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## Corporate Office Perspectives

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Where is the office market headed, are there sub-markets where we've hit bottom and when will we begin to see a general office recovery? Two months ago, I stuck my neck out (June 1, 2003, [www.officetimes.com](http://www.officetimes.com)) and predicted we'd hit bottom sometime in 2005 (6 to 18 months from June 2003). Barring a huge international catastrophe, we are still on track, but don't expect a robust pendulum swing back up once we do reach bottom. There are three reasons why a more conservative recovery is more likely. First, an increasing number of companies are either approaching profitability or experiencing rising profits, but for many this is not through increased sales but rather through decreased expenses, i.e. layoffs and downsized real estate. As Safeway Inc. CEO Steven Burd told shareholders at their annual meeting May 15, 2003, "This is the year where our spending will be down, and we'll generate significant cash flow." Safeway is planning additional cost cutting that will include layoffs at its Pleasanton headquarters. *San Francisco Chronicle*, (June 11, 2003): "Oracle Corp managed to increase profit by 31 percent in the fourth quarter despite almost stagnant sales compared with a year ago. The firm credits effective cost cutting for boosting its earnings." Reported by *Bloomberg News Service* (July 17, 2003), "AMD loss narrows – Advanced Micro has had losses in eight straight quarters, and Chief Executive Hector Ruiz has been firing workers to cut costs." *Contra Costa Times* (June 19, 2003), "Electronic Data Systems Corp. said Wednesday it would cut 2 percent of its work force, or about 2,700 jobs, and sell some assets to save hundreds of millions of dollars per year." ... same source, "Swiss financial giant UBS said Wednesday it plans to cut about 500 investment-banking jobs worldwide, or about 3 percent of its work force in that business, in an effort to slash costs. *Tri-Valley Herald* (May 5, 2003), "Cisco says cost cutting helped boost bottom line ... profits rise 35 percent despite falling sales as it pared costs amid a sales decline." *Contra Costa Times* (July 24, 2003), "Schwab touts best profits since 2000 ... Cost cutting helped propel the brokerage company to its most prosperous quarter in three years ... Revenue totaled \$1.02 billion, a 2 percent decline from \$1.04 billion last year. The eroding revenue didn't diminish Schwab's profit, largely because of the company's deep cuts in expenses. The streamlining left Schwab with 16,100 employees at the end of June, 3,000 fewer than a year ago. The cost cutting helped propel Schwab to its most prosperous quarter since the company earned \$139 million during the final three months of 2000." *Contra Costa Times* (July 25, 2003), "AT&T Corp. posted a \$536 million second-quarter profit after Chief Executive Officer David Dorman cut a third of executive jobs amid a slide in sales. Dorman is accelerating job cuts to 6,400 this year, almost twice as many as he planned in January." So, in my opinion, layoffs will continue even as corporate profits rise, mitigating any great market surges for new office space.

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Reason #2, there don't appear to be any huge "demand" drivers like the three that helped fuel the last office boom. First, we had the Y2K, perceived or real, which created millions of engineering and programming jobs, and tons of office space absorption. We also had a tech surge where both individuals and corporations had to upgrade their computers and

software just to be able to keep up with the pack. Remember how frequently we had to trade up as our PC speed, memory or operating system couldn't handle the tasks at hand. Now even though XP is to many a huge benefit (myself included), most with Windows 98 or 2000 can still keep up, and hence no great demand for PC's, PDA's, etc. The third "demand" was of course the dotcom experience, where for a while folks actually believed a company did not have to have cash flow to still be extremely valuable. We leased them tens of millions of square feet of office space and office equipment, and furniture dealers thought they were in heaven. So, what is the "demand" trigger to cause the next boom? Thirdly, I am still concerned about the increasing trend to send office work overseas. According to the *East Bay Business Times* (June, 27, 2003), "A 2002 Forrester Research study predicted 3.3 million U.S. service industry jobs – including 1 million IT jobs – will move to other countries over the next 15 years. A separate report in April from *Deloitte Research* estimated the world's 100 largest financial services companies will transfer 2 million jobs over the next five years to low-cost countries." Just using the five-year figure, 2 million jobs at an average 200 sf per employee translates to 400,000,000 square feet of empty office space. To summarize, as long as layoffs equal corporate profit, there is no huge mega-need for office demand, and just during the next five years we will send 400,000,000 sf of office space overseas, one might expect a long and bumpy recovery at best.

"Cost cutting and improved technology have led more and more U.S. companies to send skilled work like computer programming overseas." (*San Francisco Chronicle* June 2, 2003). "Those who are fighting outsourcing warn that as opportunities for computer professionals wane, American students will have no incentive to enter the field. They predict a lack of American know-how, and fear that rampant U.S. job losses will decimate the tax base and damage the economy. Most experts don't share that doomsday view. Some even say getting IT work done cheaply overseas will benefit the U.S. economy by allowing companies to become more competitive ... One company that has shifted to offshore outsourcing says the trend is beyond its control." "We're being forced, in some cases painfully, as happened in ships and shoes and sealing wax," says Raymond Bingham, CEO of Cadence Design Systems, a San Jose company that makes software for designing semiconductors, "We know how this movie ends," the executive said during an interview in the company's U.S. headquarters in Mountain View. "If a decade ago we discovered that manufacturing can be done anywhere, in this decade we are learning that knowledge can be learned anywhere." In the *East Bay Business Times* (June 27, 2003), "Bay Area companies outsourcing offshore include Hewlett-Packard, which shifted 1,200 Compaq customer service jobs from Florida to the existing H-P center in India, and Oracle Corp., which moved more than 2,000 development jobs to India and was also expected to move accounting, payroll and some customer service positions offshore. Others, including Charles Schwab, Bank of America and PeopleSoft, have moved work to countries such as Russia, India, Israel, the Philippines and Singapore. But it's not just the big companies that are outsourcing offshore. Christopher Kenton, president of the San Rafael-based marketing firm Cymbic Inc., said many small businesses like his benefit from outsourcing work overseas. Cymbic couldn't afford to pay software developers in the United States thousands of dollars to develop the software he needed, but he found a programmer in Argentina who would do the job for less than \$200." Well, at least for now, U.S. office leasing brokers don't have to worry about someone listing a California sublease with a lower-priced broker in Chile ... but who knows, one of these days, the investment property analysis, packaging and Internet-marketing might be done elsewhere for larger real estate investment sales ...

If you've ever wondered what the terms "wet column," "plenum" or "hot office" refer to, check out the Glossary of Office Space Terms at [www.officetimes.com](http://www.officetimes.com). This has been compiled from past classes I've taught as a former SIOR instructor, guest lecturer at U.C. Berkeley for the Business School, and helping teach the CoreNet/Nacore course on office leasing. Also, for a great article on the ins and outs on used office furniture written by John Schwartz, president of Sam Clar Furniture, take a look at the no-hype "Used Office Furniture – Where We Are Today and a Primer on the Overall Market" at [www.officetimes.com](http://www.officetimes.com).

According to the *San Ramon Valley Herald* (July 12, 2003) on the current job trends, "Unemployed managers and executives are finding new jobs faster, according to a report released Friday by the outplacement firm Challenger, Gray and Christmas. It took an average 3.4 months to find work in the second quarter, down from 4.2 months – a 17-year high – in the first quarter. The company said that executive hiring is typically an early signal of general hiring trends in the private sector, and suggested the job market will show significant improvement nationally by the end of the year.

Challenger said earlier in the week that the number of job cut announcements by high-tech companies has fallen significantly in the second quarter, Levy (Stephen Levy, an economist at the Palo Alto-based Center for the Continuing Study of the California Economy) said the trend is still negative.” “I don’t see this as any evidence that the turn has come,” Levy said. “A reduction in the job cuts is not the same as an increase in jobs.”

As of Q2 2003, the Downtown Walnut Creek Class A vacancy rate was 12.6 percent, Concord 6.1 percent, the overall Walnut Creek North I-680 was 9.2 percent, while the Tri-Valley office market as of Q1 2003 was 19 percent for San Ramon/Pleasanton/Dublin “officially,” with an estimated 23-25 percent including shadow space. To see more details on current vacancy rates, go to [www.officetimes.com](http://www.officetimes.com).

When we had the high office vacancies back in the late 1980s, it was due to massive overbuilding, whereas the current vacancy rate is a result of dotcom implosion and massive corporate layoffs.

With all the hype one would think California is one of the most expensive places to do business in the U.S. in terms of utility costs, but *Business Facilities*, June 2003, published a unit cost state-by-state breakdown. For commercial electricity, Alaska, Hawaii, Maine, New Hampshire, New York, Rhode Island and Vermont were more expensive. For industrial commercial natural gas, Connecticut, Hawaii, Illinois, Iowa, Maryland, Massachusetts, Missouri, Montana, New Hampshire and New York all were higher-priced. I know you’ve been thinking about this a lot ... but when you pull this tidbit out in a future executive meeting, remember where you saw it ...

*Deals and Rumors:* This is the least amount of published **San Francisco** lease transactions I’ve seen in 20 years, so hopefully there are a ton ready to surface ... Zone Labs leased 70,000 sf at 475 Brannan St.; Sotheby’s International Realty took 10,000 sf at 711 Greenwich St.; The Office of the Comptroller of the Currency leased 10,000 sf at 1 Front Street; EIP Associates signed for 10,000 sf at 353 Sacramento St.; Pacific Growth Equities expanded into 34,000 sf at One Bush, and KPFF Consulting Engineers took 13,000 sf at Levi Plaza. Up in **Novato**, BioMarin Pharmaceuticals leased 75,000 sf at Bel Marin Keys Park and Hall Kinion took 17,000 sf at 75 Rowland Way. In **Santa Rosa**, National Bank of Redwoods leased 19,000 sf at 2170 Northpoint Parkway. Down in **Mountain View**, Varian leased 27,000 sf of R&D space at 2599 Garcia Ave.; Across the Bay in **Fremont**, EXP Pharmaceutical Services leased 106,000 sf at Warm Springs Park, and Quark consolidated into 20,000 sf at 6536 Kaiser Drive. In **Oakland**, Filice Brown Eassa & McLeod expanded into 28,000 sf and Lombardi, Loper & Conant expanded into 14,000 sf, both tenants at 1999 Harrison St.; In **Alameda**, Embarcadero Systems leased 30,000 sf at 1701 Harbor Bay Parkway, and U.C. Berkeley took 29,000 sf at 2100 Shattuck in **Berkeley**. Up in **Concord**, Wells Fargo signed for 50,000 sf at the brand-new Concord Metroplex and Pipeline Systems is rumored to be leasing 12,000 sf at Conco’s North Concord Project. In **Walnut Creek**, Virgin Mobile leased 21,000 sf at Mt. Diablo Plaza, Mechanics Bank will be relocating to 10,000 sf at 1333 N. California Blvd., RBF Engineers leased 11,000 sf at 500 Ygnacio, and Dantz is moving to 27,000 sf at 3003 Oak Road. In **San Ramon**, ASAT is rumored to be looking at 18,000 sf at BR 3. In **Pleasanton**, the big news was E-Loan subleasing 118,000 sf from Charles Schwab at Stoneridge Commons; and ADT sublet 17,000 sf at 4511 Willow Road. Please feel free to e-mail deals 10K and larger for the October issue to make sure I don’t miss anything!

Here’s another viewpoint on “Have We Hit Bottom?”, from *National Real Estate Investor*, July 2003, “If, indeed, the U.S. is in the early stages of a long anticipated rebound, there were no signs of it in the commercial real estate industry in the first half. The most obvious trends were rising vacancies, falling rents, and mounting loan delinquencies. Aside from retail, every sector showed signs of stress. And, say industry watchers, the worst is yet to come. One thing is emphatically clear: The longer Corporate America avoids hiring and investing in new capacity, the further away a recovery in commercial real estate will be.” Comparatively speaking, my prognosis above seems a lot more upbeat, but, still in the same publication, Matt Valley, Editor at *National Real Estate Investor* said in his opening editorial, “While wholesale job cuts are waning in frequency, an added concern is that many jobs are moving overseas, compounding the problem for office landlords is that corporations have become quite adept at doing more with less during this downturn, leading to higher productivity in the workplace. According to the U.S. Department of Labor, the average worker today produces 7 percent more goods and services per hour than in 2001. Increased worker productivity enables employers to delay hiring additional workers and affects office leasing activity.” Reason #4 we

have a long way to go before the market recovers ...

Building security technology might be ratcheting further upward, with photo imaging card access systems, turnstyles, enhanced camera surveillance with future bio identifier fingerprint or retina scan machines on the horizon. As reported in *National Real Estate Investor*, June 2003, "Unfortunately, the whole placement of a security system is greatly misunderstood," says Gene Samburg, president of Kastle Systems. "Most building owners and managers believe that the biggest challenge is designing and installing a system. The hard part comes when you have to operate it on an ongoing basis. The typical cost of installing a card access system, including all of the hardware and software, is about \$0.25 to \$0.50 per sq. ft. In addition, Kastle charges \$0.12 per sq. ft. for the ongoing operations, compared with a cost of \$0.25 to \$0.50 per sq. ft. if the building owner operates the system independently," Samburg notes.

The Bay Area biotech/life science industry contributes \$12 billion to the regional economy, 80,000 jobs and \$900 million in annual research and development.

The end of offices? According to the *California Real Estate Journal* (June 23, 2003), "Scott McNealy, Sun Microsystems' chairman and chief executive, wants all 35,000 Sun employees to be prepared to abandon permanent desks in favor of flexible workstations and telecommuting. Proponents of the idea say it is a prototype of how millions of Americans will work within a decade. McNealy has long believed that companies could boost productivity and slash costs by eliminating regular desktop computers and giving workers access to centralized machines. Sun estimates it saved \$50 million last year and ultimately could see annual cost savings of \$140 million." Great, this sounds like Reason #5 in my opening comment about why we might experience a long, bumpy office market recovery.

For those of you who received several copies of the June 2003 OfficeTimes, we apologize. There appeared to be some type of software conflict between the main corporate server and the new spam software, which should be fixed (or the entire IT department owes me lunch).

Telecommuting is not for everyone... In an article titled "Working from home not always the right fit" (*San Francisco Chronicle* 7/14/03), "New research suggests employees may add tension to their lives by telecommuting if they don't first make a careful assessment of their personalities and employment situations." Along with researchers at Harvard University and Canada's Simon Fraser University, Ellen Kossek, a professor of human resources at Michigan State University, interviewed 300 employees and 95 managers across the country. They learned that workers' home lives suffered if they telecommuted with inadequate space or technological infrastructure. Though some workers are discouraged and returning to the office, academic and career coaches say companies shouldn't cut out flexible programs. They should just help determine when such options are a good fit. At the Procter & Gamble Co., entire teams transition to the work-at-home program together, with extensive training on telecommunications technology and discussions of how interactions will change once some members are out of the office, said Laurie DeMarco, manager for workplace effectiveness. Three to six months later, managers check to make sure no problems are developing." In an article titled "Telecommuting Cuts Lease Costs" *Commercial Investment Real Estate* July/August 2003, "AT&T estimates that since 1995 it has saved about \$500 million in office lease costs through telecommuting, IBM leases 2 million fewer square feet of office space today, saving \$700 million. Nortel saves more than \$20 million a year in real estate costs with 13,000 telecommuters. Georgia Power reduced its office space needs by two-thirds. Overall, about 28 million employees telecommute one to three days a week, a 42 percent increase since 1999, according to the International Telework Association and Council. The organization estimates that by 2005, nearly one-third of American workers – 50 million employees – will telecommute regularly for some part of their workweek. A recent survey of AT&T telecommuters revealed a 10 percent increase in productivity over a year's time, which the company values at about \$65 million, Broadband access at home increased almost 60 percent in 2002, which translates into about 33 million Americans with high-speed Internet connections. Access Markets International predicts that more than half the U.S. workforce will be mobile by 2006, with businesses of 500 employees or less driving the demand for wireless workers." Great, what a choice, get kicked out of my office cube or relocate to Bombay or Manila ...

The *Tri-Valley Herald* reported on 7/22/03, "Embarcadero Capital Partners LLC of Burlingame, a real estate investment firm, has raised about \$100 million to buy office buildings on the Peninsula, throughout California, and in

Boston as vacancies increase and rental prices drop. The group is looking for buildings that have something wrong with them, such as high vacancies.” There are several issues at work here, which may suggest we will see a rise in office building foreclosures during the next few years. Operating expenses have skyrocketed during the past 18 months, especially with utility costs, property insurance and security costs. It was not uncommon to see 10 to 25 percent jumps during each of the past two years, and with reduced rents, the two saving graces for office building investments are incredibly low interest rates and an overhang of tenants still paying way-over market rents on leases done in 1999 to 2001. With the Federal debt expected to increase by \$1.9 trillion during the next five years (*Contra Costa Times* 7/16/03), expect future interest rate hikes in long-term financing of office buildings. Then in 2005/2006 many over-market leases will burn off, which may contribute to increased office foreclosures. There won’t be the avalanche of lender take-backs like we experienced in the late 1980s, but we should see more purchase opportunities for turnaround buyers like Embarcadero Capital Partners. Of course, the office building fairy godmother could wave her magic wand and create huge demands for space and blow this theory to shreds ...

Don’t ask me why, but for some reason I recently listened to a 1992 Society of Industrial and Office Realtors (SIOR) cassette tape (no CD’s back then) titled “Office Leasing/Subleasing Techniques” and as Yogi Berra used to say, “It was déjà vu all over again!” High vacancy rates, no demand and brokers hitting their heads against the wall trying to come up with creative ways to move space ...

A recent report by the Association of Bay Area Governments on 30-year population, job and leasing projections predicts that by 2030, the Bay Area will add 2 million people, build 750,000 households (50 towns the size of Danville), create 1.5 million new jobs, and Contra Costa County will top 1 million people. I’m not sure if this is a good thing or not, as we already have a larger population than a number of states. In general, growth may be good for business but not for trying to get out of town on Friday afternoon ...

During the past 10 years seven major military bases closed in the San Francisco Bay Area, totaling 11,474 acres. Tens of thousands of military jobs vanished, but currently there are 1,700 residences with another 8,750 planned, and 4.5 million feet of commercial space now leased with another 15.3 million square feet planned for future development.

Well, the big news in our family is the addition of Madison Lillian Weil, a bubbly, energetic and very gleeful baby girl. Madison will have her first birthday this month on August 23, and her big brother, Jordan, has been awesome in helping her get adjusted to her new home. Jordan makes her laugh like no one else in the family can, and it is such a parent’s joy to see him always looking out for her and being an integral part of her life. This morning I found Jordan in her crib showing Madison how the baby toys fit together. Jordan has been having a wonderful summer, attending chess camp, Tae Kwan Do camp, soccer camp, and next will be sports and horseback riding camp. When I grew up we just hung out and tried not to get into trouble. For those who think he is being over-planned, he still has lots of “hanging around” time to be with his friends and family. It is so awesome as a proud parent to be playing chess with your 6-year old at Fresh Choice, then go to the ballpark and watch in amazement as this little guy whacks the baseball to the outfield or does a fancy soccer footwork that his dad has no idea how to guard against. I’m thinking, if this happens when he is barely 6, what will it be like when he’s 8 or 9? Madison and Jordan’s recent adventures can be viewed at <http://www.officetimes.com/JordanMadisonAug03Page.htm>.

Have a wonderful rest of your summer, whether you are in New York, Dallas, Bombay, or just around the corner from me, and please feel free to call us about any aspect of corporate real estate!

Sincerely,

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# Newsletter

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