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From time to time I almost see a glimmer of hope for the Bay Area office market, like when brokers at a regional meeting talk excitedly about a recent flurry of touring activity, but then they acknowledge it is all in under-5,000 sf tenancies, or when a company like ValleyCare leases 55,000 sf in Pleasanton. Then the same week, Providian puts 170,000 sf on the sublease market along with SBC unloading 50,000 sf of excess space. Investors eager to diversify from the wonderful returns currently available in the stock market or CDs create multiple bidding offers on office and real estate investments. Just when I begin to almost sense a positive feeling I open the paper and see Schwab plans to lay off almost 1,900 employees, which represents about 380,000 sf of office space which they won't need. Just a few days ago SBC announced 11,000 more job cuts. Survive until 2005, a landlord's heaven in 2007, but until then a field day for the few tenants who actually need office space…

Two years ago I was at the groundbreaking ceremony for 560 Mission Street in San Francisco. It was a huge gala with a live jazz band, multiple bars and a long oyster bar. Even Mayor Willie Brown spoke about how great this project was for the City. What I remember most was the developer, Hines, giving a speech and saying that the good news was, the entire 650,000 square foot 31-story building was totally preleased to JP Morgan Chase, but the bad news was rents had risen so rapidly since the ink on the new lease was dry that they were now 50 percent of current market rates. I'm sure the Hines folks are sleeping soundly in today's market! (That was back in 2000 at the height of the market, and today JP Morgan Chase has 330,000 sf up for sublease.)

Tips and Ideas for the Sublandlord, an article for those tenants who are now also sublandlords can be found at **www.officetimes.com**, as well as Disaster Recovery Information, books on office leasing, telecommuting articles, corporate real estate software and hundreds of other articles on office leasing available at **www.officetimes.com.** Thanks for checking it out!

The Twelve-Step Program for security risk reduction, as reported in *Buildings*, (September 2002) …"1) Identify and quantify assets 2) Identify the threat events and existing protective measures 3) Evaluate the likelihood of occurrence 4) Identify the risk level of each threat event 5) List the threat events in descending order by risk 6) Identify measures that could mitigate the threat events 7) Reassess the risks, assuming that each identified upgrade is implemented 8) List the proposed upgrades in descending order 9) Gather information on the costs of upgrades 10) Perform a cost-benefit analysis 11) Rank the upgrades by cost benefit level 12) Compare the prioritized upgrades against the available budget, and proceed with the highest rated upgrades until the budget is exhausted." For further information, please e-mail Tom Allen, V.P. at Johnson Controls at tom.r.allen@jci.com.

It's easy to look at negative factors facing today's office landlord, such as high vacancies, reduced rental rates and in many areas, minimal tenant demand. However, take a look at the bright side... Cap rates range roughly 8 to 10 percent (depending of course where the building is, who the tenants are, at what rate, for how long, etc.), so with commercial interest rates in the 6.25 to 6.75 percent range, there is still a significant spread to cover vacancies and turnover. Comparatively-speaking,

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owning an office building in most markets today still appears a much more stable investment than investing in the stock market, and just look at the almost non-existent interest rates being paid on CDs and bonds today. Most of the office landlords are deep-pocket institutional investors in for the long haul, and foreclosure rates on office properties are still negligible, as compared to the 1980s when it seemed 25 percent of all our office product went back to the lender. However, in the *San Francisco Business Times* (9/13/02), "The foreclosures are coming. Lenders may be another three to six months away from snatching up distressed commercial real estate, but an early warning sign suggests they will if the Bay Area slump continues. The evidence: So-called 'deed in lieu of foreclosures' have begun creeping up. In real estate cycles, they are seen as precursors to foreclosures." What do I think? Sub-markets like South of Market, where rents are so, so low and leasing activity so, so slow, as well as less-capitalized Santa Clara properties might be the first affected areas. However, I don't think we'll see anything like the bloodbath of the 1980s...

I've mentioned the industry changes in synthetic leasing during the past few OfficeTimes issues. Another downside of this once-vaunted financing tool was reported in the *San Francisco Chronicle* (9/7/02) when Inktomi was forced to purchase its Foster City headquarters, now worth between $37.5 million and $55 million, for $114 million. "The company was required to maintain a minimum level of profitability in the third quarter as part of its rental agreement. Inktomi's tenancy was under what is known as a synthetic lease, a popular way for companies to keep liabilities off their books. Firms place ownership of the property in a special purpose entity and then lease the property back." A revised article on "Synthetic Leasing" is posted on the home page of **www.officetimes.com**.

Telecommute update: Quotes from an article titled "Have modem, won't travel" published in *Silicon Valley Business Ink* (9/6/2002): "Telecommuting allowed my significant other and I to move out of the Bay Area and find some affordable housing." "One of the great things about telecommuting is that I can shut the world out if I need to, so I would claim that I'm more productive." "One downside to telecommuting is that e-mail is the bane of my existence." "There tends to be a diminished sense of company culture." "I think people thought telecommuting was going to be the answer to everything, but I don't think it's for everybody and every position!" And in the *San Francisco Business Times* (9/13/2002), "Most businesses embraced remote working programs for their sales staff years ago. But improvements in communications technology, as well as cultural shifts in business, are now allowing companies to apply the concept to workers across categories. Companies are finding that employees from public relations executives to engineers can now work from home, the road, other offices or client sites."

Deals and Rumors: Over in **Pleasanton**, ValleyCare leased 56,000 sf of office space at 5725 West Las Positas; I sold a 12,000 sf office building at 3730 Hopyard Road to The Church of Danville; Zenith Insurance is rumored to be looking at a possible 40,000 sf relocation, and EBTEL Federal Credit Union purchased a 38,000 sf office building at 7180 Koll Center Parkway. United Grocers is reportedly down to two 15,000 sf buildings in **Livermore**. In **Walnut Creek**, SRS may be taking 10,000 sf at 201 N. Civic Dr.; Wild Packet is also close to signing a 20,000 sf sublease in downtown Walnut Creek; Jacuzzi is looking at 25,000 sf in the Shadelands area; and at the new Three Ygnacio, Tier Technologies signed for 20,000 sf; Moffet & Nichols Engineers for 10,000 sf; and City National Bank is rumored to be taking 26,000 sf. The big news in **Orinda** was a 92,000 sf Class B office project, Pine Grove, which sold for $300/sf. In **Pacheco,** Bay Alarm bought the 31,000 sf former Neon HQ at 60 Berry St. In **Emeryville**, Chiron leased 71,000 sf at 5400 Hollis St.; in **Richmond,** Kaiser is rumored to be close to signing for 50,000 sf at Regatta Business Park; and up in **Hercules,** BioRad is in planning stages for a 140,000 sf expansion of its R&D campus. Up in **Napa,** TIG Specialty Insurance Solutions leased 21,000 sf at Napa Carneros Commons. In **Petaluma,** Vista Broadband Networks took 11,000 sf at 1310 Redwood Way, and in **San Rafael,** L.Elsa leased 11,000 sf at One Thorndale. In **Oakland**, the Carpenter's Pension Trust Fund and AT&T Broadband are reportedly in negotiations for a 197,000 sf build-to-suit in the Oakland Airport Business Park at Pardee and Hegenberger, and in **San Leandro,** Testing Engineers leased 10,000 sf at 2811 Teagarden St., relocating from Oakland. In **Fremont**, Scios Inc. took 190,000 sf at the Ardenwood Corporate Center. In **San Francisco**, The Bank of the West leased 52,000 sf at 180 Montgomery St.; Huron Consulting Group subleased 16,000 sf at One Front St., SB Architects Inc. is taking 11,000 sf at One Beach St.; UCSF signed for 12,000 sf at 185 Berry St. and are also rumored to be looking at 50,000 sf nearby; and Ziff Davis Publishing and Nexant Inc. each leased 35,000 sf at 101 2nd St. Down the Peninsula, E2Open took 56,000 sf at 1600 Seaport Blvd. at Pacific Shores, ePocrates leased 21,000 sf at 1800 Gateway Dr. in **San Mateo**, and Google Inc. might be signing 190,000 sf in **Mountain View**'s Legacy Shoreline Center.

Please check with your CPA, but according to a recent article in *The Wall Street Journal* (June 26, 2002), "According to some accountants, in some cases as much as 40 percent of a property's construction costs could be reclassified as personal property and land improvements and depreciated much faster, greatly reducing an owner's tax bill. The new rules all affect how fast property can be depreciated. Generally, the IRS allows owners to depreciate commercial property over 39 years and income producing residential property over 27.5 years. But under the new rules, a wide range of building improvements—from wall coverings to supplemental air conditioning to certain land improvements like swimming pools and tennis courts—can be

reclassified and depreciated as personal property and land improvements rather than structural components of a building. Depending upon what it is, personal property can be depreciated over five or seven years and land improvements can be written off over 15 years." In *National Real Estate Investor (*June 2002), "The biggest beneficiaries of the tax benefit are likely to be property owners that pay a large share of tenant improvement costs, either by direct payments incurred in the construction of tenant space or in the form of allowance dollars allocated to the tenant. On the other hand, a tenant that expands more than the allotted amount provided by its landlord may also accelerate its depreciation schedule. The way a lease is structured will help determine which party gains the benefit. The 30 percent deduction must be taken in the first year that the improvements are placed in service. Tenant improvements must be made after September 10, 2001 and before September 11, 2004 in commercial space placed in service in January 1, 2005 to qualify for the benefit. The accelerated depreciation method is available only on interior improvements that are placed in service at least three years after the completion of the building. The provision does not cover building expansions, structural repairs or improvements to common areas such as lobbies. Expenditures must be in connection with a qualified lease transaction, so a building that is owned by the occupant is not eligible." Of course and as always, please consult with your CPA…

Lenders on single-asset loans on a trophy building or pods that have a high concentration of high-profile properties can force a property owner into greater exposure for significantly higher insurance premiums for terrorism coverage. As stated in *RealEstate Forum* (July 2002), Daniel Rublock, vice president and senior analyst with Moody's stated that a building is valued on either its inherent worth or if it's destroyed, the amount of insurance it holds. "Without terrorism insurance," he said, "if an event occurs, you may only have land."

As mentioned in *Commercial Investment Real Estate* (Sept./Oct. 2002), "Tighter vendor identification and check-in was the most frequently added security measure after Sept. 11, 2001, according to a national survey of building owners and managers by the Urban Land Institute and the Building Owners and Managers Association. Most respondents said they strengthened security operations already in place instead of adding new ones. Beefed-up features include additional cameras, increased personnel and installment or more rigid enforcement of card-access systems."

Most suburban office workers in the United States have been relatively unaffected by new security measures now in place in many high-rise office buildings. Those going to work in a suburban two-story office don't have to face blocked entrances to funnel all traffic to one central security checkpoint, or have your briefcase either physically inspected or x-rayed, asked to present proper identification, and then wait if you are a visitor to be escorted to your destination. In the *San Francisco Chronicle* (9/8/2002) "Card-key controls to get in and out of buildings, more security guards in lobbies, increased scrutiny of mail and freight, and physical barriers around building parameters are the main additions to the security arsenal. It's now the rule at San Francisco high-rises for office workers to show identification upon entering the building. Visitors have to be announced and obtain passes from security guards, who have been trained to be much more vigilant in demanding ID and following security guidelines. Vehicles are searched before they can enter underground parking garages, and some garages ban trucks entirely." How are those folks selling knock-off paintings ever going to get in?

Property values in the Bay Area have increased dramatically during the past year, with assessed property values climbing $49 billion in the nine Bay Area counties last year. According to the *San Francisco Chronicle* (7/29/02), "that translates into more than $500 million in new property tax revenues." However, during recent weeks, segments of the residential home mortgage market have reported a rise in foreclosures, homes are taking longer to sell, and some submarkets like Silicon Valley have had existing home prices drop. Hopefully, municipalities will see this tax revenue as a temporary windfall, which might disappear if the residential home bubble pops during the next 12 to 24 months (in other words, governments, please don't spend all this new tax money on long-term programs!)

Two months ago, the Bay Area office/R&D vacancy rate was 68 million square feet but currently may be closer to 75 million square feet available, with 48 million square feet of this in Silicon Valley and about 15 million in San Francisco.

According to a recent report from Property & Portfolio Research in Boston, San Francisco is at the top of the list for "extreme" office markets with the sharpest drop-off in new construction starts this year, a change of 97 percent…that is a good thing, to allow the market time to absorb office space already existing…

Meeting spaces (formerly called conference rooms way back when) – *Today's Facility Manager* (July 2002) had an article illustrating the transition of meeting spaces… "From the way people meet, to the spaces, furniture, and tools they use, everything about conferencing is changing. Teaming, meetings, and in-house training are on the rise and increasingly taking place in spaces designed to spark creativity and leverage knowledge. Unlike the largely dull environments of the past, today's conference,

meeting, and training spaces are dynamic. Years past, a company would have that big conference room and it would be used when needed… today, people are focused on cost containment. Facility professionals want to utilize every square foot to the utmost. They can't have a large conference room used just two or three times a week and they sit idle the rest of the week. Increasingly, these rooms are doing double duty. Conference rooms are used for board rooms, training, and informal meetings." Not sure I totally agree that the conference room concept is as outdated as the above comments, but it did get me thinking…

My son, Jordan, who is on his way to turning 5-1/2 this November had one of the best summers of his life, and I know I sure did… Lots of camping trips with friends, including an annual Dads/Kids trip I organize every year at a nearby campground, with lots of kids games, relays, hikes (the kids love the moonlight flashlight hike) and of course s'moores around the campfire. Jordan also learned to throw a football and is just getting into soccer. It was amazing to see him come home from his first day at kindergarten and tell us how much he loved school. One of my greatest moments was helping out at his kindergarten class and seeing how proud he was for my showing up. Weird, but in spite of the struggle to get a five year old boy to bed on time (almost never happens…), reading the bedtime book, and then watching him drop off to sleep, these everyday events are one of the most gratifying parts of being a parent! Photos from Jordan's recent adventures can be seen at http://www.officetimes.com/JordanOctober02.htm. Well, here it is October once again…they seem to roll around a lot quicker than before. October 11th marks my birthday, and the first day of my 27th year leasing and selling office and commercial properties. Still super-fun, still surrounded by great people, both in the client category, the folks in my company and my respected associates in competing firms. Thank you everyone for making this first career so enjoyable and rewarding!

Sincerely,

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