Slow activity across metro Denver spurred by unpredictable economy

▲ 20.9%
Total Vacancy Rate

▼ (251K)
SF Direct Net Absorption

▶ $31.99
FSG / Lease Rate

▲ 2.5M
SF Under Construction

▼ 702K
SF Leasing Activity

Note: Arrows indicate change from previous quarter.

MARKET SUMMARY

- After three quarters of stalled activity, the development pipeline rose to 2.5 million sq. ft. after Steel House, a 297,000-sq.-ft project in the River North submarket, officially broke ground.
- Leasing activity softened in Q1 2023 with only 701,800 sq. ft. transacted, marking the first quarter since Q1 2021 with less than 1.0 million sq. ft. leased.
- Negative 250,500 sq. ft. of direct net absorption was posted in Q1 2023, a sizable dip from the negative 4,000 sq. ft. in Q4 2022 and the positive 251,900 sq. ft seen a year earlier in Q1 2022.
- Investment activity in the first quarter of 2023 totaled $183.8 million ($318.32 price per sq. ft.), a considerable improvement from Q4 2022's volume of $105.6 million.
- Total vacancy rose to 20.9%, an increase of 50 basis points (bps) quarter-over-quarter and 140 bps year-over-year. Direct vacancy increased to 17.7%, up from 17.4% in Q4 2022.
- Sublease availability increased 12.1% quarter-over-quarter and 51.8% year-over-year to 6.6 million sq. ft., marking the third consecutive quarter of record-breaking sublease volume.
- The overall average direct asking lease rate recorded nominal quarterly and annual changes, decreasing 0.2% quarter-over-quarter and increasing 0.5% year-over-year to $31.99 per sq. ft.

FIGURE 1: Downtown vs Suburban Market Statistics

	NRA (SF)	Total Vacancy Rate (%)	Direct Vacancy Rate (%)	Sublease Availability (SF)	Direct Net Absorption (SF)	Direct Asking Rent ($/SF/YR FSG)	Under Construction (SF)
DOWNTOWN							
Class A	12,177,962	21.6	17.3	901,694	(22,720)	48.02	704,036
Class B	14,461,452	32.4	26.8	1,334,120	(84,475)	38.55	-
Class C	3,977,682	34.2	33.4	80,497	9,886	29.14	-
Total	30,617,096	28.3	23.9	2,316,311	(97,309)	39.42	704,036
SUBURBAN							
Class A	41,212,714	19.8	16.2	2,819,178	(54,579)	31.23	1,771,436
Class B	38,498,999	18.1	15.9	1,270,529	(24,413)	26.84	-
Class C	10,141,793	12.8	11.4	175,974	(74,218)	22.25	-
Total	89,853,506	18.3	15.6	4,265,681	(153,210)	28.45	1,771,436
METRO TOTAL	**120,470,602**	**20.9**	**17.7**	**6,581,992**	**(250,519)**	**31.99**	**2,475,472**

Source: CBRE Research Q1 2023

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Vacancy

Total vacancy increased 50 basis points (bps) quarter-over-quarter and 140 bps year-over-year after reaching 20.9% to start off 2023. This is the fourth consecutive quarter of rising total vacancy but marks the first quarter of increasing direct vacancy, which rose 30 bps to 17.7%, after remaining stagnant for three straight quarters. This bump in direct vacancy comes as metro Denver continues to face a volatile economy, prolonged decision making among tenants, and the sustained popularity of employees working from home. Vacancy in metro Denver is at its highest level in the past 10 years, with the increase initially spurred by COVID-19 and persisting as the office landscape and US economy continues to evolve.

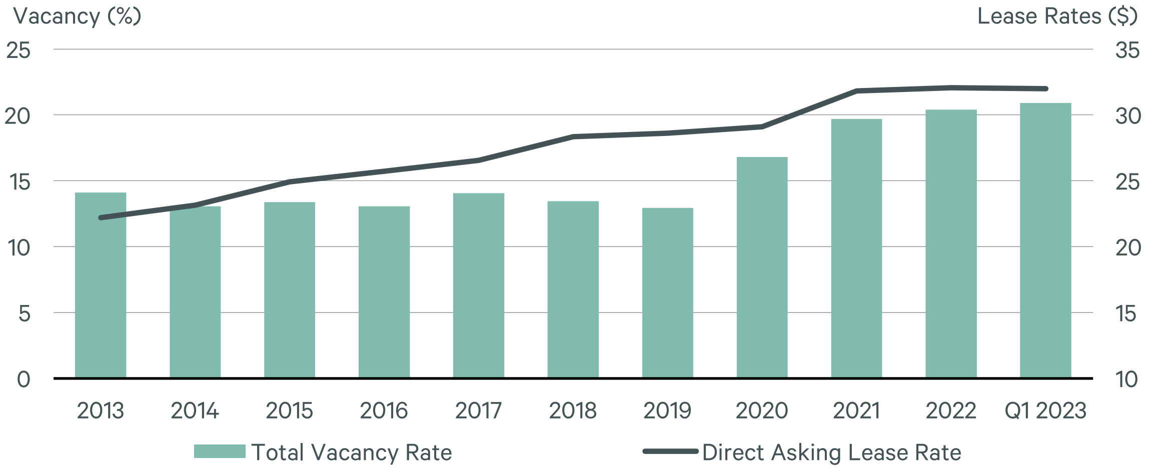
While vacancy among Class B properties remains the highest at 22.0%, Class A vacancy experienced the greatest increase in Q1 2023, rising 60 bps quarter-over-quarter and 150 bps year-over-year to 20.2%. The rise in Class A vacancy continues to stem from tenants reducing their office footprint due to hybrid work environments and cost-cutting measures. For example, Bryan Cave gave up roughly 47,000 sq ft. at 1700 Lincoln St, shrinking their space in half, while Tetra Tech, who relocated from 350 Indiana St to another Class A property, 390 Union Square, is now occupying 18,750 sq. ft. or 50% less space.

Sublease Availability

Sublease availability reached 6.6 million sq. ft., increases of 12.1% quarter-over-quarter and 51.8% year-over-year, and pushing the record level of sublease space higher in metro Denver for a third straight quarter. While the more accelerated increase in sublease availability since Q2 2022 remains tied to the lingering impact of remote work, a more recent driving force is economic headwinds causing tenants to more closely rethink their office usage needs, typically resulting in downsizing of space or shedding of some office premises altogether. The Technology sector continues to be the largest contributor to sublease availability, with roughly 1.2 million sq. ft. currently on the market.

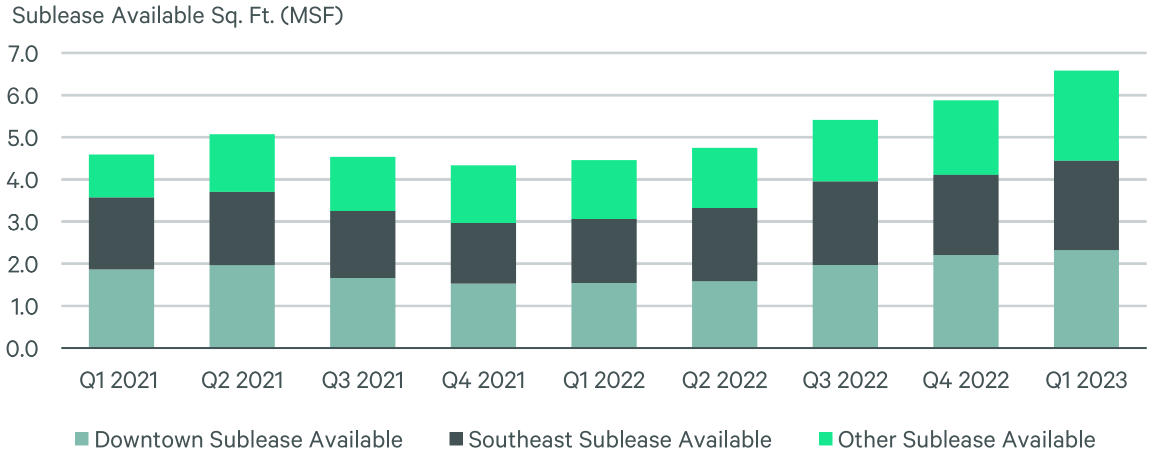
The Southeast submarket saw the largest jump in sublease availability as multiple large blocks at Class A properties were added in Q1 2023. Notable additions included: Zoom Technologies putting up their entire space of 91,506 sq. ft. at 7601 Technology Way, Comcast subletting 84,600 sq. ft. at 7250 S Havana St, and Envision Healthcare putting up 77,000 sq. ft. at 6363 S Fiddlers Green Cir. These large additions also directly affected Class A sublease availability metro wide which saw the greatest jump, increasing 13.9% quarter-over-quarter and 57.9% year-over-year.

FIGURE 2: Total Vacancy and Lease Rate



Source: CBRE Research Q1 2023

FIGURE 3: Sublease Availability



Source: CBRE Research Q1 2023

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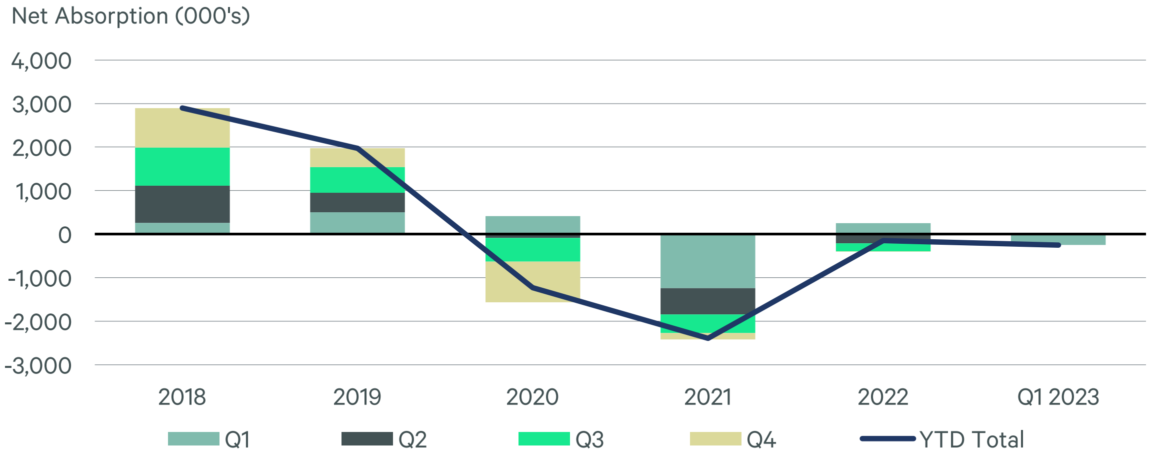
Net Absorption

In Q1 2023, metro Denver recorded negative 250,500 sq. ft. of direct net absorption. Class B properties were the primary catalyst, posting negative 108,900 sq. ft. of direct absorption, down annually from the positive 391,900 sq. ft. absorbed in Q1 2022. Class A net absorption also began 2023 in the red with negative 77,300 sq. ft. but outperformed lower-class properties and showed a slight year-over-year improvement from the negative 162,700 sq. ft. posted a year earlier in Q1 2022. This trend is expected to continue as older, lower-quality buildings face the threat of becoming obsolete amidst rising improvement costs, limited surrounding amenities, the flight-to-quality trend among tenants, and even threats of crime in certain urban areas. The negative absorption among Class A buildings was fueled by several significant downsizes and tenants shifting within similar buildings rather than outright new vacancies, which have plagued Class B and C properties to a greater degree. The Southeast submarket boasted the highest net absorption across the metro in Q1 2023, recording 108,000 sq. ft. that predominantly came from Class A properties where net absorption totaled 102,100 sq. ft. Most of the absorption posted amongst Class A properties in the Southeast came from delayed move-ins that officially occupied this quarter including, Gen II (73,000 sq. ft.) at 6900 Layton Ave., Zeta Associates (39,200 sq. ft.) at 6200 S Syracuse Way and NewFields (19,000 sq. ft.) at 9540 S Maroon Cir.

Average Asking Lease Rates

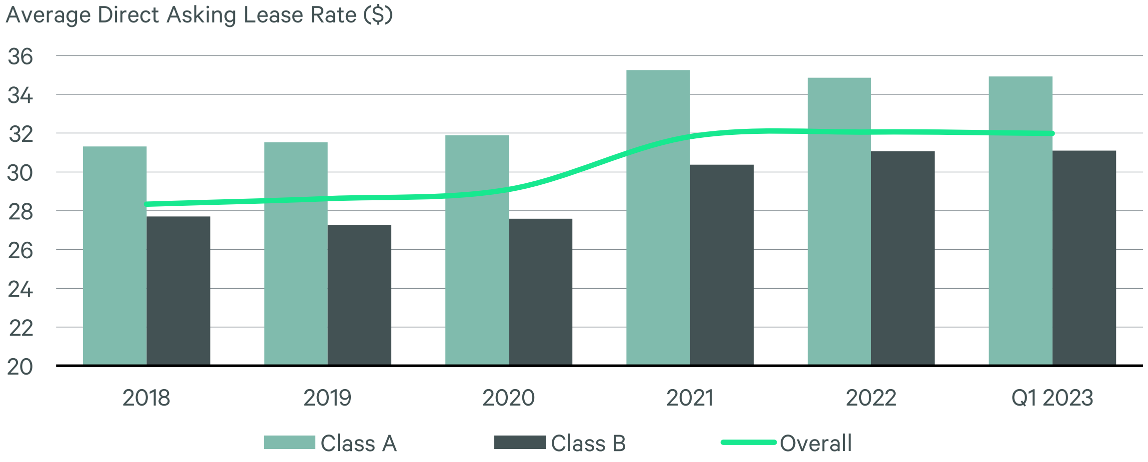
The overall average direct asking lease rate remained stable quarter-over-quarter, decreasing 0.2%, while increasing 0.5% year-over-year to $31.99 per. sq. ft. FSG. Despite the increased amount of sublease space being marketed with lower rates compared to direct space, most landlords have felt little pressure to start lowering asking rates. Class A rates posted an annual decline of 0.9% but increased slightly quarter-over-quarter to $34.93 per sq. ft. FSG, while Class B rates increased 2.4% year-over-year and 0.2% quarter-over-quarter to $31.10 per sq. ft. FSG. Only the direct asking lease rate among Class C properties experienced a quarterly decline, decreasing marginally to $25.67 per sq. ft. FSG. This is a result of flight-to-quality as these lower-class properties with high vacancy rates are attempting to remain competitive with fully amenitized buildings in more desirable locations. The three highest submarket asking rates in metro Denver are: River North ($46.85 per sq. ft. FSG), Downtown ($39.42 per sq. ft. FSG) and Boulder ($36.47 per sq. ft. FSG).

FIGURE 4: Net Absorption



Source: CBRE Research Q1 2023

FIGURE 5: Average Asking Lease Rate



Source: CBRE Research Q1 2023

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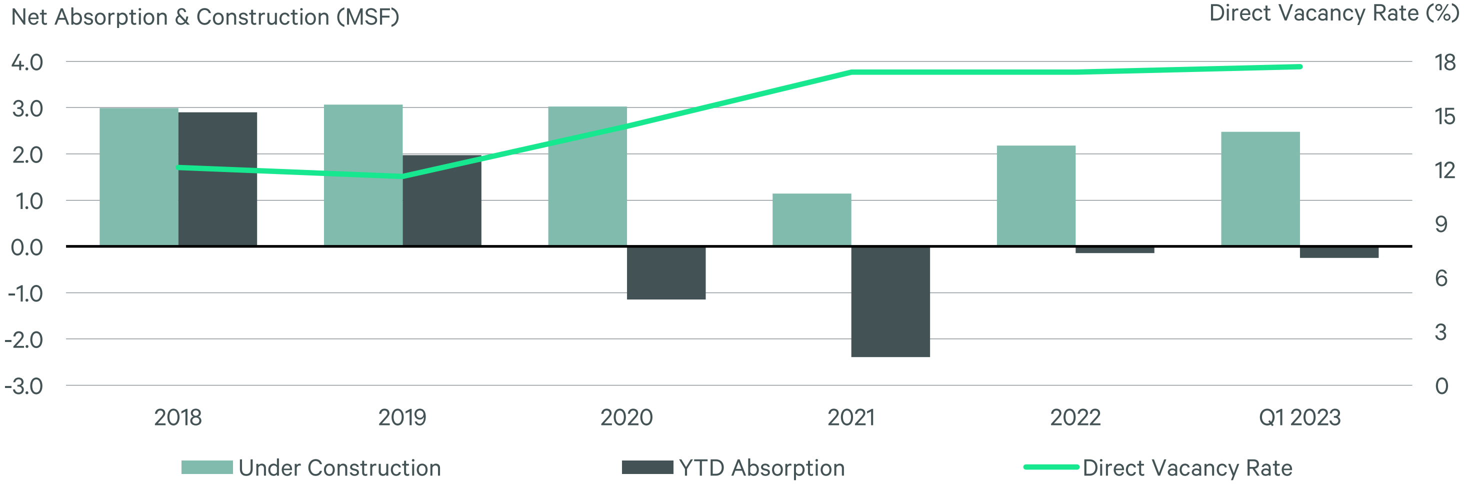
Development Activity

After remaining stagnant for three quarters, the development pipeline finally saw an uptick in construction, reaching 2.5 million sq. ft. in Q1 2023. This was driven by Steel House officially breaking ground, which added almost 300,000 sq. ft. to the pipeline. Significant challenges such as increasing vacancy, along with higher capital and construction costs, have impeded the development pipeline in recent quarters but a tightening economy will hopefully promote the Fed to ease interest rates later this year, giving way to some cautious optimism among developers as some of these current challenges would likely wane.

Steel House joins three other projects already underway in the River North submarket, bringing the total amount under construction to 957,300 sq. ft.— the most of any submarket in metro Denver. The Boulder and Cherry Creek submarkets each also have four projects currently under construction, totaling 394,000 sq. ft. and 280,500 sq. ft, respectively. These new developments are highly pre-leased at 46.7% and 88.1%, respectively, highlighting the sustained demand for new, premium office space especially in these more niche suburban markets. Meanwhile, the Downtown submarket's sole project under construction, 1900 Lawrence, has only managed to capture one 31,200 sq. ft. lease thus far. However, leasing activity amongst newer Downtown properties such as Block 162 and McGregor Square prove that flight-to-quality among tenants persists and paves an optimistic path for 1900 Lawrence.

There were no new deliveries in the first quarter of 2023 across metro Denver, as delivery dates continue to get delayed. Multiple projects are set to deliver later this year including: The Current River North (238,000 sq. ft.) in RiNo and 200 Clayton (70,500 sq. ft.) in Cherry Creek.

FIGURE 6: Construction, Net Absorption & Direct Vacancy



Source: CBRE Research Q1 2023

FIGURE 7: Notable Projects Under Construction

PROPERTY NAME	Property Size (SF)	Submarket	Preleased (%)	Spec/BTS	Est. Completion
1900 Lawrence	704,000	Downtown	4.3	Spec	Q4 2024
Steel House	297,000	River North	0.0	Spec	Q1 2025
The Current River North	238,000	River North	20.7	Spec	Q2 2023
T3 RiNo	230,000	River North	0.0	Spec	Q3 2023
Paradigm River North	200,000	River North	38.4	Spec	Q2 2024

Source: CBRE Research Q1 2023

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Leasing Activity

Leasing activity had a slow start to the year with only 701,800 sq. ft. of deals transacted across metro Denver, a decrease of 42.4% quarter-over-quarter and 49.0% year-over-year. Activity among smaller tenants less than 10,000 sq. ft. remains fairly strong, but larger tenant activity has dipped in recent quarters. While there are a decent number of large tenants currently active in the market, bigger corporations are prolonging their decision making and shelving expansions due to factors including the sustained preference for hybrid work and the developing recession. Meanwhile, tenants with smaller footprints and shorter lease terms have the luxury of being more flexible in their office-use decisions.

Class A properties continued to dominate leasing activity in Q1 2023, with 498,000 sq. ft. leased or 74.5% of total activity Comparatively, in Q1 2022, Class A properties only accounted for 59.6% of all activity, highlighting the growing importance of high-quality space in the market and the need for lower-class properties to consider adding amenities or updating their assets in order to better capture activity.

The Southeast submarket saw 269,700 sq. ft. transacted in Q1 2023, the highest submarket activity across metro Denver. Activity in the Southeast decreased annually by 34.9% but increased 93.7% from the 139,200 sq. ft. transacted last quarter. Zynex leased 41,400 sq. ft. at 9555 S Maroon Cir, marking the largest transaction in the Southeast submarket and within metro Denver.

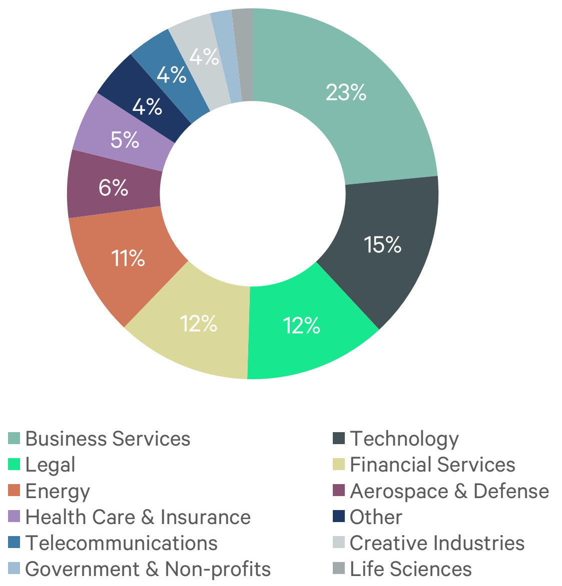
Activity amongst the historical heavy-hitting technology sector continues to remain below pre-pandemic levels with only 67,000 sq. ft. transacted in Q1 2023. Meanwhile, the traditional office-using sectors of professional and business services and energy are fueling activity with a combined total of 312,500 sq. ft. leased, or 44.5% of all activity.

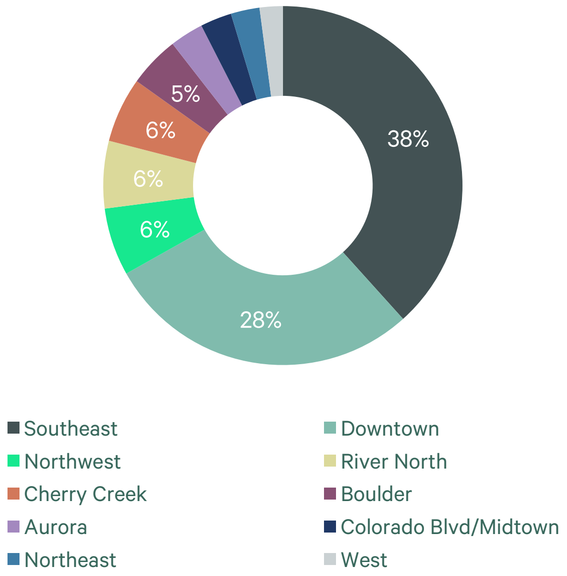
FIGURE 8: Notable Q1 2023 Lease Transactions

Tenant	Industry	Location	Submarket	Lease Type	SF
Zynex	Health Care	9555 S Maroon Cir	Southeast	New Lease	41,000
Undisclosed Aerospace Company	Aerospace & Defense	8744 Lucent Blvd	Southwest	Expansion	36,000
ION	Energy	2995 Center Green Dr	Boulder	New Lease	33,000
Kodiak Building Partners	Financial Services	9780 Mt Pyramid Ct	Southeast	New Lease	32,000
Leidos	Technology	169 Inverness Dr	Southeast	New Lease	31,000

Source: CBRE Research Q1 2023

FIGURE 9: Leasing Activity by Industry Type (Q2 2022– Q1 2023)





Source: CBRE Research Q1 2023

Source: CBRE Research Q1 2023

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Investment Trends

Investment activity improved in the first quarter of 2023, with a handful of assets selling for a total volume of $183.8 million (average price per sq. ft. $318.32). This marks a 74.0% quarter-over-quarter increase from the $105.6 million recorded in the last quarter of 2022. Compared to Q1 2022, when interest rates were still near zero, total volume decreased 86.3% from $659.7 million. With elevated vacancies throughout the market and rising interest rates, total sales volume will likely continue to be subdued through the remainder of the year. This quarter was the first since Q4 2020 that downtown sales volume outpaced suburban sales volume.

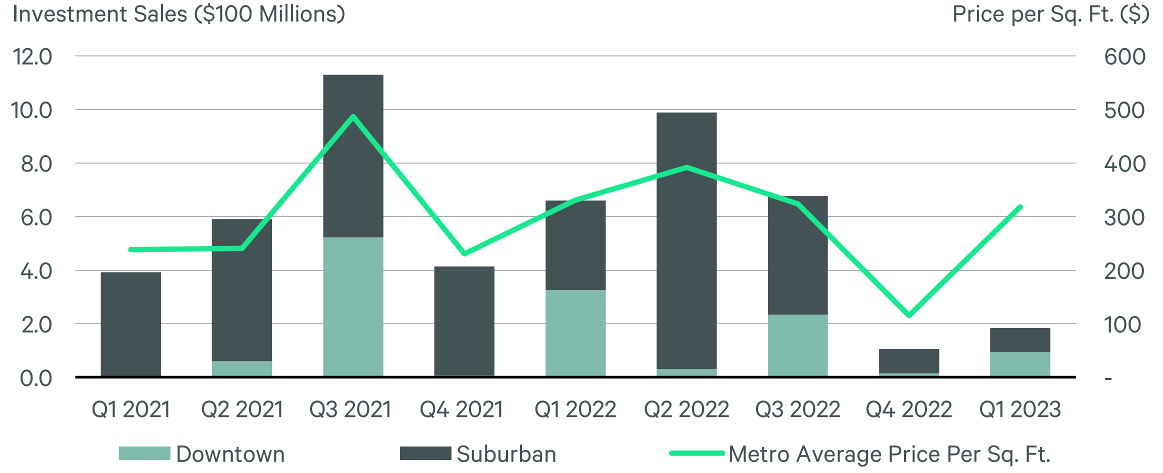
In total there were 11 properties that traded hands, seven of them being part of two separate portfolios. One was the Platte St portfolio of three historical buildings purchased by Asana Partners for $39.8 million. The other being comprised of four adjacent properties located within Cherry Creek, which sold for $53.7 million to Altus Properties. These sales, combined with Beacon Capital's purchase of 1801 Wewatta for $54.0 million, pushed the metro price per sq. ft. to $318.32, a 175.8% increase from Q4 2022's average.

Employment

The U.S. Fed implemented its second 25 basis point rate hike of Q1 2023 in late March, pushing its target rate to 4.75%-5.00%, up from 0.25%-0.50% a year earlier and the highest rates have been since 2007. The Federal Reserve expects to bring rates to 5.1% in 2023, likely signaling another 25-basis-point increase by year-end. High borrowing costs and tightening liquidity due to headwinds in the banking sector will impede consumer spending and continue to dampen business and real estate investment, which collectively are exacerbating recession fears.

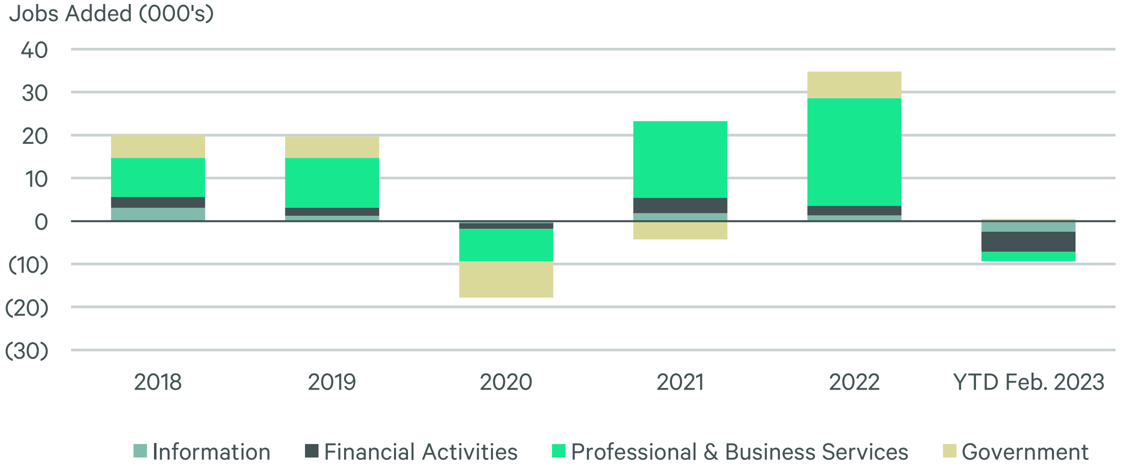
Total non-farm employment in metro Denver increased 1.4% during the first two months of 2023 on a year-over-year basis, adding 24,200 jobs. Office-using employment—including jobs in the information, financial activities, professional and business services, and government sectors—grew 0.9% over the same period. Professional and business services, which represents 45.5% of office-using jobs, posted 3.1% growth and has added 10,600 jobs. The information and financial activities sectors posted negative year-over-year job growth of 4.4% and 4.0%, respectively. Metro Denver's unemployment rate rose 20 basis points in February to 3.1% and is up from a cyclical low of 2.5% in December 2022. On a year-over-year basis, unemployment is down 70 basis points from 3.8%.

FIGURE 11: Investment Sales



Source: CBRE Research Q1 2023

FIGURE 12: Office-Using Employment Growth



Source: U.S. Bureau of Labor Statistics, December 2022

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FIGURE 13: Market Statistics by Submarket

SUBMARKET	NRA (SF)	Total Vacancy Rate (%)	Direct Vacancy Rate (%)	Sublease Availability (SF)	Under Construction (SF)	Average Lease Rate ($./SF/YR FSG)	Qtr. Direct Net Absorption (SF)
Aurora	5,719,099	20.0	17.4	256,121	-	21.45	(1,336)
Boulder	6,448,375	14.8	13.1	357,908	394,080	36.83	11,012
Capitol Hill	2,417,465	21.0	10.9	248,551	-	30.24	16,086
Cherry Creek	2,733,665	8.5	7.8	20,075	280,548	35.96	(36,564)
Colorado Blvd/ Midtown	6,608,989	20.1	18.0	189,029	-	27.69	(83,986)
Downtown	30,617,096	28.3	23.9	2,316,311	704,036	39.42	(97,309)
Longmont	850,557	7.8	7.5	7,883	-	21.44	(12,426)
North	2,976,821	16.9	16.1	28,282	-	24.39	(5,855)
Northeast	1,198,063	16.6	15.7	97,815	106,527	27.67	120
Northwest	8,431,924	22.1	18.3	462,677	33,000	29.99	(69,088)
River North	2,062,364	31.0	23.0	212,825	957,281	46.85	9,379
Southeast	37,173,163	18.3	15.4	2,134,468	-	27.92	108,002
Southwest	5,481,059	14.2	13.8	20,979	-	25.62	(32,285)
West	6,721,865	18.2	15.8	217,179	-	26.02	(68,299)
West Hampden / Alameda	1,030,097	18.2	17.6	11,889	-	20.02	12,030
METRO TOTAL	120,470,602	20.9	17.7	6,581,992	2,475,472	31.99	(250,519)

Source: CBRE Research Q1 2023

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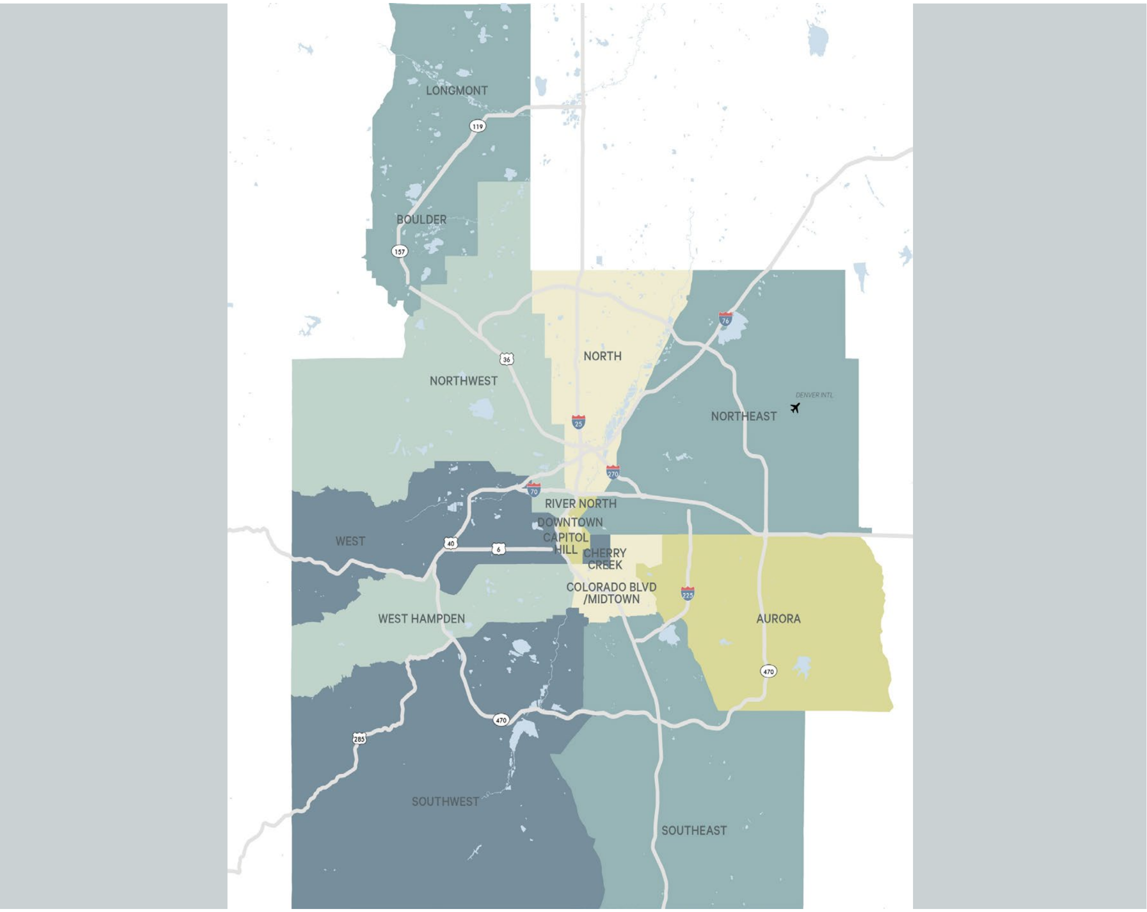
Market Area Overview



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102 South Tejon Street, Suite 1100,
Colorado Springs, CO 80903

Survey Criteria

Includes all office buildings 10,000 sq. ft. and greater in size, excluding owner-user, in Adams, Arapahoe, Boulder, Broomfield, Denver, Douglas and Jefferson counties. Buildings which have begun construction as evidenced by site excavation or foundation work.

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