Focus on Colorado Springs & So. Front Range

Question of the Week

Is the Colorado Springs market poised for recovery?

Stephen G. Bach

With industrial vacancy rates continuing to hover above 10 percent — down from the market's all-time high of 13 percent in 1985 but well above the record 5 percent low of the mid-1990s — users and owners in Colorado Springs are being presented with some unique opportunities.

Stephen G. Bach
President, Bach Commercial Brokerage Co., Colorado Springs

■ **Nontraditional uses.** Innovative brokers are starting to clue into nontraditional uses for the abundance of industrial/warehouse space currently on the market. With manufacturing and assembly jobs headed offshore and conventional users on the decline, the question becomes, "What other types of users need high ceilings, ample parking, cafeteria facilities and large restrooms?" Think schools, churches or health club/sports facilities. While the applications may seem out-of-the-ordinary, the fit is certainly there. For example, the James Irwin Charter Schools in Colorado Springs recently found the ideal home for its growing student body in a former warehouse/assembly facility in the southeast part of the city.

■ **Owning vs. leasing.** Another emerging trend is toward suite ownership in industrial/flex complexes. A popular practice in markets including Phoenix and Orange County, Calif., ownership benefits are abundant. Additional tax deductions and insurance against future rent increases are primary motivators along with the opportunity to build equity that many small-business owners consider a future retirement plan. Users comparing the relative costs of building their own stand-alone facility to purchasing one or more suites in a new, master-planned business park may find cost savings of up to 50 percent, not to mention saving time; it can easily take up to two years to build and occupy a new facility. Bottom line, tenants who are accustomed to leasing can realistically own their space in the range of $4 to $5 a square foot— about 40 percent less than a traditional leasing approach.

■ **Cycles repeat.** It can't be repeated often enough: Cycles repeat. Vacancy and rental rates inevitably — and inversely — rise and fall. The fact that rates in newer, well-located Colorado Springs industrial properties are starting to edge up is catching some prospective tenants by surprise, as landlords begin to be less forthcoming with the major concessions that a soft leasing market encourages. To interpret this trend as a sign of turnaround is premature. But market indicators — and historical trends — bear early evidence of a correcting market that will ultimately rebound. It will, however, be a market that has been reshaped by the oversupply and underdemand of recent years.

Jay P. Carlson, CLS

The quick answer as to whether Colorado Springs is poised for recovery is yes. However, as the saying goes, "The devil is in the details."

Here are some of those devilish details: Over the last two years Colorado Springs has lost more than 9,000 jobs. Early in 2003 Fort Carson sent more than 11,000 troops to the war in Iraq. Most key economic indicators for the Colorado Springs economy registered losses in 2003. All but two retail sales categories, tracked by city sales tax collections, showed negative gains in 2003 compared with 2002.

On the positive side, record-low interest rates in the residential and commercial lending arena buoyed the Colorado Springs economy in 2003. Feeding off the low interest rates, residential construction continued at a very healthy rate of over 5,200 permits issued, keeping us well above the 4,000 annual permit level, which marks a healthy residential construction market for Colorado Springs.

Jay P. Carlson, CLS
Retail specialist, Front Range Commercial, Colorado Springs

In 2003, the retail sector of the commercial real estate market remained relatively strong. Demand for leasing of existing retail space remained steady, to some degree driven by displaced high-tech workers wanting to control their own destiny by entering entrepreneurial retail businesses. The national retail interest in Colorado Springs continued at a furious pace evidenced by expansion of existing national retailers in the marketplace: Target, Kohl's, Wild Oats Market, Home Depot, Wal-Mart and King Soopers, among many others. Many new national entrants in our retail market include Galyan's, Whole Foods, Shoe Carnival and numerous upscale retail additions never seen in the Colorado Springs marketplace — such as those at the new Shops at Briargate Lifestyle Center, which opened on the north end, bringing PF Chang's, Champps, Pottery Barn, Ann Taylor, et al.

Shopping center vacancy rates inched up in 2003 to 8.8 percent, a rate very manageable compared with the higher-than-20 percent vacancy rates of the early 1990s. Shopping center sale prices experienced big growth in 2003; the weighted average sale price per square foot of shopping centers sold was up by more than 50 percent compared with 2002, driven by investor dollars seeking a limited supply of good retail investment property.

So why do I believe the Colorado Springs retail market is "poised" for recovery? Our local economists tell us that there is a rebound in the high-technology field that will prompt new employment. There is a surge in business investment, including new plant and equipment by Colorado Springs' manufacturers. Many of our 11,000 Fort Carson troops will be back in town by the end of April of this year, pumping their pent-up dollars into the economy. The stock market and consumer confidence improved tremendously in 2003, across the country and in Colorado Springs in particular. The headquarters for Department of Homeland Defense opened in Colorado Springs in 2003 and is attracting defense contractors to Colorado Springs that are gearing up for expansion in 2004. Scheduled new retail developments will be completed throughout 2004, and there are many national retailers currently scouting the market for new locations.

In 2004, Colorado Springs' consumer retail market will turn the corner into positive sales growth as the overall Colorado Springs economy puts into place the foundation blocks necessary to grow the economy. Overall, 2004 will be a year our economy will get back on its feet. However, in order to build on the economic foundation laid in 2004, we must attract and produce thousands of new primary jobs annually in Colorado Springs.

Doug Carter

Our recovery is under way. As the saying goes, "A rising tide floats all ships." Last year was our low tide.

This month marks the beginning of the recovery in our apartment market. The return of Fort Carson troops is the start of the tide coming in, the beginning of a lengthy up cycle.

Most of us in the Colorado Springs apartment market are thrilled to see the new year. Last year was difficult in both the rental and sales markets. Average asking rents dropped for the third year; citywide average vacancies peaked at 14 percent in June, a 13-year high. We finished the year at 12.8 percent.

Doug Carter
Founder and president, Doug Carter LLC, Colorado Springs

Simple supply and demand forces created our market problems with four negative events converging: 1) The weak economy and resulting job losses meant fewer renters; 2) 11,000 soldiers from Fort Carson were deployed in April; 3) many renters became homebuyers in the wake of record-low interest rates; and 4) 1,700 new apartment units were completed and delivered to our market. We have been fighting two battles during the past couple of years: too many new apartments and fewer renters to occupy them.

Apartment sales totaled $64 million last year, down from $230 million in 2000. If we exclude two buildings that were part of a national portfolio, sales totaled only $38 million. The number of apartment closings totaled 20, down from a 10-year average of 37 sales. Almost all sales were smaller buildings. Again, taking out the portfolio sale, only two building larger than 100 units sold.

What happened? Apartment incomes are down enough that owners chose not to sell. They knew that the Fort Carson troops would return and that better times lie ahead. Buyers thought they would enjoy distressed sales and great buys. However, sellers simply said no to lower values. The few owners who did sell received record prices, again as a result of record-low interest rates. There remain many more buyers than sellers, resulting in top prices for the sellers.

This year, we will see market stability and then a slow improvement during the second half of the year. At least two of the negative influences from last year will not exist. First, the 500 remaining apartment units under construction will be completed and leased during this quarter. The building cycle for apartments is over. Second, Fort Carson troops are returning between now and May. This alone will cause an improvement in this market. Additional new jobs are expected for Colorado Springs. The pace of this job growth will determine the pace of recovery in our apartment market.

Also, sales will increase this year as buyers and sellers adjust to new market realities. Investors want to grow their portfolios and are frustrated that they did not buy last year. We will recognize the 12 months that our troops were gone as the market bottom. Buyers will factor in less risk and they will lower their return requirements in the interest of completing more acquisitions. Sellers will acknowledge the changes in their incomes and to their values. A quick fix to our lower incomes is not in the near future; however, eventually, there will be more closings.

George Swintz

In contrast to the last real estate market downturn in the 1980s, the Colorado Springs market is well-positioned for recovery. By simply looking at basic real estate statistical measures, the environment that still attracts people to Colorado, and the interest rate environment, it is easy to predict that recovery is right around the corner.

George Swintz
Senior broker associate, Grubb & Ellis|Quantum Commercial Group, Colorado Springs

The average vacancy rate, which has been tracked in Colorado Springs now for more than 20 years, points toward positive trends. Office vacancy rates are on the decline, registering at 11.5 percent, including sublease space, at year-end 2003. By contrast, office vacancies at the end of the last downturn were nearly 17 percent in 1991. Retail vacancy rates that approached 23 percent in 1991 have held consistently low, around 8.8 percent for a three-year time frame ending Dec. 31, 2003. Even industrial rates, which have edged up to 11.6 percent, were registering 9.6 percent in 1991. Some experts suggest that the equilibrium vacancy rate is nearly 10 percent. Lower vacancy rates mean that there is less space, on a percentage basis, to be absorbed before rental rates will again rise.

If we contrast suburban office vacancies for Albuquerque, N.M., Las Vegas, Phoenix, Salt Lake City and Denver, which range between 13 percent and 22 percent, Colorado Springs' vacancy rate of approximately 9 percent looks pretty good.

Average asking rental rates have fallen off only slightly in the office arena, while rates have actually increased in the retail side of the market. Of course, the vast amount of new retail construction, generating higher rental rates, has had a tendency to elevate the average asking rates for *all* retail product types. Industrial rental rates have fallen slightly but never seem to fluctuate significantly, hovering around the $6.50 per-square-foot range for the last seven years.

New construction has waned as well, adding only a minimal amount of speculative space to the market for the last couple of years. The pipeline for 2004 looks lean, which should permit existing property owners to secure higher levels of occupancy without new competition. The one area of new construction that shines in a positive vein is the strong demand for new single-family housing. In February alone, there were 404 single-family permits pulled, an increase of nearly 26 percent over the same month last year.

Sublease space is no longer a major factor, as large blocks of space have been put back into the hands of entrepreneurial real estate investors. These "master" landlords have higher motivations and respond quicker than companies whose primary course of business is *not* subleasing their space. Only 2 percent of Colorado Springs' office vacancy is accredited to sublease space. Nationally, sublease space accounts for 4 percent of all office vacancy.

Some would say that the retail market never experienced a downturn. Pent-up demand to retail services has kept the retail market just chugging along without a hiccup. Let's face it, we are a consumer society, and we will do most anything to satisfy our comfortable lifestyles. This trend bodes well for continued strength in

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