Kidder Mathews

Real Estate Market Review

King, Snohomish, and Pierce Counties

3rd Quarter
2012

Seattle Office

Market Forecast

	Current / Projection	
Vacancy	10.75%	↓
Construction	831,981 sf	↔
Rental Rate	Varies*	↔
Absorption	396,211 sf	↔

* by submarket

Market Highlights

Regional vacancy rate is at 10.75%, down slightly from 10.89% last quarter. Net absorption for the third quarter was 396,211 s.f., moving the trend to a smaller annual total compared to 2011, primarily due to massive Amazon commencements last year

Office acquisitions shifted to Bellevue, as many of the prime targets in Seattle have already traded this cycle.

In the North and South ends of the Seattle CBD and in the Bellevue CBD leasing activity has continued and rental rates have shown some signs of moving up.

Institutional investors remain very bullish on the Seattle market, but the number of Class A properties in play is minimal. ■

Compared with the first half of the year the office market was very quiet in the third quarter. Total regional absorption was only 369,211 s.f., resulting in a minor drop in the vacancy rate to 10.75%. With only very focused local exceptions, rental rates were flat. Looking back over this year's performance, it is noted that the main difference between the third quarter and the second quarter is that there were no new Amazon lease commencements. That is not to say that Amazon was the only driver in the office market recovery, but it does point out just how big a role that company has played, accounting for about half of the total net absorption in the past three years.

Bellevue stands out among the submarkets in its recovery due to a wider array of significant participants, which has led to the vacancy falling to nearly 9% in the CBD and prompting developers to jockey for position to start the next tower. The rest of the region showed little leasing activity over the quarter, and the availability rate moved up by 29 basis points, stubborn at over 14% for nearly two years.

One aspect of the office market which was anything but quiet was the investment side. The number of sales was up for the quarter, and while most of the total dollar volume was in five sales, the number of smaller buildings selling was encouraging. This is a sign that local buyers and owner/users are gaining certainty that values are at their low point.

In general, confidence in the regional economy continues to improve, even as the national outlook is jittery. Employment growth has been better than forecast and the prognosis for 2013 has been upgraded in each of the last five quarterly Puget Sound Economic Forecaster reports. Eventually this will convert to new office space demand, although most traditional office-centric companies are yet to participate in the recovery as strongly as the internet and entertainment sectors.

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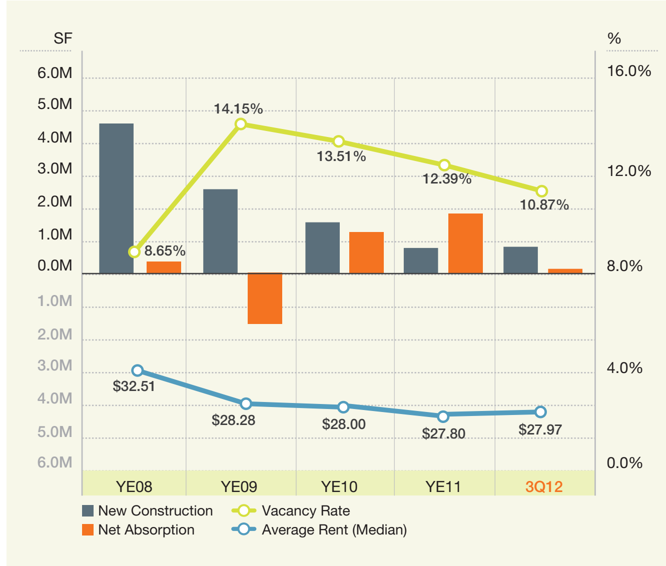
Area Review

Seattle CBD/Surrounding Area

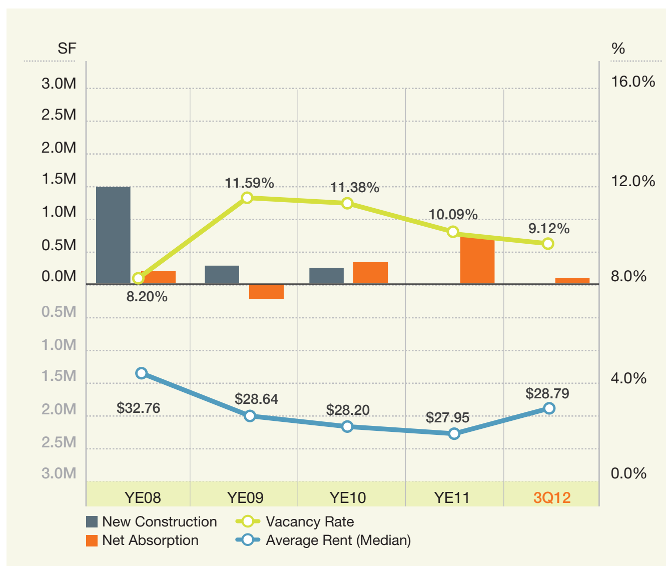
The larger central Seattle office market vacancy rate was nearly unchanged this quarter at 10.87%, compared to 10.90% in the second quarter. The availability rate bumped up by 10 basis points to 14.30%, moving back above the 2011 year-end rate. The vacancy rate is quite variable across the submarkets within the Seattle market, from 4.8% in Lake Union to 15.5% in Pioneer Square/Waterfront. Vacancy in Pioneer Square will fall significantly as the leases in the 705 Union Station building commence, accounting for an eighth of the total vacancy. The middle of the CBD currently shows a 12% vacancy rate and a growing availability rate of 18.2%, as the former premier Seattle office addresses are struggling with the lack of growth in businesses that prefer this location. Net absorption in third quarter was only 105,957 s.f., dropping the 2012 total to a level below the 2011 pace. Looking forward, the Seattle CBD vacancy rate is expected to continue to trend downward over the coming year, with some significant leases already inked to start next quarter.

Average rental rates across the Seattle market increased slightly over the past quarter, likely the result of demand at the north and south ends of the market with no movement in the middle of the market. The average asking rental rate in the Seattle market is $27.97/s.f./year full service, up 2%. The true change may be slightly higher as there is virtually no Class A new construction space remaining listed for lease in the market.



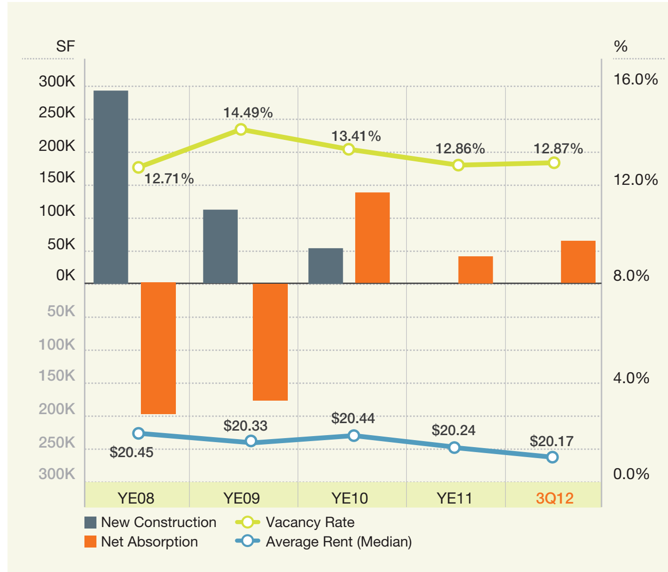
East King County

Office supply in East King County currently accounts for 26% of the total regional inventory. Eastside office vacancy continues to inch downward to an average 9.12% currently (3Q-2012), making it three consecutive quarters below the 10% mark. It remains lowest among the five major market areas in the region and notably under the overall average regional vacancy rate. The availability rate on the Eastside is higher, at 13.2%, indicating tenants continue to be in transition, although there are no new office projects presently under construction to choose from. Absorption over the last quarter was 110,475 s.f., accounting for just under a third of the regions total absorption during the third quarter. Active tenants include Blucora, Conover Insurance, and Infosys Technologies. The dwindling Class A office supply in the Bellevue CBD has helped spur Kemper Freeman's application for a building permit on the planned $850 million mixed-use expansion of Lincoln Square, which will include 545,000 s.f. of office space. Beacon Capital also has plans to build a 32-story office tower in the CBD. Beacon has been active on the disposition front as well, selling the 24-story Skyline Tower for $458/s.f. and the 27-story City Center for $463/s.f. last quarter. City Center had just seen a flurry of leasing activity, bringing it to a near stabilized level and a cap rate just over 5%. Asking rental rates in the Eastside market finished the quarter up slightly over the last few quarters at $28.79/s.f. full service. Eastside vacancy is expected to continue its downward trend with upward pressure on rents. Also in the third quarter 2012, Legacy Partners sold the nine-story Key Bank Center for $374/s.f. to a Bellevue based investor. There have also been several major suburban office park sales over the last quarter.



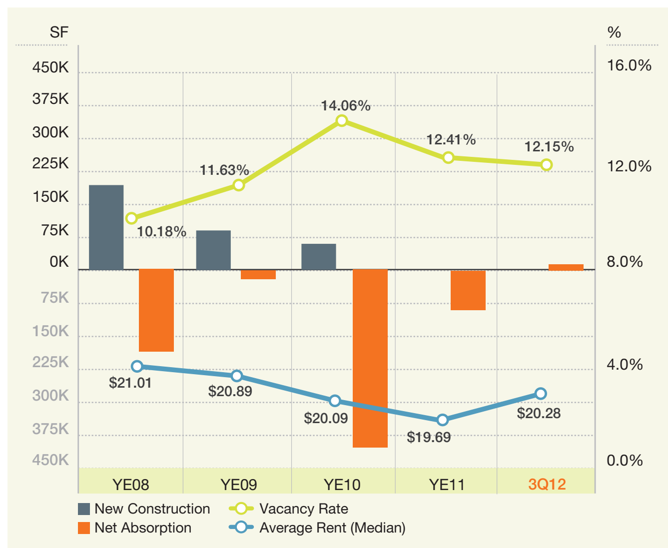
South King County

The South King County market saw a small decrease in vacancy in the second quarter, to 12.87% from 13.18%. On the other hand, the availability rate saw a 20 basis point increase, which is not an encouraging sign that the vacancy drop will last. Net absorption was respectable at 63,342 s.f. This market has always lagged recoveries, as tenants who are able to expand take advantage of low rental rates in closer-in locations to trade up spaces. Also, the smaller businesses favoring the southend locations are not yet seeing much trickle down of the local economic recovery. Rental rates in this market have not changed significantly in ten quarters, moving up only slightly to an average asking rent of $20.17/s.f./year full service, still 30% lower than the other King County markets. It will take a much wider economic recovery for this market to show significant improvement. One positive note is the sale of the Centerpoint Corporate Park, indicating some confidence in the submarket's potential for recovery.



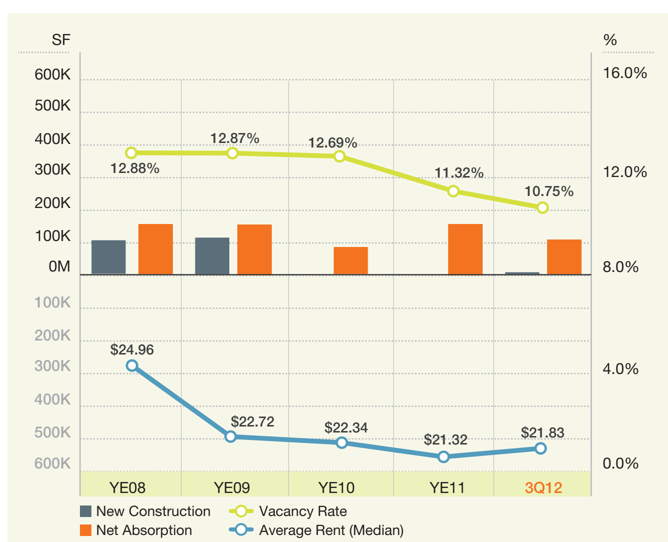
Pierce County

Pierce County showed modest improvement in the third quarter, with vacancy inching downward to 12.15% from 12.41% last quarter. The availability rate also decreased slightly from 14.50% to $14.30%, indicating that companies are continuing to scale back on space needs. Absorption was a nominal 8,156 s.f. in the second quarter, still fighting against a major first quarter loss to get out of the red for the year. The unemployment rate in Pierce County remains much higher than in King County and most local businesses which make up this market are not feeling much effect of the region's economic recovery. Downtown Tacoma continues to face the major hole left with the move of Russell Investments to Seattle in 2010. Their former headquarters space remains vacant, although still leased into 2013. Overall demand is expected to be modest, with the vacancy rate not expected to improve much before the Russell space moves from available to vacant. Average asking rental rates continue to be flat as there just is not much demand and price is not the deciding factor in that conclusion.



Northend

The Snohomish County vacancy rate has dropped slightly from 11% last quarter to 10.75% currently, with the availability rate also changing modestly from 14.70% to 14.60% this quarter. Rental rates increased a few cents over last quarter to a current average asking rent of $21.83/s.f./year full service. The majority of new leases in the Northend market are in the 500 to 10,000 s.f. size range, which is the norm for Snohomish County. One new office project was delivered at 55,000 s.f. and fully occupied at completion with a second smaller building of 4,000 s.f. under construction and fully pre-leased. The South Everett/ Harbor Point submarket continues to outperform the other Northend submarkets with a healthy vacancy level near 5%. On the investment front, an east coast REIT recently purchased 840 N. Broadway, which was fully leased at time of sale, for $20.4 million and a reported cap rate of 7.8%. The primary tenant was the State of Washington.



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Vacant Space/Vacancy Rate

Net absorption in the region during the third quarter of 2012 was 396,211 s.f., well below the total for the second quarter, but close to the first quarter. Seattle, Eastside and Northend markets all contributed about 110,000 s.f. each. The net gain in occupancy nudged the vacancy rate down for the 11th consecutive quarter. The availability rate increased to 14.30%, which could threaten the vacancy trend as the leases for the available but occupied spaces expire. In general terms, the market is still over-supplied, with the range of submarket vacancy rates from 9.12% on the Eastside to 16.80% in the Southend. The forecast is for gradual decline in the vacancy rate as resolution of the elections will allow many businesses to better plan their futures. Hopefully, the local economy's improvement will get some reinforcement from the national economy moving into 2013.

New Construction Activity

Earlier this year, market dynamics prompted the first new speculative office projects since 2007. Spear Street Capital, 202 Westlake scheduled for a Fall 2013 completion is reported to be pre-leased by Amazon. Vulcan announced an agreement to build two more buildings for Amazon on Mercer Street, adjacent to their current phases. The financial feasibility was finely focused on the South Lake Union market, but recently it is getting close in downtown Bellevue. Additional development in South Lake Union will have to take into account Amazon's plans to build 3.3 million square feet for their own use three blocks from their current headquarters. The total amount of space under construction in the region is now 831,981 s.f., including the final phase of Amazon's campus, 202 Westlake , Home Plate North, a 141,200 s.f. building in the SoDo neighborhood of South Seattle, and a 208,000 s.f. GSA building in South Seattle.

Rent Forecast

Face rental rates showed little movement through 2011 and that trend has continued through the third quarter of 2012. Exceptions to this are South Lake Union and downtown Bellevue (larger spaces only). There are indications that the rates in both of these favored locations will see significant bumps for the remaining larger spaces. These will be followed by the south end of the Seattle CBD where companies recently leased 115,000 s.f. in the 705 Union Station building, one of the largest vacancies in the submarket. The other areas of the region are expected to remain flat through the next two to four quarters, at least.

Investment Market

While the first two quarters saw the Seattle market with the majority of the sales, the third quarter belonged to Bellevue with four of the five largest sales in the quarter. Beacon Capital Partners sold two Class A towers in the Bellevue CBD as they continue to close out a fund, accounting for nearly $416 million of the $505 million total office sales in the quarter. The two remaining properties in that fund are the Plaza/Plaza East, also in the Bellevue CBD, and 1201 Seneca in downtown Seattle. The Seattle property is expected to close in October, and Plaza/Plaza East recently made the call for best and final offers. Also in the Bellevue CBD, Legacy Partners sold the Key Bank Building for $36.1 million and Unigard Insurance sold the nine-building Bellevue Technology Center, in east Bellevue near Microsoft's headquarters, for $78.7 million. The final of the top five sales is Centerpoint in Kent. This is a large suburban complex with four buildings and surface parking that sold for $46,250,000, or $106/s.f., a stark contrast to the $238/s.f. for the physically similar Bellevue Technology Center. Currently in the bid process is the new Amazon headquarters in the South Lake Union neighborhood of the Seattle CBD. The total price of the seven buildings is expected be around the $1 billion mark. Buyers continue to scour the market, but at this point the number of Class A core properties that might be available is limited.

*Source: CoStar Data