



Corporate Office Perspectives

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How is the office market? Two sides of the same coin – I get asked this basic question all the time. There are several, quite different ways to answer this. If you are an office building owner in San Mateo or San Francisco who either has owned the building for a long time or bought it five to six years ago before values doubled, your answer may well be: Terrific! On the flip side of this same coin, the office tenant who is coming up for a lease renewal after signing in 2004 may be facing a 200 percent rent hike, and their reply to the same question could well be “Terrible!” The major investor out in other parts of the Bay Area who stretched in purchase price at a 4 percent cap rate six months ago might now be experiencing increasing vacancies, with asking rental rates 10 to 20 percent above market, and wondering why all the office brokers have stopped touring. Their answer to their executives might still be “Great” but in private to others, the answer might be quite different. The office landlord who felt great in 2005 and 2006 filling his or her building with financial services like lenders, mortgage brokers and the like might now be waking up in the middle of the night wondering which tenant was going to suddenly downsize, or worse, go into default. So, same question and it could also be the same building location, but what a difference in viewpoints!

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Talk about windfall profits ... I just read a report which tracked San Francisco Class A office building sales ... the average price for Class A assets last year was \$650 per square foot, a major leap from the \$427 average in 2006, and nearly double the \$333 of 2005, *California Real Estate Journal* (February 4, 2008).

Dr. Tjove Fjeld, a professor at the Agricultural University of Oslo, Norway, conducted a two-year study in an office building; the study found significant reductions (23 percent) in ailments after plants were introduced. The reduction of ailments has translated to a 14 percent reduction in absenteeism. A study by RA Wood, MD, titled “Plants/Soil Capacities To Remove Harmful Substances From Polluted Indoor Air,” identifies which plants are best at removing the top toxins found in most indoor environments, *Buildings* (February 2008).

Cubicles may become a thing of the past. “Valley companies dump cubicles for open office spaces!” “Like other valley stalwarts, including Intel and Sun Microsystems, Cisco is casting aside the cubicle culture that has thrived in the

United States since the late 1960's. In its place, the company is embracing a new workplace design that saves space and moves, and encourages collaboration among co-workers. On any given day, said Neil Tunmore, Intel's director of corporate services, 60 percent of the company's cubes are empty because people are visiting customers, telecommuting, vacationing or in meetings. Employees work in their assigned buildings only three days a week on average and spend 20 percent of their work hours telecommuting ... Beginning this month, the chip maker will set up three experimental work sites. Open areas, comfortable armchairs, extra conference rooms and tables where people can plop down with laptops will replace the ubiquitous cubes that have been standard issue for decades" ... "My office isn't a space in a building," Rhett Livengood of Intel said, "My office is the space where I am," *Mercury News Article* (December 3, 2007).

Recession will cut deeper in East Bay – "Christopher Thornberg, an economist formerly with UCLA Anderson Forecast and founding partner of Beacon Economics, is predicting that the recession and fallout from the housing crisis will have a deeper impact on state and local revenues, more so in the East Bay than in other parts of the Bay Area ... Thornberg predicted that home prices in California will fall an additional 25 percent to 30 percent by the end of 2008, including a 10 percent drop that has already occurred. The East Bay will be hit harder than its two neighbors – San Francisco and San Jose – because it has been the center of housing growth, he said," *East Bay Business Times* (February 1, 2008). "State lost 20,300 jobs in January, Oakland, San Jose metro take far bigger hit than San Francisco zone," *San Francisco Chronicle* (March 1, 2008).

For the first time in four years, the national office vacancy rate, tracked in 79 major metro markets, rose from 12.5 percent to 12.6 percent between the third and fourth quarters of 2007. The rise is attributed to the slowing economy and the ever-growing sub prime housing crisis, *National Real Estate Investor* (February 2008).

Green Buildings ... want to view models of the 96 projects in the High Performance Buildings Database that showcase the best green architecture? BuildingGreen.com, Google and U.S. Department of Energy have teamed up at www.eere.energy.gov/buildings/database/, *Buildings* (March 2008). "Greenest Building Codes in U.S." On March 19, 2008, San Francisco moved a step closer to imposing the country's most stringent green building codes, whereby with a phased-in program developers would have until 2012 to fully comply with the strictest levels of the green building codes, *San Francisco Chronicle* (March 20, 2008).

How to do a "Green Move" while doing a corporate relocation – use reusable packing crates versus cardboard boxes, refurbish existing furniture, recycle electronics, furniture, carpet and cabling. For the complete article go to www.officetimes.com/2008/Feb2008/GM.htm. Another area of Green is in the cleaning department. "Green cleaning can be an enormously cost-effective strategy for an organization, since it is already part of the facility budget and it frequently doesn't cost more than the traditional program it is replacing. Over the past five years, a number of organizations in a variety of building segments have developed guidelines for green cleaning, including the U.S. Green Building Council's LEED for Existing Buildings, Hospitals for a Healthy Environment's 10 Steps to Green Cleaning, and 'Green Cleaning for Dummies'," *Today's Facility Manager* (January 2008). "How to Get a Greener Clean – A green cleaning program includes three things: 1. Replacement of traditional cleaning agents with environmentally friendly alternatives. 2. Equipment that is more efficient, quieter, and more effective in removing contaminants from the indoor environment. 3. Processes that minimize the use of water and

energy, and promote healthy indoor air quality, all while providing a high level of cleanliness,” *Buildings* (February 2008).

Tenant improvements may have had a recent shot in the arm by legislation just signed into law by President Bush. The Economic Stimulus Act of 2008 offers bonus depreciation by landlords or tenants who pay for improvements to newly acquired buildings more than three years old. “Bonus depreciation offers such a strong write-off potential, savvy investors in need of a quick legal tax break might even begin snapping up older buildings and improving them just for the payoff,” according to David Zaslow, a partner with CPA firm RBZ LLP. “Typically, tenant improvements depreciate in value over a period of 39 years, he explained. But the bonus depreciation means landlords or tenants can write off 50 percent of the investment in the first year – the equivalent of a \$500,000 immediate return for every million dollar investment. Of course, the entire law remains subject to IRS interpretation, said Zaslow.” Of course, check with your CPA to find out what the real story is – this sounds too good to be true ... *California Real Estate Journal* (March 3, 2008).

At the March 2008 Northern California SIOR meeting a panel made up some of the top office and industrial developers in Northern California (Opus, Legacy, Panattoni, Jay Paul) spoke frankly about how they see the current and future markets. With the economy weakening, while prices aren't going down, at least subcontractors are now returning phone calls. Construction costs have gone up 200 percent during the past 10 years, with steel going up 50 percent in just the past three years. Cap rates are headed up, there will be fewer mega portfolio sales and capital gains rates are expected to go up after the 2008 election. More and more municipalities are mandating LEED Green and it may become building standard to be at least Silver LEED certified. New office built to LEED Silver might add 2 to 3 percent to the price while LEED Gold could add 5 to 7 percent to the construction cost. It is near impossible to get a new speculative office construction loan as the credit markets are currently frozen. Those who started new office projects several years ago might reap the benefit of this lack of competition ... I'm thinking, this limitation on new office construction is probably a good thing so we don't get overbuilt like we did during the last few business cycles. I'm also thinking how smart Sam Zell was in selling Equity Office at the time and price he did.

Deals & Rumors: It was a huge past 60 days for I-680 Corridor office leasing. In **Pleasant Hill**, our office leased 137,000 sf to Contra Costa County at Ellinwood Office Park, 300/400/500 Ellinwood Way. Next door in **Walnut Creek**, Basic American may relocate to 20,000 sf at Pacific Plaza; Morrison Knox may have signed for 10,000 sf at 1550 Parkside Drive; John Muir Hospital is rumored to be subleasing 10,000 sf at Treat Towers; and Children's Hospital leased 21,000 sf at 2401 Shadelands. Further down I-680, PG&E leased 135,000 sf at 3401 Crow Canyon Road in **San Ramon**. In **Pleasanton**, Farmers Insurance leased 50,000 sf at 4460 Rosewood Dr., vacating its 140,000 sf office building sold to Safeway, and GSA might be signing a 60,000 sf office lease at Saratoga Center. Also in Pleasanton, Kaiser Permanente bought 440,000 sf of office buildings from Oracle at 4411/4433 Oracle Lane and 5840 Owens Drive. In **Livermore**, Comcast leased 219,000 sf office and R&D space at 3055-3077 Triad Drive. In **Milpitas**, Sonics Inc. leased 22,000 sf at 890 N. McCarthy Blvd. Greenberg Qualitative Research, Inc. leased 10,000 sf at 1250 53rd St. in **Emeryville**. In **Daly City**, Derry Institute signed for 17,000 sf at 2001 Junipero Serra Blvd, and in **San Bruno**, Adify leased 28,000 sf at 1000 Cherry Ave. In **San Francisco**, Gibson Dunn & Crutcher LLP leased 60,000 sf at 555 Mission St.; Room to Read expanded to 12,000 sf at 111 Sutter St.; PNC Financial Services Group leased 17,000 sf, Seacastle, Inc. took 13,000 sf, and Harris Williams &

Company 13,000 sf, all three office leases at Market Center and Turnberry Associates leased 25,000 sf at 525 Harrison St.; Omniture leased 35,000 sf at 250 Brannan St.; iStar leased 17,000 sf at One Sansome St. and HKS architects leased 11,000 sf at 500 Howard St. Relatively quiet in a few parts of the Bay Area, but deals cross my desk sometimes daily so there may be stacks of deals about to pop ... or not ...

In a recent survey of 7,660 office employees about the increasingly green trends of U.S. companies, two out of three workers at companies without environmental policies would like to see such policies implemented in their offices. Eighty-three percent of employees would like to see their companies use environmentally friendly cleaning chemicals in their offices. Nearly one out of three workers says he/she possesses allergies that are aggravated by environmental conditions in the office, *Buildings* (March 2008).

The Colliers U.S. Real Estate Review 2008 highlights: “Demand for office space off from 2005/2006 levels as the national economy slowed and hiring declined through 2007 ... rental growth is almost certain to slow even though many markets report balanced market conditions ... 2008 absorption is expected to be down from 2007 levels ... very few markets could be described as oversupplied.”

“Daylight harvesting, which uses lighting controls that switch or dim the lights either manually or automatically in response to available daylight, can generate 30-40 percent savings in lighting energy consumption, significantly reducing operating costs for the owners,” *RealCommAdvisory* (February 7, 2008).

Offshoring Real Estate Functions ... “In the real estate industry, offshoring is becoming increasingly popular for lease abstracting, lease administration, financial modeling, mortgage servicing, mortgage underwriting, and a variety of finance and accounting functions. India, China, the Philippines, South America and Eastern Europe are most commonly associated with offshoring services. Gartner projects the offshoring industry to grow more than 40 percent per year through the end of the decade,” *RealCommAdvisory* (January 31, 2008).

Hey, these aren't my words so don't go blaming me! “The commercial real estate market has entered a period of declining values with many properties overleveraged or encountering financial difficulty ... Overleveraged property investors undoubtedly will face loan defaults, workouts or foreclosures,” Jeff Gugick and Marc Schuster, managing directors with Valhalla Financial, *National Real Estate Investor* (February 2008). I'm not sure I agree with most of this statement – at least in the San Francisco Bay Area there are still trillions of dollars eager to invest, at the right price, and just because the overheated “frothy” days may be past, most properties are still healthy, commercial foreclosures have been extremely rare. While in the future, there may be a handful of suburban non-anchored and overleveraged strip retail centers in trouble, even most of these still have plenty of equity.

“Homes and businesses in Berkeley would be required to produce as much energy as they use by 2050 under an ambitious city plan that aims to combat climate change,” *San Francisco Chronicle* (January 29, 2008). One new product that might help with this is the Walkstation from Steelcase, which

integrates a treadmill with a height adjustable workstation, *Today's Facility Manager* (January 2008). It is only a matter of time before something like this is modified to capture and store the energy generated which in turn can be put back into the building's energy grid. Somehow this all sounds depressing ... And for truly getting to "power neutral," "Researchers have developed a device that generates electrical power from the swing of a walking person's knee ... with the device a minute of walking can power a cell phone for ten minutes." Maybe they can start with the health clubs to harness the recumbent bikes and elliptical machines ... (you smirk, but just wait 5 to 10 years and I'll remind you where you read about this first ...)

Where is our economy headed? Who knows ... I just keep reminding myself to continue doing what needs to be done to be the number one tenant rep broker in Northern California, be proactive and strategic in advising my clients as to what they should be doing to protect their business and personal interests, and beyond that I'm not sure what other impact we as individuals have in the overall scope of things ...

My 10-year old son, Jordan, just went through another growth spurt and I am now only a head taller. He is one of his Red Sox's key pitchers, and with his first game this week, it should be an exciting Little League season. For the first time in five years I am not his coach as I am coaching our 5 year old daughter, Madison's girl's softball team – talk about cute! Thirteen 5 and 6 year old girls, many with pink helmets, pink bats and some even with pink gloves – they voted on the team name "Red Hot Chili Peppers," which to the parents' relief was a lot better than Pink Popsicles ... While I may not have even a molecule of impact on the global world at least with our two kids the opposite is true – we are helping mold their character, even when we are not aware that everything we say and do around them is absorbed and in turn becomes a part of them ... scary, yes, challenging, absolutely, and as my friends with older kids remind me this parent-to-child impact changes and is greatly diminished as they grow older and more involved with peers and other role models. To see recent photos of their adventures go to www.officetimes.com/2008/Mar2008/JMApr08.htm. Have a great last bit of Winter, please call me if you need a great commercial agent recommendation anywhere in the world, and take care until next time!

Sincerely,

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