

# Real Estate Update

## THE GOOD, THE BAD, AND THE UGLY

By John D. Sullivan

Today's Puget Sound commercial real estate market is like a "spaghetti western" – pretty much everyone gets killed! Tomorrow's outlook is a little bit of good, lots of bad, and the whole thing will be downright ugly.

### THE GOOD

The good news is that it is a tenant's market both in the Seattle downtown business district and on the east side and a cash buyer's market. The huge office vacancy rate that was triggered by the Washington Mutual failure and over-building during the "bubble" continues to rise. Last year over 1 Million square feet of

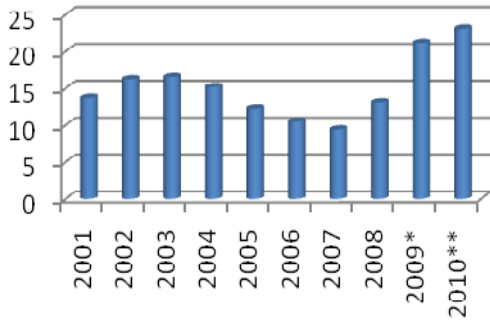
existing office space went on the market. In addition, another 2.3 Million square feet of new construction will add to the inventory for 2009-2010.

As a result, the Seattle DBD office vacancy rate at the end of the third quarter 2009 was up to 18.5%, and the east side was only slightly better at 14.8%. Cushman & Wakefield has predicted that over the next year this could rise to 20-30%! And the consensus is that we won't hit the bottom until late 2010 or 2011. This is really good news for tenants. Not only are lease rates lower – many gross rental rates are below \$25/rsf for Class A buildings –



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## Commercial Real Estate Vacancy Rates



Source: Cushman & Wakefield  
\* Estimated \*\* Projected

and sellers. Of course landlords' rental revenue is down substantially, making it very difficult for them to service their debt. But perhaps more significant is the impact on sales and development. As the net operating income goes down, so do the appraised values of the properties, keeping owners from refinancing without major equity infusion. As with the subprime residential mortgages, the property is

and 2012, many of which are held in commercial mortgage backed securities (CMBS). Most experts predict that the impact of the inability to refinance these loans will dwarf the residential subprime mortgage crisis.

Couple this with the likely high inflation due to the massive federal spending (and resultant increase in the money supply), and interest rates undoubtedly will rise significantly.

So what is the bottom line? The Puget Sound commercial real estate market will get worse before it gets better, and the recovery will be slow. And that's ugly.



but landlords are also making major concessions to attract and retain tenants.

no longer worth as much as the debt.

There are also some bargains to be had by buyers with cash and sellers who are desperate. Cash or an ability to assume an existing mortgage avoids the tight money issue discussed below.

### THE UGLY

### THE BAD

What's good for tenants and buyers isn't so good for landlords

As if this isn't bad enough, money is likely to be much tighter. Despite TARP and other efforts, FDIC Chairman Sheila Bair predicts that 2010 bank failures will eclipse the 140 that occurred in 2009. Why the pessimism? One reason is the large number of commercial real estate loans coming due between 2010

## Tip for Homeowners

by Bob Klein



*Does your King County home have interior features that negatively impact its fair market value? If so, consider a little known procedure. You can ask the King County Assessor's Office to conduct a characteristics/assessment review of your home, including an inspection of the inside living area. The Assessor's Office is not obligated to conduct an interior inspection, but has been willing to do so. If the inspection discloses poor construction or substandard quality, this may lead to a lower real estate valuation without having to pursue a real estate tax appeal.*