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PROPERTY MANAGEMENT *Quarterly*

Stormy waters for Denver office

Strategies to keep your builidng afloat

It's no secret that Denver's office market is in stormy waters. The vacancy rate hit an all-time high at 33.8% in second-quarter 2024. This has disproportionately affected Denver's stock of 1980s builds compared to buildings constructed after 2015, which have a much lower vacancy rate – as low as 5% in the Cherry Creek submarket, according to a recent news article.

■ **Contributing factors.** Remote/hybrid work, our new office norm, has left companies to reconsider how they use their office space. Many are moving to more affordable suburban submarkets or to Cherry Creek to scale up and further define their company culture. Meanwhile, downtown has lost its mojo and often feels like one big construction site in its effort to revive.

An upswing of commercial office sales between 2020 and 2022 of $7.7 billion has contributed to the increase in 2023 property tax assessments despite the occupancy problem. The 2025 reassessment will offer some reprieve, leaving Denver County with a hole in its revenue to take care of the pressing issues like homelessness and crime.

In addition to these waves, over 5.8 million square feet of sublease space is available – a key indicator of market distress – creating additional inner-market competition between office landlords and tenants on the move. As companies are rightsizing their office space, two trends seem to be emerging to entice workers back to the office: 1) building out beautiful, attractive spaces; and 2) finding buildings with great amenities. In either case, it leaves the older Denver office spaces flailing.

The new buildings are where tenants want to be *if* they choose to be downtown – and that's a big *"if."* What's more, over the next two years, 2.3 million sf of office space

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is set to come on line, with 51.1% of this space already preleased, according to Avison Young's second-quarter 2024 market report.

So where does that leave Class B office space built in the 1980s? In some unfortunate cases, in default and unable to make loan payments.

■ **Default on CMBS loans.** The rise in vacancy rates can be partially attributed to the distress caused by commercial mortgage-backed securities loan defaults as landlords struggle to maintain occupancy and meet debt obligations. CMBS are a way for banks to turn loans into bonds and sell them to investors. This helps spread the risk and makes it easier for companies to get big loans for commercial properties.

Generally, CMBS loans offer lower interest rates, higher leverage, and risk distribution but come with less flexibility, prepayment penalties, and a complex structure. As the previously outlined pressures have born down on Denver's office market, the less flexible terms of CMBS loans have forced about 65% of Denver's CMBS loans into default and foreclosure – the second- highest CMBS distress in the nation (after Chicago). Buildings like 700 17th Street are in foreclosure and even further below the new vacancy rate watermark. This is due to contracting tenant footprints, more attractive submarkets, new buildings with better amenities and downtown's struggle to stay relevant.

Strategies to keep your building afloat

In Denver's challenging office market, landlords need to adopt long-term strategies that focus on flexibility, tenant retention, and value enhancement.

■ **Flexible leasing and digital marketing.** It is crucial for landlords to provide flexible lease terms – shorter durations and rent concessions are trending up to accommodate the needs of tenants. Similarly, landlords need to leverage technology to bring their building into the modern age. Buildings hoping to survive this downturn need to utilize online platforms, social media and virtual tours to reach a wider audience. Make sure to highlight any unique features and build an interactive vacancy model showing the exact location of available spaces. Most sophisticated listing brokers can help with this. Any landlords doing their own renewals should consider bringing their broker back into the conversation to incentivize them to help keep tenants in place. Landlords cutting the listing broker out of renewals may be stepping over dollars to pick up dimes. Strong broker relationships will almost certainly enhance your property's visibility in the market.

■ **Tenant retention.** With tenant retention being more critical than ever, a responsive maintenance and management team is just the tip of the iceberg. Proactive check-ins with tenants are a must and hosting networking and tenant appreciation events helps build community. Invest in modern amenities and flex spaces like co-working areas and meeting rooms to cater to tenant "right-sizing" trends.

■ **Value enhancement.** Energy-efficient systems and sustainable practices are not meant just to appease burdensome benchmarking requirements. They attract eco-conscious tenants and lower operating costs, making your property more attractive. Focus on aesthetics where it matters – upgrade restrooms on floors with upcoming turnover, keep your lobbies modern and clean, no broken machines in your fitness centers, etc.

In a down market, commercial property managers play an imperative role in mitigating vacancy and attracting tenants. As you complete your 2025 budgets, make sure some of these strategies are discussed and addressed in your asset plan with your landlord. Be the lifeboat your landlord needs you to be. ▲

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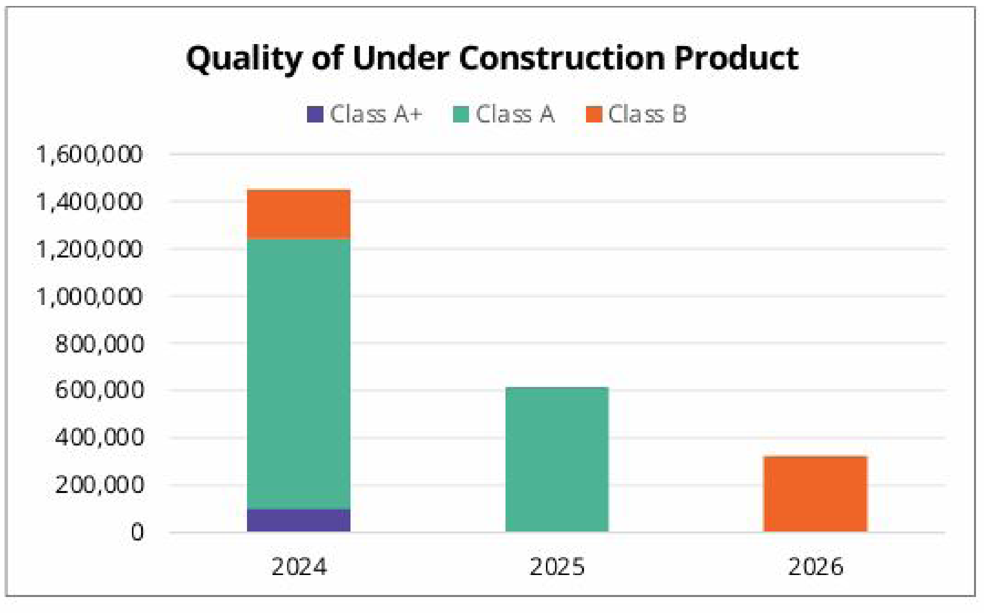

Over the next two years, 2.3 million square feet of office space is set to come online, with 51.1% of this space already preleased according to Avison Young.

Colorado Front Range – Commercial Sale Transaction Volume
7/1/2020 through 6/30/2022

OFFICE		INDUSTRIAL		RETAIL		MULTI-FAMILY	
Sale Volume ($)	Sale Transactions (#)	Sale Volume ($)	Sale Transactions (#)	Sale Volume ($)	Sale Transactions (#)	Sale Volume ($)	Sale Transactions (#)
$7.7B	1,934	$6.1B	1,781	$5.6B	2,975	$21.8B	1,674

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