

# OFFICE & INDUSTRIAL Quarterly



## Investors refocus as occupancy passes inflection point

Leasing activity has returned across the metro area. In Highlands Ranch, Lockheed Martin leased more than 200,000 additional square feet at the 8740 Lucent Blvd. building. CoStar Group

The disruptions of COVID-19 on the national office market have been significant, and while Denver has not been spared from the new challenges, the market benefits from some unique traits. Business-friendly policies have made the Mile High City an attractive place for both startups and large tech firms seeking lower rents relative to tech hubs like San Francisco, Seattle and Austin, Texas. Denver also already was a remote work hub prior to 2020, supporting one of the largest pre-pandemic untethered workforces of any major metro area. As such, Denver ultimately will see less space attrition than some other



**Brian C. Smith, CCIM, SIOR**  
First vice president investments, and director, Healthcare Real Estate and National Office & Industrial divisions, Smith Office Team, Marcus & Millichap

markets. The arrival of companies new to the area together with the expansion of some existing firms should balance out any downsizing of other office-using businesses, allowing space absorption trends to move toward pre-pandemic levels in 2022. Diminished speculative construction also will help neutralize the long-term effects

of remote work.

Denver experienced one of the larger increases in office vacancy of any major market in 2020 as firms attempted to capitalize on empty offices, applying negative pressure on rents. Office fundamentals in downtown Denver and adjacent submarkets such as Lower Downtown and Platte River were hit the hardest, with the vast majority of the 4.1 million square feet available for sublease in November located in those submarkets. Suburban office hot spots like the Denver Tech Center, Greenwood Village and Broomfield also have experienced rising vacancy, however less tenant loss and available subleasing space

have allowed for slight rent gains. Heading into 2022, many of these negative trends have begun reversing toward pre-COVID-19 norms. The amount of space available for sublease has finally contracted after peaking at 4.7 million sf in early 2021. Firms anticipating a return to in-person or hybrid work also have contributed to vacancy beginning to descend in the core as the leasing outlook improves.

Leasing activity has returned in the metro area following a pandemic-era lull. Vacancy rates have reached their peaks and have begun ticking back down, especially in the hardest-hit areas surrounding the

*Please see Market Update, Page 14*

### INSIDE

PAGE 8



#### Office rebounds

Leasing, sublease availability, transactions and investor confidence all strengthen

PAGE 12



#### Trends in action

Returning tenants should expect to find greener, wellness-focused office buildings

PAGES 19-31



#### Industrial section

Articles highlight the growing last-mile facilities footprint and outdoor storage woes



INDUSTRIAL — OUTLOOK

# Last-mile delivery primes activity beyond Denver

According to the 2020 U.S. Census, Denver is the fastest-growing city in Colorado, followed closely by Colorado Springs. Pre-pandemic, both cities had been experiencing steady, yet notable growth, largely due to the region's appealing outdoor and recreational lifestyle, employment opportunities and business climate, but 2021 has brought a surge of new demand across the entire state.

The news cycle has been dominated by the need for residential opportunities to meet the demands of a flourishing region, but the need for industrial projects has proven equally important to capture this growth as well as adapt to fast-evolving consumer demands and the active e-commerce marketplace. In fact, the Society of Industrial and Office Realtors reported that "deals are being completed, not stalled," and leasing activity in industrial has experienced a 30% increase since last year. What's more, a second-quarter report shared by CBRE reports a 2.7% direct vacancy rate for distribution space.

Needless to say, industrial is showing no sign of slowing down in 2022, and several notable trends this year signal the start of a new era of heightened confidence and interest in industrial development.

■ **All eyes are on the last mile.** Retail forecasts show e-commerce will make up 22% of global retail sales by 2023, based on the growing number of e-commerce websites that rely heavily on delivery services. At a time when 41% of consumers rank same-day delivery as their



**Mindy Rietz**  
Development  
director, Confluent  
Development

most important attribute when shopping online, the last-mile delivery approach has become more relied upon than ever. Dedicated to ensuring a product purchased on an e-commerce platform makes it to the consumer in a timely manner, last-mile delivery

facilities are strategically developed to be closer to where consumer demand exists.

As demonstrated in both 2020 and 2021, there has been a dramatic movement from many urban areas to suburban and developing communities. Now, more than ever, the last mile matters, and distribution becomes increasingly decentralized.

Amazon is a retail behemoth, and its hub-and-spoke model continues to be adopted by competitors looking to secure a location for the last leg of their delivery to service the local population quickly, efficiently and on time. In recent years, competitors in the retail market discovered unique ways to maintain pace with the likes of Amazon. Best Buy, for example, pivoted 250 of its store designs to become "hubs" to ship more online orders and handle more volume.

■ **Colorado Springs makes its debut.** From the industrial development perspective, developers across the state must take note of new trends and shifts in e-commerce. Colorado



Central Park Business Center, a speculative infill industrial park located at the intersection of Interstate 70 and Central Park Boulevard, represents one of the few undeveloped infill sites in the market. The site has experienced interest from industrial users looking for convenient access for logistics and distribution throughout the metro area.

continues to forge ahead in industrial, and development in the state is expanding along the Interstate 25 corridor, becoming less focused on Denver. As the state's capital and vibrant metropolitan area, Denver always will be a major player, but when looking at active developments, which regions are the most affordable and where residents will enjoy the best quality of life, we see this trending further and further along the corridor, from Fort Collins all the way to Pueblo.

Amid the pandemic, Colorado Springs has become a rising star. Not only has it been recognized by U.S. News & World Report, ranking the city as No. 6 out of its 150 "Best Places to Live in the U.S. in 2021-2022," but also the city is becoming an attractive destination for both

residents and companies alike. A notable catalyst for this increased interest in Colorado Springs is the master plan update to the Colorado Springs Airport, which will "provide the airport with a 20-year road map into the future." The airport already is seeing an increase in commercial flights and deliveries, as well as visitors and tourists who are coming into the Springs directly and bypassing Denver altogether.

As the standard of living in Denver is becoming increasingly challenging based on incoming demand, Colorado Springs has been a benefactor of transient growth. From new home developments to national corporations establishing headquarters, this region is well-posi-

*Please see Rietz, Page 32*

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## INDUSTRIAL — TRENDS

Continued from Page 19

shorter time frames now have companies that traditionally have distributed to Denver from surrounding states targeting the metro area. This is driving record levels of demand for industrial space. Net absorption is on pace to set a new benchmark this year in metro Denver with nearly 4.5 million sf absorbed in the first three quarters of this year, a 70% increase year over year. Require-

ments also are reaching historic sizes. To put this in perspective, Denver had only five industrial buildings over 1 million sf prior to 2020. Today, there are three new buildings over 1 million sf under construction, and there currently are five additional active requirements for over 1 million sf across the metro area.

High levels of demand aren't just impacting the largest requirements in the market. We are seeing strong demand in the midsize require-

ments around 100,000 sf across several submarkets in the metro area where, traditionally, most industrial activity ran east along the Interstate 70 corridor. Now developers are turning their attention to other submarkets, and industrial construction is beginning to surge in southeast Denver, north and northwest Denver, Boulder, Colorado Springs and Northern Colorado. There is currently 9.7 million sf of industrial space under construction in the area, with

over 50% of that space being pre-leased.

There is no doubt the supply chain is strained, and it is creating hardship for many businesses and shoppers. Yet hardship often precipitates opportunity. The industrial sector is emerging from this pandemic a changed industry, with Denver anticipated to be a major beneficiary of a shifting supply chain. ▲

todd.witty@cbre.com

### Becker

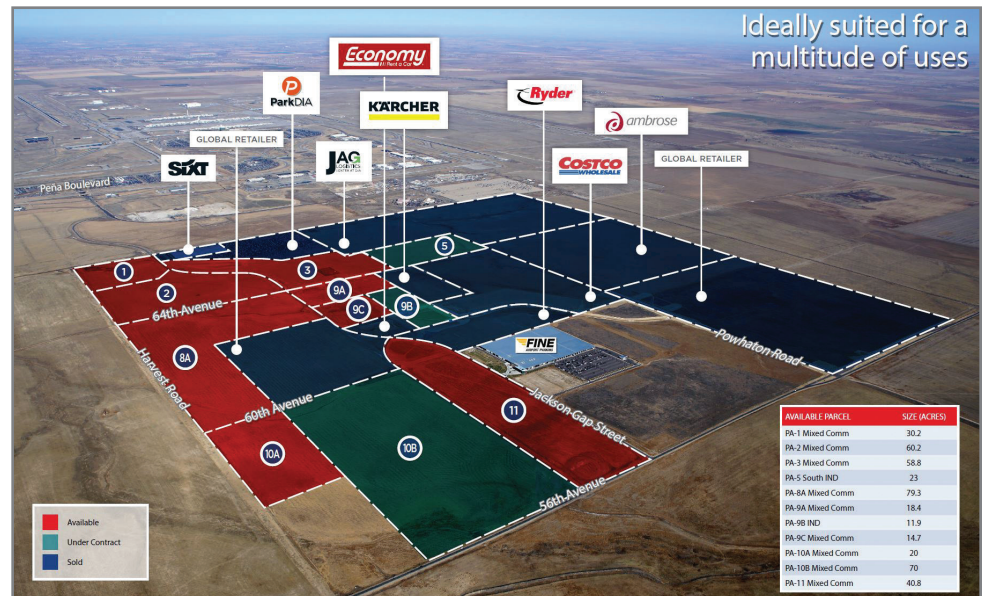
Continued from Page 24

appreciate, the surrounding rings also experience a bump. And when values increase as they have on the Front Range in recent years, the dissemination of this trend has far-reaching results: All of a sudden, outdoor storage is only available on the fringe, and the need to move farther and farther out leads to increased traffic and pollution, decreased efficiencies and a perpetual cycle of systematic business displacement.

If outdoor storage seems to be going away but is critical for so many businesses upon which we all rely, what can we do about it? First, buy industrial properties with outdoor storage components and keep their current uses ... although perhaps not in unincorporated Adams County. Supply

and demand fundamentals should bring you handsome returns from both rental income and land banking perspectives. Second, be a vocal citizen with your local government and work together to put a sustainable and responsible plan in place for how planning departments can incorporate new neighborhood plans allowing for outdoor storage in a safe and respectful way. Third, businesses can alleviate supply pressures by using only the outdoor storage area they truly need and subleasing out the rest. And fourth, we have a responsibility to continue exploring technologies and supply chain strategies that can reduce the amount of outdoor storage space on which the businesses we use depend. ▲

abecker@rec-colorado.com



CoStar Group  
Porteos is a new development in Aurora that has areas zoned for outdoor storage

### Blasdell

Continued from Page 27

We believe this fundamental decentralization of the supply chain from offshore to onshore now all the way to smaller population centers is an inflection point for Rocky Mountain industrial markets, which are by nature smaller (but growing) population centers. This is a leading reason why key centers in the Rocky Mountain geography are experiencing below-average vacancies in the region, an indicator we expect to remain relatively stable going forward. Additionally, liquidity in this region has increased as more institutional buyers are adding these high-growth markets to their portfolios for the first time – following credit tenancy in this trend toward decentralization. Institutional buyers can acquire a Home

Depot warehouse in Northern Colorado with the same underlying credit at a positive yield spread to gateway markets. As more institutional buyers add these markets, compressed yields may continue relative to gateway markets. The icing on the cake for industrial in the mountain states is that population growth is also at a similar (and compelling) point of inflection.

■ **Population growth amplifies tail winds.** Our favorite real estate metric and the oldest in the book is population growth. In our view, there's reason to believe that Rocky Mountain industrial is well positioned given the shifts in population growth. Mountain states have grown every year for 75 consecutive years, most recently by 15.9% over the last decade. Not every region in the country can say the same, and some

states are now experiencing consistent population declines. By way of example, according to the St. Louis FRED, as of Nov. 22, New York state's population has declined each year since 2015, losing 1.6% over that time. Similarly, the state of Illinois' population has declined each year since 2013, losing a total of 2.4% during that stretch. The case for mountain states is detailed further by the spread between growth rates in the western United States shown in the chart on Page 27.

This spread in population growth between mountain states and western coastal states has widened over the last decade. Interestingly, this spread has remained positive for mountain states in the last five decades except for five years between 1986 and 1990. This has not always been the case. Between

1921 and 1971, mountain states had a positive growth rate spread in only 15 years, or 30%. Strong population growth means higher levels of consumption compared to previous years, resulting in an expected growth of industrial inventory requirements over the coming years. We believe that the recent widening of this spread over the last decade, coupled with the fundamental shift in purchasing behavior and the decentralization of the supply chain to the benefit of end user markets, creates a compelling trifecta for industrial outperformance in the Rocky Mountain area going forward.

These are the trends that we believe will continue driving growth in Colorado and the Rocky Mountain region and why we're especially bullish on industrial in our backyard. ▲

### Rietz

Continued from Page 28

tioned to become a viable alternative to Denver. Traditionally known as a hub for aerospace and defense, Colorado Springs offers a solid economic foundation, which has proved attractive for companies outside of those industries and future residents. Companies that previously believed they could easily distribute their products from Denver will soon realize that, with the complications with last-mile facilities and I-25 congestion, to best service the Colorado Springs market they must be in Colorado Springs.

■ **Tailor your strategy to projected demand.** Commercial real estate developers might have their eyes on the horizon to pursue large parcels of undeveloped land in Colorado, such as near Denver International Airport, but small, infill industrial projects have long had a history of outperforming the big-box projects, and this will hold true in 2022.

In an urban core like Denver or a growing city like Colorado Springs, there often are undeveloped parcels of land, vacant lots or empty buildings that are primed for redevelop-

ment and opportunity. An example of this type of project is Central Park Business Center, a speculative infill industrial park that our team has developed, located at the intersection of Interstate 70 and Central Park Boulevard. Representing one of the few undeveloped infill sites in this market, the site has experienced interest from industrial users looking for convenient access for logistics and distribution throughout the metro area. Class A buildings with highway frontage and easy access for customers are a rare find in Denver, but they cater to a single large user or multiple mid-sized tenants.

When mapping a strategy to meet the demand for industrial space in the Denver and Colorado Springs markets, developers must keep in mind the three core tenets of a successful industrial property: location, visibility and access.

Denver always has been and will continue to be "the darling" of Colorado. However, secondary markets like Colorado Springs and Fort Collins are picking up momentum and becoming attractive residential and business destinations. As the Denver metro



Highfield Business Park, a joint development project from Confluent Development and Bradbury Properties, is a 100-acre industrial hub located in unincorporated Douglas County.

area continues to evolve, in 2022 we'll see companies become more keenly aware of the bevy of industrial and logistical opportunities that these alternative markets have to offer.

The significant rise in e-commerce and notable shifts in the competitive retail market on a national scale have local impacts. In Colorado, a growing population, coupled with heightened consumer demand for

same-day delivery, will result in a critical need for last-mile delivery properties that effectively encompass the entire market. In 2022, developers may want to consider planting a flag in each corner of the Front Range to capture these demands and trends as this state continues to grow beyond Denver. ▲

mrietz@confluentdev.com