

2005 CORPORATE REAL ESTATE SURVEY

A SPECIAL RESEARCH REPORT

Lean, Mean and Ready to Expand

With efficiency peaking, corporations will inevitably grow their real estate portfolios to increase productivity.

Corporate America has become highly adept at squeezing more productivity from existing resources. Annual output per hour increased 4.4% in both 2002 and 2003, making those two of the five most productive years since the Bureau of Labor Statistics began tracking worker output in 1947.

But improved technology and job outsourcing both domestically and abroad have led to a sluggish hiring climate. The number of non-farm payroll jobs in the United States increased a paltry 0.9% in the three years since the recession ended in November 2001, according to Grubb & Ellis Co. That figure pales in comparison to the 4.2% growth in the first three years following the 1990-1991 recession.

Instead of absorbing space, Corporate America in recent years largely has been shedding excess real estate to trim costs. And with little demand for new office and industrial space, developers and construction lenders have been forced to wait on the sidelines for fundamentals to recover. The national office vacancy rate registered an unhealthy 16.6% in the third quarter of 2004, according to Reis, a New York-based research firm. While not hurting nearly as badly, the industrial sector remained in double digits at 11.5%.

The tide is beginning to turn, however, largely because many corporations have wrung out the excess space from their portfolios and are near maximum efficiency. Employers who find themselves in that posi-

tion must add space in order to grow. "In terms of shedding excess office space, it appears that the worst is over," says George E. Slusser, president and COO of Coldwell Banker Commercial. "While the extent of moving forward depends upon the individual sector, there is an overall transitioning toward growth, which is great news for 2005."

Where, then, will corporations seek to expand in 2005, and what types of properties will they require? *National Real Estate Investor* and Coldwell Banker Commercial sought answers to those questions in an exclusive market study conducted in late 2004. The second-annual survey queried hundreds of corporate users as well as developers and owners on their plans for the next 12 months.

More than half of corporate users of real estate own or lease more than one property type, and two-thirds of owners and developers are involved in more than one property type. Overall, respondents have a median 437,499 sq. ft. in their commercial real estate portfolios [Figures 1 and 2]. Here are some of the study's key findings:

- Corporate real estate users are most likely to be active in both primary and secondary markets [Figure 3]. In 2005, more than half of corporate respondents (57%) plan to increase their existing occupancy in primary markets, compared with 31% in last year's survey. Also, 42% of corporate respondents plan to expand their existing presence in secondary markets, up from

Survey Methodology

Data for the 2005 Corporate Real Estate Survey conducted jointly by National Real Estate Investor and Coldwell Banker Commercial was collected in November and December 2004. The purpose of the survey was threefold: to determine the commercial real estate holdings of corporations and their near-term plans; to investigate which markets, primary or secondary, will experience the most growth over the next 12 months; and to assess potential opportunities for commercial real estate owners, managers and developers in these markets.

Both providers and users of commercial real estate were surveyed. An online form containing the survey questions was sent to 6,114 NREI subscribers, including 4,045 developers, owners and managers and 2,069 corporate users. The results are based on responses from 536 industry professionals. The results of this survey can also be viewed online at www.nreionline.com.

NREI covers trends in commercial real estate with an emphasis on finance. Approximately 40% of the publication's 35,210 qualified readers are developers, owners and managers. Lenders, corporate users and brokers make up the balance of the readership. This special report also appears in NREI's sister publication, *Retail Traffic*.

The Coldwell Banker Commercial® system has more than 450 commercial real estate offices and nearly 3,900 sales associates throughout the world. Coldwell Banker Commercial provides commercial real estate solutions for tenants, landlords, sellers and buyers in the leasing, acquisition, disposition and management of all property types. Coldwell Banker Commercial® is a licensed trademark to Coldwell Banker Real Estate Corporation. Coldwell Banker Real Estate Corporation is a subsidiary of Cendant Corp.



31% a year ago.

- An increasing percentage of corporations plan to enter both primary markets (47% vs. 29% last year) and secondary markets (45% vs. 41% a year ago). Meanwhile, half of developer and owner respondents plan to enter secondary markets this year, up from 45% a year ago.

- Nearly two-thirds of corporate respondents (64%) plan real estate purchases in 2005 compared with 38% a year ago [Figure 4]. Additionally, 52% of corporate respondents plan to renovate existing space over the next year, compared with 48% last year.

- Nearly half of developer and owner respondents (49%) cite retail as the product type they plan to acquire, develop or dispose of in 2005 [Figure 5]. The next most often cited product types are office (43%) and multifamily (37%). Retail surpassed office as the most likely property type to be acquired, developed or disposed of by corporate respondents in this year's survey.

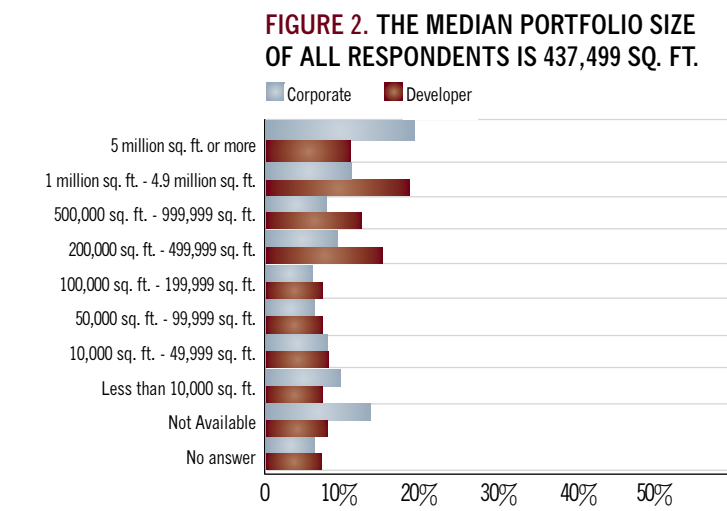
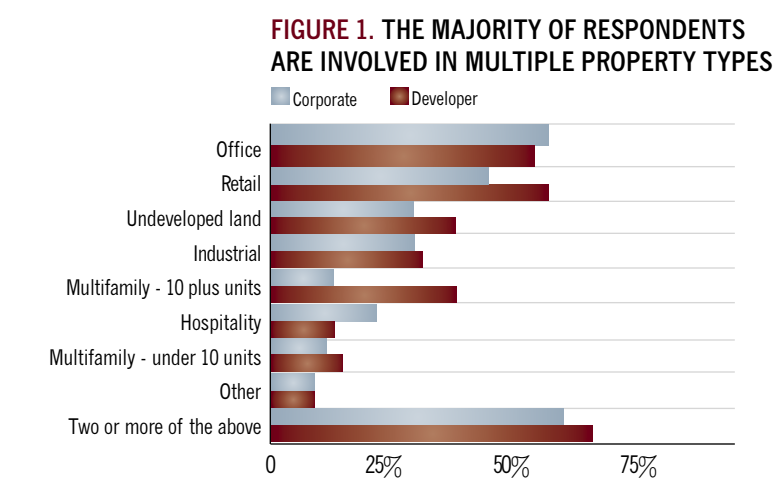
- While the majority of respondents are involved in multiple property types, corporate users are more likely to own or lease office space (53%). Owner and developer respondents are most likely to develop or lease retail (54%) followed by office properties (51%)

- Most developers and owners (67%) cite purchases as their most likely transaction in 2005, unchanged from 2004. Other likely activities include developing commercial real estate (58%), and selling commercial real estate (51%).

Corporate growth inevitable

Real estate experts say commercial real estate in the U.S. is transitioning from a post-recession period marked by belt-tightening to one of growth. "Over the last four or five years we've seen an enormous push to constrain cost in the corporate environment," explains Darcy Frank Mackay, senior managing director of global corporate services at CB Richard Ellis Consulting in San Francisco. Efforts to control real estate costs have included a switch from owned to less-expensive leased space, reduced ratios of space per employee, and the elimination of under-utilized space.

Few corporations expect space reductions to continue this year, and many plan



to grow. The study reveals that only 6% of corporate respondents plan to reduce their holdings in primary markets, while 57% expect to increase such holdings. A similar dynamic is occurring in secondary markets, with 7% of corporate respondents anticipating decreased holdings and 42% planning to grow in those metros. For the purposes of this study, primary markets have a population of 4 million or more, while the population in secondary markets ranges between 1 million and 3.9 million.

Whether a company plans to expand in primary or secondary markets relates to the prevailing theme of cost control, particularly for back-office support functions like accounting and information technology. Business strategists say secondary markets offer lower labor costs, more affordable real estate and greater expansion options than primary markets.

Major markets like New York, Chicago or Los Angeles, on the other hand, can provide a high-profile address with access to specific markets or customers some users require. Still, costs to both the employer and employee will be higher in a primary market, and employees may have to deal with longer commutes and other issues associated with large cities, say industry experts.

Mackay of CBRE Consulting says a corporation planning to expand in a primary market this year is either "bottom feeding" by taking advantage of soft conditions, or is increasing its presence to serve a core business activity that must be located in that market. A law or accounting firm, for example, may consider a costly Manhattan office worthwhile to access clients.

Support functions are more likely to

go to secondary or even smaller tertiary markets that offer lower costs of doing business. "New York will not be able to compete with Tulsa for back-office workers," Mackay says.

Citigroup is simultaneously spreading its back-office functions to secondary markets as it expands its front-office presence in New York. Having lost its leased space at 7 World Trade Center in the 9-11 disaster, Citigroup's primary motivation is to mitigate risk by spreading its business units over a large region. The corporation moved 800 of its asset managers to Connecticut immediately after 9-11, and this year the group's 1,600 information technology workers are moving their offices from Manhattan to a former Lucent Technologies campus in Warren, N.J. The shift to Warren is saving Citigroup money with lower rental rates and reduced employee commute times from 2.5 hours to about 20 minutes.

Citigroup plans to fill that vacated Manhattan space with asset managers and other employees that deal directly with customers, and therefore need offices in the city. Citigroup is also building a 475,000 sq. ft. office building in Long Island and anticipates net growth of 600 jobs in New York by the middle of next year.

"What Citigroup is doing is quite common within the financial services industry," says Slusser. "Most companies have extensive back-office operations within the tri-state metropolitan area, and often-times you'll see headquarters in New York City with operations and other functions housed in a less expensive area, which is very cost-efficient for a company."

Supply-side opportunities

Developers plan to be net acquirers of commercial real estate, adding a median 102,326 sq. ft. and disposing of a median 57,407 sq. ft. Some 76% of the developer and owner respondents plan to grow their real estate holdings in 2005, and only 6% expect a portfolio reduction.

But with limited job growth, widespread demand for large developments is unlikely. Instead, developers are finding opportunities in niche plays, particularly in secondary markets that may not offer a variety of existing space to suit specific needs. Indianapolis-based developer Simon Property Group, for example, reports

leasing at its Wolf Ranch retail center in Georgetown, Texas, is going so well that the developer already plans a second phase to begin construction after the complex opens this July. Wolf Ranch is a 670,000 sq. ft. lifestyle center anchored by Target.

"Secondary markets are extremely ripe for high-quality retail projects," says Les Morris, manager of corporate public relations at Simon's Indianapolis headquarters. "The appetite for a project is probably much greater in a secondary market, from a public perception stand-

point. There's an excitement level there."

As Figure 5 shows, developers cite retail as the property type they are most likely to acquire, dispose of or develop. "Retail has been the hottest investment in commercial real estate now for the last three or four years," Coldwell's Slusser says. "There's a direct correlation between an explosion in retail property with consumer buying behavior. And when consumers continue to exercise their purchasing power over a significant period of time, you'll see that

FIGURE 3. CORPORATE RESPONDENTS ARE MOST LIKELY TO BE ACTIVE IN PRIMARY AND SECONDARY MARKETS

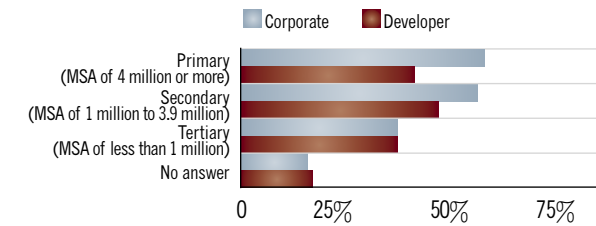


FIGURE 4. NEARLY TWO-THIRDS OF CORPORATE RESPONDENTS PLAN TO BUY COMMERCIAL REAL ESTATE IN 2005

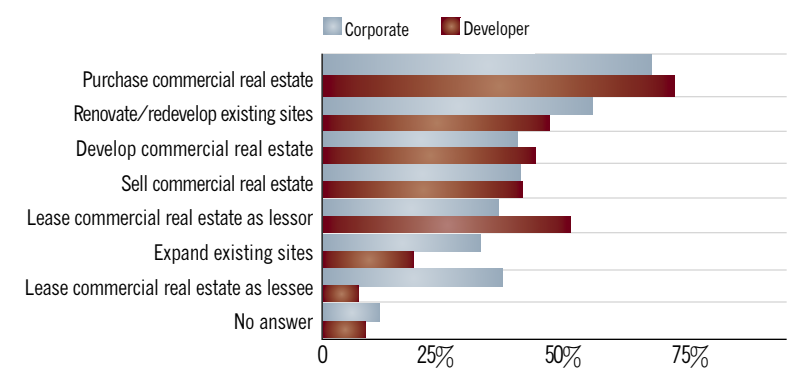


FIGURE 5. BOTH GROUPS ARE MOST LIKELY TO HAVE PLANS FOR RETAIL PROPERTIES

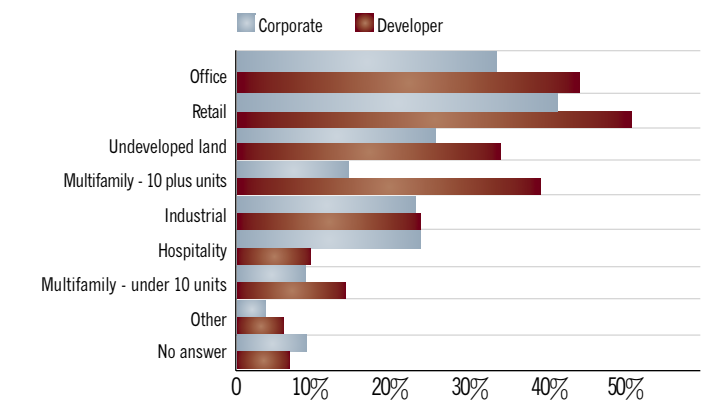


FIGURE 6. DEVELOPERS SAY REAL ESTATE FUNDAMENTALS ARE MOST LIKELY TO IMPACT TRANSACTION DECISIONS.

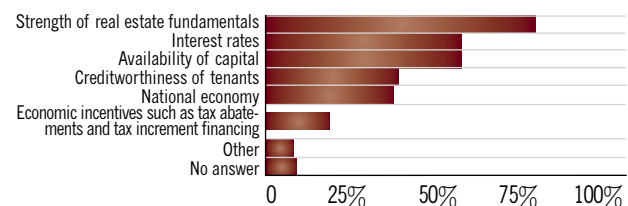
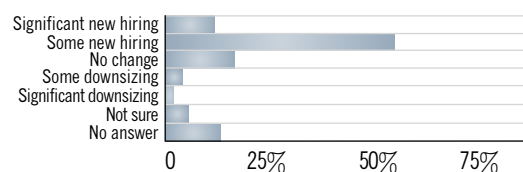


FIGURE 7. 10% OF CORPORATE RESPONDENTS PLAN SIGNIFICANT HIRING AT THEIR COMPANIES IN 2005



result in a positive way for retail and commercial real estate.”

Incentives incite developers

What criteria will influence developers and owners? Nearly one-quarter of respondents, up from 16% last year, are likely to be swayed in the site selection process by economic incentives such as tax abatements. Still, real estate fundamentals remain the driving force. More than three-fourths of respondents (76%) indicate real estate fundamentals will affect their decisions, followed by interest rates and availability of capital (tied at 55% each) [Figure 6].

Secondary markets use incentives to recruit employers or specific types of investment, but that alone won't lure a project. Richard McBlaine, president for portfolio strategies at Jones Lang LaSalle in Chicago, says incentives are only one of about 50 criteria his clients consider in site selection. “In many cases, incentives can be a tie breaker, but corporate users will not go to markets that don't have strong fundamentals.”

Incentives are more readily available

for developments that fill niche requirements, according to Scott Adams, director of business development for the City of Las Vegas. That city has roughly 80 high-rise residential projects in the works but little office or retail space downtown. To promote downtown retail, the city provided a tax abatement that convinced Los Angeles-based Furniture Mart Enterprises to develop the 1.35 million sq. ft. first phase of World Market Center, a furniture market. The project is 100% leased and is expected to create about 1,500 jobs when it opens this July. A 1.6 million sq. ft. second phase slated to begin construction this year is 85% leased. “The city's investment paid off,” Adams says. “It established Las Vegas as a major center for the furniture industry.”

Saralee Tiede, vice president at the Greater Austin Chamber of Commerce in Texas, says incentives play an increasingly important role as cities and states compete for jobs. Austin does offer incentives for some projects, but “it's not the first tool in our kit,” Tiede says. Austin's marketing efforts focus first on the metro's educated work force, then on promoting the city's high quality of life and low cost

of doing business relative to primary markets. “Businesses are going to look first for the places they want to be,” she says. “Then they're going to bargain hard once they get a short list of places that would meet their needs.”

Tepid job market

The economy is improving, but the 157,000 non-farm payroll jobs created in December 2004 fell short of economists' projections of 175,000. Only 10% of corporate respondents in this year's survey plan a significant amount of hiring in 2005, though 63% plan at least some hiring [Figure 7]. That's slightly less than last year, when 12% projected significant hiring and 69% planned at least some new hires.

Still, Slusser is encouraged by a drop in the percentage of corporate respondents planning layoffs. Last year, 7% expected some downsizing, and 2% anticipated significant downsizing. This year, those percentages dropped to 3% and 1%, respectively. “That's positive,” Slusser says. “Corporations say they're not going to be adding a lot of jobs, but they're not expecting cutbacks.”

McBlaine of Jones Lang LaSalle says the challenge to space providers in this period of limited job growth is to meet the corporation's need for flexibility and efficiency. “While the corporation may be shrinking in high-cost markets, it may be expanding in lower-cost markets,” McBlaine says. “If a developer can provide a solution that is more flexible or adaptable, it will win.”

The long-term economic outlook remains encouraging. Dave Lawton, executive managing director in the New York office of Cushman & Wakefield, expects the demand for new construction to accelerate by the end of the decade. Specifically, Lawton points to projections by the Employment Policy Foundation that suggest U.S. employment for those with a college degree will increase from 49.8 million jobs in 2002 to 69.8 million by 2013. “Recovery cannot continue without job growth,” he says. “You can only stretch the existing work force's ability to a certain level, and then it's got to grow.”