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JERILEE BENNETT, THE GAZETTE

A medical office building is under construction in InterQuest Marketplace in northern Colorado Springs. Two years after the onset of the COVID-19 pandemic, the demand for medical office space has remained strong in the area, one local commercial brokerage says. The general office market, however, is a mixed bag; small offices of 5,000 square feet and less are in demand, while offices of 30,000 square feet and larger are struggling to woo tenants, commercial real estate experts say.

HOLDING ITS OWN

Springs commercial real estate still strong two years after onset of COVID-19 pandemic

BY RICH LADEN
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Colorado Springs' commercial real estate market remains relatively strong two years after the onset of the COVID-19 pandemic — though one segment of the commercial landscape is struggling.

Shopping centers and retail buildings, where some stores and restaurant dining rooms shuttered in the wake of government-mandated closings, capacity restrictions and homebound customers, are filling up their storefronts, local commercial real estate industry experts say.

New and existing warehouses, distribution centers and other industrial spaces, meanwhile, are in demand; construction companies need places to store materials as they cater to a red-hot housing market, while retailers who sell online want space to house merchandise until it's shipped, among other businesses.

Not only have retail and industrial spaces filled up, but property owners have largely avoided foreclosures and lender takeovers that dogged commercial real estate during the Great Recession, industry experts say.

The Springs' office market, however, hasn't been as fortunate.

On the one hand, small offices remain popular for service-oriented businesses with relatively few employees, commercial experts say.

But some large offices are ghost towns as companies wrestle with whether to bring back employees who've worked at home since the start of the pandemic, they say.

"Overall, I think every sector in commercial real estate, the future's very, very bright," said Dale Stamp, president of Quantum Commercial Group, a Colorado Springs commercial brokerage. "Probably the only question mark is some of these large floorplate users."

Here's a snapshot look at the Springs' commercial real estate market two years after the start of the pandemic:

Offices

Colorado Springs' office vacancy rate jumped to 9% at the end of 2021, up from 7.7% on a year-over-year basis, according to a fourth-quarter market report by Quantum Commercial Group. The downtown area fared better, ending last year with a vacancy rate of 4.9%.

The office market, however, is a mixed bag. Spaces of 5,000 square feet and small-

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er are in demand, said Peter Scoville, an office specialist and principal with Colorado Springs Commercial, a brokerage affiliated with national real estate company Cushman & Wakefield.

Financial service firms, legal firms and real estate companies — among others — that need a support staff, file storage and other amenities are some of the businesses that covet smaller offices, Scoville said.

Most of the smaller businesses don't have out-of-town corporate owners and can make their decisions about who works remotely, who needs to be in the office and for how many days a week, he said.

Some defense contractors with government projects, meanwhile, continue to occupy their local offices and worked through much of the pandemic, Scoville said.

"They were COVID-proof."

But owners and landlords of offices that are 30,000 square feet and larger continue to feel the pandemic's effects.

Call centers and other businesses with large staffs sent employees home to work remotely at the start of the pandemic. Some of those businesses still haven't brought back all of their workers on a full-time basis.

"You go around and look at the large office spaces — call center spaces, administrative center spaces, etc.," said Michael Palmer with Quantum Commercial Group. "Their parking lots are mostly empty. People are staying home."

On Colorado Springs' northwest side, a 60,000-square-foot building that housed a local office for a national telecommunications giant is vacant, said Dave Johnson, executive managing director with Cushman & Wakefield's Denver office.

The company doesn't plan to bring back workers to the office and is trying to sublease the space, said Johnson, who's marketing the property.

"COVID definitely created dislocation in the office market," he said. "It probably will take the balance of the year for companies to figure out what the cadence is for employees to come back to the office."

In fact, that remains a major question for many large employers as they decide what to do about their blocks of office space.

Many employees grew accustomed to working from home — skipping lengthy commutes, working without colleague interruptions and having the chance to care for kids and pets. As a result, some employees don't want to come back to the office and prefer to continue working remotely.

Yet, their bosses might believe the company will be better off with them in the office, albeit if only on a hybrid work schedule, Palmer said.

"Companies need to collaborate, they need to train, they need to brand," Palmer said. "It's more productive being in the office some portion of the time. Is that a two-day model, a three-day model, a four-day model? That's to be determined depending on the particular businesses."

So will businesses and their employees come back to their large offices — and how much trouble could the office market be in before that happens?

Scoville, of Colorado Springs Commercial/Cushman & Wakefield, said he expects workers to return.

COURTESY RENDERING

A rendering shows a Denver development company's 58,500-square-foot speculative industrial building, which will be constructed northeast of Powers Boulevard and Aeroplaza Drive, near the Colorado Springs Airport.

CHRISTIAN MURDOCK, THE GAZETTE

A sign advertises office space that's available for lease on the fourth floor of the El Paso Building on Tejon Street in downtown Colorado Springs.

CHRISTIAN MURDOCK, THE GAZETTE

Office space is available for lease in the Plaza of the Rockies complex on South Tejon Street in downtown Colorado Springs.

Some employers will upgrade offices with perks and amenities to make it more comfortable for employees to come back, Scoville said. At the same time, improved workplaces will create a competitive advantage for businesses as they seek to recruit top-quality employees, he said.

"I personally don't believe the office (market) is over," he said. "It's different, and it's forever changed and people will use office space differently going forward and less frequently than the 8-to-5 program. But I don't think the need for office space, whether it's call centers or others, is over. I think it just means we're in a slow grind with these larger spaces, to get them absorbed by other users."

Palmer, however, forecasts a gloomier scenario for the office market — at least, in the short term.

Already, there's light demand for office space, more than 2 million square feet of supply — an amount equivalent to a combination of the Chapel Hills and Citadel malls — and more space coming on the market via subleases, he said.

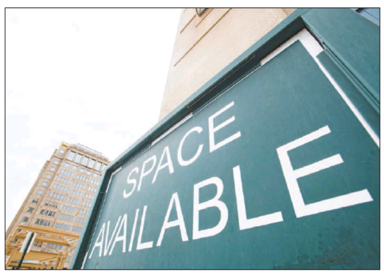
With so much space and reduced demand, property owners and landlords might have to slash lease rates for large offices, Palmer said.

Some offices might have to be chopped up into smaller spaces — though that's expensive to do — and other office buildings could even wind up in foreclosure, he said.

The Springs' quality of life and desirability as a place to live and work, however, could keep the city in a better position than other metro areas, he added.

"This is yet to be determined," Palmer said of the future for large office space. "We're in the land of unknown right now as far as what's happening with that. But I can tell you, there's going to be some pain when it comes to this office market on the larger space.

"We'll see the market eventually turn it around to more of the people going back to work," he added. "That's the good news. It's just when. And again, it's not going to be 100% like it was yesterday. But it will be some type of hybrid."



CHRISTIAN MURDOCK, THE GAZETTE

A sign advertises office space available for lease in the FirstBank Building on North Cascade Avenue in downtown Colorado Springs.

Retail

Quantum Commercial's fourth-quarter report showed the Springs' retail vacancy rate was just 4.75% at the end of 2021, down a full percentage point from 5.7% at the end of a volatile 2020.

The retail market has been buoyed, in part, by Colorado Springs' population growth, the report stated. Newcomers who've moved to Colorado Springs for its quality of life, access to outdoor recreation and cheaper apartment rents — at least, when compared with Denver — have boosted the demand for stores and restaurants, the report said.

Retailers and particularly restaurants also have benefited from a trend of younger people whose social life is built around get-togethers at restaurants and entertainment venues, said Stamp, Quantum Commercial's president.

"For us, we went out, maybe once a week was great," Stamp said. "A lot of the younger generation, they're going out two or three times a week, if not even more."

Not everything has gone smoothly for retailers and restaurants since the start of the pandemic, of course.

Some temporarily or permanently closed their doors, while others delayed expansion plans, said Mark Useman, a broker and retail specialist with NAI Highland, a Springs brokerage.

"We were doing a bank, for instance," Useman said. "They had run into a situation where they had to deal with all the stuff with COVID, in terms of the PPP (Paycheck Protection Program) loans and all those kind of things. They were a little concerned about where things were going. There were always a few (retailers) that looked at COVID and probably hesitated for a while."

Otis Moore, a principal with Westside Investment Partners of suburban Denver that's developing Victory Ridge on the Springs' north side, said a breakfast restaurant that would have occupied a multi-tenant building at Victory Ridge walked away from the mixed-use development during the early months of the pandemic.

The restaurant would have occupied a storefront, but without a drive-thru, Moore said. Drive-thrus became a life-saving source of sales for many restaurants during the pandemic's early stages when their dining rooms were closed, and later when they had limits on their capacities.

"There was a lot of chaos during the entire pandemic with retailers," Moore said. "Just from a philosophical standpoint. Some of them wanted less space. Some of them wanted more space so they could space out tables. It was a constantly shifting philosophy or attributes to the kind of property they wanted during the entire pandemic. It definitely was chaotic."

Retailers, however, remained resilient over the last two years thanks to the city's residential growth, the addition of downtown attractions and a boost in tourism with the opening of the U.S. Olympic & Paralympic Museum and other venues, said John Winsor, a broker with Olive Real Estate Group in the Springs.

"With all of that momentum, we fared better than a lot of places in the country," he said of Colorado Springs' retail market.

Now, two years after the start of the pandemic, there's a pent-up demand for space by some stores and restaurants, Useman said.

Developers, though, aren't building retail projects on a speculative basis; instead, most new retail buildings, such as ones that he's marketing at the north-side InterQuest Commons retail development, are at least two-thirds to 75% pre-leased, Useman said.

"We're leasing them ahead of time, we're leasing them on paper basically, before they even come out of the ground," Useman said. "The owners want that. The lenders want that. To get good lending, you've got to have tenants in place."

Industrial

The industrial market remained arguably the strongest segment of the Springs' commercial real estate market over the last two years, industry experts say.

Quantum Commercial's fourth-quarter report shows the vacancy rate for industrial buildings dipped to 5% by the end of 2021; the rate has declined by roughly 1 percentage point a year over the last five years, according to the report.

When the pandemic hit, there was a roughly 60-day hiatus in the demand for industrial space because of the uncertainty over what would happen next, said Randy Dowis, a principal and senior broker with NAI Highland.

After that pause, however, activity picked up and very few of his clients needed rent relief, he said.

"Everyone just kept paying rent in a timely fashion," Dowis said. "We felt very fortunate."

The demand for housing and the need for space to store construction materials, in part, helped bolster the industrial market, he said. Also, the pandemic led to even more people buying items online and retailers needed storage space, he said.

"The pandemic forced a lot of people into online shopping," Dowis said. "For e-commerce, that means you've got to have warehouses to store the product and deliver the product.

"That shift was starting to occur already, with the Amazons of the world," he added.

"But it became more and more pronounced, of course, during the pandemic. People weren't going to brick-and-mortar. They were ordering everything online. We didn't have near enough warehouse and distribution capacity to meet that kind of demand."

Developers and investors now have recognized the demand for industrial space, and have big plans to increase the local supply, Dowis said. For example, there's an estimated 1.2 million square feet of industrial space planned by developers along Platte Avenue on the city's east side over the next several years, he said.

In addition to seeking to meet the demand for more warehouse and distribution space in Colorado Springs, industrial developers and investors are being attracted to the area because of cheaper land costs compared with markets such as Denver, Phoenix and Las Vegas, Dowis said.

Unlike the retail sector, developers aren't afraid to construct speculative industrial buildings, he said.

Central Development of Denver recently launched construction on a 58,500-square-foot speculative building northeast of Powers and Aeroplaza Drive, near the Colorado Springs Airport, said Dowis, who's marketing the space.

"I was begging developers a decade ago to come to Colorado Springs," Dowis said. "I couldn't get anyone's attention. They're like, 'why would we come there? We've got plenty of activity in Denver. We don't need to go into that market.'"

Last June, Dowis said he marketed a 65,000-square-foot, speculative industrial building that was nothing more than a core and shell and lacked tenant improvements.

The building, developed by a partnership led by Peak View Roofing of Colorado Springs, was constructed with the goal of leasing it.

Three tenants were interested in leasing the building, but shelved their plans to rent the space; when that happened, the building was put up for sale — and received three full-price offers, Dowis said.

"Today, the market is ... stronger than it's ever been," Dowis said. "We have very few investment opportunities. If something hits the market, there'll be multiple offers on that property."