CBRE RESEARCH

REAL ESTATE MARKET OUTLOOK

2017

Denver

CBRE

CBRE is pleased to present our 2017 Market Outlook report, which represents not only the work of our dedicated research team but also the expertise of our 500 professionals on the ground in Denver, the Denver Tech Center, Boulder, Colorado Springs and Fort Collins.

With 400 offices in 60+ countries and more than 70,000 employees (excluding affiliate offices), CBRE is the world's largest commercial real estate services and investment firm. As the market leader in Colorado, we mobilize our global scale into actionable local insights that empower our clients to make informed real estate decisions that drive growth for their businesses and add value to their bottom line.

ECONOMIC TAILWINDS SUPPORT SOLID GROWTH FORECAST FOR 2017

Denver's economy was strong and steady in 2016 with greater employment growth than expected and continued in-migration of a talented workforce. National headwinds may come into play in 2017, testing certain components of the economy, but the overall foundation is strong and continued growth can be expected.

DENVER ECONOMIC INDICATORS

Employment gains for metro Denver topped 50,000 in 2016, marking the fourth consecutive year of this level of growth – a new record for the metro area. Employment grew by 3.2% in 2016 – 7th highest among all major U.S. metros and more than double the Moody's prediction in Q4 2015. Industry sectors that experienced the most growth included Natural Resources & Construction (8.6%), Leisure & Hospitality (6.3%), Education & Health Services (3.6%), and Professional & Business Services (3.3%). [1] Looking ahead, all sectors are expected to see positive employment growth in 2017, albeit at a moderated pace.

[1] U.S. BLS, Feb. 2017.

KEY ECONOMIC STATS

3RD	Highest State Net Migration Rate (2010-2016)
4.0%	Denver GDP Growth (2015)
3.1%	Denver Area Unemployment Rate (2016 Average)

Unemployment in Denver/Boulder reached new post-recession lows, averaging 3.1% in 2016, a drop from 3.6% in 2015 and 4.7% in 2014. These levels are well-below the long-run unemployment average (5.4%) and the natural unemployment rate (5.0%), causing tight labor market conditions for a few years now.[2]

The Denver MSA experienced 4.0% GDP growth in 2015, which was 16th highest among the 100 largest U.S. metros and significantly greater than the all-metro GDP growth average of 2.5%.[3] Economic growth is expected to moderate across the board in the U.S. as the end of the business cycle approaches.

Metro Denver population growth trended upward each consecutive year between 2005 and 2015 – reaching nearly 40,000 people in 2015.

DEMOGRAPHICS

Positive in-migration contributes locally to company expansions, greater residential demand and thus a need for more commercial real estate space. Well-educated residents support the growing demand for high tech, aerospace and engineering employees, and Denver has the fourth greatest proportion of residents with a bachelor's degree.[4] Colorado had the third greatest cumulative net migration rate between 2010 and 2016, but the state fell to seventh last year.[5] Metro Denver population growth trended upward each consecutive year between 2005 and 2015 – reaching nearly 40,000 people in 2015. The pace is estimated to have slowed down in 2016 and will moderate further in 2017 – giving the metro area a chance to adjust to some growing pains.

OUTLOOK

TIGHT LABOR MARKET
RISING COST OF LIVING
SLOW WAGE GROWTH

(headwind)

Denver ranked as the second best city for job seekers in 2017, according to NerdWallet. However, the metro's low unemployment rate and abundance of jobs are offset by stagnant wage growth and a rising cost of living. After adjusting for inflation, the median weekly wage for the Denver MSA has depreciated in recent years—falling from $20.33 in 2010 to $19.83 in 2015.[6] This is because nominal wages have not kept pace with the cost of living. Housing costs are driving much of this trend – the average home price appreciated 38.8%[7] during that time and the average apartment rent rose 47.4%.[8] This not only affects peoples' willingness to live and work in Denver, but also their retail spending habits.

INFRASTRUCTURE

(tailwind)

Denver's growth has been accommodated by nearly $14 billion of infrastructure improvements that are currently underway or have been completed in the past three years. Looking forward, as the final FasTracks commuter lines open in 2018, infrastructure improvements will remain a key feature in the health of the Denver market. The Trump administration has listed a highway project south of Denver as a priority while Governor Hickenlooper put transportation infrastructure at the top of his list for the next two years.

[2] U.S. BLS, Feb. 2017.
[3] U.S. BEA, Feb. 2017.
[4] U.S. Census Bureau, 2015 (Ranking is out of the 50 largest U.S. metros).
[5] U.S. Census Bureau, Feb. 2017.
[6] U.S. BLS CES, Feb. 2017.
[7] S&P CoreLogic Case-Shiller Index, Feb. 2017.
[8] CBRE Econometric Advisors, Q1 2017.

ENERGY
(tailwind)

Since Denver's economy is well-diversified, it was able to weather the downturn in the oil and gas industry that lasted from Q4 2014 to Q2 2016, but downtown still had 484,000 sq. ft. of office sublease space come online and gas prices are on the rise. Domestic drilling is already staging a comeback, but fossil fuels companies are unlikely to seek more Denver office space in the near-term as they brace for another recession and demand side shock.

TRADE POLICY
(headwind)

If President Trump's agenda succeeds and the U.S. suspends adherence with NAFTA and cancels unilateral trade agreements with Mexico, then Denver's GDP growth could suffer. In 2015, Colorado's exports to Canada and Mexico, the state's top trading partners, valued more than $2.5 billion.[9] Critics worry that raising tariffs on Mexican products could affect Colorado manufacturers who import parts from abroad in order to finish their products, and also make it harder to sell goods and services to neighboring countries.

LOOSENING FINANCIAL RESTRICTIONS
(unknown)

Repealing the Dodd-Frank Act – which requires more oversight of the lending practices of financial institutions after the Financial Crisis – ambiguously affects the economic outlook. While the traditional banking sector could see growth, most banks have already implemented the costly regulations, and a repeal could potentially damage the slew of unconventional institutions that arose to fill the lending gaps. However, there may be a positive effect as more funding is made available for development, thereby creating a late-cycle increase in commercial and residential construction.

OTHER TRUMP ADMINISTRATION PRIORITIES
(unknown)

Lowering taxes for corporations could potentially stimulate the economy, both at a local and national level, by incentivizing companies to hire more workers and invest in research and development. Repealing the Affordable Care Act, on the other hand, could depress local medical office absorption. While not directly affected by the new administration, the Fed's goal to target a higher federal funds rate could result in higher real wages and boost the spending power of the working populous. Other effects of rising interest rates will be discussed in the capital markets section.

INVESTMENT IN TECHNOLOGY
(tailwind)

Denver's investment in technology and renewable energy will increase the market's long-term economic health. Denver is partnering with Panasonic and Xcel Energy among others, to create the nation's smartest city - Peña Station NEXT – which will feature smart lighting, driverless shuttles, a solar microgrid, and will act as a lab for testing new technologies and business models. CDOT has also teamed up with Panasonic to test autonomous and connected vehicles on Colorado highways. Additionally, Colorado is a leader in renewable energy with as much as 13.6% of generated electricity coming from wind.[10]

[9] World Trade Center Denver, Mar. 2016.
[10] Colorado Energy Office, 2016.

CONCLUSION

Real U.S. GDP rose by 1.6% in 2016 and more tepid growth is anticipated in 2017 as economists do not foresee a change in the business cycle until the end of 2018. In spite of a multitude of unknown factors at play both nationally and locally, Denver can expect more solid growth in 2017 due to a series of robust economic indicators. Strong economic performance supports strong traditional commercial real estate markets through several avenues and the overall health of the economy improves Denver's favorability among investors and developers, driving capital markets and land sales to new heights. While the inclement effects of economic cycles are unavoidable, the metro area's economic performance and future preparedness can be supported by investment in infrastructure, housing for people of all income levels and incentives for business creation, as well as investments in the lifestyle that makes it attractive to people and establishments.

Denver can expect more solid growth in 2017 due to a series of robust economic indicators.

EXPECT STRONG APPETITE FOR DENVER'S REAL ASSETS

A number of market forces underpin our outlook that investment activity in Denver's commercial real estate will remain robust throughout the year. Strong economic and real estate fundamentals position Denver as a market for sustained growth and these dynamics continue gaining the attention of local, national and foreign capital.

Despite national sales volumes falling 11% last year, Denver posted its seventh consecutive year of growth as commercial real estate sales cleared $12.9 billion in transactions during 2016. This represents a 23% year-over-year increase in total sales volume and was supported by abundant capital, strong market fundamentals and strong employment growth. Denver ranked ninth among the nation's largest markets for total commercial transaction volume in 2016 and sixth for the year-over-year increase in volume.

KEY INVESTMENT STATS

▼ 9.0%	2016 Denver NPI Return (all property types)
▲ $12.9B	Denver Sales Volume in 2016 (office, industrial, retail, multifamily and hotel)
▲ 5.1%	Average Office Cap Rate

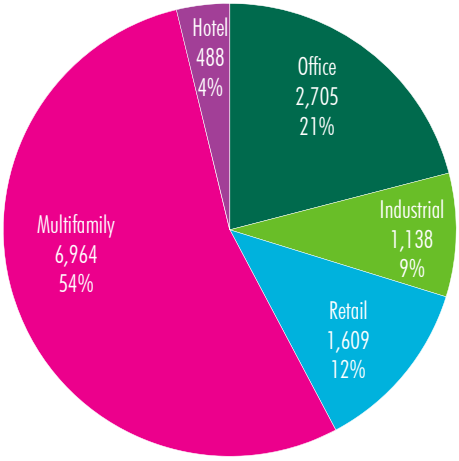
Source: CBRE Research, Q4 2016.

Multifamily transactions dominated both overall activity and growth in Denver—and set a record for annual transaction volume with $6.4 billion, well above its pre-recession peak. Industrial and retail sectors also finished 2016 with record highs of $935.3 million and $1.3 billion transactions, respectively. Office reported a 6.0% decline in sales volume from 2015, although the average price increased to $213.0 per sq. ft. from $195.5 in 2015.

Looking ahead, a wide availability of capital should remain a boon for the market throughout the balance of the year—although the volatility in the bond markets as well as persistent regulatory pressure may be a drag on CMBS and bank-lending activity. Global capital sources still consider the U.S. commercial real estate market a favorable destination when considering the comparatively strong economy and the lack of high returns elsewhere—and Denver's strong economic and real estate fundamentals continue gaining the attention of local, national and foreign capital and have helped increase Denver's share of national transaction volumes.

Pricing should remain relatively steady in 2017. Denver's cap rates have not compressed to the same extent as many of the gateway markets—and although the Federal Reserve Board has proposed two or three interest rate hikes for 2017, the Denver market is less likely to experience a significant correction in cap rates. So, while this new environment of increasing interest rates will put upward pressure on caps, the impact will not be one-to-one.

Denver Commercial Sales Volume, 2016 ($, Millions)



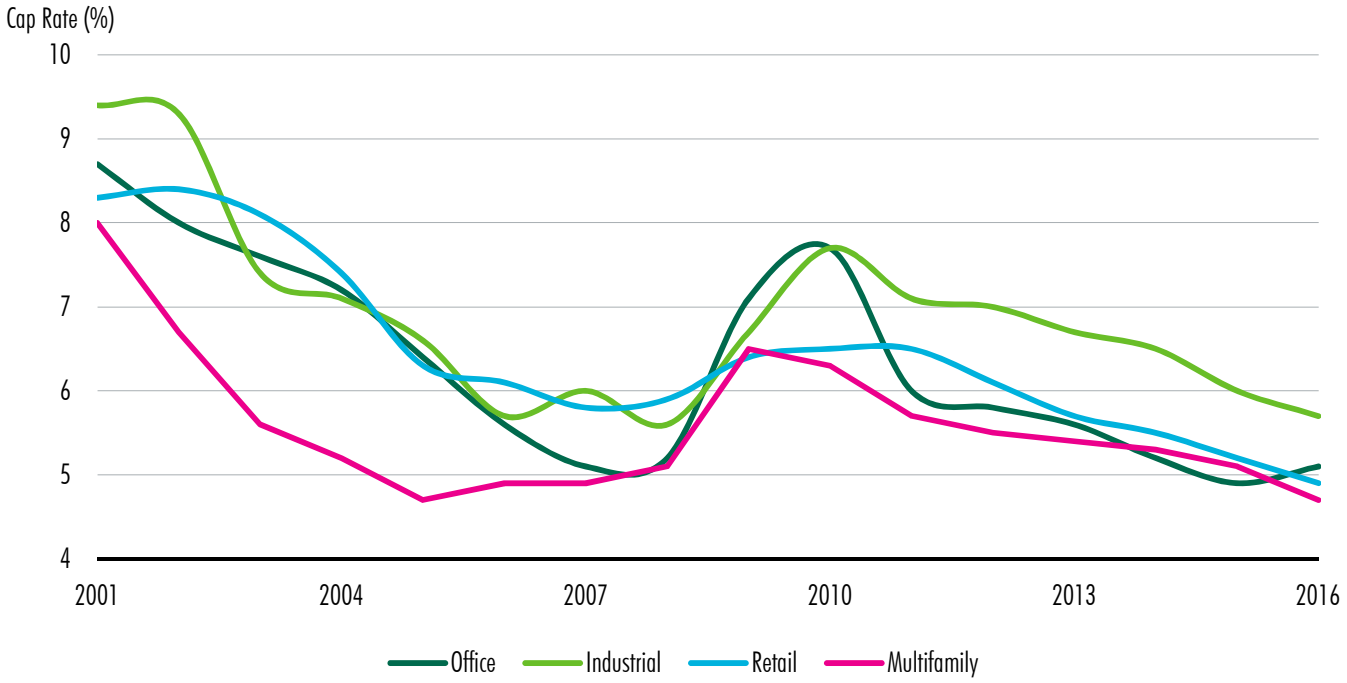
Source: Real Capital Analytics, Q4 2016.

Year-Over-Year Change in Sales Volume, 2015 vs 2016

	Total	Office	Industrial	Retail	Multifamily	Hotel
U.S.	-11%	-6%	-24%	-16%	3%	-29%
Denver	23%	-6%	13%	23%	50%	-28%

Source: Real Capital Analytics, Q4 2016.
Note: Includes sales over $2.5 million.

Cap Rates by Sector

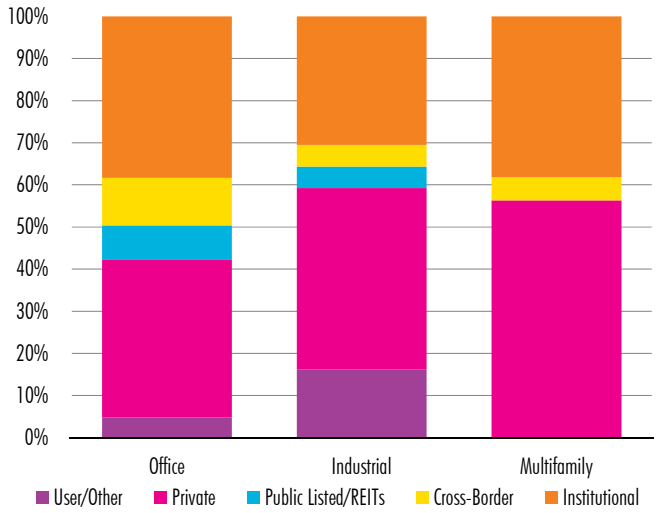


Source: CBRE Econometric Advisors, CBRE Research, Q4 2016.

FOREIGN INVESTMENT

Denver secured $788 million of foreign capital investment across property types in 2016. This represents 6.1% of the total sales volume and compares with the 13% that originated from cross-border capital in 2015. Kuwaiti and Canadian investors were the most active buyers of Denver real estate by sales volume. Wafra Capital's purchase of the Breakers Resort, a 1,523-unit apartment complex for a record price of $350 million (or close to $230,000 per unit), was one of the most significant 2016 foreign capital investment deals. It also marked the largest apartment trade in Colorado's history. Considering the deceleration in several Asian economies and the continued strength of the U.S. economy, foreign investment appetite for U.S. assets will remain strong and Denver will continue to attract an increasing share of these flows.

Buyer Types by Property Type, 2016

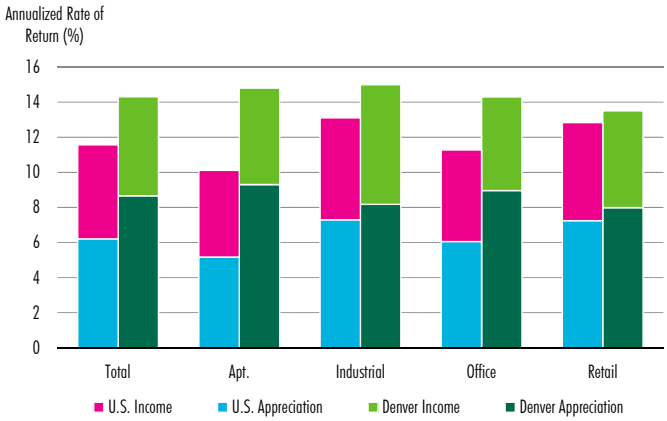


Source: Real Capital Analytics, Q4 2016.

RETURNS

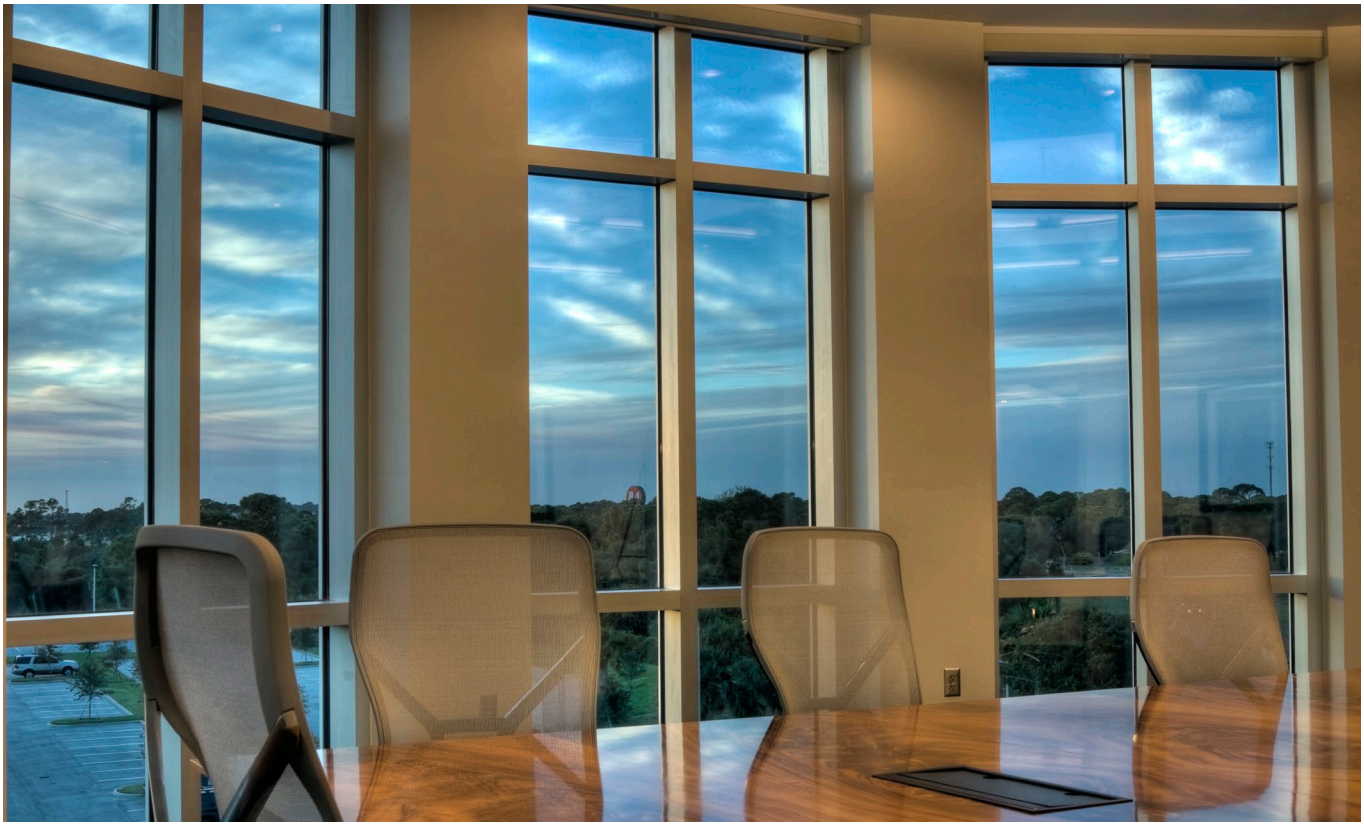
The moderating trend in the NCREIF U.S. Property Index (NPI) indicates that total returns have stabilized—due in part to slowing appreciation. The Q4 2016 NPI revealed a national 8.0% annualized total return for all property types due to a 3.1% appreciation return and a 4.8% income return. Appreciation was more volatile this year, and compared to an 8.0% appreciation in 2015. Denver reported annualized total return of 9.0% and higher-than-average returns in all property types. The industrial sector posted the highest total return (13.9%), followed by apartment (11.0%), retail (9.3%), and office (4.6%) returns.

NPI Returns by Property Type, 2016



Source: NCREIF, Q4 2016.

NEW DELIVERIES TO INCREASE VACANCY IN SUBURBAN MARKETS



Over 2.2 million sq. ft. of speculative construction is expected to deliver in 2017, with 1.9 million sq. ft. of the space in suburban markets. With just 26% pre-leased at the start of 2017, large block availabilities are expected to elevate vacancy and increase lease rates in premier Class A space.

Throughout 2016, office fundamentals continued improving due to the sustained recovery of the local and national economy. Over 500,000 sq. ft. of new office space delivered in 2016, which created additional options for tenants in a market that continued to tighten. Over 1.3 million sq. ft. was absorbed in 2016, right in line with the 5-year average. Positive net absorption pushed vacancy down to 12.1% at the end of 2016, the lowest year-end vacancy since 2000. The low vacancy, coupled with an all-time high in lease rates ($25.71 per sq. ft. FSG), has pushed overall development totals to 5.4 million sq. ft. and speculative (spec) construction totals to 4.4 million sq. ft. Nearly 32% of the spec space is currently pre-leased, however 46% of the pre-leased space is in the Downtown submarket.

KEY OFFICE STATS

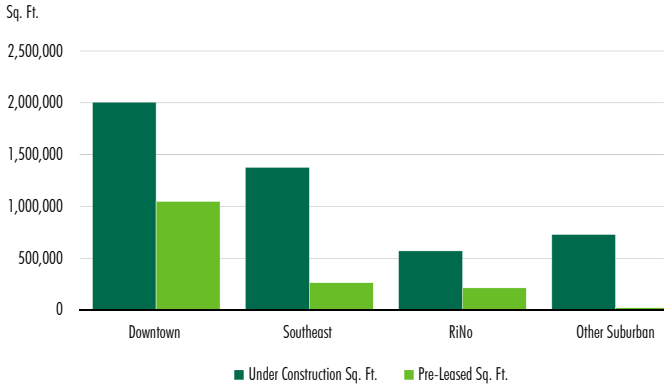
▼ 12.1%	12.1% Vacancy Rate
▲ $25.71	FSG Lease Rate
▲ 3.2 MSF	Sublease Availability
▲ 5.0 MSF	Under Construction

Source: CBRE Research, Q4 2016.

After three straight years of over $2.1 billion dollars in investment activity, 2016 saw a slight dip in transaction volume as $1.9 traded hands in the year. That being said, there were limited assets available to trade Downtown through the year. This was largely due to healthy Downtown activity from 2013 to 2015, and the suburban assets carried the bulk of the investment volume in 2016 as nearly 77% of investment volume was occurred outside of the Downtown submarket. Over the past five years, $10.5 billion in office assets traded hands. In 2017, investment activity is expected to slow overall, but remain healthy in suburban markets, where there are more assets available to trade.

Nationally, suburban markets are expected to outperform core CBD's in 2017, but this may not be the case for Denver. Over 2.2 million sq. ft. of spec construction is expected to deliver in 2017, with 1.9 million sq. ft. set to deliver in suburban markets. Of the 2017 suburban deliveries, 26% of the space is currently pre-leased – 11% comes from Comcast taking the entirety of INOVA I at Dry Creek in the Southeast. In the Downtown area, only 350,000 sq. ft. is expected to deliver between two buildings that are currently 48% pre-leased. The large amount of spec deliveries in the suburban markets with limited pre-leasing will increase vacancy. This is particularly true in the Southeast, where 950,000 sq. ft. of spec space is set to deliver, which would result in a more tenant-friendly environment. In 2018, 1.4 million sq. ft. is expected to deliver Downtown. However, 48% of the space is already pre-leased and migration to the submarket is expected to remain healthy from both in and out-of-state users.

Speculative Office Construction Pre-Leasing



Source: CBRE Research, Q4 2016.

Financing for new office construction began constricting due to a wealth of supply set to come online and projections of a downturn in late 2018 and early 2019. Despite that fact, strong migration forecasts and employment growth will continue to push Denver into the upper echelon of Tier 2 markets. New deliveries will boost lease rates as large blocks of high quality available space will push the weighted lease rate up. Rates will stabilize as space is leased in premier space over the course of 2017, but the Denver market is poised to continue its 15-quarter streak of an all-time high lease rate. In Downtown, renovations have occurred or have started in older Class A and Class B buildings in an effort to remain competitive with the new deliveries from the current cycle. This will cause the spread between lease rates between Class A and Class B space to narrow.

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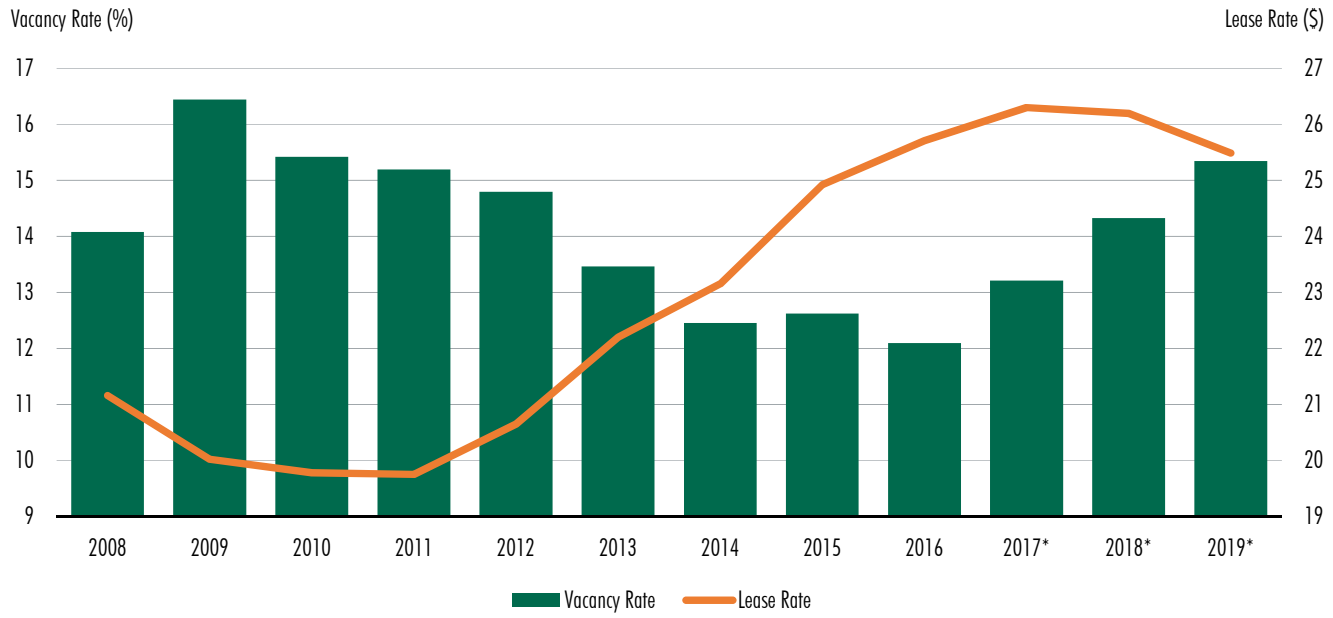
Although pre-leasing activity has remained limited and there is cause for pause in construction activity, the supply of new construction has been justified. Over the past five years, over 5 million sq. ft. delivered in Denver's office market. During that same time, nearly 7 million sq. ft. of positive net absorption was recorded, dropping the vacancy rate 310 basis points (bps). In the current cycle, Denver has seen a surge of net in-migration and the metro area has seen over 95,000 office using jobs added since 2010. This surge in office-employment is projected to continue over the next few years as Denver offers a high quality of life and a lower cost of living than Tier 1 office markets. The surge in office-using employment is a main contributor to the shrinking footprint of occupied square feet per employee. As employers grow, a greater number of employees are asked to share existing spaces. This is not atypical of previous cycle trends, as employee footprints have decreased in each previous cycle—before rising again during a downturn.
After a lull throughout the course of 2016 and a wealth of

Office Vacancy and Lease Rates



Source: CBRE Research and CBRE Econometric Advisors, Q4 2016.

sublease space put on market, the energy sector has shown signs of life in the Denver market. A well-known oil company signed a lease to occupy 123,000 sq. ft. at Riverview at 1700 Platte and will move its Americas headquarters to Denver. Other energy companies are still feeling the reverberations of the slowdown as major firms such as Encana and Noble Energy are still expected to decrease their footprint in the Denver market.

The continued emergence of Denver's technology sector has helped to hedge the negative impact of the energy slowdown – particularly Downtown where the majority of oil firms are located. The long term outlook for Denver is positive as strong migration, rising employment and diverse industry mix will keep Denver on a path of sustained growth.

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STRONG LEASING AND CONSTRUCTION EXPECTED IN 2017

The medical office market is well-positioned for continued expansion due to a strong economy, growing interest among investors and an increasing consumer base. In 2017, we anticipate continued strength in leasing activity and construction.

Denver's medical office market continued a trend of stable improvement in key fundamentals to round out a strong year. The average direct asking lease rate increased to $27.45 per sq. ft. FSG. The availability reached 12.8% at the year-end, up 88 bps over the last 12 months. Positive net absorption of 162,620 sq. ft. in 2016 resulted in direct vacancy of 10.7% in Q4 2016. Year-to-date transaction volume reached $105.2 million, an increase of 20.9% year–over-year. Looking forward, investment activity is expected to remain strong in 2017. Denver medical office will continue to be an attractive niche sector in 2017 and will likely gain momentum in the long term. The sector benefits from the increasing employment base of the healthcare sector in metro Denver as well as favorable demographic trends that are affecting the region.

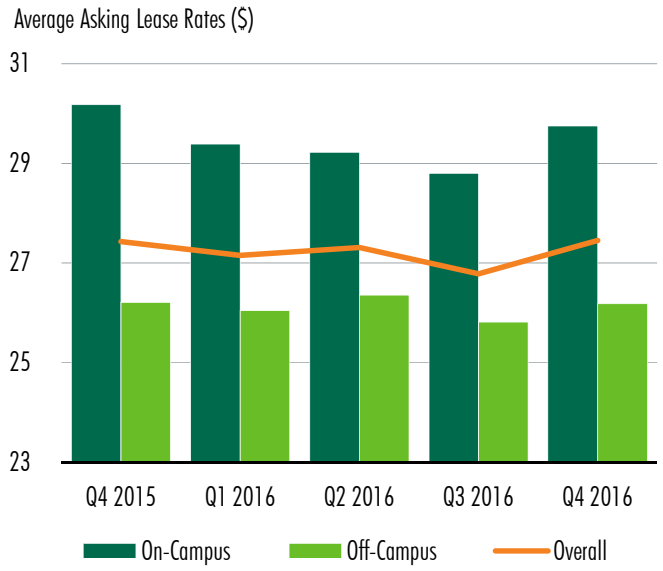
KEY MEDICAL OFFICE STATS

$27.45	FSG Lease Rate
167,351 SF	Under Construction
162,620 SF	YTD Net Absorption

Source: CBRE Research, Q4 2016.

Although a new administration poses some uncertainty, the healthcare industry continued to see noticeable consolidation activity. DaVita, a Denver-based medical group acquired Mountain View Medical Group after they bought out Colorado Spring Health Partners. This merger trend will continue in 2017 and stimulate new medical office construction due to the demand of higher quality and large medical space to meet the criteria of these expanded healthcare providers.

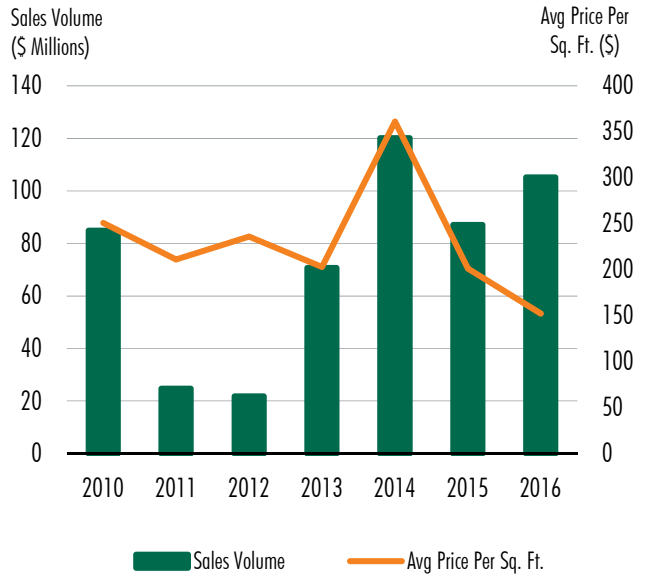
Medical Office Lease Rates by Quarter



Source: CBRE Research, Q4 2016.

Overall, the medical office market is well-positioned for continued expansion. Any changes made to the Affordable Care Act will be a long-term transition and won't have an immediate impact on the medical office sector. Simultaneously, commercial insurance is pushing more and more care to outpatient centers. Medical offices are in demand with a much higher volume of patients. Denver, which is a leader in innovative healthcare and technology, is expected to remain at the forefront of national user's expansion plans and capital investment. Strengthening fundamentals and continued economic progress will support the ability of healthcare systems to grow quality services and increase market reach in response to demand, allowing investors and lenders to elevate the value of their assets and level up the number of transactions.

Medical Office Investment Sales Volume vs. Average Price Per Sq. Ft.



Source: CBRE Research, Q4 2016.

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MORE GROWTH AHEAD

The Denver Industrial market is poised for more growth after a strong 2016, as solid economic fundamentals and e-commerce fuel demand. Historically low vacancy is expected to continue for a sixth year as absorption is predicted to be in line with the elevated amount of new supply in 2017.

Industrial property sector fundamentals were favorable throughout the year as exemplified by record high lease rates, low vacancy, positive net absorption and robust construction activity. Leasing activity amounted to 10.9 million sq. ft. in total activity – the strongest level since 2012. Unprecedented job and population growth in Denver will continue to drive growth in the food & beverage, construction/infrastructure, logistics and e-commerce industries, as it did in 2016. The e-commerce industry emerged strongly in 2016 as demonstrated by the large leases done by two e-commerce companies of 450,000 and 250,000 sq. ft. Forecasts call for continued growth in e-commerce sales; thus, these large leases are expected to continue in 2017.

KEY INDUSTRIAL STATS

▼ 4.7%	Direct Vacancy Rate
▲ $7.41	NNN Lease Rate
▲ 4.9 MSF	Under Construction

Source: CBRE Research, Q4 2016.

Metro Denver overall and industrial-using employment was strong in 2016 and that trend looks to continue in 2017 with a healthy local economy. Employment in industrial-using sectors increased by 1.4% on an average year-to-date basis through December 2016. An influx of e-commerce centers in Denver may soon bolster warehouse and distribution job growth further upward.

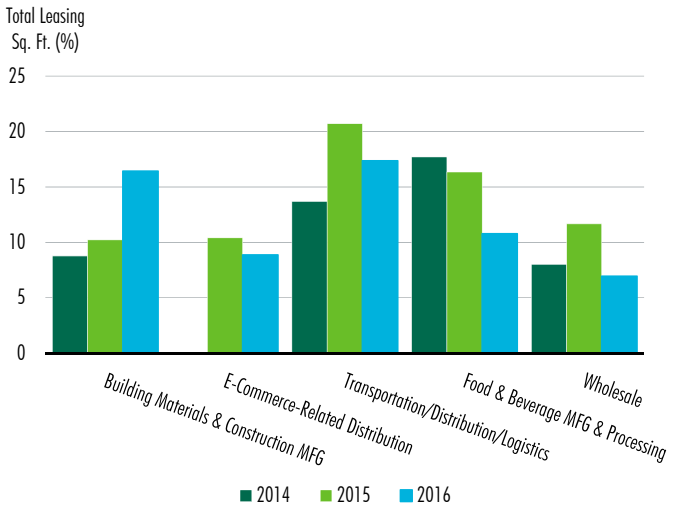
U.S. e-commerce sales are forecasted to rise by a 9.3% annual average over the next five years—clearly good news for industrial markets. Technology continues to reshape the logistics landscape and generate growing demand for space and consumer demand remains buoyant—something we expect to continue with the inflationary pressures on wages that are still building. Residential building permits is another important metric influencing demand for Denver industrial. In 2016, single-family detached permits increased 6.6% over 2015 while multifamily permits were up a whopping 37.4% and leading overall permit activity. Barring any unforeseen events, near term construction activity will stay heightened in the residential markets—including single family, condominiums and multifamily.

VACANCY/ABSORPTION/LEASE RATES

For the Denver industrial market, 2016 closed the year with the 27th consecutive quarter of positive net absorption for a total of 3.8 million sq. ft. This was an 82% increase over 2015 mainly due to a large amount of pre-leased under construction buildings coming online. This trend will continue in 2017 as many pre-leased buildings in the pipeline will deliver this year. E-commerce demand is also predicted to keep the positive streak going as it requires three times more space on average than traditional warehouse users. Vacancy reached a new cycle low in Q4 2016 at just 4.7%. This is down from a high of 7.9% (Q1 2010) and has remained below 5% for five straight years. The growing supply pipeline presents the greatest short-term risk, albeit a small one, and could put some upward pressure on availability and vacancy going forward.

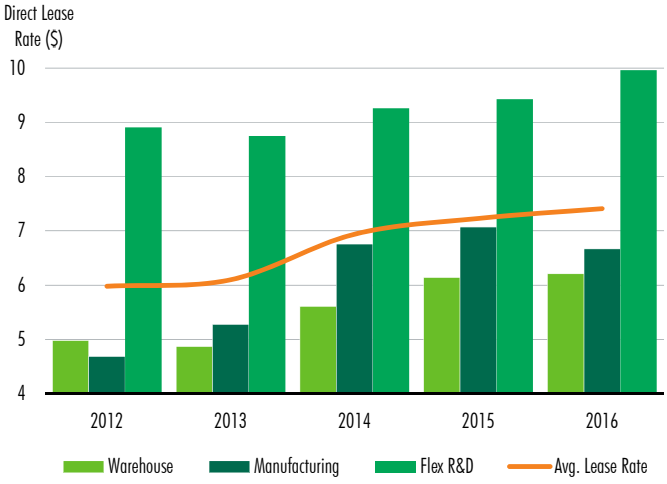
The overall average direct asking lease rate continued climbing steadily, ending 2016 at $7.41 per sq. ft. triple net (NNN) and surpassing the prior historic record set in 2015. Flex rates led the increase, ending the year at $9.96 per sq. ft. NNN for an impressive 5.6% increase year-over-year. Supply chain changes will continue to create significant premiums for small bay last mile product in a central land constrained market where new supply and availabilities are limited.

Industrial Leasing Activity by Top 5 Industries



Source: CBRE Research, Q4 2016.

Industrial Lease Rates by Product Type



Source: CBRE Research, Q4 2016.

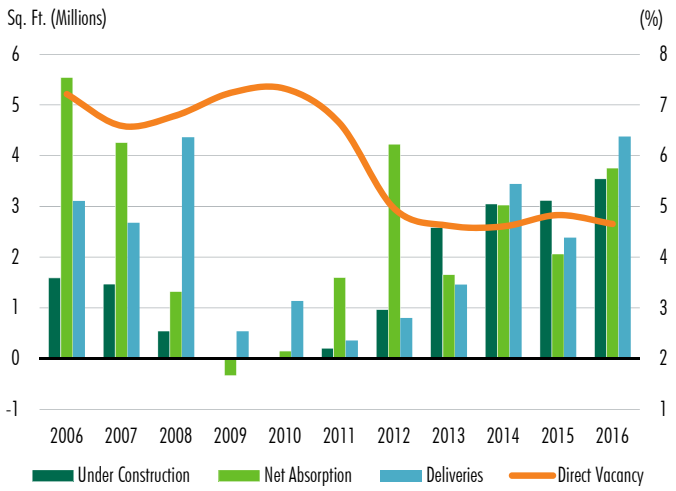
CONSTRUCTION

It was a big year for development in 2016, as 4.4 million sq. ft. of industrial space delivered, blowing away the 2.8 million sq. ft. that delivered in 2015. Construction was concentrated in the Airport submarket, with the North Central and Northwest submarkets coming second and third. Going forward, the same ranking is expected. Projects under construction will remain at an elevated level in 2017, with 29 buildings and 4.9 million sq. ft. underway, 67% of which is already pre-leased.

Large build-to-suit (BTS) and speculative warehouse distribution buildings were a theme in 2016 and many are also under construction or proposed for 2017. Two key 2016 BTS deliveries were the 545,000-sq.-ft. warehouse for Medline Industries, in the Majestic Commerce Center and 270,000 sq. ft. for KeHe Distribution in the Airport submarket. The largest buildings in 2017 include a 1.1 million sq. ft. BTS for an e-commerce user and one of the largest fully spec buildings to begin construction at 523,260 sq. ft.

Lease rates for large distribution facilities and smaller bay space are at or nearing replacement costs in Denver, thereby justifying more new construction. Small bay rents have just reached that level recently; therefore, small bay construction activity is only beginning to pick up as lease rates approach $8.00 per sq. ft. NNN.

Industrial Under Construction, Net Absorption, Deliveries & Vacancy



Source: CBRE Research, Q4 2016.

INVESTMENT

Compared to 2015, 2016 investment sales volume was substantially higher with $870.0 million transacting, a 13% increase and historic high. Investment sales and owner/user sales averaged $99.05 per sq. ft. and $91.07 per sq. ft., respectively—both at historically high levels. Cap rates compressed to levels not seen before as Denver saw a flood of institutional buyers in the marketplace for limited Class A supply. Expect these trends to continue through 2017 as a larger, more diversified national and foreign investor pool increasingly view Denver industrial as a stable and valuable place/asset type to allocate capital to.

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INNOVATION SHOWCASES FUTURE OF DENVER RETAIL

Widespread competition amongst retailers to capture consumer spending is driving companies to reinvent themselves through innovation.

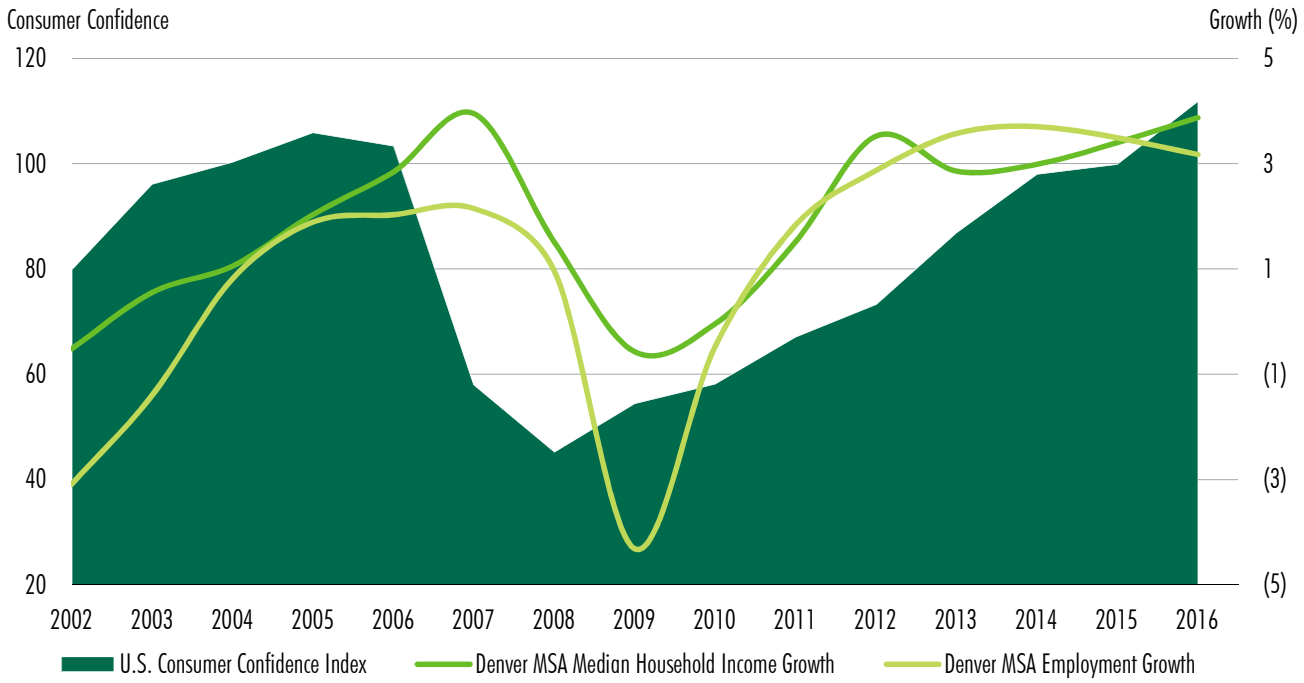
Denver's retail sector ended 2016 with vacancy at its lowest point on record, average asking rates hitting post-recession highs and a full construction pipeline. Strong economic metrics—including population and employment growth along with the stable performance of the housing market—provide momentum for the sector and fundamentals should gain strength in 2017. Additionally, the combination of above-average household income, employment growth and consumer confidence is drawing new retailers to the Denver market and propping up the decision of existing companies to expand. All told, these dynamics are underpinning forecasts of 4% rent growth in 2017.

KEY RETAIL STATS

▼ 5.3%	Vacancy Rate
▲ $17.73	NNN Lease Rate
▲ 1.3 MSF	Positive Net Absorption

Source: CBRE Research, Q4 2016.

Retail Economic Fundamentals



Source: CBRE Research, Q4 2016.

Widespread competition amongst retailers to capture consumer spending is demanding companies to reinvent themselves through innovation. The concept of "Rogue Retailing," where non-traditional retail brands and venues has launched both locally and nationally, is creating innovative solutions for retailers to better compete and better align with today's trends. Retail's reinvention of itself is being seen in many forms: experiential retail platforms are making new uses of space and formats to create an experience for the consumer, new leasing structures are evolving and reverse logistic management is gaining attention. Denver is quick to embrace new retail innovation with marketplace concepts along with other new mixed-use projects and should continue to spark further innovation in 2017.

Denver's retail evolution is more than just new experiences for consumers, as it is becoming more intimately involved in the rise of e-commerce. E-commerce across the U.S. continues to rise and is expected to account for approximately 9.2% of total retail sales by the end of 2017. For Denver, the addition of new companies focused on distribution and converging retail and industrial properties in 2016 has set the stage for strong momentum in 2017. Overall, the trends of becoming more customized and experiential will lead to further online innovation.

One unique element of Denver's retail landscape is the closings of several big box retailers in 2016 and the impact this will have on the future use of space. Notable closing announcements

Market activity has more than doubled year-over-year and represents the demand for additional supply.

included Sports Authority, Kmart and Golfsmith. The rise of e-commerce and new retail formats are forcing big box retailers to adapt whether it is creating more efficiency in their supply chains or bringing in new products, services and experiences. Quality big box vacancies are rapidly absorbed by active tenants in specialty grocery, fitness and urgent care facilities, while more than 70 box spaces in Denver remain available. Looking ahead, developers and landlords are expected to create new developments and reinvest into upgrading spaces in an effort to make them more attractive to retailers and the consumers seeking innovative experiences.

Overall strong national and local economic metrics and trends lead to an optimistic outlook for the retail sector in 2017. Denver garnered national attention in 2016 when, in addition to 20 other new retailers, Uniqlo opened their doors. The lure to Denver is anticipated in future quarters as consumer confidence continues to prop up consumer demand, clearly establishing Denver as a strong place to be in retail.

21 NEW DENVER RETAILERS IN 2016

APPAREL

EVO FITNESS · FABLETICS · FRYE · UNIQLO · ARC'TERYX · PETER MILLAR

FITNESS

CHOZE FITNESS · barre3 · CRUNCH · VASA FITNESS · CYCLEBAR

ENTERTAINMENT

Jump Craze

RESTAURANTS

Death & Co · Tupelo Honey Cafe · 801 Chophouse · Oregano's Pizza Bistro · R Taco · Public School on Tap · Dion's · SOL Mexican Cocina · Chuy's

THINGS MAY BE SLOWING, BUT THEY SURE AREN'T SLOW

We believe cautious optimism best describes our expectations for Denver's multifamily sector. Despite our outlook that real estate fundamentals will continue moderating throughout 2017, there are reasons to be excited for the future of multifamily.

The consensus calls for Denver's economy to remain a top performer going forward. With population and employment growth expected to continue driving a strong demand-side of the equation, multifamily remains a bright spot for Denver real estate.

Denver offers a high quality-of-life with a cost of living that positions the market as one of the most attractive cities for growth—particularly true in the tech industry. Colorado ranked third for net in-migration since 2010 and Denver continues drawing young talented professions to the market—something that bodes well for the multifamily sector. That said, firms are beginning to find it increasingly difficult to secure qualified workers, and competition is especially strong in the tech industry. A deceleration in hiring would negatively impact the multifamily market.

KEY MULTIFAMILY STATS

▼ 2.1%	Year-Over-Year Rent Change
▲ 5.3%	Vacancy Rate
▲ 25,382	Units Under Construction
▲ 26,884	Units Planned

Sources: CBRE Econometric Advisors and Apartment Insights, Q4 2016.

The current cycle's development peak will likely occur this year, and thus supply is the most prominent headwind at the moment. There are more than 25,000 units under construction—however, the concentration of high-end construction within the urban core offers opportunities to investors as downtown's surrounding geography continues developing the Live, Work, Play environment that many of today's renters desire. Moreover, the pipeline of planned projects is not likely to swell as lending standards tighten—mitigating the supply risk on a longer horizon.

Denver remained the 13th largest apartment market in the U.S. based on existing inventories and has grown consistently over the past few years—adding 8,660 units in 2016. Notwithstanding the robust positive net absorption of 6,300 units, new supply did give rise to the vacancy rate which climbed to an annual average of 5.3% to close 2016. As absorption continues struggling to keep pace with new supply, rent growth will only slightly decelerate from the pace set in 2016.

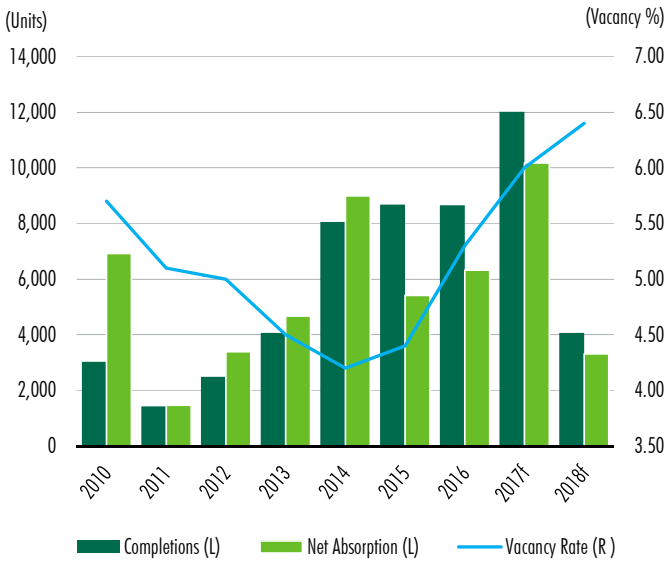
INVESTMENT

The multifamily sector set another sales volume record in 2016—totaling $6.87 billion for a 46.6% increase over 2015, according to Real Capital Analytics. Sales of multifamily product accounted for 54% of all commercial real estate sales volume in the metro Denver market during 2016. While we don't expect 2017 to bring big gains over those record levels, this should be a very active year for capital flows in the Denver market.

Average pricing reached $193,937 per unit in Q4 2016, up 26.5% from year-ago levels. Sure, some of this pricing is driven by the trends in high-end development, but rising construction and land costs as well as the overall appetite for multifamily assets have boosted pricing as well.

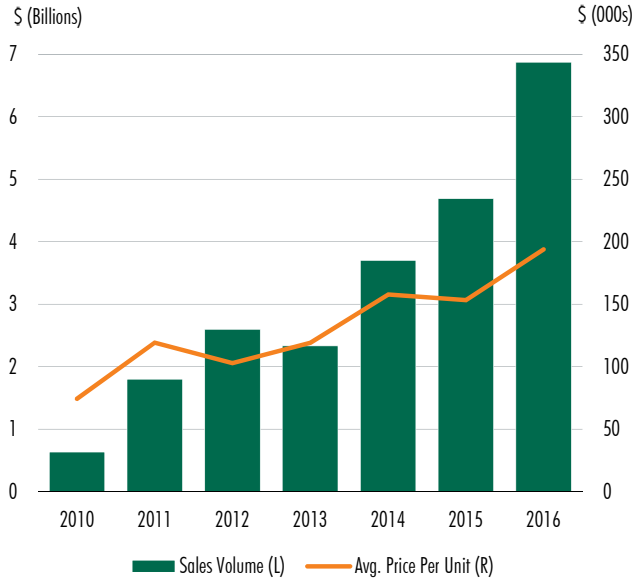
The recently released semiannual edition of CBRE's North America Cap Rate Survey reports stability in Denver's multifamily cap rates. Class A infill assets still command the highest premium and were the only subset with an average cap rate under 5.0%. The consensus outlook among CBRE professionals is for Denver's multifamily cap rates to remain relatively stable with only modest upward movements in the near term.

Multifamily Completions, Net Absorption & Vacancy



Source: CBRE Econometric Advisors, Q4 2016.

Multifamily Sales Volume vs. Price Per Unit



Source: Real Capital Analytics, Q4 2016.

HOTEL SUPPLY RESPONDS TO DENVER'S RISE IN TOURISM

Hotel supply will continue delivering throughout the Denver market in the coming quarters and will bring stability to future occupancy. More than 1,700 hotel rooms will deliver in 2017 and over additional 4,400 rooms are in the planning stages.

Tourism in Denver was active throughout 2016 and is expected to exude strength going forward via key economic fundamentals—which include population growth and a rise in median household income. Denver's hotel sector continues to experience support from consumers seeking leisure (including high-country travel), group meetings and business-related travel.

Longwoods International's most recent study reported a record 36.0 million visitors on overnight trips in 2015, up 7% from 2014. These overnight visitors represented $14.1 billion in spending, a 13.0% increase in 2015. According to the study, 20% of all overnight ski trips in the U.S. went to Colorado

KEY HOTEL STATS

▼ 64.4%	Occupancy Rate
▲ 2.8%	Year-Over-Year Increase in RevPar
▲ 4,548	Rooms Under Construction

Source: CBRE Econometric Advisors, Q4 2016.

destinations—returning to levels last seen over a decade ago. The hotel industry experienced the positive effects of the increase in visitors as spending on accommodations rose 18% to $4.0 billion. Colorado significantly outpaced the nation in travel and tourism growth during 2015, and is expected to continue to outperform national averages.

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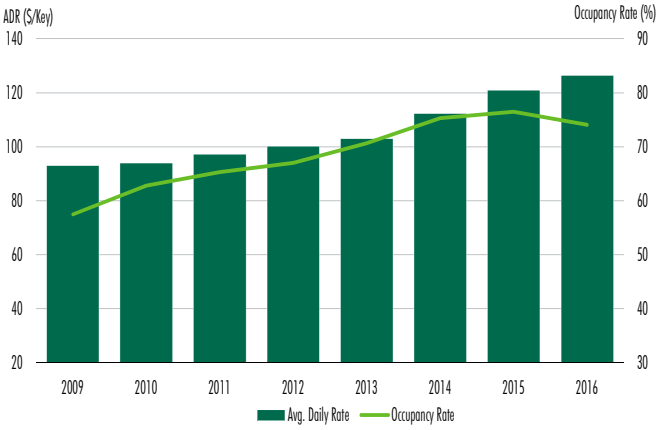
The U.S. Commerce Department forecasts international travel to the U.S. will continue to experience growth through 2021. By 2021 the growth would produce 94.1 million visitors, a 21% increase, and more than 16 million additional visitors compared to 2015. Denver International Airport (DEN), the world's ninetieth busiest airport and sixth busiest in the U.S., set a record with 54 million passengers in 2015 and will continue to serve as an economic and tourism hub. In total, DEN services 19 international destinations in nine countries stretching from Tokyo to Reykjavik to London. Of note, The University of Colorado A line launched in April 2016, further connecting Denver tourism and travel with a 23-mile line stopping at 8 stations between Union Station and DEN enabling a quick 37-minute trip.

OCCUPANCY AND ROOM RATES

Denver is the 18th largest hotel market in the U.S. and recorded a 160 bps decline in occupancy rates between Q4 2015 and Q4 2016, settling at 64.4%. Occupancy rates have remained stable—notwithstanding the seasonality in the hotel industry. Denver's highest hotel occupancy rates are in the Central Business District, the South and the Airport/East submarkets.

Due to strong seasonality in the hotel sector, first and fourth quarter fundamentals are generally softer than they are in the middle of the year. Despite RevPar (revenue per available room) falling to $78.80 in Q4 2016, strong fundamentals throughout the year left the annual average Rev Par at a record level of $93.76 in 2016. The four-quarter average is up 2.8% year-over-year and because occupancy is tight, hotels are commanding an average daily rate (ADR) that is up 5.5% over the same period. The Central Business District had the highest ADR of any submarket in Denver at $183.69. Although Denver reported the tenth highest growth in ADR, this leaves the market with a four-quarter average ADR of $127.34—which ranks 23rd among the largest U.S. markets and is good news as there is room for additional growth.

Hotel Average Daily Rate vs. Occupancy Rate



Source: CBRE Econometric Advisors, Q4 2016.

Notable Hotel Projects Under Construction

Submarket	Project Name	Rooms
Airport / East	Gaylord Rockies Resort & Convention Center	1,500
Central Business District	Marriott AC Hotel - Starwood Le Meridien Hotel	495
Northwest	Residence Inn/Fairfield Inn & Suites	212
Boulder	Embassy Suites	203
Cherry Creek	Rollnick Hotel	201
Central Business District	Kimpton Hotel & Restaurants	200
Central Business District	The Maven	172
Cherry Creek	Marriott Moxy	165
Denver Tech Center	Waterwalk	146

Source: CBRE Econometric Advisors, CBRE Research, Q4 2016.

INVESTMENT

According to Real Capital Analytics, 2016 total sales volume topped $488 million, a 27.6% decrease year-over-year. As of Q4 2016, the average sales price per room was $126,566 trailing the national average of $146,755. Notable transactions in 2016 included the 451-room Hyatt Regency Denver Tech Center selling for $96.0 million, the Marriott in Boulder which traded for $61.4 million and the Hampton Inn & Suites trading hands for $27.4 million. Looking ahead, Denver's strong economy will underpin further growth for tourism and the hotel industry. The drivers of this growth will be employment and population growth as well as upward pressure on wages.

DEMAND HIGH, LAND SUPPLY LOW IN 2017

Land values and transaction volume are expected to see steady increases in 2017 due to elevated demand for housing and increasingly scarce available land.

The Denver market experienced strong demand for land sales in 2016—and with volumes totaling $1.1 billion across 686 transactions, Denver continued climbing toward the $1.4 billion transaction volume recorded in 2007. The average price per sq. ft. increased 15.0% year-over-year to $2.45 per sq. ft.—the highest annual price on record in the past decade. Commercial- and residential-zoned parcels drove 2016 land sales. The higher prices can be attributed to increased demand for residential and commercial land and a diminished amount of supply.

KEY LAND STATS

▲ $1.1 B	Volume
▲ $2.45/SF	Average Sale Price

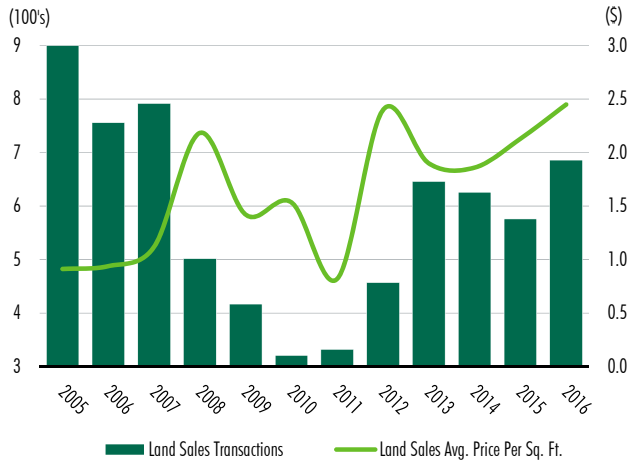
Source: CBRE Research, Q4 2016.

Volume of land sales increased across all sectors, however prices per acre only increased for residential while commercial and industrial slightly decreased—likely a result of the increasing development costs. Impact fees, tap fees and permit fees are generally on the rise which is expected to keep price increases fairly muted for all sectors going forward. Developers are facing permitting and approval timelines that are extending within several jurisdictions including Denver.

Looking ahead, expect to see strength in the single family for-sale residential market.

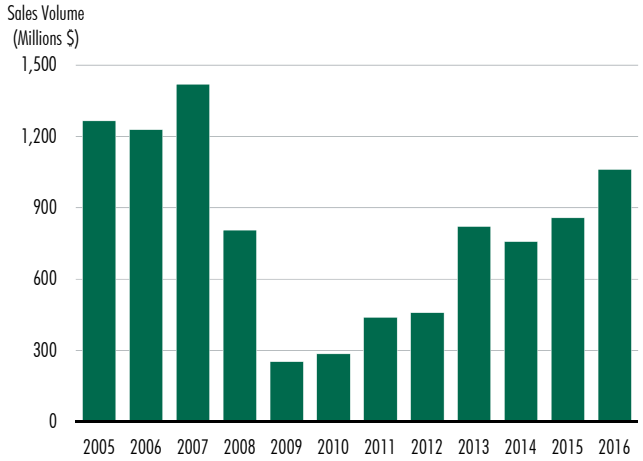
Looking ahead, expect to see strength in the single family for-sale residential market. According to the U.S. Census Bureau, residential permitting increased 21.6% in 2016 over 2015 throughout the Denver/Boulder region. This compares to the 0.8% increase that 2015 brought over 2014. Single-family detached permits increased 6.6% while multifamily permits were up 37.4%, issuing the largest number of permits in 2016. Confidence levels among U.S. homebuilders was healthy in 2016, according to the NAHB/Wells Fargo Housing Market Index, ending the year at number 69—a ranking not seen since 2005—and suggests that the single-family housing market will expand in 2017.

Land Sales Transactions vs. Price Per Sq. Ft.



Source: CoStar, Q4 2016.

Land Sales Volume



Source: CoStar, Q4 2016.

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