Seattle Office

Market Forecast

	Current / Projection
Vacancy	9.98% ↓
Construction	3.06 M sf ↑
Rental Rate	Varies* ↔
Absorption	228,193 sf ↔

* by submarket

Market Highlights

Regional vacancy rate dropped to 9.98%, down from 10.3% at the beginning of the year. Net absorption for the first quarter was 228,193 s.f., with trending slightly lower than first quarter 2013.

Construction activity increased through the year with seven major projects started; six in the Seattle CBD and one in Kirkland. Four of the Seattle projects are speculative; Amazon.com will occupy the other three and Google will fill the Kirkland project.

Office acquisitions continued to be active with a mix of core and value-add investments seen so far in 2014. Capitalization rates are stable with core properties near the 5.75% mark with strong demand for a limited number of available properties.

Rental rates were generally stable across the region into the first quarter, with exceptions in the Seattle and Bellevue CBDs. ■

The first quarter of 2014 marks the beginning of the fifth year of the office market recovery from the great recession that crash landed in 2009. Occupancy continues to inch upward; steadily in the region's two CBDs, less consistently in the secondary markets. Across the region the vacancy rate is just below 10%, almost back to the 9.6% rate at year-end 2008, just before the fall. Job growth has not recovered outside of the core markets and with office space tending to follow employment growth, slow and steady improvement on a regional basis is the most that should realistically be expected.

Good news in two suburban markets came as Boeing announced their intention to lease as much as 200,000 s.f. in the I-90 submarket of Bellevue and has signed leases for about 450,000 s.f. in Bothell. Both of these submarkets had seen very little demand over the past five years. The strong performance of the core submarkets has been enough to keep Seattle in the top ten office investment markets on a national basis.

Vacant Space/Vacancy Rate

Net absorption in the region during the first quarter of the year totaled 228,193 s.f., nudging the vacancy rate just below 10.0%. Considering Amazon.com has temporarily run out of space to lease, this performance showed encouraging life from the rest of the market. The Seattle CBD had a strong quarter with almost 307,000 s.f. of net absorption. At the other end of the spectrum was South King County with tenants giving back nearly 98,000 s.f., just less than that submarket's loss for all of 2013. The regional availability rate remains high at 12.59%, a slight improvement from 12.93% at the end of 2013. Several specific markets are out of larger spaces, including South Lake Union, Pioneer Square, and downtown Bellevue.

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Area Review

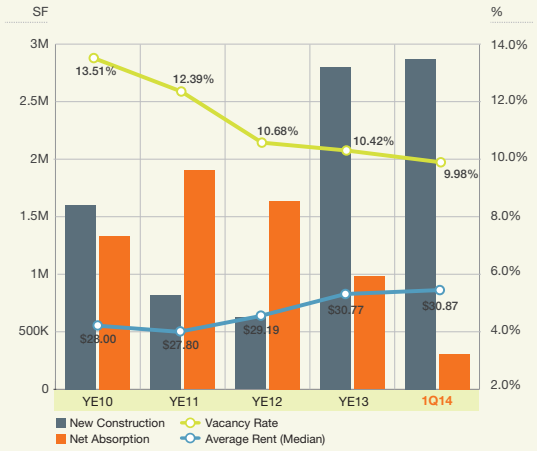
Seattle CBD/Surrounding Area Review

The Seattle CBD market turned in the best first quarter performance in the region. Net absorption was 306,868 s.f., lowering the vacancy rate to 9.98% and the availability rate to 11.9%. Among the submarkets, Lake Union fell to 4.9%, Belltown/Denny Regrade to 9.4% and Pioneer Square to 11.0%. The Seattle CBD submarket at the core of downtown vacancy is still at 13.0%. Activity continues to improve with law firms, engineering firms and wealth managers recently signing leases in the legacy Class A buildings such as Columbia Center and 1001 Fourth. Rental rates in these buildings are attractive; fully 20% below those in the newer buildings at the north edge of the CBD, and full floors are still readily available. Amazon.com has yet to look back to that part of the CBD to tide them over until their buildings under construction are ready. However, they are considering three properties in Belltown and the waterfront to house their un-ending stream of new employees. As those larger blocks of space are taken, Schnitzer West and Daniels Development are poised to start their planned Madison Centre and 5th and Columbia towers in the CBD core as soon as lead tenants are secured.

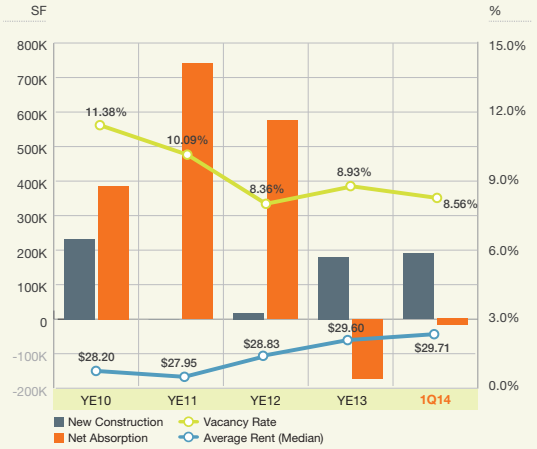
Eastside Review

Eastside office vacancy started the year trending downward from 8.93% at year-end 2013 to 8.56% at the close of the first quarter of 2014. It remains below the average regional vacancy rate of 9.98% and benefited over the past quarter from minimal new supply and a modicum of positive year-to-date absorption. With only 190,400 s.f. of new office construction underway, the Eastside is well positioned to see near term improvement especially considering that 95% of the new construction amount is from the Google campus expansion in Kirkland and fully committed. Average asking rental rates for Eastside office ended the quarter at $29.71/s.f. full service which is slightly above the average rate from last quarter at $29.60/s.f. Examples of noteworthy leases over the last quarter were from known tenants such as Symetra, HDR Engineering, Edifecs, Market Leader and EBay. On the investment front, institutional investment sale activity continued into the first quarter with the closing of the Plaza Center Buildings to KBS and the transfer of Corporate Campus East. Owner-user activity also remains steady. The lowest reported submarket vacancy is the 520 Corridor with the I-90 Corridor reflecting the highest submarket vacancy at 14.5%. The good news for the I-90 Corridor, which was hampered by the exodus of space from T-Mobile and Verizon, is Boeing's recent announcement that they intend to lease between 150,000 and 200,000 s.f. of office space in that submarket. On the development front, Trammell Crow received design review approval and permit to demolish an existing building at 833 108th Avenue NE which will help ready the site for development of their planned 19-story Bellevue Office Tower. Schnitzer West is

SEATTLE CBD/SURROUNDING AREA



EAST KING COUNTY



awaiting design review approval for its planned Centre 425 project, a 16-story office tower containing 350,000 s.f. The future of these projects will likely hinge on future demand needs from the known tech giants, gaming enterprises and any new growth that can be mustered from the traditional professional service companies.

South King County Review

The South King County took a step backward in the first quarter, with the vacancy rising to 12.60% and a net absorption loss of 96,708 s.f. The availability rate is the highest in the region at 15.9%, also showing the least improvement over the past five years. Rental rates are the lowest in the region, but that has yet to generate significant leasing momentum. Boeing still has a significant presence in this market, but it remains to be seen if there is any consolidation of employees from their Renton space to their planned expansions in Bellevue and Bothell.

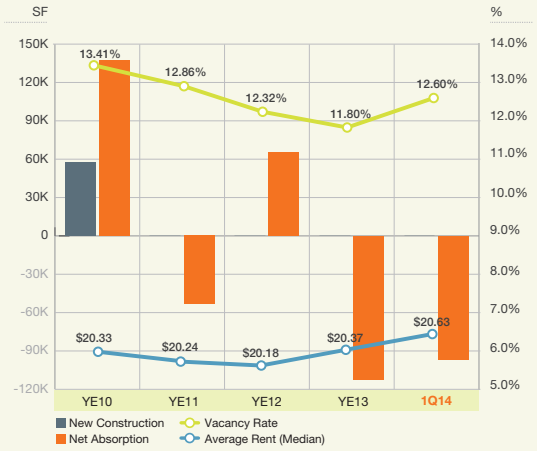
Snohomish County Review

The Snohomish County office market contains an office supply of nearly 21.5 million s.f. which is about 11.7% of the region's total office supply. There is 2,237,614 s.f. of total vacancy including sublease space. The current first quarter 2014 vacancy rate is 10.41%, slightly lower than the year-end 2013 vacancy rate of 10.53%. The availability rate has improved more decidedly from 13.2% last quarter down to 12.7% currently indicating a continued tightening. There is no new office construction underway in Snohomish County despite a generally healthy year-end 2013 office absorption total of 205,854 s.f. The current year-to-date absorption for the first quarter 2014 remains positive at 22,566 s.f. Perhaps the most significant news this quarter for the Snohomish County office market stems from Boeing's recent commitment to about 450,000 s.f. in five Bothell buildings. As these 5-year leases commence, they will drop the Bothell vacancy rate below 5% and stabilize this historically volatile submarket. Average rental rate quotes for Snohomish County have increased from $20.17/s.f. full service last quarter to $22.52/s.f. currently. On the investment front, the Northend remains primarily an owner-user market with some investment appeal in South Everett near Boeing.

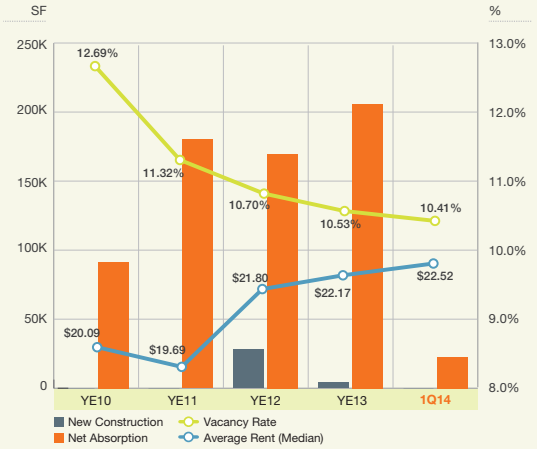
Pierce County Review

The Pierce County market vacancy rate rose to 10.28% in the first quarter, following a net negative absorption of 24,149 s.f. Looking forward, the availability rate fell to 13.4%, the lowest rate since CoStar started reporting that indicator. Asking rent rose slightly in the quarter, but actual deals have not followed that trend. State Farm Insurance continues to move staff into their new downtown Tacoma space, which is expected to be a catalyst of that submarket's recovery. Sales in this market have been limited to smaller properties, including a growing number of owner/use acquisitions.

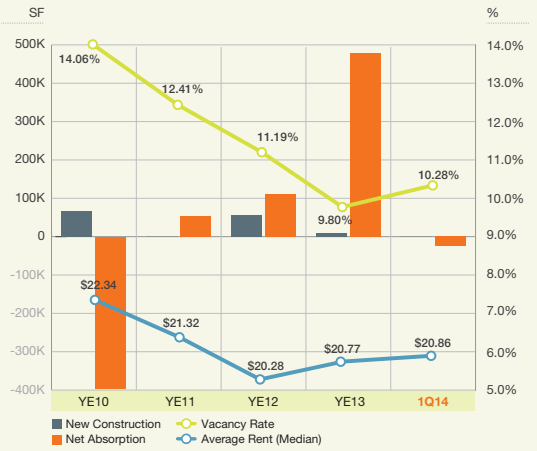
SOUTH KING COUNTY



SNOHOMISH COUNTY



PIERCE COUNTY



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Q1 2014 Seattle Office Sales

Name	City	Date	Price	SF	$/SF	Cap Rate
Plaza Center	Bellevue	Jan-14	$186,500,000	488,709	$381.62	6.10%
401 Terry	Seattle	Mar-14	$106,125,000	140,605	$754.77	5.95%
World Trade Center East	Seattle	Jan-14	$74,500,000	186,117	$400.29	5.65%
Merrill Place	Seattle	Feb-14	$57,700,000	258,071	$223.58	N/A
Corporate Campus East	Bellevue	Jan-14	$43,400,000	154,200	$281.45	6.00%

New Construction Activity

Construction continued to increase in the first quarter with an eighth project, the Troy Block, starting site preparation in the South Lake Union market. This is Touchstone's second project in that neighborhood with their Hill7 project moving up to street level. Both of these projects are speculative, joining Dexter Station and 400 Fairview. Preleased projects include Amazon Phase VI in South Lake Union, Brooks Sports in Fremont and Google in Kirkland. The final major projects under construction are Amazon.com's owned towers and the Allen Brain Institute building, also in South Lake Union. Tenants looking for larger blocks of space in both the Seattle and Bellevue CBD will have to step up to cost feasible rents. When they do, there are five developers in downtown Bellevue with plans in hand and two major projects in the Seattle CBD just waiting for the next major space requirement.

Rent Forecast

There has been little significant movement in rental rates outside of pre-leasing tenants in South Lake Union signing at cost-feasible terms. Asking rents inched up across the region in the first quarter, but that has only partially translated to higher rates in signed deals.

Investment Market

The first quarter of 2014 has already seen a good level of office investment volume. There were 35 sales of properties over $200,000, combining for a total volume of $473.8 million. The largest sales closed were the Plaza Center Buildings in the Bellevue CBD at $186.5 million, 401 Terry in South Lake Union at $106.1 million and World Trade Center East, on Seattle's waterfront for $74.5 million. On a national basis there has been a slight institutional cooling on office investments, tied to the sluggish jobs market. Seattle is outperforming on the job front, although outside of the CBDs, major investments have been rare as owners who have held on this long see no real reason to sell today.

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