Kidder Mathews

Real Estate Market Review

King, Snohomish, and Pierce Counties

1st Quarter **2016**

Seattle Office

Market Forecast

	Current / Projection	
Vacancy	7.87%	↓
Construction	7.7M sf	↔
Rental Rate	Varies*	↑
Absorption	672,927 sf	↑

* by submarket

Market Highlights

The regional vacancy rate trended down over the quarter to 7.87%. Net absorption was strong at 670,000 s.f., 71% of that in the Seattle market. The availability rate increased as additional projects got started in the quarter.

Construction activity increased in the quarter as only one project was delivered and two major projects got started. There are now 20 office projects underway: 15 in the Seattle CBD, three in the Bellevue CBD, one in Kirkland and one in Renton. Thirteen of the Seattle projects are speculative. Currently about 42% is pre-leased.

Office property sales was strong in the quarter, with several major institutional-quality sales, both new construction and vintage properties. Non-CBD properties continue to see more interest.

Rental rates moved upward slightly in the quarter, a trend expected to continue. ■

The strength of the national economic recovery may be in question, but there are no signs of any slowdown in the Seattle office market. The first quarter of 2016 saw the expansion of the tech industry continue. Google, Tableau Software, Wave Broadband and Amazon announced major new leases. Encouraging activity was also seen by more traditional businesses. Examples in the quarter included REI (retail) leasing space in two Bellevue locations and Saltchuk (shipping and logistics) in a newly started building in Seattle's Pioneer Square.

General leasing activity improved significantly outside of the Seattle and Bellevue CBDs, which had led the region coming out of the recession. Regional first quarter absorption was just over 670,000 s.f., a bit off the 2015 pace, but well above the previous ten years. This left the regional vacancy at 7.87%. Rental rates continue to move up at a steady but modest rate, with some localized micro markets such as South Lake Union and Fremont feeling more pressure as sites for new inventory are nearly gone. Companies are definitely being careful about overextending, but it is expected that there will be at least two more years of strong demand following the employment growth peak in 2015.

VACANT SPACE/VACANCY RATE

All five of the regional markets registered a drop in vacancy rates in the first quarter. Overall, the regional rate dropped by 23 bps to 7.87%. This leaves about 15 million square feet vacant out of a standing inventory of 190 million square feet. The availability rate moved up to 11.92% from 11.59% as new projects are started and others already underway make space available for lease. This rate is expected to hold near this level near-term as about four million square feet of new inventory is delivered over the next two years. The current quarter shows 39% of the space under construction pre-leased. As a worst case, without any further pre-leasing the effect of all this new space would be to increase the region's vacancy rate by a total of only 125 bps. However, it is fully expected that there will be significantly more leasing secured prior to completion of many of these projects.

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Area Review

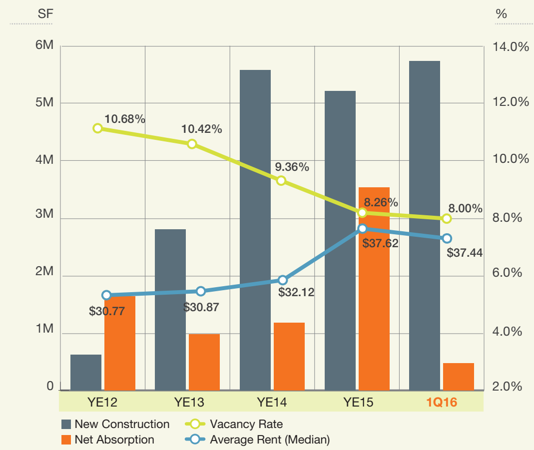
Seattle CBD/Surrounding Area Review

The Seattle submarket recorded another strong quarter with net absorption at 476,245 s.f. The vacancy in the submarket dropped to 8.00% while the availability rate inched up slightly to 11.70%, with two new buildings starting construction. In the Seattle CBD submarket, the vacancy rate dropped to 10.0%, a 140 bps decrease. The availability rate remains high at 18.7% due to the significant amount of available space under construction. The speculative space under construction in the Seattle market totals just more than 3.9 million s.f. About 42% of that space is pre-leased. About half of the available space under construction is in the two new high rises under construction in the financial core, with no pre-leasing announced so far. Significant leases continued to be finalized in the last quarter of the year, continuing the pressure on rental rates. Leasing activity remains strong in the attractively priced and renovated space in financial core legacy Class A buildings and in Pioneer Square locations. The downward vacancy trend in the Seattle market, and the Seattle CBD in particular, is expected to continue through the next two years, moderated somewhat by the lack of pre-leasing in the two core towers. Upward pressure is still affecting rental rates; however, the increases have slowed to a more stabilized pace as new construction continues to be delivered.

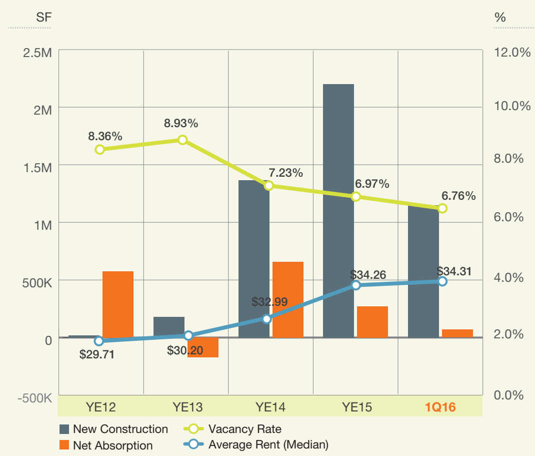
Eastside Review

The Eastside market vacancy rate dropped by 21 bps in the first quarter to 6.76%. Net absorption for the quarter was modest at 69,295 s.f. following 409,431 s.f. absorbed in the fourth quarter of 2015. The availability rate continued to decrease, to 10.8%, down 40 bps over the quarter. Vacancy in the Bellevue CBD ended the quarter at 10.0% with the availability rate dropping to 19.2%, nearly 400 bps over the quarter, mainly due to Microsoft's decision not to sublease their Bravern space. There are a few large tenants looking for larger spaces in the Eastside markets, but there has also been growing caution in the face of the volatile stock market and reduced equity funding. Outside of the CBD, the Redmond and 520 submarkets continue to perform very well, ending the quarter with vacancy at 3.1% and 3.0%, respectively. In Kirkland, Google occupied the second half of their 360,000 s.f. campus and Kirkland Urban started construction on their project. Tableau Software and Wave Broadband have each pre-leased the top three floors in two of the three six-story office buildings in that project. The Spring District at the northeast corner of central Bellevue got a major boost with the announcement that REI will move their headquarters to that development around the planned Link light rail station. The initial REI space is in the 200,000 s.f. range, but there is the potential for expansion. Rental rates in the suburban submarkets around the Bellevue CBD continue to firm up as smaller companies expand. Continuing to move into the mid-$20/s.f./year, NNN range for newer product, they still offer a $10 edge over Bellevue CBD rates, even before parking costs are considered. Sales activity increased significantly in these suburban locations with the first quarter sales of Sunset North Corporate Center and One Newport in the I-90

SEATTLE CBD/SURROUNDING AREA



EAST KING COUNTY



Corridor, and The Offices at Riverpark in Redmond. The entire Eastside market is expected to see vacancies trend downward and rental rates upward over the next few years.

South King County Review

The South King County market took a small breather in the first quarter following a very strong end to 2015. Absorption was positive at 31,651 s.f., nudging the vacancy rate down slightly to 9.33%. The availability rate jumped to 17.17% with the addition of the 840,000 s.f. Southport Office Campus to the space offered for lease. That project consists of three nine-story, 280,000 s.f. office buildings and a 12-story Hyatt Regency hotel on the south shore of Lake Washington. The asking rent for the office space, with strong retail support nearby and good access to I-405, is $27/s.f./year, NNN. No pre-leasing has been announced to date, but this rate undercuts Bellevue significantly. In general, leasing activity in South King County continues to consist of mostly small tenants, pointing to the steady rising confidence of small businesses. No major changes from the recent trend are expected in the South King County market in the coming year, resulting in modest reduction in the vacancy rate and some firming of rental rates.

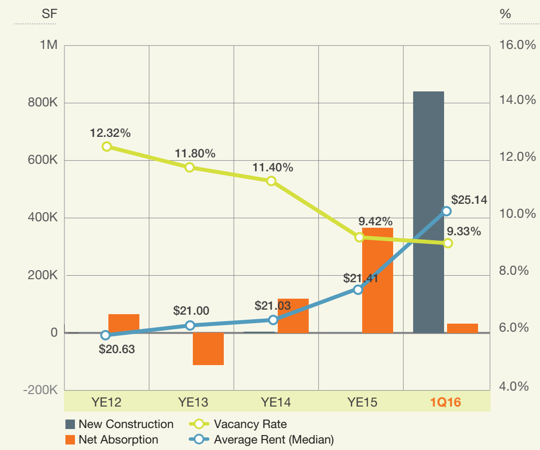
Northend Review

The vacancy rate in the Northend office market continues to move downward, ending the first quarter at 8.09% on the strength of 62,743 s.f. of net absorption. The availability rate held steady at 10.50%. The performance was encouraging as it was in spite of Bothell losing over 50,000 s.f. of occupancy in the quarter. The various Northend submarkets are attractive for their lower cost office space and more affordable housing for workforces. Asking rental rates were flat through all of 2015 and the first quarter of 2016 and are not expected to increase significantly in the near future.

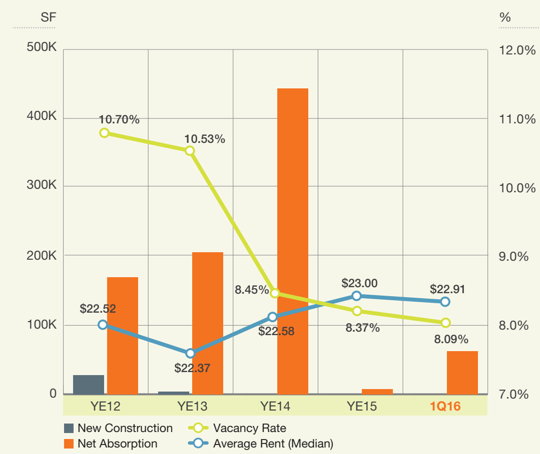
Pierce County Review

The Pierce County market ended the first quarter with positive net absorption of 32,993 s.f., knocking 25 bps off of the vacancy rate which fell to 8.26%. The availability rate saw a minor decrease to 12.70%, down 20 bps for the quarter and over 200 bps year-over-year. Asking rent was up just slightly in the quarter, following a strong increase in the fourth quarter of last year. Tacoma CBD vacancy fell to 8.73% this quarter, the second 60 bps quarterly decrease in a row. In the CBD the availability rate is 12.1%, unchanged from year-end 2015. The CBD vacancy rates will be difficult to improve upon as there is a significant amount of vacant space in the CBD that is non-functional for most users. This may change as the conversion of the Old City Hall to an alternate use is expected to remove it from the office inventory. Sales in this market continue to be focused on smaller properties, primarily owner/user acquisitions. No sales of non-medical office properties over $1.5 million closed in the quarter.

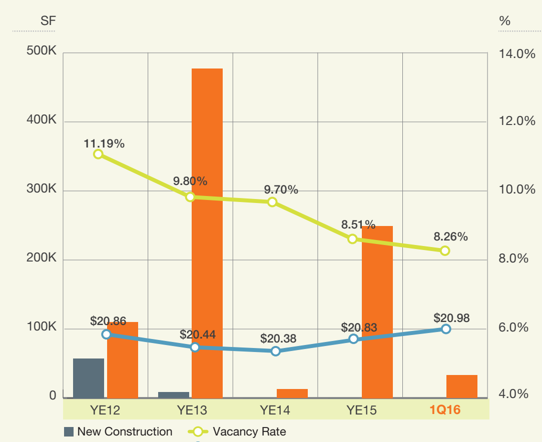
SOUTH KING COUNTY



SNOHOMISH COUNTY



PIERCE COUNTY



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1Q 2016 Seattle Office Sales

Name	City	Date	Price	SF	$/SF
West 8th	Seattle	Feb-16	$370,000,000	497,798	$743.27
Sunset North Corporate Center	Bellevue	Mar-16	$155,200,000	464,062	$334.44
Alley 24	Seattle	Feb-16	$129,400,000	215,402	$600.74
101 Elliott Building	Seattle	Feb-16	$40,400,000	101,738	$397.10
The Offices at Riverpark	Redmond	Mar-16	$36,900,000	106,281	$347.19
One Newport	Bellevue	Jan-16	$29,075,000	83,164	$349.61

NEW CONSTRUCTION ACTIVITY

The amount of office space in the market continues to increase with 20 office buildings under construction in the region at the end of the first quarter. Two major projects got underway in the first quarter. Kirkland Urban, formerly Kirkland Parkplace, is a mixed use redevelopment project in downtown Kirkland including three office buildings with a total of 660,000 s.f. Demolition of the existing buildings started soon after an announcement of leases totaling about 180,000 s. f. to Tableau Software and Wave Broadband. Both of these tenants already have smaller Kirkland offices. Work was also started on the long-planned 840,000 s.f. Southport Office Campus at the southern end of Lake Washington in Renton. The developer of that project is targeting value-oriented tenants looking for big blocks of new space that are currently only available in CBD high-rise projects. Another project that will be added to the list in the near future is a group of four mixed-use buildings in the heart of South Lake Union that Vulcan will build for the Seattle expansion of Google. The initial plans show six floors of office space with residential units above. The total office lease is expected to be about 607,000 s.f., about three times what the company currently occupies in Fremont at the north end of Lake Union.

RENT FORECAST

Rental rates continue to increase across the region with some catch-up increases in secondary and tertiary locations that are just recently feeling tightening availability. The satellite markets should see more of these increases as smaller business generates more demand and vacancy falls over the next few years. The increases in the Seattle market are expected to moderate as significant speculative new space is added, competing for a relative small number of major lead tenants. Other moderating factors include Amazon's identification of most, if not all, of their stabilized space requirement and the further downward revision of job growth forecasts for 2016 and 2017.

INVESTMENT MARKET

Non-medical office sales in the first quarter totaled about $1 billion, with a total of 85 sales. Half of the total was accounted for in the sales of West8th in the Seattle CBD and Sunset North Corporate Center in the Eastside's I-90 Corridor submarket. The West8th sale at $370 million was enlightening, as that price represented at 33% increase in value over the seller's purchase in November 2012. Both that sale and Sunset North highlighted the demand for well leased properties with strong tenants (Amazon at West8th and Boeing and Intellectual Ventures in Sunset North). The capitalization rates for these projects were reportedly below 5% for West8th and just above that for Sunset North. The average price for the entire quarter's sales volume was $386/s.f at an average capitalization rate of 6.6%, both indicators reflecting the higher ratio of suburban space in this data set. Overall, there is strong investor confidence in the region's long-term growth potential, and they are becoming more willing to invest outside of the CBDs.

Data Source: CoStar