



Corporate Office Perspectives

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Commercial real estate office tenants Good News department: Office tenants can lock in long-term low rent leases in most U.S. regions and negotiate landlord concessions that may have been difficult to obtain just a few years ago. Tenant improvement contractors, for the most part, are aggressive in their bids. There are a wide range of government rebates, tax credits and other inducements for energy efficiency and “green”. Commuting is easier as is finding an office building parking space when the vacancy rate is 20 percent plus. Fewer historical building demolitions and pristine acreage depletion when new construction is almost non-existent ... and no fear of your local office building supply store running out of gold ceremonial ground-breaking shovels!

Corporations still prefer leasing over ownership ... “most corporate space users opt to funnel funds into their core business, which ideally is generating higher returns than asset ownership.” Additional issues helping tilt Corporate America towards leasing versus ownership is that many corporations still view ownership as a risk (and anyone who bought in 2006/2007 can sure attest to this!) versus corporate investment in acquisitions, new technologies or stock buy-backs. Another problem with owning versus leasing is projecting a 10 to 15-year cash flow compared with a five-year leasehold. *Real Estate Forum* (May 2010)

Traits of a Successful E-Worker (a telecommuter): Has a supportive family • Does not care for young children during work hours • Has a quiet, secluded area in the home in which to work • Has moderate need for social contact • Is able to connect with people nonvisually • Has strong communication skills • Is a self-starter and self-sufficient • Has a strong work ethic • Is an effective time manager • Is goal-oriented • Is comfortable with technology • Has a strong desire to work at home. “Undress For Success: The Naked Truth About Making Money From Home” by *Kate Lister and Tom Harnish*.

The average square footage per employee nationally is 175, a number that has been moving downward for the past 20 years, according to Christopher Lee, president of CEL & Associates, a management consulting firm speaking at a recent CoreNet Global conference. Nationally, the office sector experienced

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negative absorption of 20 million square feet as of April 2009, but the number would have been closer to 450 million if the total available that isn't leased were counted, according to CoStar Group, Inc. "The huge vacancy is a combination of actual vacant space, available space and excess space simply held for expansion," Norman Miller of CoStar said, "so it is easy to see where we get to something close to one-fourth of all stock as vacant, available or simply extra." *California Real Estate Journal* (March 29, 2010)

"A recent AT&T study that showed that the average telecommuter gives back half of the time saved by not commuting to the company ... workers freed from a 90-minute commute, for example were working an additional 40 minutes per day." *California Real Estate Journal* (March 29, 2010)

Co-working office space – "lets entrepreneurs and freelancers use tables, conference rooms and shared facilities on a pay-per-use basis, allowing tiny enterprises to project an image of bigness at lower cost." Some of these in San Francisco: Hub SoMa, Citizen Space, Sandbox Suites, The Reactor ... for a great link listing many of these, please go to <http://links.sfgate.com/ZJTY> *San Francisco Chronicle* (June 4, 2010)

What about those Pixar animator offices! Highly personalized and decorated in a variety of themes, from Polynesian tiki to 1970s-era love lounge, some even have their own working bars, complete with beer on tap and a collection of single-malt whiskeys. *Wired Magazine* (June 2010)

Office subleases ... during my past 34 years subleasing office space a number of "almost certain" have become evident ... I've been fortunate to have sublet or terminated 90 percent of all the sublease assignments I have worked on but most of them were far from easy, and the additional headaches involved in disposing of excess space can only be appreciated through experience. Here are a few caveats: 1. The first offer on the sublease space, no matter how low or terrible it might seem, is usually the best offer and it will only go downhill from there; 2. Brokers representing tenants usually have to take a 50 to 75 percent commission cut in placing a client in a sublease ... don't believe me? ... take a direct 5-year lease at \$2.50/rsf and a 5 percent fee, as compared with say a 30 month deep discount sublease space at \$1.50/rsf and a 6 percent fee and see how the numbers line up; 3. Many credit tenants don't go into subleases as they prefer direct 5-year landlord leases where they can negotiate their own lease terms, get a renewal option and not have to worry about the sublandlord credit; 4. Almost all subleases are as-is, which means either the subtenant must be able to fund their own tenant improvements or take the space without any changes which is usually a much less efficient layout; 5. Most subleases are tied to masterleases and master landlords will rarely change the masterlease terms for the subtenant ... 6. The shorter the remaining term, usually the lower the remaining value i.e. who wants to move into a 12-month sublease even at a super-bargain rent when you may have to relocate in a year which can be expensive? Again, the above caveats have exceptions i.e. when the sublease space is long-term, low rent in a rising rental market with low vacancy, but in general ...

Buildings Magazine recently reported survey results of office worker satisfaction with their restrooms ... only 38 percent of respondents described their restrooms as “always super clean” ... 26 percent said that visiting the restroom was a 50-50 gamble ... sometimes clean, other times a disaster ... 25 percent said that office restrooms weren’t as clean as the restrooms in their homes ... and a note to landlords thinking of saving money by cutting restroom expenses — 83 percent of participants said they would notice if management switched from a quality tissue, towel or soap to an inferior version ... only 17 percent said they wouldn’t notice ... *Buildings* (June 2010).

There are 30 Federal programs worth \$72 billion to enhance efficiency in commercial buildings and multi-family housing with no new legislation required ... for the full report go to www.usgbc.org/government.

Deals and Rumors: In **San Francisco**, Morrison & Foerster LLP downsized by about 40,000 sf to 220,000 sf and renewed at 425 Market St.; Deloitte has a pending downsize from 280,000 sf to 180,000 sf at 45 Fremont St.; Salesforce leased 225,000 sf at One Market St.; Trulia, Inc. took 32,000 sf at 116 New Montgomery St.; CAI International signed for 18,000 sf at One Market St.; IRS (yeah, those guys) leased 72,000 sf at 100 First St.; Joyent took 17,000 sf at 345 California St.; GyroHSR inked 10,000 sf at 1045 Sansome St.; Diageo leased 27,000 sf at Levi Plaza where Public Library of Science signed for 13,000 sf; The Trust for Public Land took 33,000 sf at 101 Montgomery; Forward Management leased 25,000 sf at 101 California St.; Cisco leased 32,000 sf at 185 Berry St., and Arnold & Porter LLP signed for 24,000 sf at 1 Embarcadero Center. In **South San Francisco**, Onyx Pharmaceuticals leased 126,000 sf at 249 E. Grand Ave. relocating from Watergate in Emeryville. In **Oakland**, I represented ITT Educational Services for 20,000 sf at 7901 Oakport Street and Kazan, McClain, Abrams, Lyons, Greenwood & Harley (I just can’t wait until they add more partners to their name ...) took 25,000 sf at 55 Harrison St. Up in **Concord**, USA North leased 10,000 sf at 4005 Port Chicago Highway, and in **Pleasanton**, Workday leased 33,000 sf at 6230 Stoneridge Mall Rd; Callidus leased 32,000 sf at 6200 Stoneridge Mall Road and Hatch Mott MacDonald Group leased 20,000 sf at 4301 Hacienda Drive. Cosco Fire Protection leased 25,000 sf at Pacific Corporate Center in **Livermore**. I’m involved in more than 100,000 sf of office leases out for signature in various East Bay cities but we’ll save those for next time ...

A recent report out by Gensler compares “Old Downtown” office usage with “New Urban cluster”... the Old Downtown workday was 9-5, office space utilization was 38 percent, the place where everything happened was “the office,” and the average office building floor plate was 20,000 square feet. New Urban workday is 24/7, average office space utilization is 80 percent, the place where everything happens is “everywhere” and the average office building floor plate is 10,000 square feet. As one example noted, more than 60 percent of San Francisco office leases are far less than 5,000 square feet, reflecting the growth of smaller, highly innovative firms that cater to larger partners.

Property tax decline lag effect ... I've surmised this in past newsletters going back three to four years ... first the residential real estate market collapse sent property tax revenues severely downward for two reasons – homes previously assessed at \$800,000 were foreclosed and reselling at \$300,000 ... secondly, with the new homes sale collapse, the number of houses being sold also tanked ... on top of this double-whammy, we now have the trillion dollar commercial real estate collapse, with values down 40 to 50 percent or more in a number of market sectors such as office, land and strip retail ... but the big kicker is the lag effect we will be facing for years to come as, even the if economy recovers and even if vacancy rates drop, it will still take years for real estate values to get back up. Until then, most levels of government face long-term cutbacks and/or tax hikes and if your local city council person tells you this deficit is just temporary, understand “temporary” may mean five to eight years.

Last month I attended a Society of Industrial and Office Realtors program with a panel of some of the largest Northern California commercial developers in the industry. Not to put any of the individual panelists on the spot, here are a few of their key comments ... “When the office market recovers, Class A rents will jump up way faster than Class B rents, and Class B rents might actually stay down for a long period of time ... commercial flex buildings which sold for \$220 a square foot only a few years ago are now being offered at \$75 a square foot ... a number of major banks have stopped lending on tenant improvement dollars which has made it difficult to lease up leveraged buildings ... there has been a 35 percent drop in commercial property values, and I am not sure we have yet seen the bottom ... but replacement cost isn't going down ... appraisers five years ago were behind the trend and they are still behind the trend ... properties might be performing on their loans with payments being made, but still might not be performing on valuations ... activity is up 300 percent, but not actual deals ...”

The cost of solar panels has gone down more than 40 percent in just the past year, which has increased economic viability for this. In Chicago there is a 40-acre solar plant with 32,000 solar panels that slowly tilt every few minutes following the path of the sun. It generates 10 megawatts of clean power. I can imagine in the not-too-distant future, there will be technology allowing for solar paint on commercial and residential buildings where enough power is generated just through the solar paint to not only supply the entire building but put power back into the grid ... along with this, what about nano-windmills, tiny tiny windmills so small that they aren't visible to those looking up at the structure that are attached to the exterior of commercial buildings and again generate substantial clean power?

One factor responsible for major differences in office rental rates are the operating expenses of a Class A office building with a parking structure as compared with a garden-office building with surface parking. In the East Bay region in the same city a downtown mid-rise might experience annual per square foot expenses in the \$10 to \$13/sf range while just a few miles away, a single-story garden office building may have operating expenses of only \$7 to \$8/sf ... cost factors include not having the expense to maintain or man the parking structure, not having

elevators in a single-story building, perhaps not having a security guard in the main lobby, not having on-site building engineers and day porters, etc.

Web 2.0 incubator phenom ... this is probably happening elsewhere around the country but at least here in San Francisco there has been an expansion of incubator set-ups for small start-ups which enjoy both the low cost, i.e. \$500/month for a desk and high-speed Internet connection, as well as the cross-fertilization of being in a space filled with other entrepreneurs who can share ideas, funding sources, clients and the excitement of working on what could be a future Facebook ... some of these incubators are on the Bay in old pier warehouse space, others in South of Market office buildings ... names like Kicklabs, Dogpatch Labs, Mission*Social, and I/O Ventures to name a few ...

Tax Incentives for Green Improvements: Of course, check with your own tax specialist, but in a recent article published in theregistry.com ... the federal code also allows a deduction of up to \$1.80 a square foot for improvements to make commercial property more energy-efficient. The upgrades must improve interior lighting systems, heating, cooling, ventilation and hot water systems of the building envelope. The dollars can be substantial. A landlord with a 50,000 square foot commercial building who upgrades lighting, building envelope and HVAC systems could achieve a \$90,000 tax deduction.

Our San Francisco Bay Area might not have the least amount of governmental deficits or unfilled potholes in the country but at least we have the headquarters for Apple, Cisco, Oracle, Facebook, Twitter, Salesforce.com, HP and Google ... to name a few ... and now San Francisco is becoming a web magnet for tech companies flocking from all over the world looking to tap into the creativity and intelligence of our workforce ... according to one local commercial brokerage house, 83 tech companies are in the market looking for 1.5 million feet of office space in San Francisco to create more Farmville and Mafia Wars ... hey, maybe we don't make sports equipment and power tools like we did in the 1950s, but we kick butt in the virtual world!

I heard somewhere that banks overall are taking a 43 percent hit on their commercial real estate loan portfolios and that in many cases they are better off selling the notes at deep discounts rather than taking the properties back in foreclosure, running the risk of the debtor declaring bankruptcy, being a larger part of the legal chain of title as actual owner vs. lender, having to manage the asset, and in the case of office buildings, facing the prospect of sinking more cash into the building for tenant improvements and leasing commissions to keep the building occupied.

It is at this point in the Officetimes newsletter that I attempt some type of sage message. As one of the Assistant Scoutmasters for a fairly large Boy Scout Troop (110 Scouts), this past month was in part spent in the Sierras, with no Internet connection whatsoever. Compared with most of the rest of the year of 24/7 connectivity, it was amazingly refreshing to hike up to the top of a mountain, sit and meditate on the awesome beauty of the Stanislaus River waterfalls, glacier-carved valleys, pine trees, immense boulders and not once even think of checking email. My clients were well

taken care of by my staff and associates, and I could spend quality time with the young Scouts Board of Reviews for their rank advancement and leading overnight hikes. The high quality of these 10 to 17-year olds intellect, physical ability, comprehension and articulation gives me no doubt that the generations following us will do a terrific job of taking care of the earth and humanity. Teach a boy how sacred "Leave No Trace" is when he is a youth and just see how small a carbon footprint he will make as a corporate leader! Jordan has spent part of the past two months of summer at sports camp and two Boy Scout camps, Camp Wolfboro in the Sierras and Camp Wenten up by Willits. Next month he will be a Life Scout and begin completion of his Eagle Scouting requirements. Madison, who just turned 8 last week, has been in Tahoe, Carmel, sports camp and starts her soccer season in just a few weeks. Their recent photos can be seen at <http://www.officetimes.com/2010/Aug2010/JMAug10.htm>.

Have a great summer and our 15,000 Colliers specialists worldwide are just a phone call away!

Sincerely,



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