OfficeLease
OfficeIntelligencer

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Commercial Real Estate
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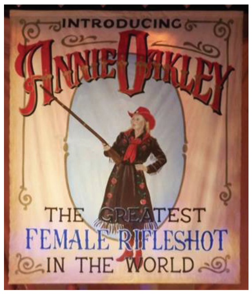

Annie Get Your Gun!
in a two pack...... at Costco.

"Everything you can do I can do better. I can do anything better than you" sings Annie.

A group of us had the pleasure of visiting with Jim Sinegal last month. He first walked us around their Issaquah store, explaining the logic behind the layout, proudly telling us the stories behind various products that have evolved into mainstays such as their USDA prime quality steaks hitherto mostly available in restaurants, Wild Alaskan salmon filets for $7.99/lb, freshly rotisseried chickens for $4.99 and a diamond ring on sale for (and I'm not kidding) $399,999.99.

Some of us recalled our membership in the very first Costco store before bar code scanning was implemented and where employees memorized the four digit product code and would call them out faster than the checkout clerk could enter them in the register. It is now the third largest retailer in the country.

After the store walkabout we joined him for lunch in the company's utilitarian conference room.

Warren Buffett has his hamburger and Coke for lunch. For Sinegal it's an all beef hot dog washed down with Pepsi. This was the first hot dog I'd allowed myself for over 10 years, and had our host been anyone other than Jim, I would have skipped it for something more aorta-friendly.

And through sauerkraut, mustard and ketchup, we learned more about the solid principles that comprise the foundations of this $76 billion enterprise.

In our last OfficeIntelligencer I wrote about the Bill George's book 'True North' which defines authentic leadership.

Jim is as authentic as any business leader in the country today. And in his avuncular, approachable way, he commands, rather than demands respect. He clearly loves his job. And as he walks around his store people recognize him and ask for a photograph with him. He always obliges.

Jim recounted that when Costco first applied for a beer and wine sales license they posted a notice near their front door for the requisite period. But then were told that it had been placed incorrectly; that they had to move it a couple of feet. And then were required to repeat the notice period. This picayune bureaucracy was an epiphany for the Costco team as they realized that, increasingly, they were in the cross hairs of public scrutiny.

People and consumer watchdogs assumed this 'discount wholesale club' would be selling 'seconds' which were somehow marred; that there would be little recourse for buyers, and that the experience would be one of 'caveat emptor'....buyer beware.

So then and there, Jim and his team vowed that they would embrace Annie's primary theme. They would do everything better. In fact they would take it up a notch. They would have the best return policy in the business, would exercise strict quality control on themselves and suppliers, would pay the best salaries and have the best employee benefits in the industry and would take the wind out of would-be critics' sails by exceeding expectations on all fronts. In short, they decided that they would be above reproach on all fronts. This calculated strategy was one which came naturally to Jim. Because it is, as a matter of course, simply the way he conducts himself on a daily basis.

As he talked, I recalled a breakfast I attended 20 years ago for Ambassador James Goodby who had led strategic arms limitations talks with the Soviet's since the '60s. Someone asked him how he kept track of all the details and what he said, during these immensely complex START negotiations. *"Simple"* he retorted *"I always tell the truth; that way I never need to remember what I said."* Which would seem to be the underlying

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Capital flight to Seattle......What Next?

With Equity markets in turmoil, interest rates at all-time lows and anemic US growth, achieving targeted returns for most asset classes, including real estate, has become extraordinarily challenging. Diminished lender and investor interest in commercial mortgage backed securities (CMBS) adds to the challenge of financing acquisitions and refinancing existing loans.

Pension funds are particularly affected by the combination of increasing payouts to members in the form of retirement and other benefits while experiencing volatile returns from various investment categories. According to the Real Estate Roundtable, pension funds provide approximately $160 billion of equity capital to commercial real estate, even though it only represents 5% to 10% of total fund investments. How they allocate that capital to the various commercial real estate categories, and in which markets, can significantly affect pricing and investment return, particularly when competing for the same limited number of core properties in the major US markets (generally, New York City, Washington D.C., Boston, Chicago, San Francisco and Los Angeles).

The pursuit of well-leased 'trophy' properties in those markets, are driving prices towards those of the credit-fueled buying frenzy that peaked in 2007, (followed by two years of negative returns). For example, a Manhattan office building was sold in May for $485 million with a capitalization rate of 4%, according to Real Capital Analytics. The Wall Street Journal pointed out that in 2009 a similar building nearby sold for a 6% cap rate. Moody's reported that the price of trophy properties in primary markets rose an impressive 26.7% from the low in December 2009 to March of this year. Given the volatility of alternative investments, there is reason to believe this trend will continue.

These high prices are causing some funds to alter asset allocations or put the brakes on further real estate investing until the climate is more settled. On August 15, the country's largest pension fund, the California Public Employees' Retirement System , CalPERS, with an investment portfolio of $226 billion, decided to reduce their real estate allocation target from a goal of 10% of the total fund (now at 7.8%, due primarily to write downs during the housing bubble) to 8% for the balance of 2011 increasing to 9% in 2012. Why? Because core properties have reached price levels that make it challenging to find assets that will achieve their desired returns.

As prices in the major markets exceed the appetite of all but the most aggressive investors, attention turns to secondary markets like Seattle but on a very selective basis. As in the major markets, the newest office buildings with the latest technology that are fully leased or nearly so by credit tenants are the targets of the major funds.

Last year, Principal Real Estate Investors, the fourth largest institutional real estate manager in the country, acquired the Bravern Office Towers in Bellevue, which were built in 2009 and are fully occupied by Microsoft. The price paid was $547/sf, the second highest price per sf paid in the region since Market Place I and II in Seattle sold for $698/sf during the 2007 buying frenzy.

Prior to the Bravern sale, another Bellevue property leased to Microsoft, City Center Plaza, was acquired by Cole Real Estate Investments for $532/sf. The all cash transaction of $310 million was one of the largest in the country last year. Cole owns and manages property worth approximately $8 billion, largely through non-traded REITs.

The most recent major local acquisition was by J.P. Morgan Asset Management of the two new office towers in Seattle developed by Schnitzer West. 1918 8th Avenue sold for $524/sf and 818 Stewart fetched $557/sf. Amazon's lease of the majority of 1918 8th was the key to the sale of that property and 818 Stewart is over 90% leased.

These examples of large investors' 'flights to safety' are unlikely to be repeated anytime soon in this market. With the Seattle CBD office vacancy rate at 16%, (according to OfficeSpace.com), the older Class A properties with significant vacancies that would otherwise appeal to institutional investors don't offer the prospect of occupancy and rental rates increasing enough to justify speculative investment. The Bellevue CBD vacancy rate stands at 14%.

So the question is, with the newest class A+ buildings now all but fully leased, when might we see announcements from developers about the next generation of downtown towers? After all, Scientific American just ranked Seattle as the #1 tech friendly city in the US. And we'll need to accommodate all the growth somehow!

Larry Pflughoeft larryp@officelease.com

A Client Comments:

"I want to thank OfficeLease for the work you did to help us secure our new corporate headquarters. A move of this magnitude is a once in a business lifetime event for our company. We feel we have the perfect space and got the absolute maximum for our money. Your group repeatedly went beyond the borders of the "deal" to ensure the success of the entire process. Apart from introducing us to move specialists, you worked seamlessly with our accountant, space planner, lawyer and various internal departments. It was a pleasure working with the entire staff at OfficeLease. You have helped us jump to the next level and definitely earned your keep!"

Nick Staub, CEO, Romaine Electric

Industrial Real Estate News

In this 'Information Age' of bits and bytes, intellectual property and internet commerce it is refreshing to be reminded of that which took this country to its global dominance. A free market economy protected by democracy and powered by industrial ingenuity and productivity.

At OfficeLease, in addition to all the office users we serve, we really enjoy getting to know and work with a broad range of industrial use and warehouse clients. From flower distribution to design and manufacture of rockets, solar powered gates, auto generators and renewable energy technology. And unlike office space where the majority of our clients tend to lease space, it seems as if almost 50% of our industrial clients are buyers.

The Industrial real estate market has been one of the brighter spots in the commercial real estate Industry and tends not to experience the sorts of broad rate fluctuations in the retail or office market and vacancy rates held reasonably steady, at single digits, through the recession.

Boeing, Paccar and the Ports of Seattle and Tacoma certainly have been the historical drivers in this market but other, smaller home town entrepreneurs come to the fore. But keep in mind that even in a high vacancy market, especially for users with specific requirements; there are a finite number of alternatives that will work well.

The US Institute of Supply Management took a detailed look at statewide manufacturing data for the period from 1994 through 2008, a 15-year period that included the 1990s boom, the dot-com bubble bursting, a severe Boeing slump followed by a major recovery and 9/11, along with major structural changes in the economics of our nation and the globe.

During this time of great tumult, in our state they reported:

- 94% of our manufacturing jobs were retained (compared to 75% of all US manufacturing jobs);
- Revenues for manufacturing companies grew by 131% to $132 billion, more than twice the rate of manufacturing revenue growth for the US, and;
- Per-worker revenues for Washington manufacturing companies more than doubled, rising to $442,268 from $185,437 per worker.

The overall growth trends are muted because they include the numbers for manufacturing sectors that performed poorly. Outcomes were far rosier for those that did well, such as the machine makers and metal fabricators who comprise the metal trades.

Since hitting bottom in 2009, manufacturing in Washington has been rebounding, adding about 9,000 jobs. From the third quarter of 2009 to the third quarter of 2010, manufacturing revenues in the state grew by 10.4%. That compared with 6% growth for overall business revenues.

Here's a quick snapshot of the industrial real estate market:

Close in Seattle: (Ballard to So. Seattle) The Vacancy rate is 5.4% and the average rental rate is $.40-$1.00 per square foot and the average selling price is between $80.00-$150.00 per square foot depending on condition, size and location of the property.

Kent Valley: The Vacancy rate is 7.5% and the average rental rate is between $.28-$.60 cents per square foot and the average selling price is $45.00-$80.00 per square foot depending on condition, size and location of the property.

*In the Kent Valley there is typically an add on rate for office space of approximately $.60-$.85 cents per square foot.

Depending on your business it's crucial to understand industrial zoning in the areas under consideration. 2008 legislation for the South Seattle market limits zoning classifications by "use" and caps the amount of office space and retail space in the building.

The Industrial market is also categorized by light and heavy industrial zones which determine where different types of business may locate. Working closely with the DPD (department of planning) and other city officials can help guide you through the change-of-use process or how best to adhere to the zoning classifications.

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Annie, Get Your Gun!...

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principal behind a corporate policy of simply exceeding expectations in whatever one does.

How does this relate to OfficeLease's business of commercial tenant and buyer representation? On many levels as it turns out.

Whether you are a Fortune 500 CEO representing your company or a commercial real estate professional representing someone else's company, irrespective of their size, you have a responsibility to always take the high road and the long view. And time spent with the likes of Jim Sinegal is a living reminder that there is no substitute for authenticity and transparency. *"Doin' what comes Natur'lly"* is another song from 'Annie'. And it might well be written for Jim in his role as Costco's doyen.

As always your comments are welcome. email Pauls@officelease.com

SEATTLE CHILDREN'S

PLAYGARDEN

A Garden for Everyone

The Seattle Children's PlayGarden provides children with physical and/or mental challenges full access to a safe recreation space and offers inclusive programs that encourage their potential.

Join us for our annual "Play, Grow & Learn" Luncheon

Wednesday, October 12, 2011 at Seattle's Four Seasons Hotel • If interested, please contact pauls@officelease.com

Digging in the dirt, swinging in the sun, chasing butterflies. All children deserve these simple pleasures—no matter what their level of ability. **The Seattle Children's PlayGarden provides children with physical and/or mental challenges full access to a safe recreation space and offers inclusive programs that encourage their potential.** The PlayGarden is a private nonprofit organization partnering with the Seattle Department of Parks and Recreation to serve children with special needs and their families from all over King County.

First of Its Kind

The PlayGarden is unique in the region—and possibly the nation—for providing inclusive recreational and therapeutic programs for children ***in a public space.*** With an indoor/outdoor facility located at the Seattle Parks Colman Playfield location at 24th Avenue S. and S. Grand, the PlayGarden provides the following:

- Two sessions of preschool during the academic year
- Day camps throughout the summer for children from toddlers to teens
- School-break camps
- Field trip and special event opportunities for local schools and organizations
- Support for parents and families of children with special needs
- Community events and classes

More Than Just a Playground

The PlayGarden is not just a playground, nor does it function like other area organizations that provide recreational opportunities for children with special needs:

All PlayGarden programs focus on "inclusion," so that children with special needs can play and learn beside their typically developing siblings and peers.

A child's experience with the recreational elements of the space is augmented by having staff on hand who can assist him or her, such that everyone can participate to his/her fullest.

The landscape is purposefully designed to be accessible yet challenging; staff encourage children to stretch themselves. Wagons full of soil strengthen muscles, tending a garden enhances coordination and improves motor skills, and climbing up a play mound improves balance.

The inclusive nature of the programs allows typically developing children to participate with their siblings or friends with special needs, and their sensitivity toward these peers increases.

Parents/caregivers appreciate a place where all their children are welcome and where they can relax, network with parents in similar situations, and learn to advocate for their children.

Neighbors are encouraged to attend programs and to steward the garden, which imbues the neighborhood with a sense of involvement and pride.

General Information:
Address:
1745 – 24th Avenue South, Seattle, WA 98144
206-325-5576 www.childrensplaygarden.org

For more information, contact Kathy Sitchin, 206-601-0635; sitchin@comcast.net