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Paul Suzman, Don MacLaren, Frances Sullivan, our newest team member, Rick Page, and Larry Pflughoeft in front of OfficeLease's home at 1301 5th Avenue.

THE TAO OF THE DEAL

Lessons from the Chinese tradition can help corporate executives secure the best real estate deals.

By Paul Suzman

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The art of negotiating deals and contracts is as old as business itself. Yet while such deals can be crucial to long-term business success, there are often many misperceptions in the strategic process that comprises negotiating.

This is certainly true when it comes to negotiating real estate leases, often a company's second highest expense after paying salaries. Because so much is riding on making the right deal for an office or facility, it's important for company executives to take the time to examine their practices and evaluate their negotiating posture. This can be done through contingency real estate planning.

Such planning provides an opportunity to question and perhaps challenge the norms and established ways of an industry. This process, if well executed, can be a catalyst for change if such is needed; or can lead to reaffirmation of a business plan that is working.

Industrialist Frank Tsao's, the author of "Lessons from the Chinese Tradition," offers a number of traits that we see as conducive to good corporate real estate planning:

- **Zhi**: The wisdom to take honest measure of one's own abilities and limits of one's knowledge and expertise. "Pay attention to what is unpleasant to the ear."
- **Ren**: The essence of which is patience and commitment. "Lack of patience will disrupt the best laid plans, and where both are resolutely applied even metal and rock can be broken."
- **Xin**: Credibility; which is priceless. "Prepare for adversity before the world is aware of its coming but wait to partake in prosperity only after the world has tasted prosperity."
- **Cheng**: Interpersonal responsibility, sincerity, personal integrity, and commitment. "Integrity demands that you don't harm others in order to benefit yourself."

EXPERTISE NEEDED

With these in mind, let us focus on some common assumptions about corporate real estate planning:

Assumption: "Our facilities manager will take care of it."

Reality: Most corporate facilities managers have full-time jobs within the company and the infrequent process of evaluating alternatives, negotiating a lease or purchase-and-sale, then coordinating a move will often result in overload. If their CEO assumes that this is part of their job description, many will not want to appear inept and will accept the responsibility. In reality they will usually need outside support from project managers and real estate brokers to get the job done in a timely and efficient manner.

Often those directing corporate facilities are not brought into strategic corporate planning at an early stage; which is unfortunate because facilities issues are often those that need the longest lead time to manage and are the least flexible.

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Assumption: "The landlord pays the brokerage commission. It won't cost us anything."

Reality: The developer amortizes or expenses them. So brokers, to justify their contributions, need to add value in excess of these costs...and, if they are competent and experienced, they will. But your broker needs to be quite transparent as to the amounts and source of potential commissions. In a soft market landlords are, quite reasonably, vying for the attention of the brokerage community with various incentives and bonuses. And commissions are often negotiable.

Be sure that negotiations on commissions are not at odds with your brokers' efforts to negotiate on your behalf. And understand who they really represent. Do they represent both your firm and the owners of buildings being considered? And if they are leasing agents and not purely tenant representatives, how is this reconciled?

NO BLUFFING

Assumption: "Tell the landlord we have several alternatives and we'll walk away from the deal if we don't get what we want.."

Reality: Do not bluff. Smart landlords know their markets well. Always have a real fallback alternative. And be willing and able to walk away to plan "B" if you do not get what you know to be reasonable. After thorough research of criteria and objectives, choose the best of the alternatives and tell the landlord. " It's yours to lose; here are the terms upon which you have a deal".

The lead US negotiator at the Strategic Arms Reduction Talks with the USSR summed it up simply: "Never lie; that way you don't have to remember what you said".

Assumption: "A letter of intent is just a 'comfort letter'; it does not bind us"

Reality: Do not enter lightly into a letter of intent. There are two reasons for this. Firstly, depending on the wording and contingencies it can be binding. It is a contract. Secondly, and more importantly, it is a declaration of your intent. It is your word. And should not therefore be employed unless you are willing to move forward if the terms are met.

Assumption: "Let's sublease; we'll get a great deal"

Reality: Quite possibly, but, there is a checklist of assurances you will want from the landlord to cover yourself if the sub-landlord defaults. You should always have a good real estate attorney review both master and sub-lease.

Assumption: "A lease document should cover every aspect of our deal"

Reality: If a tenancy is to stand the test of time it must be balanced. One can never cover every possible contingency so do not allow your attorneys to beat every point to death. Both parties, at some time or another, will rely on the others' reasonableness. However, know with whom you are dealing. The intent of the deal needs to be very clear in the content of the lease when read by a third party. Be explicit not implicit.

THE VALUE OF TENANT IMPROVEMENTS

Assumption: " The developer is offering a $35 a square-foot for tenant improvement allowance. This is generous. We should be able to build out all our offices for that."

Reality: You first have to ask the question: is it over 'cold' or 'warm' shell? A cold shell is bare concrete; space as you see it, nothing added. A warm shell will usually include a ceiling grid that is in place, tiles and light fittings on the floor ready for installations, heating and air conditioning and basic electrical distribution and core walls finished and ready for painting. This is usually an $11 to $13 a square-foot value. You add the tenant improvement allowance to this amount "below ceiling".

Assumption: "The lobby is impressive with all sorts of amenities; we probably will not pay for it directly."

Reality: It is a building common area, as are the corridors on a multi-tenant floor. And therefore adds to the 'load factor' or difference between useable and rentable space. Typically the larger the floor, especially if one occupies the whole floor, the lower the load factors. These can range from as little as 6 percent to more than 20 percent.

Assumption: "It's a soft real estate market. Finding space will be a no-brainer."

Reality: Even in a 'soft' market there will be relatively few spaces that really fit your corporate needs. And it takes time and planning to identify the needs and those spaces that fit. Hiring an architect to produce a space program can be a very useful way to measure one space against another. The program is essentially a graphic illustration of one's operational plan.

Assumption: "Our lease expires over two years from now; we should wait until next year to initiate discussions"

Reality: While we do believe that the current market will remain very favorable for tenants, landlords will work hard to pre-lease space they know will be vacated at a certain time in the future. Empty space is something a thoughtful landlord will work hard to avoid. We are currently negotiating leases, which commence as far out as 2007! Do not assume anything.

PRUDENCE IS KEY

Mr. Tsao offers some meaningful final advice:

Shen: Prudence, critical thinking, realistic planning. "Examine thoroughly, think critically, analyze logically, and execute prudently with perseverance."

Good corporate real estate planning in a nutshell!

Paul Suzman is founder of OfficeLease which has, since 1981, exclusively represented tenants and buyers of corporate real estate in the Puget Sound market.

LEASE VS. OWN

IS THE TIME RIGHT FOR OFFICE CONDOS?

By Don MacLaren

Can space users better control occupancy costs by buying a building or a condominium with a fixed rate mortgage? It may seem like a simple discounted cash flow analysis of the two alternatives over the next 10-15 years. But it isn't that straight forward.

Take today's high vacancy rate market where rents are depressed to the bottom of this real estate cycle, yet buildings are selling for near top dollar anticipating the normal cyclic recovery in rents. Given that situation, your best strategy may be to negotiate a 15 to 20 year lease with a fixed rent schedule based on annual CPI increase with a maximum of say 2.5%/year. The landlord may be delighted to know he has a sure, long-term tenant at a return he can live with and that puts a reasonable value on his building when he decides to sell.

But timing in the real estate cycle is only one of many issues that need to be considered. The most fundamental questions involve location, your size and growth. Is there a building for sale in the "right" location that meets your present needs, yet provides for your projected growth? And are you willing to be a landlord for the expansion space until you need it? Or is there a piece of property for sale in a "right" location on which you could contract for a build-to-suit? Etc, etc.

A solution for smaller businesses is beginning to emerge. The business condominium. These are starting to appear in California's Bay Area and to some extent here in our area. Many building owners who have been having trouble leasing their property in the present depressed market are converting the space to condominiums to sell to small businesses. And the Wall Street Journal recently reported that a few developers, like the Venture Corporation in Silicon Valley, are looking for sites in Las Vegas, Reno, Phoenix, California's Orange and San Diego counties and here in the Seattle area.

Many large corporations are trying to free up capital by selling off their real estate. But small businesses who often lack the leverage to negotiate a really good lease deal are looking to own and control their own space and at the same time, profit from investing in real estate. Also spurring small businesses are low interest rates and more than $4 billion available in below market, fixed rate real estate loans from the U.S. Small Business Administration that require only 10% down. There are also tax deductions for depreciation, mortgage interest and maintenance.

While the Wall Street Journal reported that most small business owners in Silicon Valley pay about the same, or less in monthly mortgage payments than they would in NNN rent for same amount of space, this does not appear to be true in this area. The few condos that are listed sell for about $250/RSF. At an 8 CAP rate, this is $20/RSF/yr NNN, which is high in today's suburban market, but less than at the market's peak a few years ago.

And while there is a ready market for residential condominiums, many would-be office condo buyers should well question overall local market acceptance of the concept when contemplating future resale. When deciding whether to lease or purchase, an assumption of future sales value is an important component in ones calculations.

Will office condos become commonplace in the Puget Sound? Time will tell.

YOU'RE THINKING OF MOVING OUT OF YOUR GARAGE?

By Frances Sullivan

...here are some of the things you need to consider first.

Assuming a 10 person office (2,000RSF in a downtown Class A mid-rise)

Monthly Operating Costs for Basic Office

(does not include salaries, taxes, dues, subscriptions, client lunches, etc.)

Rent	3,700.00
Health Insurance	2,700.00
Office Supplies	250.00
Postage	60.00
Basic Phone Service	563.00
DSL	350.00
Bottled Water	45.00
Parking (1 person)	260.00
Messenger	30.00
Liability Insurance	42.00
	$8,000.00/Month

To equip and furnish your new office using 'middle of the road' but new equipment you should realistically budget >$59,000 for the moving costs and set up. This includes a phone system, corporate identity and stationery, copier, fax machine, postage meter, furniture, computers, supplies, etc.

So...if you have $160,000 to invest; you are ready for your first full year of operations...assuming you have figured how to pay yourself and everyone else a salary.

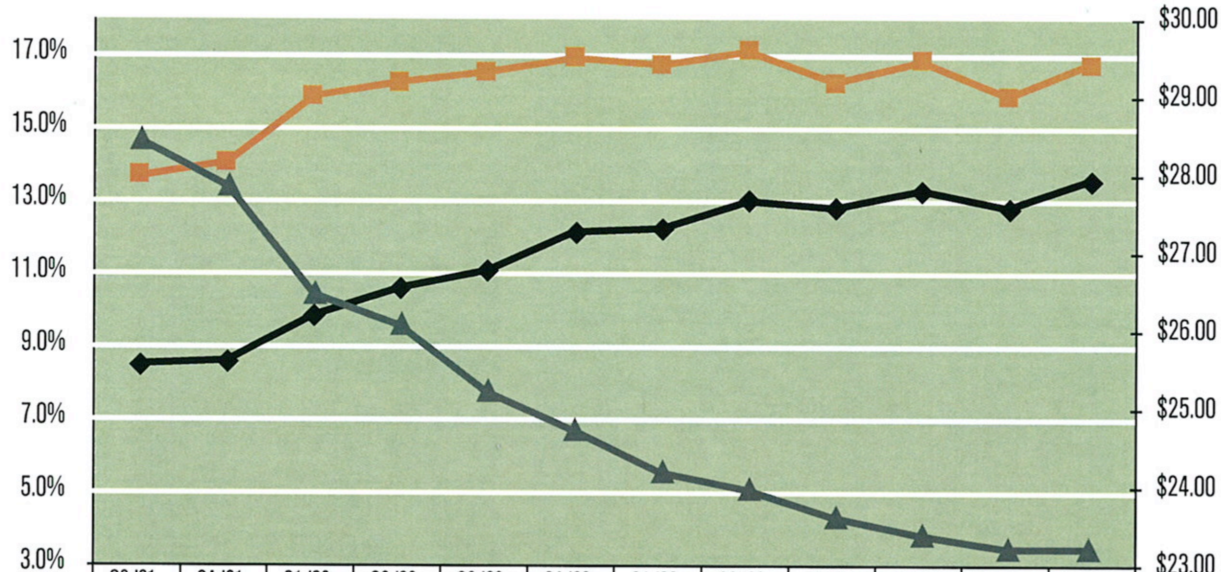
Sometimes that old garage looks pretty good as an alternative!

If you would like a breakdown of costs please email me at frans@officelease.com

HAVE RENTAL RATES HIT BOTTOM?

Asking office rental rates held steady at $23.23 per square foot fully serviced. This is the first quarter that rates have not dropped since their high of $29.89 in the first quarter of 2001. However, vacancy rates increased over half a percent. More deals are getting done as tenants see that rental rates are not likely to fall much and will likely bounce along the bottom as vacancy rates bounce along the top. The most positive news has been coming from the Eastside with the most deals and the most talk about new or revamping of previous projects.

HISTORICAL VACANCY AND RENTAL RATES



	Q3 '01	Q4 '01	Q1 '02	Q2 '02	Q3 '02	Q4 '02	Q1 '03	Q2 '03	Q3 '03	Q4 '03	Q1 '04	Q2 '04
Vacancy (w/Sublease)	13.7%	14.0%	15.8%	16.2%	16.5%	16.9%	16.7%	17.1%	16.2%	16.8%	15.9%	16.6%
Vacancy	8.5%	8.6%	9.9%	10.6%	11.1%	12.1%	12.2%	13.0%	12.8%	13.3%	12.9%	13.6%
Asking Rental Rate	$28.43	$27.86	$26.45	$26.09	$25.21	$24.75	$24.22	$23.98	$23.65	$23.42	$23.23	$23.23

Space available for sublease held steady at 2.8 million square feet accounting for 18% of vacant space. Direct vacancy rates and vacancy including sublease space improved on the Eastside and Tacoma but slid back slightly in Downtown and the Northend. The Southend faired the worst with significant increases in vacancy in Federal Way, Renton and Tukwila. The number of buildings under construction increased from seven to eight and forty-eight projects, totaling over eleven million square feet, are still in the pipeline.

MARKET OVERVIEW

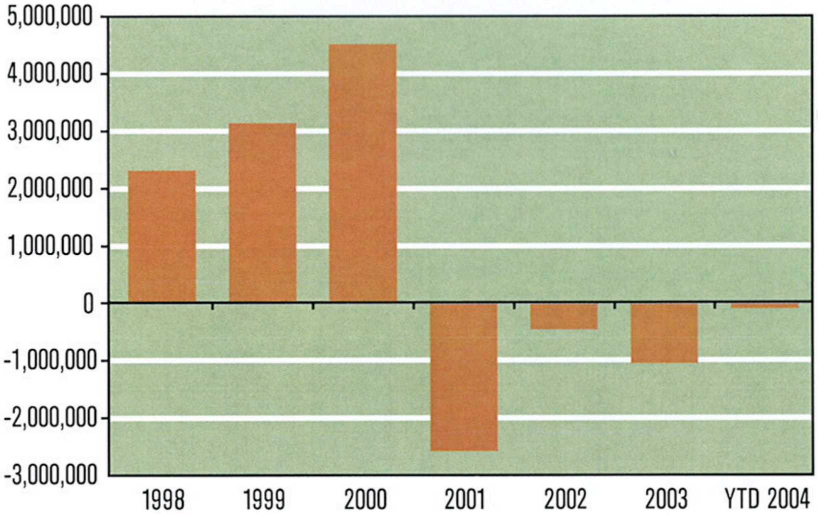
			AVAILABLE SPACE			VACANCY RATES		UNDER CONSTRUCTION		PROPOSED	
Market Area	Bldgs.	Total Sq. Ft.	Direct Vacant	Sublease	Total Vacant	Direct Vacant	w/Sublease	Bldgs	Sq. Ft.	Bldgs	Sq. Ft
Downtown	475	42,345,629	5,063,159	1,449,135	6,512,294	12.0%	15.4%	6	632,781	20	5,306,982
Eastside	645	26,940,425	3,373,876	1,106,717	4,480,593	12.5%	16.6%	2	903,000	16	3,011,558
Northend	168	6,151,158	895,774	66,412	962,186	14.6%	15.6%	0	-	6	1,089,482
Southend	279	12,138,331	2,633,738	155,441	2,789,179	21.7%	23.0%	0	-	5	1,895,000
Tacoma	124	4,448,748	509,328	23,406	532,734	11.4%	12.0%	0	-	1	120,000
TOTAL	1,691	92,024,291	12,475,875	2,801,111	15,276,986	13.6%	16.6%	8	1,535,781	48	11,423,022

AVERAGE ASKING RENTAL RATES

	Gross Rental Rate			
Market Area	Class A+	Class A	Class B	Class C
Downtown	$33.72	$27.16	$19.99	$17.89
Eastside	$24.33	$22.88	$19.73	$18.64
Northend		$21.75	$18.50	$16.29
Southend		$21.18	$17.90	$14.66
Tacoma		$20.46	$15.25	$13.48

Absorption was negative for the second quarter and wiped out the positive absorption from the first quarter for year-to-date absorption of negative 55,439 square feet. Looking closer at what makes up the overall number reveals that the Southend is the only market with year-to-date negative absorption primarily due to 309,048 square feet of negative absorption in the Renton/Tukwila submarket, resulting in negative absorption of 372,309 for the Southend and dragging the total for all of the markets into the red. The strongest submarket was the Bellevue CBD with 234,222 square feet absorbed resulting in a total of 135,625 feet absorbed in the Eastside market. Tacoma, Downtown and the Northend followed with 78,758, 63,526 and 38,961 square feet respectively.

ABSORPTION
SQUARE FEET



The best news is clearly in employment. Employment grew 3.0% in the first five months of the year and the unemployment rate dropped to 6.1%. Finally, the increasing unemployment rate trend, which started in 1998 at 3.4%, has been reversed. Increasing employment will increase the demand for space; however, distribution space will see improvement sooner than office space. The table below shows the employment statistics for the combination of the Seattle/Bellevue/Everett and Tacoma PMSA's provided by the U.S. Department of Labor's Bureau of Labor Statistics.

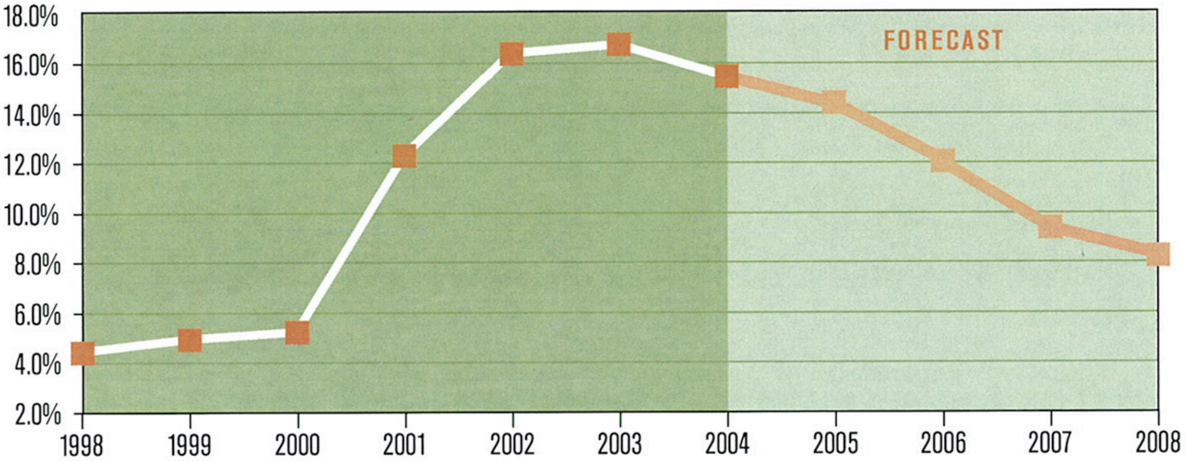
EMPLOYMENT

	Labor Force	Growth	Employment	Growth	Unemployment
2004*	1,781,367	1.8%	1,671,851	3.0%	6.1%
2003	1,749,225	0.1%	1,623,083	-0.2%	7.2%
2002	1,747,142	2.2%	1,625,860	0.5%	6.9%
2001	1,710,055	-1.1%	1,617,803	-2.5%	5.4%
2000	1,729,468	-1.2%	1,659,810	-1.6%	4.0%

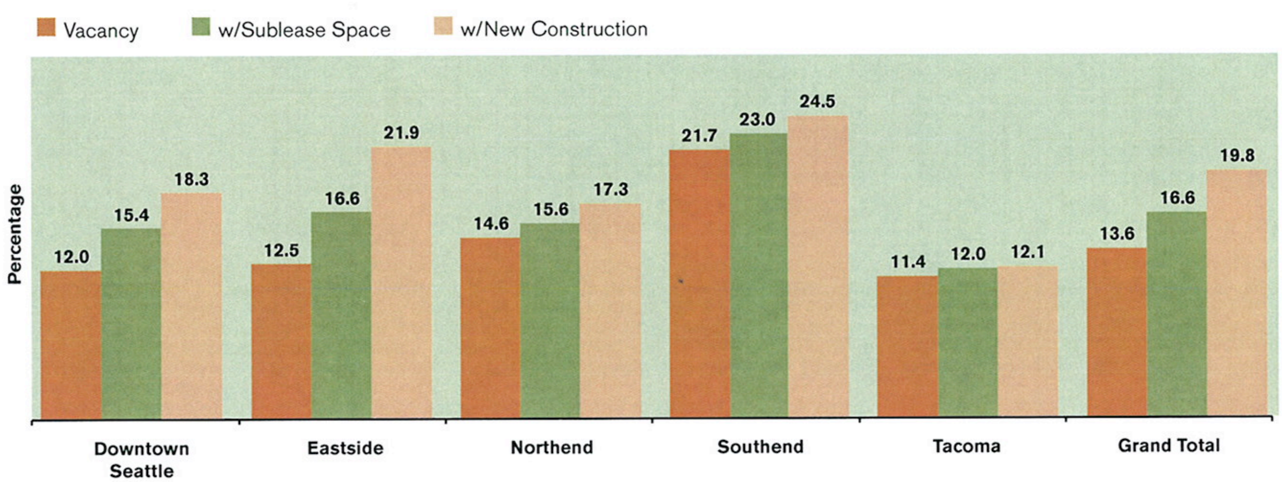
*Through May 2004

Office vacancy, including space available for sublease is projected to decline to nearly 8% over the next five years. This projection assumes employment growth of 3.0% in 2004, 2.5% in 2005, 3.5% in 2006 and 2007 and 2.5% in 2008. This projection also assumes that 750,000 square feet is returned to the market this year and 1,000,000 square feet is returned to the market in 2006 as companies move into newly constructed headquarters or relocate out of Seattle. The single largest change will be Washington Mutual's move into their new 1.1 million square foot office tower in 2006.

VACANCY FORECAST
INCLUDING SUBLEASE

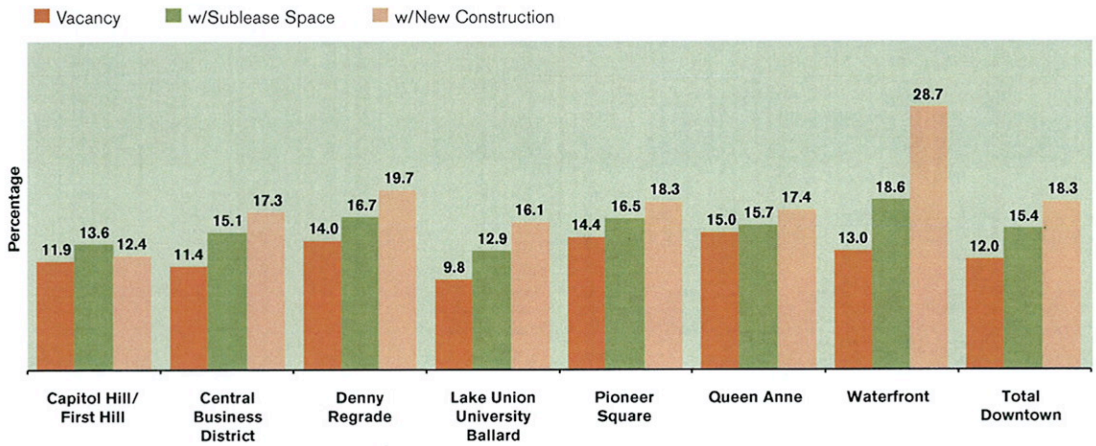


PUGET SOUND OFFICE

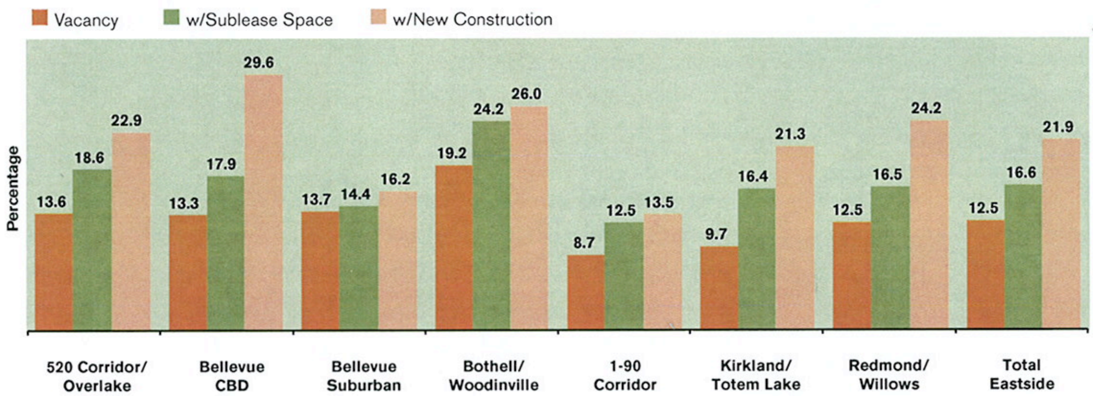


The Tacoma office market was the most improved for the second quarter in a row continuing a steady improvement trend started in the second quarter of 2003. During that time the vacancy rate declined from 14.9% to 11.4%, vacancy including sublease declined from 15.7% to 12.0% and vacancy including new construction declined from 16.3% to 12.1%. During the second quarter, the Eastside market improved 0.2%, 0.2% and 1.0% for vacancy, vacancy including sublease and vacancy including new construction, respectively. The Southend market, led by Federal Way and Renton/Tukwila submarkets had vacancy increases of 3.3%, 3.3%, and 2.1% respectively. The Downtown and Northend markets both had slight increases in vacancy. The new construction rates are really availability rates as they include all available space, including space that is marketed now as available in the future, which may currently be occupied.

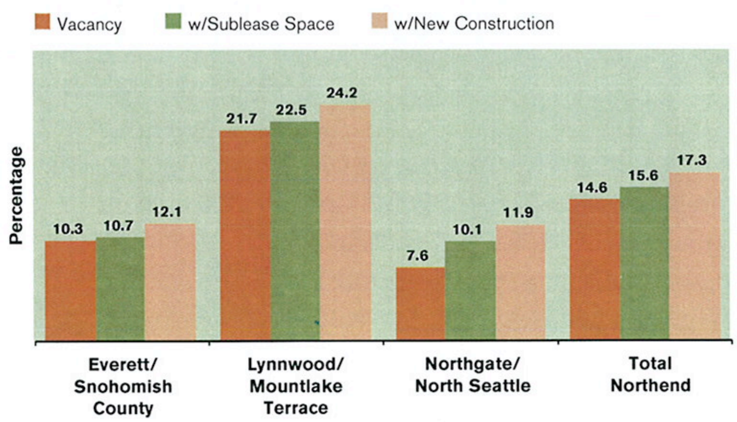
DOWNTOWN SEATTLE



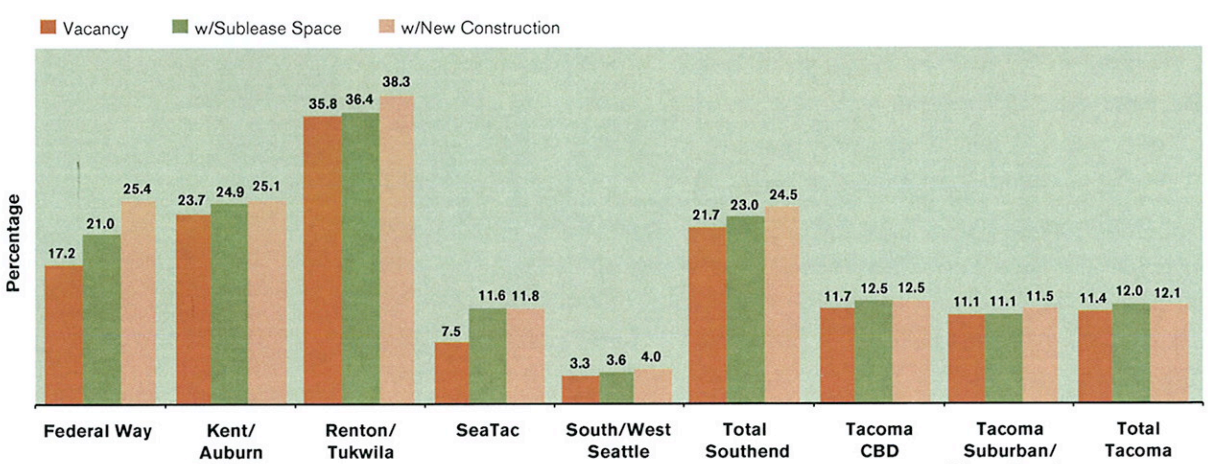
EASTSIDE



NORTHEND

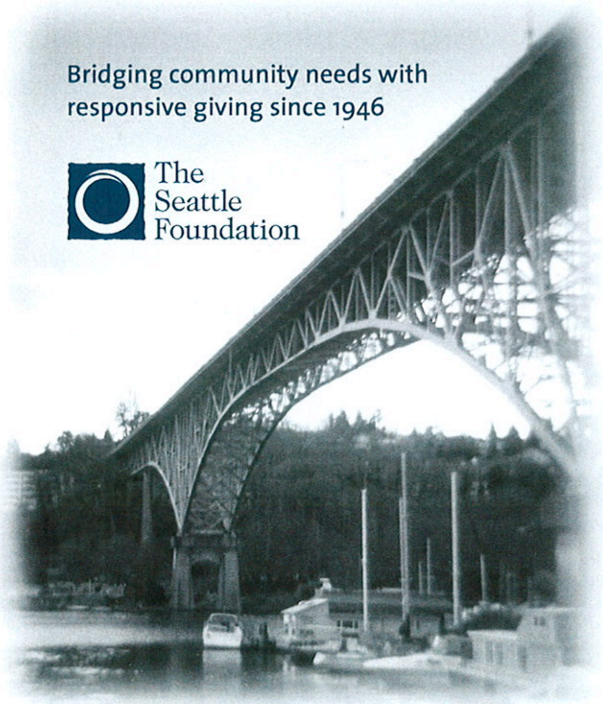


SOUTHEND AND TACOMA



The Seattle Foundation

www.seattlefoundation.org



OfficeLease is proud to have assisted this outstanding organization with real estate planning and lease negotiation. If you are interested in learning more about The Seattle Foundation, please contact Molly Stearns, Senior Vice President, at (206) 515-2103 or visit www.seattlefoundation.org.

The Seattle Foundation, the oldest and largest community foundation in Washington, was founded to support individual and family giving and improve the quality of life in our community. We manage over 1,300 individual philanthropic funds totaling more than $350 million and, together with our donors, make over $33 million in grants annually to thousands of diverse nonprofits locally, nationally and internationally. We help make giving easy through an array of services and resources for donors. We take on the paperwork, offer years of professional experience evaluating nonprofits and help implement the giving mechanism that provides the maximum benefit for a donor.

A fund at The Seattle Foundation works much like a private foundation but without the administrative burden and often offering better tax benefits. Funds are established through a tax-deductible contribution that is invested to optimize current income and achieve long-term capital appreciation while ensuring preservation of principal. Donors can then make grants over time and according to their interests with as much or little support as they want from our professional staff. With 10.5% annualized return over the past ten years, people who establish a fund at the Foundation find they have more resources to give, can time their tax benefits and can create a lasting legacy in their name that continues beyond their lifetime.

Having outgrown its current space in the Washington Federal Building at 5th and Pike, The Seattle Foundation will be relocating to a new office space in downtown Seattle this fall. *"In addition to being a wonderful landlord, the Washington Federal building has been our home for the last 18 years," says Jeff Rudd, CFO at The Seattle Foundation. "The decision to move was a difficult one, and OfficeLease helped us to evaluate all the options and to find the solution that will cost effectively contain The Seattle Foundation's growth over the next 15 years on a single floor. We are thrilled with the services provided, and I was especially impressed with the fact that throughout the entire process, OfficeLease remained committed to our needs as The Community Foundation serving King County. They really care about The Seattle Foundation, and the work that we do, and this distinguishes them."*