

City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 5, 2001

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: PHILIP SUNDERLAND, CITY MANAGER *ps*

SUBJECT: BUDGET MEMO # 7 : GRUBB & ELLIS COMMERCIAL REAL ESTATE
TRENDS AND INSIGHT

As another view of the local economy, attached is a recent article that describes the potential impact of high tech firm downsizing on the Northern Virginia office market (which has implications for the entire Northern Virginia economy). Despite the details in the report, the Grubb & Ellis conclusion is still positive, but less so than the Delta Associates' analysis (Budget Memo #2) review of the regional office market (budget pages 79-81).

Attachment: *"High Tech Downsizing,"* an article from *Metropolitan Washington, DC Market Monitor*, April 3, 2001



METROPOLITAN WASHINGTON, DC

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High Tech Downsizing

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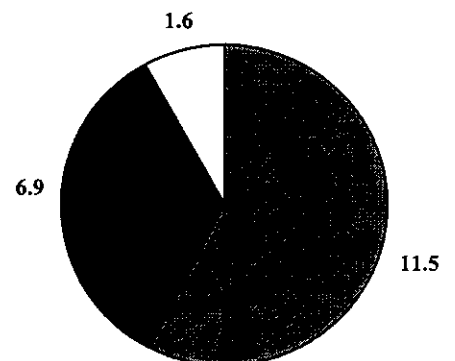
Relative to the rest of the metro area, Northern Virginia has benefited the most from growth in the high technology economy. The Greater Washington Board of Trade estimates that 55% of technology employment in the metropolitan area is located in Northern Virginia and anecdotal evidence suggests that number probably underestimates growth in recent years. In fact, in a recent article highlighting federal spending as a primary economic driver (particularly for the tech sector), local economist Dr. Stephen Fuller states: "Federal procurement closely parallels the differential area growth rates, with Northern Virginia's share increasing from 30% to 53% from 1980 to 1999. Since 1992, local federal procurement has increased \$10.3 billion, a gain of 66%; Northern Virginia captured \$6.9 billion, of 67% of this increase."

Tech Sector Leasing

The tremendous growth of Northern Virginia's technology sector has directly translated into demand for office space, leading to levels of net absorption rivaling that of the late 1980s. The table below supports this point. In 2000, Northern Virginia recorded 19 lease transactions (excluding renewals and expansions) that were larger than 100,000 square feet. Of the 19 transactions reported, 12 were deals executed by technology firms and roughly 70% of those represented net growth. The space demands of these companies in Northern Virginia grew by more than 1.3 million square feet in 2000.

Furthermore, technology firms have comprised much of the leasing activity in buildings that have been built over the last few years. The technology boom in Northern Virginia is relatively recent - really no more than a few years old. Five years ago, the vacancy rate was around 7%; yet, over the next few years it dropped to 4.5%. The confluence of a booming technology industry and an office market with little existing space, forced technology firms into these new buildings. There simply was a lack of existing space to accommodate

Square Feet of Occupied Space in NoVA Buildings Constructed Since Jan. 1998 (000,000's)



■ Occupied by tech ■ Occupied by other □ Unoccupied

Market Monitor is a publication of Grubb & Ellis Research and Client Services

the growing technology workforce of Northern Virginia. In addition, most business plans anticipated aggressive growth, leading most firms to contract for more space than they initially needed. This led to some fantastic leasing figures.

Recognizing this, developers began rapidly building office space and tech firms rushed to lease them. In fact, of the 20 million square feet of office space constructed in Northern Virginia since the beginning of 1998, 11.5 million is occupied by technology firms, 6.9 million square feet is occupied by other types of companies and 1.6 million square feet remains unoccupied. Technology companies now represent roughly 60% of all of the space occupied in office buildings constructed since January 1998. This is a staggering statistic and a present cause of concern for class A property owners.

Tenant	SF Leased	SF Growth (% Growth)
PTO	2.5 million	500,000 sf (20%)
Cable & Wireless	275,000	275,000 sf (100%)
E*TRADE	224,000	65,000 sf (30%)
Institute for Defense Analysis	222,000	222,000 sf (1%)
Xo Communications (Nextlink)	116,000	191,000 sf (88%)
Proxicom	185,000	95,000 sf (50%)
Aether Systems	157,000	117,000 sf (75%)
Verisign (Network Solutions)	156,000	156,000 sf (100%)
MicroStrategy	146,000	23,000 sf (15%)
Wang Global	154,000	77,000 sf (50%)
Lifeminders	131,000	131,000 sf (100%)
Nextel Communications	125,000	125,000 sf (100%)
VDOT	122,000	66,000 sf (50%)
Siebel Systems	118,000	95,000 sf (80%)
Net-Tel Communications	114,000	84,000 sf (74%)
Anser	106,000	16,000 sf (20%)
Regus	103,000	103,000 sf (100%)
AppNet (Commerce One)	100,000	44,000 sf (44%)
Arthur Andersen	100,000	100,000 sf (100%)
Totals:	5,122,000	2,225,000 sf (43%)

Shaky Credit

The stability of many new buildings (and much of Northern Virginia's class A sector) will be in large part dependant on the stability of technology industries. If 2000 is any indication, the technology sector, while growing at an extraordinary rate, is still subject to growing pains. Many firms have yet to prove that they are viable businesses. It is common knowledge that many technology firms have yet to achieve positive earnings. This, in turn, leads to concerns about the sustainability of a company, regardless of future potential, that is currently paying short-term expenses (such as rent) with long-term capital (such as venture funding). The table below profiles the stock market's financial perspective of the technology companies that occupy the most space in office buildings constructed in Northern Virginia during the last three years. For the purposes of this chart, the square feet of space leased in new buildings is also included.

Firm	Square Feet	Market Cap	P/E Ratio	52 Week EPS
WorldCom *	1,600,000	\$45,505,150,000	12	1.460
Winstar Communications	880,000	\$928,050,000	N/A	-7.230
America Online *	830,000	\$198,066,960,000	58	0.140
Cable & Wireless	506,000	\$82,699,090,000	48	0.800***
Nextel Communications	324,000	\$18,046,470,000	N/A	-1.220
Qwest Communications	287,000	\$59,453,990,000	56	0.160
Cisco Systems	261,000	\$185,722,400,000	63	0.230
E*TRADE	240,000	\$2,902,170,000	122	0.004
MicroStrategy	221,000	\$767,310,000	N/A	-3.580
Xo Communications (Nextlink)	216,000	\$5,348,230,000	N/A	-3.850
Oracle *	200,000	\$122,890,200,000	20	0.190
Proxicom	200,000	\$323,990,000	N/A	-0.100
E*Spire Communications	166,000	\$36,190,000	N/A	-7.060
Aether Systems	158,000	\$1,134,450,000	N/A	-9.660
Verisign (Network Solutions)	157,000	\$9,649,050,000	N/A	-17.030**
BCE (Teleglobe)	142,000	\$19,043,580,000	5	1.300**
Siebel Systems	141,000	\$21,262,690,000	92	0.250
Net2000 Communications	135,000	\$109,310,000	N/A	-3.140
Road Runner	132,000	Not publicly traded		
Lifeminders	131,000	\$50,560,000	N/A	-4.470
Net-Tel Communications	114,000	Not publicly traded		
Network Access Solutions	113,000	\$59,200,000	N/A	-3.160
marchFirst / US Web	110,000	\$232,930,000	N/A	-43.670**
BMC Software	106,000	\$7,857,130,000	39	0.080
Commerce One (AppNet)	100,000	\$82,699,090,000	N/A	-1.930
Landmark Systems	100,000	\$51,630,000	N/A	-0.190
Total/Average:	7,570,000	\$36,034,992,500		

*Owner occupied

**Reflect merger and acquisition activity

***Consensus estimate

Price data as of February 26, 2001

Earnings data for fiscal year 2000

Data provided by S&P Comstock and Interactive Data Corp.

Though market caps are down significantly from their zenith, many firms still have valuations that are barely fathomable. Given negative earnings, a P/E ration cannot be calculated for most firms in the list above. It is no surprise then that most technology companies have lately taken a beating on Wall Street. Northern Virginia companies have had to cut costs and the collective belt tightening has impacted the commercial real estate market in two ways: first, companies are now more frugal with their real estate and are trying to unload excess office space; and, second, many of these companies have laid off employees. As a result, a growing number of companies have either returned leased space to the market or pulled the plug on pending transactions. A brief outline of several of these Northern Virginia technology-companies follows.

Companies that are relocating employees and putting space on the market, such as MCI at Meadows 5 in Westfields, are not included below because their actions are not a net loss to the market. This list is also limited to technology firms that appear to be downsizing. It is important to distinguish between firms that leased excess

office capacity for future expansion and fully intended to sublease that space with those firms that are now second-guessing their initial real estate acquisitions. Thus, companies such as E*Trade, which is currently offering 100,000 square feet for sublease in Ballston Tower, are not posted below. Finally, this table does not outline space returned to the market by conventional (non-tech) companies. For example, American Management Systems's recent 52,000 square foot addition to the sublease market is not considered here.

Tenant	Building	SF Returned to the Market
Proxicom	12000 Sunrise Valley Dr.	185,000
Computer Associates	198 Van Buren / 1800 Alex. Bell	126,000
Net-Tel Communications	7901 Jones Branch Dr.	114,000
Litton PRC	12005 Sunrise Valley Rd.	109,000
marchFirst / USWeb	8444 Westpark Dr.	97,000
Orbital Sciences	21819 & 21839 Atlantic Blvd.	90,000
LCC	7925 Jones Branch Dr.	90,000
Motley Fool	1101 King St. / 108-110 S Wash. St.	80,000
ECI Telecom	12950 Worldgate Dr.	78,000
Portal Software	2250 Corporate Park Dr.	69,000
Yellowbrix	1100 Wilson Blvd.	59,000
Xpedior	4825 Mark Center Dr.	53,000
Averstar	1593 Spring Hill Rd.	50,000
OneSoft	1505 Farm Credit Dr.	50,000
Unisys	12100 Sunset Hills Rd.	48,000
Network Access Solutions	13650 Dulles Technology Dr.	47,000
Commerce One	2107 Wilson Blvd.	40,000
Maingate	607 Herndon Pkwy.	40,000
Intuit	44 Canal St.	38,000
Net2000	2180 Fox Mill / 1420 Spring Hill	37,000
Worldstore	3975 Fair Ridge Dr.	31,000
Global Integrity	12100 Sunset Hills Rd.	30,000
Luminant Worldwide	220 Spring St.	29,000
CAIS Internet	1560 Wilson Blvd.	29,000
Blacksmith.com	1775 Wiehle Ave.	26,000
E*Spire	12975 Worldgate Dr.	25,000
Teligent	12001 Sunrise Valley Rd.	24,000
MusicMaker	10780 Parkridge Blvd.	21,000
InterRealty	1951 Kidwell Dr.	21,000
Sapient	1515 N. Courthouse Rd.	21,000
Level 8	45365 Vintage Park Plz.	20,000
Broadview Networks	3928 Pender Dr.	19,000
Internos	45195 Business Ct.	18,000
Newbridge Networks	200 Fairbrook Dr.	17,000
Kinkos.com	814-816 King st.	16,000
KnowledgePlanet.com	11490 Commerce Park Dr.	15,000
Total:		1,862,000

Furthermore, not all internal restructuring results in vacated office space. Some firms are merely rolling back future expansion plans and growth expectations. Landmark Systems, for instance, let go of some of its employees, but has yet to

return its space to the sublease market. This could, of course, change and Landmark Systems may opt to offer sublease space later this year, but at this point it has not. Several snapshots of recent tribulations in the Northern Virginia technology community are posted below. Similar to Landmark Systems, some of these companies have yet to restructure their real estate holdings. Others, however, are listed on the table above as having already returned office space to the market.

- **AOL Time Warner** is one of the largest companies in the metropolitan area. This new economy giant handed out pink slips to 300 area employees on January 23, 2001.
- **Brainbench** recently laid off about one-third of its 96 employees as party of a restructuring to achieve profitability.
- **Crosswalk.com** laid off 23% of its workforce, 15 people, in January 2001.
- **Cybercash** filed for Chapter 11 bankruptcy last month leading to the layoffs of 81 employees.
- **Cysive**, a seven year-old internet consulting firm, announced a second round of layoffs that will cut 90 to 95 workers, or roughly 30 percent of its workforce. Cysive is based in Reston.
- **E*Spire** leased 165,000 square feet in Herndon in June 1998. Shortly thereafter, this telecommunications company returned 70,000 square feet of this space to the sublease market. While that space has since been leased, in the past 10 days, E*Spire filed Chapter 11. As a result, many in the real estate community expect to E*Spire to return more space to the market.
- **Equalfooting.com** recently let go of 62% of its workforce. This company occupies approximately 20,000 square feet in 22977 Eaglewood Court.
- **Global One** has announced plans to cut 100 employees from its global workforce, most of them in Reston.
- **Kinkos.com** let go of 70 people. They are based in Alexandria and have placed 16,000 square feet on the sublease market.
- **Landmark Systems** occupies 100,000 square feet in Reston. It laid off 12% of its workforce in 2000.
- **Lifeminders** let go of 40 employees. This Herndon-based firm had extraordinary growth projections. As a result, the company leased more space than it required, with the intention of subleasing some of this space to short-term tenants and growing into this excess space over several years. After laying off 19% of its workforce, this growth profile would appear to be in jeopardy.
- **MicroStrategy** was once considering a campus, this Vienna-based company has now shelved all real estate expansion plans until its stock recovers. Last summer, MicroStrategy gave pink slips to 230 employees, or 10% of its staff.
- **Motley Fool**, laid off 115 people, a third of its staff as part of a restructuring effort to remain profitable.
- **MusicMaker** leased 21,000 square feet in a new Reston building. This space is now on the market as the company is liquidating its assets.
- **Net2000** will put a roughly a floor on the sublease market in its headquarters building in Herndon. This company released 90 employees in January 2001.
- **Net-Tel Communications** leased 114,000 square feet in Tysons Corner in a new building developed by the West*Group. Only weeks prior to the scheduled date of occupancy, Net-Tel declared bankruptcy and informed the West*Group that it would not be occupying the building.

- **Network Access Solutions** laid off 145 staff members in November 2000. This company leased an entire building in Herndon and is now trying to sublease nearly 50,000 square feet.
- **OneSoft** released 90 employees, roughly 60% of its workforce, in the first few weeks of 2001. Another local company, **Etensity**, later purchased OneSoft. In a bit of irony, Etensity also dismissed 50 employees at roughly the same time.
- **PlanetGov** laid off 45 employees at its Chantilly headquarters citing difficulty raising additional venture funding.
- **Proxicom** announced two weeks ago to cut 227 workers nationwide, or 20% of its workforce. These cuts include 36 workers at its Reston headquarters.
- **PSINet** purchased a 204,000 square foot office building early in 2000. Yet, financial difficulties now have the company looking to sell the asset to an investor who is willing to lease it back to them. PSINet let go of 300 workers in December 2000. PSINet occupies a number of buildings throughout Northern Virginia.
- **Sandbox.com**, a Reston tenant, laid off 30 members of its staff.
- **Sapient** announced in March 2001 that it would cut 720 jobs across North America. These layoffs account for roughly 20% of the company's worldwide workforce. In the Arlington office, where the company occupies 70,000 square feet, it will put one floor up for sublease.
- **Teligent** has laid off more than 700 employees and has abandoned their campus requirement and office consolidation plan in Northern Virginia.
- **Xpedior** leased more than 50,000 square feet Alexandria at the end of 2000. This company recently let many of its employees go and has put all of the space it leased only a few months ago back on the market.

Summary

Technology, as a sector, is currently serving penance for its bacchanalian growth and expansion in recent years. Yet, the tech sector remains a vibrant component of the Northern Virginia economy. While the percentage of office space occupied by technology companies as compared to the entire inventory may be relatively small, the percentage relative to buildings recently constructed exceeds 60%. This is an important statistic given the sector's present lack of stability. A brief review of the financials of these companies, recent layoffs, and the space they have returned to the market underscores the current beating these firms are taking on Wall Street. Given the current vector of the stock market, we would expect the tech sector "shakeout" to continue through the first half of 2001, probably leading to negative absorption when first quarter statistics are produced. However, our long-term outlook is more positive. Office demand should improve once stock valuations are reset and firms refocus their business plans.

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