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Office market shows signs of recovering

[Michael Perrault](#)

Denver Business Journal

Most of metro Denver's office market continues its robust recovery two months into 2006, with landlords ratcheting up rents as available space tightens downtown, in Cherry Creek and in other areas of the city.

Some sectors, however, are lagging behind, with vacancy rates edging upward. Others have negative absorption rates, prompting landlords to offer more concessions or drop lease rates. For tenants eyeing expansion or relocation into portions of Aurora and Denver, such market stagnation can mean opportunities for better lease deals.

In the southeast suburbs, which includes the Denver Tech Center and Inverness Business Park, 1.2 million square feet of space was absorbed last year, more than four times the absorption rate of the next-closest sector, said Phillip Ruschmeyer, senior managing director of [Frederick Ross Co.](#)'s commercial real estate services division in Denver.

"In the southeast suburbs where you may have had 40 buildings that had 40,000 square feet a year-and-a-half ago, you probably only have 20 buildings right now," Ruschmeyer said. "So we're doing a lot of leasing. There's a tenant looking at taking the entire IGC building."

The sprawling southeast suburban office sector boasts 29 million square feet of space, about 22 percent of which is vacant. While that vacancy rate is only down about 2.5 percentage points from a year earlier, the figure is a little misleading, Ruschmeyer said. The sector added almost 2.5 million square feet of new space last year as single-tenant buildings were converted to multitenant space.

In contrast, an area just to the north of the southeast suburbs -- from Hampden Avenue north to about Sixth Avenue, and from Broadway east to I-225 -- has lagged behind in its recovery. Of 8.6 million square feet of office space in that sector, 2.4 million square feet remain vacant -- a 27.6 percent vacancy rate, according to Frederick Ross Co.'s year-end report.

Class B buildings in that sector posted a negative absorption rate of more than 180,000 square feet, bringing the vacancy rate to 33.3 percent, up from 29 percent last year.

The vacancy rate in the central business district, encompassing 23 million square feet in the heart of downtown, has dipped to 16 percent, with a median leasing rate of \$18 per square foot. Brokerage CB Richard Ellis reported that the central business district experienced the highest absorption of all sub-markets in Denver, with a year-end total of 863,317 square feet. It's a trend that helped spur a dozen building acquisitions last year in the area, the company reported.

"The central business district appears to be tightening up," said Jim McGrath, senior vice president and branch manager of commercial real estate services firm Studley in Denver. "Clearly, that's the case with Class A space, especially any kind of space that has decent western views. We were recently out in the market with a 50,000-square-foot tenant, and I think we only found five quality options for them."

Good opportunities in Aurora

Todd Wheeler, executive director with [Cushman & Wakefield Inc.](#), said the real activity and focus is in areas with high demand and where vacancy rates are plummeting. In more stagnant office markets such as areas of Aurora, it's a different story.

Some properties in Aurora are offering "phenomenal rent opportunities and value," Wheeler said, although many big-block properties have been absorbed, scarfed up by larger tenants such as [Northrup Grumman](#) and [Corporate Express](#).

"It's really tough not to find a good opportunity in Aurora," Wheeler said. "It's an interesting mixed bag."

Lower Downtown has a vacancy rate of about 8 percent and high-rise product is commanding \$6-to-\$8-per-foot pricing differences, and the entire central business district is at about 16 percent, according to year-end reports.

"As a result, LoDo has at least four new projects that are not just on the drawing board but are going through approvals," Wheeler said.

"There's clearly a lot of pent-up demand for new product in the central business district, in LoDo or the Cherry Creek market," Wheeler said. "However, Cherry Creek's ability to absorb larger blocks of space is very suspect."

At least part of the reason for all the activity downtown is because it's populated with growing oil, finance, insurance, real estate and service companies, Ruschmeyer said. "Those industries are doing well in the economy and, in turn, are doing well here," he said. "If you look for a block of space in a Class A building in the central business district, there's nothing over a couple of floors," he said.

Frederick Ross Co. said the midtown area had overall absorption of 116,171 square feet, and vacancy rates declined more than 2 percentage points to 12.9 percent. The vacancy rate in the Glendale subsector, on the other hand, with 2.3 million total square feet, climbed to 23.5 percent from 21.5 percent, and had negative absorption of 44,877 square feet.

"The culprit was the Class B market and, within it, the Galleria North and South buildings," Ruschmeyer said.

Northwest No. 2 in absorption

The northwest sector has improved, achieving the second-highest absorption rate at just under 350,000 square feet last year, with vacancy rates at 24.7 percent, commercial brokers said. The area could get a boost from the high-tech sector this year, and 75 percent of leases in the sector will roll over in the next 27 months, according to a year-end report by [Jones Lang LaSalle](#).

The northeast sector suffered a modest setback with absorption negative at just over 35,000 square feet, Frederick Ross Co. reported. Its vacancy rates increased more than 2 points, to 17 percent from 14.6 percent.

Often, a matter of seven or eight blocks can make a big difference in both perception and rental rates.

"Look at a submarket like Cherry Creek, where demand for space north of the mall has been strong despite congestion and parking hassles," Wheeler said. "Those buildings are getting premiums of \$2 to \$8 over buildings of comparable quality east of the mall, only eight or nine blocks away."

"There are big spreads in rental [rates] from one submarket to another, really depending on the demand that occurs in that given market," he said.

Many rental increases have more to do with recent building acquisitions, commercial brokers said.

"There's so much capital that's chasing real estate, that sale prices are increasing, capitalization rates are decreasing and the only way building owners can achieve a decent return is to increase rental rates, decrease concession packages or both," McGrath said.

In a recent deal, for instance, [Brookfield Properties](#) sold the 28-story World Trade Center I and 29-story World Trade Center II buildings at 16th and Broadway to Chicago-based [Transwestern Commercial Services](#) and Palo Alto, Calif.-based [Broadreach Capital](#).

"I think rates have gone up in those buildings by a dollar or two a foot since the sale," McGrath said.

For tenants shopping for Class B or B-minus properties, there are good deals if companies can take into account challenges such as insufficient parking and floor designs or inadequate HVAC and electrical systems.

As tenants considering an expansion or move eye all the options, McGrath suggests they think strategically and give themselves enough time to consider myriad factors.

"Ideally, a tenant should think through issues such as projected headcount, location, image, business unit adequacy and budget prior to looking at office space," McGrath said. "Too many tenants treat office space as a commodity. Unfortunately, ill-conceived space can have an adverse impact on your business that could cost much more money in the long run than the actual cost of the space itself."

McGrath, Ruschmeyer, Wheeler and other commercial brokers said clients' internal expansion is driving much of the market growth, although there's increasing interest from prospective new tenants. Cushman & Wakefield is seeing companies from California and the East Coast, Wheeler said.

"We've got a 100,000-square-foot national company taking a hard look at a building we've got in the 'burbs, and another 50,000-square-foot out-of-state-company looking, and that's not all that common," Ruschmeyer said.

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