A Colorado Real Estate Journal Publication

February 2022

RETAIL PROPERTIES *Quarterly*

A recap of the net leased investment market's stellar year

Grocery's strong performance translated into ample demand for single-tenant net leased grocery deals, which traded at a premium last year, including the Sprouts in Green Valley Ranch.

James Rassenfoss
Director, Net Leased Properties Group, Marcus & Millichap

Net leased properties traded in record numbers in 2021, eclipsing a transaction volume of $90 billion, according to CoStar Group. Bolstered by a flurry of store reopenings and more relaxed COVID-19 protocols, retail sales soared above pre-pandemic levels in almost every category in 2021. Retailers have pivoted to adjust to the current climate and adapt accordingly by implementing omnichannel strategies. These pivots including click and collect, integration of delivery services, and creating designated pickup lanes and parking spaces. It has paid off. Nimble retailers are thriving, and their success has led to an increase in investor demand in the single-tenant net lease sector.

In addition to a retail rebound, a large pool of 1031 exchange buyers flooded the marketplace, seeking hands-off net leased investment product. These cash-equipped exchangers, in pursuit of stable tenants and long-term leases, drove net leased cap rates to a record low in the third quarter of 2021, in what already was a record year for transaction volume. The fact that interest rates remained low last year helped, creating opportunity for attractive financing options for investors. Despite momentum from a banner year, the sector now faces challenges heading into 2022. A tightening labor market and supply chain issues are driving historically high inflation and are among the biggest threats to the asset class this year.

■ **Strong performance by STNL retailers.** The swell of activity in the 2021 net lease investment market has a lot to do with the strong performance of the tenants that make up the space. Grocery, for example, has performed admirably during these past few years. According

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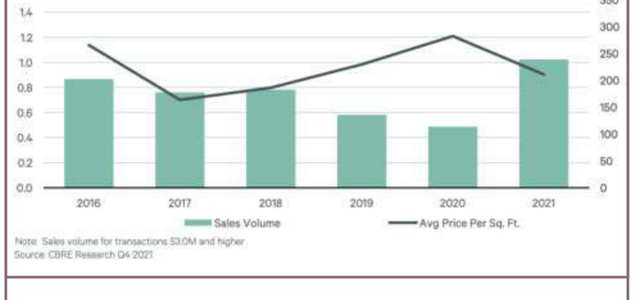

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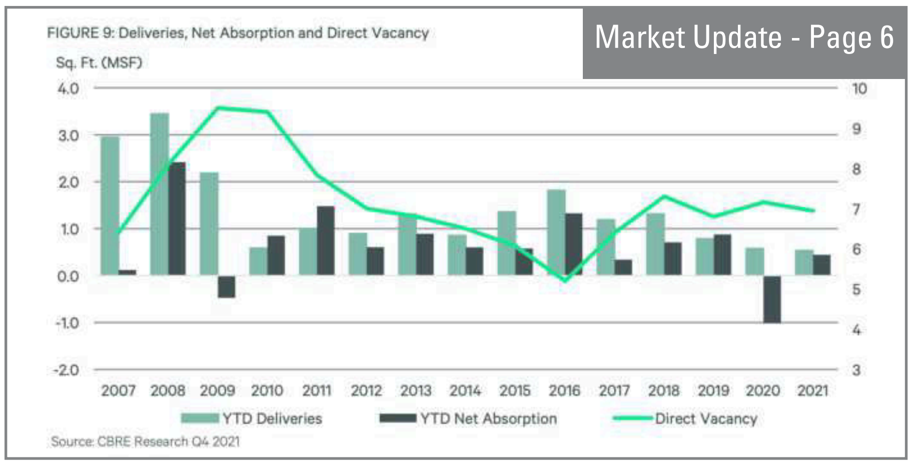

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Letter from the Editor

Returning to 2019 levels

Nationally, retail is on the upswing. Tenant demand returned to pre-pandemic levels in 2021 with net absorption totaling 75.2 million square feet, according to Lee & Associates. Pre-pandemic levels of foot traffic also have returned to many open-air and lifestyle centers, and several major merchants have announced plans for significant expansion this year, according to the report. Openings outpaced closures in 2021 for the first time since 2016, with the number of merchants seeking bankruptcy protection falling to a five-year low.

In Denver, the city ended the year with positive absorption of 1 million sf and a decline in vacancy to 4.6%. Ten of the 11 submarkets tracked by Lee & Associates posted positive absorption. The one that's still in negative territory is the central business district.

It makes sense that the CBD has not bounced back as well as some of the other areas when you consider the sizable amount of foot traffic that is still missing from the area due to delayed or abandoned return-to-office plans. As Jon Hendrickson reminds us on Page 8, foot traffic and discretionary spending fuel retail success.

Enter Popup Denver, a Downtown Denver Partnership and Denver Economic Development & Opportunity initiative to bring new life to the 16th Street Mall. In the pilot phase, five vacant storefronts in Upper Downtown (representing 30% of the available space on the mall) will be paired with entrepreneurs who will receive $20,000 in interior design, setup and merchandising support. The businesses will pay no base rent, only operating expenses, for the tenure of their popup, which will be a minimum of three months.

"Programs like Popup Denver are crucial in the partnership's mission to foster a culture of innovation and entrepreneurship that drives economic opportunity for all," said Kourtny Garrett, president and CEO of the Downtown Denver Partnership. "We're excited to see a diverse base of local businesses get the opportunity to transform 16th Street Mall storefronts and offer unique experiences, flavors, and so much more to downtown visitors and residents. These vendors represent the brand and culture of Denver and continue to create a place where people want to be."

Businesses are invited to team up with a joint application if there's interest in running a shared space, which seems smart as the average-sized retail lease is decreasing, according to the Lee & Associates report.

I know I'll be watching the pilot program closely. If businesses are able to focus their core business – the merchandise and consumers as well as providing healthy wages – will they be able to successfully combat two of 2022's most looming question marks: inflation and labor?

Michelle Z. Askeland
maskeland@crej.com
303-623-1148, Ext. 104

Market Update

Denver's retail sector offers reasons for optimism

After weathering a difficult 2020, metro Denver's retail sector saw significant improvement in 2021.

Over 162,000 square feet of positive net absorption was recorded in the fourth quarter alone, marking the third consecutive quarter of positive net absorption, according to CBRE research. In total, 2021 netted 443,000 sf of positive retail space absorption, making up for almost half of the negative total in 2020.

Leasing activity was particularly strong in suburban markets, including the northwest and northeast, where retail development is following residential rooftop growth. For example, a new 128,000-sf King Soopers center is under construction at Amber Creek (East 136th Avenue and Quebec Street) in Thornton with several retailers under contract. Also, residential growth has continued to occur in Arvada at the Candelas master planned community. Several new retailers joined the project in the past year, including SCL Health and medical offices, Bluegrass Coffee and Bourbon, Mountain Breeze Optometry, Yeti's, West Arvada Dental, Panorama Physical Therapy, Anytime Fitness and Resolute Brewery. Freedom Street Social (a new food hall) also is opening near the new King Soopers at Candelas.

Jon Weisiger
Senior vice president, CBRE

Lease rates, which had risen dramatically in the years immediately preceding the pandemic, remained relatively flat in the fourth quarter as the market continued to absorb some of the lingering vacancy from 2020. Down just 16 cents from the third quarter, lease rates ended the year at $20.14 per sf triple net. Looking ahead, we expect lease rates to rise in 2022 as newer projects are driving lease rates upward.

Perhaps surprising to the public, metro Denver retail vacancy declined in 2021. Total availability fell 46 basis points year over year to 8.1%, while direct vacancy dropped 22 basis points to 6.9%. Driven by new and existing retail concepts expanding their footprints, the market has tightened for high-quality retail and restaurant space. While new projects underway will provide some relief, overall the metro Denver area needs more retail development. Until the construction pipeline strengthens, vacancy will continue to decline.

Jim Lee
First vice president, CBRE

Construction activity did improve over the course of 2021, ending the year with 537,000 sf of retail space delivered. New deliveries included some unique projects, like McGregor Square and Market Station, both located downtown. At the end of the fourth quarter, 757,000 sf of new retail space was underway. Most of the construction activity is in the northwest and northeast submarkets. New projects slated to deliver this year include Amber Creek in Thornton and the Shops at Olde Town in Arvada, which is a Trammell Crow Co. development located at West 56th Avenue and Wadsworth, near the light-rail station. The Shops at Olde Town is already almost entirely preleased with several exciting restaurant concepts committed to the project. While this is encouraging, the rising cost of construction materials is a factor in additional retail development in the coming quarters.

Sales of retail properties in 2021 totaled $1.3 billion, which is nearly double the sales volume of 2020. Several large properties traded hands this year, including Orchard Town Center and the Belmar Shopping Center. This is clear proof investors are feeling more bullish about the health of the retail market.

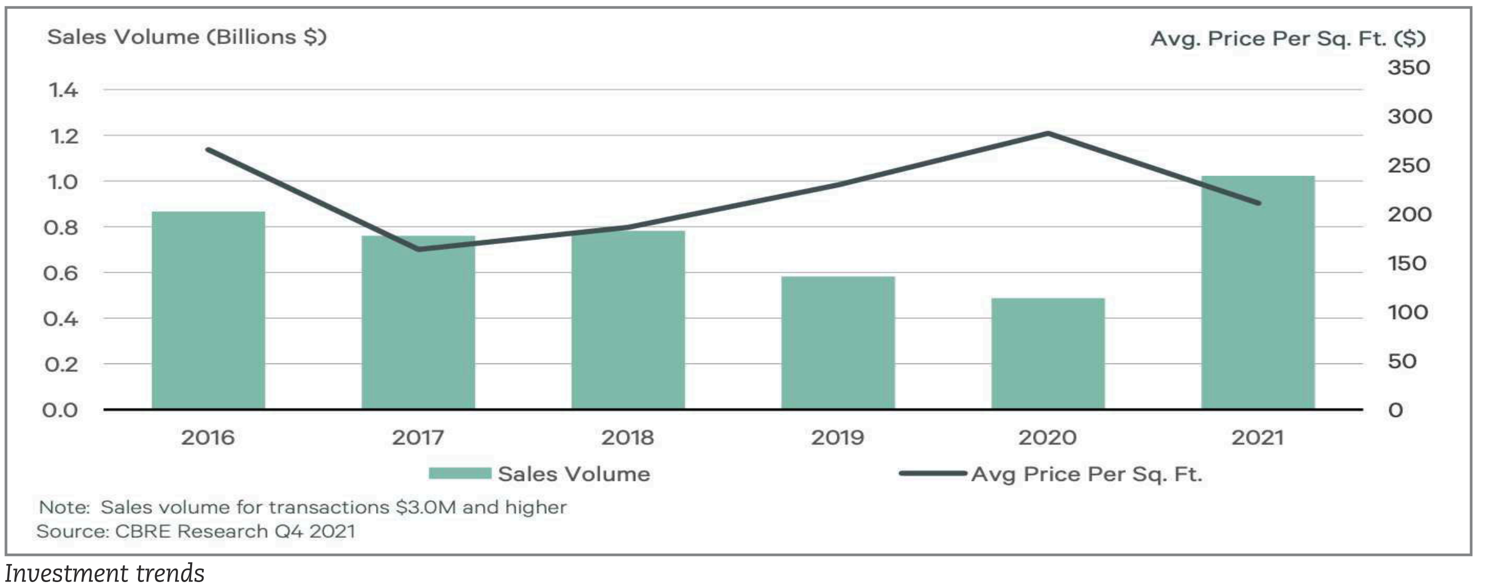
Nationally, consumer sentiment is edging downward amid concerns over rising inflation and the lingering effects of the pandemic. Wage growth remains high, however, as job openings outpace job seekers, creating a competitive environment for employers looking to hire. Wage growth typically leads to more retail spending.

Speaking of spending, the 2021 holiday sales season ended on a strong note. Total retail sales increased by 16.9% year over year. E-commerce sales increased by 10.4% year over year. Food services and drinking places sales increased 36% from the fourth quarter of 2020, fueled by rising vaccination rates and the easing of dine-in restrictions.

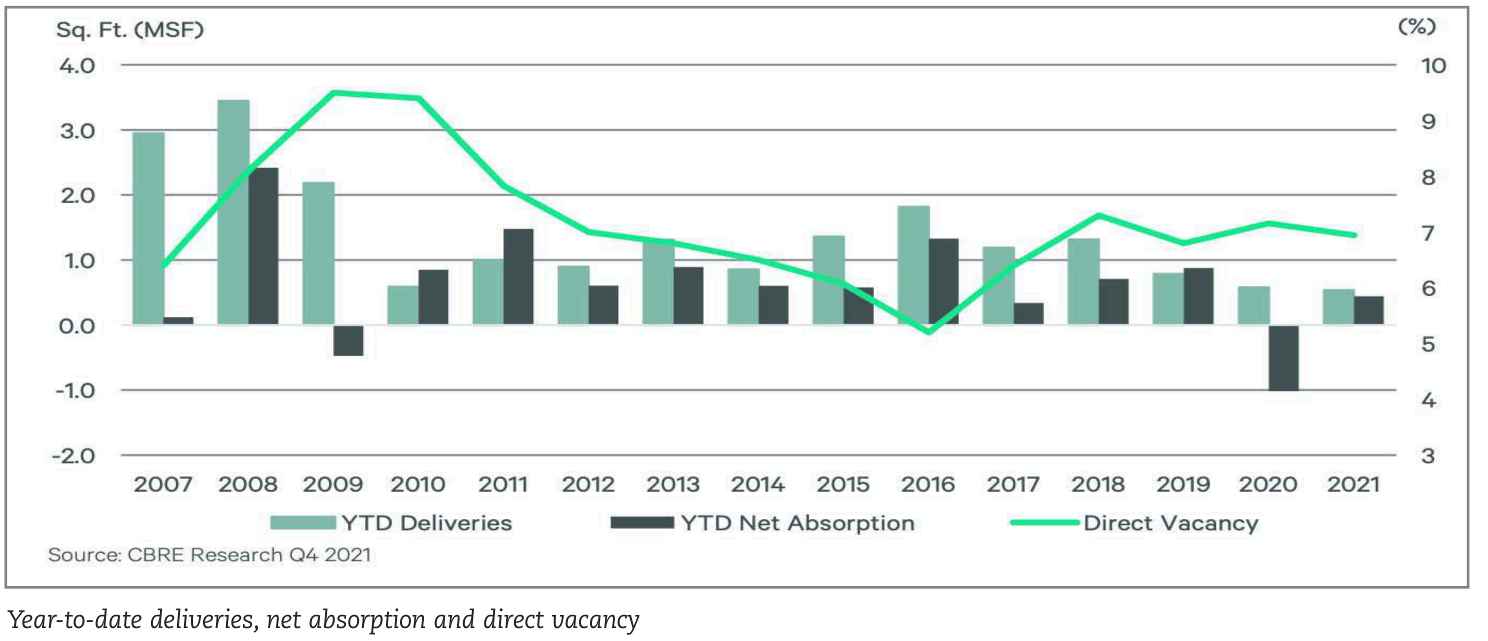
There are many reasons to feel optimistic about the metro Denver area's retail market in the year ahead. Colorado's residential growth will continue to spark interest in new retail and restaurant development. We anticipate seeing signs of retail recovery in downtown Denver by midyear 2022 as workers continue to return in earnest to their downtown offices. We also are seeing renewed interest in experiential concepts that were gaining traction pre-pandemic but stayed fairly stagnant over the past two years. These include theaters, sports and music-themed retail, like the newly opened Dierks Bentley's Whiskey Row in downtown Denver.

As consumers we have all been hungry for the day we can put the pandemic in the rearview mirror and return to a greater sense of normalcy. If Denver's retail market fundamentals are any indication, that day is drawing near. ▲

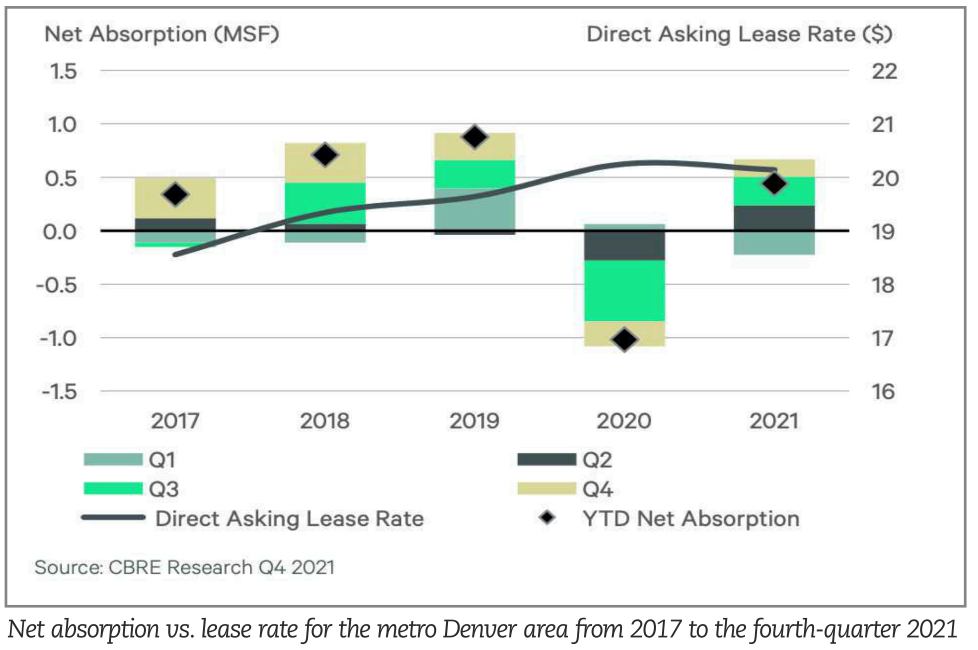
jon.weisiger@cbre.com
jim.lee@cbre.com



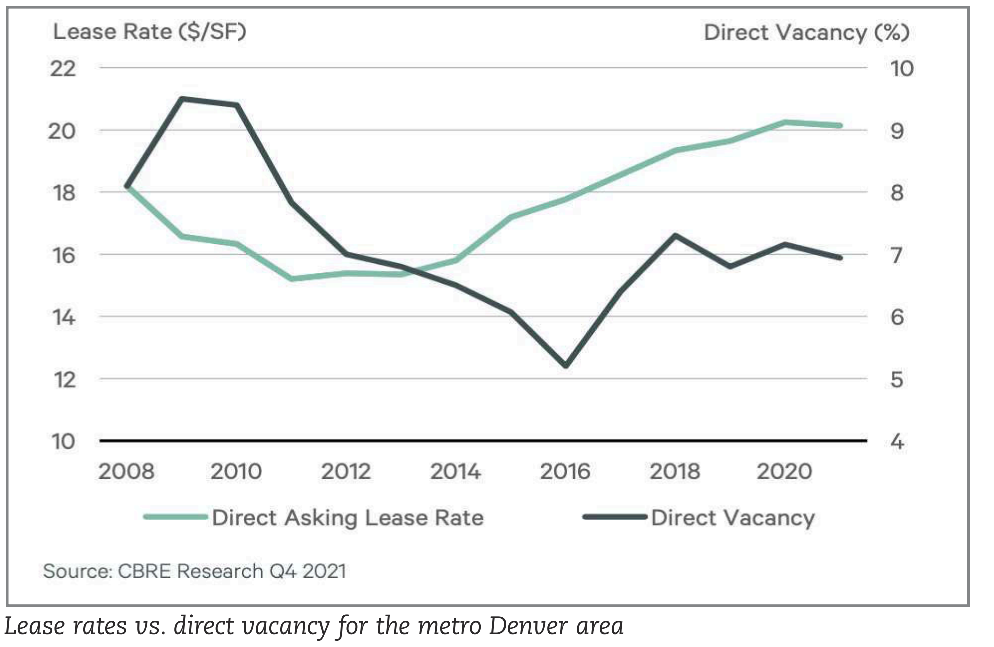
Investment trends



Year-to-date deliveries, net absorption and direct vacancy



Net absorption vs. lease rate for the metro Denver area from 2017 to the fourth-quarter 2021



Lease rates vs. direct vacancy for the metro Denver area

Market Update

Increasing prices mark good sign for the recovery

It's not unusual to hear remarks about how commercial real estate brokers "don't need to be brain surgeons" because it isn't "rocket science" and "it doesn't take a genius" to do our jobs. Admittedly, there are many times that we allow ourselves to overcomplicate the business. In reality, all four major product types correlate to a primary leading indicator:

- Multifamily housing equals population growth;
- Industrial equals consumption and supply chain;
- Office equals job growth and employment rates; and
- Retail equals consumer spending.

Retail is the byproduct of all other commercial real estate product types and their respective leading indicators. Retail requires people who live or work nearby generating discretionary income from the wages and salaries they earn to then spend on goods and services. The last two years have been the ultimate test for the retail product type, and throughout this article we will provide our perspective on the dynamics in play for retail real estate values, while trying to keep it simple.

Denver and population growth have seemed synonymous for many decades. Our market has been a desirable destination for people seeking a balanced lifestyle and Colorado's unmatched amenities. Per the latest census, Denver was one of only 14 cities nationwide to add more than 100,000 new residents between 2010 and 2020, resulting in growth of nearly 20%. The population of metro Denver has grown to over 3.3 million people. The pandemic forced (or allowed)

Jon D. Hendrickson
Managing director, Cushman & Wakefield

people to reevaluate their lives. People of all ages started asking where they want to live and work as well as reexaming the best ways to spend their limited time. Denver was the answer to many of these introspective questions, ranking as the eighth most-moved-to city in the U.S. from April 2020 to October 2020.

While the overall population in the metro Denver area continues to steadily increase, the shake-up for retailers relates to the location of these people, most notably during the day. Retail requires population density, and in the case of certain retail locations, the density fluctuates throughout the day. The return-to-work policies of corporate America continue to leave uncertainty as to the best locations for retail to thrive. The central business district and suburban office campuses have averaged 30% employee occupancy (trending up), altering sales trends surrounding office buildings. However, the other 70% of people are working from home and utilizing the services and restaurants closest to their residence.

Wages and salaries are increasing, and in some cases at a very rapid pace. The circulation of a given dollar leads to inflation, and the cost of goods and services is going up. As retailers increase wages and salaries, these additional costs will be passed

> Each offering that we have introduced to the market in the last year has had substantial buyer demand, no exceptions, and pricing has strengthened since third-quarter 2020.

on to the consumer, which further circulates the dollar. We believe that retail real estate values are poised to increase from the pressures of inflation and the connected nature of rent-to-sales ratios. Long-term fixed interest rates, increasing costs of goods and services, supply constrained product and a growing population base could all lead to the perfect storm for retail landlords.

It's been revealed that after an era of restrictions, the consumer is eager to shop, travel, dine out and return to the experiences of a pre-pandemic world. According to Bloomberg research, Americans have accumulated a total of $2.3 billion in excess savings since February 2020 due to the restrictions. This has led to the demand shock that is discussed as supply chain disruption, when it is actually the demand side that has caused the disruption. In April 2020, when consumers faced restrictions, spending dropped 42%. From March 2021 through December 2021, consumer spending levels were above pre-pandemic levels, reaching a high of 15% above that of March 2020. Retail sales are projected to grow at an average annual rate of 3.7% per year over the next five years.

During 2021, retail investment sales transaction volume was the lowest of the four major product types, totaling $1.3 billion in metro Denver for all transactions over $3 million. However, much of the activity took place in the fourth quarter and is spilling into 2022. Each offering that we have introduced to the market in the last year has had substantial buyer demand, no exceptions, and pricing has strengthened since third-quarter 2020. Larger centers have equated to larger challenges, while the neighborhood goods and services have excelled. The investment demand drivers lead back to the opening concepts that the consumer is strong, retailers are allowed to conduct business, alternative yields are less attractive, and metro Denver is growing. Stabilized cap rates have ranged from 5% to 9%. While interest rates are now moving upward, we continue to believe that the demand for quality cash flowing investments will equate to pricing strength and going-in yield requirements trending down. Retail has persevered and withstood the most unfathomable scenario, and somehow here we are on the other side with prices simply going up. ▲

jon.hendrickson@cushwake.com

Retail 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	170 - 230 bps over the comparable US Treasuries	• Up to 65% LTV • 1.50x Minimum DCR	3-30 Years	20-30 Years	• Grocery-anchored centers (majority of income derived from grocer) • Internet proof infill neighborhood centers • Top tier credit tenants • Major metro areas • Low leverage requests	• Life companies are internally evaluating retail exposures, so appetite varies from lender to lender •Life companies have tightened underwriting parameters to be more conservative. This includes: lower loan to values and higher vacancy factors • Best execution at or below 60% leverage, but many will push to 65% on the right deal. • Strong operating history helps lenders get comfortable at higher leverage points • Full-term I/O available on some grocery-anchored centers up to 55% LTV
CONDUIT (CMBS)	• Sales of mortgage-backed securities through public markets	• Non-Recourse • Longer-term fixed rate loan	180 - 250 bps over the greater of swaps or treasuries	• Up to 70% LTV • 1.40x Minimum DCR on NCF • 8.5% Minimum Debt Yield on NCF	5 & 10 Years	25-30 Years	• Grocery-anchored centers (majority of income derived from grocer) • Internet proof infill neighborhood centers • Top tier credit tenants • Major metro areas	• Have broadened their appetite for well positioned grocery and non-grocery anchored retail centers • Reserves have been removed in most cases • Focused on acquisitions or cash-neutral refinances in the current environment • Full-term I/O available on some properties up to 65% LTV
BANK	• Corporate Debt • Deposits	• Recourse (some non-recourse available) • Shorter-term fixed and floating rate loans	200 - 300 bps over corresponding treasuries L + 300-400 floating (0.50% Libor Floor)	• Up to 65% LTV	5-7 Years Fixed	Interest Only to 25-30 Years	• Grocery-anchored centers (majority of income derived from grocer) • Well located non-anchored retail • Major metro areas or Colorado secondary markets	• Most competitive for Sponsors with established banking relationships and strong borrower history that are willing to accept recourse; standards are tightening for Sponsors with no deposit relationship • Good at understanding local environment and can get comfortable with well-located retail and strong Sponsor • Primarily recourse loans, with non-recourse available to strong Sponsors • More flexible (open) prepayment terms
DEBT FUND / BRIDGE LOAN	• Private Capital • Institutional Capital	• Non-Recourse • Shorter term bridge loans for acquisition and/or repositioning	LIBOR + 350-550 bps (0.50% Libor Floor)	• Up to 75% LTC, more appetite at 65% - 70% LTC • Going-in 1.0x DCR preferred, some bridge lenders will lend on non cash-flowing assets for a pricing premium	1 - 5 (3+1+1)	Interest Only Years 1-3	• Value-Add Transactions or repositions • Properties with heavy near-term rollover • Recapitalizations	• Lenders want a compelling story and logical business plan for retail repositions • Retail repositions with heavy near-term rollover that aren't quite a fit for permanent lenders could be a good fit for light bridge, with pricing on the low end of the range • Pricing depends on leverage level, property quality, and Sponsor strength
MEZZANINE/ PREFERRED EQUITY	• Private Capital • Institutional Capital	• Junior financing secured by a pledge of, or participation in ownership interest	Mezzanine 7%-12%	• Up to 85% LTC • 1.10x DCR	2 - 10	Interest Only (in most cases)	• Neighborhood Centers • Strip Centers • Second tier credit tenants • Secondary/Tertiary Markets	• Preferred equity offers higher funding than mezzanine, but at a higher cost • Minimum investment is typically $5M but can start as low as $1M 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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Credit Union

Arcadia Crossing
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Life Insurance Company

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$6,000,000 Permanent Loan
Life Insurance Company

Jeff Riggs
Founder and Chairman
(303) 843-0440
jriggs@essexfg.com

Cooper Williams
President / Principal
(303) 843-4581
cwilliams@essexfg.com

Peter Keepper
Principal
(303) 843-6002
peterk@essexfg.com

Alex Riggs
Principal
(303) 843-4027
ariggs@essexfg.com

Paul Donahue
Vice President
(303) 843-4021
pdonahue@essexfg.com

Blaire Butler
Vice President
(303) 843-4024
bbutler@essexfg.com

Chris White
Assistant VP
(303) 843-4583
cwhite@essexfg.com

Market Update

In the pandemic aftermath, expect retail growth

The dramatic shift in the retail market continues to play out due to the lingering effects of the COVID-19 pandemic and the subsequent variants that have emerged over the last year. In the past, many larger retailers like Sears, Bed Bath & Beyond and others sought large retail locations to show and hold merchandise, but many of these have now shut their doors forever. At the start of the pandemic, and ever since, the acceleration of online shopping, curbside pickup and delivery ushered in a heightened demand by retailers looking for industrial and flex space to store product for delivery and last-mile destinations. Some also shifted their operations solely online.

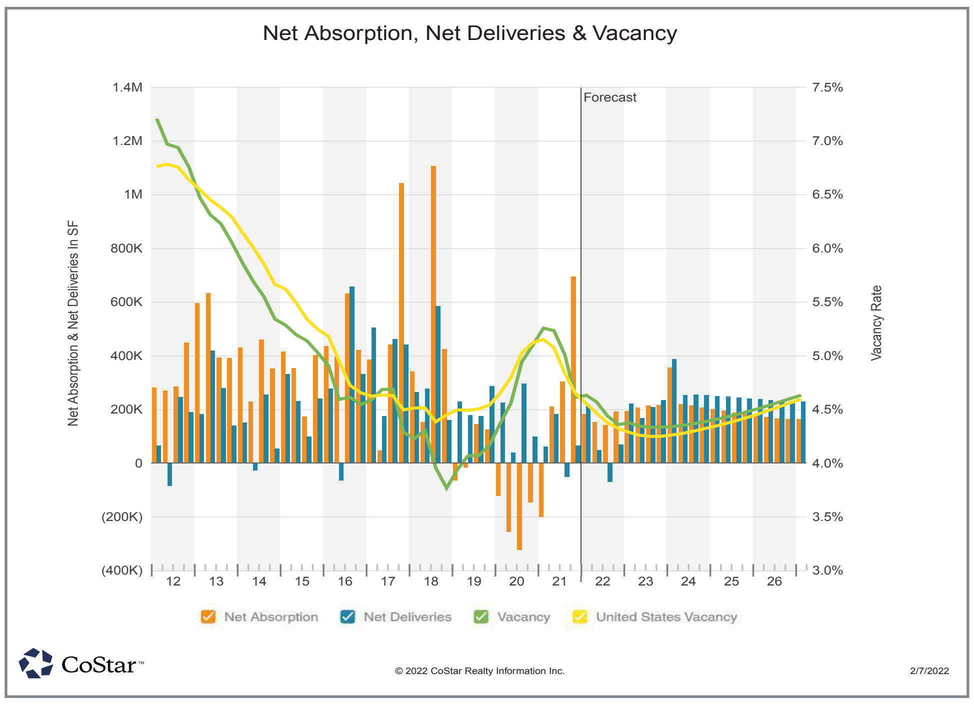
Jessica Brejcha
Broker associate, Impact Commercial Real Estate

With society ready to move past the pandemic, foot traffic is set to increase. The shift to smaller, boutique shops means the need for outdoor space and off-site storage is here to stay. This will allow well-positioned businesses to grow into larger spaces and absorb some of the new product that has been delivered, and existing vacant product can be absorbed by those downsizing or just entering the market. Now that social distancing mandates are expiring, retailers will continue to look to expand and reinvent their operations as leases expire and developers continue to deliver new product to the market. Due to this demand, there was a 2.8% increase in asking rent year over year, according to a February report.

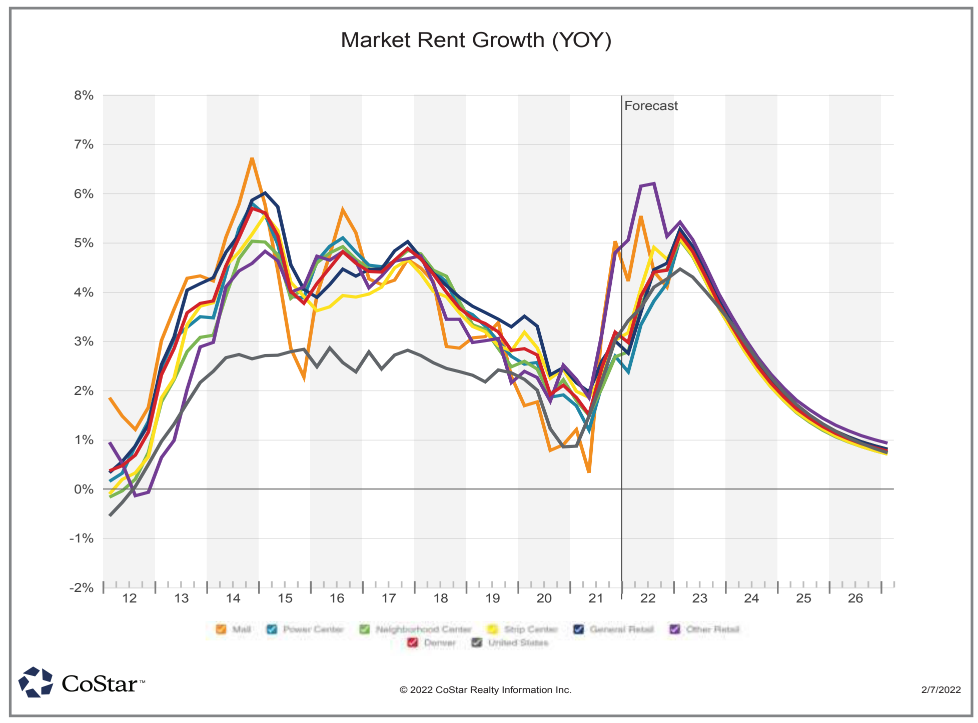
Anthony Palumbo
Vice president, Impact Commercial Real Estate

With the projection of increased foot traffic and less restrictions on retailers, local, regional and national investors and developers are looking to purchase and hedge their investments on a growing and stabilizing retail market. CoStar Group predicts Denver to remain an above-average buying power, based on median household income multiplied by total households. Alongside an average $23.96 per square foot lease rate and the contrasting national leasing trends, both mall rates and general retail rates are up 4.4% and 2.6%, respectively, year over year, according to a first-quarter market

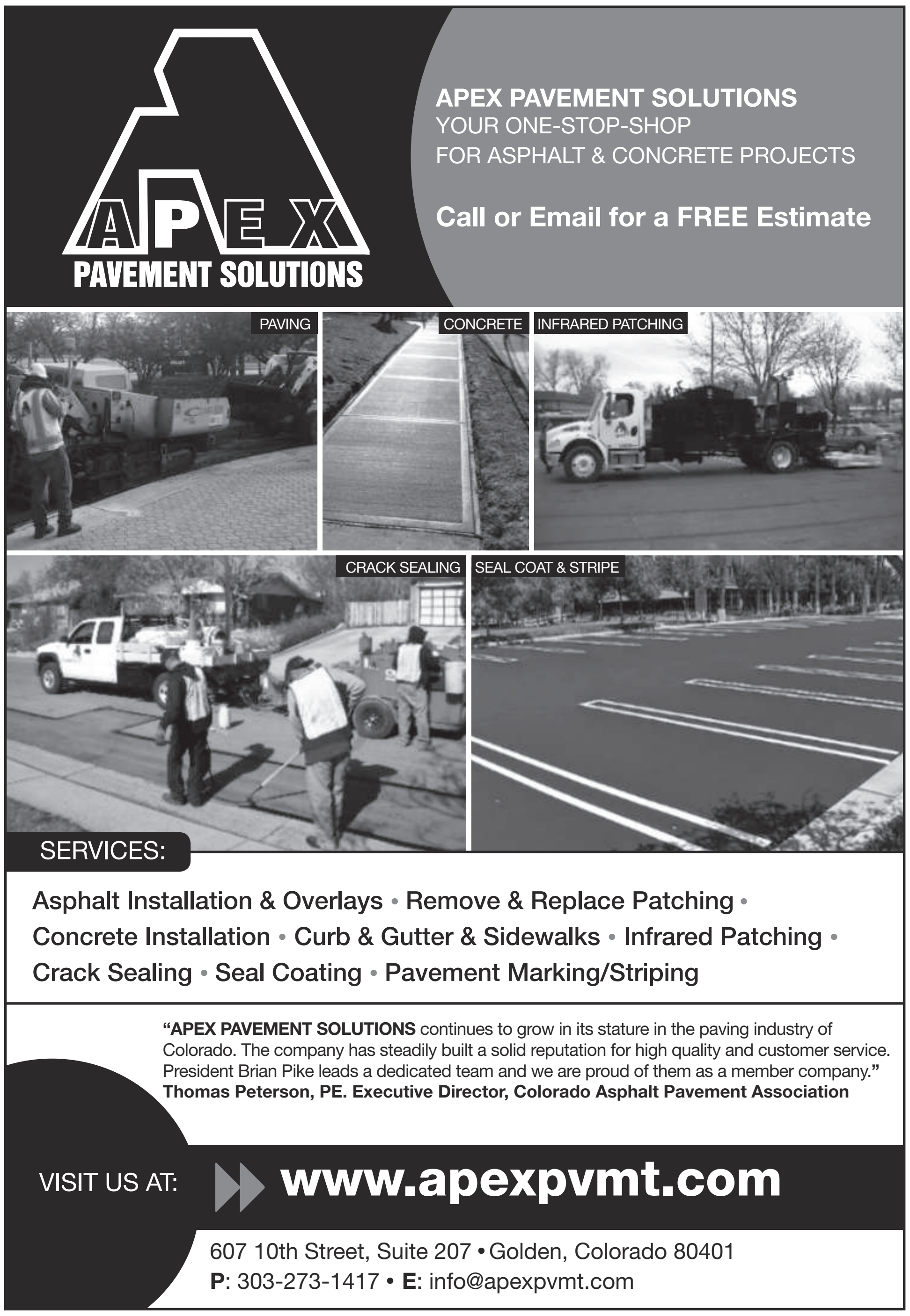
Please see Brejcha, Page 22



Net absorptions, deliveries and vacancies for the Denver metro area as well as the national vacancy level



Market rent growth, year over year, for specific retail sectors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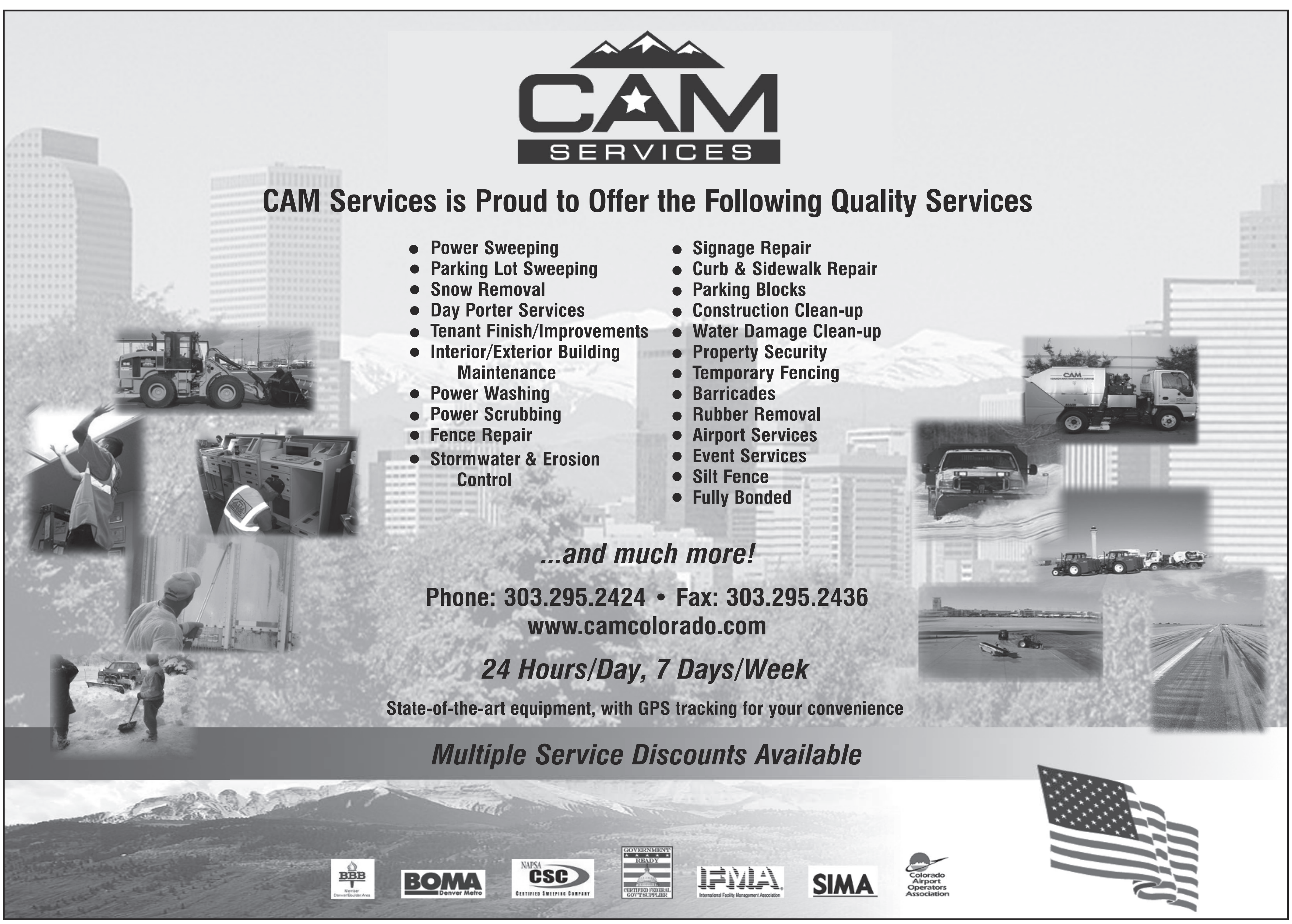
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Leasing

The importance of lease insurance provisions

Commercial lease negotiations may feel, to property owners, like a burdensome hurdle prolonging cash flow or, to business owners, like a roadblock to getting operations up and running. However onerous, the negotiations by property owners and prospective tenants alike should include a firm understanding of the allocation of risks under a lease agreement to ensure a long and prosperous landlord/tenant relationship in spite of any unexpected liabilities and casualties.

Commercial general liability coverage is a standard insurance product offering coverage against liability claims for bodily injury and property damage arising at the premises and from operations therein. All leases should obligate the insuring party to carry a CGL policy on an occurrence basis, as opposed to a CGL policy on a claims basis. The former provides lifetime coverage for claims arising during the term of the policy, while the latter provides coverage only for claims arising and reported during the term of the policy.

Property owners should ensure that a tenant's CGL coverage includes coverage for contractual liability, which covers the tenant's indemnity obligations under the lease. Depending on the nature of a tenant's operations, property owners also may require that a tenant's CGL policy includes coverage for products-completed operations, which insures against injury or damage that happens off of the insured premises but arises from the insured's work or products. Parties also should be aware of the limitations to bodily injury and property damage coverage. A CGL policy does not provide coverage for personal property in the care, custody or control of the insured, and it will not insure against losses resulting from the consequences of the insured's conduct, liquor-related accidents, injuries to employees, auto loss or pollution accidents.

Tal Diamant
Shareholder, Brownstein Hyatt Farber Schreck

The general aggregate limit establishes the maximum an insurer will pay for damages. Typical limits for many retail and office tenants range between $1 million and $5 million, but can go as high as $10 million or $20 million in more complex deals. Excess and umbrella liability coverage generally insure losses beyond the limits of underlying liability insurance policies.

Whenever a tenant is the insuring party under a commercial lease agreement, the property owner should ensure that the lease also requires a tenant to name a landlord as an "additional insured" on each of the tenant's liability policies. As an "additional insured," the property owner reserves a direct right to defense under the applicable policy and may obtain coverage even where a tenant's indemnity obligations are deemed unenforceable.

In addition to CGL coverage, commercial leases should provide for property insurance. Basic form property insurance provides coverage against losses arising from fire, lightning, explosion, smoke, windstorm, hail, riot, civil commotion, aircraft, vehicles, vandalism, sprinkler leakage, sinkhole collapse and volcanic action, while broad form property insurance insures those named perils, and also provides coverage for losses arising from falling objects, weight of snow, ice or sleet, water damage (from leaking appliances) and collapse from named causes. Special form coverage (formerly known as "all risk" coverage) offers expanded coverage whereby the insured must only prove that a loss was not excluded, and not that a specific peril occurred. Special form coverage excludes losses arising from boiler and machinery, earthquakes and flooding.

Miranda Norfleet
Associate, Brownstein Hyatt Farber Schreck

A commercial lease agreement should require such coverage to be carried by the party with responsibility for reconstruction. In a single-tenant building, the tenant typically is responsible for reconstruction and should be obligated to carry such coverage. However, in a multitenant project, the landlord often maintains coverage for casualty damage. Regardless of the insuring party with respect to casualty damage, a commercial lease should require a tenant to carry property insurance coverage for its personal property and improvements.

Most often, property insurance coverage employs the replacement cost valuation method, which insures the cost to repair or replace insured improvements with materials of the same or comparable quality – the calculation does not factor in depreciation, but excludes coverage for the costs of excavation, foundations and footings. Some property insurance utilizes an actual cash value valuation method, which functions in a manner similar to the replacement cost method but deducts depreciation. Functional replacement cost is a valuation method where a functionally equivalent improvement can be built for less than the original insured improvement – and in such event, the coverage may offer the policyholder significant cost savings.

The latest trend in insurance policies is cyber liability coverage, which insures parties against losses incurred when their information technology systems are compromised as a result of third-party malicious activity. Some companies have experienced heavy economic damages when their technology has been hijacked, lost or otherwise disrupted, and significant portions thereof can be recovered through cyber liability insurance, provided the company has implemented certain policies and measures as dictated by the insurance company. Look for these policies to be required by tenants for their businesses and landlords to protect sensitive information. ▲

tdiamant@bhfs.com
mnorfleet@bhfs.com

Leasing

Leasing a full center: Consider buyouts & splits

Savvy owners and property managers of retail centers are normally concerned about maximizing their center's value by raising net operating income and/or lowering the acceptable market capitalization rate (a key measurement of a commercial property's income, value and investment return/risk). While owners of fully leased shopping centers may feel limited in their ability to increase their center's value, even a 100% leased shopping center offers opportunities to do this via the use of lease buyouts and store splits.

Benjamin Yoder
Director of commercial management, Dorman Commercial Real Estate

■ **Lease buyout.** This normally occurs when an owner of a given property pays a tenant of that property to extinguish its existing lease and vacate the premises. In some cases, no payment is necessary. In other cases, payment incentivization is the only means of ousting a tenant midlease term. Other times, tenants buy out of their own lease (it's incredibly rare for tenants to be allowed to dissolve their lease without some form of financial repercussion). A lease buyout typically is done to bring in new tenants that more appropriately match the tenant mix goals of the property, to increase rental income and, in some cases, to more easily rehab the space (in order to command higher rents, attract a given tenant type, etc.).

■ **Store split.** Normally this occurs when an owner offers a tenant the option of decreasing its useable square footage at a higher per-square-foot rate (generally a rate that makes financial sense to the tenant given the new square footage); though, the tenant occasionally will request this of its own volition if the economy surrounding its business is struggling or it's simply repositioning to narrow its focus. In the end, the space that's given up may be rented to another tenant at a higher per-square-foot rate, ultimately increasing the rental income for the property.

Keeping this in mind, struggling tenants and/or those who do not fit the tenant mix of the property are prime candidates for a lease buyout or a store split, and these tenants often are readily willing to consider an offer, assuming they haven't already asked about this. Look for tenants with declining sales or with sales that are below the national average, tenants whose rent is typically not paid on time or with rent that is below market value, tenants that offer/provide obsolete services or products, those with occupancy costs that are too high relative to their sales, or tenants that, at a visual glance, have very little foot traffic into their respective spaces.

> Struggling tenants and/or those who do not fit the tenant mix of the property are prime candidates for a lease buyout or a store split, and these tenants often are readily willing to consider an offer, assuming they haven't already asked about this.

Another scenario often seen on the management side of things is one in which a tenant (or a tenant's clientele) is habitually challenging, unreasonable and/or problematic, but not necessarily in violation of its lease provisions. It's important to note that much of a property manager's job is to act as a buffer between tough tenants and property owners. Good managers should have already fine-tuned their diplomacy skills to handle almost all tough tenant situations, but some tenants ultimately aren't worth the frequency or level of challenge they pose. As you can imagine, this creates a difficult situation and can be a real thorn in the owner's or manager's side. An owner may find this tenant too much to deal with and, because of this, the owner may choose to buy out the tenant's lease so the space can be leased to tenants who cause fewer problems.

Leases can be mutually terminated or bought out by either the landlord or the tenant, with values depending on the negotiating strengths of each side and usually related to the length of the remaining term and options. Tenants that are able to generate the same sales volume in less space are perfect candidates for store splits. Generally, smaller space rents for a higher per-square-foot rate, but the cost of separating out and retrofitting the space must be weighed against the increase in revenue. It's important to note that if utilities in the units are separately metered prior to demising a given unit, demising the space inevitably will cause problems if these electrical, water, sewage and HVAC systems are not properly rerouted. While this isn't a problem with triple-net buildings, this can create challenging billing issues for tenants with modified gross leases in which tenants are paying their own utility bills.

It's also important to remember to look for creative ways to add leasable area for not only existing long-term tenants but also for seasonal tenants like Halloween pumpkin sales operations, Christmas tree dealers or local produce distributors that can operate out of available parking lot space. Sometimes, owners will maximize large exterior lots by adding leasable storage units (like shipping containers) or even fenced-in areas of garden centers. In some cases, depending on zoning limitations and the certificate of occupancy for a property, even rooftop space is converted to dining space for restaurants and bars. Remember that being imaginative in your approach to managing your property is a great way to easily and inexpensively increase your property value.▲

Trends

Top retailer concerns could impact property owners

Danaria Farris McCoy, CRRP
Vice president of operations and marketing, NewMark Merrill Mountain States

As retail net absorption in the U.S. enters its fifth consecutive quarter in positive status, the importance of the physical store to retailers is not waning. It is evident that retailers have not moved any closer to an either/or, zero-sum game analysis of brick-and-mortar vs. online presence. Having attended the National Retail Federation Big Show earlier this month, the topics retailers are focused on provide insight for shopping center owners and property managers into what topics are top of mind for retailers.

1. Supply chain issues. Flexport's Ocean Timeliness Indicator measures the amount of time taken to ship freight from the point the cargo is ready to be picked up at the production facility to when it is offloaded and ready for pickup at its destination port. Historically, this period has been about 30 days. As of Jan. 23, the OTI is at a near record high of 111 days. As retailers factor in such a large lead time, they rely on predicative models to order inventory, which is not in play for many smaller, owner-operated retail operations.

While the Infrastructure Investment and Jobs Act earmarks about $17 billion for port infrastructure upgrades, these improvements likely will not be realized for several years to come. While consumers and retailers may be getting into a rhythm of living with these logistical challenges, two items on the immediate horizon stand to further complicate an already precarious situation: expiration of the West Coast longshoreman labor contract in July and the deadlines for cargo ship greenhouse gas reduction requirements by the International Maritime Organization. Previous labor contract negotiations resulted in significant port delays in 2014 and 2015 and purport to possibly further complicate shipping this year. With regard to the reduction of carbon emissions, many experts believe that to make the majority of cargo ships compliant with GHG reduction requirements in the short term, ships will have to rely on slow steaming, which involves reducing travel speed and carrying less.

2. Inflation. With the all-items inflation rate reaching 7% in January, retailers are hyperfocused on customer confidence and sentiment. Retailers are expecting an upward push in wages and are developing strategies to address inflation. These strategies, of course, include the realities of increasing prices and cutting expenses but also leaning in to white label products that can provide the most value to consumers. During these inflationary periods for which there is historical reference, retailers also are projecting consumers to drive less, eat at home more, consolidate shopping trips and choose generic options over brand favorites.

3. Labor. While Colorado enjoys the fourth-highest labor participation rate in the country, retailers across the U.S. and here in our state are continuing to evolve strategies to attract and retain talent in an environment of shortage. There has been a definitive shift in elevating the employee experience as an essential function of superior customer experience. After listening to hourly employees identify challenges that create barriers to work, select Yum Brands franchisees, for example, have begun a program of prepaid Uber vouchers and day care benefits to attract and retain employees. Removing friction in the application process has led to simplified text-to-apply programs, and same-day pay options are gaining in popularity.

4. The future. Major retailers are acutely focused on developing technology and strategy to serve the customer of the future. While this often brings visions of drones and robots, the CEO of Best Buy, Corie Barry, shared that 40% of the company's online orders are picked up in the store, even when free next-day shipping is offered. While previously future-proofing looked somewhat like the physical store providing all of the experience and online shopping facilitating the point of sale, more and more retailers are looking at creating a seamless and engaging experience across all channels with the brick-and-mortar store having an increased fulfillment center role. A large number of startups have emerged in the Asian market focused on 10-minute deliveries of groceries, and this 10-minute metric is projected to be the norm of the future.

The notion of omnichannel retailing seems outdated as completely new sales channels, like the metaverse, emerge. Large national clothing and accessory brands are designing and selling digital products. Nike recently acquired RTFKT, a company that makes digital sneakers in the metaverse. In 2021, the company sold $3.1 million in digital shoes in 7 minutes. Luxury brands like Ralph Lauren and Gucci are already selling clothes on platforms like Roblox to court Gen Z digital natives.

Shoppable livestreaming also is penetrating the U.S. market, with influencers and brands using platforms like Amazon Live and retailers determining how to integrate livestreaming capabilities into physical stores. Consider Situ Live opened at Westfield London, which is a direct-to-consumer retail experience that allows brands to showcase their products their own way and gives customers the opportunity to experience products in a live retail environment. Store associates are not traditional salespeople, but rather influencers and actors who demonstrate products both in-store and during shoppable livestream events in a storytelling format.

Diversity, inclusion and sustainability also are key topics discussed by retailers at their largest annual gathering. While looking ahead allows merchants and landlords to work together to strategize on the shopping center of the future, understanding the challenges that retailers large and small face today remains key to providing the best environment for success. ▲

dmccoy@nmc-mountainstates.com

Trends

An in-dining revival is coming but challenges remain

Kelly Greene
President, Legend Partners LLP

It sure is a good thing that we're such an adaptable species. When we step back, take a deep breath and consider the myriad cultural and technological changes, as well their magnitude and rapid pace, we should be patting ourselves on the back for even attempting to absorb and process it all. The retail and restaurant industries have been creatively and vigorously adjusting on the fly to the ramifications of COVID-19, supply line interruption, automation, social media, the mega-shift in labor, and the evolving shopping and dining habits of Generation Z, millennials and Generation X. Some of the specific retail trends that are likely to emerge or gain more traction in 2022 are:

- Online shopping is a virtually mandatory component of any retailer's success and survival. Today's shoppers are making 37% of their purchases online, according to Retail Dive.
- Same-day delivery or pickup will continue to be a competitive advantage.
- Social commerce and online media in support of online sales is a significant digital trend in retail.
- 72% of retailers are planning to use, or are already using, automated technology to decrease their team's time on hands-on work, according to Town Square.

And believe it or not, apparel is making a comeback. While 2020 appeared to be the year that finally finished off apparel sales, whose growth had been diminishing for many years, 2021 was the year that indicated new life. In 2020, 1.8 million consumers didn't buy a stitch of clothing, according to research by the NPD Group. In 2021, more than 60% of U.S. consumers said their wardrobes needed to be refreshed. For example, November 2021 sales grew by 47% compared to the same month in 2020. This was still up 29% over the same period in 2019. This year is predicted to experience less apparel sales growth, however.

Despite the challenges besieging the restaurant industry here and around the country, demand for restaurant dining is seeing a revival. The contagious nature of the omicron variant diminished the quantity and reliability of restaurant staffs. Simultaneously, establishments are limiting their seating to comply with mandates around masking, seating proximity and social distancing. While omicron is limiting the volume that restaurants can accommodate, business is bustling in numerous trade areas (Cherry Creek, Denver Tech Center and Castle Rock, for example). Omicron has not fundamentally changed the restaurant industry so much as it has exacerbated existing problems. Prior to the pandemic, many owners complained about the lack of reliable, committed labor. Millennials continue to receive the brunt of criticism for this dynamic – they are seen as unwilling to work for market wages or stay with the same restaurant operator or group for an extended period. Labor shortages and instability lead to fierce competition for both back-of-house staff and servers, which may partially explain the short employment periods of staff who are seeking better pay or working conditions. With omicron, the staffing crisis has accelerated, leading many places to alter their hours or simply close their doors. This phenomenon is not unique to this sector; the "great resignation" has been among the top news stories for the last three quarters. According the Bureau of Labor Statistics as well as the Harvard Business Review, this unprecedented trend saw 4 million people quit their jobs in July, 4 million in August, 4.4 million in September, followed by a modest reduction in October. Through November, an average of 3.9 million workers quit their jobs each month. Interestingly, Gen Z employee resignations (workers aged 20-25) decreased, while millennial employees in the 30-45 age group had the greatest increase (20% over 2020).

The financial impact of labor shortages on restaurants is significant. High staff turnover and staff instability lead to greater expenses through head hunting and staff training. Recent minimum wage increases have contributed to higher labor costs. What's more, property taxes have increased. Since those are a direct pass-through to the tenant, occupancy cost has proportionately (and in many cases disproportionately) increased. The Paycheck Protection Program has expired, removing an essential safety net to help restaurants balance these growing challenges. And while some restaurants watch their profit margins dwindle behind the scenes, all of Denver will be hunting for reservations to eat at Culinary DropOut, Blanco, La Loma Water Grill, Apple Blossom, 801 Fish, Water Grill, Modis and Lucina, among many other new destinations.

Among the restaurant real estate trends, small neighborhood restaurants continue to be popular. They're easier to finance, build, manage, staff and fill, and the overhead is less daunting. Local establishments reduce transportation time, meaning they aren't impacted by prime-time traffic congestion and DUI enforcement. The Denver consumer appears to favor local, independently owned establishments with a more intimate setting. There also is a continuing supply of restaurant opportunities on the first floor of new apartment and office projects that have been specifically designed to accommodate this category of first-floor amenity. These developers often offer the most advantageous terms for restaurant entrepreneurs in terms of substantial ($100 to $150 per square foot) build-out allowance plus free

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Trends

For retail and restaurants, being average is over

John Ward
Managing partner, 505Design

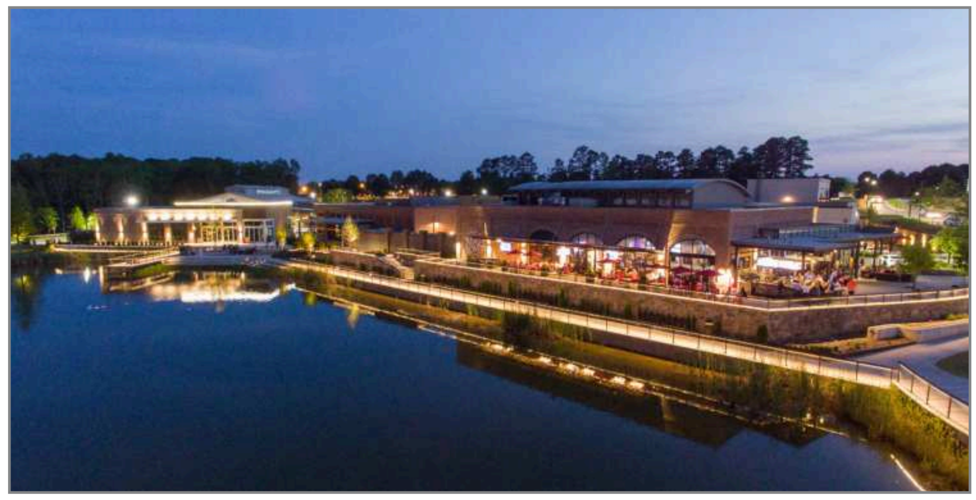
In today's world, being average no longer cuts it. It is happening everywhere, in the workplace, where you live, even with the automobiles you drive. If you are average, it is over. Differentiation is critical, and aligning with where the culture is evolving is imperative to survival in today's world.

For example, the retail/restaurant world is changing. Ten years ago, you could go to any restaurant you wanted to and get in. Today you can't get into one of the top 10 restaurants in any city unless you make a reservation a month out or know someone. Why is that? Social media: Instagram, Facebook, Tik Tok, etc. People do not go to places that are a reflection of who they are; they go to places that are a reflection of how they imagine themselves.

The retail/restaurant world is all about creating alignment with the consumers' aspirations. The access and amount of information available to the consumer has never been more prevalent. People look at media highlighting restaurants or stores and they subconsciously think, "That's me, that is who I am, that's where I should be." Social media has significantly shifted the food and beverage segment.

The same phenomenon is occurring in the retail world. People are looking for ways to differentiate themselves, express their individuality and uniqueness. They are shopping for that special article of clothing, that unique jacket, that cool pair of shoes. People say that Amazon is killing retail. I don't think people shop on Amazon; I think people buy on Amazon, meaning they have a good idea what they are looking for and are seeking out the best price. Looking for a unique or special item on Amazon is difficult. Today's consumers don't want what can be found everywhere; they want to differentiate themselves. That desire is driving a plethora of small entrepreneurs producing and selling highly specialized and unique products, many of which are primarily digitally native brands (only available on the web).

This proposes a new challenge for the digitally native brands – getting access to new customers. It can be hard for consumers to find them on the web, and it is actually more expensive to find customers on a per customer basis on the web than it is in a brick-and-mortar store. There will continue to be a significant move by companies to open brick-and-mortar stores. The huge thrust by the market for the unique items is driving a shift in the retail world. Today we have 20 companies doing 2,000 to 5,000 stores. Tomorrow, I think we will see 10,000 companies doing one to 10 stores. Those stores will be located in markets where the demand for above-average is prevalent and, more importantly, in places that align with how those consumers imagine themselves. For example, in the restaurant world, in a chef-driven restaurant, it is very important that the chef envisions being in a place that aligns with how he sees himself.



Retail owners and developers need to understand where their customers want to spend their elective time, what other places compete for their attention and what will elicit the comment, "This place feels like me." Pictured above is Kingsley Town Center, which was designed to give a nod to the area's rich history in a fresh foward manner.

So what does it mean to the retail property owners and developers? Average is over. That means we have a lot of real estate that is not aligned with the aspirations of the evolving market and the consumer. It has been said we are over-retailed. A more accurate statement would be we are under-demolished.

There will be a significant repositioning of retail from the large regional malls to neighborhood centers. B and C class centers will see a reduction of the amount of retail and an increase in residential, hospitality, office, medical, food and beverage, and entertainment uses. The integration of these uses will create an energy and liveliness as the result of bringing disparate groups of people together. Humans are social by nature and ultimately are attracted to places that offer a variety of spaces for people to gather.

As to neighborhoods and neighborhood centers, the retail strategy has never been more important. You need to be clear about the attitude your center needs to have, create an environment that aligns with that attitude of the future con-

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Design

Restaurants move forward with innovative designs

Few other industries have had to deal with as much change and as many challenges during the past two-plus years as the restaurant industry. And the fact that so many restaurant owners and operators were able to steer through the storms they confronted makes their navigation into the future all the more fulfilling and exciting.

Georgia Brown
Associate, Semple Brown Design

Among the more pleasing aspects of their work, beyond making incredible meals and creating exquisite culinary concoctions, is envisioning and designing restaurants and lounges that express and magnify the overall flavor and ambiance of their patrons' overall dining experience.

There are many inspiring and invigorating design trends that already are taking place, and many more that will continue to enhance and to heal the restaurant industry, helping it to flourish in the months ahead.

■ **Architectural enhancements.** Restaurants are ready to return to the pre-pandemic model of dining out while applying many of the lessons that they had learned. Knowing that it will be difficult if not impossible to sustain a restaurant business financially with the social distancing requirements that we experienced during the pandemic, restaurants will need to find effective ways to return to the pre-pandemic layout of their space. Creating a perceived sense of privacy through architecture will be one way for restaurants to achieve this goal. Either by higher booth backs or other architectural separation from table to table, there are design options that will help patrons feel comfortable while still providing the unique experience of being in the restaurant environment.

■ **Giving people what they want.** Tighter seating, lively spaces and open kitchens are all something people in the restaurant industry want to return to. Addressing this request can come via changes to the design so that the experience can be made significantly different or special – something that a person cannot have at home and something that will be entertaining and memorable. That is why many restaurants are pursuing design elements like adding space for games, great music and a more open kitchen concept to showcase the entertainment of cooking.

■ **Restaurants in repurposed buildings.** Another way to enhance the dining experience – and the potential for profitability – is by repurposing existing buildings and turning them into restaurant space. One of the Mayor's Awards for Design winners, the Benzina restaurant on East Colfax, is a perfect example of this approach. Recently highlighted in Architectural Digest, the wildly popular neighborhood restaurant was once a 1950s Phillips 66 gas station. The angular, midcentury structure, with its sharp roof piercing the Colorado sky, is providing people with a piece of visual architectural eye candy while they enjoy wood-fired Neapolitan pizzas.

David Lauer Photography
The Benzina restaurant was once a 1950s Phillips 66 gas station. The angular, midcentury structure, with its sharp roof piercing the Colorado sky, is providing people with a piece of visual architectural eye candy while they enjoy wood-fired Neapolitan pizzas.

■ **Look and feel.** Giving a restaurant space a residential look and appeal is another way to give people a chance to return to the enjoyment of dining out. Neutrals, warm tones, lighter oak woods; less wall-washed lights and more focused lighting; decorative lighting and furniture lighting such as table and floor lamps are all elements of a cozy residential feel. These are the kinds of design ideas and elements that make going out feel easy and inviting again. Terrazzo is also back and very popular, and there will be a continuing resurgence of colors.

■ **High-end dining is back.** High-end dining is a step in the opposite direction of the trend of the fast-casual dining concept and is providing people who are looking to return to a finer dining experience with a place where they'll be taken care of. Restaurateurs are looking to capitalize on this need for something better and different, and designers are filling this need by creating formal sit-down environments that give room to upscale design and making a space that is inviting and in which people want to stay. High-end dining isn't

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COMMUNITIES OPEN FOR BUSINESS

EDC DIRECTORY

ADAMS COUNTY REGIONAL ECONOMIC PARTNERSHIP

Lisa Hough
President/CEO
303-902-6920
lisa.hough@adamscountyrep.com
www.adamscountyrep.com
Targeted Industries: Aerospace; Aviation; Bio/Life Science; Energy; Food, Agribusiness & Beverage; Manufacturing

BERTHOUD, TOWN OF

Walter J. Elish
Business Development Manager
970-344-5806
welish@berthoud.org
Targeted Industries: Aerospace, IT Software, Fabrication and Production Technology Manufacturing, Distribution and Electronic Commerce, Plastics, Food Processing and Manufacturing

BOULDER ECONOMIC COUNCIL

Scott Sternberg
Executive Director
303-442-1044
scott.sternberg@boulderchamber.com
www.bouldereconomiccouncil.org
Targeted Industries: Aerospace, Bioscience, Cleantech, IT/Software, Natural Products, Outdoor Recreation

BROOMFIELD, CITY & COUNTY OF

Jeff Romine
Economic Vitality Director & Economist
303-464-5579
jromine@broomfield.org
www.investbroomfield.com
Targeted Industries: InfoTech, Finance/Asset Management, Global, Aerospace, Healthy Living/Foods and HealthTech. Community-focused targets include experience retailers and creative restaurants.

CHERRY CREEK NORTH BID

Nick LeMasters
President & CEO
303-394-2904
nick@cherrycreeknorth.com
www.cherrycreeknorth.com
Targeted Industries: Retail, restaurants, hotels, boutique office including legal, accounting, wealth management and residential uses.

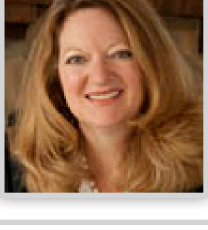
COLORADO SPRINGS CHAMBER AND EDC

Cecilia Harry, CEcD
Chief Economic Development Officer
719-575-4310
charry@cscedc.com
www.cscedc.com
Targeted Industries: Aerospace & Defense, Aviation Related & Specialty Manufacturing, Cybersecurity, Information Technology, Healthcare & Medical Technologies, Sports & Outdoor Recreation

COLORADO SPRINGS, DOWNTOWN PARTNERSHIP OF

Susan Edmondson
President & CEO
719-886-0088
susan@downtowncs.com
www.DowntownCS.com
Targeted Industries: Retail, food-and-beverage, creative industries, tech/software, aerospace, cybersecurity, health and wellness, multifamily

COMMERCE CITY ECONOMIC DEVELOPMENT



Michelle Claymore
Economic Development Director
303-289-3747
mclaymore@c3gov.com
www.c3gov.com
Targeted Industries: DIA Technology, Advanced Manufacturing, Logistics and Distribution, Business and Professional Services, Retail/Hospitality/Leisure

DENVER SOUTH

Thomas Brook
President/CEO
303-531-8379
Tom@Denver-South.com
www.denver-south.com
Targeted Industries: Aerospace/Aviation, Software and Electronics/IT, Health Sciences, Broadband and Internet, Engineering Services, Financial Services.

DOWNTOWN DENVER PARTNERSHIP

Kourtny Garrett
President & CEO
303-534-6161
kgarrett@downtowndenver.com
www.downtowndenver.com
Targeted Industries: Downtown has a strong and diverse concentration of industries, including: legal services, accounting, energy/natural resources, finance/insurance, engineering/architecture and broadcasting/telecommunications

FIRESTONE, CITY OF

Paula Mehle, AICP
Director of Economic Development and FURA
303-531-6265
pmehle@firestoneco.gov
https://www.firestoneco.gov/
Targeted Industries: Retail Trade, Accommodation and Food Services, Residential, Business & Professional Services, Sports & Outdoor Recreation, Health & Wellness, Technology

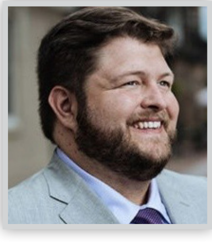
FOUNTAIN, CITY OF

Kimberly Bailey
Economic Development / Urban Renewal Director
719-322-2056
kbailey@fountaincolorado.org
www.fountaincolorado.org
www.furaco.org
Targeted Industries: Manufacturing (*specialized "niche" advanced, food/AG*) - Transportation & Logistics - Homeland Security (*military, law enforcement*) - Entrepreneurialism - Renewable Energy - Motorsports Economy (*tourism & entertainment*)

GRAND JUNCTION ECONOMIC PARTNERSHIP

Steve Jozefczyk
Interim Director
970-245-4332
steve@gjep.org
www.gjep.org
Targeted Industries: Aerospace and Advanced Manufacturing; Agriculture; Energy and Renewables; Health and Medical Care; Outdoor Recreation; Technology and Entrepreneurship; Opportunity Zone projects.

JEFFERSON COUNTY ECONOMIC DEVELOPMENT CORP.



Jansen Tidmore
President & CEO
303-202-2965
jtidmore@jeffcoedc.org
www.jeffcoedc.org
Targeted Industries: Aerospace, Aviation, Adv Manu, Beverage Prod., Bioscience, Energy, Engineering, IT/Telecom

LAKEWOOD, CITY OF

Robert Smith
Economic Development Director
303-987-7732
rsmith@lakewood.org
www.lakewood.org
Targeted Industries: Healthcare/Bioscience, Professional, Scientific & Technical Services, Arts, Entertainment & Recreation, Transit-Mixed Use Development (TMU), Retail Trade, Federal/State Government and Public Administration

LONGMONT EDP

Jessica Erickson
President/CEO (we have photo)
303-651-0128
jessica@longmont.org
www.longmont.org
Targeted Industries: Smart Manufacturing, Food & Beverage, Business Catalysts, Knowledge Creation & Deployment

COMMUNITIES OPEN FOR BUSINESS

EDC DIRECTORY

LONE TREE, CITY OF

Jeff Holwell
Director of Economic Development and Public Affairs
303-708-1818
jeff.holwell@cityoflonetree.com
http://www.cityoflonetree.com
Targeted Industries: Aerospace, Financial Services, Health Care, Professional Services, Retail, and Technology

METRO DENVER ECONOMIC DEVELOPMENT CORP.

Raymond Gonzales
CEO
303-620-8092
raymond.gonzales@metrodenver.org
www.metrodenveredc.org
Targeted Industries: Aerospace, aviation, bioscience, broadcasting/telecommunications, energy, financial services and information technology/software, health and wellness, food and beverage production.

NORTHWEST DOUGLAS COUNTY EDC

Amy Sherman
President
303-791-3500 ext. 5
asherman@nwdouglascounty.org
www.nwdouglascounty.org
Targeted Industries: Aerospace, Health Care, Outdoor Recreation, Professional Services, Technology

SUPERIOR, TOWN OF

Jill Mendoza, CEcD
Economic Development Manager
303-499-3675 ext. 141
jillm@superiorcolorado.gov
https://www.superiorcolorado.gov/
Targeted Industries: Entertainment, Hotel, Life sciences, Outdoor industry, Recreation, Retail, Restaurant, Taproom/tasting room, Technology

THORNTON, CITY OF

John Cody
Economic Development Director
303-538-7448
john.cody@thorntonco.gov
www.businessinthornton.com
Targeted Industries:

WESTMINSTER ECONOMIC DEVELOPMENT

Stephanie Troller
Business Development Manager
303-658-2318
stroller@cityofwestminster.us
www.westminstereconomicdevelopment.us
Targeted Industries: Aerospace, Information & Technology, Life Sciences & Healthcare, Professional & Technical Services, Experiential Retail & Entertainment, Unique Dining

WINDSOR, TOWN OF

Stacy Miller
Economic Development Director
970-674-2414
smiller@windsorgov.com
www.windsorgov.com
Targeted Industries: Manufacturing; Retail Trade; Professional, Scientific and Technical Services; Accommodation and Food Services

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STNL Update

Continued from Page 1

to Creditntell's 2022 retail outlook, "Grocery has been one of the most consistent beneficiaries of the pandemic and sales are expected to remain elevated in 2022, as inflation and eat-at-home trends continue to provide top-line tailwinds."

Grocery's strong performance translates into ample demand for STNL grocery deals, which trade at a premium. It also has driven investors to favor grocery-anchored retail centers over other types of multitenant retail.

Quick-service restaurant listings have yielded the lowest cap rates, on average, of any sub-asset in the net lease market. This clear sign of strong investor demand should come as no surprise, given that visits to fast-food locations increased last year, with McDonald's and Chick-fil-A dominating the space. Sonic, Whataburger, Shake Shack, White Castle and In-N-Out Burger increased their visits by 33.8%, 17%, 15.1%, 10% and 20.7%, respectively, according to Placer.ai's Shira Petrack.

"While legacy chains are focusing on holding on to what they have, certain QSR rising stars are forging ahead," Petrack said. Shake Shack, which in the past primarily focused on urban retail and dine-in formats, is changing its approach to keep up with its fast-food rivals. The retailer is now targeting suburban locations and double drive-thru QSR building formats.

Investors are bullish enough on the new approach that Shake Shack properties are garnering significant interest at sub-4% cap rates.

Last year showed the resiliency of many net lease tenants and paved the way for new ones like Shake Shack to gain ground. Even Amazon is now building small-format convenience stores in major markets. Some tenants opted to rethink their space, like Walgreens, which is looking to open at least 600 primary care practices by 2025, according to an article by Lynn Pollack on GlobeSt.com. Regardless of what STNL retailers are doing to get ahead, investor demand for them remains at an all-time high because of their performance and passive nature that comes with owning them.

■ **Challenges ahead.** Despite the record year for net lease investment and the improved performance of retail in 2021, this year presents new challenges that investors will closely monitor. A report from Marcus & Millichap cites inflation, currently near a 40-year high, will be the largest threat to retail sales. "The pressure on the Fed to draw down quantitative easing and begin raising interest rates has risen significantly in the past few months, and at least two increases are likely," the authors predict.

Shake Shack, which in the past primarily focused on urban retail and dine-in formats, is changing its approach to keep up with its fast-food rivals. The retailer is now targeting suburban locations and double drive-thru quick-serve building formats, like the one planned for its Castle Rock location.

The supply chain also is proving to be tricky for retailers. John Chang with Marcus & Millichap points out that although retail sales are up 16% over 2019 numbers, the amount of product moved by trucks in the United States is down 5.1% over the same period. These issues could affect pricing of the assets and disrupt the market if interest rates were to spike and the cost of goods were to continue this rise.

■ **2022 outlook.** Despite the obstacles that retailers are facing, we expect the net leased real estate market to be just as active, if not more active, than in 2021. Development pipelines are full, which will provide new inventory to a market where demand is still at an all-time high. In addition, we are anticipating a large volume of 1031 exchange transactions will provide sustained demand throughout the year. ▲

james.rassenfoss@marcusmillichap.com

Greene

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and reduced rent to land the kind of difference-makers that separate one project from its direct competition.

In order to adapt to the myriad cost issues, supply line delays and availability, restaurants will be:

- Shortening their menus to save on labor and cut down on waste;
- Opening smaller units;
- Opening fewer days per week;
- Raising prices;
- Enforcing cancellation policies; and
- Serving more comfort food (thank goodness!).

And we'll keep enjoying. ▲

kgreene@legendllp.com

Brejcha

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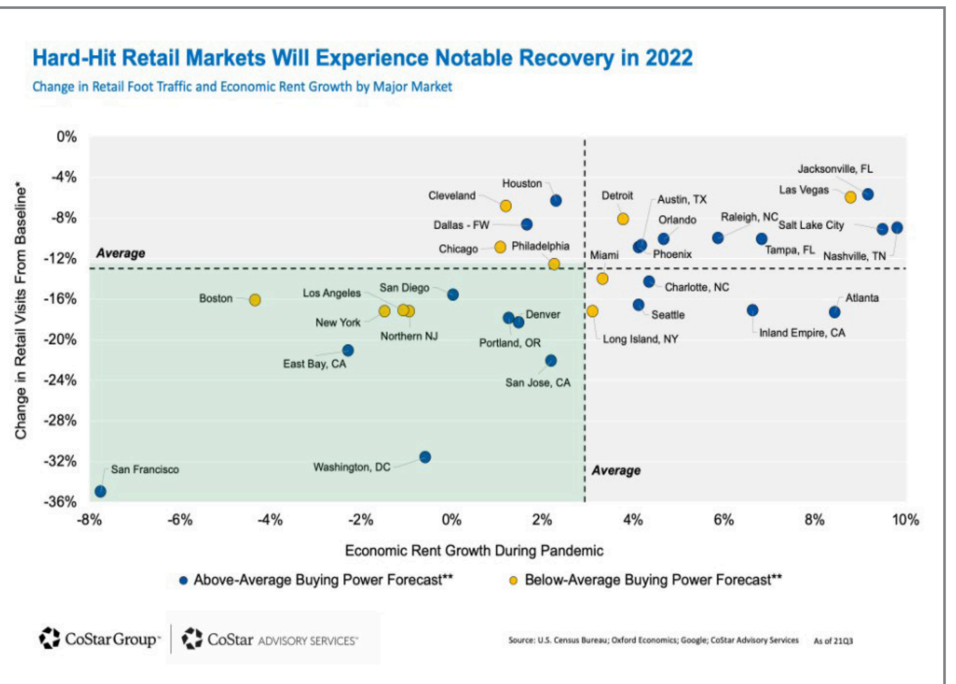
report. This further shows that Denver's retail real estate is strong and a great investment.

Economic growth and the likelihood that such growth will increase inflation are two of the biggest factors impacting the long-term interest rate outlook, according to a Forbes article by Calvin Schnure published April 29, 2021. "To the extent that faster growth generates higher inflation, it also generates higher business activity and demand for commercial space, higher occupancy rates, higher earnings for commercial real estate, and higher property valuations," Schnure writes. "These higher earnings generally offset any drag from rising interest rates during periods when growth accelerates."

Furthermore, the global investment firm Carlyle acquired iStar's net leases to help it expand into the retail market. Mark Jenkins, head of global credit at Carlyle, said he believes ground leases will become the "next evolutionary wave in commercial real estate."

Restaurants also are seeing a shift with the increasing demand for online ordering. The introduction of delivery services is a blessing and a curse to the restaurant industry. It is a blessing because it allows smaller restaurants the ability to add another revenue stream. However, it's a curse because it keeps people out of the rented restaurant space. Based on pure speculation, the next evolutionary wave for restaurants will be ghost kitchens; thus, eliminating the need for traditional retail space and instead driving demand for more flex industrial spaces. With Denver's industrial market growth rate at 5.6% and the vacancy rate at 5.7%, industrial space is the most resilient asset and one for which most investors are willing to pay top dollar. ▲

jessica@impactcommercial.co
anthony@impactcommercial.co



*Since the baseline: Jan. 3 - Feb. 6. Some markets are estimated based on nearby market data.
**Median household income multiplied by total households.

Ward

Continued from Page 16

sumer and be extremely focused on leasing to that strategy. Be mindful of who the tenants are that you are trying to attract, and make sure your real estate looks and feels appropriate to that market. How can you be differentiated from the competition? Consider how to make your property appeal to the tenants, so that when they arrive at your property, they immediately identify that the center is the place they want to come to every day and reflects their customers' aspirations.

You need to understand where your customers spend their elective time, what other places compete for their attention and what will elicit the comment, "This place feels like me."

In the end the keys words to pay attention to are differentiation, attitude and alignment. Creating a simple, singular narrative on where you are and how you are positioning your project in the market will help achieve that coveted destination. In your market you do not want to check the box – you want to define the box. Think of 20 special moves you can make that will connect your customer to your location. It is not about architecture; it is about attitude. ▲

jward@505design.com

Brown

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focused on quick turns of tables but instead provides the diner with a more refined ambiance and reason to dine out.

■ **Open concept kitchens.** Open concept kitchens bring the "cook line" out where the diners can see it and add to the joy of dining out. Restaurateurs are very interested in bringing a part of the kitchen out where diners and chefs can interact. This design element can mean anything to a visual presentation of the full cook line or bringing something like a rotisserie into the dining space. The pandemic put these design elements to the test, but they are moving forward and look like they're here to stay. Guests like to see where their food is coming from and to see a nice clean kitchen in action, similar to watching a performance where diners are being entertained. ▲

gbrown@semplebrown.com

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Dunton Commercial www.dunton-commercial.com	●	●	●	●	●	●		●	●		●		**Nate Melchior** nmelchior@dunton-commercial.com
Elevate Real Estate Services www.elevateres.com		●	●	●	●	●		●		●	●		**Dan Meitus** dmeitus@elevateres.com
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Hospitality at Work www.hospitality-work.com	●	●	●	●	●	●		●	●	●	●	Association Mgmt.	**T.J. Tarbell** ttarbell@hospitality-work.com
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MDC Realty Advisors https://mdcra.com/	●	●	●	●	●	●		●	●	●	●		**Bruce Backstrom** bbackstrom@mdcra.com
Newmark wwwnmrk.com	●	●	●	●	●	●		●	●	●	●	Land, Association Mgmt.	**Jennifer Heede** Jennifer.Heede@nmrk.com
NewMark Merrill Mountain States https://www.newmarkmerrill.com/						●		●	●	●	●	Retail / Community Engagement	**Danaria McCoy** dmccoy@nmc-mountainstates.com
Olive Real Estate Management Services www.olivereg.com	●	●	●	●	●	●			●			Association Mgmt.	**David Hewett** dhewett@Olivereg.com
Panorama Commercial Group www.panoramacommercialgroup.com	●	●	●	●	●	●		●	●	●	●		**Rich Wilcox** Rich@panoramacommercialgroup.com
Prime West Real Estate Services, LLC www.primew.com	●	●	●	●	●	●		●	●	●		Associations	**Brie Martin** brie.martin@primew.com
Revesco Property Services, LLC www.revescoproperties.com				●	●	●		●	●	●	●		**Brian Fishman** bfishman@revescoproperties.com
Sessions Group LLC www.sessionsllc.com	●	●		●		●		●		●	●	Association Mgmt.	**Kade Sessions** kade@sessionsllc.com
Stream www.streamrealty.com		●	●		●	●			●				**Tom Bahn, CPM** tom.bahn@streamrealty.com
Transwestern www.transwestern.com		●		●	●	●		●	●				**Rene Wineland** rene.wineland@transwestern.com
Western Asset Services www.westernassetservices.com	●	●	●	●	●	●		●				Mixed-Use: Office/Retail	**Lisa A. McInroy** lmcinroy@westdevgrp.com
Wheelhouse Commercial www.wheelhousecommercial.com	●	●	●	●	●	●		●	●		●	Mixed-Use: MF/Retail	**Mark Kennedy** mkennedy@wheelhousecommercial.com
Vector Property Services, LLC www.vectorproperty.com		●		●	●			●					**Linda Mott** linda.mott@vectorproperty.com

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

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BUILDING OPERATING SERVICES & SUPPLIERS

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Advantage Security, Inc.
Manny Arias
marias@advantagesecurityinc.com
303-755-4407
www.advantagesecurityinc.com

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Shannon Smith
shannon@fasonline.cc
303-466-8800
www.fasonline.cc

Mathias Lock & Key
Dispatch
303-573-9000
dispatch@mathias1901.com
www.mathias-security.com

ACOUSTICAL CEILINGS & TREATMENTS

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Jason Gordon, LEED AP
jason@heartland-acoustics.com
303-694-6611
www.heartland-acoustics.com

Art Consultant

Noyes Art Designs LLC
Danielle Reisman
danielle@noyesartdesigns.com
303-332-8838
www.noyesartdesigns.com

ASPHALT & PAVING

Apex Pavement Solutions
Brian Pike
bpike@apexpvmt.com
303-273-1417
www.apexpvmt.com

Asphalt Coatings Company, Inc.
Judson Vandertoll
jvandertoll@asphaltcoatings.net
303-340-4750
www.asphaltcoatingscompany.com

Brown Brothers Asphalt & Concrete
Shawn Bartlett
bartletts@asphaltconcrete.net
303-781-9999
www.brownbrosasphaltconcrete.com

Coatings, Inc.
Drew Leskinen
aleskinen@coatingsinc.net
303-423-4303
www.coatingsinc.net

Economy Asphalt & Concrete Services, LLC
Scott Hardy
scotth@economypavinginc.com
303-809-5950
www.economypavinginc.com

Foothills Paving & Maintenance, Inc.
Michael Horn
mikeh@foothillspaving.com
303-462-5600
www.foothillspaving.com

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Advantage Security, Inc.
Jeff Rauske
jrauske@advantagesecurityinc.com
303-755-4407
www.advantagesecurityinc.com

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Shannon Smith
shannon@fasonline.cc
303-466-8800
www.fasonline.cc

Mathias Lock & Key
Dispatch
303-573-9000
dispatch@mathias1901.com
www.mathias-security.com

CONCRETE

Brown Brothers Asphalt & Concrete
Shawn Bartlett
bartletts@asphaltconcrete.net
303-781-9999
www.brownbrosasphaltconcrete.com

Economy Asphalt & Concrete Services, LLC
Scott Hardy
scotth@economypavinginc.com
303-809-5950
www.economypavinginc.com

Foothills Paving & Maintenance, Inc.
Michael Horn
mikeh@foothillspaving.com
303-462-5600
www.foothillspaving.com

DISASTER RESTORATION

ASR Companies
Jason Luce
jluce@asrcompanies.com
720-519-5433
www.asrcompanies.com

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dispatch@mathias1901.com
www.mathias-security.com

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Dean Stone
DStone@amteck.com
303-428-6969
www.amteck.com

Encore Electric
Encore Electric Service Team
303-934-1414
serviceteam@encorelectric.com
www.encoreelectric.com

RK Mechanical
Marc Paolicelli
303-785-6851
www.rkmi.com

Weifield Group Contracting
Weifield Group Preconstruction Team
awilemon@weifieldgroup.com
303-407-6642
www.weifieldgroup.com

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SavATree
Matt Schovel
mschovel@savatree.com
Denver – 303-337-6200
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jhuddleson@advancedexercise.com
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www.advancedexercise.com

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mbolsinger@arrowheadcares.com
303-432-8282
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kfabian@bartlett.com
303-353-0520
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Kimberly Jewell
kim@groundmastersls.com
303-750-8867
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Andrea Nataf
anataf@martinsonservices.com
303-424-3708
www.martinsonservices.com

Snow Pros Inc. Sitesource CAM
Connie Rabb
connie@sitesourcecam.com
303-948-5117
www.sitesourcecam.com

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Shanae Dix, CSP
shanae@camcolorado.com
303-295-2424
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Gene Blanton
gblanton@horizonpropertyservices.net
720-298-4323
www.horizonpropertyservices.net

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Jim McLure
jmclure@mccommercialrealestate.com
303-758-3336
mccommercialrealestate.com

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Connie Rabb
connie@sitesourcecam.com
303-948-5117
www.sitesourcecam.com

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Shanae Dix, CSP
shanae@camcolorado.com
303-295-2424
www.camcolorado.com

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Shannon Smith
shannon@fasonline.cc
303-466-8800
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Todd Harrison
tharrison@frontierfireprotection.com
303-629-0221
www.frontierfireprotection.com

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303-557-1820
ira.coleman@integrityfiresafetyservices.com
www.integrityfiresafetyservices.com/

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kevin.olmstead@wsfp.us
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303-293-9377
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DStone@amteck.com
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www.amteck.com

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Shanae Dix, CSP
shanae@camcolorado.com
303-295-2424
www.camcolorado.com

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Mathias Lock & Key
Dispatch
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dispatch@mathias1901.com
www.mathias-security.com

MECHANICAL/HVAC

CMI Mechanical, Inc.
Rick Dassow
rdassow@coloradomechanical.com
303-364-3443
www.coloradomechanical.com

MAI Mechanical
Grant Blackstone
GBlackstone@mai-mechanical.com
303-289-9866
www.mai-mechanical.com

Murphy Company
Paul Gillett
pgillett@murphynet.com
720-257-1615
www.murphynet.com

RK Mechanical
Marc Paolicelli
marcp@rkmi.com
303-785-6851
www.rkmi.com

Tolin Mechanical Systems Company
Tom Padilla
tpadilla@tolin.com
303-455-2825
www.servicelogic.com

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Bauen Corporation
Joey Andrews
jandrews@bauenroofing.com
303-297-3311
www.bauenroofing.com

Douglass Colony Group
Kate Faulkner
kfaulkner@douglasscolony.com
303-288-2635
www.douglasscolony.com

Superior Roofing
Saori Yamashita
syamashita@superiorroofing.com
303-476-6513
www.superiorroofing.com

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Kelly Reidy
kreidy@aol.com
303-361-9000
www.reidymetal.com

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Buehler Companies
Tami Anderson
tami@buehlercompanies.com
303-667-7438
www.buehlercompanies.com

Cowboy Moving & Storage
Michael Folsom
mike@cowboymoving.com
303-789-2200
www.cowboymoving.com

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Jim Diaz
jim@dccpaint.com
303-861-2030
www.denvercommercialcoatings.com

Preferred Painting, Inc.
Chris Miller
chris@preferredpainting.com
303-695-0147
www.preferredpainting.com

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CAM – Common Area Maintenance Services
Shanae Dix, CSP
shanae@camcolorado.com
303-295-2424
www.camcolorado.com

Martinson Services
Andrea Nataf
anataf@martinsonservices.com
303-424-3708
www.martinsonservices.com

PLUMBING

MAI Mechanical
Grant Blackstone
GBlackstone@mai-mechanical.com
303-289-9866
www.mai-mechanical.com

Murphy Company
Paul Gillett
pgillett@murphynet.com
720-257-1615
www.murphynet.com

RK Mechanical
Marc Paolicelli
303-785-6851
www.rkmi.com

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CAM – Common Area Maintenance Services
Shanae Dix, CSP
shanae@camcolorado.com
303-295-2424
www.camcolorado.com

Rocky Mountain Squeegee Squad
Bruce Sompolski
brucesompolski@squeegeesquad.com
720-408-0014
www.SqueegeeSquad.com

Snow Pros Inc. Sitesource CAM
Connie Rabb
connie@sitesourcecam.com
303-948-5117
www.sitesourcecam.com

Top Gun Pressure Washing Inc.
James Ballen
jamesballen@topgunpressurewashing.com
720-540-4880
www.topgunpressurewashing.com

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CAM – Common Area Maintenance Services
Shanae Dix, CSP
shanae@camcolorado.com
303-295-2424
www.camcolorado.com

Facilities Contracting, Inc.
Michael McKesson
mmckesson@facilitiescontracting.com
303-798-7111
www.facilitiescontracting.com

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Bauen Corporation
Brett Sowers
bsowers@bauenroofing.com
303-297-3311
www.bauenroofing.com

CIG Construction
Janice Stitzer
janice@cigconstruction.com
720-897-1886
cigconstruction.com
www.cigconstruction.com

CRW, Inc. – Commercial Roofing & Weatherproofing
Pete Holt
pete@crwroofing.com
720-348-0438
www.crwroofing.com

Douglass Colony Group
Kate Faulker
kfaulkner@douglasscolony.com
303-288-2635
www.douglasscolony.com

Flynn BEC LP
Lauren Fry
Lauren.Fry@Flynncompanies.com
303-287-3043
www.flynncompanies.com

Superior Roofing
Saori Yamashita
syamashita@superiorroofing.com
303-476-6513
www.superiorroofing.com

WeatherSure Systems, Inc.
Dave Homerding
daveh@weathersuresystems.com
303-781-5454
www.weathersuresystems.com

Western Roofing, Inc.
Curtis Nicholson
cnicholson@westernroofingco.com
303-279-4141
www.westernroofingco.com

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Stefanie Horner
SHorner@atslab.com
571-302-6692
www.atslab.com

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Advantage Security, Inc.
Jeff Rauske
jrauske@advantagesecurityinc.com
303-755-4407
www.advantagesecurityinc.com

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DaVinci Sign Systems, Inc.
Kevin J. Callihan
kevin@davincisign.com
970-203-9292
www.davincisign.com

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CAM – Common Area Maintenance Services
Shanae Dix, CSP
shanae@camcolorado.com
303-295-2424
www.camcolorado.com

Facilities Contracting, Inc.
Michael McKesson
mmckesson@facilitiescontracting.com
303-798-7111
www.facilitiescontracting.com

Martinson Services
Andrea Nataf
anataf@martinsonservices.com
303-424-3708
www.martinsonservices.com

SMS, Snow Management Services, LLC
Kimberly Jewell
Kim@smssnow.com
303-750-8867
www.smssnow.com

Snow Pros Inc. Sitesource CAM
Connie Rabb
connie@sitesourcecam.com
303-948-5117
www.sitesourcecam.com

SOLAR

Douglass Colony Group
Kate Faulker
kfaulkner@douglasscolony.com
303-288-2635
www.douglasscolony.com

SOUND MASKING

Margenau Associates
Adam Faleck
afaleck@margenauassoc.com
303-979-2728
www.margenauassoc.com

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CAM – Common Area Maintenance Services
Shanae Dix, CSP
shanae@camcolorado.com
303-295-2424
www.camcolorado.com

Martinson Services
Andrea Nataf
anataf@martinsonservices.com
303-424-3708
www.martinsonservices.com

Top Gun Pressure Washing Inc.
James Ballen
jamesballen@topgunpressurewashing.com
720-540-4880
www.topgunpressurewashing.com

Tennis Courts

Coatings Inc.
George Tavarez
gtavarez@coatingsinc.net
303-423-4303
www.coatingsinc.net

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Bartlett Tree Experts
Konstanze Fabian
kfabian@bartlett.com
303-353-0520
www.bartlett.com

SavATree
Matt Schovel
mschovel@savatree.com
Denver: 303-337-6200
Fort Collins: 970-221-1287
North Metro Denver:
303-422-1715
www.savatree.com

WEATHERPROOFING

ASR Companies
Jason Luce
jluce@asrcompanies.com
720-519-5433
www.asrcompanies.com

Douglass Colony Group
Kate Faulker
kfaulkner@douglasscolony.com
303-288-2635
www.douglasscolony.com

WeatherSure Systems, Inc.
Dave Homerding
daveh@weathersuresystems.com
303-781-5454
www.weathersuresystems.com

WINDOW CLEANING

Bob Popp Building Services Inc.
Bob Popp
bobpoppservices1@aol.com
303-751-3113
www.bobpoppbuildingservices.com

Rocky Mountain Squeegee Squad
Bruce Sompolski
brucesompolski@squeegeesquad.com
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Colorado's Only Shopping Centers Publication

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November 16	October 26	November 2

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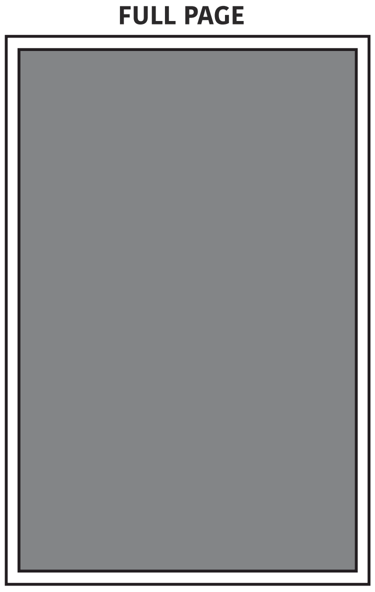

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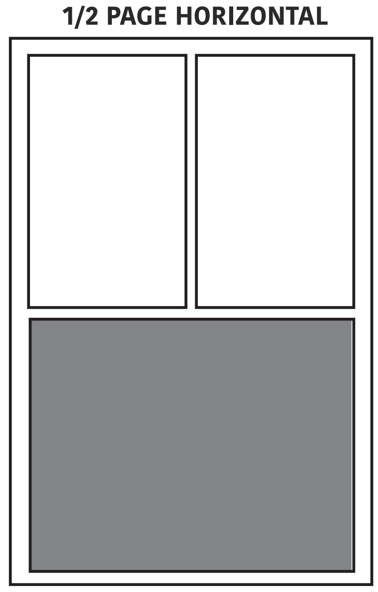

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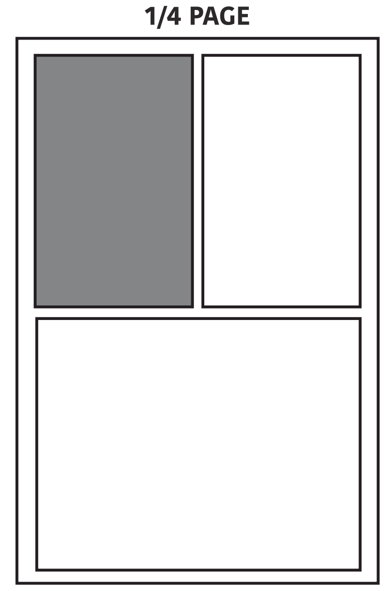

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