



Denver office market: Recovery is full steam ahead



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Record sales, increasing lease rates, falling vacancy! The smiles on the faces of office building owners and real estate brokers are well justified. All the statistics show the market's best performance since 2001. So, what makes this market recovery better than the boom times of the 1980s and 1990s, both of which having been followed by a market crash?

For those intricately involved in the continued creation of value in Denver properties, this is a very important question. To answer this, let's look at some economic market highlights:

- Job growth drives the market and Colorado's unemployment rate dropped to an impressive 3.6 percent.
- Colorado placed highly on the honor roll for the Corporation for Enterprise Development with high marks for location, business competitiveness and prospects for future growth.
- Improved transportation systems with the completion of T-REX and higher-than-expected ridership created development opportunities along the light-rail corridors.

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- Significant increase in lease rates in all classes of office property still reflect an occupancy cost well below the lease rate that would be related to new construction.
- The real estate market is mirroring the record levels exhibited on stock market indexes of the New York Stock Exchange. For a change, real estate is not moving countercyclically to alternative investments.

But, before we assume this wonderful world of rising values and occupancy will never cease, we would be well served to take a look on the horizon for the leading edge of any black clouds that may be gathering.

Items that may directly or indirectly affect office market performance might include the following:

1. The war in Iraq. While this seems far removed from local impact, we have learned the world is indeed flat. And what happens thousands of miles away may have a way of showing up on our local economic doorstep.

2. Rising interest rates. We have all become "Fed watchers" for signs that an improving economy and falling joblessness leads to inflation and a quick response from the Fed with a rise in interest rates. It is no secret that real estate values move in the opposite direction of interest rates.

3. A change in the balance of supply and demand as office building developers move to create new product. The central business district has more than 1.3 million square feet under construction with almost all of that amount in Class A product, which requires the highest possible lease rates to justify the costs of these new buildings. Suburban development is much more measured and at this time only represents an amount approximately one-half of the square footage under construction in the CBD.

4. Continued deterioration in the housing market as significant foreclosures continue and home values drop. The economic boom in the early part of this decade was driven in large measure by perceived increases in personal wealth as home values soared. Individuals purchased new homes and invested in second homes. Home construction and related industries expanded rapidly to meet with demand as capital flowed relentlessly into the home market. When rising interest rates slowed demand and increased the monthly mortgage costs, foreclosures followed and values began to drop. Families were forced to revalue their budgets with energy and housing costs taking a much bigger bite of the families' income. This particular area of concern requires close and ongoing examination.

Given this quick review of positives and negatives, what is the forecast for the rest of year? In the near term for the balance of 2007 it is unlikely that anything will be significant enough to disrupt the market momentum being experienced today. The business climate is excellent; Colorado's reputation as a state with underwriting characteristics that justify large capital investment is growing; and the unusual balance between supply and demand all should combine to see even more records established by the end of the year. I look for lease rates to continue to rise, vacancy to continue to fall and office property values to continue to rise.

If timing is everything (as well as location), then be pleased you were here to enjoy this special time. Keep on smiling, but be vigilant. Time brings cycles and changes.