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San Francisco's office leasing market has had 12 straight quarters of rising rents and decreasing vacancies. One broker predicted "rents will creep up, and vacancy rates will inch down." Another San Francisco broker said "deals over $50 per annual square foot represented almost 28 percent of total absorption in the last quarter." Thus creeping rents and inching-down vacancy seems to sum up the entire San Francisco Bay Area office market. Buildings where my clients were being quoted $1.85/rsf per month, full-service a year ago are now hanging firm at $2.25/rsf. In Downtown Walnut Creek there are a number of office buildings getting more than $3.00/rsf. In Pleasanton, whereas a year ago there might have been 15 locations able to accommodate a 30 to 50,000 sf office user, today there are only a third this many. Factors helping temper an overheated office market: companies are getting more done with less employees due to technology; India, China and elsewhere have accommodated tens of millions of square feet of office users who otherwise would have pushed U.S. rents skyward; freeing up domestic office space; cutbacks and downsizing is still an ever-continuing trend (i.e. just two weeks ago Washington Mutual announced a 900-job reduction, Intel analysts are predicting more than 10,000 layoffs, HP announced large-scale consolidations, etc.); the residential real estate industry, including mortgage, title and other related sub-industries is undergoing a slowdown-layoff mode.

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

"The office environment continues to evolve. Young people do not want to work in a sea of cubes. There's a very negative association," according to Christine Barber, Knoll's director of workplace research. "Office work spaces keep getting smaller and privacy scarcer. Some furniture designers are radically changing the cube in ways that provide privacy without closing workers in, while others are doing away with enclosures altogether to keep Generation Y happy. In one new version of the cubicle, curvilinear panels of translucent glass with sliding doors and windows surround workers with light while screening out distractions. There are enough amenities inside these bright little spaces to coax even recalcitrant managers out of dry-walled offices" … "squeeze is continuing. The average middle manager's workspace shrank by more than 16 percent in an eight-year period through 2002, to 126 square feet. Clerical staff lost 4 percent, ending up with an average of 66 square feet according to the International Facility Management Association. Today's corporations are equally cost-conscious, but they are changing even faster than when cubicles were novel. Technology has made workers far more mobile and more work is done collaboratively. "Scootable" furnishings are all the rage. Some organizations also are looking for spaces that make employees happier and more productive because competition is

increasing for so-called knowledge workers, researchers, planners, programmers, engineers and the like. Industry research suggests the key to a sense of privacy is not isolation but control over one's environment." *Contra Costa Times*

"Two-thirds of Building Owners, Managers Unprepared for Pandemic. While property managers can't stop the global spreading of an infectious disease, preventative steps can help their clients stay functioning during an outbreak. Impacts on business include having 40 percent of the marketplace out, supply and delivery chain disruptions and disruptions to health care operations. Despite a cutback in operations, building owners and managers have the unique ability to control a perimeter and maintain regulated operations while educating their tenants," *California Real Estate Journal* (6/12/06). Building Owners and Managers Association (BOMA) also recommends establishing sick tenant protocols, setting up lobby handwashing stations, and possibly quarantining entire floors. Owners and managers should also make plans for critical staff members to work off-site in the event an entire building is closed. Building owners and managers aren't necessarily in the clear once a pandemic abates. Tenants may be unwilling to return to the property unless the building manager carries out a strict sanitization campaign. OSHA guidelines say that tenants are legally entitled to break their lease if a building is deemed hazardous. Most office leases contain so-called 'quiet enjoyment' clauses requiring landlords to ensure that the space isn't hazardous. These clauses can apply to any number of hazardous conditions that would impact an office tenant." *National Real Estate Investor* (June 2006)

Last week I stumbled on a 40,000 sf office tour I did back in May 2, 2000. Downtown Oakland Class B rents were $3.33/rsf, Emeryville Class A was $4/rsf nnn (close to $5/rsf fully serviced) and if memory serves me, San Francisco rents on an annual basis were $70-100/sf plus stock warrants and your firstborn. Of course, gas was a bargain back then so it is all relative …

Deals & Rumors: In **Pleasanton**, Robert Half sublet 35,000 sf at 4055 Hopyard, and in next-door **Dublin**, Taleo Corp. leased 35,000 sf at 4140 Dublin Blvd. Up the I-680 in **San Ramon**, Reply, Inc. is rumored to be leasing 15,000 sf at Bishop Ranch 15, and BenefitStreet has been out for 35 to 40,000 sf along the I-680 Corridor. In **Walnut Creek**, I leased Regency Retail 11,000 sf of office space at 2999 Oak Road. Up in **Concord**, Tickets.com is rumored to relocating to 25,000 sf at 2400 Bisso Lane. Jumping up to **Vacaville**, State Compensation Insurance Fund purchased 32 acres in Vaca Valley Business Park for a future 430,000 sf office campus. In **Emeryville**, Kaiser took 70,000 sf at 2100 Powell Street, while in **Oakland**, Keenan & Associates leased 13,000 sf at 1111 Broadway and Kaiperm Federal Credit Union took 19,000 sf at 2101 Broadway. Moving down the I-680, in **Fremont**, Bay Area School for Independent Study leased 32,000 sf at 300 Kearney St. and MicroFluidic Systems took 18,000 sf of R&D space at 47790 Westinghouse Dr. The big news in **Newark** is Sun selling its 1.4 million sf Newark campus to BioMed Realty Trust for $215 million. Jumping across the Bay, Google will be purchasing its 1 million sf headquarters in **Mountain View** for $319 million. In **Palo Alto**, Thoits Law Firm leased 15,000 sf at 1 and 2 Palo Alto Square. In **South San Francisco**, Genentech leased 121,000 sf for a build-to-suit at 1 DNA Way. In **San Francisco**, United Airlines is reportedly looking around for 150,000 sf; GSA leased 31,000 sf at 160 Spear St.; MicroTek took 17,000 sf at 350 Bush St.; Mypoints leased 12,000 sf at 188 Embarcadero; Riptopia inked 10,000 sf at 901 Battery; Vontu leased 21,000 sf at 475 Sansome St.; Bellamax took 13,000 sf at 388 Market St.; Zoom Systems leased 15,000 sf at 625 Second St.; Hines is rumored to be selling the 650,000 sf 560 Mission St. building which is leased to JP Morgan Chase for $700/sf;

Jeffrey S. Weil, MCR.h, CCIM, SIOR, Senior Vice President ◆ Colliers International
1850 Mt. Diablo Blvd. ◆ Suite 200 ◆ Walnut Creek, CA 94596 ◆ Ph. 925.279.5590 ◆ Fax 925.279.0450
jweil@colliersparrish.com ◆ **www.OfficeTimes.com**

Hands On Mobile expanded to 28,000 sf at 580 California St.; California Savings Bank sublet 33,000 sf at 345 California St., and lastly, Friedman Fleisher & Lowe took 21,000 sf at One Maritime Plaza.

The trade-off between corporate space flexibility and cost – "Nearly 40 percent of respondents to The Boston Consulting Group's (BCG) 2005 study of real estate executives said that their five-year projections for space demand were typically off by more than 100 percent due to new businesses, shift in market demand and inaccurate forecasting methods. The inability to accurately predict space needs is a key driver in the demand for lease options. In fact, all 16 Fortune 500 corporate real estate executives in BCG's survey indicated that they were willing to pay extra for flexibility. Similarly, a recent research report from CoreNet Global titled "Portfolio Optimization Flexibility" found that 93 percent of 48 real estate executives surveyed were also willing to pay for lease options. In 2004, a similar CoreNet survey found that only 65 percent of respondents were willing to pay for flexibility … seven out of 10 respondents feel that a lease with flexibility is worth as much as 5 percent more than one without it." However, owners offering flexibility can be penalized by the lending and investment community. Early terminations and space contractions can be onerous to owners. *National Real Estate Investor* (June 2006)

During the past five years, housing was in high demand and there were a number of office buildings which were bulldozed to accommodate new residential development. I was involved in several office sales, including selling the former four-acre IBEW headquarters in Walnut Creek on what now sits 54 single-family residences. I sold 7 acres in Concord and the former Systron headquarters is being transformed into 76 single-family dwellings. Housing commanded a 200 to 300 percent premium over what the land would have sold for as an office site. This phenomenon is now changing, as the condo and residential market in general has cooled down. Interest rate increases have diminished demand and construction costs have soared, while at the same time office submarkets throughout the Bay Area have begun to rebound. As summed up in the *San Francisco Business Times* (June 23, 2006) "You could make the argument that an office site is worth more than a residential site in today's market," said developer Robert Birmingham, whose site at 201 Second St. in San Francisco is entitled for both housing and office.

"Total job growth in the East Bay over the past year far outstripped employment gains in all of California and the Bay Area. 'The job market in the East Bay is becoming the envy of the Bay Area, and has become one of the job growth leaders in all of California,' said Scott Anderson, an economist with San Francisco-based Wells Fargo Bank. 'The East Bay also outgained other large urban centers in California, including Los Angeles, Sacramento, San Diego, Orange, Riverside-San Bernardino, Stockton, Stanislaus and Fresno counties, both in private industry jobs and total jobs.'" *Contra Costa Times* (6/17/06)

"New earthquake models show that the seismic waves of an earthquake may be at least 25-percent less intense than previously thought. This new discovery could have a direct impact on building codes in California and the Pacific Northwest. Should the findings hold true, billions of dollars in retrofit projects to keep buildings standing in an earthquake may no longer be needed. Many scientists and engineers are hesitant to relax building codes despite the new information, choosing to err on the side of building safety." *Buildings* (June 2006)

In *Real Estate Forum* (June 2006), there were several quotes I believe very applicable to our Northern California office markets, but were stated about Southern California. "Anthony Manos, SVP Trizec Properties, has a message for office tenants in the area: Do a deal as soon as possible, or you may lose the space you want. And be prepared to pay higher rents … Tenants are about to experience 'sticker shock' in the coming months. Construction costs are at all-time highs and to replicate the assets that we have is very expensive. Rental rates are not going to stay static; they are on the move and they are going to move dramatically. Tenants must move quickly or they are going to lose the opportunity," he says. Now please remember this was spoken by a landlord, but many of us representing Northern California office tenants fear this same trend is coming our way. However, we have seen some landlords much too aggressive in their pricing, raising asking rents too high too soon, while at the same time, there are tenants out there overly ambitious in their lease concession requests. It is often up to the astute brokers on each side to bring market reality into the picture.

Business 2.0 (June 2006) ranked 2,000 technology companies which have been publicly traded on a U.S. stock exchange for at least three years, have a market cap of at least $50 million, and have had positive operating cash flow over the past 12 months. The ranking was based on profit, operating cash flow and 12 month stock return. While most companies were U.S. based, there were finalists from China, Russia and Israel. Out of the Top 100, 23 are based in the San Francisco Bay Area (in spite of our exorbitant housing prices, state tax policies and lack of municipal snow plows …)!

Our son, Jordan, recently turned 9, and looking at him a few weeks ago in a dress shirt and tie gave me mixed feelings. On the one hand, I am incredibly proud of who he is, and how he is maturing. His school grades are over the top, he loves to read for hours on end, yet he will drop the book to go bike riding, play baseball, or just hang out with his friends. Those of you have been where I currently am might identify with the mixed feelings. I was almost in tears writing this portion of my newsletter, because spending time with my kids, doing things together daily, being the mentor, role model, friend and parent is a role that is ever-evolving and while I consciously treasure today's moments, I'm also aware that there will come a time far too soon where he would rather be with his buddies than hang out with dad. College, empty-nester all flash through my mind as I watch Jordan grow into a young man … enough of that … Jordan finished up his Little League Season with hitting a string of triples and great fielding. He and his almost-four-year-old sister, Madison, have been spending a lot of time at Lake Tahoe, where they have gone bike riding along the Lake. Little Madison has even pedaled her tiny bike along the Truckee River, surprising her parents with the stamina to endure a one-hour ride. They've gone several times to the Reno waterslides and have built some pretty incredible sandcastles at the beaches of Lake Tahoe. To see photos of their recent adventures, please go to **www.officetimes.com/JMAug2006.htm**.

On behalf of my family and our team here at Colliers we hope you have a terrific summer!

Sincerely,

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