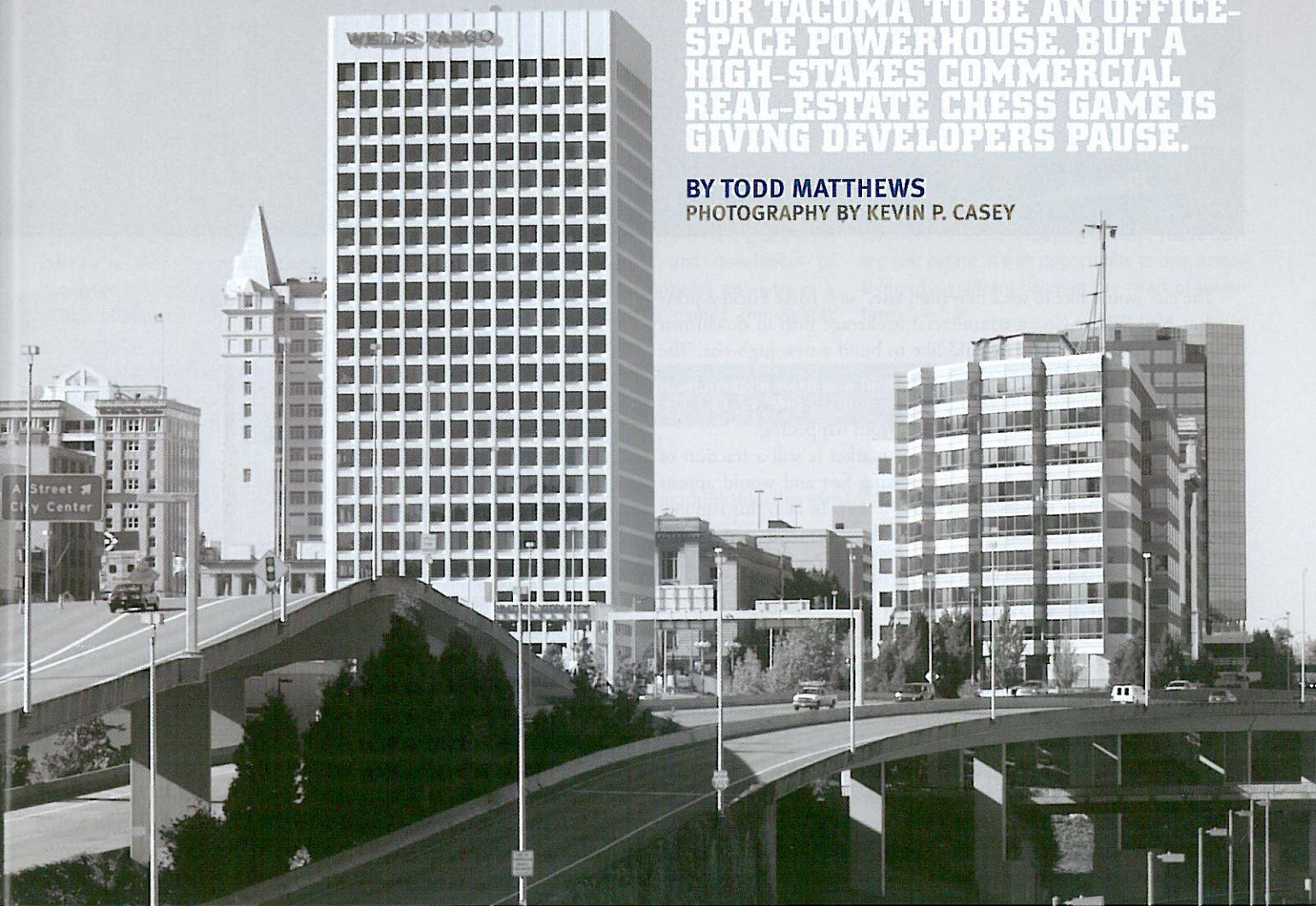


# TACOMA'S WAITING GAME

THE PIECES ARE IN PLACE FOR TACOMA TO BE AN OFFICE-SPACE POWERHOUSE. BUT A HIGH-STAKES COMMERCIAL REAL-ESTATE CHESS GAME IS GIVING DEVELOPERS PAUSE.

BY TODD MATTHEWS  
PHOTOGRAPHY BY KEVIN P. CASEY



**AT TACOMA'S MANY MUSEUMS**, which are often pointed to as signs of the city's progress, it's easy to find a few souvenir postcards depicting the city's skyline.

Photographers typically set up their tripods at the same spot: a patch of shoreline on the east side of Foss Waterway. The location offers a view of downtown's hillclimb, the rusty steel stretch of Murray Morgan Bridge and a handful of stumpy, mid-rise office towers.

This image, for the most part, hasn't changed for nearly two decades.

By contrast, high-rise construction thrives in Seattle and Bellevue. Shiny new office towers and the spindly, right-angled arms of cranes

crowd downtown Bellevue's skyline. Seattle saw its largest office towers rise in the late 1980s and early 1990s, and now enjoys a boom in expensive, high-rise condominium projects.

But Tacoma's skyline has a few cobwebs. Its largest tower—the 23-story Wells Fargo Plaza, a simple box with a dated white-and-black chessboard façade (above)—was built in 1970. Two blocks away, the 17-story Tacoma Financial Center opened 23 years ago. Tacoma's newest tower, the mid-rise, nine-story Columbia Bank Center, turned seven this year. Surveying downtown Tacoma's skyline, one can reasonably ask: When will the city see a new office tower?



“The city would like to see a new high-rise,” says Mike Hickey, principal at Neil Walter Co., a commercial brokerage firm in downtown Tacoma. “Private developers would like to build a new high-rise. The problem is we don’t have tenant demand. We don’t have a tenant saying, ‘I’ll commit to 100,000 square feet if you build it.’ That’s what’s keeping [construction of a new high-rise] from happening.”

While Tacoma’s commercial real estate market is still a fraction of Seattle’s, this former timber town is growing fast and would appear to be a perfect market for developers. But it isn’t. In fact, this regional hub, military center and major port is a study in contradictions.

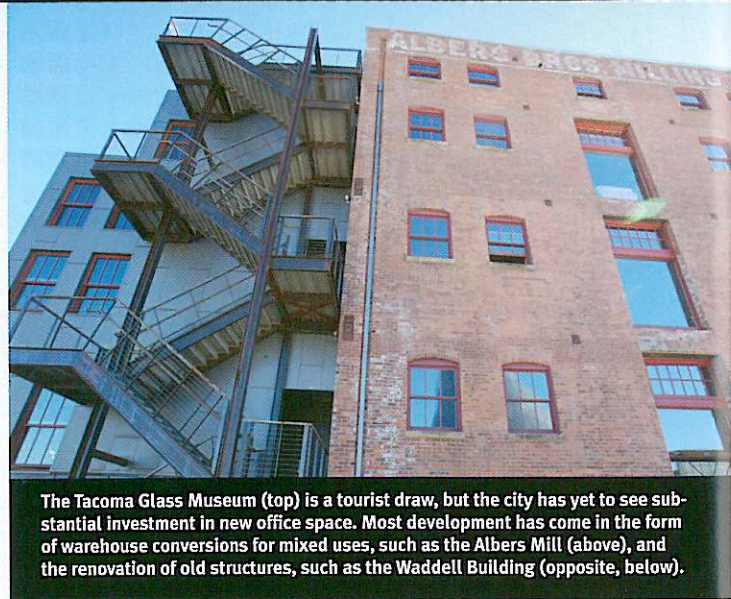
## SPACE CONUNDRUM

TO PUT TACOMA’S office-space market into perspective, consider this: According to various real estate services, Tacoma’s central business district has a total of between 2.95 million and 3.6 million square feet of office space. Of that, between 1.14 million and 1.785 million square feet is considered Class A space. Almost all of that space is in seven large office buildings in the downtown core. By contrast, Seattle has more than 37 million square feet of office space downtown, more than 27 million square feet of which are considered Class A.

Vacancy rates for Class A office space in Tacoma’s central business district are between 1 and 2 percent. But ironically, even with such low vacancy rates, it remains downright cheap to lease in Tacoma. The city’s Class A lease rates range from about \$13 to \$25 per square foot. Seattle and Bellevue, with vacancy rates between 5 and 6 percent, can demand prices averaging around \$40 a square foot, depending on the floor.

That said, Tacoma has proven an attractive location for businesses. A number of major corporations (Columbia Bank, Labor Ready, Russell Investment Group, Rainier Pacific) have large footprints in Tacoma’s downtown. The Washington State Attorney General’s office occupies five floors in the 17-story Washington Building; a collection of state agencies occupies the six-story Tacoma Rhodes Center.

“I’m frankly surprised,” says Paul Ellis, director of metropolitan development for the Tacoma-Pierce County Chamber of Commerce. “We’re sort of flabbergasted. My question is, ‘What’s going on?’ Are people not



The Tacoma Glass Museum (top) is a tourist draw, but the city has yet to see substantial investment in new office space. Most development has come in the form of warehouse conversions for mixed uses, such as the Albers Mill (above), and the renovation of old structures, such as the Waddell Building (opposite, below).

aware of our market? I’m amazed somebody isn’t stepping up.”

One would think that a vacancy rate of less than 2 percent would surely spur developers to build. But, as the low leasing rates point out, there still remains a lack of demand. Without tenant-led interest, developers won’t build, say local brokers. Meanwhile, big companies have claimed expansive swaths of office space; what’s left is a small quantity of space scattered throughout downtown office buildings. It’s a challenge for brokers trying to lure more big companies downtown.

“We get quite a few requests from companies and individuals wanting [Class A] space in Tacoma,” says Morgan Alexander, a commercial real estate broker with Coldwell Banker Hawkins-Poe downtown. “It’s getting to the point where we need something newer and larger. I think as a lot of companies are getting priced out of Seattle and Bellevue, they’re looking at downtown Tacoma. But the space just isn’t there.”

“For those larger tenants, what they want is a 20,000-square-foot footprint,” says John Bauder, senior associate at CB Richard Ellis in Tacoma. “That’s where we have the shortage.”

## SMALL-SCALE SUCCESSES

DESPITE THE LACK OF NEW HIGH-RISES, DEVELOPERS ARE FINDING CREATIVE WAYS TO BRING ADDITIONAL, LOW-RISE OFFICE SPACE TO DOWNTOWN TACOMA.

While Tacoma developers remain wary of committing to building commercial high-rises, players like Blaine Johnson are finding success through smaller projects, such as commercial condominiums.

Never heard of commercial condos? You're not alone. Similar to the residential business model, the relatively new sector provides businesses the opportunity to own office space and pay monthly association dues for general and common-area maintenance of the building.

This system may be just the thing to help ease Tacoma's demand for office space. "I think what's driving [commercial condos] is a recognition that we have probably the lowest vacancy rate of any major city in the state," explains Paul Ellis, metropolitan development director at the Tacoma-Pierce County Chamber of Commerce. "There's got to be demand when you have that low of a vacancy rate and there's not any new office space coming online."

Blaine Johnson and his business partner,

Warren Foster, were among the first to develop the concept in downtown Tacoma. In early 2000, they bought a drab, windowless, four-story building on Broadway for \$550,000, and spent \$2.5 million transforming it into what is now known as the Passages Building.

"This building went through probably as dramatic a transformation as any building downtown," says Johnson, a former sports reporter for *The Seattle Post-Intelligencer*, who now lives in Tacoma and develops real estate projects full time. "From our standpoint, even back then, it just seemed like commercial condominium space obviously had benefits to owner-users. In that light, we felt that there was a real opportunity for Tacoma."

True, it's not Class A space (Johnson calls it "Class B-plus"). But the 42,000-square-foot Passages Building has become the place both historic preservationists and developers of small-scale real estate projects point to as a success story. Originally named the Abbott

Building when it was erected in 1889, the structure's uses evolved over the years, serving as a post office, hotel, vaudeville theater and automobile showroom.

Today, it sports a bold, red facade with large windows dressed in white trim, and a curved, stone entry that reminds visitors of its century-plus-long history. Inside, high ceilings, an open floor plan, exposed brick and sturdy wood beams provide character and charm.

The building, located at 708 Broadway, has given small businesses an option other than leasing Class A space in a generic high-rise. The model has drawn an array of businesses to the address. Financial planners, real estate developers, mortgage brokers, architects and a chapter of the American Heart Association work at the site; a café and home-furnishings store are located on the building's back side, which fronts Opera Alley.

"The scale of development in Tacoma includes a lot of people who are not [part of] big corporations or really large property investors," says Johnson. "Instead of paying a lease, you're buying real estate. It's an opportunity to own something of significant value in the heart of downtown." —T.M.



For more information about how Tacoma's Gintz family is adding office space to downtown, visit the "Web Exclusives" section of [seattlebusinessmonthly.com](http://seattlebusinessmonthly.com)

## THE RUSSELL FACTOR

THE AMOUNT OF Class A office space that high-rise developers will be willing to create in downtown Tacoma may hinge on a single decision to be made by hometown favorite Russell Investment Group: Should they stay or should they go?

The company, founded in Tacoma in 1936 by Frank Russell, has long been one of the city's strongest boosters. It has resisted the lure of moving to the money centers like Wall Street, even as it grew into one of the world's most prestigious financial services companies, now occupying three downtown buildings. But when then-CEO George Russell Jr. sold the firm in 1998 to Milwaukee-based Northwestern Mutual Insurance Co. (NMI), many wondered if that Northwest devotion would survive the shift in ownership.

Currently, Russell's 1,300 Tacoma-based employees are spread across close to 400,000 square feet of office space. The firm sold its 12-story, 226,000-square-foot headquarters on A Street in 1998 when NMI purchased it. Today, Russell occupies space in its former headquarters, as well as in the Wells Fargo Plaza and the Columbia Bank Center.

The clouds hanging over Tacoma stem from the fact that Russell's leases will all expire in 2013. To get a sense of Russell's influence on the Class A scene downtown, consider this: The main reason Tacoma's Class A vacancy rate dropped below 1 percent this year was the company's decision to lease 26,000 square feet in the Wells Fargo Plaza.

"It's pretty well known that Russell has some decisions to make in the next few years as it relates to its corporate headquarters," says Kip Spencer, co-founder of OfficeSpace.com and chief strategy officer at Nu-Mark Office Interiors. "At this point, it's anyone's guess. Ten years ago, the thought of Russell ever leaving downtown Tacoma would have been

unthinkable. But with institutional ownership, there are a lot of variables to consider."

Neil Walter's Hickey says the question about Russell's future has caused plenty of uncertainty in the downtown area.

"If Russell leaves, you have dumped 400,000 square feet onto the market, and you have lost all the momentum that comes from those people who work downtown at Russell," Hickey explains. "It's economic suicide. It puts developers on hold. Everything is on hold."

It's a poker game for developers who hesitate to build anything new, even while Class A vacancy rates continue to drop, for fear that they could see oceans of office space open up in a few years if Russell leaves.

For Russell's part, the high-powered money manager is playing its





The Tacoma branch of the University of Washington (below), which opened in 1997, plus the new Greater Tacoma Convention Center and the light rail line (above), are the centerpieces of the downtown core's recent plans for revival: to attract more businesses and more educated young people.



cards close to the vest. Company officials haven't commented yet on what they will do in 2013. And though communications director Steve Claiborne offered information about the number of employees and square footage Russell has downtown, he declined to comment on whether the business would remain in Tacoma.

The lack of clarity about Russell's future appears to have stalled at least one construction project. In May 2006, the Foss Waterway Development Board selected Tacoma-based developer Prium Companies Inc. to build a five- to six-story, \$27.8 million, 262,500-square-foot mixed-use building on the downtown waterfront; the project would have created 27,000 square feet of Class A space. The facility was originally scheduled to open at the end of this year, but Prium has yet to break ground.

"The Frank Russell [situation] is very interesting in many respects," adds Spencer, who grew up in Tacoma and remembers playing on a youth baseball team sponsored by Russell. "Frank Russell has been a major pillar in Tacoma for many years. Its identity is with Tacoma. I think city leaders will do what they need to do to keep Russell in town."

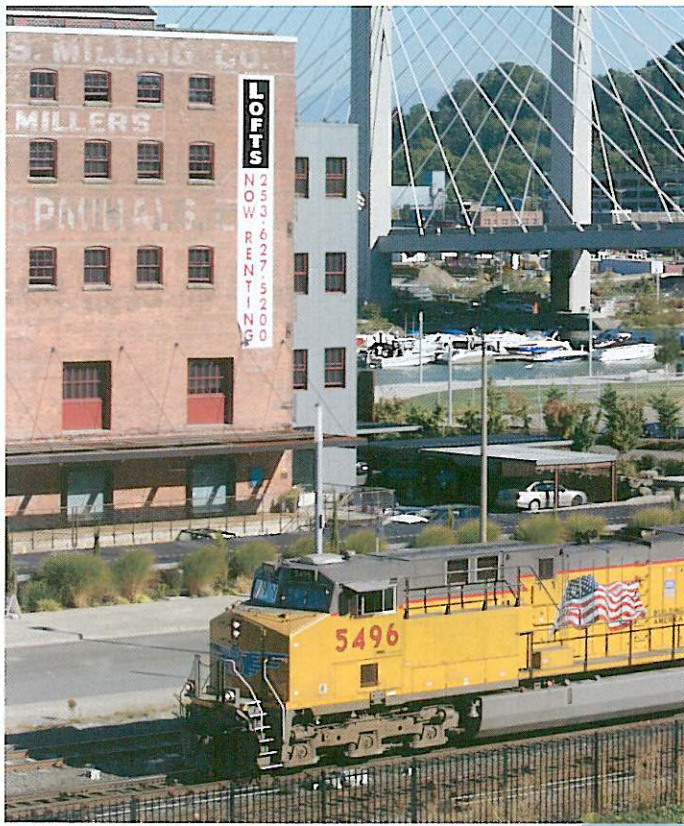
## PAST GLORIES

TACOMA DEVELOPERS haven't always been so reticent. For instance, back in 1983, they were eager to break ground on the Tacoma Financial Center. At the time, Russell was starting to take over much of downtown's office space.

"As Russell experienced growth, it created a demand for space in the market," recalls Hickey. "Tenants were forced to look elsewhere because Russell was gobbling up space in the Wells Fargo Plaza. There was demand."

Also, development activity downtown was on a roll. The Tacoma Sheraton and YMCA were built near the corner of South 13th and Commerce streets. Down on Pacific Avenue, the Rust Building was renovated into Class B office space.

"In that period of time, there was a lot of office development activity," says Hickey, adding that the Tacoma Financial Center was completely



## SIGNS OF LIFE

DON'T GET THE wrong impression. It's not that Tacoma's office real estate market is dead. It's just dormant.

The Tacoma City Council is working to revive the sector. In July, it authorized the issuance of \$9.9 million in bonds to partner with Absber Construction to develop the city-owned Park Plaza South parking garage, now crumbling from neglect. When completed in 2009, the \$32.5 million project will create 68,000 square feet of office space and 30,000 square feet of retail space along busy Pacific Avenue.

But the most promising sign comes from Stratford Co., a Seattle-based developer headed up by a group of retired Microsoft executives. The company owns two historic commercial high-rises downtown: the Old City Hall, purchased in May 2005 for \$3.76 million, and the Washington Building, purchased in July 2005 for \$9.6 million. In August of this year, the company announced it had placed Spokane-based Sterling Financial Corp. in the Washington Building.

The holding company for Sterling Savings Bank will lease an entire floor (7,500 square feet). Also in August, Stratford announced that it had changed its business plan for Old City Hall. Originally, the building was supposed to be renovated into residential condominiums. Now, the company plans to turn the four-story, 50,000-square-foot

leased. "What changed all that was when Russell decided to buy land and build its own building [on A Street]. That created a massive hole in our market—a huge vacancy—and it took years to backfill."

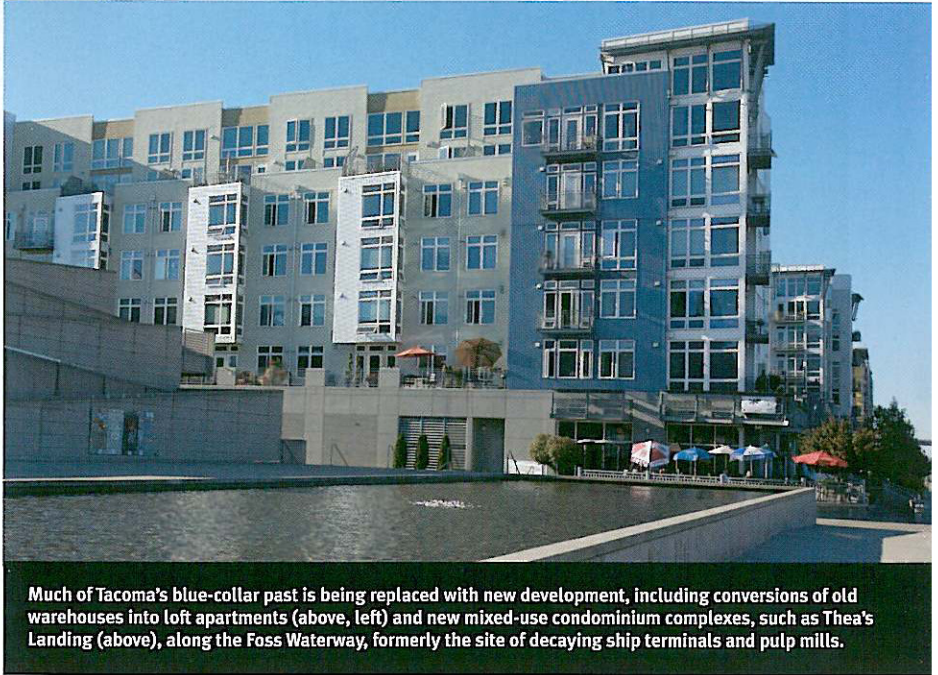
Still, things recovered. In the late 1990s, Russell outgrew its headquarters and started moving into other office buildings. According to Hickey, Columbia Bank was committed to locating its headquarters in a new building downtown and helped convince Russell to join. In the end, Columbia Bank and the Russell Co. agreed to lease 60,000 square feet apiece, or three floors, in Columbia Bank Center.

The decision by Russell and Columbia Bank gave German billionaire and local real estate magnate Erivan Haub (see sidebar profile on [seattlebusinessmonthly.com](http://seattlebusinessmonthly.com)) the confidence to take a chance and build in the city's center, according to Hickey, who assists Haub on commercial projects.

In 1999, Haub broke ground on the Columbia Bank Center. The rest of the building was leased shortly after it opened.

Another issue of concern for commercial developers is the market's absorption rate. Even if Russell and the city's other major economic players stay put, there remains a fear that new developments could overwhelm the current equilibrium. With so little Class A office space in the downtown area, adding another mid-rise or high-rise tower would flood Tacoma's modest market.

"If you build a new Class A building, like the Columbia Bank Center, you're adding [what amounts to] 20 percent of existing space to the market," says CB Richard Ellis' Bauder. "Absorption isn't going to take care of that. As a percentage of the overall market, it's too large. In downtown Seattle, that's nothing. It's not a big hit."



Much of Tacoma's blue-collar past is being replaced with new development, including conversions of old warehouses into loft apartments (above, left) and new mixed-use condominium complexes, such as Thea's Landing (above), along the Foss Waterway, formerly the site of decaying ship terminals and pulp mills.

building into Historic Class A commercial office space.

When Mark Isner, Stratford Group's director of asset management, was asked if his firm's investments in downtown high-rises meant that Stratford was bullish on Tacoma, he chuckled. He says Tacoma has some "differentiating characteristics" that Seattle does not: good lease rates, low vacancy rates and less competition among developers.

"I think buildings and commercial real estate in Seattle are, frankly, overpriced at this point," Isner says. "Anytime a quality property goes on the market in Seattle, it's a feeding frenzy. It's ridiculous. Tacoma is the land of opportunity. I think there's still some value down here. And we're certainly not the only people who think that."

"Maybe 'new frontier' is a little bit of a hyperbole," Isner continues, "but there is opportunity down here that doesn't exist in Seattle. As they say in the sporting world, we like our chances." **SB**



For a profile on Tacoma's reclusive Erivan Haub, see [seattlebusinessmonthly.com](http://seattlebusinessmonthly.com) and click on "Web Exclusives."