OFFICE — MARKET UPDATE

A market being relandscaped: Cautious optimism

No one reading this will be a stranger to the notable office market fluctuations in recent years caused primarily by evolving work patterns and economic shifts created by the COVID-19 pandemic. The complexity of the current landscape, further complicated by rising vacancy rates, adaptive reuse initiatives, the interest rate environment and a wide range of differing regional activity, has made it nearly impossible to forecast short- or long-term horizons.

Ground zero for Colorado being the metro Denver area, we've got some catching up to do, relatively speaking. Denver's central business district, in particular, owns a 34.9% office vacancy rate, greatly surpassing the current national average of 19.7%. We're all lucky to live is such a great state, with easy access to beautiful wilderness, outdoor recreation and vibrant urban environments, but those charms have largely led the workforce to prolong the enduring impact of hybrid and remote work programs. Quarter after quarter, we hear the good news that people will be returning to the office, and quarter after quarter, the "trickle back to the office" happens slower than we expect. Will the office environment soon reflect pre-pandemic levels of occupancy? Not likely. Will a combination of adaptive reuse, flexible landlord/ownership, settling interest rates and burgeoning industries (quantum, AI, etc.) keep us on the road toward increased and sustainable occupancy? Yes, we believe it will.

Christian Smith
Senior commercial broker, Dean Callan & Company Inc.

To combat these rising vacancy rates, developers and landlords have made monumental efforts to work with municipalities to explore adaptive reuse strategies, most notably, the conversion of aging, vacant office buildings into residential units. Easier said than done, but savvy and experienced developers have been able to navigate these waters somewhat successfully, and we will see major projects come on line toward the end of 2025 and into 2026. And while the downtown Denver office market was hit hard by the pandemic and ensuing years, certain areas have shown incredible resiliency – Cherry Creek, for example, currently boasts an impressive 8.5% office vacancy rate.

Northern Colorado has also shown impressive adaptability. While Loveland, Greeley and Fort Collins did post negative absorption for 2024 of approximately 90,000 square feet (out of roughly 10.5 million sf of net rentable area), the direct vacancy rate hovers around 6%. With almost no new product under construction, the market figures to continue its relatively strong performance.

While the Boulder County office market was significantly impacted by the abruptly transforming workforce, with a current office vacancy rate of 23%, it has remained relatively steady over the previous 12-24 months – indicating strong fundamentals and a readiness to capitalize on its highly educated workforce. The diversity of Boulder County's economy is a real strength, with significant players in the tech, aerospace, natural foods and products, and research and development spaces. The University of Colorado continues to fuel innovation, attracting startups and major companies to the area. Incentives and shorter-term lease deals offered by landlords are helping to buoy a market that was not immune to a workforce seduced by work-from-home flexibility. In addition, office vacancy rates are forecasted to decline in the short term with several significant office projects being converted to life science/lab space. But as of the first quarter, more than 20% of Boulder workforce continues to work remotely or from home. Workspace utilization continues to evolve in this unique market.

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From an investment perspective, capitalization rates on Colorado office sales continue to rise, providing motivation for opportunistic buyers. And while volume is down, anyone who works in the office investment world would say pencils are not down. The buyers are there, patiently looking for opportunities. We still have a significant expectation gap between buyers and sellers, but the gap is narrowing in real time and transactions are closing. A timely example, Lone Star Funds (you guessed right, out of Texas) recently closed on the Seventeenth Street Plaza in downtown Denver. The 709,402-sf office tower was purchased for $132.5 million, indicating a national appreciation for the Denver market and a belief in the future of office product. Investors appear focused on well-located, high-quality office properties with strong tenant profiles – or the ability to add value and bring in credit tenants for the long term.

The future of our regional markets hinges on more factors than are trackable, and they are rapidly evolving – but the Colorado office markets have largely displayed obvious signs of innovation and resiliency. The success of suburban markets with live-work-play amenities has gained traction and provides investors and developers with a road map to success. Thanks to a strong and educated workforce, the target market is there. And thanks to skillful developers and patient investors, the means are there. Optimism for the future trajectory of property values and lease rates is warranted, but as always – proceed with caution. ▲

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