



## *Rooting for the Underdog? The Office Building Investment*

Alexander F. Becker, Real Estate Consultants of Colorado, LLC

Earlier this year I was speaking with a client who owns extensive commercial real estate holdings in Colorado, including two large office buildings, and he said he would be nervous to buy another office property these days. He was voicing a concern about the office investment sector that I have been hearing often lately: the evolution of technology has (a) allowed machines to fill the roles of people (requiring businesses to lease less office space) and (b) prompted many employees to work remotely by phone, video, and internet (which again requires less office space). The result, I have witnessed, is that like big box retail, office properties as a long-term investment have become stigmatized as lacking in relevancy.

Consequently, many former office investors have shifted their attention to multi-family properties (everyone still needs a place to live) and industrial properties (goods come from shipping distribution hubs instead of retail locations in the age of online shopping). Don't get me wrong: the logic behind investing in multi-family and industrial makes sense. But as we have seen that retail is still important (exemplified by, for example, Amazon's acquisition of Whole Foods<sup>1</sup>), I argue that the office sector is here to stay and presents perhaps the best value for investor capital in Colorado today. Here are three reasons why:

First, the office remains a crucial component to successfully running most businesses. While we have all witnessed the rise in the remote workforce,

---

<sup>1</sup> Brent Kendall and Heather Haddon. *FTC Approves Amazon-Whole Foods Merger*. *The Wall Street Journal*. <https://www.wsj.com/> August 23, 2017.



companies large (for example, IBM<sup>2</sup>) and small are reversing work-from-home policies because there is no substitute for the benefits of in-person collaboration. Furthermore the increasingly competitive job market today is prompting company decision makers to [further] define their image through their office space – of course for clients who visit but also for themselves and for recruiting and retaining the best talent. Nearly 100 percent of my office lease tours start with a client-led conversation about the image they wish to achieve in their new office because they want their employees and recruits to be excited about coming to work. And offices are cool again! Collaborative office concepts are popping up everywhere - even in “regular” office buildings - and existing operations like WeWork are expanding into more office space at greater velocity than ever.<sup>3</sup> Although individual offices in these co-working facilities are efficient, consider the massive common areas that tip the scale back towards more old-fashioned square-foot-per-employee figures.

Next, consider office properties’ relatively high return on investment. Margins are thinning for commercial real estate investments across the board in Colorado but my perception is the non-office asset classes are doing so more rapidly. These days it is nearly a guarantee that on-market multi-family investments are offered at sub- 6 percent or even sub- 5 percent cap rates. Industrial and retail investment properties are often offered at sub- 7 percent rates. Compare that to the 28 office buildings over 10,000 square feet listed for sale in Denver County as an

---

<sup>2</sup> Chris Weller. *IBM Was a Pioneer in the Work-From-Home Revolution – Now It’s Cracking Down*. Business Insider. <http://www.businessinsider.com/> March 27, 2017.

<sup>3</sup> Amy DiPierro. *WeWork is Out Hunting Again for More Office Space*. Business Den. <http://www.businessden.com/>. July 31, 2017.



investment on Costar in late August, of which 78 percent had a cap rate advertised at 7 percent or higher.<sup>4</sup> Whereas five years ago when full service office leases without expense reconciliation provisions were prevalent, office landlords are more frequently switching to a NNN platform or requiring a hard-line expense reconciliation policy for “full service” leases. The result is the landlord’s lack of responsibility to eat rising tax and CAM expenses – and a clearer path to profitability.

And lastly, consider Denver office leasing trends in recent years. Office rates exceeding \$50 per square foot in Union Station and Cherry Creek have pushed tenant demand to the east side of Downtown, Glendale and DTC, where you would be hard pressed to find a full service Class B offering for less than the high \$20’s (downtown) and mid \$20’s (in Glendale and Cherry Creek) – representing a double digit increase in just the last few years. In the first two quarters of 2017, leasing absorption is positive despite nearly a million square feet of deliveries per quarter, while the vacancy rate has decreased by over five percent since 2009.<sup>5</sup> Average rental rates and cap rates have each increased by 1 percent in Q2 over Q1 2017.<sup>6</sup> Factor in Colorado’s expected population growth,<sup>7</sup> the increasing strength of the entrepreneurial and tech scenes, and it would appear the Denver investment office market is on solid ground.

---

<sup>4</sup> Costar Office Search Conducted August 30, 2017. <http://www.costar.com>.

<sup>5</sup> *Costar Office Statistics: Denver Office Market*. Mid-Year 2017. <http://www.costar.com/>.

<sup>6</sup> *Id.*

<sup>7</sup> Kevin Hamm. *Colorado’s Population Could Increase by Nearly 3 Million People by 2050, According to Forecast Numbers*. *The Denver Post*. July 28, 2017. <http://www.denverpost.com>.



In summary, while the office market is evolving, it is not dying. The office place will maintain its importance in American commerce; higher returns are readily available for office investors; and the office market remains healthy in Denver. A quality I admire most in my clients is their motivation to go where the profits are, regardless of their asset type comfort; what I have noticed is those willing to keep an open mind, or better yet, buck the current trend, oftentimes enjoy the most success.