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Headlines: "S.F.'s office bust not as bad as elsewhere, but it may get worse" (*SF Business Times* 12/6/02), "Valley vacancy rate highest in U.S," (*San Francisco Chronicle* 1/9/03), "Biotech Firms Hand Out The Pink Slips" (*SF Business Times* 1/10/03), "Office Vacancies Climb to 16%: Landlords Face A Tough 2003" (*Wall Street Journal* 1/13/03), "Office Properties: The Worst Could Be Ahead" (*National Real Estate Investor* December 2002), "California Jobless Rate Worsening" (*Contra Costa Times* 1/18/03), "Biotech firms lay off workers at increasing pace" (*East Bay Business Times* 1/17/03).

Okay, where is the good news in the office sector? If you're an office tenant with a lease coming up within the next 18 months just about everything is good news, but for the office landlord good news may be harder to find. Yes, interest rates are still very low and office building investor demand is still high, and this is good if you have long-term credit tenants. In a number of sub-regions (i.e., downtown San Francisco, San Ramon) the bulk of the market activity is in small office leases for less than 10,000 square feet, with prime small space exacting a premium, especially as compared with the numerous larger blocks of space offering deep discounts. At a recent economic forecast there was mention of the two-growth industries of 2002, residential real estate and government. Well, with the Fed $200 billion underwater, California negative more than $30 billion, and city and county municipalities in severe financial turmoil such as San Francisco, with a negative $300 million, Contra Costa a negative $100 million, etc. and etc., look for potential jettisoning of thousands of jobs in 2003. K-mart just announced firing 37,000 employees, United gave layoff notices to 22,000 workers in California alone, and the Labor Department reported 101,000 jobs were lost in December 2002. Even when there is corporate good news, future earnings forecasts may still bring about corporate layoffs as shown by the *San Francisco Chronicle* (12/6/02) headlines, "Cessna to cut 1,500 jobs despite record year." *The San Francisco Business Times* (1/10/03) "VC's pulling in their horns – Venture capitalists are quietly closing the doors to satellite offices and shedding partners amid the industry's worst downturn ever. And there's no sign of the pullback ending anytime soon – many expect it will accelerate … others expect more dramatic firm closures will occur late next year and in 2005 when venture capitalists will have to raise new funds from institutional investors." "Law firms advise clients: Give us more business – Half of the region's largest firms as measured by number of attorneys – reported layoffs and drops in revenue last year" (*San Francisco Business Times* 1/10/03). In the December 2002 Corporate Office Perspectives, the Bay Area office/R&D vacancy rate was estimated at 84 million, but it may actually be closer to 95 million as of today.

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Telecommuting continues to be beneficial to corporations. In the *San Francisco Chronicle* (11/29/02), "Companies find benefits from telecommuting – Employees are happier, more productive. Heralded as the workplace of the future, telecommuting is thriving today and saving companies millions of dollars. About 25 percent of IBM's Corp.'s 320,000 workers worldwide telecommute from home offices, saving $700 million in real estate costs," said Jeanette Barlow, marketing manager for IBM Lotus. "IBM reaps additional benefits in higher worker productivity and a happy workforce," Barlow said. The International Telework Association and Council estimates 28 million people telecommute one to three days a week – up 42 percent from 19.6 million in 1999. By 2005, one-third or 50 million, of the nation's workers will be part – or full time teleworkers, Kane said. "For employees, the top benefit of working from home is balance", said Jeff Zbar, the author of Teleworking & Telecommuting: Strategies for Remote Workers and Their Managers. "Telecommuting has some real advantages for companies too," Zbar said. "It aids in recruiting and retaining workers. Some studies indicate that telecommuters work longer hours and more workdays than the average employee because they spend less time commuting … many employers encourage telecommuting because they see it as a way to get more work out of people who are already productive."

As reported in *Silicon Valley Biz Ink* (11/24/02), "The United States is home to about 1,450 public and private biotech companies, more than three times the number in Canada, the closest global competitor, according to a report by Ernst & Young. There were 412 companies based in California in 2001, concentrated mainly in the Bay Area, with additional clusters in San Diego, Los Angeles, and Orange Counties."

We now have more than 50 commercial real estate organizational programs listed on www.officetimes.com, so if you want to know when and where CREW, BOMA, SIOR or IFMA is meeting, how to register for CoreNet, NCCAR, NAIOP, or IMF programs, or when the Bay Area CCIM educational courses are happening, one click and get all the details at www.officetimes.com. Also posted is a recent speech we gave to the Northern California CCIM Chapter on where the Bay Area office market is headed in 2003 and 2004.

In the December 2002 issue of *Real Estate Forum*, the top U.S. brokerage firm presidents and CEOs gave their predictions for the future commercial real estate markets. Here are highlights from this interview: Mark Burkhart, chairman of Colliers, "We're just hoping for business to remain at the current pace and certainly, indicators show it could fall below that level." Robert Zerbst, president of CB Richard Ellis Investors, "… we are not betting on rents going up anywhere next year." Ronald Uretta, president, Insignia/ESG, "I don't want to be a doomsayer, but the next 24 months are going to be quite challenging." Julien Studley, chairman, Julien Studley Inc. "Regardless of the economic conditions, there's going to be a set-back in rentals and we're going to see more dispositions of major assets." Earl Webb, CEO, Jones Lang LaSalle, "For 2003, you're probably talking about a duplication of 2002, where corporate spending is down, expansion is virtually non-existent, CBDs are at zero or at slightly positive net absorption, and there's downward pressure on rents in office, retail and industrial as well as oversupply in the multifamily market." Well, that certainly mirrors all of my cheerful market comments…

An increasing number of corporations are sending work to less-expensive locales. In previous issues I've mentioned call centers going to India, engineering projects to South America, and manufacturing to China. According to the *Silicon Valley Biz Ink* (1/13/03), "HP Moving More Work Abroad… Palo Alto-based Hewlett Packard Co. will move more integration and consulting work to lower-cost countries, including China and India. HP would not say if U.S. or European jobs would be cut. In addition to China and India, some HP work may also go to Eastern European countries."

Deals and Rumors: In **San Francisco**, Dodge & Cox leased 60,000 sf at 555 California St.; Arthur J. Gallagher expanded from 16,000 sf to 28,000 sf at 580 California St.; Orrick, Herrington & Sutcliffe may be signing 150,000 sf at Foundry Square where Gordon Chong & Partners may be taking 45,000 sf; State Compensation leased 86,000 sf at 560 Mission; RBC Dain Rauscher Inc. leased 35,000 sf and Bingham Osborne, 11,000 sf, both leases at 345 California St.; EDAW leased 36,000 sf at 150 Chestnut; and the City and County of San Francisco is on-again, off-again for developing a 400,000 sf Class A office building in Civic Center. Down the Peninsula, Icon Clinical Research leased 34,000 sf at 555 Twin Dolphin Drive in **Redwood City.** In **Palo Alto** on University Circle, Law & Associates leased 53,000 sf. In **Oakland**, Cambridge Systematics took 11,000 sf at 555 City Center; State Compensation might be leasing 19,000 sf at 180 Grand Ave.; and Alameda County Social Services Agency inked a 30-year 100,000 sf lease for a future office development at 20th St. and San Pablo. In **Emeryville**, Cambria Technologies leased 14,000 sf on Hollis St.; Netopia is relocating to 30,000 sf at 6001 Shellmound; Electronic Arts is studying several opportunities for a 100,000 sf expansion; and State Farm expanded by 16,000 sf at EmeryTech. Over in **Alameda**, EDD leased 12,000 sf at 1601 Harbor Bay; and in **Novato**, Hall Kinion & Assoc. leased 17,000 sf at 75 Rowland Way. In **Pleasanton**, TUT Systems vacated 90,000 sf and moved into 17,000 sf at 5200 Franklin Drive and Vineyard Technologies might have sublet 10,000 sf at 4473 Willow Road. In **San Ramon**, Irwin Home Equity is close to subleasing 42,000 sf from Verizon at Bishop Ranch 15 and Lanier may have leased 11,000 sf at 2000 Crow Canyon Place. In **Walnut Creek**, State Compensation (yes, them again) is rumored to be subleasing 19,000 sf from Barclays Global Investors at 1277 Treat Blvd., and RMC Engineers leased 11,000 sf at Three Ygnacio. In **Concord**, Secure Computing is relocating to 17,000 sf at 1855 Gateway.

Silicon Valley Biz Ink (11/22/02) had an interesting interview with Paul Wiefels, co-founder and managing director of the Chasm Group, a San Mateo based strategy-consulting firm serving technology companies. In one form or another technology has been the reason for the office sector rise and fall during the past 10 years, and thus in this context I found Mr. Weifels' comments insightful. "From about 1993 until 2000, we had the characteristic high-tech binge cycle in the Valley (Silicon Valley). A number of tornados (A tornado is a phase in market development where infrastructures get completely swapped out. The question is not "if" you're going to buy something, but "from whom.") took place and we binged on different technologies. Now there aren't any tornados. We've gone from the binge cycle to the purge cycle. Customers are full and they need to start making sense out of all the things they bought." *Biz Ink* question: Is the doom-and-gloom attitude that's so prevalent in Silicon Valley warranted? "Yes, to a certain extent. How can you be chipper and energetic when your market capitalization has been chopped by 90 percent and your stock options are so far underwater that you're living in a submarine? *Biz Ink:* What opportunities can be found the rubble of the dot-com collapse? "I don't see any great opportunities in the short term. It's not because there are not great technologies there, it's because customers just don't want to buy anything right now. There are certainly some promising things - including wireless, next-generation PDA's, business analytics software, biotechnology - but in traditional information technology, nothing is really exciting."

What a difference just two years make… It was only 2001 when top San Francisco office rents were going for $90 to $110/sf per annum, and now most of the best space is at $30 to $35/sf with generous tenant improvement allowances. However, there have been several "premium" leases recently at $50/sf for the top floors of trophy buildings. Top rents in Walnut Creek in December 2000 topped out at $4.66/sf a month, "as-is" and now Class A Downtown space is going for $2.60 to $3.15/sf with great TI packages. Pleasanton Class A office space is down from $4.25/sf to $2.10/sf; Peninsula rents down from $5/sf to $2.25/sf (or less); Santa Clara rates down from $5-6/sf to $2/sf or "just make me an offer"…Check out http://www.officetimes.com/BayAreaOfficeRates for a one-page overview of the office rents.

In *Today's Facility Manager* (October 2002), the concept of value-add to facilities by developing strategies directly aligned to business goals brought up a number of interesting points. "Cost per square foot or cost per employee are commonly used expressions. If the only available measures are cost based, it is no surprise that organizations continue to exert pressure to slash facility costs. Yet these measures have little relevance to organizational goals of innovation, improved performance, service quality, shareholder value, or customer loyalty. An expanded approach to measurement is necessary to demonstrate the value, impact, and benefit of facilities. Most organizations spend between $10 and $15 on human resources for every $1 they spend on facilities, real estate, and workplaces. Consequently, facilities have significant leverage, especially in light of the impact of the physical environment on employee performance and the consequent contribution to organizational effectiveness and profits."

According to an article in *Red Herring* (December 2002), "The Bankrupt Go Bankrupt," "The worst is yet to come in the telecom sector. Companies that have spent the past 12 months clawing their way out of bankruptcy will only go bankrupt again, killed by the continued decline in bandwidth prices. Bandwidth prices have fallen to such a low level that it's hard for companies to cover expenses… Expect a cycle of bankruptcies, much like those the airline industry suffered in the late '60s and early '70s."

Business Facilities (September 2002), cited a May 27, 2002 *Forbes* magazine survey that has California cities holding 10 of the top 25 spots on the list, with San Diego at number one, Santa Rosa number two, and Ventura number four. "Nearly 300 U.S. Metro areas were ranked according to a wage and salary growth, job growth and high-tech output growth, among other criteria. This year, the study included a 'job momentum' category that tracks employment during the first quarter of 2002 to gauge how metro areas were dealing with the effects of the slowing economy." Details of this survey can be viewed at www.forbes.com/bestplaces.

As reported in the *California Real Estate Journal* (11/11/2002), "The office market bust could turn into a boom for multifamily housing projects in the San Francisco Bay Area if an emerging trend to convert offices to apartments and condominiums takes off. Developers, large and small, are working on plans to convert high-vacancy office space to high-density housing. Converting office buildings to housing makes economic sense for several reasons in the Bay Area. Despite the recession, California has a greater demand than supply for all kinds of housing, with an annual undersupply of 90,000 units. "In addition to conversion projects, vacant business park land is being rezoned for both multi-family and single-family throughout Santa Clara, in San Francisco, Pleasanton, Emeryville, Oakland, and elsewhere." Paul Menzies, president of Levin Menzies will be building 53 condos instead of 50,000 sf of office space, and said, "I doubt anyone will build spec office space in the Bay Area for at lease five years, but there is still an unmitigated demand for housing here."

According to the U.S. Patent and Trademark Office (2000), out of the top 10 R&D Universities by Utility Patents, University of California ranked number one, Stanford was number four, and California Institute of Technology was number 5. In terms of patents issued, California was number one in 2001 with 20,863 patents, followed by New York with 7,181, Texas with 6,764 and New Jersey with 4,286. California is the fifth largest economy in the world and the nation's number one exporting state accounting for 15 percent of all U.S. exports.

Real Estate Forum (November 2002), "The lack of sufficient technology platform is among the greatest obstacles facing corporate executives when it comes to managing their real estate portfolios." So said a panel of top corporate professionals at the recent National Association of Industrial and Office Properties annual conference held at the Opryland Hotel here. When it comes to technology, "our industry is struggling to make it into the next century – the 20th century," remarked Robert Patterson, senior vice president of Corporate Real Estate for Bank of America in Charlotte. "The problem," observed Peter Kane, VP of Global Real Estate for American Express, "is that there is not an existing software solution on the market today that ties together finance, project development, management, and lease administration functions. A solution might have two of the functions, but not all." However, the *PikeNet Dispatch* (1/15/2003) calls the Oracle E-Business Suite for Real Estate the "Swiss Army Knife for the Enterprise," offering fully integrated Construction Management, Lease Administration, Space Management, and Facilities Management, linking the entire real estate life cycle to the corporate financials.

Real Estate Forum (December 2002), interviewed Peggy Binzel, CEO of CoreNet Global. "In an independent survey conducted in April 2002, it was reported that 48 percent of corporate executives were planning a net decrease in the amount of office space they occupied. Furthermore, just 13 percent indicated that they were planning an increase and 38 percent said they had no changes planned." In the November 2002 survey, a new question was posed. What percentage of your company's current portfolio is shadow space - excess space that is held for future use or vacant space no longer needed? The answers showed that 29 percent of corporate respondents held between 10 percent and 30 percent of their portfolios as so-called shadow space. Additionally, for 68 percent of the corporations, up to 9 percent of their portfolios were designated as shadow space.

I'm occasionally reminded by clients and friends that you can buy a great, large house on several acres in Iowa or Ohio, at a fraction of the price of a California home, and you even get a full basement and an attic, which is usually unheard of with our houses built during the past 30 years. However, two weekends ago, I drove three hours door-to-door to ski at Lake Tahoe, one of the prettiest spots on the entire planet, and it was blue sky, incredible snow, and a choice of more than 20 ski resorts. One guy on my chairlift told me he had skied five days straight and he was headed back to the Bay Area to go water-skiing the next day. Much of January was sun block weather back at home, and the weekend after the ski trip I went to the annual ZAP festival in San Francisco, at Fort Mason overlooking the San Francisco Bay where more than 300 wineries were pouring new releases with more than 600 different wines available for sampling. If we wanted, a 90-minute drive takes you to the heart of Napa/Sonoma with more than 400 wineries to visit (definitely designated driver territory). We have the Raiders, the 49'ers, the A's the Giants, the Warriors, the Sharks, and on any given night a choice, literally, of more than 500 different symphony, opera, jazz, musical, and other live performances, all within a one-hour or less drive. Do we Californians pay the price? You bet … Is it worth it? To some, nope, and back to Alabama or Minnesota they go, but to most, absolutely …

According to *Commercial Investment Real Estate* (January/February 2003), "Terrorism insurance was not available at any cost for 27 percent of building owners who responded to the BOMA survey (National Survey of Security Concerns Within The Real Estate Industry, BOMA/ULI, March 2002). Of the 73 that obtained coverage, 80 percent had higher premiums and deductibles, coverage caps, shorter cancellations, and exclusions for chemical, biological, or radiological acts."

Many major Bay Area office-building owners are appealing their property tax assessments, hoping for 40 to 65 percent tax cuts based upon the current office economy (that will make government budgeting even more fun with further decreased revenue…).

The *CoStar Advisor* (Fall 2002), summarized the professional designations available to the commercial real estate practitioner. "The National Association (NAR) recognizes more than 15 such professional designations, including the two most widely recognized ones among commercial real estate professionals: the SIOR designation from the Society of Industrial and Office Realtors and the CCIM (Certified Commercial Investment Member) from the CCIM Institute. Behind both designations are hours of difficult educational courses concerning real world real estate issues and taught by experienced professionals. The Society of Industrial and Office Realtors is a professional commercial and industrial real estate association with more than 2,200 members in 450 cities in 20 countries. The CCIM (Certified Commercial Investment Member) designation, "the Ph.D of Commercial Real Estate," covers a wider assortment of commercial real estate professionals. Brokers of land, retail space, hotels and self-storage properties can earn a CCIM as can corporate real estate officials, appraisers and lenders. Of approximately 125,000 commercial real estate practitioners nationwide, about 7,000 currently hold the CCIM designation. For additional information please go to www.sior.com or www.ccim.com.

During the past two years I have occasionally been accused by office landlords and their broker representatives of being too "gloom and doom" in my market assessments and predictions. However, looking back over the during 23 years and 136 issues of this newsletter, in almost every case, the predictions held true. When the office market was hot these same folks didn't seem to mind my comments about skyrocketing office rents…

In *Buildings* (November 2002), the concept of Workplace Resource Management is discussed as a much more efficient method of calculating workplace costs. Data is pulled from each of the "silos" (multiple departments with inter-relationships) and consolidated into a central, Web-based repository for immediate access and decision-making. Within the company, complete workplace data is shared - when an employee is hired, fired, moves to a new location, is assigned new office resources, when a new lease is signed and more. "With the click of a mouse, companies can find out: From Facilities Management - what space, assets and inventory are newly available and where they are located … From Real Estate - which spaces can be consolidated and which leases eliminated … From Information Technology - which resources can be eliminated, including cell phone contracts … From Security - how changing space requirements impact security needs and costs … From Human Resources - the impact on payroll, benefits and space requirements … From Finance - the overall cost benefit to the organization. By analyzing data from each of these silos, organizations can easily construct what-if scenarios …"

I'm writing this February 2003 Newsletter after just returning from a wonderful three-day weekend skiing up in Lake Tahoe. Our son, Jordan, is 5-1/2 and just graduated to level 5 in ski school. My wife and I sometimes spy on his ski school class coming down the mountain, and little kids skiing are one of the cutest sights imaginable, especially when they don't know you're watching. Jordan started when he was two, and we make sure he progresses at his own comfort level so he doesn't rebel in being forced to do something against his will. Jordan is in kindergarten, and it's amazing that they actually get homework at that early age. We are also teaching him to read and it is so neat to watch things "click" in a young child's mind when concepts begin to come together. Jordan's past two months adventures can be seen at http://www.officetimes.com/JordanWinter03. We hope this winter has been kind to you and your family, and as the daylight hours slowly get longer and the last neighbor has finally taken down the holiday decorations, we know spring is just around the corner …

Sincerely,

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