical insulation of the walls is critical, as is a door to this room. Glass panels in the door or sidelight glass will make the room seem less confined and alert others that the room is in use. Another excellent strategy is to vary the size of these "Zoom rooms" to allow for one, two or four people to use the rooms. Most of these rooms are placed in the office interiors for better light control, with the added benefit of allowing other zones to be located in the daylighted areas.

Collaboration zones are more ad hoc, as they tend to be noisier and have more energy for group meetings. These are the areas that we miss most

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OFFICE — WORKPLACE TRENDS

Top post-pandemic workspace design changes

Even pre-pandemic, workspace design had evolved significantly in the last decade or so to accommodate for flexibility, commuting and social interactions.

We evolved from the strictness of closed offices, hierarchies and enclosed cubicles to open layouts, disappearing desks, meeting spaces to promote collaboration, the concept of "office culture" and rooms within places of work to promote creative thinking.

COVID-19 has turned our working worlds upside down, and we are at a point in history where our needs and expectations have changed fundamentally. Designers and corporations are faced with the opportunity to reimagine what offices will look like in the future. With these demands, our task is to create a successful and safe work environment that encourages joint problem-solving, as well as generating revenue and collaboration so we, as human beings, can continue doing what we do best: Move the world forward.

There are several ways that companies can approach the workplace in the future, but it will rely on the nature of each business and its leadership.

According to an article on steelcase.com, "While some headlines suggest the office will go away as people embrace working from home almost exclusively, the research identifies a more nuanced, hybrid future. Most people expect to work in the office most of the time, but they also expect greater flexibility from their organizations going forward."

Cecilia Hanover
Interior architect, Design Studio Interior Solutions

What does this mean for the look and feel of workspaces in general? While I believe the office is the core of a business and a portrait of its brand and culture, the workplace most likely will become something that is optional, providing rotating employee schedules for safety and health considerations, with a large focus on well-being. Some key design considerations might be:

■ **Space planning.** The layout of an office will be dictated by hybrid collaboration and why someone needs to go to an office in the first place. We might see a decrease in the number of enclosed offices and more collaboration spaces such as small-scale meeting and training rooms, a larger connection to outdoor spaces and access to fresh air and natural light.

The use of technology will continue to be relevant in preparation for any future crisis in order to provide ample options for teleconferences and ease of working from home, for example.

The work-from-home culture has brought more demands on how the space should feel: comfortable, relaxed and flexible. We might see fewer workstations and more work lounges, areas designated for short conference and video calls and a softer flow that allows employees to experience different scenarios throughout the day, both to avoid burnout and to promote creative thinking.

■ **Materials and finishes.** As opposed to a single-person office, flexible and communal spaces require a lot more thought in the materials used. These materials need to endure more wear and tear, last longer and withstand heavy cleaning and sanitization without the concern of destroying them. The use of washable surfaces for flooring or wall materials and the use of performance fabrics on furniture will be key – all while keeping in mind sustainability and focusing on the use of recycled content. Most importantly, materials that support the company's branding will be instrumental in distinguishing the space to ensure that employees recognize it as one where they belong.

■ **Health and safety considerations.** We all know about hand-sanitizing stations and rigorous cleaning schedules. Companies most likely will push this to the next level with several tools that provide peace of mind (and concise data) to anyone entering the workspace.

■ **Access to wellness tools.** Companies have long made efforts to keep their employees happy by offering spaces to work out, worship, tend to children, etc. While we are unsure what the future holds for these spaces for several reasons (safety and health concerns, the real estate they occupy), it is now more important than ever to promote a culture of well-being and physical activity. Physical and mental health are essential to do and enjoy our work – and teams will feel good knowing that this is an option in their workspace.

■ **Revenue and flexibility.** The market for commercial spaces saw a significant decline in demand. Property owners might need to consider offering more flexibility and possibly shorter or flexible leasing agreements (e.g., several companies renting the space at once). In terms of design, this will require the use of transitional spaces such as buffers and physical connections between indoor-outdoor, as well as modular spaces and moving walls with proper acoustics to maintain flexibility in leasing. As much as this sounds like a logistic challenge, we've proved – especially these past 18 months – that we can adapt quickly to maintain our production.

Regardless of our current conditions and what the future holds for workplace design, I believe no conference tool replaces the human interactions and synergies that take place in an office space. The ideas that emerge from a simple chat in passing, sharing our challenges and wins, quick "check-ins" with colleagues to move a project forward, and the healthy balance of work and socialization are some of the elements that truly make a company and its individuals grow and move forward. Companies will thrive if they reinvent and design a better work experience that supports the team's needs. ▲

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OFFICE — CONSTRUCTION

Rising costs, delta variant may stall return to office

Momentum in Denver's office market may face some unforeseen barriers, at least in the short term.

Inflated construction costs and new pandemic fears are the culprits, neither of which could be predicted in the market's midyear fundamentals, and both of which could cause significant delays along the path to stability.

Second-quarter metrics in the market have again indicated guarded optimism. Vacancy metrowide stood at just over 14%, according to CoStar's analysis of the quarter. Net absorption is still in the red at negative 512,000 square feet, a startling number for sure, but down from the over 1 million sf registered in each of the previous three quarters.

Average asking rates hover at around $30 per sf, not an alarming change from first quarter, but enough to prompt landlords to accelerate nonrent concessions in this tenant-leaning market.

Another key indicator is office-using employment. Those are professional service, information, financial and government jobs, among others, clearly on the rebound. This type of employment recovered almost 33,000 jobs since the low in July 2020, according to the U.S. Bureau of Labor statistics. Still, companies both large and small seek ways to minimize their real estate footprints, a clear sign that the overall market is experiencing continued volatility from COVID-19 fallout.

One factor not widely accounted for in midyear fundamentals is the spike in construction materials cost on the rise as supply chains struggle to catch up to pre-pandemic levels. While increases have ticked up since last year's shutdown, it is only recently that developers, landlords and end users have been clamoring for ways to mitigate the sting of cost increases in lumber, steel, drywall, cement, insulation and dozens of other products.

Peter Brumley
Project manager, Aberdeen Construction

Input costs for construction rose to 24.3% from May 2020, according to a "Construction Inflation Alert" posted on the Associated General Contractor of America website in June, a startling indication that the construction industry is experiencing a more jagged recovery than expected.

"If you look back on modern history, 2008 was a year of extreme price increases and that high was roughly 12%, so we're double the previous high," said Michael Gifford, president of ACG Colorado. "This is predicted to last a couple of years versus the six months we saw in 2008, and it's not easy for contractors to pass those costs along to an owner for existing contracts already signed for a fixed cost."

Indeed, general contracts have to grapple with how much of those costs to pass on, when and with which clients. For some contractors, the next six months to a year will be a struggle for survival.

"Small to midsize firms are a bit nimbler than larger contractors with extensive overhead and projects in process," said Tom Newman, senior property manager with Denver's 1st Commercial Realty Group. "Those guys can shave some dollars and help us perform value engineering much more quickly if that is necessary." Newman noted that creativity is key when contractors work with landlords and their representatives.

"It's increasingly competitive out there," he said. "Deals are getting done, but with these inflated costs, there has to be more give and take when increases come so quickly."

Savings for landlords might come from repurposing materials from within building stock, like doors, frames, blinds, lighting and electrical items, Newman said. Some contractors can stockpile materials.

"General contractors are problem solvers," Gifford said. "Nine out of 10 issues get resolved by contractors before a conversation with an owner becomes necessary. That's the value proposition they bring to the table."

But no contractor can pass along a 24% cost increase to an owner. Many firms will include a "price escalation clause" in their contracts as a method of self-preservation for just this type of eventuality. Although these clauses can be structured in many different ways, the gist is that owners would pay the difference between a price

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Aberdeen Construction
Sharp increases in construction materials include lumber, steel, drywall, cement and dozens of other products. Costs are expected to stabilize in 2022.

OFFICE — CONSTRUCTION

How to design and build for the unknown future

Joel Pennick
Vice president, JE Dunn Construction

With many workplace return-to-office policies still in flux, recently designed and soon to be constructed office spaces are in a quandary. The ratios of open office to closed office, square footage per employee and the shifting needs of the modern office environment are all in question. To provide answers that are nimble and responsive to the evolving needs, owners are finding innovative and collaborative solutions to move them forward. They are finding success in partnerships rooted in the principles of creating a unified team that fosters ongoing dialogue between the owner, employees, architect and contractor, allowing all parties to be able to maximize the budget while integrating next-generation solutions.

While remote working and hybrid schedules are not a new practice, the events of the past year have challenged many companies to make long-term decisions about the working location of their employees. Given COVID-19 and social distancing requirements, the average square footage per employee is increasing from pre-pandemic requirements. These increases can create challenges for owners from a budget and design standpoint. By working through the design and building process as a collaborative team, architects and general contractors can be transparent about costs and associated value upfront to allow owners to align their budget from the start without sticker shock later. This continuity also can lead to time savings down the road by allowing for prioritization of the decision-making process. If an owner is unsure about certain design aspects of a project, the contractor and architect can support them in prioritizing decisions that allow construction to move forward, while offering more time to make decisions based on evolving owner workplace policies and technology on the horizon.

In an ever-changing environment, it is hard to predict the future of working in an office, but companies still need to move forward with new spaces for their employees as leases turnover to promote growth and maintain the vitality of their businesses. The best way for owners to combat this uncertainty is to be open to construction and design ideas that can add future flexibility. Concepts such as access flooring, multipurpose spaces, movable furniture and increased audiovisual and video conference capabilities add increased flexibility. Access flooring provides an elevated floor above the building's original floor to allow for electrical components and wiring to fit below, offering future flexibility as workstations can be easily moved around as the office layouts are modified. Moveable furniture with multipurpose spaces allows for more nimble environments that easily can change based on the evolving needs of the business. Finally, there is no doubt that advanced technology is here to stay, and planning for this element no longer can be an afterthought. Planning needs to start in the design and early construction phases

Joseph Roybal

The best way for owners to combat uncertainty is to be open to construction and design ideas that can add future flexibility.

to ensure maximum functionality and productivity. Ensuring that all the telecom, audiovisual, security and access controls are integrated and planned early into the project is paramount for an optimal employee experience and work efficiency.

The office space of the future is still a work in progress, but a few trends are being explored that can provide some insight into where it is headed. Many building owners have been focused on enhancing the functional items of their workplace to promote employee safety from COVID-19 and other viruses that could be spread in the workplace. We have seen increases in air purification systems being applied to the air supply systems in the building to keep employees safe from the flu and common cold. These systems are primarily bipolar ionization, HEPA filtration and ultraviolet light systems that can be retrofit into existing air-handling equipment or be integral to new air handling equipment.

We also are seeing many different devices being installed in office environments to minimize the touching of surfaces such as touchless faucets, water coolers and motion-activated auto door operators. Additionally, antimicrobial coatings are available on highly touched surfaces such as fixtures, faucets and door hardware, and copper buttons are being used in elevators as copper is a naturally antimicrobial solution. As a population, we are moving toward a more touch-free

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OFFICE — SUSTAINABILITY

The value of an asset's high-performance landscape

When considering creating a high-performance landscape surrounding or within an office building environment, you might consider sustainability as the only goal. True, this type of environmentally friendly landscape architecture often is energy-efficient, improves air quality and rejuvenates natural resources, but the benefits to office buildings and end users go a large step further. High-performance landscapes also increase in value over time – whereas a building can depreciate with age, landscapes fall under the asset management umbrella, ultimately increasing real estate value. Additionally, incorporating this type of sustainable architecture into office environments supports employees' and visitors' overall well-being by providing positive health and wellness benefits.

What exactly is a high-performance landscape? These specialized, strategically planned sites are designed with and for a local climate. During the design process, the landscape architecture team thoughtfully approaches the design of the site understanding the program needs and its natural ecosystem. The program needs include considerations such as creating safe pedestrian and vehicular access and circulation, connecting to the main entry points of the building, consideration of program and service needs for maintenance and deliveries and fire access. Examples of natural ecosystem include the site's existing topography, the drainage patterns and stormwater approach that needs to be analyzed, existing vegetation, etc. It is a balance of understanding and designing for the hardscape (pavements and pervious materials) and softscape (plantings, lawn areas) to meet the program and context of the site.

Jessica Petro, PLA, ASLA
Lead designer, landscape architect, EYP

This approach to sustainable and high-performance landscapes also provides numerous benefits, including the ability to reduce or eliminate the need for irrigation and less required time and maintenance of the site. Native plants are more resilient to the environment and local ecosystem as well as require less fertilizers to thrive and pesticides to fight off pests and diseases. A design team that includes certified professionals who can aid in integrated pest management further reduces the need to rely on solely pesticides, instead using knowledge of the pest and its life cycle to determine the most appropriate management and timing to address the threat.

This type of installation can dramatically impact an office environment, even years into a building's future. At the end of a new construction project or in the case of an existing property seeking to reinvigorate its site, high-performance landscape isn't just cost-effective and better for the environment, but also demonstrably appreciates in value over time.

■ **Environmental benefits.** High-performance design, by its very nature, is better for the environment. For instance, it lowers consumption of fossil fuels, sequesters carbon and cleans the air, and supports local ecosystems with increased biodiversity of insects and pollinators resulting from a mixed palette of native plant materials. Native plants also are more resilient and do not require additional pesticides and herbicides. Additionally, high-performance landscapes reduce the amount of long-term time and maintenance dedicated to caring for them.

The green roof at Birch Bayh Federal Building and U.S. Courthouse

All landscapes need initial care with installations, watering to ensure they root well early on and initial weeding while plants start to grow, but the level of care needed levels off and eventually lessens once established. Sustainable landscapes consume less water, which saves money and is very important for water conservation in our area of the nation. Further, allowing for stormwater recharge on site by installing rain gardens, swales and retention systems, instead of piping into the stormwater system, is preferred to naturally allow for water recharge within our soils and aquifers.

■ **Human/well-being benefits.** A connection to nature, whether visual, physical or both, is proven to improve our overall well-being. Studies show that employees and staff are happier and more productive working in well cared for office environments and properties (satisfaction is based on both softscape and hardscape). A varied landscape incorporated into and throughout an office building – perhaps with a seasonal display where one can witness pollinators like birds or butterflies – is calming and allows for reflective and restorative time, hallmarks of well-being. High-performance architecture also promotes comfort in a variety of ways, including shaded areas for meetings, quiet working spaces and break spaces that seamlessly integrate with and embrace the natural environment.

■ **Cost savings and appreciation.** High-performance landscapes have a big impact on both the bottom line and on an office environment's resources. For example, sustainable landscapes are less demanding on stormwater systems since they retain and allow for water recharge on site. Additionally, tree canopies that create shade on a building or on a parking lot can aid in keeping it cool in the summer

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OFFICE — LENDING

Continued from Page 1

aggressive on 55%-60% suburban office loans. Our point here is: Lenders are willing to finance office deals – they're just very selective. Here are some recent takeaways from deals that are getting done:

■ **Operational history matters.** Lenders are laser focused on operations. They're doing deep dives into historical asset management to ensure landlords are experienced with office products and have maintained their reserves prudently.

■ **A diversified rent roll is more attractive than ever.** From a lender's perspective, diversification of the rent roll and rollover mitigates a lot of risk. While this always has been the case, a varied tenancy is carrying more weight today than it has in the past.

■ **Smaller tenants are in favor.** Smaller tenants are more inclined to return to the office setting, compared to corporations, which tend to have more elaborate, large-scale plans for returning to the office. Smaller tenants are more nimble and better able to accommodate the working parent who wants to be in the office away from the distractions at home.

■ **Medical office tenants are uniquely alluring to lenders.** Medical office remains in favor with lenders. At the onset of the pandemic, medical office was uncertain due to the rise in telehealth. However, now more than 1.5 years into the pandemic, patients have returned to the doctor's office, proving the asset class to be somewhat recession resistant. The inelastic nature of medical services and the sticky tenancy are highly attractive to lenders.

Until investment committee members can ditch their sweatpants and Zoom meetings themselves, it will remain difficult to envision a rush to the office market. However, financing for the right office product is available and still attractive. The pool of interested lenders has shrunk, but life companies are actively quoting office loans for good operators at sub-60% leverage with a good tenancy story. Likewise, debt funds flush with cash are finding good yield on value-add stories up to 80% loan to cost. ▲

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Scoville

Continued from Page 6

is that landlords are holding to their asking rates and providing reduced concessions in the form of tenant improvements, and base rental abatement is offered more sparingly. While some deals remain to be had, primarily in single-story product in the north I-25 submarket, we anticipate lease rates to hold steady or escalate throughout the balance of 2021; and with a significant delta between rates for existing product versus new construction, there remains room for significant growth in rates over the coming years.

■ **Absorption.** All submarkets posted negative absorption in the first half of 2021, albeit the north I-25 market bore the brunt of this with approximately 52,000 sf of negative absorption. Both the airport and CBD submarkets had minimal negative figures, and overall the market remains healthy. COVID-19 clearly had an impact on new requirements in the market, and so, while you expect some inherent churn in tenancy, there was no activity to take the place of those spaces vacated. As things hopefully start to get back to normal, and more employees go back into the office, we do not anticipate this trend to continue and forecast 2022 to reflect some very healthy positive figures.

■ **Medical office market overview.** The medical office market has remained very strong through all of 2020, despite a very uncertain time in the general economy and health care. With the last speculative construction being almost 12 years ago in 2008-2009, the existing MOB market has remained very tight with sub-9% vacancy rates for the last several years. With the steady improvement in the market (pre-COVID-19), we are seeing multiple projects that are ready to break ground on a speculative basis with 30%-60% prelease requirements. These projects are what attribute to the slight increase in vacancy for 2021. Given the market demand, we expect many of these projects to do very well in their lease-up despite the fact that the costs likely will be 30% higher than current market.

In addition to a vibrant leasing market, the appetite for quality medical investments has remained strong from both the medical real estate investment trusts as well as private capital investors, and we anticipate that to continue throughout 2021. ▲

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Machado

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the terms and conditions to consider if a hybrid concept is adopted. These include items such as:

- Salary, job responsibilities and benefits;
- Work hours, overtime and vacation;
- Equipment requirements; and
- Office supply requirements.

With these specifications and guidelines in place, companies and their employees can set expectations and determine what the best approach is for both. It also provides a valuable opportunity for companies to track and measure results on multiple fronts (including everything from employee performance to how much a company is helping to reduce its carbon footprint).

Obviously, companies want their employees to be able to perform at their best. Finding ways to provide safe and productive options for those who want to work in an office setting or from a home office is a delicate balance. Denver South is helping the companies we work for and represent to find ways to strike this balance and continue to thrive.▲

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Jenkins

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when working remotely because we lose the meaningful transfer of information between workers. These loosely defined areas typically have some food or beverage service, have more people around and are less formal than the standard conference room. However, isolating these areas from the quiet and communication zones serves to make these areas less disruptive if the noise levels increase. When possible, these are great areas to have next to break rooms because they can double up as internet cafes.

These zones will not necessarily reduce the office footprint – but they will make the office space more efficient and attractive to workers who need to adapt to the hybrid office environment. The collaborative office was created to provide a new sense of energy to the office and to provide an environment of shared humanity. We just didn't anticipate all the rules that would come with a pandemic.

We still need our office environment. As with other times in history, we evolve into better situations given the chance, and this new hybrid work experience will provide flexibility for remote and in-house workers. ▲

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Brumley

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quoted in the bid and the actual price of delivered materials if that is what is specified in the contract. In this case, both parties are protected from the kind of market volatility we're seeing now.

Owners and landlords, too, have ways of adapting to short-term cost increases.

Some simply will seek bids from new or untested construction firms that they would not have engaged in an otherwise stable market. Some firms hire temporary in-house construction managers to deal specifically with short-term cost spikes in tenant buildouts. Others contract with third-party outfits that perform similar duties.

Again, creativity and communication can bear fruit for both general contractors and their clients if markets can self-correct with at least some measure of predictability. COVID-19 was and is the exception to that rule. Markets don't like uncertainty, and the delta variant is clearly stalling a more robust return to the office.

Granted, vaccinations have helped ease the panic we experienced during the early days of the pandemic, but the delta strain is proving to be a formidable barrier to tenants in the market already buckling under the strain of cost volatility, the anti-vaxxers and the continued uncertainty infecting both short- and long-term project planning.

Owners and users are free to remove those employees not willing to be vaccinated, but that is not always easy, and it doesn't resolve the larger issue of marketwide fear – and potentially holding off on fiscal decisions, including those affecting real estate.

Hopefully, the lingering effects of the pandemic will level off sooner rather than later. Office leasing activity here is on the rise, albeit more deliberately than ever before. Denver is a more resilient and diversified market than most others of similar size. Colorado's quality of life is intact. Cost increases will ease because they always do. With fewer intangibles and unforeseen failures, the office market should be approaching pre-pandemic heights by this time next year. ▲

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Pennick

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world and these trends aim to keep employees safe and allow employees to feel comfortable as they return to the office.

Collaboration, flexibility and early planning are the keys to moving forward. Designers often are leading the charge in the progression of the modern office space, with insights from stakeholders, and team synergy in the earliest stages of the project between the owner, designer and contractor is more important than ever to carry these advancements forward. We have heard it many times over the past year that we are all in this together, and to move toward the future of office environments it is apparent that we must work in concert to meet the needs of businesses and their employees. ▲

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Petro

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and reduce pavement maintenance; and incorporating trees, shrubs and ground covers can reduce the amount of impervious paving, reducing heat island effect – all of which reduce overall operating costs. Established plantings and shade trees are desired aesthetics that beautify a building site. To have established and mature planting on the site takes time for growth and the design professional to select the right material. Purchasing young plant material is one way of achieving cost savings since younger plant material adapts quicker and with less initial care than older, more mature material. If you ever had an arborist assess a tree's value and cost for replacement, you know that established/healthy aged trees are costly to replace.

Creating high-performance landscapes that are resilient and regenerative are imperative to our environment and a key step in creating long-term success for healthy communities. They benefit both natural and human systems in a multitude of ways, and the cost savings accrue over time. ▲

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A Colorado Real Estate Journal Publication

September 2021

INDUSTRIAL PROPERTIES

Community developers keep industrial on the back burner

The Prologis Broadway Distribution Center in central Denver is a 143,000-square-foot Class A speculative warehouse, which broke ground this month and will deliver in second-quarter 2022. Prologis plans to pursue LEED certification for the building.

Matt Trone
Managing director, Cushman & Wakefield

Joe Krahn
Director, Cushman & Wakefield

Joey Trinkle
Senior associate, Cushman & Wakefield

Since the onset of the pandemic in March 2020, online retail sales purchases have skyrocketed in the United States, with online retail sales increasing nearly 32.4% from 2019 to 2020, according to a preliminary report published by the United Nations Conference on Trade and Development. Beyond a simple increase in online retail sales year over year, the UNCTAD report also reported a 3.2% increase in the share of online sales as a share of total retail volume, with Forbes reporting that the pandemic may have accelerated the growth of e-commerce by four to six years. For consumers, this has translated to an inexorable shift in the way we purchase everything, from goods to groceries to even cars. For industrial developers in high-growth markets like Denver, it has meant significantly increased demand for warehouse/distribution space in both the traditional urban core as well as in areas with anticipated population growth in the future.

Still, despite the mounting demand for warehouse space, there seems to be something of a disconnect between the need for industrial real estate and the policies of communities needing to be served, both in the Denver market and beyond. Too often, comprehensive plans generated by city councils and development committees fail to provide suitable land allocation or zoning to allow for future industrial buildings. This often translates to an uphill (and often costly) rezoning battle for developers looking to build warehouse/distribution space to satisfy e-commerce retailers' needs.

A salient example is the city of Westminster's 2040 comprehensive plan, which is currently posted for

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INSIDE

INDUSTRIAL — MARKET UPDATE

Industrial real estate demand outpaces supply

A new report from the NAIOP Research Foundation finds that across the United States the demand for industrial real estate is outpacing supply. This is no surprise, given that the pandemic accelerated an already fast-growing trend toward having more goods, supplies and even groceries delivered to the home or office.

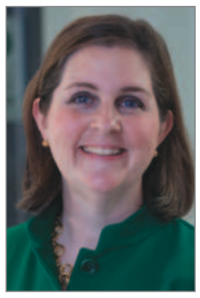
In Denver, the center of Colorado's industrial and warehouse real estate market, supply still is edging out demand and restricting rent growth at least in the short term, said Brian Dietz, vice president, investment officer with Prologis and a member of the NAIOP Colorado board of directors.

"In Denver, it's a story of mixed results," Dietz said. "We have a very strong capital market, and there is a lot of capital that wants to be in Denver industrial from local and large institutional sources. Cap rates are lower than we've ever seen, and properties are highly valued.

"We've seen for the last couple of years significant deliveries of new product, but what we've also seen is absorption that is only average. That is having a moderating effect on rent growth. It is our belief that an increase in leasing activity this year will take up some of that supply," Dietz said.

That would mirror the national trend, according to the August NAIOP Industrial Demand Forecast.

Although nearly 100 million new square feet has been delivered since



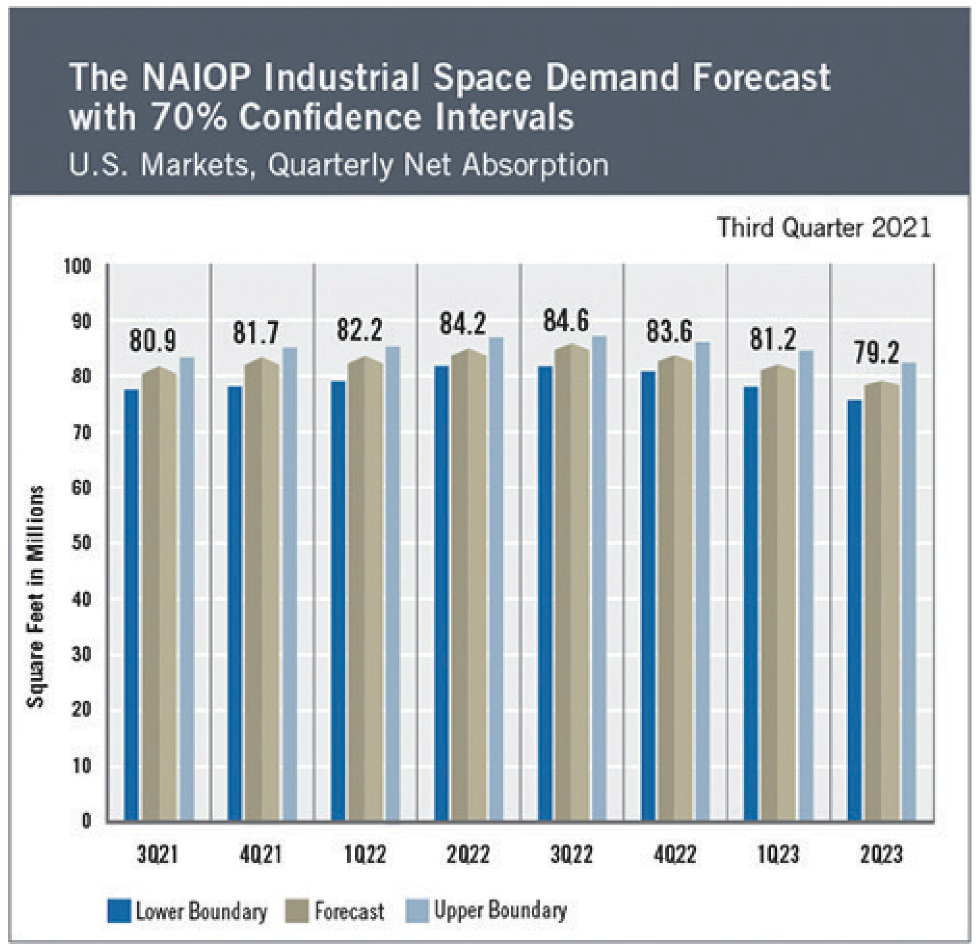
Kathryn Hamilton
Vice president, communications, NAIOP

the beginning of the year, 450 million sf is under construction and another 450 million is planned, the demand for industrial real estate still outpaces supply.

Because of this, the authors of the report, Dr. Hany Guirguis and Dr. Michael Seiler, forecast that total net absorption in the second half of 2021 will be 162.6 million sf, with a quarterly average of 81.3 million sf. In 2022, the projected net absorption is 334.6 million sf, with a quarterly average of 83.6 million sf.

"Led by coastal port cities, industrial transaction prices per square foot are on the rise, vacancy rates remain low and new leases are being signed at higher rates. Despite new current and planned supply that is greater than it has been in years, higher demand for industrial real estate is causing net absorption to remain strong. A continued surge in imports from retailers restocking depleted inventories has exacerbated the shortage of warehouse space near major logistics hubs, highlighting the need for additional construction," according to the report.

The report notes that during the pandemic, savings rates increased and demand for consumer goods surged. Consumer preferences have shifted recently from saving to consumption of both goods and services, despite burgeoning inflationary concerns. But



NAIOP

Although nearly 100 million new square feet has been delivered nationally since the beginning of the year, 450 million sf is under construction and another 450 million is planned, the demand for industrial real estate still outpaces supply.

just when the nation seemed to be turning the corner on COVID-19, the delta variant has renewed concerns about the pandemic's impact on the economy. If the uptick in infections and hospitalizations continues, consumers could again shift more of their purchases from in-person stores and services to e-commerce, which would support additional demand for indus-

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INDUSTRIAL — MARKET UPDATE

How Denver's footprint stacks up nationally

Industrial space is the hottest commercial real estate asset class in the U.S. at the moment. Not at all surprising, given the sharp growth of the e-commerce sector since last year – online commercial activity now accounts for 17% of core retail sales nationwide. Moreover, the need for data center infrastructure expansion has grown with the percentage of work, education and other communication being conducted online since the onset of the pandemic.

Across the nation's largest markets, asking rents and sales prices were on a sustained upward trend during the first half of 2021, and Denver is no exception. According to a recent report released by CommercialEdge, Denver saw some of the fastest-growing sales prices in the country and one of the highest shares of industrial stock under construction. Of course, Denver's industrial sector has been on an upward trend since before the pandemic and broke several records in terms of sales and construction since 2020.

■ **Average asking rents for Denver industrial space up 4.2% year over year.** Asking rents for industrial space in Denver averaged $7.27 per square foot in June. This marked a 4.2% year-over-year increase, which was on par with the national average. Among the 20 top industrial markets we analyzed, average rates in Denver were the eighth highest halfway through the year, surpassing hubs like Chicago ($5.32 per sf) and Dallas ($4.67 per sf).

In terms of tenant absorption, Denver recorded a vacancy rate of 8.4%, the fourth highest among the top markets surveyed for the report. This means that 91.6% of industrial space in Denver was occupied through June, as local supply and completed projects absorbed increased demand from new and expanding tenants.

Irina Lupa
Real estate writer, CommercialEdge

■ **Denver industrial sales totaled $771 million through June.** By the close of June, the volume of industrial transactions made up roughly 52% of sales recorded in 2020. As such, 2021 transaction activity seems on track to surpass last year's totals. Industrial sales closed during the first six months of this year totaled $23.3 billion across the top 20 industrial markets. During that same time frame, sales closed in Denver amounted to $771 million and accounted for nearly 4% of the nationwide total.

The estimated 2021 sales volume likely will be driven by rising average sales prices rather than the number of assets changing hands – properties sold for an average of $113 per sf in the second quarter, up a staggering 30.6% year over year and 13.3% higher than in the first quarter. This trend began in the second half of the past decade, but market shifts generated by the pandemic boosted price growth.

Among the markets analyzed, Denver saw the third-fastest rising prices for industrial space, with rates increasing by a whopping 39% year over year – from $119 per sf in June 2020 to an average of $164 per sf this June. The surge placed Denver sixth among the top markets by average sales price, ahead of industrial clusters such as Phoenix ($138 per sf) and Boston ($143 per sf).

Average Rent by Metro

Market	Jun-21 Average Rent	12-Month Change	Avg Rate Signed in Last 12 Months	Vacancy Rate
National	$6.64	4.2%	$7.24	5.8%
Los Angeles	$10.30	6.7%	$11.85	3.5%
Inland Empire	$6.36	6.2%	$7.57	1.6%
Nashville	$5.02	6.1%	$6.50	3.3%
Bay Area	$10.69	6.1%	$11.62	8.1%
Seattle	$8.64	6.1%	$10.18	7.5%
Philadelphia	$6.07	5.6%	$6.52	4.6%
New Jersey	$7.58	5.5%	$9.08	3.4%
Atlanta	$4.42	4.4%	$5.31	4.6%
Miami	$8.43	4.4%	$9.48	5.8%
Denver	$7.27	4.2%	$8.51	8.4%
Orange County	$11.22	4.1%	$12.48	3.9%
Boston	$7.63	3.6%	$6.38	10.5%
Dallas	$4.67	3.5%	$5.07	4.8%
Phoenix	$6.95	2.9%	$6.79	6.6%
South Carolina	$5.71	2.8%	$5.32	9.5%
Houston	$5.78	2.6%	$6.53	12.8%
Twin Cities	$5.87	2.2%	$5.55	7.5%
Chicago	$5.32	1.9%	$5.78	5.8%
Kansas City	$4.15	0.7%	$3.45	5.7%
Detroit	$5.56	-0.2%	$4.28	6.6%
St. Louis	$4.06	-1.7%	$3.41	5.7%

Source: CommercialEdge. Data as of June 2021. Rent data provided by Yardi Matrix Insight. National rent and occupancy data is an average of the top 20 markets.

In June, average rent in the Denver metro area had increased 4.2% in the past year, matching the national average.

■ **11 million sf of new industrial space under construction in Denver.** Halfway through the year, 447 million sf of new stock was under construction across the nation, while nearly 130 million sf of industrial space had been completed. The latest pipeline forecasts estimate that developers will deliver around 300 million sf annually until 2026.

Developers had almost 11 million sf of new Denver industrial space under construction in June, which accounted for 4.7% of total stock. This placed Denver fourth by share of under-construction totals, well ahead of markets such as Los Angeles (1.1%) and New Jersey (1.6%).

It's no secret that construction costs have been rising rapidly across the country, while coastal regions have been struggling with scarcity of developable land. These factors are expected to push the construction pipeline further inland, with markets such as Denver poised to gain from the shift. This trend is noticeable already, as Denver also ranked fourth by the share of planned and started construction projects, which account for 8.4% of the total industrial stock in the market.

Overall, the industrial real estate sector is growing at an accelerated pace, and Denver is firmly positioned on an upward trend. In an economic environment of rising consumer spending and expanding tenant demand, Denver's healthy, diversified economy has attracted increased attention. With such a potent mix of factors, it will be interesting to see how industrial space in Denver evolves through the second half of the year. ▲

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INDUSTRIAL — MARKET UPDATE

Denver's hot industrial market continues its streak

The explosion of the Denver industrial market has seen a continuation of its nearly 10-year run in 2021, as both a rebuttal of the global pandemic and as a further cementation of Denver as a top-tier industrial investment target market. Denver's unique geography in the center of the United States, combined with its attraction as a top live-work destination, has continued to boost industrial development and investment.

Brandon Kramer
First vice president investments, national office and industrial properties group, Kramer Group, Marcus & Millichap

There are really two main drivers that we can point to that explain the reason Denver not only survived the pandemic but thrived. The first is population growth: Colorado gained roughly 50,000 people between July 2019 and July 2020, according to the U.S. Census Bureau. Additionally, relocation services provider Updater cited Denver as a top five city for inbound growth during 2020.

The second is job creation: Denver is expected to add 95,000 jobs in 2021, equating to a 6.6% rate of annual employment growth. This hiring activity enables the metro area to recoup 91% of the positions lost last year. This strong job recovery will support additional relocations and household formation that will lift demand for essential and nonessential goods. These two drivers explain everything about how Denver's economy as a whole has thrived, but let's look at the way Denver's industrial developers and investors have been able to maintain this growth through solid fundamentals and disciplined development.

Industrial developers completed nearly 2.8 million sf of industrial space from January through June of this year, the largest first-half delivery total since 2000. Another 2.3 million sf is slated for delivery during the final six months of 2021, highlighted by a 900,000-sf distribution center in Aurora for Shamrock Foods, along with several Amazon developments over the past few years. The furtherance of large block building leases being signed is another data point for investors that Denver is not a fluke; it is an industrial powerhouse in the making. Total supply additions this year will surpass 5 million sf for the first time in more than two decades, increasing the metro area's industrial inventory by 2.5%. At the onset of July, construction was underway on an additional 3.1 million sf pegged for 2022 completion. Most of these projects are speculative and have yet to secure a tenant. The fact that developers have made the switch from historically build-to-suit and less speculative developments to fully speculative developments has signaled to the national and international capital markets that Denver is a safe place to invest speculative capital.

But this development spree, although disciplined, can create its own headwinds. All Denver submarkets with at least 10 million sf of inventory recorded an increase in vacancy during the past 12 months ended in June. These widespread increases contributed to metro area vacancy elevating 170 basis points to 7.2%, the highest rate since the first quarter of 2012. At 12.4%, vacancy is highest in north Denver, with availability tightest in west Denver at 1.8%. Accounting for 40% of Denver's industrial inventory, the east Interstate 70/Montbello submarket recorded a 30-basis-point increase in vacancy over the past year ended in the second quarter. The absorption of more than 1 million sf of space prevented a larger rise from occurring and enabled local vacancy to remain in the 7% range, which is a tolerable vacancy rate in most analyses.

Development activity should naturally see a bit of a plateau in the remainder of this year and into next as developments deliver and tenancy is established. Supply driven pressure will be minimal during the second half of this year as, outside of a 526,000-sf speculative warehouse, most of the space slated for near-term finalization has a tenant in tow. Still, vacancy is expected to rise by triple-digit basis points during 2021, ending the year at 7.4%. This increase will represent a sixth consecutive year of rising vacancy for the metro area. Since July 2020, nearly 60 leases have been executed for spaces larger than 50,000 sf. Roughly one-fourth of these agreements have been for floor plans that exceed 100,000 sf.

The rise in vacancy should be a welcome relief to prospective tenants looking at the Denver market, hoping for the plateau of lease rate appreciation rates given the large amount of planned deliveries. But despite widespread vacancy increases, the metro area's average asking rent has consistently risen since the third quarter of last year. At $8.71 per sf entering July, the mean marketed rate was up 5.8% on an annual basis, somehow coinciding with a rise in deliveries, pointing largely to demand from outside companies and expanding companies as the main driving factor. Every submarket with at least 10 million sf of space recorded positive rent growth over the past year, except for northwest Denver. Double-digit rent growth was notched in northeast Denver, where local vacancy is 130 basis points below the metrowide average. The demand for industrial will be met with supply additions and positive absorption during the second half of the year, which will support continued rent growth, allowing the area to register a nearly 7% increase

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INDUSTRIAL — MARKET UPDATE

Leasing activity paints picture of Northern Colo.

Joe Palieri, CCIM
Senior adviser, NAI Affinity

This year has been a good year, so far, for commercial real estate in Northern Colorado. Developers and investors have not been detoured by the turmoil caused by the resurgence of the COVID-19 virus, increased construction costs, the shortage of labor and materials, or the political upheaval both here and globally.

The office and retail markets are not as strong as they once were. However, well-located, properly maintained assets still are in high demand by buyers and tenants. Multifamily and industrial properties still are being developed at a staggering pace. Tenant demand for industrial/flex space still is strong, and absorption of newly developed buildings keeps vacancies low.

Investors are driving much of the commercial activity. They are competing for what were considered marginal investment returns a few years ago. Sellers with net-leased investments are entertaining multiple competing offers. Most properties are under contract before official marketing even begins. Commercial investment specialists have multiple clients looking to purchase investment real estate ranging from $500,000 to over $10 million. Demand is being driven by the appreciation of real estate over the past four or five years, concerns about possible changes in the tax code and companies using the sale-leaseback strategy to generate capital. Capitalization rates remain at historic lows due to strong demand and low interest rates.

To illustrate the difference in the industrial and office market this year, I will analyze lease comps in Northern Colorado (Larimer and Weld counties combined).

■ **Industrial and flex.** From Jan. 1 to mid-August there have been 145 industrial/flex leases signed, totaling over 1 million square feet, according to CoStar. Leasing takes about six months, but over 50% are completed in three months. Most leases (123 of 146) are less than 10,000 sf. The majority of the reported leases have lease rates between $12 and $15 per sf plus triple-net expenses. Larger leased spaces, over 50,000 sf, typically have seen a bit lower lease rates if the leased space consists of mostly production and warehouse space. Very few are below $10. New construction is being marketed with base rents between $16 and $18 per sf. Normally new construction lease space has minimal finish. Lease rates are closer to $15 per sf if the leased space requires more than 10% office finish. The more tenant improvements required, the higher the lease rate. Landlords and tenants negotiate how much tenant improvement dollars will be included in the transaction. It is reasonable to expect $10 to $15 per sf. Longer-term leases, over seven years, may include a bit more tenant improvement allowance. Any costs over the allowance are either amortized over the lease term or paid for upon completion by the tenant. The final cost of the tenant improvements and the financial strength of the tenant are major factors in determining who pays for what.

The total industrial/flex market combined for Larimer and Weld counties is about 50 million sf, according to CoStar. There currently is 1.6 million sf under construction, which is an increase of 39% in the last quarter. The 12-month absorption is 433,000 sf, almost a two-fold increase from last year. The vacancy rate is 4.6% and is slightly higher than last quarter due to the amount of new construction.

One notable lease was Ranger Energy Services in Milliken for 127,865 sf, which was not really a new lease but an example of a sale-leaseback. The property was purchased by Ninigret Group out of Salt Lake City as an investment for $13 million in a 1031 exchange, according to the company's website. Other notable leases include a new construction lease at the Axis 25 project, developed by Etkin Johnson, on Byrd Drive in Loveland by Beckman Coulter for 95,114 sf and the lease of 46,600 sf in Greeley by Emit Technologies at 2985 First Ave.

■ **Office/medical.** From Jan. 1 to August there have been 226 office leases totaling 449,924 sf, according to CoStar. Leasing of office space also takes about six months on average. Larger spaces, greater than 3,000 sf, may take several months longer. Many office users are downsizing because of the work-from-home trend. Many leases are relatively small on a per-sf basis. Of the 226 leases reported, 93 were less than 1,000 sf, and 46 of those were less than 500 sf. Most of the recorded leases have base rents between $15 and $20 per sf. Class A and medical space leases are reporting much higher rates, typically $25 to $30 per sf plus triple net.

The total office/medical market combined for Larimer and Weld counties is about 18 million sf, according to CoStar. There is only 117,000 sf under construction, which is a slight decrease in the last quarter. The 12-month absorption is negative 151,000 sf, almost a two-fold decrease from last year. The vacancy rate is 6.7%, which is an increase of 1.3% from last quarter.

Not much has changed since the fourth quarter of last year. Industrial real estate is in high demand, and new product is being produced. Office space is in much less demand, and users are downsizing. I expect these trends to continue until the demand for industrial space is satisfied. ▲

joep@affinitycre.com

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	2.50%-3.50%	• Up to 70% 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) • Older industrial product with good operating history and good occupancy • Flex industrial product, subject to location and quality	• Industrial is seen as one of the most attractive asset classes for insurance companies given the perceived risk 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 55% - 60% with strong sponsors • 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%-3.75%	• Up to 70% LTV • 1.25x Minimum DCR • 7.0% Minimum Debt Yield	5, 7, & 10 Years	Typically full-term I/O, 25-30 Years	• Secondary/Tertiary Markets • Large transactions or portfolios that are tough for other lenders to pursue alone • Staggered rollover or small individual tenant exposure that will reduce CMBS required reserves	• Strong B-piece buyer demand for stabilized industrial • Leasing capital reserves or cash management incorporated for large rollover events • Can be more competitive on larger one-off deals or portfolios that may be too large for other lending sources • Will compete on flex product as well, if metrics make sense for securitization
BANK	• Corporate Debt • Deposits	• Recourse (non-recourse becoming more available on case-by-case basis) • Shorter-term fixed and floating rate loans	2.25%-3.50%	• Up to 70% 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 • Clients with relationship potential • Secondary/Tertiary Markets	• Very strong appetite for construction or re-position on assets with strong sponsor and good location • Floating rate programs range from L+150-L+250 • 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 more available to strong sponsors at lower leverage • More flexible (open) prepayment terms • For loans under $10M, pricing closer to 3.00%
DEBT FUND / BRIDGE LOAN	• Private Capital • Institutional Capital	• Non-Recourse • Shorter term bridge loans for acquisition and/or repositioning	L+275-375 bps spreads	• Up to 80% LTC • Going-in 1.0x DCR	1-5 Years (3+1+1)	Interest Only	• Value-Add Transactions • Transactions with major rollover within the next 3 years • Recapitalizations • New construction	• Most lenders have a LIBOR floor of 15 or 25 bps • Competing on ground up construction at higher leverage than banks are considering • Pricing depends on leverage level, property quality, Sponsor strength , and loan size • 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

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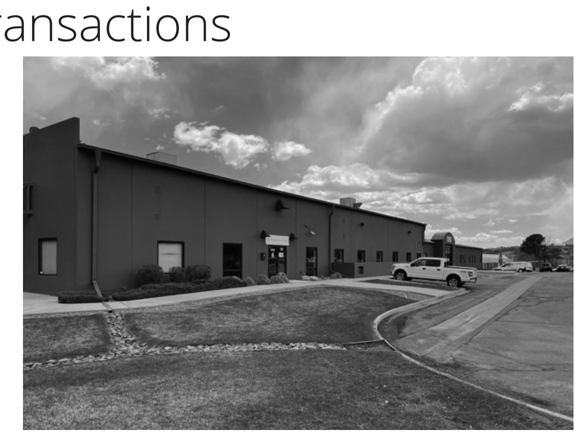

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INDUSTRIAL — CAPITAL MARKETS

Private & institutional capital allocations shift

The industrial sector has been a consistent headliner in commercial real estate, boasting overwhelming demand from end users and investors alike. This asset class has been flooded with investors who see value in allocating capital toward industrial and away from office and retail as a safer investment vehicle in today's favorable economic environment. The increased investment volume into the sector has created changes to both individual and portfolio opportunities as the market has more aggressively pursued this asset class. The composition of capital pursuing the various industrial asset class subtypes has been notably shifting as well, which has led to record-breaking pricing and heavily competed transactions.

Garrett Neustrom
Director, Kenai Capital Advisors

As competition has increased for industrial assets, institutional investors have reduced their minimum equity check size in an attempt to place capital. Simultaneously, private investors have increased their interest in industrial opportunities and have exchanged or diversified out of their retail, multifamily and office assets for industrial holdings. This has led to intense competition for middle-market industrial assets (meaning those valued between $5 million and $30 million). Portfolios that traditionally may have been uninteresting to institutional buyers because of the tenant credit and building vintage are being seen now as opportunities for institutional capital in the current market. The individual assets within these portfolios were traditionally geared toward private investors, but now as a package, these assets are being flooded with offers from institutions trying to place equity to meet capital allocation goals. Although many of the marketed portfolios still are large from a valuation and square footage perspective, the makeup of many portfolios on the market includes properties that typically would have been on the smaller size for institutions. On an individual asset basis, institutions are proving to be less sensitive to remaining lease term on existing buildings, as well as more willing to involve themselves earlier in forward contracts for new construction assets whereby they assume lease-up risk for a discounted spread versus a similar, fully occupied asset. Furthermore, many large investors have adopted aggregation strategies that add middle-market products into their portfolios as a strategy to meet their allocation demand.

Jules Sherwood
Principal and founder, Kenai Capital Advisors

The Church Ranch portfolio in Westminster was recently purchased by Kenai Capital Advisors to meet investor demand for industrial products outside of traditional high cube distribution. The 150,000-square-foot flex industrial portfolio is made up of three buildings and a development parcel.

Many private investors, high-net-worth individuals and family office groups who traditionally have played in the multifamily space have identified value in diversifying their portfolio into the industrial asset class as multifamily returns have shrunk. These groups, specifically family offices, recognize industrial as an opportunity for consistent dividend paying assets, an extremely liquid debt market and longer-term leases than multifamily or office. As family offices and other private investors shift their allocation goals to meet their portfolio return requirements, they are realizing that industrial assets provide arguably better risk-adjusted returns compared with multifamily in today's market. Not only are they shifting their asset allocations, but also they are writing larger equity checks to compete for both portfolio and individual industrial assets. As family offices enter the already heavily competed upper-middle-market industrial space, their adjusted return profiles and larger equity checks place them in direct competition with private equity firms, funds and other institutional investors in the space. Denver has been identified as one of the preferred geographic locations for private capital to invest, with family offices and high-net-worth individuals diligently looking for investment opportunities. The result for current owners of industrial assets, regardless of the size or age of the buildings, is that there will be someone

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INDUSTRIAL — MARKET OUTLOOK

The demand driving the great industrial land grab

Jason White
Executive vice president, JLL

The second quarter continued to usher in positive news for the Denver industrial market while also reflecting its ongoing navigation of the COVID-19 economy. Following a rush of more than 2.4 million square feet of new industrial space added during the first half of the year, new construction starts and permit applications continue to roll in.

However, if land transactions serve as an indicator, Denver may be heading into a new wave of large-scale industrial construction. Throughout the metro area, industrial parks and projects of all shapes and sizes are undergoing entitlements or permitting to pull light-industrial or bulk warehouses out of the ground at a record pace. Currently, there are at least 20 sites that are either existing parks with vacant entitled land or that represent land undergoing entitlement for industrial development. This has the development pipeline expanding at breakneck speed and causing potential bottlenecks to the entitlement and permitting process.

In a world where time is of the essence, speed to market is critical for capturing demand. That's when having big-box product already coming out of the ground that a user can "touch and feel" can be a big advantage, as can be seen with First Aurora Commerce Center's bulk building currently under construction at the E-470 and Interstate 70 interchange.

Demand for mega-sites (larger than 80 acres) has escalated over the years as user requirements for unique distribution, manufacturing and processing facilities evolve. Based on Denver's current industrial land activity, interest in large sites and large-scale industrial could continue to shape the market's future.

Currently in Denver, there are multiple 1 million-sf user requirements circulating, with the hopes of finding a nice rectangular development site with great access and perfect circulation. But the reality is that very few available sites check all these boxes, so compromises must be made. For instance, there are several local requirements where the user would like to purchase and control the site. But local developers who spent time and money acquiring and preparing these sites for construction would like the honors of developing the land they've worked so hard on. Most of this large-format activity is concentrated in the airport submarket with projects such as Denali Logistics Park and DIA Logistics Park, both of which are able to offer fully entitled swaths of land for projects of nearly any size.

Demand remains high for hot spot corridors like the airport/I-70 and north central, however, new submarkets are emerging as preferred alternatives to the now concentrated areas of demand. The most apparent evolution of the Denver industrial market can be seen along the Interstate 76 corridor – not long ago perceived as the gateway to oil and gas field services but now legitimized as a viable option for any industry thanks to several pioneering developments. We've also seen a completely new industrial submarket emerge up north, where Interstate 25 and E-470 converge, after a large e-commerce group planted a massive flag. Developers followed and now are experiencing real rewards for their risk.

Even with the emergence of alternative solutions, infill demand still reigns supreme. Land values have more than quadrupled over the past five years thanks to buzzwords like "last mile" and "fulfillment." Dense population centers driving consumer demand and a robust labor force make these sites obvious choices for users who are willing to pay the freight. Although the real challenge can be navigating sometimes-tricky municipal demands, especially for sites that do not have an industrial or distribution use by right. While consumers want their products quicker and faster by the day, that speed requires a logistical framework that not all communities are willing to embrace. Some infill projects, such as North Central Logistics Center, have navigated this process and as a result are realizing successful leasing from high-profile logistics providers.

While Denver's increase in vacancy would lend belief that there could be a downward pressure on rates, industrial asking rents still posted gains year over year, although rate growth decelerated thanks to increasing supply and some competitive developer behavior. Absorption picked up in the second quarter, bringing the first half of 2021 to just under 2 million sf, however, there are several monster build-to-suits scheduled to deliver in the second half of the year that will push that number substantially higher.

The real question will be focused on absorption of the speculative projects currently in the market or under construction. We may see some of these demand question answered once COVID-19/delta restrictions abate and the economy throttles back into gear. Pandemic-related restrictions have slowed market tours and site visits and as such have limited the potential for deal making. But in the meantime, industrial remains the most active asset class in terms of deal flow velocity and investor interest and, for the development community, will continue to pick through opportunities in hopes of satisfying a seemingly insatiable demand. ▲

INDUSTRIAL — DEVELOPMENT

Colorado leads the way for industrial development

While the pandemic caused uncertainty for the trajectory of commercial real estate, industrial real estate has continuously performed well. In fact, most developers are realizing we've only seen the tip of the iceberg, with vast opportunity still lying below the surface.

Prior to the onset of COVID-19, e-commerce was driving growth in the industrial real estate sector, holding steady at 16.2% of retail sales in the first quarter of 2020. CBRE's Global E-Commerce Outlook 2021 report validates that the demand for industrial property continues to advance, as retail sales increased to 21.6% by second-quarter 2020 and are forecasted to jump to 27.5% by 2025. As e-commerce trends continue to evolve, the demand for last-mile distribution will only grow.

Colorado is uniquely primed to support this surge, and we strongly believe in the future of industrial development along the Front Range.

Megan O'Brien
Vice president, commercial development, McWhinney

■ **Demand drivers along the Front Range.** As one of four major cities in a 500-mile radius, Denver continues to experience demand from a growing population with an increased "need for speed" – a growing expectation from consumers to receive deliveries in one to two days.

Denver's airport submarket is seeing particularly heightened activity for big-box distribution space and last-mile distribution facilities, with additional last-mile facilities emerging in every major Denver submarket. For example, in McWhinney's Baseline master planned community in Broomfield, a 200,000-square-foot last-mile delivery station is underway that will feature 32-foot clear heights plus 395 associate parking spaces and 1,198 van delivery parking spaces.

Jeremy Kroner
First vice president, CBRE

The latest tenants at the Centerra master planned community's industrial campus in Loveland include large distribution users like a Fortune 500 e-commerce distributor and a major home improvement retailer, and there is interest from construction supply, food manufacturing and local recreational users.

In Northern Colorado, the demand for general light-industrial space remains steady. The latest tenants at the Centerra master planned community's industrial campus in Loveland include large distribution users like a Fortune 500 e-commerce distributor and a major home improvement retailer, and there is interest from construction supply, food manufacturing and local recreational users. As the region continues to see population growth, activity from last-mile distribution users is anticipated to accelerate.

In addition to e-commerce, the life science market is prompting growth. CBRE's 2021 Midyear U.S. Life Sciences report named Denver-Boulder a top U.S. life sciences market. Due to strong leasing activity since third-quarter 2020, the region's vacancy rate sits at just 3.8%. Demand for space has increased 87.7% in the last nine months. Currently, 33 life sciences companies are searching for a cumulative 1.6 million sf of lab space in the Denver-Boulder area with only 635,000 sf of new construction space planned.

The pandemic also has caused a surge in demand for cold storage space, given the uptick in direct-to-consumer food delivery and buy-online-pick-up-in-store grocery trends. CBRE's research finds an additional 75 million to 100 million sf of freezer/cooler space will be needed to meet this shift in consumer demand and online shopping preferences.

■ **Design and construction trends.** Industrial building designs also are evolving to support these industries' latest needs. McWhinney is seeing taller facilities that support efficient racking systems to account for the future of robotics. For instance, in both Baseline and Centerra, 24-foot clear heights had long been the norm and worked well for the vast majority of users. Still, to futureproof the buildings, both communities' latest industrial projects have transitioned to 28-foot clear heights. McWhinney is even considering a potential increase to 30- or 32-foot clear heights in Centerra's next industrial campus.

Facilities also are growing to accommodate the shift to safety stock in response to supply chain shortages exposed during the pandemic, when companies had previously planned for just-in-time inventory. Not only are buildings growing, but their parking lots are too. Industrial properties are seeing increased parking requirements in even greater proportion than the expansion in building sizes, leading to lower site-coverage ratios.

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Short-term challenges bring temporary disruptions

Throughout the Denver metro area, we have continued to see increased levels of activity in the industrial markets. The entire region also has seen an influx of new residents as a result of a COVID-19 migration from other states. According to a local publication, Denver was among the top five markets for inbound growth. People from around the country chose to depart from America's largest, most densely populated cities and took to slightly smaller markets, hence Denver's growth. The migration to Colorado helped lead to record low industrial vacancy with rising lease rates, all due to the increased growth of the Denver metro area, which made the area extremely attractive for institutional investors looking to plant a flag in the Mile High City.

Just how has this impacted demand for industrial properties? According to CoStar, at the end of the second quarter, the estimated industrial vacancy rate was 6.7% in the Denver metro area with an average market lease rate of $10.20 per square foot plus triple net. The Boulder area had an 8.6% vacancy rate with an average lease rate of $12.30 per sf plus triple net, Greeley had a vacancy rate of 5.2% and an average lease rate of $10.95 per sf plus triple net, and Fort Collins had a 4% vacancy rate with an average lease rate of $10.53 per sf plus triple net. An estimated 29 tenants have signed leases for properties larger than 50,000 sf.

Fortunately, there is over 10 million sf of industrial space currently under construction in Colorado, and 7.5 million of that is located in the Denver metro area. But we are starting to see some short-term challenges for projects due to material pricing, transportation costs and supply chain problems. With the price of oil jumping from $38 per barrel to about $70 per barrel in the past year, petroleum-based products like paint and asphalt cost more, and transportation services are dealing with higher fuel costs. This also is impacting how we use energy. The Public Service Company of Colorado, a subsidiary of Xcel Energy, estimates it has spent an extra $650 million in electricity and natural gas costs due to the surging prices in commodities.

Keith Kanemoto, SIOR
Broker associate, commercial division, Re/Max Traditions

As any contractor can attest, U.S. lumber costs are creating significant challenges for construction of all kinds. There is a widely reported shortage of pressure-treated pine and softwood framing lumber used in new building and deck construction. Contractors are having trouble sourcing lumber, and when they can, the costs have soared in response to the shortage. In fact, joist and deck material prices have increased from $4 per sf to $18 per sf, all due to pandemic-driven shortfalls. Prices for other building materials also are rising. Andy Welch, with Sun Construction, said that in addition to the rise in lumber costs, he is seeing a 70% increase in steel prices from last year. As a result, lead times for a steel building jumped from up to eight weeks to as much as nine months. Whether it's steel or lumber, these increased costs are forcing some suppliers to only guarantee a price quote for 48 hours, which makes the adage of "time is money" a very real statement when looking at projects.

As designs get close to the final version, long lead times for materials are forcing many contractors to recommend that clients make the commitment to start ordering necessary items to ensure that construction can begin on time. These supply chain issues have forced project schedules to be written in pencil, not ink, as start and completion dates are now moving targets. PVC piping delivery can take six to 10 weeks, metal studs can take up to 24 weeks, TPO and insulation delivery can be six to nine months out, overhead doors now are 20 weeks or more from delivery, and getting fire alarm equipment can take up to 12 weeks.

Another major hurdle that already was a challenge before the pandemic is finding workers. Nearly every subcontractor is looking for qualified employees, and overtime is a common theme among many job sites to get projects to the finish line. In this current climate, another round of increased stimulus money for unemployment would be a crushing blow to the construction industry, as contractors struggle to find applicants.

Even tenants are dealing with supply issues. In many cases, necessary machinery or automation pieces that were planned for the space are unavailable as the lead times for some equipment went from a few months to up to 10 months out.

But even with the challenges outlined above, the industrial market is seeing interest from a wide range of clients, from service companies to large e-commerce users, to tenants and buyers of all sizes. A few of the recent leases we have seen include Wesco Distribution inking a lease in Colorado Springs for 13,000 sf, Sashco signing for 121,000 sf in Thornton and U.S. Venture signing for 139,000 sf in Denver. As e-commerce continues to evolve, we will see more last-mile users looking for space in the central corridors.

In my opinion, many of the aforementioned short-term supply chain challenges will be resolved in the next six to eight months unless another significant COVID-19 outbreak emerges. I also don't expect to see a reset of material prices to pre-pandemic levels, but they will stabilize. And unless another stimulus package is rolled out, employees will begin to show back up to work. Another piece of good news is that the cost of money is historically low and will help to offset some of the increased costs in Denver's industrial real estate market, and beyond. ▲

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INDUSTRIAL — MARKET TRENDS

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the community's review. Though the document cites a land use plan that proposes to increase the industrial land usage from its current 1.4% to 2.1% in the future, the development characteristics set forth seem to support more flex/research lab space, and indeed the plan stipulates, "The city may impose a stricter standard for more intense industrial uses." Within the plan, warehousing and wholesale distributors are classified under secondary uses, which "are not intended to be dominant within a character type and are evaluated on a case-by-case basis to determine appropriateness." As a result, there is not a single piece of land outlined in the 2040 comprehensive plan that allows distribution as a use by right.

The de-emphasis of industrial-use zoning is common practice within community planning, where the development of industrial warehouses often feels antithetical to the community goals of fostering beauty, sustainability and future growth. While this may have been the case 20 years ago, new strides within efficiency and design practices have spawned a new era of industrial development, one in which industrial buildings are more efficient and attractive as well as play a vital role in the economic prosperity of their communities.

The first and most important change within industrial development is the increase in LEED-certified industrial projects within the last decade. Though LEED certification was contained to build-to-suit industrial projects, given the narrow parameters, a 2013 revamping of the U.S. Green Building Council's criteria allowed for speculative buildings to achieve LEED certification as well, driving a shift toward green building practices. As of 2016, there were 307.1 million square feet of LEED certified industrial projects in the U.S., with another 348.8 million sf of industrial projects registered to be certified.

Along with the trend of lessening the environmental impact of industrial buildings, the shift toward LEED certification and green building also has had a profound influence on industrial building design. Far from the dreaded "big box" of old, features like clerestory glass windows and sustainable landscaping make industrial buildings more visually appealing. With this shift, buildings have become less intrusive and fit more comfortably within community visions of synergy and beautification among property types.

Another factor that often seems overlooked in community development plans is the fiscal impacts of different land uses, which influences the types of services that shall be rendered, tax rates that must be levied, budgets for school systems and public safety, costs of infrastructure projects, etc. This information often is determined by a "cost of community services" study, which calculates the net fiscal impact of land use by comparing revenue generated by a particular land use to its associated expenditures to identify the overall impact.

Residential land uses, for example, often have a negative fiscal contribution, meaning that the local government must spend more on services than it receives in tax revenue. On the other hand, commercial/industrial have a positive fiscal impact, providing tax revenue and local employment opportunities while requiring relatively little in terms of public service.

Even before the pandemic, the industrial sector has been a major driver for economic activity and growth within a community. However, the perceived negative impact of industrial buildings on neighborhood values has caused local municipalities to work to restrict industrial development, causing a shortage of industrial-zoned land. As industrial buildings evolve to be more efficient and less intrusive and the need for last-mile space grows, it's reasonable to hope that land allocation for industrial product in the Denver market may increase. ▲

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Hamilton

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trial real estate.

Experts expect Denver to follow that trend, with JLL's Industrial Insight reporting that: "Tenant appetite for space caught up with new supply added in Q1 and Q2 2021, helped in-part by the ease of new construction starts compared to the prior quarter. Another shift from quarter to quarter was the rise of a more diverse tenant mix engaging in the market, as the previous darling, e-commerce, took a temporary back seat. The return of a more varied tenant mix over the past three months – present in both leases executed and users seeking space – is a promising sign that Denver's economy, payrolls and consumer confidence have begun to rebound."▲

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Kramer

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in average asking rent this year. The gain will prolong a stretch of positive annual rate growth that started in 2011.

The capital markets and investors in Denver industrial real estate ultimately will be the biggest benefactors from this unprecedented bull run. Industrial deal flow in Denver rose 5% during the trailing 12-month period ending in June. The number of transactions executed during fourth-quarter 2020 represented the highest three-month total dating back to at least 2000. Amid the uptick in sales activity, average pricing fell 2% to $176 per sf, while the mean cap rate increased 20 basis points to 7%. Warehouse sales have accounted for three-fourths of all sales activity since last July, with nearly 70% of these trades involving sub-$5 million properties. Investors have been most active in east I-70/Montbello and northeast Denver, with the two submarkets accounting for roughly 40% of metrowide deal flow since July of last year. Out-of-state investors have accounted for approximately 40% of total deal flow since the onset of last July, with these buyers most active in Centennial, Commerce City and north Denver. Outside the Denver metro area, industrial sales activity was elevated during the past year ended in June. Deal flow in both Boulder and Colorado Springs more than doubled on a year-over-year basis, while transaction velocity in Fort Collins improved by nearly 20 property trades.

So, you ask, how is it to be in industrial real estate here in Denver? The answer is simply great! ▲

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Neustrom

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interested in buying their properties.

As the industrial market continues to see increased competition, investors still feel compensated for their risk, even as cap rates continue to compress. Market characteristics show a favorable outlook that generally supports the increased pricing on a square-foot basis, as construction prices for new product have accelerated upward at a faster rate than existing product's sales pricing per sf. Positive absorption is promoting investor movement toward industrial products and bolstered the belief in upwardly trending market rents. The low interest rate environment and lender demand for industrial product also have supported the yield compression within the sector. Each of these items allows investors favorable conditions to underwrite industrial assets and feel comfortable with their risk-adjusted returns compared with other assets classes.

There are risks associated with the sector, however. As new supply is planned and delivered in the Denver metropolitan statistical area from developers rushing to build product to meet current demand, investors are seeing new industrial assets coming on line (and to market) at a record pace. High-cube distribution and manufacturing spaces top the list for product in the pipeline, yet subsections of the industry such as flex-industrial, life science and data center space also are teed up for near-term delivery. Projections are for approximately 9 million sf of supply to come on line in the Denver MSA over the next few years, potentially applying downward pressure on rents and rent growth as demand for space is met and excess supply is realized.

To combat this risk factor, some developers have begun to diversify their offerings of new properties to life science and single-story flex properties, as these asset types have become desired for their high ceilings and multifaceted uses. Thanks to COVID-19, traditional office users are finding value in the single-story, open floor plans and lower occupancy costs found in flex-industrial assets. With no elevators, less common area to maintain (lower operating expenses), lower rents and the popularity of an industrially designed office, there has been increased demand from tenants for this type of space. As more user types enter the industrial market, the risk of oversupply diminishes and may create even more opportunities for investors to enter the industrial space, and into assets that are not just oriented toward logistics, manufacturing and warehousing.

Owners of existing industrial assets should rejoice, as the current market conditions are extremely favorable for them if they choose to sell, refinance or recapitalize. The investment market continues to show favor toward, and value in, industrial assets as more investors and lenders have entered the space. The shift in portfolio allocation from nearly all classes of investors also has led to increased demand for industrial opportunities. This has led to an increase in developer activity, promoted by tenant demand for all types of industrial product, and favorable capital markets that have kept prices rising. Even with significant supply coming on line, investors can realize favorable risk-adjusted returns in today's climate. Whether it is institutional or private equity, capital allocation has shifted favorably toward the industrial space with investors looking aggressively for more opportunities in Denver. ▲

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O'Brien

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McWhinney, to support brand commitment and core values, is also focusing on amenities, architecture and the worker experience to make for a healthier, safer and friendlier environment. The Iron Horse Industrial Park in Johnstown will include a landscaped outdoor plaza with a communal fire pit and seating, featuring an artistic stone bench to be fabricated by a local artisan.

■ **On the horizon.** As the pandemic recovery advances, Colorado's industrial real estate sector will continue to benefit as demand for industrial product remains strong. Changing consumer patterns will continue to drive e-commerce, and retailers will continue to increase inventories to avoid shortfalls. CBRE is forecasting that the U.S. market will see positive absorption for the foreseeable future.

McWhinney is planning further development in Centerra with a new industrial campus for large distribution users and additional spec product in Iron Horse. In Baseline, additional speculative flex industrial space is underway with 152,000 sf under construction plus two buildings totaling over 300,000 sf in the design and entitlements stage, planned to be fully permitted and in position to break ground by March 2022. The community also has about 15 acres currently available for build-to-suit flex industrial users.

While the past year has been a stark reminder to always remain prepared for the unexpected, we feel confident in the future of industrial real estate, with the best yet to come.

Additional contributors to this column include: Peter Lauener, executive vice president of master planned communities for McWhinney; Clyde Wood, vice president of commercial development – Northern Colorado for McWhinney; and Mike Eyer, first vice president with CBRE. ▲

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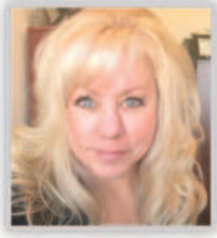
WINDSOR, TOWN OF



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If your firm would like to participate in this directory, please contact Lori Golightly at lgolightly@crej.com or 303-623-1148 x 102

The BOSS Directory

BUILDING OPERATING SERVICES & SUPPLIERS

ACCESS CONTROL SYSTEMS

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www.advantagesecurityinc.com

Fire Alarm Services, Inc.
Shannon Smith
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Mathias Lock & Key
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303-292-9746
dispatch@mathias1901.com

ACOUSTICAL CEILINGS & TREATMENTS

Heartland Acoustics & Interiors
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Art Consultant

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ASPHALT & PAVING

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Avery Asphalt, Inc.
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Economy Asphalt & Concrete Services, LLC
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CCTV/DIGITAL VIDEO SURVEILLANCE SYSTEMS

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DISASTER RESTORATION

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Doors and Frames

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ELECTRICAL

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Encore Electric
Encore Electric Service Team
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Weifield Group Contracting
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EMPLOYMENT STAFFING

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Denver – 303-337-6200
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EXERCISE EQUIPMENT

Advanced Exercise
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EXTERIOR LANDSCAPING

Arrowhead Landscape Services, Inc.
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Bartlett Tree Experts
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FACILITY MAINTENANCE

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FENCING

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FIRE PROTECTION

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Integrity Fire Safety Services
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Western States Fire Protection Company
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FIRE STOPPING/FIRE PROOFING

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FURNITURE FOR PUBLIC SPACES

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GLASS

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The BOSS Directory

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MOVING & STORAGE

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PAINTING

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Preferred Painting, Inc.
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PARKING LOT STRIPING

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PRESSURE WASHING

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PROPERTY IMPROVEMENT/ TENANT FINISH

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ROOFING

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SNOW REMOVAL

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SWEEPING

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TREE AND LAWN CARE

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WEATHERPROOFING

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WINDOW CLEANING

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