Davis Wright Tremaine LLP
DEFINING SUCCESS TOGETHER

Landlords and Tenants

Partners in Hard Times

Anchorage
Bellevue
Los Angeles
New York
Portland
San Francisco
Seattle
Shanghai
Washington, D.C.

www.dwt.com

Agenda

1. Current Market Conditions
2. Owner/Landlord Strategies
3. Tenant Strategies
4. “Win-Win” Situations

Economic conditions in Puget Sound continue decline in 2009

Current Market Conditions

Unemployment rates (August 2009)

- Washington: 8.9%
- National: 9.6%
- Approx. 55,410 jobs in region lost over last 12 months

Home prices

- Washington: down more than 15% from mid-2008 to mid-2009
- Nationwide: down more than 20% over same time period

Credit markets virtually frozen

Retail

Continued softening of market

Liquidations from national chains

- 2008: Linens ‘n Things; Shoe Pavilion
- 2009: Joe’s Sports; Circuit City

National retailers headquartered in Seattle struggling

- Starbucks, Eddie Bauer

Store openings at a virtual stand-still

- Especially high-end and apparel retailers

What does this mean for the commercial leasing market?

Retail

- Suburban markets vacancy rate up to 7.8% (mid-2009)
- Vacancy for Seattle CBD: only 2.4%
- Vacancy for Regional Malls: 15.9%
- Vacancy for Community Centers: 14.8%

Retail

New development in check

- Tight credit market
- Significant lack of demand

Only one major project underway

- The Shops at the Bravern (just opened in Bellevue)

What does this mean for the commercial leasing market?

Office

Record negative absorption and vacancy levels

- Nearly 15% at mid-year – and climbing
- Causes

Downtown Seattle market hit particularly hard

- West 8th office tower completed and completely vacant
- 7th and Madison project on Capitol Hill
- WaMu Tower (to be renamed Russell Tower?)
- South Lake Union

Eastside market in similar position

Industrial

Kent Valley – declining market fundamentals

- Reduced cargo activity
- Vacancy rate: 8.3% (end of Q2 2009)
- Negative absorption: 1.9 mil sf during first half of 2009

South King County

- Vacancy rate jumped from 4.6% (end of Q1 2009) to 6.5% (end of Q2 2009)
- More than 1.0 mil sf given back during first half of 2009

What does this mean for the commercial leasing market?

Industrial

North Pierce County

- Vacancy rate: 14.7% (end of Q2 2009)
- Puyallup only submarket to report a drop in vacancy during 1st half 2009

Eastside

- Vacancy rate increased from 5.4% (end of Q1 2009) to 7.4% (end of Q2 2009)

No new construction

All Categories

Increased vacant space

+ Decreased pool of tenants to fill it

= Downward pressure on rents

What does this mean for the commercial leasing market?

Downward Pressure on Rents

Office lease rates

- Dropping for all classes of space
- CBD Seattle hardest hit
- Eastside seeing similar decline

Retail rates

- Varying widely by type/amount of space
- A market rates for 2010 predicted 20-30% below peak 2007
- 40% drop for space over 5,000sf

Industrial rates

- Asking rents for shell space in Kent Valley also down 2.5% from year end 2008, to average $0.38sf/mo for space over 5,000sf

Three types of landlords

So what does this market mean for owners/landlords?

Three Types of Landlords

Type 1: Patient

- Example: smaller local players who have owned property for years; deep-pocket individual investors

Strategy

- Tolerate vacancies in projects and interruptions in cash flow

Three Types of Landlords

Type 2: Need cash flow

- Example: out-of-state owners who bought huge portfolios of properties during run-up of market in the past decade

Strategies

- Reduce rents or offer concessions
- Trade higher rents for more generous TI packages or turnkey buildout

Three Types of Landlords

Type 3: Worried about financing

- Example: anyone with a mortgage

Strategies

- Maintain rent structure at all costs

It's A Tenant's Market

Step 1:

- Know what type of landlord you're dealing with

Step 2:

- Depending on landlord's perspective, consider proposing one of the following options

Tenant Strategies

Reduced Rent

- Lower psf rent
- Abated rent
- Percentage rent only (retail context)
- Lower extra charges
- “Blend and extend”

Other Options

- Increased tenant improvement allowances
- Shorter terms / kickout rights
- Reduced space
- Retail store closure / delayed opening
- Wait
- Seize opportunity

How can all of the above benefit landlords as well as tenants?

Win-Win Situation

- More secure, viable tenants
- Cash flow (albeit reduced) preserved
- Property occupied
- Refinancing easier/compliance with existing financing maintained (unless reduced rents jeopardize that)
- Reduced marketing/re-tenanting costs
- Reduced operating costs for vacant space
- Retail co-tenancy provisions avoided
- Long-term relationships preserved

Thank You!

Questions?

Mig Schaaf

migschaaf@dwt.com