



Corporate Office Perspectives

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Hopefully this is not a premature conclusion, but there are a number of signs that indicate the San Francisco Bay Area may already be on its way to recovery. Before you break out the fireworks in celebration, please note that this may be a slow recovery and uneven between different Bay Area sub-regions. The recent announcement by Oracle that it may not give up most of its Pleasanton campus is a great positive boost to the East Bay marketplace. Safeway's recent 150,000 sf office sublease in Pleasanton is additional good news. During the past 60 days, while I have not heard about major corporate downsizing due to global offshoring, I still have encountered several companies planning significant downsizing which will add additional major blocks of office space to the current sublease market. One critical element remains missing from our office market recovery: what industry growth will lead to massive amounts of new hiring and this major office space absorption? Why would any major company move to the Bay Area from elsewhere in the country, in light of our high cost of housing, expensive tax policies, workers comp, overburdened traffic infrastructure, minimum wage and other less-than-business-friendly policies? I anticipate a slow, incremental office market improvement with stagnant rental rates due to both the vast amount of available office space (still more than 80 million feet vacant throughout the Bay Area!). The major market velocity will be in the under 10,000 sf category, and larger office transactions will still be far and few between.

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“With the US dollar currently trading at an all-time low against the euro, Europeans now view the United States as one giant half-off sale on everything from clothes to coffee to restaurant meals.” *CC Times* (12/7/04) What about our investment real estate? Does this mean our office and retail investment properties selling at astronomical prices might actually be a bargain to foreign buyers?

According to a recent article titled “US To Lose More Than 400,000 Jobs To Other Nations” in *Expansion Management* (November 2004), “The number of jobs lost will be around double the number from three years ago ... The study projected that nearly 100,000 jobs would move to China in 2004 ... The principle motive for production shifts to China is cost reduction, rather than producing for the massive Chinese market.”

Oh great, hit me again ... In *Expansion Management* (October 2004), "Foreign workers have better skills than their American counterparts, according to a survey by the Earth Institute at Columbia University in New York. Of the 45 companies surveyed, a majority said product quality improved after they shipped the work overseas. Eighty-two percent of the companies surveyed said they outsource jobs, and 70 percent of those companies said production of the business processes increased 5 percent to 25 percent after outsourcing."

One of the most compelling reasons behind the global offshoring boom: *San Ramon Times* (1/21/05), "China's edge in exports these days goes far below the low wages of Pan (a 29-year old factory worker in northern China), who earns \$1 an hour, plus free room and board ... rent for the operation is a quarter of what it would be in a city like Houston ... The big orange plastic injection molding machine costs \$18,000 here compared with as much as \$60,000 for American models."

Reported in *Today's Facility Manager* (December 2004), BOMI Institute has a new book available, Jane's Workplace Security Handbook, which outlines effective workplace security planning guidelines. The strategies include discussion of threat assessment, crisis management and crime prevention. Crime prevention methods listed in the book include: minimizing the number of entry and exit points; creating unobstructed views of parking lots; implementing effective security lighting; removing bushes or undergrowth that could conceal an offender and clearly delineating property from public space. For more information, go to www.bomi-edu.org.

Of the 322 home markets across the United States, a 2,200 sq. ft. house with a family room and a two-car garage runs \$130,000 in Minot, North Dakota. The same 2,200 sq. ft. house in La Jolla, San Diego County, would cost \$1.7 million, San Mateo \$1.14 million, and San Francisco \$1.13 million. California cities accounted for seven of the top 10 spots, *San Francisco Chronicle* (9/30/04). Of course, the median sale price of all homes sold in 2004 in Lima, Ohio was only \$82,000. According to an article in the *Tri-Valley Herald* (1/16/05), "Nine of the 10 most affordable markets are in Ohio, Michigan and Illinois, and all of the 10 least affordable markets are in California." According to the *California Real Estate Journal* (Dec. 6, 2004), "High rents and rising house prices are pushing one in every four Californians to consider moving elsewhere in the state or leaving California entirely, says a new statewide survey by Public Policy Institute of California." Of course, you can get free room and board working in Beijing ...

The Chief Economist for the Society of Industrial and Office Realtors, James F. Smith, recently published a report titled, "Why 2005 Will Be a Great Year For Commercial Real Estate." Here are a few snippets: "Every month in 2005 will set a new record for total employment. Disposable personal income will set new records in 2005. There is no housing bubble. Plan for an inflation rate below 2 percent. There are at least 100 in-sourced jobs for every one 'offshored' job in the US. Quit talking about 'offshoring.' The decline in the dollar will lead to a huge increase in US exports in 2005. So sit back, relax and enjoy 2005!" His words, not mine, but sure to cheer up a lot of folks seeking a positive forecast!

The Association of Foreign Investors in Real Estate ranked San Francisco No. 4; the 10th time in 13

years S.F. has scored in the top five slots. Reasons: access to venture capital, an educated workforce, declining vacancy rates, stable rents and increasing positive absorption. No. 1 was Washington D.C. followed by New York and Los Angeles. *SF Business Times* (1/14/05)

Deals and Rumors: In **Pleasanton** the big news was Safeway's recent sublease of 150,000 sf from Charles Schwab at Pleasanton Commons. Rumored to be looking in the Tri-Valley market is APL for 170,000 sf, currently at Oakland City Center, and MDL for 80,000 sf. I helped in the relocation of Aetna Insurance from 100,000 sf in San Ramon to 60,000 sf at 2625 Shadelands Drive, **Walnut Creek**, and John Muir Hospital is rumored to be looking for 25,000 to 30,000 sf around the PH BART Station. Also in Walnut Creek, Potlatch recently relocated from Pringle to 10,000 sf at 1600 Riviera Drive. In **Concord**, Contra Costa County leased 15,000 sf at 4071 Port Chicago, and First Advantage took 10,000 sf at 2600 Stanwell Drive. In **Oakland**, Richard Avelar & Assoc. leased 10,000 sf at 318 Harrison St. In **Emeryville**, Ofoto took 30,000 sf at 1480 64th Street. Down the Peninsula, Informatica leased 159,000 sf at **Redwood City's** Seaport Plaza, and at Pacific Shores, Watry Design and Currenex took a total of 22,000 sf. In **San Mateo**, Sorrent leased 26,000 sf at 1800 Gateway Dr., and Akimbo Systems took 17,000 sf at 411 Borel Ave. Activision may have signed a LOI for 25,000 sf at Bayside Towers in **Foster City**. The huge news in **South San Francisco** was Genentech's leasing of 780,000 sf (60% lab/40% office) in a build-to-suit on East Grand Ave., and in the same city Lifemasters Supported Self-Care leased 29,000 sf at 5000 Shoreline Court. In **San Francisco**, Lawson Software committed for 15,000 sf at 185 Berry St., James Irvine Foundation inked a 13,000 sf lease at 575 Market St.; Sedgwick, Detert, Moran & Arnold did a 52,000 sf direct lease and a 60,000 sf sublease at One Market, where Morgan Lewis expanded by 19,000 sf and Duane Morris expanded by 13,000 sf; FivePrime Therapeutics sublet 32,000 sf at Mission Bay's J. David Gladstone complex; Bingham McCutchen renewed and expanded to 144,000 sf at Three Embarcadero and, Low Income Investment Fund leased 11,000 sf at 100 Pine St. (sounds like my stock portfolio - what happened to the High Income Fund?).

According to PriceWaterhouseCoopers's "Emerging Trends in Real Estate 2005," "Even with the proliferation of help-desk folks, the technological revolution reduces per-capita office space requirements. Many companies no longer boast once-significant support staff – Blackberries, laptops and voicemail reduce the need for administrative assistants and receptionists. Workers spend more time toiling on DSL-connected computers from home or hotels, and don't require as much space when they show up at headquarters. Taken a step further, companies can easily outsource more jobs to "consultants" and part-timers, who work from refitted basements or garage home offices and don't receive costly benefits. Controlling employee health care expenses – escalating on average to upwards of \$3,000 per worker annually – appears to be a major factor extending the corporate hiring slump and keeping some cubes empty ... Most interviewees express some discouragement over the slow pace of the office market recovery. Vacancy rates hover in the high-teens for suburban and mid-teens for downtown buildings. Rents have plummeted in many markets and new lease transactions will roll down net operating incomes from late 1990's markets even as rents recover. Tenant improvement packages, higher local taxes and inevitable capital costs depress returns further. Smaller businesses take advantage of the tenants' market and lead a budding leasing wave. Tenant reps say large companies finally are poised to follow, now that a surfeit of sublease space on their books has been re-tenanted and corporate profit outlooks improve. "Although the worst is over," many observers extend the recuperation period into 2007 and even 2008 for commodity office in

fringe districts, "2005 is too early to expect much improvement."

According to *Expansion Management* (October 2004), the top 40 real estate markets for corporate facility expansion or relocation include four regions in Texas, four in Florida, three in Ohio and none in California ...

The East Bay Business Times (October 22, 2004), "The high cost of office space, payroll, benefits, government regulations and other expenses forced many high-tech companies to flee California for such places as Phoenix, Denver, Las Vegas or Salt Lake City, but those cities have become "a victim of their own success," said John Boyd, president of The Boyd Company, a company site location consulting firm based in Princeton, N.J. Operating costs for a hypothetical 125 employee information technology business in a 35,000-square-foot office/R&D building were compared and included the building lease, salaries, benefits, equipment amortization, utilities and corporate travel. Out of 30 cities, 18 in California and 12 in the West and Midwest, San Francisco is the most expensive (annual average operating costs of \$12.12 million), San Jose second-most expensive and the East Bay third highest." On the other hand, "The cost of not being in the Silicon Valley is going to be greater than any cost savings you would have by moving to Des Moines," said Russell Hancock, president and CEO of Joint Venture: Silicon Valley Network. "Although productivity was not taken into consideration in the Boyd report, which focused on operating costs, Silicon Valley tech workers are more than twice as productive as the national average."

Recently mentioned in *PikeNet Dispatch* January 20, 2005 was an article about REISAC, the Real Estate Information Sharing and Analysis Center which coordinates its activities with the Department of Homeland Security. "REISAC is launching a campaign this month to promote business readiness in our industry as a part of DHS's READY BUSINESS program. How quickly your company can get back to business after a terrorist attack ... depends on emergency planning done today ... the benefits go well beyond terrorism to natural disasters, like hurricanes, floods, and earthquakes ... Members of REISAC are professional associations like BOMA, not individual companies. Yet via its members, REISAC can deliver 100,000 emails across our industry if an alert demands immediate attention." For example, at BOMA's Security Alerts you'll see an alert posted titled "Air-Cleaning Systems To Guard Buildings Against Attacks." You must be a BOMA member to read it. For further information on REISAC go to www.reisac.org.

Overall, the San Francisco Bay Area currently has more than 83 million square feet of vacant office, flex and R&D space. For a more detailed breakdown go to www.officetimes.com. In the good news department, *Business 2.0* (November 2004), "Despite all the gloomy news, corporate profits at US companies are more than 20 percent higher than they were at this point in 2003. That's one of the strongest rates of profit growth since the 1980s. Up to now, managers have been squeezing more hours out of existing employees rather than hiring new ones. But, statistics suggest that tactic has reached its blood-from-a-stone end point, and many economists predict a building wave of new job creation that will start in 2005 and roll on for many years."

Global offshoring is morphing into international companies investing "overseas" in every direction. "Nokia plans Indian mobile handset-making plant in India," "Virgin Group is planning to set up a

mobile phone service in mainland China and expects to invest about \$300 million ... on top of that, we're looking at Mexico, South Africa and Nigeria." "A subsidiary of Bank of America said last week it has invested \$6.5 million in Bangalore, India-based technology firm Ittiam Systems. Ittiam designs semiconductors for modems, mobile phone sets, compact disc players and video-phone." *Silicon Valley Biz Ink* (12/17/04) IBM said it will sell its PC business to Lenovo Group of Beijing for \$1.75 billion, creating the world's third-largest PC company. Lenovo, which currently has a workforce of about 9,000, will take in 10,000 IBM employees, about 40 percent of whom are already based in China."

The proposed Sprint/Nextel merger may result in large-scale job slashing. The executives said the combined company hoped to create savings of about \$2 billion by merging their operations, a central reason for the deal. "Sprint employs about 850 workers in the SF Bay Area, and Nextel's West region headquarters are based in Walnut Creek." *San Ramon Times* (12/16/04) Regarding the Oracle acquisition of PeopleSoft, *The Times* (1/4/05) reported, "Tad Piper, an analyst with Piper Jaffray & Co., estimated that Oracle will have to make \$900 million in cost cuts. Most of that will come from eliminating 4,500 to 4,800 jobs, though some of it will also come from consolidating offices and other resources."

Mountain House, out in the San Joaquin Valley near Tracy is one of the first new cities in Northern California in decades. It will have 43,000 residents, 15,000 homes and if all goes according to plan, more than 20,000 jobs. Prices range from \$500,000 to \$700,000, and the 25-mile commute to Pleasanton takes nearly an hour. *SF Chronicle* (1/16/05)

San Francisco Chronicle (1/21/05), "When economist Stephen Levy peers out his window in Palo Alto, he sees two Silicon Valleys: Business is booming, but jobs are scarce. Major companies are reporting soaring profits and revenue. But some of these same companies are slashing their payrolls, making it harder than ever for many average residents to find work in the area. Instead of hiring, many businesses are finding ways of becoming more efficient, relying on fewer employees or less expensive contract workers elsewhere to boost profits."

To illustrate the still depressed furniture and office equipment market, last month I was forwarded an email from a corporate headquarters that was relocating, "Free Furniture: Desks, 300 chairs, 100 filing cabinets, 180 cubicles, fridges, copiers, etc. Bring your own trucks and your own help to haul away!"

I was a bit confused by a recent article in *Commercial Investment Real Estate*, Jan/Feb '05, "2005 Forecast – Help Wanted." "Job growth momentum and high corporate profits bode well for demand and recovering fundamentals. Markets forecast to have the largest vacancy decline: San Jose, Calif., Dallas-Fort Worth, and California's East Bay." Just as I was about to pop the champagne cork to begin celebrating, farther along in the same article came this quote, "Only a few hard-hit, high-tech centers including Boston, California's East Bay and San Jose, as well as a handful of Rust Belt metrics such as Indianapolis and Pittsburgh continue to lose jobs." At least "California's East Bay" was mentioned twice! For more details go to www.ciremagazine.com.

It was one of these very special moments a few weeks ago when I went skiing with my wife, sister

and 7-year-old son at Alpine Meadows. For the first time our son, Jordan who is an advanced-skier, and was able to keep up with us (actually, at times even went quicker than the three of us) down the double-black steep chutes throughout Alpine, like Waterfall, Palisades, The Face and other advanced ski runs. What a special joy to be able to make these memories with your immediate family! For photos of their recent adventures and travels, please check out www.officetimes.com/JMFeb05.htm. I've been working 12-hour days and too many weekends, so my son and I are headed this week to ski in Taos, New Mexico where both of us will be in a six day high-performance ski class. Have a great rest of winter, spring is almost around the corner, and let me know if I can ever be of assistance regarding any type of commercial real estate anywhere in the world!

Thank you!

Sincerely,

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