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During recent weeks I've given a number of presentations forecasting what might happen to the office market during the next few years. In preparing for those, I've had to scour economic forecasts from a variety of sources, government, lender, and industry predictions, and lastly I have interviewed my peers and mentors. My office leasing broker counterparts in most of the United States (other than a handful of regions such as Texas and Washington, D.C. that haven't experienced the same downturn) concur that 2010 and 2011 will be a continuation of challenging office leasing conditions. I am not sure we have hit bottom yet and job growth, at least in my region, does not appear in the cards in the near future. Okay, here it goes … February 22, 2012 we will be on the way back up. Office velocity might increase later this year as businesses feel secure enough about survival to take advantage of the incredible office leases and sublease bargains, and those with foresight may look into longer lease terms. We may not experience the commercial real estate "tsunami" but we will suffer huge rolling waves of office building foreclosures – especially for those purchased 2005 to 2007 with debt that now exceeds the building value. Office building purchase bargains will be hard to locate and even harder to secure – note holders will scoop up buildings at great discounts, and portfolio sales, again at deep discount, will prevent one-off bargains from ever coming to market. Sometime during the next three years when lenders feel certain we have passed the bottom of the value curve and are on the way back up, lending will cautiously begin, but expect much higher interest rates, conservative lending and shorter loan terms. I wish I was wrong on this and office leasing recovery was just around the corner, but looking high and low, I just don't see jobs coming back any time soon. If I was a CFO who slashed payroll, managed to stay profitable and had access to temporary employees as needed, why be in a hurry to burden the corporation with longer-term overhead and possibly have to pay the substantial termination write-offs if this recovery is not sustainable?

A University of San Diego study involving more than 2,000 workers from 154 different green buildings – workers who formerly worked in conventional, non-green facilities – are more productive than their counterparts in non-green facilities. The study showed that 45 percent of respondents reported an average of 2.9 fewer sick days in the green location … however, 45 percent noted little change and 10 percent reported an increase in sick days after going green … *Buildings* (November 2009).

FASB (Financial Accounting Standards Board) to change accounting for commercial real estate leases, "The proposed changes will eliminate the distinction between capital and operating leases and essentially require lessees to treat all leases as capital leases. All companies that lease assets will have to capitalize those assets. Balance sheets will be significantly inflated and companies will appear more highly leveraged. The most likely transition rules will require applying the new guidance to leases that are in place as of the effective date, so leases entered into today could fall under these new accounting rules when they become effective," Paul O'Grady, Armanino McKenna LLP. The complete report is available here: http://www.amllp.com/FASB-to-Change-Accounting-for-Leases

Office space usage predictions: Daniel Winey, managing principal, Gensler said "Historically, a very strong indicator for our business was employment. I am not sure it will be an accurate predictor in the next decade. Mobility programs, such as allowing employees to work virtually, will profoundly impact long-term corporate real estate needs. Corporations want less space, not more. The goal now is to enhance employee productivity, effectiveness and satisfaction." *The Registry SF* (January 2010), "Self-employed software engineer Martin Ford thinks technology and automation will replace so many jobs that society will face long-term, structural unemployment," *SF Chronicle* (December 30, 2009).

Yet another worry for lenders foreclosing on commercial properties … in the November 8, 2009 *California Real Estate Journal* an article about the exposure of deep-pocket lenders who take back a property that might not be in code compliance … and maybe the former mom-and-pop owner was able to get away with this, but jurisdictions might view financially-heeled ownership, even if involuntary and temporary, as a way to bring buildings into code compliance which in some cases can get very expensive …

Commercial real estate growth niches: in addition to the health care and greentech industries, one other market niche is undergoing rapid expansion. Data centers are once again hot commodities, with a number of new speculative data centers currently under development. Fueled by both personal and business demand for more and higher speed internet capacities, this industry has been constrained by clogged credit markets, skittish lenders and the high costs of construction (often $1,000 to $1,500 per square foot to develop), *The Registry SF* (January 2010).

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Commercial real estate value summary: "Values should bottom out in early 2010. But commercial real estate will need to get through a full year of demand, growth and vacancy declines before rents stop falling and start to improve. Look to mid-2011 for rents to start moving up. Your typical commercial real estate asset should see no improvement by mid-2011. However, for individual owners lease rollovers could extend the pain of the recession. Indeed, as shown by our estimates, average rent roll downs will not fully pass through the market before 2014." Suzanne Mulvee, senior real estate economist, *California Real Estate Journal* (December 28, 2009). "Foresight Analytics' figures show that the percentage of commercial property owners in the Bay Area with mortgages 30 days or more past due increased about half a percentage point in the third quarter and in big cities verged on five percent – a level that analyst say restricts lenders' ability to issue new loans. Also daunting is the fact that more than half of the $1.4 trillion in commercial mortgages coming due nationwide in the next five years are underwater," *SF Chronicle* (December 20, 2009). "As CFO went to press, the labor department released some bleak news about the job market: at the current rate of expansion, U.S. employment won't return to its pre-recession level until 2016," *CFO* (November 2009). "With the exception of multifamily housing, which will not benefit from the continuing slack in home sales, all major sectors are expected to see increasing vacancies, negative rent growth, and generally weak absorption in 2010. In the office sector, vacancies will continue to rise (to 18.9 percent from 16 percent) but the news won't be all bad. Absorption is expected to improve, although it will remain in negative territory and rents will take more hits, staying negative with a mild improvement from a negative 14.1 percent to a negative 10 percent," www.realtor.org (January 2010). "Larry Fink, CEO of BlackRock, Inc. believes the economy will take three to four to five years to get back to normal," *SF Chronicle* (December 25, 2009). "The recovery is underway but unemployment will persist," Steve Buster, CEO of Mechanics Bank said, noting that he won't be surprised if California's jobless rate hits 14 percent, up from 12.3 percent in November, *SF Business Times* (January 1, 2010). "We believe valuations will rebound off the bottom and settle in for the longer term at levels 30 percent to 40 percent below the market top as liquidity and investors return to the sector and property cash flows begin to recover," said Nick Levidy, managing director of Moody's, *Real Estate Forum* (November/December 2009). "Commercial real estate exposure will lead to hundreds of billions of dollars in real losses and many hundreds of bank failures," Richard Parkus, the Deutsche Bank head of commercial real estate debt research, forecast this fall … "The largest group of banks, those with assets of $25 billion or less, are most at risk. They are heavily exposed to construction loans, half of which are expected to default," *The Registry SF* (January 2010). "Commercial property foreclosures will at least double in 2010 and job growth won't return for two years after that, held back by U.S. consumers who are saving more and getting back in line with sustainable spending habits," said Jon Haveman, principal at Beacon Economics, *SF Chronicle* (January 6, 2010). "Everyone recognizes job growth is essential for a healthy market. Not as many know that it typically takes 18 months after job growth turns positive before occupancy and rental rates start increasing. Today, monthly job losses are decelerating, and that is positive news. So, expect the economy to break even on job creation during 2010, but also expect rent and occupancy declines to occur on a macro basis within the office sector. Rosy rent and occupancy news will have to wait for 2011 … 2010 could become known as the year of the foreclosure," *Real Estate Forum* (November/December 2009). "We are in for a long, hard slog in the labor market," said Zach Pandl, an economist at Nomura Securities. "And it will take several years for the economy to create enough jobs to bring the unemployment rate back down to pre-recession levels of about five percent." "We've seen two years of recession and we're looking at another five years of elevated unemployment on top of that," said Heidi Shierholz, an economist at the Economic Policy Institute, a liberal think tank. "We've never seen anything like this in modern times," *San Ramon Valley Times* (January 8, 2010).

Telecommuting connection tool just became way cheaper … Cisco announced it is taking its high-resolution, high-definition videoconferencing experience into the home … it is seamless, no lag, allows lots of eye contact, and I can envision future telecommuters who need to speak to their boss or co-workers or be part of a virtual teleconference utilizing this type of system to enhance working from home …

Deal and Rumors: In **San Francisco**, Kaplan Test Prep leased 17,000 sf and Wikimedia took 11,000 sf, both at 149 New Montgomery St.; Novak Druce & Quigg sublet 15,000 sf at 555 Mission St.; Betfair signed for 16,000 sf at 201 Mission St.; Heald College leased 44,000 sf and Carat took 34,000 sf, both at 875 Howard St.; Davis Wright Tremaine LLP expanded by 15,000 sf at 505 Montgomery St.;

Babcock & Brown Airline Management sublet 29,000 sf at 525 Market St.; Folger Levin LLP signed for 12,000 sf at 199 Fremont St.; Zoosk sublet 21,000 sf at 475 Sansome St.; Bay Equities sublet 13,000 sf at 88 Kearny St.; HAS Partners LP sublet 12,000 sf at 199 Fremont St. and Techshop sublet 15,000 sf at the Chronicle building. In **South San Francisco**, LS9, Inc. leased 30,000 sf of office and lab space at 600 Gateway Blvd. Sud-Chemie leased 10,000 sf at 1350 W. Bayshore Rd. in **Palo Alto**. YottaMark expanded to 12,000 sf at 1400 Bridge Parkway; PBC San Mateo leased 18,000 sf, and Keyrose Corp. took 13,000 sf, both at 1900 S. Norfolk St., and Openlane may have inked a 13,000 sf lease at 2200 Bridge Pkwy. in **Redwood City**. American Institute for Research leased 24,000 sf at 2600 Campus Dr. in **San Mateo**. American Insurance leased 10,000 sf at 950 Tower Lane in **Foster City**. In **Fremont**, Wafergen Biosystems leased 19,000 sf at 34781 Campus Drive, and in **Oakland**, TransSystems Corp. took 13,000 sf at 505 14th St., Pacific Business Centers leased 12,000 sf at 1300 Clay St., Ben C. Gerwick, Inc. may have leased 15,000 sf 1300 Clay St., Devry Institute leased 14,000 sf at 505 14th St., and Bechtel National Inc. leased 24,000 sf at 1111 Broadway. In **Livermore**,
Admedes Schuessler leased 18,000 sf at 2800 Collier Canyon Rd., Bridgelux subleased 240,000 sf from Lam Research at 1 Portola Ave.; and in **Dublin**, Perquest Inc. leased 38,000 sf at 4160 Dublin Blvd. In **San Ramon**, Quintara Inc. leased 13,000 sf at 111 Deerwood Road. Up in **Walnut Creek**, Civil Service Employees Ins. Group expanded to 33,000 sf at 2121 N. California Blvd., and up in **Fairfield**, the County of Solano leased 20,000 sf at 435 Executive Ct. Fresenius signed for 10,000 sf at 2163 Country Hills Dr. in **Antioch**.

Commercial loan refinance slogans: Extend and Pretend; A Rolling Loan Gathers No Loss; Delay and Pray; Loan coming due, think … then drink;

Bay Area Office Market Statistical Changes 2008 Third Quarter vs. 2009 Third Quarter

	2008	2009	
I-680 North	14.6%	18.9%	2.9 million sf available
Tri-Valley	13.4%	18.5%	5 million sf available
I-880 Corridor	13.9%	15.4%	5 million sf available
San Francisco	10.5%	14.1%	12 million sf available
Peninsula	12.6%	19.9%	5.6 million sf available
Silicon Valley	17.3%	21.0%	46 million sf available

National Real Estate Investor polled online readers about which economic recovery curve the U.S. will take, and 26 percent voted on a U-shaped recovery, while 32 percent believe a double-dip W recession-recovery is most likely … I personally prefer the ice cream double-dip version … www.nreionline.com (November/December 2009). For daily updates on topics such as the economy, office buildings and the commercial real estate market, subscribe to my blog at http://feeds2.feedburner.com/officetimes

San Francisco here we come … or maybe not … a number of years ago back when Willie Brown was Mayor of San Francisco, I had reported in www.OfficeTimes.com that it appeared San Francisco had an awful lot of city/county workers … I think it was up to 23,000 way back then … and that the population didn't seem to be increasing at a rate to support this increase in government payroll … this week I saw a report by the *San Francisco Business Times* stating San Francisco now has

25,554 employees, so there are even more government mouths to feed … not to worry … in another report by the San Francisco Small Business Network on behalf of 19,000 firms in SF there are a number of new tax proposals currently in discussion by the Board of Supervisors … Utility users tax aimed at commercial users … sales tax increase … hotel tax increase … parcel taxes with higher rates for commercial properties … congestion pricing for vehicles driving downtown … and a host of other taxes contemplated … how about just tax the city and county workers at whatever rate is needed to break even rather than kill the golden goose of business by driving them out of town … of course, we in the suburbs are ready for whomever wants to escape this madness!

Soundmasking may become more challenging in LEED-certified buildings, as LEED points are achieved by installing shorter systems furniture panels. New HVAC technology can also impact acoustics in an open-plan office environment. Underfloor air distribution systems are quieter, resulting in lower levels of ambient noise and, consequently, less speech privacy. Soundmasking may be the most cost-effective and acoustically effective solution for privacy. There are three different kinds of soundmasking systems: centralized, distributed and networked. The key to successfully achieving a green office with adequate speech privacy is considering acoustics at the project's onset, *Buildings* (November 2009).

"Everybody's watching their money, but that doesn't mean they want to buy crap or put people in crappy places. People still have to go to work at places where people want to work," Anne Benge, UniSource Solutions, *California Real Estate Journal* (November 30, 2009).

Leasing now available in tallest office/mixed use building in the world … The Burj Dubai, over half a mile high, 160 stories, with 40 mile per hour elevators has office space available … I have no idea what the rental rates are but just thinking about being 160 stories up makes me dizzy …

SF Squared … a new program about to be rolled out in San Francisco which would allow property owners to fund environmental improvements to their buildings related to energy efficiency, renewable energy, etc. by taking a loan from the city and paying it back over time through increased property taxes … and this city is also proposing that owners of large commercial buildings conduct an energy audit within five years to secure their business license renewal, and the results of the audit would be published in a public database … To learn more about what's going on in San Francisco and the East Bay subscribe to my daily blog at http://feeds2.feedburner.com/officetimes

When would be the best time to sell a commercial property, at the height of the market or when the market is in the tank? The State of California just announced it will sell $2 billion of real estate, which works out to 17 office buildings, to raise money … the buildings will be leased investments, and after paying off the bond obligations on the buildings, the State hopes to net $660 million … wonder what the values would have been had they begun this sale project in 2006?

Bargain hunters interested in buying distressed vacant commercial buildings need to be aware of a plethora of dangers … "Properties on the market for extended periods may have had minimal or no ongoing maintenance and deterioration could affect exterior components like roof coverings, flashings, with water intrusion leading to termites or other costly issues. Vacant buildings can be targets for vandals stripping copper lines. HVAC equipment degrades due to non-use. Unventilated, unheated space may cause mold problems. Whatever bargain price you pay may still not be low enough if you get major building condition surprises," *The Registry SF* (January 2010).

During Thanksgiving our 12-year-old son, Jordan, helped out for his fourth year feeding hundreds of guests at a local Thanksgiving charity event. Jordan is in seventh grade and like most kids his age is learning to juggle hours of daily homework, Boy Scouts, religious school, clarinet and still have plenty of time left over to have fun. In December, both Jordan and his seven-year-old sister, Madison, went skiing for a week at Lake Tahoe. Madison, who first started skiing at 18 months on tiny skis and a harness, graduated in her ski school to the advanced level as she is paralleling down the slopes. Madison's Dad is teaching her piano, and she just lost her first tooth … recent photos of their adventures at http://officetimes.com/2010/Feb2010/JMFeb10.htm I've seen Avatar multiple times already and each time my eyes, ears and heart uncover different sensations, both visual and surreal – if you go, and this movie has something for almost everyone, try to see it at an IMAX … ('I see you …'). Stay warm and dry, Spring is just around the corner and regardless of the economy and vacancy rates, with Spring will come flowers, green trees, and baseball … I promise!

Please call me for any and all of your commercial real estate needs – with 15,000 service professionals at Colliers International, we are here to serve you!

Sincerely,

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