

January 9, 2012

A Denver Based Commercial Real Estate Investment and Management Company
Contact Ken Gillis at 303-407-8715

Technology, Energy Hubs to Outperform the National Office Market in 2012

After generating strong momentum in the first half of 2011, the national office sector will experience slow growth in 2012. The financial crisis in Europe, coupled with government budget-cutting in the U.S., will put a damper on demand for new office space next year, except for the select markets that serve as homes to technology firms and energy companies. By the end of 2011, the average office vacancy rate for the U.S. as a whole will stand at 16.8 percent, according to research by Grubb & Ellis, a national real estate services firm. Over the course of 2012 it will likely budge just 110 basis points, to 15.7 percent. What's more, average rents will continue to stagnate. Asking rents on class-A properties might rise 0.7 percent next year, while rents on class-B buildings will go up 0.2 percent, according to Robert Bach, senior vice president and chief economist with Grubb & Ellis. "In some ways, it's the best case scenario. It's hard to fathom right now how what's going on in Europe is going to affect the financial markets and exports," Bach notes. "The U.S. economic indicators seem to be picking up, but at the same time, some of the global indicators are softening. Growth in the U.S. won't be robust if the rest of the world isn't participating, and that will carry over into leasing demand for commercial real estate." Research from real estate services firms Jones Lang LaSalle and Cushman & Wakefield supports this thesis. Jones Lang LaSalle estimates that today, the vacancy rate in the U.S. office market stands at 17.5 percent. Over the course of next year, it might reach 16.5 percent, but is unlikely to drop further. "Twelve months ago, we would have predicted that it would come down below 16 percent, but we don't see that as a result of companies being a little more conservative in their hiring," says John Sikaitis, director of office research with the firm. The most recent Bureau of Labor Statistics employment report, issued on Dec. 2, estimates the national unemployment rate in November at 8.6 percent, its lowest level since March 2009. However, the job openings rate in October, the most recent month for which data is available, stood at 3.3 million—a decline from 3.4 million in September. "The level of leasing activity we saw in the first half of 2011 has tapered off," says Maria T. Sicola, executive managing director for Americas research at brokerage firm Cushman & Wakefield. "We just don't see the demand there and the strong employment growth yet." The markets that have a high concentration of technology and energy firms might see a different picture next year. Because technology and energy sectors have been experiencing strong growth lately, leasing demand in such cities should begin to fall in line with supply. The outperformers will likely include San Francisco, Seattle, Houston, Oklahoma City and Pittsburgh. In San Francisco, the heart of Silicon Valley, Cushman & Wakefield expects the vacancy rate for class-A office buildings in the Central Business District (CBD) to fall to 8.8 percent, from 9.5 percent today. In 2013, the vacancy rate in San Francisco's CBD will likely drop further, to 7.4 percent. "It's not necessarily the banks and the law firms that have been responsible for the office sector recovery: it's technology and sciences and energy," Sicola notes. "It's the Googles and the Twitters, and their employees have been driving where they want to be. It will be very interesting to keep an eye on Silicon Valley in particular. That's a market that's very, very strong." Nevertheless, Cushman & Wakefield expects rents to stay flat throughout most markets in the country in 2012. So does Jones Lang LaSalle. "Many markets are still bouncing around the bottom," says Sikaitis. "Nationally, we might see a slight uptick, but it's going to be very minor." In view of a muted outlook for office sector fundamentals, investments sales activity next year will show only moderate growth. There is plenty of capital still waiting to be deployed, according to Sikaitis, so class-A office buildings in primary and secondary markets will continue to get

traded. But given that the industry posted a 45 percent increase in office sales this year, a 15 to 20 percent increase next year will look more measured by comparison. It will also be more within historical norms. Part of the reason investment sales showed such strong growth in 2010 and 2011 was because the industry was coming off almost no activity in 2009, according to Bach. But real estate investors still remember the consequences of risky deals made in 2006 and 2007, so they will continue to look carefully at property fundamentals before plunking down their money. "What we are really doing here is returning to normal," Bach says. "There is a good amount of liquidity, both debt and equity, there is price transparency and fairly reasonable expectations on the part of sellers. It will be like something we saw in 2004." In 2004, the U.S. office market saw \$74.5 billion in investment sales, according to Real Capital Analytics, a New York City-based research firm. The average cap rate on office transactions that year was 7.99 percent. **(National Real Estate Investor/Elaine Misonzhnik)**

...

Real Deals: Portland Company Buys Offices at the Promenade

A Portland, Ore.-based commercial real estate investment company has completed its first purchase in the Denver market, buying the Offices at the Promenade in the Denver Tech Center. Felton Properties Inc. bought the two-building, 128,000-square-foot office complex for \$11.7 million, or \$91 per square foot. Equity West Investment Partners LLC sold the buildings, 7935 and 7995 E. Prentice Ave., Greenwood Village, which also came with nine acres of land. "We are very excited about entering the Denver market," President Matt Felton said in a news release. "We think that we have found a market where deals with intrinsic value can be purchased at a price that makes sense." Managing Director David Reinhart said in an interview that Felton Properties has been investigating the Denver market for six months and were swayed by a few area highlights. "Denver is in a recovery mode, which was nice to see," Reinhart said. "And there's some good office space leasing momentum throughout downtown and the southeast suburban markets. So those two factors got us interested." Cushman & Wakefield Vice Chairmen Tim Richey and Mike Winn, along with associate Chad Flynn and Senior Director Patrick Devereaux, represented Equity West. "This location is right in the heart of the Denver Tech Center on a large parcel of land," Winn said. "Strategically, this is a piece they saw a lot of potential with and an upside over time with this asset." The brokers received more than 10 offers. "It's really unusual to find a older building in a double 'A' location like this," Winn said. Reinhart agreed the location of the Class B buildings, which Equity West redeveloped in 2007, was the biggest selling point. "We believe that over time, tenants will place a higher and higher value on being able to walk from their office buildings to get lunch, get coffee and take care of errands during the day," Reinhart said in the release. "These buildings provide that better than almost any in the DTC. With these buildings, we're able to deliver tenants a Class A experience at a lower price point." The buildings are adjacent to the retail center Belleview Promenade, near I-25 and Belleview Avenue. Felton, (www.feltonpropertiesinc.com) which owns and operates some 2.5 million square feet of commercial real estate in Oregon and Washington, plans additional upgrades to the buildings' mechanical systems. They were 75 percent leased at the time of the sale. "Our strategy, or main focus, right now in Denver is those two markets," Reinhart said. "But we're really looking at properties anywhere in

metro Denver.” Said Felton, via the news release: “We are looking forward to substantially growing our footprint in Denver.” **(Denver Business Journal)**

...

Newmark Predicts Better CRE Market in 2012

Metro Denver’s commercial real estate finished 2011 stronger than 2010, and looks even brighter for 2012 — depending on growth in key economic sectors such as employment, housing, manufacturing and consumer spending — according to a 2011 year-end report by Denver-based Newmark Knight Frank Frederick Ross. All three submarkets finished the year with positive, full-year absorption — meaning business used more space in 2011 than 2010 — had decreased vacancy rates and stable rent rates that at least stayed flat or grew slightly in some submarkets, according to the report. “Our local economy has made solid and consistent progress in the last few months, and the Denver market continues to build momentum,” Kevin McCabe, executive vice president, states in the report, released Friday. “I believe we’ll look back on 2012 as the year we finally came out of this downturn. I’m bullish on all sectors of the Denver market for 2012.” Here’s a breakdown of the three submarkets:

- **Office** — The fourth quarter helped boost the office market’s absorption level above 2010’s, with 1.4 million square feet for all of 2011, compared to 1.1 million for 2010. The overall vacancy rate, which includes both direct and sublease, finished at 18.1 percent, down from 2010’s rate of 18.9 percent. The median rental rate was \$17.58, with the strongest rents still coming in the central business district (CBD) at \$24.35, and the Skyline and LoDo submarkets leading the way at \$28.15 and \$26.50, respectively. “The future of Denver’s CBD has never looked brighter,” Tom Lee, executive managing director, stated in the report. “The last 18 months brought an influx of new tenants, including Bridgepoint, HealthGrades, DaVita, Jacobs Engineering, AON, Suncor Energy and Hub International. Union Station is taking shape with redevelopment plans for the historical building moving forward. Decision makers are realizing that Downtown is the place to be.” NKFFR’s research points out the stark difference in the demand for Class A space versus B or C, dubbing it “increasingly bifurcated.” “The Class A sector posted full-year absorption of 1,343,469 square feet, and vacancy decreased year-over-year from 17.8% to 15.1% while the Class B and C sectors ended the year with flat absorption and no improvement in vacancy,” the report states. “The first half of 2012 will bring strong gains in occupancy from leases signed this year,” according to Lee. “There are positive trends in the labor market. Colorado’s unemployment rate fell to 8.0% in November, which is the lowest rate since March 2009, and we are anticipating continued growth in the service sector, including energy, engineering and law.”

- **Industrial** — “Even though the worst seems to be behind us, it’s still a slow industrial market overall,” said Chris Nordling, senior managing director, said in the report. “For the small to mid-size spaces, with a few exceptions, not many tenants are expanding or moving around in the market, so we show relatively flat net absorption for the year.” The overall absorption was almost flat, with 8,306 square feet in the black. The report breaks out the warehouse segment, with a negative absorption of 76,449 square feet, while 84,755 square feet of R&D/flex space was scooped up. “The big tenants in the R&D/Flex market this year

have been the telecommunications, medical and health care companies," said David Lee, executive managing director. "Their requirements for large blocks of space with high finish, data center compatible, loading capacity, and significant amounts of parking are features that the office market cannot provide." The highest median rent rates were in the northwest submarket at \$7.25 per square foot and southwest submarket at \$7.24. "Very likely by the end of 2012, we will see rates increase by 3 to 5% in the Southeast Suburban Class A R&D/Flex submarket," Lee said. "Other submarkets could also see some large-block activity in early 2012," the report states. "General Electric Solar has already leased 280,000 square feet at 19503 East 34th Drive, Building 20 at Majestic Commercenter and is expected to occupy the space sometime during the first quarter of 2012."

• **Retail** — Look no further than Ikea's big blue box store at I-25, between County Line and Dry Creek roads, for the push in retail absorption numbers for 2011. It occupied its 415,000-square-foot store at midyear and helped push the overall vacancy rate to 9.4 percent. The report also noted H&M taking over the NikeTown spot at the Denver Pavilions downtown. "Denver's retail market was robust in the face of significant closures by national retailers resulting in over 500,000 square feet of negative absorption," Justin Kliever, managing director, stated in the report. "Even so, the Denver retail market ended the year with positive absorption and with stable vacancy and rental rates." Total absorption for 2011 came in at 451,705 square feet, with the small strip and single-tenant space being absorbed the most and "super-regional" — or big box spaces — having the most negative absorption, with 201,794 vacated. No surprise the highest median rental rates came from the Cherry Creek submarket, at \$28.25 per square foot, followed by the CBD at \$23.75. The lowest rates occurred in the west submarket, at \$13.50 per square foot. "In addition to these new international retailers, many empty big-box and grocery spaces were backfilled by retailers looking to expand their presence in the Denver market," Kliever said. "Infill development will drive growth over the next few years, including the Sembler Company's redevelopment of the former University of Colorado Hospital campus, the King Soopers anchor in the Kent Place infill project, located at Hampden and University, and the Target-anchored center that will replace the aging Tamarac Square. We expect Walmart to start backfilling empty grocery spaces next year with its 50,000-square-foot Neighborhood Market concept." **(Denver Business Journal)**

...

U.S. Unemployment Nears 3-Year Low; 200,000 Jobs Added in December

The U.S. unemployment rate fell another notch in December, to 8.5 percent, reaching its lowest level in almost three years, as the nation's economy added 200,000 nonfarm payroll jobs. The latest report, released Friday by the U.S. Department of Labor Bureau of Labor Statistics was better than many economists had expected, and "certainly suggests that labor market conditions are improving," said Paul Ashworth, chief U.S. economist for Capital Economics in Toronto. Some analysts had predicted an uptick in the unemployment rate, Bloomberg reported. The December jobless rate -- down from a revised 8.7 percent in November -- is the lowest since February 2009, and is down 0.6 percentage points since August 2011. The latest Colorado employment report, covering November, showed a jobless rate of 8 percent for the state. BLS's survey of the nation's employers showed that private companies added 212,000 payroll jobs last month, while government jobs fell by

12,000. The biggest gains were in transportation and warehousing, retail trade, durable-goods manufacturing, health care, and mining. The U.S. economy has now added at least 100,000 jobs each of the last six months for the first time since 2006, officials said. For full-year 2011, the nation added 1.6 million payroll nonfarm jobs, up from 940,000 added in 2010. Average hourly wages in December stood at \$23.24, up 2.1 percent from a year earlier, but lower than the inflation rate of 3.4 percent for the same period, BLS said. The agency's separate survey of households, from which the unemployment rate is compiled, showed that the number of unemployed Americans actively seeking jobs has declined by 823,000 since August, to 13.1 million. BLS said 42.5 percent of the unemployed have been jobless for 27 weeks or more. Another 8.1 million people are working part-time because they can't find full-time work or have had their hours cut back. And 2.5 million are counted as "marginally attached to the workforce" -- people who said they want to work but haven't looked for a job in the last four weeks. The household survey includes farm and non-payroll jobs not covered by the employer survey, including the self-employed. The numbers are adjusted for normal seasonal job fluctuations. The administration of President Barack Obama -- who has been blasted as "a job killer" by Republican presidential front-runner Mitt Romney -- was quick to tout the new employment numbers as a fresh sign that its economic-recovery strategy is working. Alan Krueger, chairman of Democrat Obama's Council of Economic Advisers, hailed Friday's jobs report as "further evidence that the economy is continuing to heal from the worst economic downturn since the Great Depression. It is critical that we continue the economic policies that are helping us to dig our way out of the deep hole that was caused by the recession that began at the end of 2007." But GOP House Speaker John Boehner issued a statement saying that, while "it's good news that more Americans found work last month despite a sluggish economy," December was the 35th straight month with an unemployment rate over 8 percent. "In order to achieve sustained, robust job growth, both parties must work together on common-sense solutions to help small businesses create jobs," said Boehner, R-Ohio, who accused Democrats in the U.S. Senate of blocking "nearly 30 jobs bills" passed by the Republican-led House of Representatives. The new job numbers follow a series of upbeat reports Thursday that pointed to improvement in the U.S. job market as private payrolls surged, planned layoffs fell and initial claims for unemployment declined, Tucker Echols of the Washington Business Journal reports. Payroll firm ADP Inc. estimated private employers added 325,000 jobs in December, the best gain since December 2010. Outplacement firm Challenger Gray & Christmas Inc. reported that planned layoffs in December declined 1.6 percent from November to 41,785, the lowest level since June. And initial jobless claims fell by 15,000 in the last week of December to 372,000, according to the U.S. Labor Department. The four-week average of new claims also declined, falling by 3,250 to 373,250. That is the lowest level since June 2008. And the Labor Department said continuing claims, which are reported with a one-week lag, fell by 22,000 to a seasonally adjusted 3.6 million in the week ended Dec. 24. **(Denver Business Journal)**

...

	CURRENT	1 MONTH PRIOR	1 YEAR PRIOR
FED TARGET RATE	.25	.25	.25
3 MONTH LIBOR	.58	.54	.30
PRIME RATE	3.25	3.25	3.25
10 YEAR TREASURY	1.98	2.03	3.40
30 YEAR TREASURY	3.02	3.06	4.51