

SEATTLE OFFICE MARKET

THIRD QUARTER 2017

No slowdown in the Seattle/Puget Sound office market

Regional office vacancy rate down to 10.8% in the third quarter 2017

In the third quarter 2017, the Seattle/Puget Sound office market reported high net absorption due to completions of new office buildings which are 100% leased. This pushed regional office vacancy down to 10.8%, which is the lowest level reported in the area since 2007. Office sales volume remains steady as Seattle's strong employment and population growth, led by the area's resurgent technology sector, continues to attract institutional capital. For the remainder of 2017, expect more large transactions and high pricing as Seattle is now firmly considered a core gateway market for many institutional and overseas investors.

ECONOMY




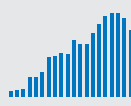


Unemployment rate in Seattle metro now at 4.2% in August

The seasonally adjusted unemployment rate for Seattle-Tacoma-Bellevue was 4.2% in August, which is both lower than the statewide unemployment rate of 4.6% and the national unemployment rate of 4.4%. Year-over-year nonfarm employment increased by 52,400 (2.7%) while office-using employment increased by 15,500 (2.8%), respectively. Compared to a year ago when both nonfarm employment and office-using employment in Seattle grew at 3.3% and 3.7%, respectively, year-over-year job growth has slowed as the regional economy continues to operate at or near full employment. However, with the region's technology sector acting as a catalyst for growth, expect very little slowdown in economic fundamentals over the short-term, especially as year-over-year employment growth is nearly double the national average.

SUPPLY AND DEVELOPMENT

Nearly 5.6 million square feet of office space now under construction

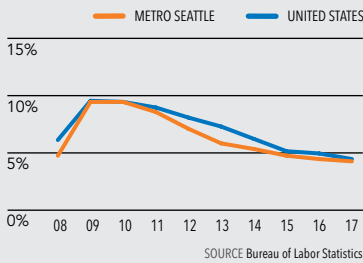
In the third quarter, a total of 1.1 million square feet was delivered, including Troy Block's North Building in South Lake Union and Tilt49 in the Denny Triangle, which were both 100% pre-leased to Amazon. Over 4.7 million square feet is currently under construction, constituting 4.5% of the existing competitive office base of the region. Of this amount, 29% is currently pre-leased and includes projects such as F5 Tower in the Seattle CBD where all 515,518 square feet is now pre-leased to F5 Networks, as well as Arbor Blocks in South Lake Union where all 388,911 square feet is pre-leased to Facebook. While office development activity remains elevated and concerns over overbuilding are warranted, the general sentiment is that tenant demand is so strong right now that the current supply pipeline will have very little trouble getting leased.

TRENDLINES	
5-YEAR TREND	CURRENT QUARTER
VACANCY 	10.8% Vacancy rate down 30 basis points from 2Q
ABSORPTION 	1,328,009 SF Downtown Seattle leads absorption
RENTAL RATE 	\$30.96 PSF Rates up 2.4% year over year
UNDER CONSTRUCTION 	4,704,128 SF 43% of office space is pre-leased
CAP RATES 	6.2% Cap rates down 20 basis points from 2Q
JOB GROWTH 	52,400 jobs Growth of 2.7% year over year

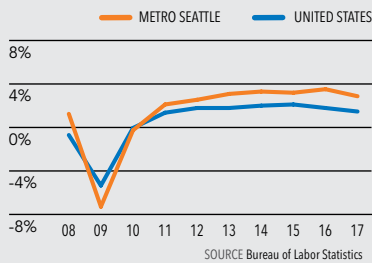
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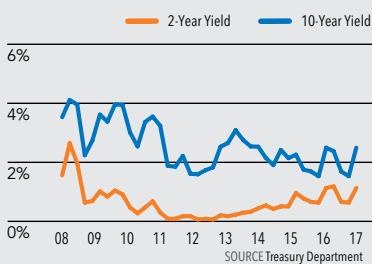
UNEMPLOYMENT RATE



PAYROLL JOB GROWTH



TREASURY RATES



DEMAND

Net absorption strongly positive at over 1.3 million square feet

Demand for office space in the third quarter surged to over 1.3 million square feet. Led overwhelmingly by Downtown Seattle and the Eastside, this brought 2017 year-to-date net absorption to nearly 1.5 million square feet, which remains healthy yet is down 54% from the 3.2 million square feet of net absorption reported in the first nine months of 2016. It should be noted that while the Downtown Seattle submarket of Lake Union has seen much media attention due to tech sector growth (mostly due to Amazon), Bellevue CBD has quietly seen the second-most gains in space occupancy in the Puget Sound region in 2017 (485,409 square feet) as companies throughout the Eastside increasingly look at the live-work-play and amenity-rich urban environment that Bellevue CBD offers.

VACANCY

Regional total vacancy rate down to 10.8% in the third quarter

The total vacancy rate ticked down 30 basis points to 10.8% in the Seattle/Puget Sound region. In Downtown Seattle, total vacancy decreased to just 9.4% while in the Eastside, total vacancy decreased to just 9.0%. As mentioned in previous reports, vacancy levels in Downtown Seattle submarkets such as Seattle CBD (9.4%), Ballard/U District (7.6%), Belltown/Denny Regrade (9.3%), Pioneer Square/Waterfront (6.4%), and Queen Anne/Magnolia (3.9%) are amongst the lowest ever reported. Not to be outdone, Eastside submarkets such as Bellevue CBD (7.7%), and 520 Corridor (8.4%) are also experiencing vacancy levels that are historically low. Moving forward, expect vacancy levels to remain low for the foreseeable future as tenant demand remains high.

RENTAL RATES

Direct weighted average rental rate now up to \$30.96 per square foot

The direct weighted average asking rental rate increased to \$30.96 per square foot region-wide (up 2.4% year over year). Average Class A rental rates increased to \$40.92 per square foot (up 4.9% year over year) while average Class B rental rates remained flat at \$26.52 per square foot (up 1.8% year over year). Region-wide, the most expensive submarkets were Bellevue CBD (\$42.12 per square foot), Belltown/Denny Regrade (\$42.00 per square foot), and Seattle CBD (\$41.04 per square foot). In addition, the rise in Bellevue CBD rents could result in Eastside tenants shifting their focus back to Downtown Seattle. Looking into year-end 2017, expect no slowdown in rental-rate growth due to low vacancy levels and more expensive Class A space delivering to the market over the next several months.

Metro Seattle Office Market Indicators

PROPERTY CLASS	INVENTORY	UNDER CONSTRUCTION	Q3 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Class A	52,125,009	4,704,128	1,267,041	1,791,886	8.5%	0.6%	9.1%	\$40.92
Class B	53,385,810	0	60,967	-313,412	11.5%	0.9%	12.4%	\$26.52
Metro Total	105,510,819	4,704,128	1,328,008	1,478,474	10.0%	0.8%	10.8%	\$30.96



INVESTMENT MARKET

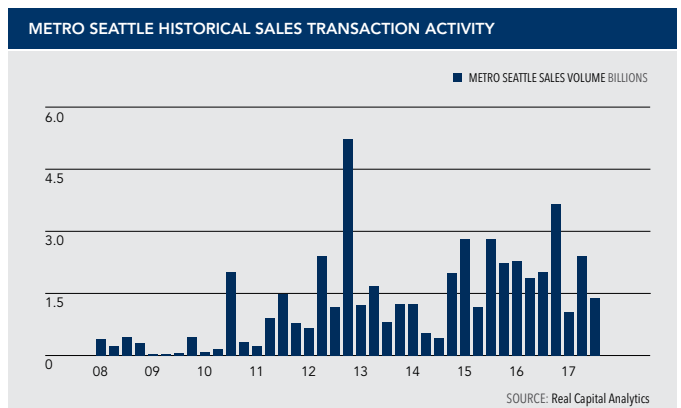
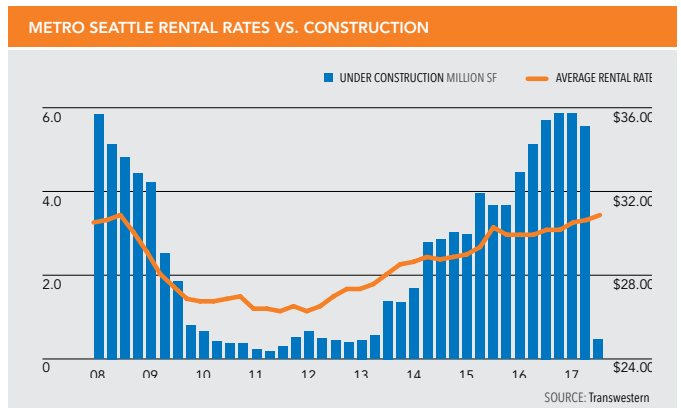
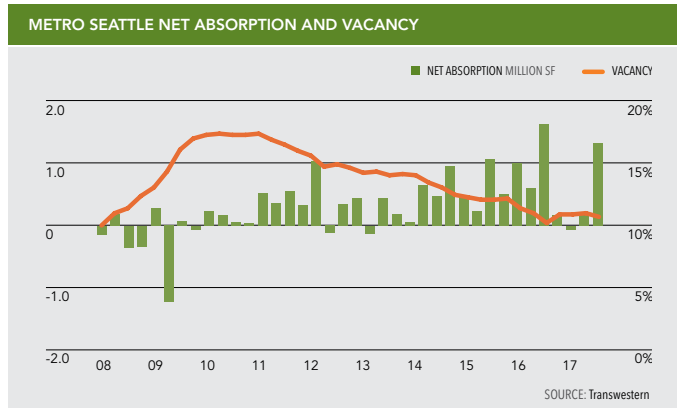
Nearly \$700 million in office sales transactions in the third quarter

In the third quarter, \$698.2 million worth of office buildings traded in the Seattle/Puget Sound region, which brought 2017 year-to-date office sales volume to \$2.4 billion (down 36% from the first nine months of 2016). The largest office sale of the quarter involved Clarion Partners acquiring the 100% Tableau-leased NorthEdge building (3301 Densmore Ave N) in North Lake Union from Touchstone for \$157.85 million (\$752 per square foot). This was followed by Blackstone acquiring the Exchange Building (821 2nd Ave) in the Seattle CBD from Beacon Capital Partners for \$156.5 million (\$521 per square foot). With the Puget Sound region continuing to have some of the strongest office market fundamentals in the US, expect no slowdown in the area office investment sales market in the short-term as investor interest remains high and the cost of capital continues to be relatively low.

OUTLOOK

Seattle/Puget Sound office market still strong in the second half of 2017

With local tech sector office demand still high despite the relatively modest size of the region’s office market, it is no surprise that Amazon this quarter requested proposals from other cities around the country for a second corporate headquarters location, dubbed HQ2, outside of Seattle. While Amazon remains committed long-term to the region and news broke early in the fourth quarter of them leasing all 722,000 square feet of the long-proposed Rainier Square project in the Seattle CBD, it now appears that Amazon, and the rest of the tech sector, could be rapidly outgrowing a metro area that ranks only 15th in population nationally, one spot behind Detroit and just ahead of Minneapolis. As a result, it could be possible that the only issue to slow the region’s red-hot economy (other than geopolitics) involve how to sustainably handle this rapid growth in population, housing costs, and current and future strains on existing infrastructure. ■



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Metro Seattle Office Market Indicators

MARKET	INVENTORY	UNDER CONSTRUCTION	Q3 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Downtown Seattle	53,184,980	3,360,363	1,058,423	1,307,562	8.8%	0.6%	9.4%	\$38.40
Eastside	27,800,610	660,000	367,160	394,930	7.9%	1.1%	9.0%	\$34.20
Northend	8,248,515		-85,628	-178,710	13.1%	0.6%	13.6%	\$25.32
Southend	9,175,765	683,765	-68,753	-123,692	20.3%	1.5%	21.8%	\$23.28
Tacoma	7,100,949		56,806	78,384	11.0%	0.0%	11.0%	\$22.08
SEA Office Market Total	105,510,819	4,704,128	1,328,008	1,478,474	10.0%	0.8%	10.8%	\$30.96

MAJOR LEASE ACTIVITY

PROPERTY	TENANT	SF	TYPE	MARKET	SUBMARKET
1745 114th Ave SE	OfferUp	71,329	Class B New Lease	Eastside	Suburban Bellevue
1099 Stewart St	WeWork	54,336	Class A New Lease	Downtown Seattle	Belltown/Denny Regrade
1301 2nd Ave	Indeed.com	44,631	Class A Sublease	Downtown Seattle	Seattle CBD
2033 6th Ave	Industrious	28,713	Class B New Lease	Downtown Seattle	Belltown/Denny Regrade

MAJOR SALES ACTIVITY

PROPERTY	PRICE	PRICE PSF	BUYER	MARKET	SUBMARKET
3301 Densmore Ave N	\$157,850,000	\$752	Clarion Partners	Downtown Seattle	Lake Union
821 2nd Ave	\$156,500,000	\$521	The Blackstone Group	Downtown Seattle	Seattle CBD
2401-2415 Elliott Ave	\$65,000,000	\$486	Unico Properties	Downtown Seattle	Belltown/Denny Regrade
7525 SE 24th St	\$41,000,000	\$388	Sterling Realty Organization	Eastside	Mercer Island

DEVELOPMENT ACTIVITY

PROPERTY	SF	TYPE	DEVELOPER	MARKET	SUBMARKET
920 5th Ave	764,000	Class A	Schnitzer West	Downtown Seattle	Seattle CBD
1201 2nd Ave	665,000	Class A	Skanska USA	Downtown Seattle	Seattle CBD
333 Dexter Ave N	650,000	Class A	Kilroy Realty Corp.	Downtown Seattle	Lake Union
801 5th Ave	515,518	Class A	Daniels Real Estate & Stockbridge Capital	Downtown Seattle	Seattle CBD

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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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