

# Seattle Office

## Market Forecast

	Current / Projection	
Vacancy	7.76%	↑
Construction	7.05M sf	↑
Rental Rate	Varies*	↑
Absorption	283,573 sf	↑

\* by submarket

## Market Highlights

Regional vacancy rate increased slightly over the quarter to 7.76%, with net absorption of 283,573 s.f. in the quarter, led by the Seattle market. Availability rate dropped to 10.58% as leasing activity continues.

Three buildings were delivered this quarter, all in the Seattle market. The total is now 17 office projects underway; 12 in the Seattle CBD, one in the Bellevue CBD, one each in Kirkland, Renton and Des Moines. Eleven of the Seattle projects are speculative, currently about 58% pre-leased. Region wide 7 million s.f. under construction is 60% pre-leased.

Office property sales were strong in the quarter, with only five institutional-quality sales, and 20 sales over \$5 million. Suburban properties transactions are increasing.

Rental rates were virtually flat over the quarter, growth is expected to increase.

The region's office market saw a wide variety of activity in the second quarter. Leasing activity was strong, led by the announcement that f5 Networks will lease all 28 office floors in The Mark; several buildings were delivered; a couple more got started; and an array of projects were sold, including two major South Lake Union buildings and an increasing number of suburban investment sales in the Eastside. This strong performance is pushing against the national slowing of commercial real estate investment and leasing. The reason for this is jobs, high wage tech jobs, creating demand for office space, but also supporting expansion in all of the other commercial real estate categories. Recent forecasts have revised the region's job growth to 2.5% in 2017, up 50% from previous quarters' projections. An additional facet of the tech core in this expansion is that most of these companies are viewed as being somewhat recession resistant, helping stabilize the region's economy. This has inspired confidence in investors worldwide, exhibited in the 4.4% capitalization rates in those two South Lake Union sales of major properties leased to Facebook and Amazon.

In the numbers, regional vacancy rate ticked upward slightly from 7.69% to 7.76%. This was due to new deliveries and some lagging commencements in those properties, along with sluggish demand in the secondary markets. A few basis points (bps) were whittled off the availability rate dropping that indicator to 10.58%. This on net absorption of 283,573 s.f. in the quarter. The average asking rent was generally flat over the quarter, but the starting rate of about \$40/s.f./year net for the f5 Networks lease highlights strength at the top of the market.

The number of projects under construction dropped to 17 in the quarter with the completion of Midtown21, 2701 Eastlake, and 3rd & Battery, all in the Seattle CBD. New buildings started in Renton (Group Health build-to-suit) and South Lake Union (Kilroy's 333 Dexter, 650,000 s.f. of speculative space). The total amount of space underway is 7 million s.f. Overall, these buildings are 60% pre-leased, including 49% of the 5,454,065 s.f. of speculative space.

## VACANT SPACE / VACANCY RATE

The regional office market has 15.2 million s.f. of vacant space, out of a standing inventory of 195.3 million s.f. The vacancy rate inched upward in the second quarter to 7.76%. The increase is tied to a lack of major lease commencements in the quarter, other than those in new buildings delivered to the market. Currently there are only 21 spaces over 50,000 s.f. listed for

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# Area Review

## Seattle CBD / Surrounding Area Review

Net absorption in the Seattle submarket in the second quarter was 300,672 s.f., making up for the net loss in the previous quarter. That result was powered by the delivery of Midtown21 with its entire 365,000 s.f. pre-leased by Amazon and 3rd & Battery with its 72,400 s.f. pre-leased by Antioch University and Sound Community Bank. Without those deals the net absorption would have been negative although there were no major vacations or downsizings in the market. The larger Seattle vacancy rate increased slightly to 7.35% from 7.30% last quarter. The availability rate fell 210 bps to 10.20%, due to the f5 Networks lease, by far the largest lease announced in the quarter. Partially offsetting the availability reduction of that lease, f5 is already marketing their 85,000 s.f. in 401 Elliott for sublease. Also adding to the availability this quarter is the 106,000 s.f. 1260 Mercer Building, which Amazon will vacate at the end of 2017.

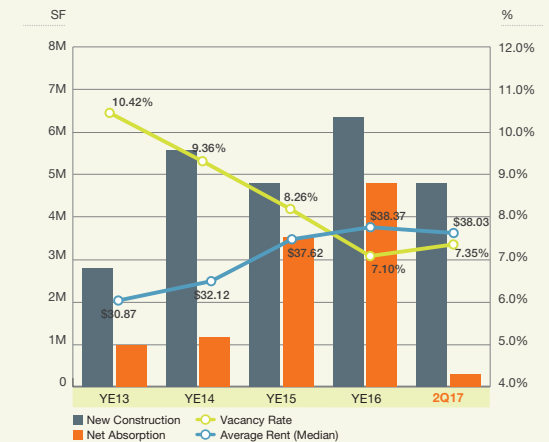
In the Seattle CBD submarket, the historical core of the market, the f5 Network lease did more than reduce the availability rate from 14.8% to 12.8%. It is hoped to be a start of expanding new economy tenant interest in this sector. Home to about 20 million s.f. of legacy Class A office space, demand languished as those companies preferred new buildings in South Lake Union to the north or character buildings in Pioneer Square to the south. Over the past few years several buildings, from the Exchange Building to Wells Fargo Center and recently 800 5th Avenue, have been renovated with tech tenants in mind. It will be interesting to see if traffic issues in South Lake Union, the lack of space in Pioneer Square, and relatively affordable rental rates will be enough to bring others to join f5 in the core. The current vacancy in the Seattle CBD is 10.3%, including most of those over-100,000 s.f. vacancies noted earlier. Rental rates for the renovated legacy Class A towers are about 10% lower than the newer space in South Lake Union, not much of an incentive to the Amazons or Googles in the market, but attractive for companies on their way up.

The downward vacancy trend in all submarkets of the Seattle market should continue through the next two years with minor blips if projects like 333 Dexter and Madison Centre deliver with large blocks of space unleased. On the investment side, the region's two major sales during the quarter are located in South Lake Union. Midtown21, leased to Amazon just before completion closed in June at \$899/s.f. Dexter Station opened in 2016, fully leased to Facebook sold in May for \$827/s.f. Both sold to German investors and both showed going-in capitalization rates of about 4.4%. On the last day of the quarter, Vulcan sold 428 Westlake to a private investor for \$81.5 million, pushing the regional record to \$924/s.f. for the 88,225 s.f. building fully leased by Amazon.

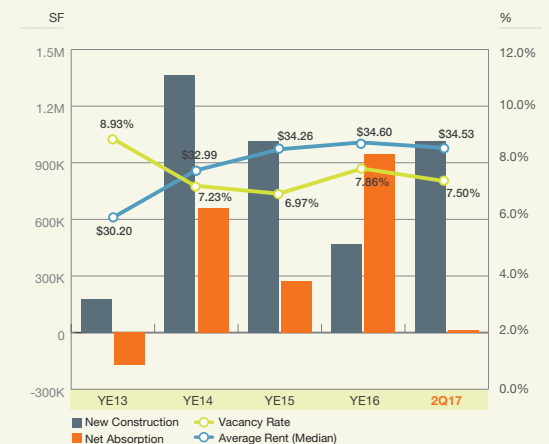
## Eastside Review

The Eastside office market has two projects under construction: Centre 425 in the Bellevue CBD and Kirkland Urban on the edge of downtown Kirkland. Centre 425 is fully leased by Amazon; Kirkland Urban remains at 27% leased to Tableau and Wave Broadband. Demand has prompted Hines to move toward restarting construction on Summit III, which was stopped just before vertical construction in 2009. The 302,000 s.f. building could be delivered in 18 months. Net leasing activity was modest in the second quarter at 13,784 s.f., leaving the Eastside vacancy rate at 7.5%. The availability rate decreased to 8.6% based on leases written in the quarter that have not yet commenced. The Bellevue CBD vacancy decreased from 16.6% last quarter to 14.6% and availability decreased from 12.5% to 11.5%. The CBD is still facing pending vacation of more than 500,000 s.f. leased by Expedia in its named building and Skyline Tower. Recently it was announced that about 120,000 s.f. of that space will be retained past the current late 2018 expiration date to accommodate employees living on the Eastside. The timing of that potential that give-back and the performance of Lincoln Square South Tower, now 87% leased, and 929 Tower, approaching 50% leased, has moderated the risk of major spikes in the CBD vacancy rate. If 380,000 s.f. of the Expedia space is returned with no pre-leasing, the effect would be a 360 bps increase in the CBD vacancy rate. Considering the continued demand for space, that seems to be the worst case scenario. The submarkets outside of the CBD continue to perform quite well, ending the quarter

## SEATTLE CBD / SURROUNDING AREA



## EAST KING COUNTY



with vacancy rates of 6.2% and 4.1% respectively in Kirkland and Redmond and 6.1% along the I-90 Corridor. Rental rates in the suburban submarkets around the Bellevue CBD continue to firm up as smaller companies are re-positioning as rates continue to increase in the strong submarkets with little new construction underway. There were several Eastside sales this quarter, all were suburban office park style properties including the four-building Park 120 and the two buildings of the Commons on 90, both selling in the \$410 to \$430/s.f. range.

### South King County Review

The South King County market gained back some of the occupancy lost in the previous quarter with a net gain of 47,200 s.f. The vacancy rate remains as the high indicator for the region at 10.67% and the availability rate is also the highest at 17.50%. The main component of that availability rate is the 748,000 s.f. Southport Office Campus under construction in Renton with no pre-leasing announced. In the second quarter it was joined by a 146,910 s.f. Group Health building starting construction in Renton. In general, leasing activity in South King County continues to consist of mostly small tenants moving around without much expansion. Boeing continues to give back space and no major company has been found to replace their demand for office space in this submarket. No major changes from the recent trends are expected in the South King County market. Traditionally this market is the last to recover, providing lower rental rates as the more active Eastside and Seattle markets price out some tenants.

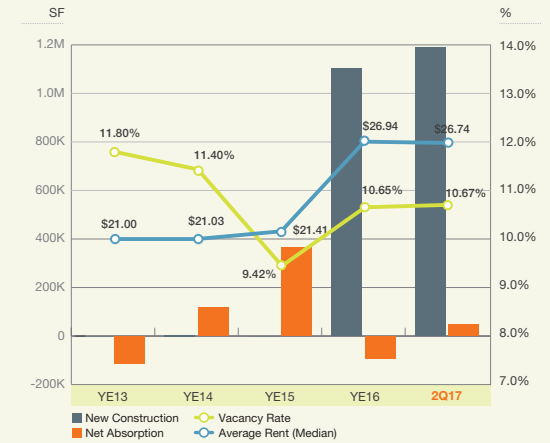
### Snohomish County Review

The Northend office market had a minor setback in the second quarter as negative net absorption of 90,011 s.f. pushed the vacancy rate up 43 bps to 7.61%. The source of this was Boeing's cancellation of leases in the Bothell market, as that company continues to move divisions out of state. The availability rate declined slightly as some older office space was demolished dropping the overall inventory by almost 56,000 s.f. The Everett CBD has been fairly quiet with a current vacancy of 6.5%. The Lynnwood/Edmonds submarket remains one of the more active Northend submarkets with vacancy at 5.9%, down from the year-end 2016 vacancy rate of 6.9%, fueled by 160,016 s.f. of net absorption over the past year. The Northend submarkets continue to attract smaller office tenants looking for a combination of affordable office space and good proximity to lower cost housing for its employees. Asking rates moved up by \$0.49/s.f. from last quarter to \$24.18/s.f./year, full service which still is very affordable compared with the Eastside and Seattle markets to the south. There were no major sales in the second quarter; however, Redstone Corporate Center I in Lynnwood and Redstone Corporate Center II in Mountlake Terrace, among the nicest multi-tenant properties in that market, were recently offered for sale at \$200/s.f. for the combined 320,000 s.f. buildings. Overall, the Northend market should see gradual decline of vacancy and slow but steady increase in rent.

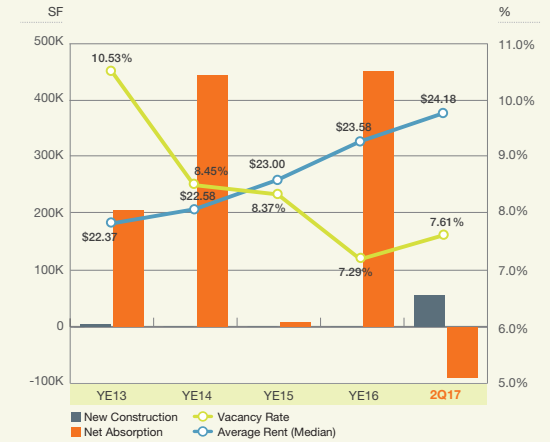
### Pierce County Review

The Pierce County market extended the positive absorption seen in each of the past six quarters with net leasing of 11,906 s.f. The vacancy rate moved down slightly to 7.28%, and the availability rate fell by 40 bps to 10.6%. The Tacoma CBD vacancy rate is 7.5%, down 10 bps over the quarter and the availability rate is down 120 bps to 8.2% over the past quarter. The reason for the improvement was the conversion of the functionally obsolete vintage Washington Building to residential use. The trend is expected to accelerate with non-functional vintage buildings being redeveloped as the Tacoma CBD is seeing a renaissance in terms of office, residential, and retail support. Rental rates in the Pierce County market were flat in the quarter. Sales in this quarter were all smaller properties, primarily for owner/users, or for redevelopment. The pace of improvement in the market overall is expected to continue to increase as the neighborhoods surrounding the CBD are contributing to the renaissance with strong interest in housing, including new multifamily geared toward professionals working in the CBD.

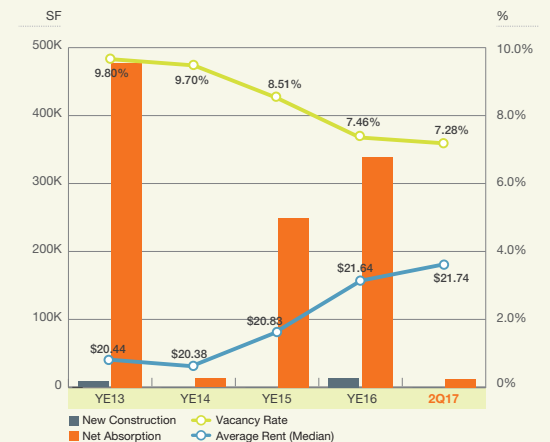
### SOUTH KING COUNTY



### SNOHOMISH COUNTY



### PIERCE COUNTY



## 2Q 2017 Seattle Office Sales

### Offices

Seattle	206.296.9600
Bellevue	425.454.7040
South Seattle	206.248.7300
Tacoma	253.722.1400
Olympia	360.705.2800
Portland	503.221.9900
San Francisco	415.229.8888
Redwood Shores	650.769.3600
Silicon Valley	408.970.9400
Sacramento	916.970.9700
Roseville	916.751.3600
Los Angeles	213.880.5250
Long Beach	562.472.0071
Commerce	323.727.1144
Orange County	949.557.5000
Inland Empire	909.764.6500
San Diego	858.509.1200
Carlsbad	760.430.1000
Reno	775.301.1300
Phoenix	602.513.5200

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Name	City	Date	Price	SF	\$/SF
Midtown 21	Seattle	Jun-17	\$330,200,000	367,453	\$898.62
Dexter Station	Seattle	May-17	\$286,000,000	345,992	\$826.61
428 Westlake	Seattle	Jun-17	\$81,500,000	88,225	\$923.77
90 East	Issaquah	Jun-17	\$153,000,000	573,000	\$267.02
Park 120	Bellevue	Jun-17	\$32,000,000	75,000	\$426.67
Sweeney Conrad Building	Bellevue	Apr-17	\$13,500,000	33,155	\$407.18

lease in the entire region. Of those only 14 are larger than 100,000 s.f.. The largest existing space ready for occupancy is the 312,000 s.f. repurposing of four floors in the vintage Macy's department store in downtown Seattle. Interestingly, the developer of the Macy's space is considering purchasing two more floors to have the ability to accommodate a tenant with needs for an even more contiguous space. Tenants looking for newer construction space over 100,000 s.f. are limited to first generation space in 929 Tower in Bellevue, recently renovated space in 800 5th Avenue or hold off for completion of Madison Centre later this year. The availability rate, which tracks space being marketed but not necessarily completed or currently vacant, has continued to drop, ending the second quarter at 10.58% region-wide down from a peak near 16% in the depth of the recession. Both of these indices are expected to continue falling, with some temporary upward pressure on the vacancy rate later this year if Madison Centre doesn't lease its 580,000 s.f. of unspoken for space. That space alone would increase the regional vacancy rate by 30 bps. However, with a number of tenants actively looking in the market, it is likely that additional preleasing will be announced before those doors open.

### NEW CONSTRUCTION ACTIVITY

The total amount of space delivered in the second quarter totaled just less than 490,000 s.f., including three Seattle CBD projects. Looking forward, the next quarter should see Tableau 744 N 34th, Troy Block North, Tilt49, and 450 Alaska finished. Out of the 852,628 s.f. in those four buildings, only 67,500 s.f. in 450 Alaska is not pre-leased. The fourth quarter will see Centre 425 open in the Bellevue CBD, bringing the first Amazon employees to that location. Also in the fourth quarter Madison Centre and f5 Tower (fka The Mark) will be delivered to the Seattle financial core. All of these buildings except Tableau started off as speculative developments, targeting multi-tenant occupancy. The buildings under construction in the region now total 7 million s.f. of which 2.77 million s.f. is still available. Kilroy started 333 Dexter in South Lake Union with 650,000 s.f. in two 12-story towers attached via an elevated walkway. No leasing has been announced, but its location

near several Amazon buildings and planned projects pre-leased by Google and Facebook would make it an attractive spot for other tech companies looking at Seattle. Work continues on Southport in Renton and the Kirkland Urban project, the latter 27% pre-leased. Looking forward there still appears to be little potential of significant over-supply in the near term.

### RENT FORECAST

Rental rates continue to be stable as the market's supply and demand are balanced. Changes in the overall rates quoted quarter to quarter are attributable to the quality of the available space, more than rate movement in actual deals. Tech company demand has allowed Class A space and the more attractive vintage space to see better rent growth, although even those changes have been incremental with no recent spikes. Businesses outside of the tech category have seen slower growth, both in terms of hiring and revenues, limiting their expansion. Even with construction costs continuing to increase, the current rent levels remain cost feasible. The forecast is for rent growth at a steady 3-5% annual rate, depending on location and asset class.

### INVESTMENT MARKET

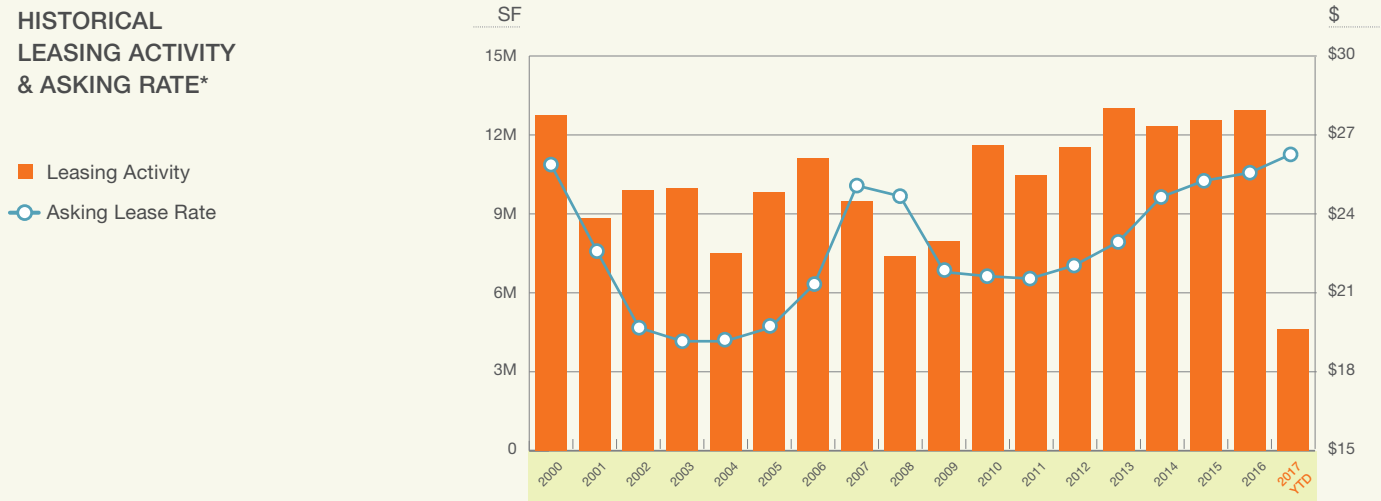
Office investment increased significantly in the second quarter with a total volume of \$1.08 billion. There were 20 sales over \$5 million. Three sales over \$150 million accounted for over 66% of the total dollar amount. Foreign investors, particularly from Germany, took the lead in the second quarter with a hand in each of those three largest sales. There remains more interested buyers than properties for sale in the market, a factor in the 4.4% capitalization rates in the top two sales. In terms of number of sales, suburban properties were in the majority as mid-level buyers are attracted to returns on those properties in the 6% range for seasoned properties. Overall, there is strong investor confidence and interest in the region based on its long-term growth potential and broad-based employment growth.

Data Source: CoStar

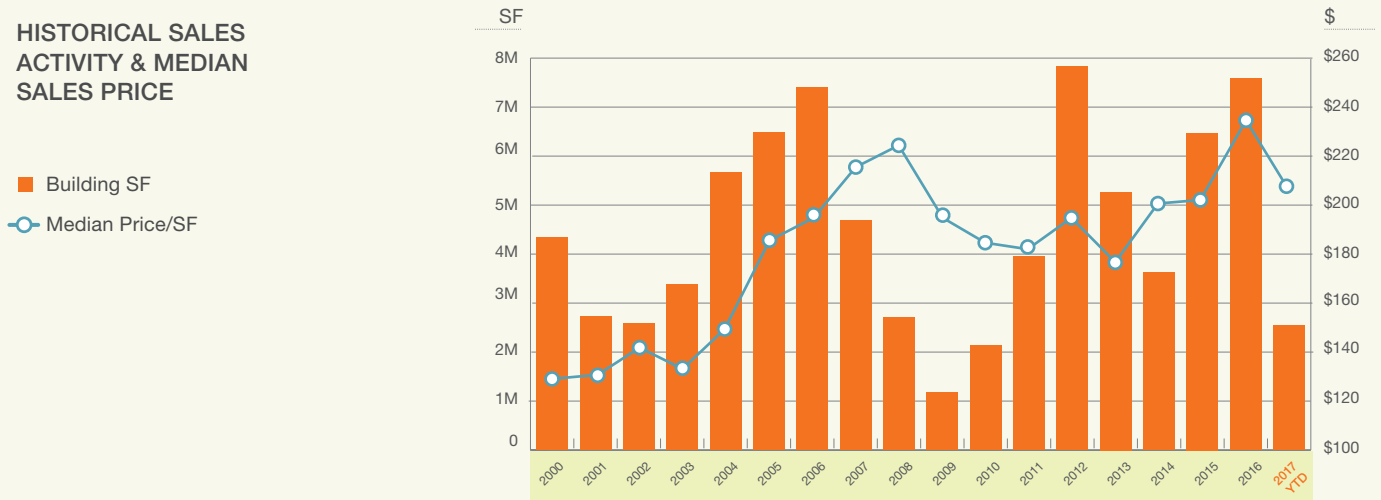
# 2nd Quarter 2017 Seattle Office Market Statistics

MARKET BREAKDOWN	2Q17	1Q17	2Q16	Annual % Change
Vacancy Rate	7.80%	7.80%	7.50%	4.00%
Availability Rate	10.60%	10.90%	11.10%	-4.50%
Asking Lease Rate	\$26.23	\$26.16	\$25.36	3.43%
Leased SF	2,380,711	2,229,310	2,961,286	-19.61%
Sold SF	1,432,758	1,114,795	2,040,900	-29.80%
Net Absorption	283,579	-118,810	997,214	N/A

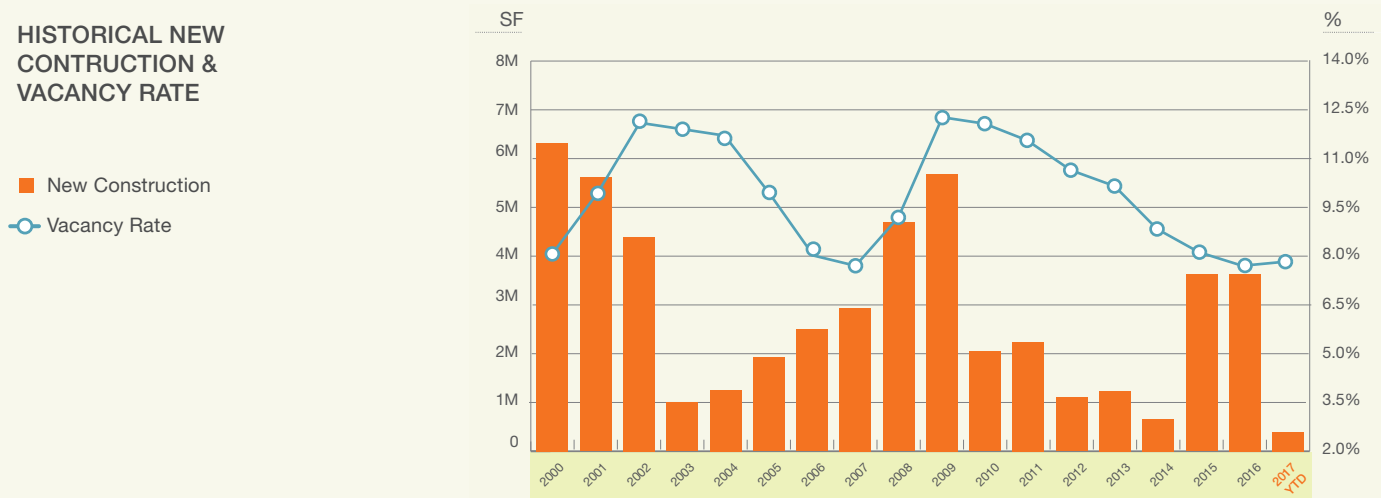
## HISTORICAL LEASING ACTIVITY & ASKING RATE\*



## HISTORICAL SALES ACTIVITY & MEDIAN SALES PRICE

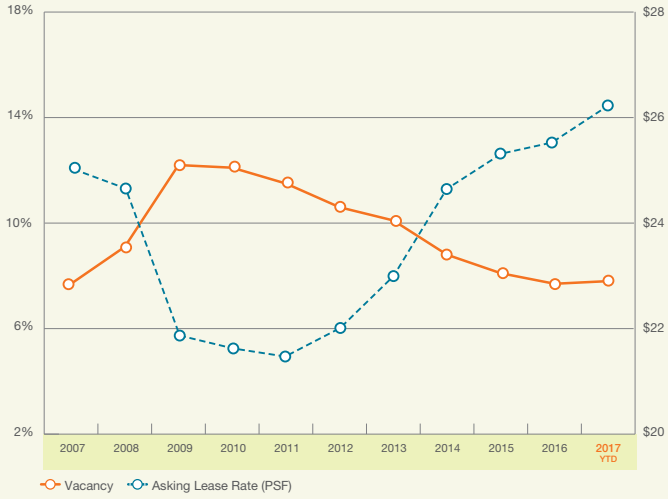


## HISTORICAL NEW CONSTRUCTION & VACANCY RATE

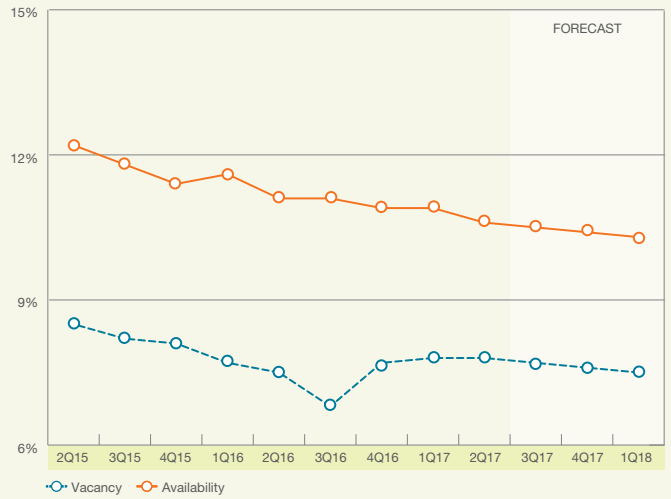


# 2ND QUARTER 2017 SEATTLE OFFICE MARKET STATISTICS CONTINUED

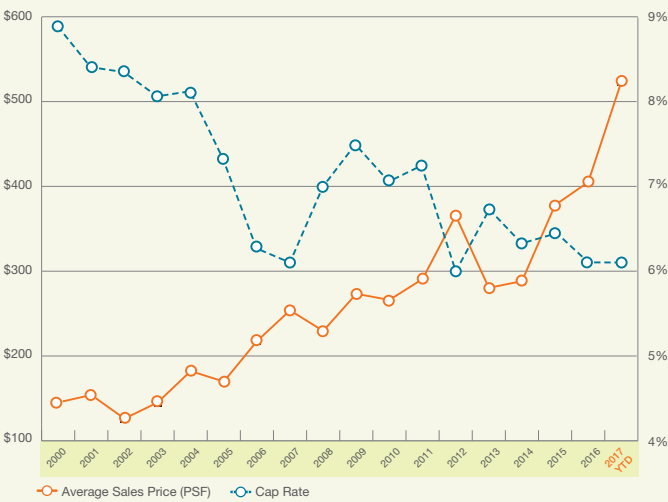
### VACANCY VS ASKING LEASE RATE



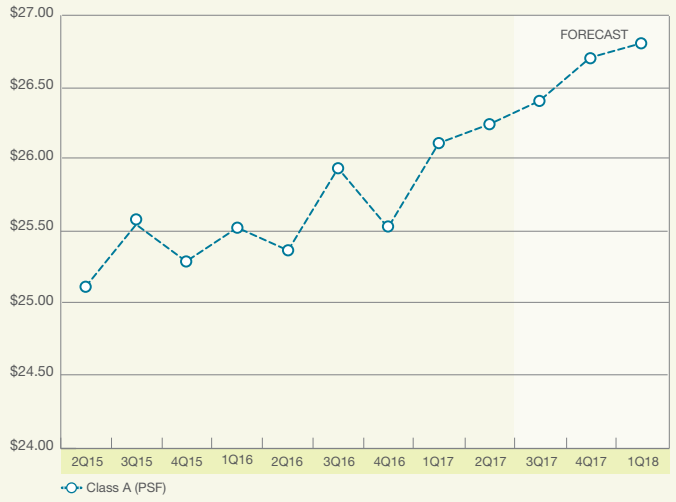
### VACANCY VS AVAILABILITY



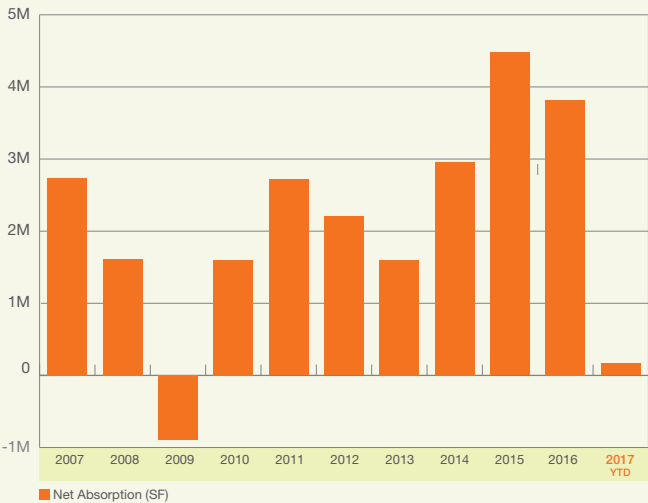
### AVERAGE SALES PRICE & CAPITALIZATION RATES



### ASKING LEASE RATE



### NET ABSORPTION - HISTORICAL



### NET ABSORPTION - QUARTERLY

