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The office market is beginning its recovery in a number of subregions such as the San Francisco Peninsula and Silicon Valley, but lagging in other areas like the Pleasanton/San Ramon Tri-Valley and Walnut Creek/Concord areas. For several years, I have been predicting (but hoping I would be wrong) the office market wasn't going to recover in the East Bay until 2012 and unfortunately this still looks like the case. Also, our commercial real estate tsunami finally hit, and we have millions of square feet of office buildings in default and foreclosure. Lenders have gone from "Pretend and Extend" to "You've Got Woes, Well Let's Foreclose" ... The City of San Ramon just purchased a 61,000 sf Class A office building for \$116/sf, and the 550,000 sf Class A BART location Stoneridge Business Park in Pleasanton just went under for \$160/sf (the San Ramon property was vacant, the Stoneridge property was mostly leased) and what does this do to value comps for the remaining office buildings regardless of their individual financial strength? So, some markets are at the bottom and slowly headed back up, and others are wondering where the heck the bottom is ...

*Editor:*

**Jeffrey S. Weil,**  
MCR.h, CCIM, SIOR  
Senior Vice President

1850 Mt. Diablo Blvd.  
Suite 200  
Walnut Creek, CA 94596

Phone: 925.279.5590  
Fax: 925.279.0450  
jweil@colliersparrish.com  
[www.OfficeTimes.com](http://www.OfficeTimes.com)

CNNMoney recently reported that nationwide office vacancies are now at 16 year highs, with more than 700 million square feet of office space unoccupied. This is the highest level since 1994. Detroit has the highest vacancy rate at 25 percent, with Washington, D.C. having the lowest rate at 10.4 percent "... analysts at Reis noted that rents and the level of office vacancies are unlikely to improve until sometime next year, given that commercial real estate typically lags what is happening in the broader economy ... rents will still decline and vacancies will still continue to rise ..."

Just think if office building owners began thinking like the airlines, or at least like those asking for carry-on baggage fees on top of checked baggage fees ... I can just see it now ... cash-strapped office building owners installing coin and credit card slots for their pay elevators and pay toilets ...

For those curious how investors purchase discounted commercial real estate debt, as a recent example reported in *Cityfeet* (5/14/2010), Lionstone Group, which is made up of former Hines executives, just paid \$52.5 million for a \$90 million construction loan on an empty 280,000 square foot office building at 500 Terry Francois Blvd. in San Francisco's Mission Bay. The loan was previously held by U.S. Bank which inherited it when it took over the original lender, Pacific National Bank. The building owner has not missed any payments and the loan is due in 2011. The building is in warm shell condition and estimates are \$14 to \$21 million to build out the tenant improvements.

These are the factoids from Cityfeet and the following are my thoughts, not verified or confirmed as I have not spoken with any of the players. If the landlord gets lucky and finds tenants, it would have to invest the \$14 to \$21 million and face a loan refinance next year. If the new lease substantiates a higher value than all the underlying debt and can support a conservative low-leverage refinance, perhaps the owner will be ok, and the Lionstone Group gets \$37.5 million out of the refinance. If the building isn't leased, Lionstone may be in a position to take over ownership at a low enough value to allow tenant improvements, etc. Often there is more complexity behind the scenes and the risk involved is not for the faint of heart. I remember stories during our last down cycle where one bargain investor thought he had a bottom-of-market deal only to lose the property himself 18 months later ...

Office Annoyances: I borrowed this straight from Office Furniture Trends, who sourced from Reuters.com ... the Top 10 Office Annoyances: 1. Grumpy or moody colleagues; 2. Slow computers; 3. Small talk/gossip in the office; 4. The use of office jargon or management-speak; 5. People speaking loudly on the phone; 6. Too much health and safety in the work place; 7. Poor toilet etiquette; 8. People not turning up for meetings on time or at all; 9. People not tidying up after themselves in the kitchen; 10. Too cold/cold air conditioning

"Lighting accounts for 37 percent of an average commercial building's utility bill, which is the largest cost category, followed by the buildings heating and cooling systems. Oftentimes the lowest hanging fruit on your 'green' tree today is changing your current inefficient lighting. A T8 is 22 percent more efficient than a comparable T12 and a similar T5 achieves 51 percent added economy. They produce the same lighting output while consuming less power. It is actually possible to replace and upgrade current fixtures with fewer lamps per unit and still maintain or even improve on current lighting levels ... there are also significant tax incentives currently available." *Harrisburg Commercial Real Estate Review*

*Deals and Rumors:* Out in **Walnut Creek**, I sublet 10,000 sf of former Golden Gate University office space to Clearwire at 1990 N. California Blvd. In **Livermore**, Wiley X Inc. bought a building in downtown Livermore for its 32,000 sf operation and Peterson Tractor will be having a 144,000 sf headquarters facility built at Oaks Business Park. In **Oakland**, Livescribe signed for 24,000 sf at 7677 Oakport St.; Foley and Mansfield leased 23,000 sf at 300 Lakeside Drive; Donahue Gallagher Woods leased 19,000 sf at Lake Merritt Plaza and Social Security took 26,000 sf at 2100 Franklin St. In **Alameda**, City National Bank leased 13,000 sf at 1105 Atlantic Ave. and Bishop Barry Drawth law firm downsized to 16,000 sf at 2000 Powell St. In **San Rafael**, Clairmail Inc. leased 12,000 sf at San Rafael Corporate Center. In **San Francisco**, Blue Shield signed for 125,000 sf at 225 Bush St.; Ubisoft took 42,000 sf at 625 Third St.; Teachscape sublet 18,000 sf at 71 Stevenson St.; Holt International Business School leased 28,000 sf at Levi Plaza; Charlotte Russe, Inc. leased 53,000 sf at 575 Florida St.; Case Central sublet 20,000 sf at 50 California St.; at One Montgomery, Posit Science took 14,000 sf and Medicine 360 took 12,000 sf; Ngmoco leased 15,000 sf at 475 Brannan St. In **South San Francisco**, Five Prime Therapeutics took 70,000 sf at Two Corporate Drive and Bayer leased 75,000 sf at 455 Mission Bay. In **Redwood City**, YuMe leased 12,000 sf at 1204 Middlefield Rd., and Covington and Burling leased 15,000 sf and Merced Systems took 28,000 sf both at 333 Twin Dolphin Drive. Glam Media leased 20,000 sf at 2000 Sierra Point Parkway in **Brisbane**. In **San Mateo**, Webroot took 47,000 sf at the Crossroads Office Complex. In **Foster City**, Perfect World Entertainment took 28,000 sf at 950 Tower Lane. In **San Bruno**, the big news was Walmart.com signing a 266,000 sf office lease at 850 Cherry St.

A few weeks ago 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 B rents, and Class B rents might actually stay down for a long period of time" ... commercial

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 ...

Silicon Valley Leadership Group's 2010 survey reports 8 to 1 as the ratio of Silicon Valley CEOs who plan to add workers versus those who don't. I spent time a few weeks ago with our San Jose office brokers and their recovery is underway ... we in the East Bay region of the Bay Area know we are 12 to 18 months behind and can only wait and hang on ...

*CFO Magazine* (April 2010): While finance chiefs expect double-digit growth in earnings and significant growth in capital spending during the next 12 months, CFOs say they expect to expand their full-time domestic workforces by less than 1 percent during the next 12 months, and increase outsourced hiring by 4 percent and temp hiring by less than 1 percent.

The San Francisco office market, according to the Colliers office, as of April 2010 had 201 office tenants in the market with 5.23 million square feet of office space requirements. The average tenant requirement is 26,018 square feet. Another national firm reported the vacancy rate at 20 percent, overall asking rents are down, and market "activity primarily consists of tenants downsizing as they renew or move." Another national competitor reported that in the past 15 months, downtown San Francisco has reported 2.7 million square feet of space vacated, and in a recent *SF Business Times* headline, upper floor view space rents have risen to more than \$60/sf per year. Go figure what reality is ...

While the overall economy appears to be getting back on track, no job growth reducing the office vacancy in most parts of the U.S. may mean the office market segment is still in trouble. Loan defaults will continue to escalate for U.S. CMBS, with an additional 4.4 percent likely in 2010 and the overall rate to exceed 11 percent among Fitch-rated deals by the end of the year, according to Fitch Ratings. "Office defaults spiked in the fourth quarter last year, with further rental and net operating income declines likely through next year before a rebound takes place," said Richard Carlson, Fitch senior director.

Did you know that the State of California owns 22,272 buildings? Not all are giant properties like the Los Angeles Coliseum but also include rest stops and piers ... and did you also know the state has 237,000 employees? This works out to one employee per 160 California residents, but I have no idea how this compares with other states like Texas or Colorado ...

I've been reading report after report about how local and regional banks are struggling with commercial real estate loans ... Steve Andrews, president of Bank of Alameda said "Commercial real estate is a falling knife at the moment" ... I might liken it more to a roaring chainsaw that was just thrown out into a crowd ... the FDIC currently has 702 banks on its problem-bank list ...

Too much distraction working from home by being in your home? A radical work space called OfficePOD can be placed in your backyard. Made out of recycled materials, this 56 square foot work space has a power hookup for lights and computers, phone and Internet jacks, and has built-in HVAC and storage. For more information on this \$24,000 novel idea go to [www.officepod.co.uk](http://www.officepod.co.uk).

Summer is just around the corner for Jordan, who just turned 13 last week, and Madison, who will be 8 in two months. Jordan had a blast in Little League, making consistent outfield catches, usually getting on base and loved just hanging with his teammates. Madison's girls softball team won most of their games this season, thanks in large part to all the parent volunteers who came out before every game and practice-pitched to all the players — it sure made my coaching job that much easier! Go to [www.officetimes.com/2010/June2010/JMJun10.htm](http://www.officetimes.com/2010/June2010/JMJun10.htm) to see their latest adventures. Every week I try to ride up our local mountain, Mt Diablo, with a group of bike buddies. Most folks aren't aware that this 3,810 foot elevation has the most unobstructed view of any mountain in North America, due to the fact that there are no other mountains nearby to get in the way. Commercial foreclosures and lease contract issues seem eons removed, and the wild turkeys, foxes, snakes and incredible views help put my world back into perspective. If your own situation is going great, take time to celebrate, and if it isn't, then perhaps find your own personal mountaintop to allow re-energizing and regaining inner peace. I know at some point, our group must head back down the mountain and the problems may still be there waiting, but it sure seems easier dealing with them after a Mt. Diablo bike ride!

Please keep your calls coming regarding any aspect of commercial real estate. Colliers is 15,000 strong and in more than 50 countries ...

Sincerely,



Jeffrey S. Weil, MCR.h, CCIM, SIOR

Senior Vice President

(925) 279-5590

[jweil@colliersparrish.com](mailto:jweil@colliersparrish.com)

<http://www.officetimes.com/blog/jeffblogger/>



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# Newsletter

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