



## Corporate Office Perspectives

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What interesting dynamics currently going on in the office industry ... there are billions of dollars chasing commercial real estate investments with limited quality sale opportunities, so cap rates (the rate of investment return) for some product types are at an all-time low. Short- and long-term financing is plentiful and also still at record lows, and I've heard of unreal super-low interest rates (3 to 4 percent) for those willing to go the variable rate route. Sellers are selling at high prices and then are challenged when they try to locate decent exchange properties as everyone else is selling at crazy high prices. At the same time, in some office submarkets, office rents are still sliding downward and the only good news is that the rate of descent has slowed. In some U.S. regions, office expenses are at record highs, such as in San Francisco, where annual operating expenses run \$12 to \$16/sf. Rental rates in some areas are down back to 1990 or 1995 levels. I recently completed a direct triple net office lease in Pleasanton that was only \$.15/sf a month higher than one I did in a similar building in 1983! Vacancy rates in some regions are 20 to 25 percent. Global offshoring, corporate downsizing and shadow space add greater uncertainty as to when the office markets will recover. Office building foreclosures are still a rare event, although Santa Clara and other severely impacted submarkets are starting to encounter these. The office building owner/user market is very strong, and it is not uncommon to see multiple offers on a vacant building due to low interest rates and pent-up demand. It was the best of times and it was the worst of times ...

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Global offshoring continues unabated ... Siemens will move most of its 15,000 software programming jobs from offices in the United States and Western Europe to India, China and Eastern Europe ... Five years ago, Wipro was a consulting firm in India with just 3,000 people. Now, the company has 27,000 employees and its annual revenue has increased almost tenfold as U.S. companies send more work overseas. The capacity of fiber-optic lines connecting telephone systems into India has increased sevenfold from 2001 to 2002, and is expected to more than double again by the end of this year ... "For internal IBM accounting purposes, a programmer in China with three to five years experience would cost about \$12.50 per hour, including salary and benefits. That's less than one-fourth of the \$56 per hour cost of a comparable U.S. employee, which also includes salary and benefits" ... "Future projections are all over the map. One predicts 3.3 million service-sector jobs will go overseas in the next 15 years, while a UC Berkeley report estimated 14 million U.S. service jobs are at risk" ... "Tax experts say Indian chartered accountants will prepare 150,000 to 200,000 returns this year, up from about 20,000 in 2003 and only 1,000 in 2002" ... Outsourcing appraisal reviews to an offshore contractor allows Citigroup to both save money by using lower-paid overseas workers and to expedite the loan process by taking advantage of the more than 13-hour time difference between California and India. The Appraisal Institute's Joe Napoliello (spokesman) said the most likely upshot of CitiGroup's actions is that other major lenders will now end up outsourcing as well ... "Customers using online lender E-Loan now have a choice about who will process their

application. They can let the company make use of their workers in India, or they can request to have their loan processed domestically by U.S. workers – and wait as many as two days longer. Since the company started offering the option four weeks ago, roughly 86 percent of its customers for home equity loans have chosen the India route. To offer the faster service, E-Loan contracts with a unit of Wipro, a big Indian outsourcing company that is growing so rapidly it is expanding its workforce by 3,000 each quarter” ... “E&Y does its tax return in Bangalore, India and says that they’re seeing reports stating that 50 million sf of corporate real estate will be offshored each year in the future. Long-term, offshoring will affect corporate real estate more than anything else” ... “The Chicago consulting firm Diamond Cluster International found that among companies that already outsource some technology work to countries with lower labor costs, 86 percent plan to send more in the next 12 months. Of companies that have tried offshore outsourcing, 79 percent are satisfied with the experience.”

Depending on which study you refer to, San Francisco office vacancy rates range from 12 million to 16 million square feet. One reason is that the various brokerage firms track space differently, using different minimum building sizes, different geographical boundaries and different definitions of just what is vacant and what is not. This same disparity exists in most metropolitan areas across the United States. For example, is a space available if a tenant plans to vacate in six months, three months, next month, or is it counted as occupied until it is actually physically empty? If a tenant has a 50,000-square-foot operation with a skeleton crew of five employees versus the original 250 headcount, is the space considered vacant or occupied? The same goes for building classifications. A Class A office building in New York or San Francisco might be vastly different than a four-story Class A in Walnut Creek or Roseville.

A third variable in our office industry exists in defining what a rentable square foot is. “When the definition of a rentable square foot means one thing in San Francisco and another in New York, or that real estate deals done metrically in Europe won’t calibrate with U.S. database records measurements, it’s clearly time for more consistency. This small example points to the larger problem: the industry of Corporate Real Estate lacks a consistent, common vocabulary. And without a common vocabulary, it’s difficult for us to develop a common way for our industry to interact via the Web using new technologies, much less in person,” says Keith Perske, manager of business systems for Sun Microsystems’ corporate real estate department. The Open Standards Consortium for Corporate Real Estate has been formed to develop open standards that will provide a universal resource for the consistent preparation and delivery of electronic transactions, portfolio and facility management, process management, project management, performance metrics, communications and other asset management needs. Organizations which might be involved with these efforts include CoreNet Global, BOMA, IFMA, ULA and AIA.

“While some are feeling optimistic regarding the possibility of an economic recovery, especially those on Wall Street, conditions haven’t been robust enough for Moody’s Investors Service to give a positive outlook for real estate investment trusts. The ratings’ agency has stamped a negative outlook on the sector because of the continued pressure on firms operating performance, which Moody’s attributes to a weak economy and a lack of job growth,” according to *Real Estate Forum* (December 2003). They did slip in some positive news in this release, “However, available space is being absorbed and the sector should show evidence of rental rate growth by the close of 2004 as office employment slowly creeps upwards.”

If you want a quick view of Worldwide Leasing Guidelines for the top 46 countries with information on how long leases are in general, how rent is quoted, the possibility of options to renew or extend, and what the major markets are, please visit: <http://www.colliers.com/Content/Attachments/Corporate/AboutUs/WWLGSummary.pdf>

**www.OfficeTimes.com** is one of the leading corporate real estate informational web sites in the United States. Recently, we posted an article on how to deal with after-hours HVAC and pitfalls to avoid, and another very informative article on the impact of recent wiring/cablings rulings that may affect who pays to remove unused wiring upon lease expiration. You can find these articles, as well as hundreds more, at **www.OfficeTimes.com!**

*Deals and Rumors:* In **Concord**, Fremont Bank leased 61,000 sf, On-Line Documents leased 21,000 sf, and University of Phoenix leased 25,000 sf; all three transactions happening at the new Concord Metroplex project on Willow Pass Road. Also in **Concord**, Hartford Steam will be relocating to 12,000 sf at 2300 Clayton Road. In **Walnut Creek**, ITSI sublet 16,000 sf at Walnut Creek Executive Park; I helped the Outsource Group with its 9,000 sf lease extension at 1676 North California Blvd.; and Central Garden & Pet is out looking for 25,000 sf. In **Pleasanton**, PenCal Insurance sublet 15,000 sf at Corporate Commons, and in **Livermore**, Wilmington Finance leased 19,000 sf of office space at 7455 Longard Road. In **Emeryville**, I represented Ex'pression Center for New Media in its 20,000 sf campus extension at 1650 65<sup>th</sup> Street, and All Posters sublet 23,000 sf at 2100 Powell Street. In **Oakland**, Dreyers Ice Cream may have leased 24,000 sf at 555 City Center. Down in **Fremont**, Centillum Communications leased 104,000 sf at 215/255 Fourier Avenue. Across the Bay, Computer Associates may have an LOI on 46,000 sf at Sierra Point. In **South San Francisco**, Actelion expanded from 15,000 sf to 26,000 sf at 5000 Shoreline Court, and Genentech took 141,000 sf at 611 Gateway. In **Brisbane**, IGN leased 25,000 sf at 8000 Marina Boulevard. A lot of activity in **San Francisco** these past 60 days! Think Twice and Schlesinger & Associates each leased 10,000 sf at 150 California St.; The California Culinary Academy might be looking at 100,000 sf at 100 Rhode Island St.; Dmax Imaging leased 12,000 sf at 400 2<sup>nd</sup> St.; San Francisco Design Court took 11,000 sf at 525 Brannan St.; Sidley Austin Brown & Wood sublet 30,000 sf at 555 California; T.Y. Lin International expanded by 34,000 sf at 825 Battery St.; Design Within Reach leased 59,000 sf at 225 Bush St.; Gymboree sublet 160,000 sf at 500 Howard St.; CRI took 11,000 sf at 130 Sutter St.; Levin Simes & Kaiser leased 16,000 sf at One Bush St.; Barger & Wolen took 23,000 sf at 650 California St.; Topica leased 13,000 sf at 685 Market St.; Carat might be subleasing 25,000 sf at 475 Brannan St.; The Securities and Exchange Commission expanded to 44,000 sf at 44 Montgomery St.; Kirkland & Ellis leased 47,000 sf at 555 California St.; Cooley Godward leased 101,000 sf at 101 California St.; Claim IQ took 12,000 sf at 575 Market St.; Morgenstein & Jubelirer doubled in size to 40,000 sf at One Market St.; The Exploratorium might be looking to buy the 275,000 sf Francisco Bay Office Park; and California Pacific Medical Center leased 42,000 sf at 475 Brannan St.

According to *Silicon Valley Biz Ink* (3/5/04), "San Jose is the most expensive city in which to do business, according to a study by New York-based business services firm KPMG. In addition, nearly 40 percent of California companies are planning to move jobs out of state, according to another study, released by the California Business Roundtable, a Sacramento-based non-profit organization comprised of CEOs of California businesses ... San Jose is more cost-effective now than it was two years ago ... employees today are willing to work for less. In addition, facility costs are down 60 to 70 percent."

As reported in *The National Real Estate Investor* (February 2004), "A glut of unused office space threatens to stall the long-awaited recovery ... The sublease overhang that has been plaguing the national office market for nearly two years is finally showing signs of shrinking. Roughly 30 million square feet of vacant sublease space was absorbed in 2003, leaving a still hefty 111 million square feet on the market at the end of December, reports the CoStar Group. The vacancy rate, including direct and sublease space, was an unhealthy 16.9 percent at the end of 2003 ... Market researchers estimate that shadow space can add as much as 3 percent to the overall vacancy, which kicks the real vacancy rate up to nearly 20 percent."

Europe is experiencing its own "job shift" as corporations seek lower wages and more accommodating unions. The *Wall Street Journal* (3/11/04) reported that Ford Motor Company moved delivery van production from Belgium to Turkey, and VW moved small delivery truck production from Spain to Poland, which is reminiscent of our "global offshoring." "For VW, the advantage was obvious: Slovak workers earn about \$7.40 an hour – a fifth of the cost of workers in Germany."

An upcoming California State ballot measure could boost commercial property taxes by \$4.5 billion if passed. It would increase the tax rate on commercial real estate including commercial residential by .55 percent. Most owners of leased property would be able to pass that on to their tenants, adding another cost disadvantage to companies struggling to do business in California. Owners of vacant properties would get yet another body blow.

Regarding offshoring, we should run government like E-Loan...click "1" if you want the work handled at the lowest possible cost, or click "2" to have the work performed in the U.S at higher taxes ... "The Senate voted Thursday to prevent Federal contractors from using taxpayer dollars to move American jobs out of the country," *San Francisco Chronicle* (3/3/04). Just imagine what would happen if the government mandated purchases of U.S.-made computer equipment, PDAs, uniforms and many other items which seem to be made primarily offshore ...

San Francisco comes up with some doozies ... In February, San Francisco Assessor Mabel Teng asked the larger property owners to make sacrifices to help the city of San Francisco, which has a \$300 million shortfall. Currently, the owners of 174 of these high-priced buildings singled out by Teng have appealed their property tax assessments. Their requests, if granted, would lower revenue to San Francisco by \$97 million, and the Assessor would like them all to drop their tax assessment challenges ... yeah, right, that makes a lot of sense ...

Call centers used to be located in urban centers, and then 10 to 15 years ago were relocated out to the suburbs. About 5 to 10 years ago even the suburbs near major metropolitan areas became comparatively too costly and a number of call centers took advantage of economic incentives offered by job regions in smaller U.S. towns, which had formerly been industrial, manufacturing, mining, etc., and were very motivated to attract new jobs. Now, these same call center jobs have been relocated to India and other offshore countries. However, for many in this industry, this might be a transitional phenomenon as a number of computer folk think much of the call center business will be fully automated within the next 10 years.

I'm not sure what it is a testimonial to ... not all companies think offshoring is how they want to do business? ... the high cost of the Bay Area in some cases is worth every cent if you rely on brain-power that might not pick up and move to Kansas? ... a recent case in point is the eBay purchase for \$126.4 million of its 460,000 square foot headquarters complex in San Jose. eBay could have gone anywhere in the world and chose to stay here!

Corporate "rightsizing" has created tens of millions of square feet of available office space. Corporate America has discovered the corporate basic formula that lowered expenses usually leads to higher profits. This in turn has put a lot of pressure on office REITS to reduce their expenses to offset falling rents and increased vacancies. What is good for the goose department ... *National Real Estate Investor* (March 2004), "Expense control and efficiency are the buzzwords for office owners and managers today, and Equity Office is at the forefront of that effort. The company's EOPlus program is expected to reduce expenses by \$75 million to \$100 million. The savings will be achieved through procurement and the consolidation of property management offices from 170 to about 50 reducing employee headcount by about 400, or 15 percent." Two years ago, I gave a presentation at RealComm and suggested the larger landlords might have significant cost savings in sending their back-office accounting, property management call center, building system offsite management and remote guard monitoring offshore ... why pay someone in the U.S. \$35,000 to watch a security monitor when you might get the same job done offshore for \$10,000 or less, considering in both cases, if the monitor spots trouble they have to call for local assistance anyway?

Brainpower rules in California ... The *San Francisco Business Times* (2/13/04) reported that the University of California scored the most patents of any American university in 2003, grabbing first place for the 10<sup>th</sup> consecutive year. California Universities had three of the top five spots with 663 patents compared to Massachusetts with 127 and Texas with 96.

Here are my two cents on global offshoring, and a number of other major factors currently impacting demand of U.S. office space. Technology has allowed fewer employees to do more and still our productivity per employee gains are at amazing levels. There are battalions of middle-managers made obsolete by the PC, which allowed senior management at a click of a mouse to see real-time inventory, sales and other summarized reports which formerly took days or weeks to produce. Clerical levels are empowered by today's PC software and Internet to

work at levels formerly of management domain. A very significant portion of the U.S. workforce telecommutes, or has virtual office space without a permanent office or cubicle. Even a few years ago it was hard to envision having such warp-speed web access from a home PC or wireless laptop. Corporate America is continuing to “right-size.” Costs were driven down in wave after wave of downsizing, and in many cases each cutback in employees brought additional bottom-line financial strength. No wonder many companies didn’t stop with the first or second reduction. *CNN Money* (2/25/04), “AT&T Corp. Wednesday told analysts it was planning to cut 8 percent of its workforce, or about 4,600 jobs, this year in a drive to cut costs. The nation’s largest long-distance company said the moves would save about \$400 million this year, and leave it with about 57,000 employees. SVP and CFO Thomas Horton said the company cut 18 percent of its workforce in 2003 and saved \$800 million.” So do you think the current job cut will be the last? What about the long-term costs inherent in hiring new full-time employees versus hiring temporary workers or squeezing more work out of your existing employees? In the *Wall Street Journal* (March 11, 2004) “GM’s Liabilities For Retiree Health Top \$60 Billion.” Companies commit to paying for future benefits for a retired workforce ... wonder what type of benefit programs are offered in India or China?

Here is building efficiency in action. According to the *San Francisco Chronicle* (2/28/04), “The new U.S. Embassy in Beijing will house 600 workers in four buildings tightly arranged around a formal set of pathways and courtyards inspired by traditional Chinese town planning. With 500,000 square feet of enclosed space, it is more than twice the size of new embassies in Moscow and Berlin.” I know they probably have a lot of conference and banquet facilities, but this is still a spacious 833 square feet per employee ...

Job cuts announced during the past 60 days: *Tri-Valley Herald* (1/28/04), “Kraft to cut 6,000 jobs” ... *CNN Money* (2/25/04), “AT&T to slash 4,600 jobs” ... *SF Chronicle* (3/18/04), “13,000 job cuts loom in Merger, FleetBoston, BofA” ... *Tri-Valley Herald* (3/27/04), “MCI cuts 4,000 jobs due to costs.” However, in the retail sector, the *Albuquerque Journal* (2/7/04) reported a partnership with Home Depot and AARP to hire 35,000 people in 2004. Great, my programming job just went to India, but at least when I’m 65 I can sell hammers for a living ...

*PikeNet* (2/5/04) referred to an article featured in *Wired* magazine (February 2004), “*The New Face of the Silicon Age* paints a vivid picture of the offshore outsourcing dilemma. Just read the first three paragraphs about a highly-trained Indian programmer writing code for handheld devices. She makes \$11,000 per year vs. \$70,000 for a comparable engineer in the U.S. Yet she is paid 22 times the per capita annual income in India! ... The outsourcing hullabaloo riles up real estate economist Hugh Kelly. He’s seen it all before with the predicted demise of demand due to “hoteling” or “telecommuting” or “e-tailing.” Instead, Kelly predicts net new demand for office space of 400 million square feet by 2015.”

What contradictions in job survey headlines! *San Francisco Chronicle* (1/21/04), “CEOs say they plan to hire staff this year.” *East Bay Business Times* (1/30/04), “Bay Area execs plan to restart hiring in 2004.” *San Francisco Business Times* (2/6/04), “Bay Area companies are rapidly recovering their appetite for employees.” *Tri-Valley Herald* (3/4/04), “Economy is recovering.” *USA Today* (3/8/04), “Fewer small businesses plan to hire.” *San Ramon Valley Times* (3/13/04), “Recession makes way to East Bay.” *San Ramon Valley Times* (3/16/04), “Survey finds hiring may increase.” Same paper only 10 days earlier, “New jobs just a sixth of what experts forecast.” What is my opinion from hundreds of corporate calls personally made during the past few months? Global offshoring may make a much greater impact than folks today realize, especially when it filters down to medium and smaller business processes. Companies continue to stay lean and mean, and several I’ve spoken with recently plan to move office operations to the back of distribution centers, or shut down offices at lease expiration and consolidate into other company-owned or longer-term lease space elsewhere. Some plan to relocate either partially or totally out of California due to relatively cheaper housing, labor and more business-friendly regulations. Companies still have great amounts of shadow space which will cause a six to 12 month lag effect once hiring actually begins, so I do not see significant amounts of net office leasing during the next one to two years. I do see companies in Class B space moving to Class A product, and there is still an ongoing influx of new sublease

availabilities, but this has slowed down as the tenants signing five-year leases back in 2000 and 2001 now have little remaining existing terms.

Our local Contra Costa County just passed the 1 million population mark. Los Angeles passed 10 million last year, and San Joaquin now has 625,000 residents.

The Editor of *Real Estate Forum* said this in her January 2004 Editor's Page, "I'm not convinced that the long-awaited, full throttle rebound is going to happen this year. The primary reason for this pessimism is the job situation ... the results of the monthly analysis for December from job placement firm Challenger, Gray & Christmas Inc. ... all told, some 1.2 million people were left jobless last year due to corporate downsizing, according to the firm, which predicted that it might be 2008 before the next employment boom will hit."

*San Francisco Business Times* (2/6/04), "Regional jobs forecast says storm's over, sun is on the way ... The Bay Area economy will add 17,000 jobs this year in sharp contrast to the 62,000 jobs last year, the region will add 33,000 new jobs in 2005 which will just start to offset the 268,000 lost since the end of 2000."

*San Francisco Chronicle* (2/28/04), "State gaining jobs ... joblessness appears to be shrinking ... the numbers are moving in the right direction."

*Tri-Valley Herald* (3/4/04), "Economy is recovering ... One-third of the executives surveyed said they expect to increase hiring in the next six months, while 22 percent expected to cut payrolls and 45 percent expected no change, according to a Business Roundtable survey."

*USA Today* (3/8/04), "Fewer small businesses plan to hire ... Small businesses, the engine of U.S. job creation, are retreating on hiring plans – magnifying the jobless recovery."

*The Wall Street Journal* (3/8/04), "Job Growth Falls Short of Estimates ... 21,000 payroll jobs were created in February; economists had expected about 125,000."

*San Ramon Valley Times* (3/13/04), "Recession makes way to East Bay ... The East Bay, which had been spared the brunt of the job recession, may be starting to suffer the side effects of the high-tech meltdown and the state budget deficit."

*San Ramon Valley Times* (3/16/04), "Roughly one in four employers plan to add workers in the second quarter of the year to keep pace with increased demand for their products or services, according to a survey of 16,000 businesses by Manpower."

*San Francisco Chronicle* (3/25/04), "Commercial real estate will remain weak, especially in the Bay Area, the report (UCLA Anderson Forecast) predicts. Demand for commercial space will be dormant this year, which will keep vacancy rates high and prevent rents from rising."

Two major new residential growth areas are the Dougherty Valley region of San Ramon, where thousands of new homes are expected to house 40,00 residents, and Mountain House near Tracy, where 16,000 homes at build-out will house 43,000 residents. For a 3,000-square-foot new home on a 5,000-square-foot lot in San Ramon, the price tag is about \$800,000, while the same home on a 7,000-square-foot lot at Mountain House may cost you \$550,000. Of course, there are a lot of places in the country where this same price tag would get you a 5,000-square-foot home on two acres with money left over ...

*San Francisco Chronicle* (2/24/04), "Jobs moving out of state ... Discouraged by high costs and strict regulations, just under 60 percent of California business leaders interviewed for a new study said they have policies to restrict

job growth in the state or move jobs to other locations in the United States ... It costs an average of 30 percent more to operate in California than in other western states, largely due to higher wages and benefits ... California business regulations are more costly, complex and uncertain than those in any other state, by a wide margin ... As a result, 40 percent of California companies interviewed said they have an explicit policy to move jobs to other states. Just under 20 percent said their policy is to avoid adding jobs in the state.”

Baby Madison is almost 18 months old. She loves music and starts dancing by herself almost every time she hears music. Madison is not quite talking yet, but occasionally out of the blue, she will say “thank you” or point to an animal and say its name. During the first week of February, Madison went skiing for the first time at Taos, New Mexico, going down the bunny slope on tiny skis and boots with her dad crouched over her to control speed and direction. Jordan, who will be 7 on May 26, is a level 8/9 skier and at Taos went down a number of black diamond runs and even some double-blacks. What a surprise when Jordan and his class were on the same challenging run at the same time as his parents! Jordan is very much into the Little League season and is now at the Farm level for the San Ramon Little League Rockies. His dad is helping coach and the first game will be this week. You can view the kids’ most recent adventures at [www.OfficeTimes.com/JMApr04.htm](http://www.OfficeTimes.com/JMApr04.htm)

I know spring is here when I get up at 4:45 a.m. and don’t need to put on the outside lights to see the newspaper. In Northern California, it has been in the 70s most of the past month, flowers are blooming, and the smell of barbeque grills permeates the evening air. While the “big” issues are still important, it seems the great “little” things, like your daughter’s first ski run, your son falling asleep with a book in his arms at age 6, and a client thanking you for a job well done on their office renewal are what seems most central to being alive! Take care, and please call me if I can help out in any way.

Thank you!

Sincerely,

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# Newsletter

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