

SEATTLE OFFICE MARKET

SECOND QUARTER 2017

Seattle/Puget Sound office sales volume surges at mid-year

Downtown Seattle office vacancy ticks down to just 9.6% in the second quarter

In the second quarter 2017, the Seattle/Puget Sound office market saw a rebound in overall space gains after a flat first quarter, with 202,012 square feet of net absorption for the region. While leasing activity is lower than the same period 12 months ago, the region still saw the largest office lease reported in 2017 with F5 Networks leasing all 515,000 square feet of office space at 801 5th Ave, now named F5 Tower, which is currently under construction in the Seattle CBD. In addition, office sales volume bounced back in the second quarter from a slow start to 2017 with over \$1.2 billion in buildings trading hands, indicating continued high interest on the part of investors attracted to the region's booming economy.

ECONOMY



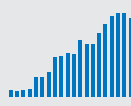

Unemployment rate in Seattle metro at just 3.6% in May

The seasonally adjusted unemployment rate for Seattle-Tacoma-Bellevue of just 3.6% in May continues to be at levels last reported in 2008, as well as 70 basis points lower than the national unemployment rate of 4.3%. Year-over-year nonfarm employment increased by 48,300 (2.5%), while office-using employment increased by 15,500 (2.5%), respectively. Compared to a year ago when both nonfarm employment and office-using employment in Seattle grew at 3.6% and 4.3%, respectively, year-over-year job growth has slowed over the past year as the regional economy nears full employment.

SUPPLY AND DEVELOPMENT

Nearly 5.6 million square feet of office space now under construction

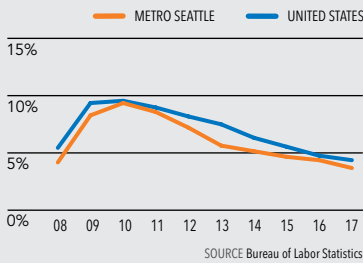
In the second quarter, 305,525 square feet was delivered to the market, which mostly consisted of Alexandria Real Estate Equities completing their 288,850-square-foot 400 Dexter Ave North project in South Lake Union, which is 54% leased to Juno Therapeutics. A total of 5,591,077 square feet is currently under construction, which constitutes 5.4% of the existing competitive office base of the region. Of this amount, 43% is currently pre-leased. It should be noted that an additional 1.4 million square feet of owner-occupied space is also under construction, with Block 20 of the Amazon headquarter campus expected to deliver 1.1 million square feet of Class A space early next year. With development activity now at its highest level since 2008, concerns about overbuilding are warranted, especially if there is any slowdown in leasing activity.

TRENDLINES	
5-YEAR TREND	CURRENT QUARTER
VACANCY 	11.1% Vacancy rate up 10 basis points from 1Q
ABSORPTION 	202,012 SF Downtown Seattle leads absorption
RENTAL RATE 	\$30.72 PSF Rates up 2.4% year over year
UNDER CONSTRUCTION 	5,591,077 SF 43% of office space is pre-leased
CAP RATES 	6.4% Cap rates unchanged from 1Q
JOB GROWTH 	48,300 jobs Growth of 2.5% year over year

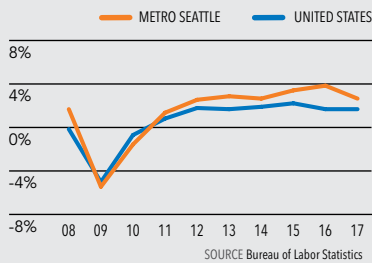
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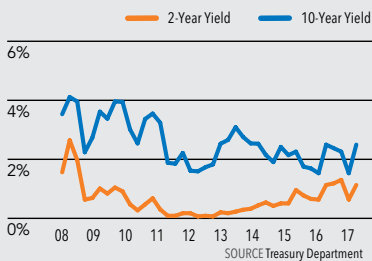
UNEMPLOYMENT RATE



PAYROLL JOB GROWTH



TREASURY RATES



DEMAND

Second quarter net absorption bounces back, led by Downtown Seattle

Demand for office space in the second quarter bounced back with 202,012 square feet absorbed around the region. Led by 339,322 square feet in space gains in Downtown Seattle (mostly in Lake Union), year-to-date net absorption in the region is now 150,466 square feet (down from 1.6 million square feet absorbed in the first six months of 2016). As mentioned above, leasing activity has slowed from a year ago with approximately 1.5 million square feet reported in the second quarter (down 37% from a year ago). However, with the continued strength of the area economy, most notably the tech ecosystem, expect more large leases to be signed around the region in the second half of 2017 as tech firms are attracted to the region's large engineering talent base and lower cost of living than the San Francisco Bay Area.

VACANCY

Regional total vacancy rate ticks up to 11.1% in the second quarter

The total vacancy rate ticked up 10 basis points to 11.1% in the Seattle/Puget Sound region, mostly due to new vacant space delivered to the market in the second quarter. In Downtown Seattle, total vacancy decreased to 9.6% (just 8.8% direct vacancy) with vacancy levels in submarkets such as Seattle CBD (9.8%), Ballard/U District (8.6%), Belltown/Denny Triangle (10.9%), Pioneer Square/Waterfront (5.7%), and Queen Anne/Magnolia (4.2%) amongst the lowest ever reported. Not to be outdone, Eastside vacancy levels remain mostly low as well at 10.0% (just 8.7% direct vacancy) with sub-10% vacancy reported in submarkets such as the 520 Corridor, Redmond, and Suburban Bellevue. Moving forward, expect vacancy levels to remain low, although if leasing activity slows, an uptick in vacancy could be seen from new space delivered to the market vacant.

RENTAL RATES

Direct weighted average rental rate up to \$30.72 per square foot

The direct weighted average asking rental rate increased to \$30.72 per square foot (up 2.4% year over year). Average Class A rental rates increased to \$40.32 per square foot (up 6.3% year over year), while average Class B rental rates increased to \$26.52 per square foot (up 5.2% year over year). At mid-year 2017, several office submarkets have reported office rents at new historical peaks due to strong occupier demand led by the region's tech sector, most notably from Amazon. As a result, average rental rates are forecasted to continue to increase in 2017, although rental rate growth is expected to slow this year.

Metro Seattle Office Market Indicators

PROPERTY CLASS	INVENTORY	UNDER CONSTRUCTION	Q2 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Class A	51,005,609	5,591,077	493,722	524,845	9.0%	0.6%	9.6%	\$40.32
Class B	53,385,810	-	-291,710	-374,379	11.3%	1.2%	12.5%	\$26.52
Metro Total	104,391,419	5,591,077	202,012	150,466	10.2%	0.9%	11.1%	\$30.72



INVESTMENT MARKET

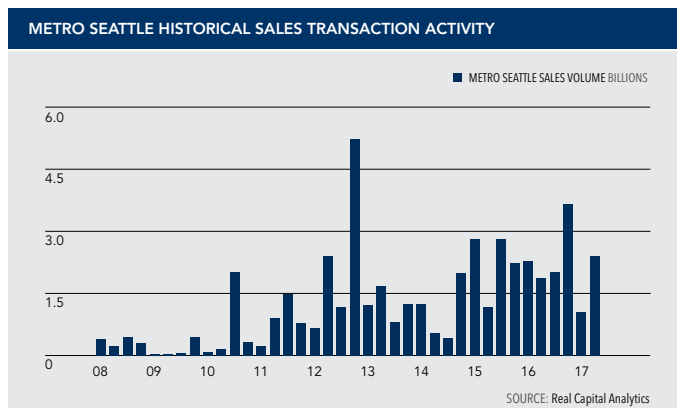
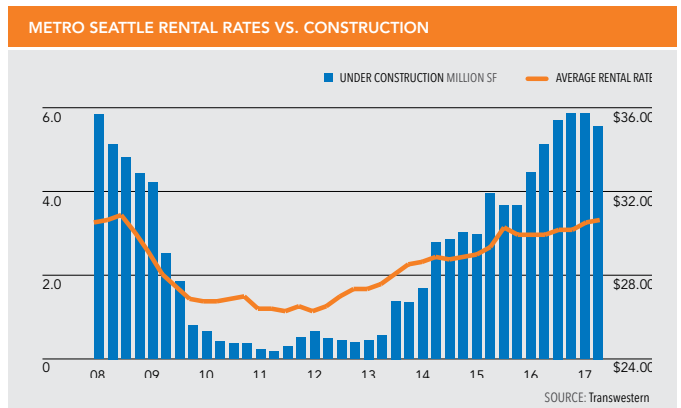
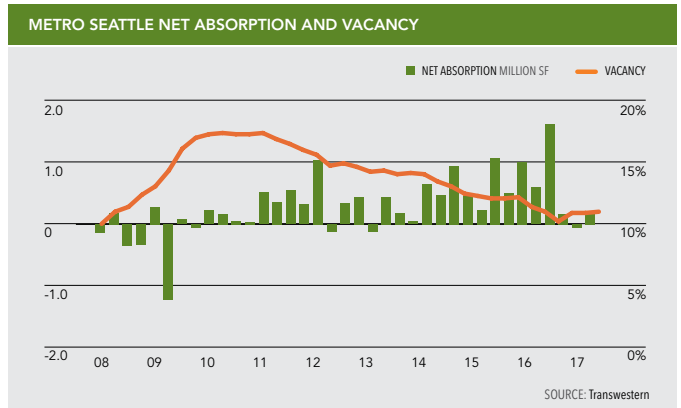
Investment sales market volume up to \$1.2 billion in the second quarter

In the second quarter, \$1.2 billion worth of office buildings traded in the Seattle/Puget Sound region, which was up 128% from the \$527.8 million of office sales reported in the first quarter 2017. This brought year-to-date office sales volume to \$1.7 billion (down 17% from the first six months of 2016). The largest office sale of the quarter involved Union Investment Real Estate GmbH acquiring the 100% Amazon-leased Midtown21 building (1007 Stewart St) in the Denny Triangle from a joint venture of Trammell Crow and MetLife for \$330.2 million (\$884 per square foot). As mentioned in previous reports, the general sentiment of rising interest rates leading to a cooling in building valuations remains mostly valid. However, Seattle remains a consensus top-5 market for office investment nationally due to its strong regional economy, continued population growth, and enviable growing business clusters in technology and life sciences.

OUTLOOK

Seattle/Puget Sound office market still healthy at mid-year 2017, but for how long?

In the second quarter, the Seattle/Puget Sound office market bounced back after relatively slow leasing and sales activity reported in the first quarter. Occupier demand remains strong and the envy of most office markets around the country with a “who’s who” of large technology firms continuing to lease space around the region (e.g., Amazon, Microsoft, Google, Facebook, Salesforce, etc). However, with lower leasing activity compared to last year, due in large part to the regional economy nearing full employment combined with the high amount of speculative office development now underway, expect vacancy levels to rise over the next few quarters if leasing activity and net absorption do not pick up. On the other hand, the region’s office market segment remains one of the best performing in the entire US, with a high amount of local, national, and international investor interest causing Class A valuations to more closely resemble other West Coast gateway markets such as San Francisco and West Los Angeles. ■



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Metro Seattle Office Market Indicators

MARKET	INVENTORY	UNDER CONSTRUCTION	Q4 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Downtown Seattle	52,164,580	4,378,245	339,322	249,139	8.8%	0.8%	9.6%	\$38.40
Eastside	27,701,610	539,000	-155,962	27,770	8.7%	1.3%	10.0%	\$33.72
Northend	8,248,515	-	-42,443	-93,082	12.1%	0.5%	12.6%	\$24.96
Southend	9,175,765	673,832	42,040	-54,939	19.5%	1.5%	21.0%	\$23.04
Tacoma	7,100,949	-	19,055	21,578	11.8%	0.0%	11.8%	\$21.84
SEA Office Market Total	104,391,419	5,591,077	202,012	150,466	10.2%	0.9%	11.1%	\$30.72

MAJOR LEASE ACTIVITY

PROPERTY	TENANT	SF	TYPE	MARKET	SUBMARKET
801 5th St	F5 Networks	515,000	Class A New Lease	Downtown Seattle	Seattle CBD
17425 NE Union Hill Rd	Aduro	46,568	Class B New Lease	Eastside	Redmond
720 Olive Way	Airbnb	42,772	Class A New Lease	Downtown Seattle	Belltown/Denny Triangle
10900 NE 8th St	Xevo	39,516	Class A Sublease	Eastside	Bellevue CBD

MAJOR SALES ACTIVITY

PROPERTY	PRICE	PRICE PSF	BUYER	MARKET	SUBMARKET
1007 Stewart St	\$330,200,000	\$884	Union Investment Real Estate GmbH	Downtown Seattle	Belltown/Denny Triangle
1101 Dexter Ave N	\$286,000,000	\$853	Tristar Capital & RFR Holding	Downtown Seattle	Lake Union
21925, 21930 & 21933 SE 51st St (3 bldgs)	\$153,000,000	\$261	Kennedy Wilson	Eastside	Coal Creek/Issaquah
428 Westlake Ave N	\$81,500,000	\$920	Commonwealth Holding LP	Downtown Seattle	Lake Union

DEVELOPMENT ACTIVITY

PROPERTY	SF	TYPE	DEVELOPER	MARKET	SUBMARKET
505 Madison St	764,000	Class A	Schnitzer West	Downtown Seattle	Seattle CBD
333 Dexter Ave N	650,000	Class A	Kilroy Realty Corp.	Downtown Seattle	Lake Union
801 5th Ave	515,000	Class A	Daniels Real Estate & Stockbridge Capital	Downtown Seattle	Seattle CBD
1812 Boren Ave	423,000	Class A	Touchstone & USAA	Downtown Seattle	Belltown/Denny Triangle

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METHODOLOGY

The information in this report is the result of a compilation of information on office properties located in the Seattle metropolitan area. This report includes single-tenant and multi-tenant office properties 10,000 SF and larger, excluding condo and medical office facilities and those properties owned and occupied by a government agency.



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