

OfficeLease

OfficeIntelligencer

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Commercial Real Estate Planning

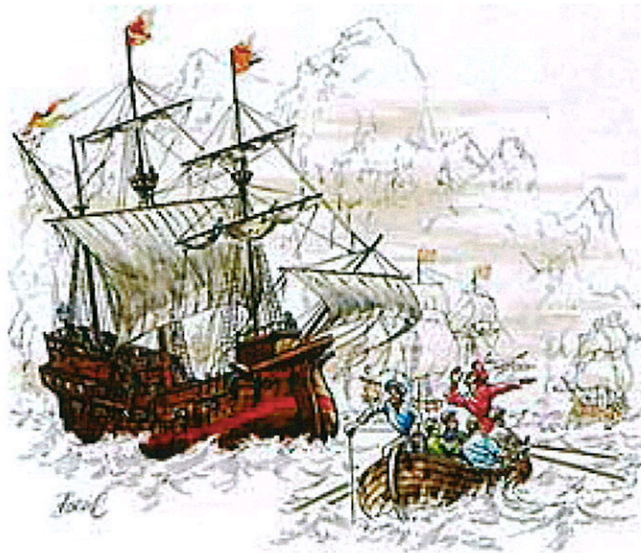
Tenant & Buyer Representation

Since 1981



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

"WORTH ITS WEIGHT IN CLOVES..."



*"Aboy Captain General! Landlord's escalation clause to larboard Sir, and your right of 'quiet enjoyment' in question!!!" **

By Paul Suzman

In 1519, on behalf of King Charles of Spain, Ferdinand Magellan of Portugal, set out with five ships across the Atlantic to discover a new route to the Spice Islands. (The lesson; you better recognize talent in your corporation before a competitor hires them away!)

He was convinced that the shape of the Earth allowed circumnavigation and that you would not, as was popularly understood in those days, simply fall off the edge if you sailed too far.

An alternate fate for anyone attempting anything this rash was consumption by irritable, territorial sea-monsters or to have every piece of iron on board ship be drawn inexorably toward magnetic rocks; the crew going along for the ride. He had Ptolemy (the Greco-Egyptian astronomer) to thank for much of his information about these dubious roadside attractions, and for very creative maps, which completely discounted the existence of the Pacific Ocean and most of the Americas.

As far as Magellan was concerned, once you got around the tip of South America, if you could and wherever that was, you would be a stone's throw from the much vaunted East Indies and their exotic, hugely profitable spices.

He had to put down a mutiny off the coast of Patagonia (not all that surprising given the rations and living conditions) and had strangled, drawn and quartered the ringleader as a disincentive to any other would-be mutineers. Finally, after fighting the towering swells of the roaring forties and feeling his way through the Straights (now known as Magellan), he discovered..... several thousand miles more uncharted ocean which was not supposed to exist. Luckily, he also discovered the Trade Winds.

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Eventually, after some bothersome personal setbacks such as being hacked to death in April 1521 on the island of Cebu (The Cebuans for some reason were happy with their status quo and a little resistant to being subjects of Spain and subject to a then rather humorless Church) Magellan was finally vindicated; albeit posthumously as his remaining ship Victoria, and her decimated, scurvy ridden crew, limped back to Seville via the Cape of Good Hope with 381 bags of cloves; enough for the whole expedition to be profitable for its backers! The loss of lives, ships and teeth was regarded merely as the cost of doing business!

It has been many years since I studied Magellan's voyage and what I have recounted above is a crass synopsis of an excellent, recent book by Laurence Bergreen entitled "Over the Edge of the World".

So, you may well ask, what does Magellan's adventures have to do with real estate negotiations?

For a start, we are enthusiastic about both. And while the risks and downside are hardly comparable, we cannot help but reflect that real estate buyers and lessees sometimes launch themselves into the voyage of an acquisition process with poor charts, inadequate preparation and equipment and sometimes,

potentially mutinous team members.

And while they might ultimately, successfully navigate their way through the shoals to reach their goal of a lease signed or a property acquired, the cost in terms of time and energy invested and money spent is often much higher than anticipated.

There is no avoiding the rigor involved with the process of identifying, ranking and negotiating on business space. But with qualified real estate advisors on board, you will have a clear understanding of the time involved and the associated expenses, resources and disciplines required; and the likely outcome that might be expected.

Just imagine if Magellan had had access to a pilot who had visited the Spice Islands many times, was equipped with current charts, had access to The Weather Channel, radar, a depth finder and GPS, and who knew that just a teaspoon of lemon juice a day would have prevented scurvy.....

As always we value your comments and questions.

Paul Suzman

Pauls@officelease.com

**Note: Original painting of Victoria by Basil Smith available at artworkoriginals.com*

SO YOU REALLY WANT TO BUY A BUILDING?

By Larry Pflughoeft

ALLOW PLENTY OF TIME THEN ADD 20%.

Whether the building is to house your own company, or you're buying as an investor, always plan for the process to take longer than you expect. It can easily take nine to twelve months from starting the search to closing the purchase.

BE FLEXIBLE AND PLAN FOR GROWTH.

As in residential real estate, your being open to a variety of sizes, features, ages and locations will result in more alternatives from which to choose. If buying for your company's use, make sure that the building or site will accommodate the growth expected during the next five years or more.

UNDERSTAND LOCAL ZONING ORDINANCES.

Do not be surprised by a restrictive overlay or code issue. If a Conditional Use Permit or SEPA is required, leave sufficient time for the process.

KEEP FUTURE UTILITY IN MIND.

A property that is too unique, in a poor location or lacking up-to-date features (such as sufficient clear height in the case of an industrial building) expected by the majority of occupants will be more difficult to resell or lease out. What may seem like a bargain initially can be more costly in the long run. Conversely, a newer building that is more expensive, with utility for more users, will generally keep its value longer and is more likely to appreciate.

CRITICAL WORK STARTS AFTER THE PURCHASE AGREEMENT IS EXECUTED.

Allow at least ninety days for due diligence and to obtain financing. Intensive analysis of all aspects of the property will be done. Expect the fees for attorneys and any needed outside consultants such as a Project Manager to run into the thousands of dollars each month, regardless of how much of the work will be done by your broker. A Phase 1 environmental assessment is essential and is usually required by the lender. The title company generally requires a current ALTA survey.

RETAIN AN EXPERIENCED REAL ESTATE ATTORNEY.

Beginning with preparation of the purchase agreement, it's essential to have an attorney on board that specializes in real estate. Issues discovered during the due diligence period often require their assistance in addition to the preparation and review of closing documents.

If you have questions about the process, please contact **Larry Pflughoeft: larryp@officelease.com**.

BLINDSIDED BY RISING TENANT IMPROVEMENT COSTS?

By Rick Page

Tenants are often surprised by how much tenant improvements (TIs) cost. Understanding the extent of these costs early in the process can help avoid unnecessary surprises later.

First some basics: TI allowances should always be quoted on rentable square feet (rsf) not useable square feet (usf); the differential is known as the load factor and depending on the building and floor plate this can range from 6-22%!

You also need to understand if the TI is being provided from the base of a 'cold' or a 'warm' shell (also known as 'under ceiling'). The cost of providing limited HVAC distribution, basic lighting and ceiling tiles including the grid is in the \$12.00/rsf range. So it's important to understand the base condition of the space for which a TI allowance is quoted.

Anyone visiting China recently comments on the torrid pace of construction. The rise in new and recycled steel prices worldwide is a direct reflection of this growth. And, as many new office buildings and most of the internal drywall framing systems are now steel, this, plus ever increasing labor costs, has a dramatic impact on the overall cost of TIs. A crude illustration of how costs have crept up lies in our rules of

thumb. Three years ago we would expect a typical law firm build-out to cost \$40-\$50/rsf (although those who chose expensive custom finishes would be considerably more). Today, that number is a good 25% higher.

Tenant improvement allowances are market driven. In a 'soft' market (such as in Seattle today) the more aggressive the TI allowances will be. Sometimes, for a tenant with solid credit, the landlord is willing to finance the costs and amortize them over the term of the lease. But, can the tenant finance these less expensively?

So what TI allowance should suffice? Preconstruction services provided by your architect, HVAC contractor and a construction firm will help you realistically plan and budget. Unless an existing space configuration really works for your company and you can occupy the space with minor changes (new paint and carpeting alone will cost approximately \$7.50/rsf) it is often easier to demolish space and start from scratch.

No one likes to scale back their plans at the eleventh hour. If you have realistic expectations up front, disappointment can be avoided. For more information about this and other corporate real estate related subjects please contact **Rick Page:** rickp@officelease.com.

CAP RATES ARE WHAT? (PART I)

Just what is the "Cap Rate" that you keep hearing about when evaluating the purchase of a piece of property? The term is an abbreviation for "capitalization rate" and provides a simplistic method for determining the percent return on an investment and is often referred to as an "X% Cap". The Cap Rate represents the relationship between the price of the property and its triple net rental income stream. Said another way the percent return an un-financed property would earn in that year (or for an owner occupant, the fair market rent they should 'charge' themselves). For example, if the net operating income before debt service, frequently referred to as triple net (NNN) rent, is \$200,000 per year and the Cap Rate for similar properties is 8%, then the price of the property should be \$2,500,000 (\$200,000/.08). It simply provides a quick way to compare the value of different properties.

Sounds easy enough, but what is net operating income, really? When considering the value of a property for a sale or purchase, the net operating income must represent the sustainable yearly income. It has to allow for vacancies and some percentage of associated costs (frequently reducing income to about 97%). If a representative NNN market rental rate is \$15/RSF/year, the "sustainable yearly income" should also be reduced by the average expected occupancy rate. Occupancy rates for high rise, multi-tenant buildings are usually assumed to be 95%. However, for smaller properties

with just a few tenants, a single vacancy could reduce the occupancy rate to 75-80%. Thus, the adjusted NNN rent would be about \$13.82 (\$15x.95x.97) for a high rise, but only \$11.64 for a small building (\$15x.80x.97).

And the Cap Rate itself? In the Puget Sound market today, 8% Cap keeps coming up as a "good" number for commercial space, but the "real figure" is impacted by both supply and demand and is reflective of the quality of the buildings and creditworthiness of its tenants; and the currently low mortgage rates. Cash flush institutional investors are willing to pay what would appear to be notably high prices (low Cap Rates) for "trophy properties" occupied by credit tenants, such as Seattle's IDX Tower which recently sold at an estimated 6.5% Cap! (indicative of the buyer's bullish long term outlook). Does an investor look at cap rates differently than does an owner-user? (such as an industrial company which OfficeLease recently represented in the purchase of a 4 year old building at an estimated 7.6% Cap) And how do Cap rates relate to IRR?

We'll discuss these questions in the next OfficeIntelligencer.

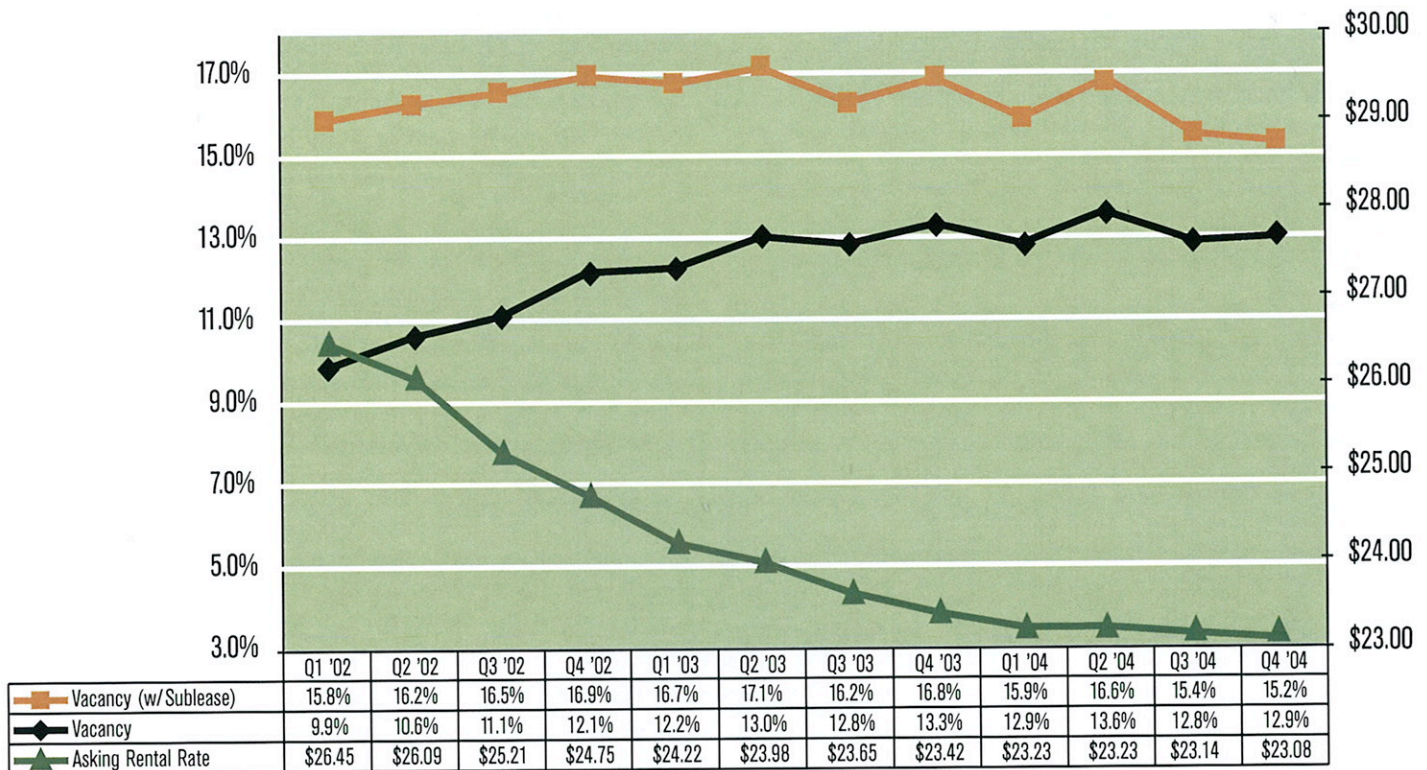
If you have any questions please contact **Don MacLaren:** Donm@officelease.com

(Part II of this article will be continued in the next OfficeIntelligencer)

NOT MUCH BETTER BUT NOT WORSE EITHER...

Employment is getting better but it hasn't flowed through to the office market, yet. Asking office rental rates dropped slightly to \$23.08 per square foot fully serviced extending the downward trend to four full years. Vacancy rates showed mixed results with vacancy increasing slightly to 12.9% and vacancy including sublease space decreasing slightly to 15.2%. Vacancy and vacancy including sublease in the Eastside, Southend and Tacoma markets improved, however, Downtown and Northend markets saw rates increase.

HISTORICAL VACANCY AND RENTAL RATES



Office space available for sublease decreased slightly to just over 2.2 million square feet, now accounting for 15.5% of vacant space. Nearly three million square feet of space is under construction almost evenly split between Downtown Seattle and Bellevue's Central Business District. Almost 12 million feet of additional space is being planned or considered.

MARKET OVERVIEW

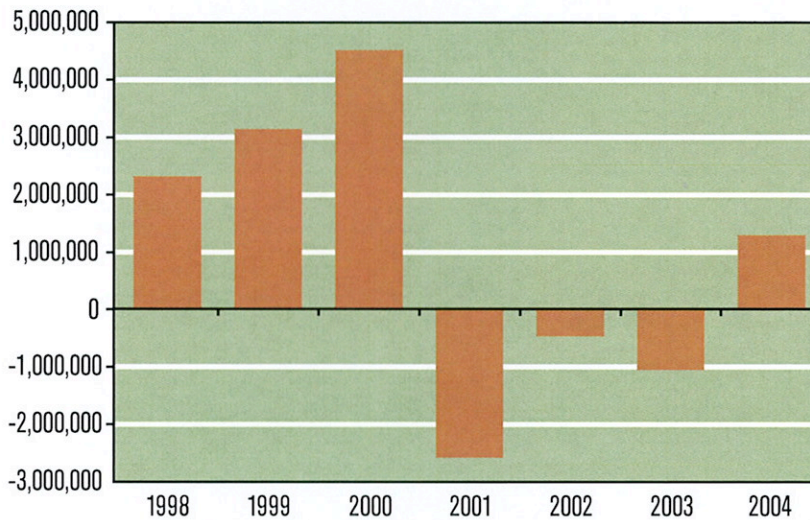
Market Area	Bldgs.	Total Sq. Ft.	AVAILABLE SPACE		Total Vacant	VACANCY RATES		UNDER CONSTRUCTION		PROPOSED	
			Direct Vacant	Sublease		Direct Vacant	w/Sublease	Bldgs	Sq. Ft.	Bldgs	Sq. Ft
Downtown	487	43,152,925	5,291,408	1,243,722	6,535,130	12.3%	15.1%	4	1,314,713	22	5,615,449
Eastside	647	27,300,743	2,802,383	714,631	3,517,014	10.3%	12.9%	5	1,329,498	13	2,051,693
Northend	171	6,187,226	820,324	87,980	908,304	13.3%	14.7%	2	102,848	7	1,788,962
Southend	290	12,237,255	2,645,426	145,947	2,791,373	21.6%	22.8%	0	-	7	1,956,166
Tacoma	130	4,729,500	495,095	26,629	521,724	10.5%	11.0%	2	74,400	1	559,800
TOTAL	1,725	93,607,649	12,054,636	2,218,909	14,273,545	12.9%	15.2%	13	2,821,459	50	11,972,070

AVERAGE ASKING RENTAL RATES

Market Area	Gross Rental Rate			
	Class A+	Class A	Class B	Class C
Downtown	\$32.32	\$26.69	\$19.69	\$17.82
Eastside	\$26.76	\$23.03	\$19.86	\$18.79
Northend		\$21.72	\$18.64	\$16.79
Southend		\$20.94	\$17.66	\$16.36
Tacoma		\$20.61	\$15.40	\$11.70

Office rental rates increased again on the Eastside, with the average A+ rate increasing \$.33 to \$26.76 per square foot fully serviced. This rate has increased \$2.43 per square foot over the last two quarters. The other classes of space on the Eastside have also increased albeit at a much more sedate rate. Rental rates in Tacoma have inched up. Downtown Seattle saw rates fall further and the Southend and Northend rates were mixed. Absorption was positive in every market except for the Southend, which experienced negative absorption of 374,503 square feet. Year to date the Eastside absorbed the most space, 1,101,765 square feet, followed by Downtown Seattle at 408,343 and the Northend and Tacoma with 53,726 and 84,668 square feet respectively. Total net absorption for the year was 1,273,999 square feet.

ABSORPTION SQUARE FEET



The best news continues to be in employment. Employment grew 3.5% in the first ten months of the year and the average unemployment rate dropped to 5.9%. Even more encouraging is that the unemployment rate for September and October dropped to 5.1% and 5.2% respectively, a full percentage point improvement over the first six months of the year. 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.

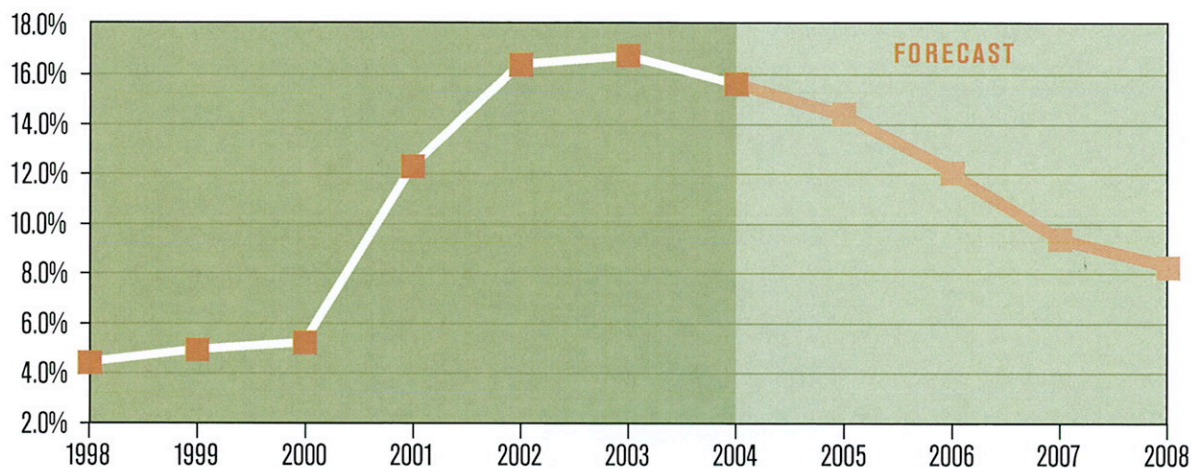
EMPLOYMENT

	Labor Force	Growth	Employment	Growth	Unemployed	Unemp. Rate
2004*	1,784,486	2.0%	1,679,667	3.5%	104,819	5.9%
2003	1,749,225	0.1%	1,623,083	-0.2%	126,142	7.2%
2002	1,747,142	2.2%	1,625,860	0.5%	121,282	6.9%
2001	1,710,055	-1.1%	1,617,803	-2.5%	92,252	5.4%
2000	1,729,468	-1.2%	1,659,810	-1.6%	69,658	4.0%
1999	1,750,029		1,686,815		63,214	3.6%

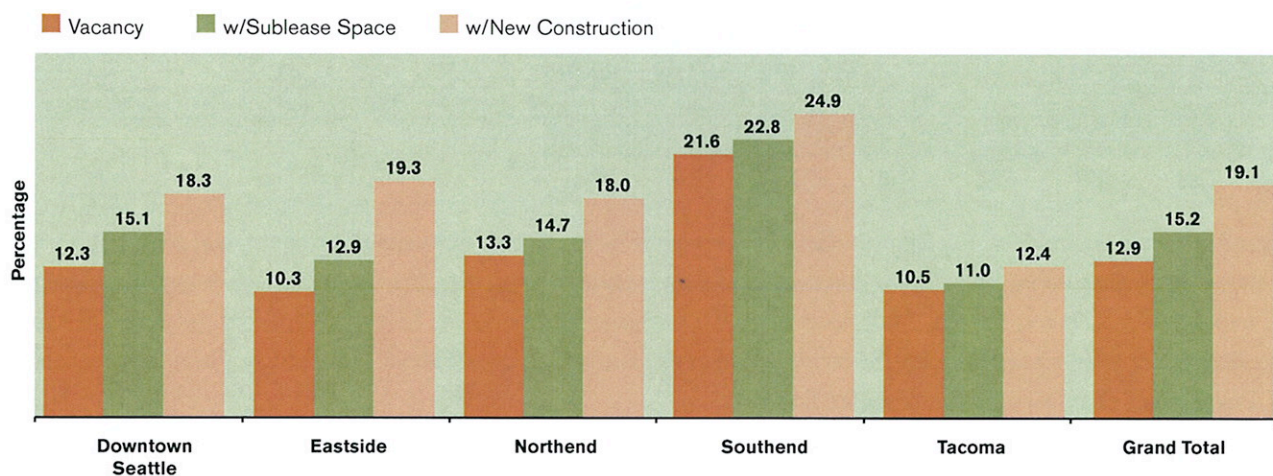
*Through October 2004

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 office tower in 2006.

VACANCY FORECAST INCLUDING SUBLEASE

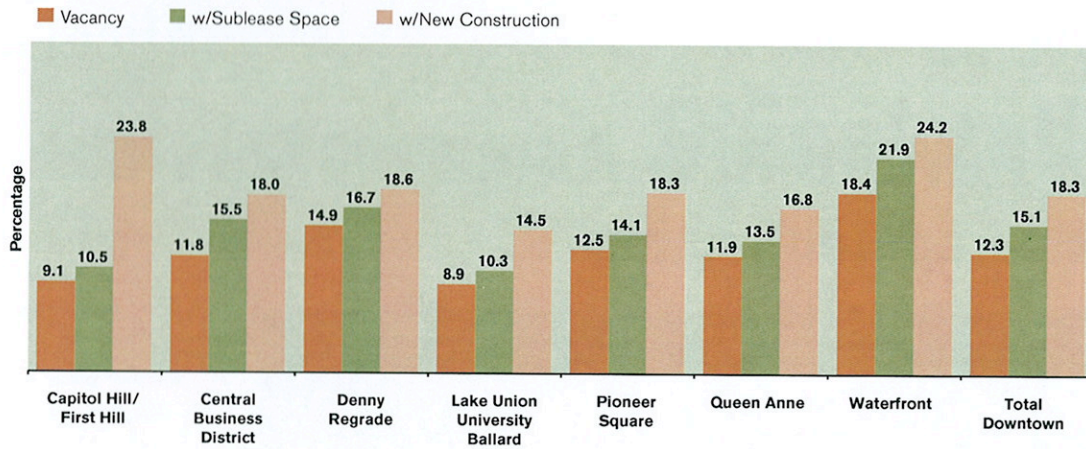


PUGET SOUND OFFICE

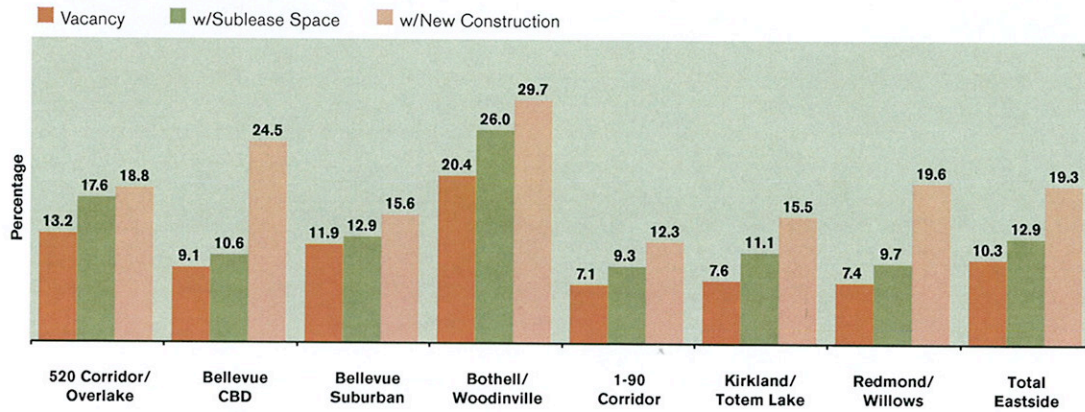


The Eastside office market was the most improved for the second consecutive quarter. Eastside vacancy decreased from 10.9% to 10.3%, vacancy including space for sublease decreased from 13.9% to 12.9% and vacancy including new construction decreased from 19.4% to 19.3%. The Tacoma office market extended its streak of improving occupancy to six consecutive quarters, however, the Eastside vacancy rate of 10.3% edged out Tacoma's 10.5% for the healthiest market in the Puget Sound region. Downtown Seattle is two full percentage points behind at 12.3%. When space under construction is included, Tacoma wins easily at 12.4% versus Downtown's 18.3% and the Eastside's 19.3%. 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.

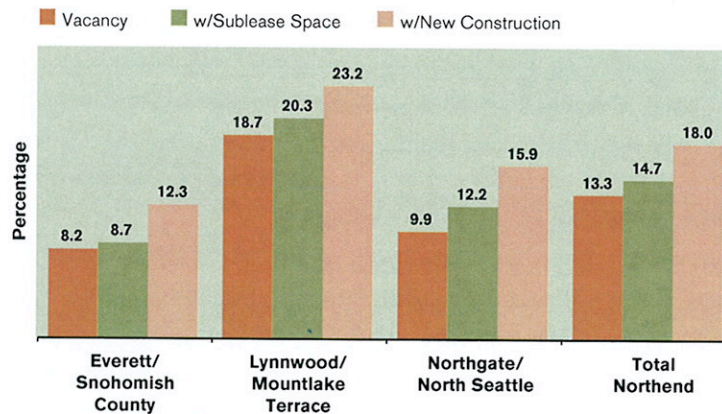
DOWNTOWN SEATTLE



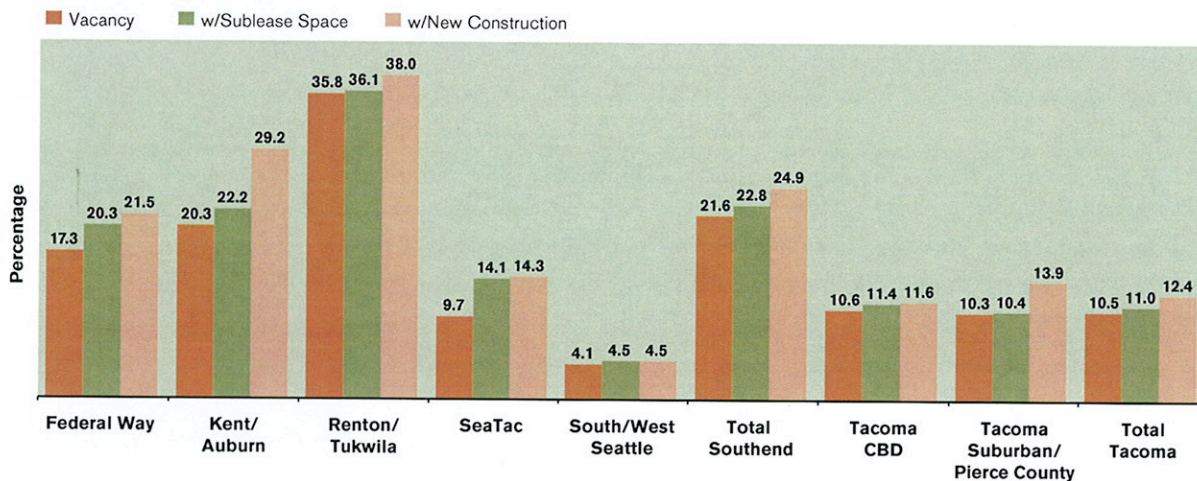
EASTSIDE



NORTHEND



SOUTHEND AND TACOMA



Amara Parenting & Adoption Services

www.amaraparenting.org



OfficeLease is proud to be assisting this outstanding organization with real estate planning and lease negotiation. If you are interested in learning more about Amara Parenting & Adoptions Services (formerly Medina Children's Services), please contact Alyssa Farber, Development & Marketing Director, at (206) 260-1714 or visit www.amaraparenting.org.

More than 11,000 children in Washington State are living in temporary foster care on any given day. Over 2,000 of these children can never safely return to live with their birth families. Those who remain in foster care until their 18th birthdays often find themselves alone and ill prepared for the challenges of adulthood. Many end up living in poverty, experiencing homelessness or transitioning in and out of prison. Too often, these children grow up only to repeat the cycle of abuse and neglect experienced during their own childhoods.

Amara Parenting and Adoption Services offers solutions for these children and other children who are at-risk of separation from their birth family. For over 84 years, Amara has been providing preventive, pro-active parenting and adoption services that ensure that children grow up in

loving, nurturing environments where they have a chance to reach their full potential in life. Thousands of parents around Western Washington have relied on Amara's professionalism and expertise to build and nurture their families. As a result children who may have spent their childhoods adrift in foster care are thriving with the love and support of a permanent family.

Amara Parenting and Adoption Services began its service to the community in 1921 as the Medina Baby Home, an orphanage and home for unwed mothers located in the city of Medina, Washington. In an effort to better serve the needs of its clients, the agency moved its headquarters to Seattle's Central neighborhood in the late 1920s - where it later became known as Medina Children's Services. In Fall 2004, the agency not only changed its name to Amara Parenting and Adoptions Services, it also sold its home of 35 years (located at 123 16th Ave) to their neighbors, The Goodwill Baptist Church. **OfficeLease** is currently working hard to find Amara a new home in Seattle that will enhance the agency's service capacity and effectiveness and allow them to continue to meet the needs of children and families throughout Western Washington.