

FALL 2008

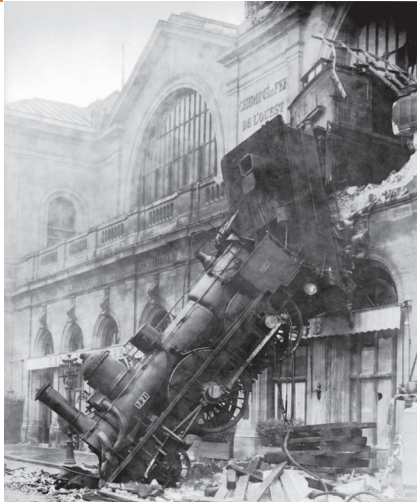
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Commercial Real Estate Planning
Tenant & Buyer Representation
Since 1981



NO BAILOUT FOR COMMERCIAL TENANTS... SO WHAT TO DO?

"in the event the Dow Jones industrial index should drop more than 700 points in one day or LIBOR rates rise above 5.22%..." (pick your crisis du jour) "...lease termination date shall be extended for a period of no less than 12 months, on the same terms and conditions as outlined in article 1.1 "Basic Lease Terms

Things could be worse...

Unfortunately lease terms and terminations tend to be blind to changing business conditions and deaf to the wishes of a business owner who in times of turmoil would prefer to defer real estate decisions to take care of other priorities and get a better feel for future business environment.

And we've never seen such a Dow or LIBOR clause...

however, the good news is....

Based on real estate market conditions, and clients' contingency planning it is possible to call for lease terminations or space contraction provisions. In one case we negotiated a rolling option to terminate the lease on either one or two (of five) floors with 18 months notice. There was a \$2.00/RSF/annum premium paid just on those two floors. This was, in effect, an insurance premium. When the tenant waived this option the lease rate dropped to the scheduled rate. Space planning with possible contraction in mind is also prudent. i.e. choosing or designing space that is easy to subdivide and sublease or assign. Your real estate plan should, to the extent possible, reflect the priorities of your strategic corporate plan. (see "The 5 Rules of Real Estate Planning" on page three)

HORATIO NELSON FOR PRESIDENT!

The incoming president of our United States faces local socio-economic and global challenges not experienced since the 1930s. British naval tradition fostered in its golden age of the late 18th century called for a warship's captain or fleet admiral to stand, on the most exposed part of the quarterdeck, motionless, in the thick of battle, engaged, but seemingly indifferent to the carnage around him. The attrition rate among such leaders was high and they took all the risks and most of the kudos for the success or failure of their enterprise.

One does not suggest that our next president literally emulate this tactic. (Note: the Viscount Nelson proved to be a rather ineffective politician). But it is worth noting that the morale on board, and efficiency of, navy vessels, and their resulting dominance of the oceans for almost two centuries was testimony to disciplined training, a clear method of communications between ships, and this unflappable, confidence-inspiring, demonstration of leadership. Flagships of the day also carried names which reflected this style. Audacious, Indomitable, Indefatigable. May our next Master and Commander embody some such characteristics! It is time that the US resume its position as the world's most admired country.

As always your comments are welcome.

Paul Suzman

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**Need help finding the right space or with real estate negotiations?
Call OfficeLease today at 206-624-0000 or e-mail info@officelease.com.**

“IT WAS 20 YEARS AGO TODAY”... SERGEANT PEPPER REFLECTS”



In 1988 over 4,000,000 space feet of office space came on line in Seattle's CBD office market including 1201 3rd Avenue, US Bank Center, Two Union Square, 2nd & Seneca, 1000 Second Ave etc., and the largest development in the city, Columbia Seafirst Center, was not yet fully leased. The total was roughly equivalent to **all** of the new unleased office space currently coming on line in downtown Seattle in 2008/9, **plus** all the space that might be freed up were WaMu and Safeco to vacate entirely, all of their local office space.

But 1988 was last century and there were few 'mega tenants' such as Microsoft (now also expanding on this side of the pond) and Amazon, UW Health Sciences, The Fred Hutch, Gates Foundation and its associated global health organizations. These were a fraction of their current size if they even existed. Not to mention Google & Co trolling local waters for new hires and other VC backed technology and biotech companies continuing to grow long term despite the current downturn.

A newly vibrant 24/7 residential downtown community is attracting knowledge workers, which makes downtown office space that much more attractive (high gas prices, environmental awareness and crowded freeways also spur this trend). And with low vacancy rates in Bellevue's CBD, cross-lake osmosis will draw users from areas of a higher occupancy to lower occupancy, as has happened in the past.

So over the next couple of years we will likely see double digit vacancy rates in Seattle and commercial property values fall but less than in most other markets. While we might not experience **sharply** declining lease rates, it seems more likely that developers of new buildings will strive, rather, to attract good credit tenants, by agreeing to more front end incentives such as lease assumptions, rent abatement and better tenant improvement packages. There will also be competitive deals to be had in sublease or re-leased spaces, but not quite the sort of bargains we saw in the late 80's....but, as then, the best deals will come to tenants best informed about the market.

CONSTRUCTION COSTS A MAJOR FACTOR IN OFFICE SPACE DECISIONS

It seems not all that long ago that a \$35.00/RSF TI allowance could buy you some pretty well appointed offices. Not these days unfortunately. Over the last few years overall construction costs have risen 8-10% per annum. We recently polled 5 construction and project management companies for their estimates of future escalation. And consensus indicates that 8%+ is the number we should budget for each of the next few years. Mechanical/metal costs showed the greatest inflation...up to 15% per annum and wood products were essentially flat.

How to minimize construction exposure:

1. Try to find space built out close to your specifications
2. Be flexible as to location: i.e. broaden search parameters
3. Hire a good architect and a seasoned contractor
4. Consider the tax implications of tenant-financed TIs depreciated over term of lease vs. landlord financed 39.5 years
5. Consider work stations vs. private offices (good quality stations may cost more than private offices initially but will pay for themselves if a growing company requires layout flexibility)

**“Finding space can be a complicated, time consuming, and potentially expensive foray into an unfamiliar world:
best managed by those who do it on a daily basis.” – Law Office Administrator.**

FIVE RULES OF REAL ESTATE PLANNING:

Time marches inexorably onwards and tenants sometimes do not realize that by delaying real estate decisions they limit the number of alternatives available (within their timeframe). And therefore the less negotiating leverage they will have, even if intending to extend a current lease. It is usually to the landlords' benefit if a tenant or prospective tenant have limited alternatives available or sufficient time to make a decision. And it is easy to underestimate the time it takes to find the right space, negotiate a lease and remodel. So:

Rule #1:

always budget sufficient time to explore alternatives

Rule #2:

**effective negotiations require at least 3 parties:
The tenant and landlords of at least
two alternative space solutions**

Rule #3

**the lower the vacancy rate the earlier
tenants should develop contingency plans**

Rule #4:

**negotiations always take longer and construction
inevitably costs more than originally anticipated.**

Rule #5:

see rule #1

Rules of thumb? We believe that if a tenant occupies 35,000RSF or more they really should initiate discussions about renegotiation/relocation strategy at least 4 years prior to lease expiration (these are the tenants which could be anchors for new developments and might achieve the most advantageous deals while developers are preleasing properties)

25,000RSF + tenants, should start considering a plan of action at least 3 years prior to expiration. Not to say that one cannot make a decision once you have weighed likely alternatives, to defer the process for a few months. But at least you are in control of your circumstances and are making informed decisions based on fact rather than by default

10,000RSF or smaller tenants (especially those willing to contemplate shorter (5 year or less) lease terms are often able to find competitive deals as 'infill' users in space that is slated for larger tenants' future expansion. Or in appropriately sized sublease space

3500RSF users will often find sublease spaces that are well below current market rates. There are many small space users that are stable long term organizations who look to long term tenancy.

Do remember that, depending on market conditions, a motivated landlord may agree to renegotiate lease terms ("blend and extend") well before lease expiration if it means that they will be assured of retaining a good tenant. And it never hurts to ask!

CAVEAT SUBLESSEE:

Be sure to check with your attorney when considering a sublease. Understand that should a sub-landlord default on the (master) lease a subtenant's rights of sub-tenancy might be at risk i.e. tenants have a 'right of quiet enjoyment' which protects their tenancy (or their sub-tenant): should the landlord sell the building. Should a sub-landlord default on the lease however, their sub-tenant's rights are at risk unless the subtenant has some sort of direct agreement with the landlord (or the lease has been assigned *).

Just as a landlord or sub-landlord will typically require a review of a subtenant's financials, so should a subtenant understand the financial condition of their prospective sub-landlord. In the last sublease we negotiated, we stipulated that rent payments would by-pass the sub-landlord and go directly to the landlord (to ensure that no such default would occur)

* (assignment means that the landlord has agreed to transfer all of the rights and obligations of a leasehold to a new entity and the former tenant is usually "off the hook". With a sublease the original tenant remains obligated to perform under the terms of the lease)

*OfficeLease
welcomes
Katy Heller.*



Her initial experience was as a paralegal and then as a building manager in Portland and Bellevue. Katy has also coordinated and managed large tenant improvement projects and understands the needs of commercial tenants. She is a great addition to the team which includes Paul Suzman, Larry Plughoeft, Rick Page, Fran Sullivan and emeritus Don MacLaren

VillageReach®

Going the last mile...

Imagine that you are a parent in rural Mozambique, walking for hours to reach your nearest health center.



In a country where thousands of children die of vaccine-preventable diseases, successful immunization is literally a life and death issue. The rural health system, however, is under-resourced. Stock-outs of essential medicines are rampant and often, a parent who has walked hours with their baby for a vaccine will be turned away for lack of medicine. You will not only lose an entire day of productive work time, you will eventually

lose your trust in the health system and with it, your best opportunity at protecting your children from disease.

Enter Seattle based VillageReach. Working with Mozambique's Ministry of Health, they strengthen the behind-the-scenes logistics that enable healthcare to happen. Its teams deliver vaccines and supplies to health centers each month, and spend time with each health worker to provide ongoing training. They also collect valuable data from each center, and then aggregate that data to provide a clear view of the system as a whole. This enables better decision-making. And most importantly, people regain their trust in the public health system.

The VillageReach model impacts 251 health centers, serving more than 5 million people in northern Mozambique. In just one province, the model increased vaccine coverage rates for children under one year old by 40%. The Mozambican Ministry of Health has requested that VillageReach expand its model nationwide, clear recognition of the success of this program.

In Mozambique, less than 10% of the country has access to electricity; most people use firewood or charcoal. Vaccines must be kept between 2 and 6 degrees Celsius; if they get too warm or too cold, they must

be discarded. In order to keep vaccines cold, the health system was using old, unreliable kerosene-powered fridges. This had to change but there were no other reliable sources of energy available.

So, in partnership with a Mozambican nonprofit organization, FDC, they started a propane distribution company, called VidaGas. It is now the largest propane distribution company in the northern part of the country. They supply propane to the health centers for vaccine fridges and lamps (used in nighttime medical emergencies), as well as to households, restaurants, hotels, schools, and small and large businesses. VidaGas has been internationally recognized as a successful social business, winning both the World Bank's Development Marketplace prize and the UNDP World Business Award.

The VillageReach team is laying the groundwork to bring elements of their model to Malawi, a neighboring country in Southern Africa. Paul Suzman, OfficeLease's President, is proud to be a founding board member.

For more information, visit www.villagereach.org. View a compelling seven-minute documentary film that illustrates the problem and what they're doing to help solve it.



A Client Comments:

"Over the past 10 years as the CEO of two different businesses while negotiating three different leases I have utilized the services of OfficeLease as my tenant representative.....The firm is able to attract dedicated talented professionals that are pleasure to work with and are reassuring to have working in your best interests. They are the best in the field. If you are an executive in the Greater Seattle area considering tenant representation and this written testimony is not sufficiently convincing you may contact me directly at 425 286 9200 ext 201"

Scot Cocanour, Promium LLC. Bothell