OfficeLease
OfficeIntelligencer

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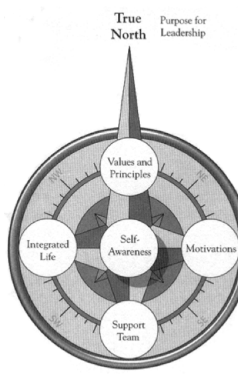

Bill George, former CEO of Medtronic, is a Harvard professor and author of several books including "True North".

Laird Norton Tyee, Seattle's most venerable wealth management firm and OfficeLease client, hosted a forum at which Mr. George shared his observations and stories of a few of the business leaders he has interviewed.

No surprise that in most cases these men and women were molded by their earliest and most personal relationships with those who cared for and about them.

George talked about 'crucibles', defining periods when illness, loss and other negative life experiences, have caused these leaders to step back and reflect on their priorities. And how, then strengthened and refreshed by this reflection, they recalibrated and applied the lessons learned.

Adherence to core values, self awareness and a willingness to be vulnerable is his central theme. He illustrates how great leaders truly know their strengths, recognize their weaknesses and will frequently seek out advisory or peer groups; those who will honestly critique their style and choices. And, no surprise here, they are good listeners; to customers and peers, to family and subordinates. They listen, learn and adjust.

"Each one of us has a moral GPS" he writes, *"a compass or conscience programmed by parents, teachers, coaches, grandparents, clergy, friends and peers. This compass is an integral part of our being. It continues to differentiate between proper and improper behavior until the day we die."*

He quotes Young & Rubicam CEO Ann Fudge who maintains *"Don't worry about the challenges. Embrace them. Go through them even if they hurt. .... Every challenge develops your core of inner strength which gets you through these storms. Nothing worth doing in life is going to be easy."*

And Jaime Irick of General Electric. *"When you become a leader, your challenge is to inspire others, develop them, and create change through them. You've got to understand that it's all about serving the folks on your team."*

And to the purpose of business? Narayana Murthy, founder of Infosys believes *"you cannot sustain long term shareholder value unless you create sustainable value for your customers, while assuring fairness to all stakeholders: customers, employees, investors, vendor partners, governments and society."*

My favorite nugget from mining this book is that of Jon Huntsman, CEO of a $13 billion chemical company, who asserts unequivocally that "there is no such thing as a moral agnostic". Huntsman, also founder of the Cancer Institute bearing his name, has on his desk a sign which proclaims: *"The greatest exercise for the human heart is to reach down and lift another up."*

In addition to technical proficiency and qualifications these leaders all display simple human decency, fairness and empathy.
Mr. George then described three leadership styles.
Directive Leaders (who demand compliance and obedience with rules).
Concensus Leaders (who build agreement through participation) and
Coaching leaders (developing people for leadership roles)

A reader might ask what these styles have to do with our field of corporate real estate decision making. As it turns out: everything. They will dictate how a leader will want to negotiate, who they will want to involve in the process and ultimately the outcome of their spaces' designs.

Irrespective of styles, the real estate evaluation process can be a very positive 'crucible' which, if well orchestrated, and if initiated before space issues become critical, can result in a better understanding by all key participants, of their corporate culture and the strengths and talents of their compatriots.

As always your comments are welcome. ***Paul Suzman*** ***pauls@officelease.com***

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New Lease Accounting Standards Impact Lease Treatment.

Two years ago in the Puget Sound Business Journal we co-authored an article about proposed changes then being initiated by the Financial Accounting Standards Board and their International cousins at IASB.

Well, these changes are almost upon us and a recent article in 'Accounting Today' outlines what likely will be adopted.

Currently, American and foreign companies list many leases as footnotes in their financial statements. As a result of the change, public companies will have to put some $1.3 trillion in leases on their balance sheets, according to estimates by the Securities and Exchange Commission. Because many private companies also follow GAAP accounting, the number could be closer to $2 trillion, experts say.

"Perhaps most significant is the proposed change from operating to capital treatment of leases – that is, requiring tenants to place the obligation to pay rent over the entire lease term on their balance sheets as a liability, where before only the current rent was booked on the financials as an expense on the income statement."

What does this mean?

"In calculating the long-term rental obligation, contingent payments in retail leases, such as "percentage of sales" rent would be required to be estimated and included in the total. When addressing renewal options, accountants preparing financial statements under the new GAAP standards would be required to use the longest term that is more likely than not to occur. Tenants will discount the full stream of rent payments to present value, using their borrowing rate.

The rent liability will be offset by an equivalent asset, representing the right to use the leased premises. Both the asset and liability totals attributable to leases diminish over time as the expense is booked.

While both sides of the balance sheet are grossed up under the new rules, many tenants – especially those with large lease portfolios – will not be happy seeing their debt loads suddenly balloon and their financial picture appear shakier. And existing leases are not slated to be grandfathered in under current rules, meaning that the predicament may already be somewhat of a foregone conclusion for many companies."

In a recent New York Times article a managing director of corporate capital markets at the real estate services company Jones Lang LaSalle observed:

"…On the day the standard gets implemented, all these companies will suddenly have to record much higher rent, and they are going to have to record this as a significant liability on their balance sheet."

Among those most heavily affected by the changes will be companies that are already struggling under heavy debt loads, as well as large retailers that have hundreds, if not thousands, of leases. Commercial banks with multiple branches may also be severely hit in 2013, especially if that industry is still recovering from the recession.

The new standard is expected to have ripple effects in the leasing market. One of the chief changes is to remove many of the differences in the way companies account for property that they own and property they lease. This may cause more companies to buy their offices and drive down demand for leased space, experts said.

The NYT article notes that *"Under the new standards, companies that lease space are considered to be buying the right to use that space for a certain amount of time. So, not unlike a home buyer who begins with a large mortgage but then reduces it as the principal is paid down, companies will record their rent as a major liability at the start, but will eventually reduce this debt over the term of the lease"*

The bottom line is that companies are going to need to plan more thoughtfully for the future.

Another interesting wrinkle is accounting for lease renewals. If a company, for example, signs a 10 year lease with an option to renew for another five years. Under the new rules, if it is likely that the company will execute the renewal option, they must account for the lease as if it were actually 15 years!

Many retailers sign leases based on a percentage of sales. Under the new GAAP standard, these companies will have to estimate their sales numbers over the entire term of the lease to book it on their balance sheet.

So given these and other nuances of the newly proposed standards it would be wise to consult your accounting firm; let not these upcoming changes catch your firm unawares. Caveat Lessee!

A Client Comments:

"We have worked with Paul and his firm OfficeLease on a number of occasions, and their work with our clients has been excellent. Paul is intelligent, creative, and very client responsive. And perhaps more important, I find Paul's personal integrity of the highest calibre, something that I have not always found with real estate professionals. I recommend him with no hesitation."

Gerry Michael, President, GA Michael & Company, PS

Commercial Real Estate
2010/Wrap–2011/Preview

In the movie Field of Dreams, Kevin Costner was assured: "Build it and they will come". A sentiment that moved many office developers to initiate construction on projects in 2007/2008. Several, with partially completed projects, were faced with the dilemma of a perfect storm; collapsing demand for space, formerly strong tenants rendered weak by an imploding financial system and free falling rents which no longer justified new construction. Fortunately for the health and appearance of our CBDs, the developers chose to complete these projects despite the knowledge that they would be hemorrhaging cash flow for years to come. Or that they might forgo their equity and see all their hard work go back to the lenders. That said, the Greater Seattle area has been more fortunate than most. Some of the highlights are as follows:

Of all our neighborhoods, South Lake Union is most positively impacted and its transformation will accelerate as Amazon employees flood into their new 1.46MM SF headquarters (and Institute for Systems Biology occupies their space) while The Gates Foundation moves from scattered low profile buildings into its new, highly visible consolidated presence complete with interpretative center. And at in the Northern fringes of the CBD two more of the area's most active non-profits relocated to new quarters, PATH and the Casey Family Foundation. Puget Sound Blood Center also announced that their research division would be absorbing the primary Gates Foundation space on the shore of Lake Union. At the time OfficeIntelligencer went to press there were unconfirmed reports that KPMG and Amazon were committing to leasing the balance of 1918 Eighth Avenue thus filling one of the largest remaining Field of Dream holes!

And there are similar reports that Zillow and several other tenants are joining Russell, and Nordstrom to, essentially, fill most of the available remaining space in Seattle's newest high-rise; Russell Investment Center, a gleaming reminder of the WaMu saga. It was in 2009 that Russell's parent company, Northwestern Mutual, acquired the building for $133/SF, a fraction of its cost or replacement value. This neighborhood will be further enhanced when Target opens its new store in a building it acquired at Second and Pike.

One of I-5's most visible downtown locations and, gateway to Pill Hill, the new 7th and Madison building should soon, pending city approval and addition of a parking structure, become PolyClinic's new HQ. The building, like the WaMu/Russell Center, had been returned to its lenders and was acquired at a fraction of its cost (this time by HAL Real Estate in a creative deal predicated on the lease to Polyclinic). As the year drew to a close, Fred Hutchinson Research Center acquired, via deed in lieu of foreclosure, for less than $200/SF, the 177,000SF building at 1100 Eastlake which had been vacant since its completion in 2007.

On the Eastside, Sunset Corporate Campus on the I-90 corridor won Intellectual Ventures' tenancy.....152,000SF of intense creativity and more patents/SF than any other space user in the region! And two Bellevue buildings occupied by Microsoft, one, the suburban Advanta and the other in the downtown, City Center Plaza, sold for fair market values. Respectively $377/SF or 6.6% cap and $532/SF or 6.5% cap. And Microsoft also added to its Bellevue downtown presence as it absorbed the former Eddie Bauer space in Lincoln Square

And what of the area's largest landlord? Well according to **Standard & Poors**, after subtracting operating expenses of Beacon Capital's 20 buildings, rents only covered 20% of its debt payments! (A side note here: unlike the geese that in 370BC alerted Rome to an attack by the Gauls, rating agencies such as S&P, failed to honk when confronted by the dangers that caused the whole financial meltdown; so they do not escape blame) Earlier last year Beacon reworked its Columbia Center loan, and near the end of 2010 negotiated a 5 year extension on its interest-only loan, adding $200MM of collateral. In return, its interest rate was cut from 5.8 to 3%.

In summary: in 2009 the local office market experienced over 1.5MM SF of negative absorption. In 2010, with a few exceptions, most activity consisted of 'laterel relocation' (trading existing space for higher quality at lower rates). However when all the shadow space (leased but not occupied) has been factored in we'll likely exceed 1.5MM SF of overall **positive** absorption. (**OfficeSpace.com** estimates absorption at over 1.75MM SF with Puget Sound's office inventory base standing at 115MM SF).

Washington State unemployment rates peaked in January 2010 at 10.4% and as of the end of 2010 stood at 9.1%. Hopefully this downward trend will continue. We believe overall, for **Class A- and B** buildings that lease rates and packages will remain relatively flat or experience only slight inflation through 2011. If however the overall vacancy rates at Russell Investment Center and 1918 Eighth Avenue actually do fall below 10%, we'll likely see an increase in Class A+ asking lease rates as optimism starts to return to this end of the market.

Real Estate Investment Perspectives

More often than not, investors have a particular capitalization (CAP) rate (initial return on an all cash investment) in mind when evaluating income property. The conservative investor may weigh that yield and the inherent risk of real estate investment, against relatively safe government-issued securities.

When vacancy rates are low and rental rates are increasing, sellers can obtain prices at low cap rates, particularly for high quality properties in stable cities.

It's not possible to predict the optimum point in time to enter the market, but investors can compare CAP rates to the yield on 10-year Treasuries, one of the lowest risk investments.

When real estate prices peaked in 2007, the spread between Treasuries and real estate shrank to 80 basis points, according to Moody's Investors Service. By the first quarter of 2009, the spread hit a record 539 basis points as property prices dropped and rents were sliding.

With the 10-year T-Bill at 3.3%, the spread is in the range of 300 to 500 basis points, with cap rates varying by type and location of property.

The Real Estate Research Corporation tabulated sales in the Western US for 12 months ending September 30, 2010 and noted the following CAP rates:

	Office	*Industrial*	*Retail*	*Apartment*
Range (%)	**5.0 – 12.9**	**4.2 – 12.2**	**5.9 – 12.6**	**4.2 – 11.1**
Average (%)	**7.0**	**8.4**	**8.6**	**5.9**
Median (%)	**7.9**	**8.8**	**7.7**	**6.1**

CHILD
CHILDREN'S INSTITUTE
for Learning Differences

www.childrensinstitute.com

Children's Institute for Learning Differences (CHILD) is **committed to providing innovative school programs and therapies that promote social, emotional, and academic development for children with special needs.** With 34 years of successful experience, we have emerged as a nationally recognized leader in the arenas of sensory processing and social-emotional development. We know how dramatically these factors impede school success. CHILD, a non-public agency and non-profit organization, currently contracts with 20 school districts to serve their most complex and challenging children—from Olympia to Stanwood/Camano Island, while many additional families elect to privately place their children at CHILD. OfficeLease is proud to be assisting CHILD with its real estate planning.

Understanding CHILD's Students

According to the Centers for Disease Control and Prevention

- 1-in-110 children contend with Autism Spectrum Disorder
- 1-in-20 children has a Sensory Processing Disorder
- 1-in-5 children and youth contend with a severe mental, emotional, and behavioral disorder including Anxiety Disorders, Bipolar Disorder, and Conduct Disorders
- An estimated 3.6 million children (6%) in the US are diagnosed with Attention Deficit Disorder

The children we serve face these complex emotional, behavioral and neurological challenges, among others. These challenges can lead to difficulties with problem solving, regulating behavior, the ability to clearly express themselves, and difficulties interpreting social behaviors. These children are often thought hopeless by traditional educators and providers who find themselves confused, frustrated, and powerless in the face of repeated failure to create relationships and access to learning for these complex children.

CHILD's Unique Approach

"The CHILD Way" provides a **model of intervention and a level of service that is unparalleled in the region.** We are committed to the pursuit of missing skills and the use of empathy which are proven to not only create true "learning moments" and increased student engagement during instruction, but allow students to participate fully in their personal development. Onsite occupational, speech, emotional, behavioral, life skills and academic therapies are available to both our day school students and to hundreds more children and families on an outpatient basis annually.

Since 1977, we have worked with over 2,400 students and 5,000 parents and caregivers. Our model is successful.

- 100% of our students make significant emotional, behavioral and academic improvements
- After 1 - 3 years, students successfully transition into mainstream school settings
- Our graduates complete high school and many attend college – all students embark on a pathway toward self-sufficiency and a world of greater choice, possibility, and community involvement