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SPECIALIZING IN OFFICE SALES AND LEASING, THE CROS TEAM COMBINES EXPERIENCE WITH SUPERIOR SERVICE TO EXCEED YOUR REAL ESTATE EXPECTATIONS.

# CROS

## Word When Distress Calls

### Where Are Office Rents Headed?

You've heard the saying, "I've got good news, and I've got bad news." And the person usually says, "Would you like to hear the good news or the bad news first?" When asking this of rental rates in the greater Sacramento market, I will give you the good news first. The good news is that the bad news is not as bad as it seems, and the bad news is that the economy fell off the cliff in October 2008, and fear and a lack of vision on where the economy is going rules the market at this time.

In one month, almost across the board, there was a sense that effective rental rates dropped 5% to 10%. Free rent offered in the market went from 3 to 4 months for a 5-year lease, to 6 to 8 months. There are of course exceptions to this in certain submarkets, certain square footage requirements and certain tenant needs. However, it is a fair measure for what is going on in the

market at this time. Tenants in the market looking for space certainly are aware of the economic conditions we face at this time and are reading the papers and understand that fear in the market has given them the upper hand in negotiations.

We don't expect to see rental rates continue this decline for a number of reasons. First, we don't expect the stock market to fall over 30% in any of the upcoming months. Secondly, we expect there will be a feeling of the economy settling. Confidence coming back to tenants that the economy has bottomed and the crystal ball becomes more clear, allowing them to plan for the future. We do believe the rental rate may dip a little further mainly through free rent and other initial front-end giveaways, but not to the tune we saw in the late 1980's.

The good news is that new construction has come to a grinding halt and there does not appear to be any market force that would encourage new construction for the foreseeable 12 to 18 months. Therefore, as the market

stabilizes, we expect to see vacancies in the 4th quarter of 2009 start to subside as leasing activity normalizes. As vacancies decline, front-end giveaways will decrease and initial lease rates will start to solidify and reflect the cost of new construction.

Therefore, we don't expect to see any substantial new construction in the market until the 1st quarter 2010. New construction will begin because land prices will have been reduced substantially from their peaks in 2007; hopefully municipalities will be more realistic about the fees they charge for new development; banks will lend again; and rental rates will have solidified to justify new construction; especially office submarkets that entered this recession with fairly healthy leasing activity.

So hold onto your hats for the next 12 to 18 months, it's going to be a bumpy ride. But as my business partner, Bruce Hohenhaus says, "There is light at the end of the tunnel, and it is not the oncoming headlights of a train".

Bruce Wirt, SIOR

Ron Thomas, SIOR

- ◆ As transaction activity in the US commercial real estate market has slowed, many observers from economists to the financial and mainstream media to investors – warn that US commercial real estate is poised for a crash.
- ◆ Although the long, downward trend in cap rates in recent years clearly has left commercial real estate vulnerable to a sharp correction in asset values, space market fundamentals remain balanced and investor demand for real assets and yield remains healthy.
- ◆ In the near term commercial asset values could fall, perhaps by as much as 15% to 20% from peak to trough.
- ◆ However, structural changes in the real estate capital markets and increased acceptance of the asset class will affect the nature and roll of distress over the next year or two.

[Link to Complete Article:](#)

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# WILL IT BE GREAT IN 2008?

## A Mid-4th Quarter Update

In my First Quarter article for our CROS Word News Letter, I quoted some insight from the "Emerging Trends in Real Estate 2008". The new "Emerging Trends in Real Estate 2009" has been published and we will address our thoughts on how those predictions will affect Sacramento in our January CROS Word. Lets take one last shot at the 2008 predictions.

◆ Remember all those cute little phrases we embraced during those previous economic downturns? How about "stay alive until 95"; or "make due until 2002"; and that very famous line uttered from this newsletter, "will it be great in 2008?". Or how about "drink some more wine to help endure 2009?".

◆ We have a new President-elect and Mayor-elect of Sacramento. Are these psychological boosts? Let's hope so. I'll bet everyone reading this article has had their retirement date pushed out another 7 to 10 years. Just two days after the Presidential election, the Dow lost almost 1000 points. Will this ever end? Yes it will. Will we survive and be leaner and meaner as a result of the huge drop in wealth that a lot of us have experienced? Yes.

OK, enough. Now for some insight.

◆ As predicted, we have not had any \$760 million Sacramento portfolio purchases. That was a tough one. I'm not sure if that will ever be surpassed in this city, but we did have a 140,000 square foot building along the Highway 50 corridor sell for just under \$27 Million. In today's lack of credit climate, that was phenomenal. Bottom line, investment transactions continue to remain at less than one-third of what they were last year at this time.

◆ "Building Owners need to be realistic in their rent expectations and tenant concessions." I just saw a flyer where the initial rent on a five year deal was \$1.00 per square foot on a full service basis. We have also seen 10 months of free rent on five year deals. Not all landlords have jumped on the bandwagon, however, almost 100% of the landlords have been easier to convince that concessions are needed to secure a transaction. As brokers, we all dream of being tenant representatives during these difficult times.

◆ Don't expect the State of California office requirements to bail us out, but it will create a "softer landing". The State is still out there

searching for space, although not at the pace they were last year at this time. The Department of Corrections is probably the most active with a 200,000 square foot need, plus expansion, looming on the horizon. I heard a rumor that the Department of Finance just signed a 130,000 square foot lease. Let's hope that's true. The Department of Industrial Relations and DMV have also recently secured locations. With a \$11 Billion (or is it closer to \$28B?) budget deficit looming on the horizon and our Governor suggesting furloughs and no pay for holidays, we can only guess what the State activity will be in the next twelve months.

◆ "Look for activity in healthcare, education and public sector office requirements". In our last newsletter I added engineering firms. Expect a Canadian based engineering firm to send RFP's to accommodate a 60,000 to 70,000 square foot use. Drexel University has had a site approved in the Roseville area. Kaiser Permanente may have found a new home in Point West. Expect this trend to continue.

◆ Regarding the competition among new and existing Class "A" Capitol Mall buildings, Downey Brand has moved in to their new digs at 621 Capitol Mall, and the McDonough Law Firm continues to move forward on the 500 Capitol Mall building. The Kronick Law Firm has elected to remain in their 400 Capitol Mall location. I'll bet the owners of 400, 500, 555 and 621 Capitol Mall are having the time of their lives.

◆ How about the housing crisis enhancing the Sacramento affordability index? We seem to be definitely affordable at this juncture, we just need the buyers and in-migration of residents for this area. Without jobs, that isn't happening.

◆ Other insights related to the weak dollar persuading American based companies to relocate their overseas call centers back to the US. That hasn't happened and in fact, I recently heard that a very famous company is relocating one of their Sacramento call centers out of the US. We also forecasted employment growth for this region and instead we are continuing to experience unemployment growth. Expect no job growth for most sectors in the next 12 months.

My last comment from our most recent article indicated that we should not panic. This one's tough. Stay focused.

Bruce Hohehaus, SIOR

## Coach's Corner

MATHER COMMERCE CENTER  
SACRAMENTO, CA



Mather Commerce Center is part of the master planned Mather Field office campus built by McCuen properties. With 6 buildings already built, and 6 more planned from 25,000 to 160,000 SF, the park can offer up to an additional 450,000 SF of Class "A" office space. The Center provides nearby dining, lodging and recreation at the 29 acre Mather Sports complex. 3 fibre optic providers are currently available in the area, and public transportation is easily accessible from all sites. Current Tenant in the area are: Bloodsource, The County of Sacramento, EdFund and Sutter Health. Please contact the CROS team for further information and BTS opportunities.

- CHRIS SCHWARZE

## TOP TRANSACTIONS 3RD QUARTER 08

### 10670 White Rock Road, Rancho Cordova

The CROS Team represented both parties, Howard Goldenberg (Seller) and Gary Quattrin (Buyer) in the \$2.2 M sale of this 14,000 sf building.

### 9838 Old Placerville Road

The CROS Team represented both parties, GE Capitol (Seller) and POPI LP. (Buyer) in the sale of this 139,500 sf office building for \$26,500,000.

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