Kidder Mathews

1st Quarter 2018

Real Estate Market Review

Seattle Office

After a solid performance for the regional office market during 2017, Q1 office metrics do not show any signs of losing much steam. The Puget Sound region's office market saw the vacancy drop down to 7.15%, compared to 7.74% last quarter. With the exception of the Q3 2016 vacancy mark of 6.97%, this is a 10-year low. The quarter saw healthy absorption of 6,503,439 s.f. region-wide, highlighted by just over 4.7 million of net absorption in the Seattle market. This includes the commencement of leases in several new buildings delivered over the previous three quarters.

The primary drivers in the market continue to be a mixture of old and new tech companies including Cisco, Apple, eBay, and Alibaba along with Tableau, Valve, and Wave Broadband. Amazon also remains active despite their pursuit of a second national headquarters campus which has been narrowed to 20 finalist cities. Meanwhile, Microsoft has also been discussing plans to grow their campus in Redmond.

Despite some economists concerns of an economic slowdown, some of the economic indicators would suggest otherwise. Washington State's economy added 6,800 new jobs in January 2018 according to the Washington State Employment Security Department. This compares to a gain of 1,510 new jobs in January 2017. This latest employment growth was fueled by construction, services, and retail. The only sector losing jobs was a minor loss in mining and logging. The growing employment base, along with the fact that new construction has generally been added at healthy levels with strong pre-leasing, has maintained a strong regional commercial real estate market across the categories and specifically in the regional office market. Long-term confidence in Seattle's economy and office market has been exhibited in cap rates well below 5% across a variety of product sold. In conjunction with strong rent growth in the Class A category and limited investment opportunities, these rates pushed prices above $900/s.f. National and international real estate funds and private REITs continue to be the most active buyer classes, with foreign investors primarily looking at development investments. The largest problem currently facing these investors is lack of properties for sale across the board.

The regional trends continued to be positive and statistics were steady. The total inventory of office space in the region rose by 2.9M s.f. in the final quarter of 2017, including three significant buildings in the Seattle CBD. With no major deliveries in the past two quarters, and this quarter's strong net absorption of 6,503,439 s.f., the net result was a decrease in the availability rate to below double digits for the first time since CoStar has been tracking that statistic. The current regional availability is 9.88%. The average asking rent decreased in the two major markets of Seattle and the Eastside compared to last quarter, but increased slightly in the other three smaller market areas.

The number of projects under construction stands at 13 with a total of 6,503,439 s.f. Skanska's 2&U tower, Alexandria's The Atrium, and Wright Runstad's Rainier Square started in the fourth quarter of 2017. Only Rainier Square has announced any pre-leasing - Amazon has spoken for all 722,000 s.f.

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Market Forecast Trends

↑ ABSORPTION	↓ VACANCY
↔ RENTAL RATE	↓ CONSTRUCTION DELIVERIES

Market Highlights

Regional vacancy rate reversed the 4Q 2017 spike, dropping to 7.15%, with strong net absorption of 1,722,641 s.f., tied mainly to leases in new buildings leasing commencing.

The region's availability rate fell from 10.40% to 9.88%, supporting the conclusion that lease timing was the cause of the vacancy bump.

There are 13 office projects underway; 10 in the Seattle CBD, one each in Kirkland, Renton, and Des Moines.

Region wide the 6.44M s.f. under construction is 57% pre-leased (30% of the speculative space is pre-leased).

Office property sales were slow Q1 2018, following an active end of 2017.

Suburban properties transactions continue to see increased demand.

Rental rates were nearly flat over the quarter, except for 5% bumps in Seattle and Bellevue. Investors are becoming more cautious regarding longer-term rent growth.

Area Review

Seattle CBD / Surrounding Area Review

Net absorption in the Seattle submarket in Q1 was 1,251,334 s.f., well above the 2017 total to 503,601 s.f. The commencement of three major Amazon leases accounted for most of that leasing. Those buildings/leases also contributed to the slow absorption last year as they were initially included as vacant space prior to the leases starting this quarter). The Seattle market vacancy rate returned to its downward trend, ending Q1 at 7.29% compared with 8.13% last quarter. The availability rate decreased by 20 bps to 9.70%, the smaller fluctuation reflecting a fairer picture as availability is not affected by the commencement lag.

The Seattle CBD submarket also benefitted from the commencement lag and vacancy in the CBD decreased 200 bps to 10.7% in Q1. Availability saw a smaller improvement from 12.9% to 12.4% in Q1. Leasing continued across the central Seattle submarket, but the number of available larger spaces did increase over the quarter. This is healthy in terms of attracting and retaining tenants as the economy continues to expand.

The downward vacancy trend in all submarkets of the Seattle market should continue through the next two years considering that 67% of the ten buildings under construction is pre-leased. There may be additional minor blips if 333 Dexter and 2&U deliver with large blocks of space unleased; however, with several tenants still looking for large blocks of space in the market, that is not a major concern. On the investment side, the Seattle market was relatively quiet after a busy 2017. The only major sale was the vintage Joseph Vance Building, selling to Brickman Real Estate, a national investment fund manager with two other vintage buildings in Seattle.

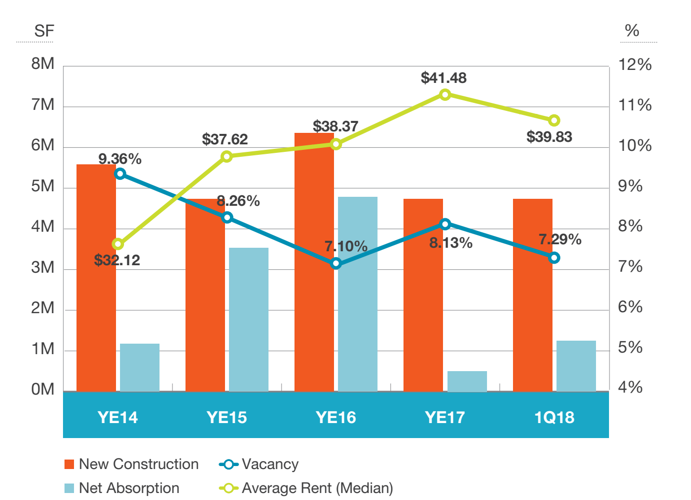
Eastside Review

The Eastside office market inventory currently stands at just over 50.5M s.f. accounting for about one fourth of the total regional office supply. Kirkland Urban is the only major office project underway in the Eastside. The North building is expected to be delivered before the end of 2018, but no additional pre-leasing beyond Tableau Software and Wave has been announced. The Eastside has the lowest office vacancy rate in the region at 5.77% as of Q1 2018. The vacancy rate has steadily declined since 2010, now at a ten-year low. Demand has filled three office towers in the past 24 months, in addition to chipping away at vacancy in existing space. The availability rate has also trended downward to the current 7.90%, 120 bps lower than last quarter. Net absorption was 34,837 s.f. in Q1 2018, compared to negative last quarter (-58,527 s.f.) which dropped the year-end total net absorption for all of 2017 to 922,126 s.f. The Bellevue CBD vacancy dropped to 7.1% from 7.6% last quarter, while the CBD availability rate decreased more modestly from 10.3% to 10.2%. The CBD still faces vacation of part or most of the 500,000 s.f. leased by Expedia in its named Tower 333 building and Skyline Tower, in late 2018 which will be tempered some by the renewal of 120,000 s.f. to create interim office hotel space. All three of the recently opened office towers including Lincoln Square South Tower, Centre 425 (Amazon), and 929 Tower are now stabilized. Based on the current CBD vacancy of 7.1%, even if all 380,000 s.f. of the Expedia space is returned with no pre-leasing, the effect would be a 350 bp increase in the CBD vacancy rate, which is a worst case scenario. Most of the peripheral Eastside submarkets continue to perform well, ending Q1 2018 with vacancy rates of 3.2% and 4.0% respectively for Kirkland and Redmond, both declining from last quarter. An exception to the submarkets is the I-90 Corridor due to the vacation of two buildings by Boeing, including Sunset Corporate Campus North V. The current asking rent for the Eastside market of $36.96/s.f./year is second highest in the region next to Seattle. The Eastside saw the region's largest office sale in Q1, the $200M Shidler Group acquisition of the Advanta Commons in the I-90 submarket. Interestingly, this was $40M less than the seller (JP Morgan) had paid for the property in July 2010. The price differential is tied to the fact that Microsoft's lease for the three-building property was expiring in June 2018 and the rate negotiated for their recently signed 5-year renewal. Other notable Eastside sales in the quarter include Mercer Pointe selling for $26.7M, or $374/s.f., at a reported cap rate of 6.70%. The same buyer, Nicola Crosby, also purchased the Bellevue Gateway Building for $25.5M, or $373/s.f. Six other office buildings transferred for over $5M in Q1 2018, indicating the Eastside investment market remains active.

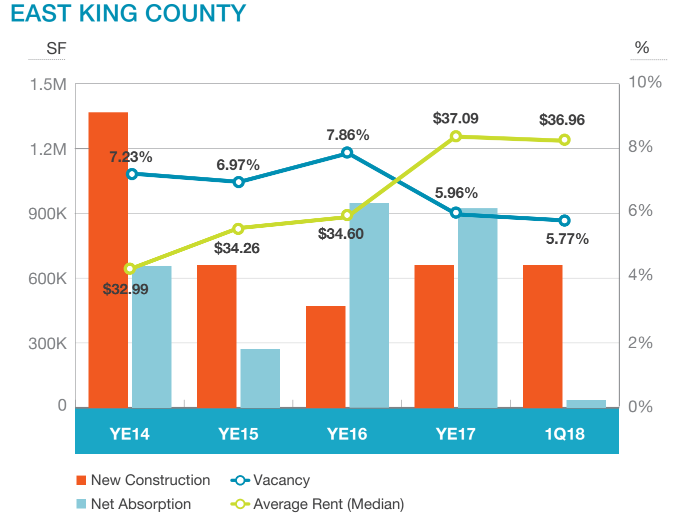
South King County Review

South King County commenced 2018 with a solid 349,620 s.f. of net absorption in Q1, despite Boeing's giveback of office space in 2017 as the company reduced local employment by about 6,000 jobs. This compares to negative 67,857 s.f. in net absorption for all of 2017. The South King County office market vacancy rate remains the only double digits vacancy indicator in the region, now at 10.9%. The positive is that vacancy in this market dropped down from 12.0% at year-end 2017, a 110 bp decline over the past quarter. The availability rate is also the highest at 15.2%, but also declined from the 16.6% mark last quarter. The main component of the availability rate remains the 748,000 s.f. Southport Office Campus under construction in Renton with no office pre-leasing of note. That project is joined by the build-to-suit FAA Regional Headquarters in Des Moines as the only major office buildings under construction in South King County. In general, leasing activity in South King County consists of mostly smaller

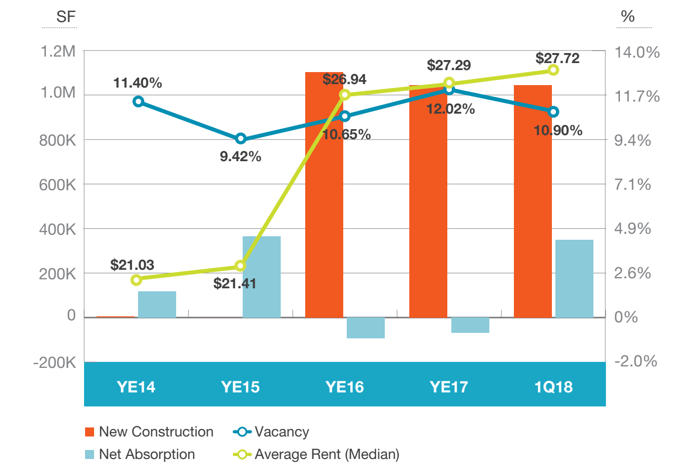
SEATTLE CBD / SURROUNDING AREA



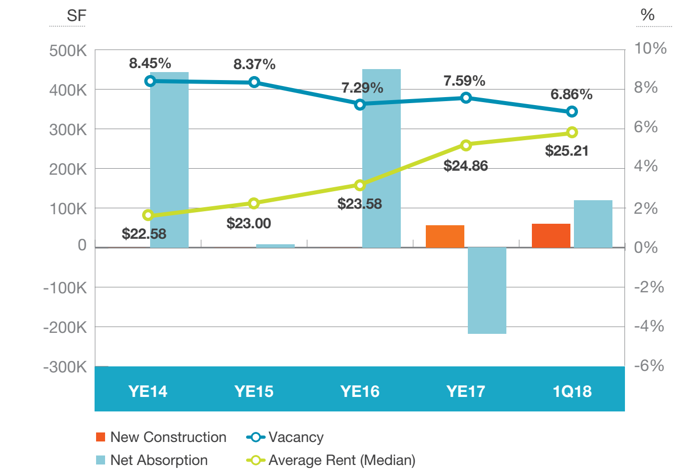
EAST KING COUNTY



SOUTH KING COUNTY



SNOHOMISH COUNTY



tenants that tend to be stable in size and without much need for expansion. No companies have been found as a replacement for the formerly Boeing occupied space in this submarket that has created the surplus in office inventory. The former 342,000 s.f. Weyerhaeuser office campus also continues to contribute to the higher Southend vacancy, although there has been some leasing activity of late. The current rental rate quote is $27.72/s.f./year full service compared to $26.32/s.f./year in 4Q 2017. Sales this quarter included only two office building sales over $5M, and the disposition of Boeing's Duwamish Towers for redevelopment. Traditionally this market has taken the longest to recover, often serving as a secondary alternative to tenants that are priced out of Seattle and Bellevue.

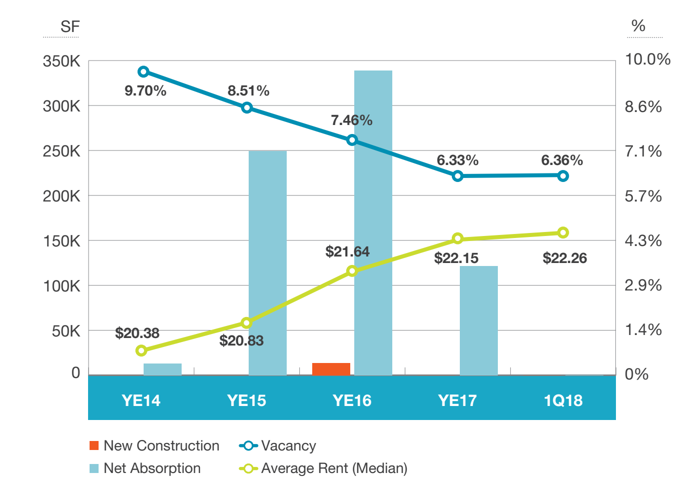
Snohomish County Review

After posting negative 218,027 s.f. of net absorption during 2017, the Northend office market rebounded in Q1 2018, with positive net absorption of 119,328 s.f. The vacancy rate also compressed from 7.59% at year-end 2017 to 6.86% after the first three months of 2018. Contributing to the positive absorption was a flurry of new leasing activity in the Bothell submarket after Boeing's exodus of more than 100,000 s.f. The Bothell submarket ended the first quarter 2018 at 8.8%, compared to 12.9% at year-end 2017. The Everett CBD continues to perform steadily with a current vacancy of 6.1% (8.0% availability) compared to 6.9% at year-end 2017. The Lynnwood/Edmonds submarket remains one of the stronger Northend office submarkets with vacancy continuing to hover just above the 5.0% benchmark at 5.4%. The Northend submarkets continue to attract smaller office tenants looking for both proximity to more affordable housing for its employees and affordability with the average rent quotes running $14.62/s.f./year lower than Seattle running $11.75/s.f./year lower than the Eastside. The current asking rate for the Northside is $25.21/s.f./year which is a 1.4% increase from last quarter and 6.0% increase from a year ago. The most significant Snohomish County sale was the March 2018 acquisition of the Redstone Corporate Center I and Redstone Corporate Center II buildings in Lynnwood and Mountlake Terrace, respectively by Westport Capital Partners. The closing price of $70,750,000 indicates the buyer paid $215/s.f. for these Northend assets. Overall, the sales activity has been steady in the Northend market with a mix of investment and owner-user purchases. Gradually declining vacancy is expected.

Pierce County Review

After eleven consecutive quarters of positive net absorption in the Pierce County market, the streak was continued in Q1 2018, with barely 508 s.f. The vacancy rate moved up slightly to 6.36% from 6.33% at year-end 2017. Tacoma CBD's vacancy rate increased from 5.7% last quarter to 6.1% currently while the availability rate shot up from 7.8% last quarter to 11.8% currently, an increase of 400 bps over the last three months. This increase is on the heels of State Farm's announcement in early 2018 that it will close its two Tacoma offices by the end of the year, potentially putting 800 people out of work. State Farm's Tacoma operation is split between offices at the Frank Russell Building and Columbia Bank Center, where approximately 1,400 are employed. Some of the jobs will be relocated to DuPont. Despite the State Farm announcement, the Tacoma CBD continues to see improved office and residential demand. Rental rates in the Pierce County remain relatively flat with a slight increase up to $22.26/s.f./year n Q1 2018, compared to $22.15/s.f./year last quarter. Sales in this quarter were active, but primarily smaller properties for owner/users or for redevelopment. After seeing only four office sales over $5,000,000 in all of 2017, the slow pace continued into Q1 2018. Optimism remains prevalent surrounding the CBD which continues to gentrify the strong interest in downtown housing, including new multifamily for professionals working in downtown Tacoma. The strongest office market segment in Pierce County continues to be medical-related properties.

PIERCE COUNTY



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1Q 2018 Seattle Office Sales

Name	City	Date	Price	SF	$/SF
Advanta Commons	Bellevue	Mar-18	$200,000,000	636,322	$314.31
Bellevue Gateway	Bellevue	Mar-18	$25,500,000	68,290	$373.41
Redstone Corp. Center I & II	Lynnwood	Mar-18	$70,750,000	209,410	$337.85
Kirkland 405 Corp. Ctr, Bldg A	Kirkland	Mar-18	$14,800,000	41,405	$357.44
Quadrant I-5 Corp. Pk, Bldg A	Redmond	Feb-18	$14,400,000	74,974	$192.07
Mercer Pointe (Former AAA)	Bellevue	Jan-18	$26,700,000	71,329	$374.32
Joseph Vance Building	Seattle	Jan-18	$37,307,539	112,686	$331.08

Vacant Space / Vacancy Rate

The regional office market has a standing inventory of 201.5M s.f. Vacancy continued its long-term downward trend, dropping 59 bps to 7.15%. This reflected a combination of new leasing and start of leases in the new buildings delivered over the past three quarters. A big part of the latter was the Amazon leases in Troy Block-North, Tilt49, and Centre 425, a total of 1.08M s.f. Absorption was positive in all of the region's submarkets in Q1 with a net gain of 1,755,641 s.f., exceeding the total of 1,261,370 s.f. for all of 2017.

There are 57 spaces over 50K s.f. listed for lease and near-term occupancy in the region. Of those, 25 are larger than 100K s.f., including nine in the Seattle CBD and three in downtown Bellevue. The largest existing contiguous spaces ready for occupancy in the Seattle CBD are 246,400 s.f. in Madison Centre and 220,000 s.f. in 800 5th Avenue Building. In the Eastside market the largest spaces ready for occupancy are the 177,000 s.f. in Summit II and 119,700 s.f. in Skyline Tower in the Bellevue CBD. The regional availability rate showed a significant decrease over the quarter, ending at 9.88%, compared to 10.40% last quarter. South King saw a 140 bps drop to 15.20% and the Eastside decreased by 120 bps to 7.90%. Both vacancy and availability are expected to continue their downward trend over the next few quarters as preleases in new buildings commence.

New Construction Activity

The total amount of space delivered Q1 2018 was 555,645 s.f. The most significant was an owner-occupied medical-oriented building. Three major projects started last quarter and are well under way. These include the 664,245 s.f. 2&U by Skanska (downtown Seattle), The Atrium by Alexandria (212,000 s.f. in South Lake Union), and the 58-story Rainier Square with 722,000 s.f. being built by Wright Runstad and fully pre-leased by Amazon. The three projects under construction outside Seattle continue on as planned with no additional leasing reported at the speculative Kirkland Urban or Southport Office Campus. There has been little in the way of new leasing activity at either project thus far into 2018. The 13 buildings under construction in the region total 6.5 million s.f. of which about 55%, has been pre-leased. There still appears to be little potential of significant over-supply in the near term considering the limited amount of speculative space being built.

Rent Forecast

Rental rates are primarily stable as the market's supply and demand is balanced, evidenced by three of the markets experiencing a slight increase in average rent quotes from last quarter, and two moving slightly downward. The upper end of the market has seen more growth as premier Class A space is in relatively short supply and businesses looking at that space are able to afford cost feasible rent to get new space built. Changes in average asking rates showed a 4% decrease quarter-to-quarter in the Seattle market and a 1% decrease in the Eastside market. Other markets showed slight quarter-to-quarter gains in rent ranging between 0.5% and 1.6%. These trends are expected to continue; however, investors are starting to pull back on Class A rent increases due to concerns regarding the pace of office job creation.

Tech company demand continues to pressure larger blocks of new Class A space rent upward. This has also affected attractive vintage spaces. A recent example is the nearly completed renovation of the Maritime Building located near the waterfront in Downtown Seattle. Beacon Capital added two floors to the building and leased all of the office space to Big Fish, at rates similar to new space in South Lake Union. For most non-full floor or full building leases these changes have been moderate with no significant spikes. Even with construction costs continuing to increase, the current rent levels remain cost feasible. Investors have become more cautious, moderating rent growth projections closer to an average annual rate of 3%, anticipating a market plateau.

Investment Market

After office investment reached a record dollar amount in 2017 at $3.1B, about $100M over 2016, sales activity for Q1 2018 included 79 transactions totaling $629M in sales volume. These include five over $20M. The largest sale was Advanta Commons (Microsoft) in the Eastside I-90 submarket, followed by the Redstone Corporate Center I & II at $70.75M in Lynnwood, Joseph Vance Building in Seattle at $37.3M, Mercer Pointe at $26.7M, and Bellevue Gateway at $25.5M, both in the Eastside 405 submarket. Noticeably absent this quarter was the volume of institutional investment activity seen in past quarters. There remain more interested buyers than properties for sale, a factor in the below 5.0% cap rates seen in top sales. Suburban properties continue to make up the majority of sales as mid-level buyers are attracted to returns in the 6% range for seasoned properties. Owner-user activity has also picked up, but generally accounts for the smaller scale transactions. Overall, there remains strong investor confidence and interest in the region based on its long-term growth population and employment growth and sound economic fundamentals.

Data Source: CoStar