

SEATTLE OFFICE MARKET

FOURTH QUARTER 2017

Amazon expansion continues in the Puget Sound office market 2017 total regional net absorption of nearly 2.4 million square feet

In the fourth quarter 2017, the Seattle/Puget Sound office market continued to see high levels of demand from tech firms and co-working operators. Strong net absorption was led by Lake Union and the Bellevue CBD submarkets, with Amazon signing the three largest office leases in the quarter. While the delivery of new buildings in Downtown Seattle caused the total vacancy rate region-wide to increase to 11.2%, average rental rates continue to be elevated with single-digit vacancy levels reported across numerous submarkets around the region. Looking into 2018, expect these fundamentals to hold steady as the Seattle office market continues to be amongst the best performing in the US.

ECONOMY




Unemployment rate in Seattle-Tacoma-Bellevue at 4.1% in November

According to the Bureau of Labor Statistics, the Seattle-Tacoma-Bellevue unemployment rate was 4.1% in November, which is lower than the statewide unemployment rate of 4.5% and the same as the national unemployment rate. Year-over-year nonfarm employment increased by 47,900 (2.4%) while office-using employment increased by 19,200 (3.4%). Compared to a year ago when both nonfarm employment and office-using employment in Seattle grew at 3.4% and 3.6%, respectively, job growth has slowed over the past 12 months as the regional economy is now operating at or near full employment. With the region's booming tech sector fueling demand for talent, expect very little slowdown over the short term, especially as year-over-year employment growth remains a full percentage point higher than growth at the national level.

SUPPLY AND DEVELOPMENT

Over 4.3 million square feet of office space now under construction

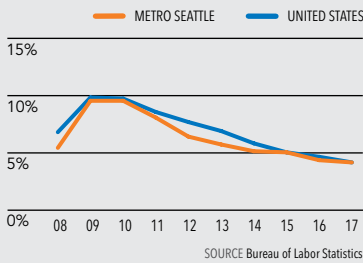
In the fourth quarter, over 1.4 million square feet was completed, including Schnitzer West's Madison Centre, as well as Daniels Real Estate and Stockbridge Capital's F5 Tower both in the Seattle CBD. Over 4.3 million square feet is currently under construction, constituting 4.0% of the region's existing competitive office base. In terms of pre-leasing, 36% is currently pre-leased, including Rainier Square in the Seattle CBD where 738,902 square feet is leased to Amazon, Avalara Hawk Tower in Pioneer Square which is now fully leased to Avalara and WeWork, and Arbor Blocks in South Lake Union, now leased to Facebook. While concerns over overbuilding are warranted, the general market sentiment is that tenant demand for new fully amenitized office properties is so strong that only a wider macroeconomic shock could slow down the market.

TRENDLINES	
5-YEAR TREND	CURRENT QUARTER
VACANCY 	11.2% Vacancy rate up 40 basis points from 3Q
ABSORPTION 	872,300 SF Downtown Seattle leads absorption
RENTAL RATE 	\$31.20 PSF Rates up 3.2% year over year
UNDER CONSTRUCTION 	4,330,953 SF 36% of office space is pre-leased
CAP RATES 	6.0% Cap rates down 20 basis points from 3Q
JOB GROWTH 	47,900 jobs Growth of 2.4% year over year

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UNEMPLOYMENT RATE

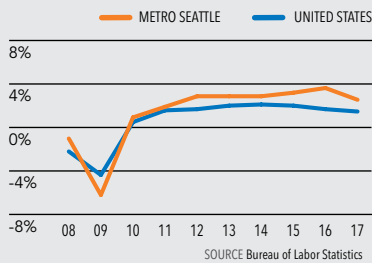


DEMAND

Quarterly net absorption strongly positive, led by Downtown Seattle

Office space demand in the fourth quarter was 872,300 square feet, which brought 2017 total net absorption to nearly 2.4 million square feet region-wide. While down 31% from the 3.4 million square feet absorbed around the market in 2016, this is still the second highest amount of annual net absorption ever recorded within the region. Driven by strong demand from tech companies, many of whom are coming from outside the region to take advantage of the region's large pool of engineering talent, as well as co-working operators such as WeWork looking to expand in the Pacific Northwest, we expect very little slowdown around the market as a whole in 2018.

PAYROLL JOB GROWTH

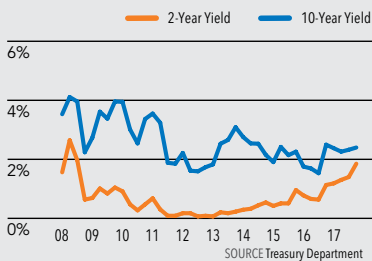


VACANCY

Total vacancy rate ends 2017 at 11.2% (10.4% direct vacancy)

The total vacancy rate ended 2017 up 40 basis points to 11.2% as large newly-completed office projects such as the fully leased F5 Tower were delivered to the market but not yet occupied. In Downtown Seattle, total vacancy ended the year with a total vacancy rate of 10.7%, while the Eastside saw total vacancy decrease yet again to just 8.4%. Vacancy levels are in the single digits in six of the eight submarkets that comprise Downtown Seattle, including 8.8% in Lake Union and 9.1% in Belltown/Denny Regrade. In addition, seven of the nine submarkets that comprise the Eastside ended the year with vacancy in the single digits, including Bellevue CBD (6.3%), Suburban Bellevue (5.8%), and I-90 Corridor (9.5%). Moving forward, expect vacancy levels to remain low for the foreseeable future as vacant-yet-encumbered office projects eventually become occupied next year.

TREASURY RATES



RENTAL RATES

Direct weighted average asking rate now up to \$31.20 per square foot

The direct weighted average asking rental rate increased to \$31.20 per square foot region-wide (up 3.2% year over year). Average Class A rental rates increased to \$41.76 per square foot (up 7.7% year over year) while average Class B rental rates decreased to \$26.40 per square foot (still up 0.5% year over year). Region-wide, the most expensive submarkets were Bellevue CBD (\$43.56 per square foot) and Seattle CBD (\$42.84 per square foot). Looking into 2018, expect average rental-rate growth of 3-5% due to low vacancy levels and more expensive Class A space delivering to the market over the next year.

Metro Seattle Office Market Indicators

PROPERTY CLASS	INVENTORY	UNDER CONSTRUCTION	Q4 NET ABSORPTION	YTD NET ABSORPTION	DIRECT VACANCY	SUBLEASE SPACE	TOTAL VACANCY	AVERAGE RATE PSF
Class A	53,572,621	4,251,318	758,251	2,550,137	9.5%	0.7%	10.1%	\$41.76
Class B	53,385,810	79,635	114,049	-199,363	11.3%	1.0%	12.2%	\$26.40
Metro Total	106,958,431	4,330,953	872,300	2,350,774	10.4%	0.8%	11.2%	\$31.20



INVESTMENT MARKET

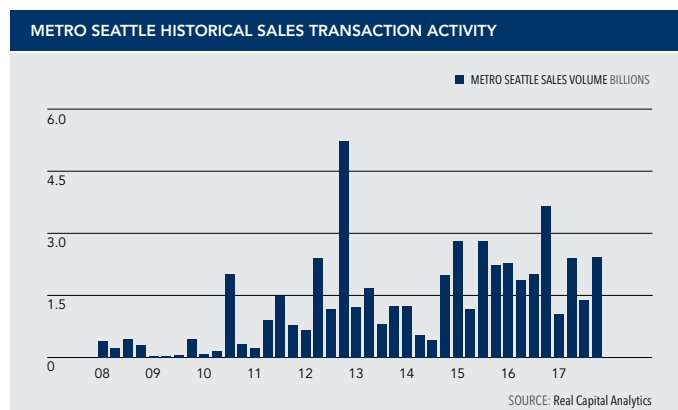
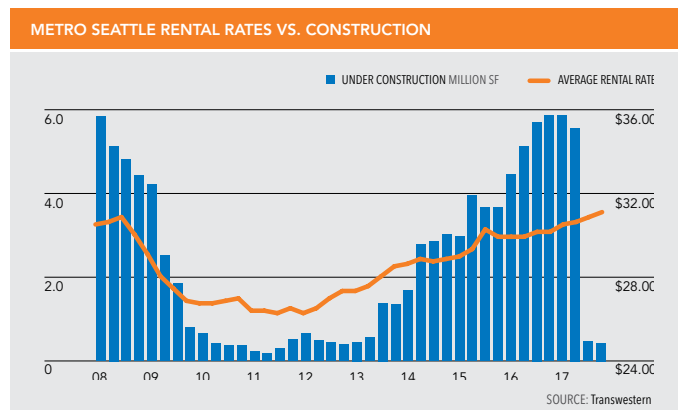
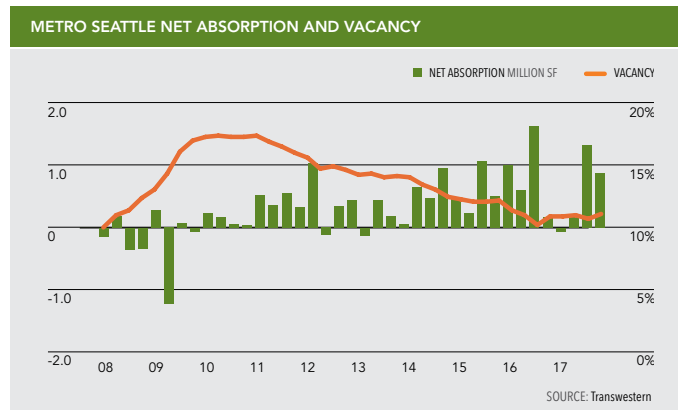
Over \$1.2 billion in office sales in the fourth quarter includes record pricing

In the fourth quarter, \$1.2 billion worth of office buildings traded in the Seattle/Puget Sound region, which brought 2017 total office sales volume to \$3.6 billion (down 26% from 2016). The largest office sale of the quarter involved Tristar Capital and RFR Realty acquiring the 100% Amazon-leased Centre 425 (425 106th Ave NE) from Schnitzer West for \$313 million, which at \$877 per square foot is a record price for Bellevue CBD. This was followed by Japan-based Takenaka Corporation acquiring the also 100% Amazon-leased Tilt49 building (1812 Boren Ave) in the Denny Triangle from Touchstone for \$268.5 million (\$924 per square foot). While 2018 is expected to see the Federal Reserve increase interest rates, office pricing is forecasted to remain high although the trophy Class A office cap rate compression into the low-4% range is now considered the floor for most investors.

OUTLOOK

Seattle regional office market remains one of the strongest markets in the US

As mentioned in previous reports, Amazon has been the primary driver of office space demand on both sides of Lake Washington this cycle. Not to be outdone, other well-known tech companies such as Microsoft, Oracle, Google, and Facebook continue to seek out high-quality office space around the region but mostly limited to a handful of trendy submarkets in Downtown Seattle and the Eastside. Unlike the San Francisco Bay Area where space demand has been comprised of a combination of venture capital-funded startups and established firms, the Seattle regional office market has mostly been driven by Fortune 500 tech firms and more recently, fast-growing national co-working operators such as WeWork. Considering most office tenants in other sectors such as legal and financial services continue to right-size, any slowdown in tech sector hiring in 2018 will disproportionately affect Seattle. In the meantime, expect fundamentals to remain amongst the strongest of any office market in the US next year. ■



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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	54,632,592	2,946,193	603,310	1,910,872	9.8%	0.9%	10.7%	\$39.24
Eastside	27,800,610	686,995	170,733	565,663	7.4%	1.0%	8.4%	\$35.64
Northend	8,248,515	14,000	120,304	-58,406	11.7%	0.5%	12.2%	\$25.44
Southend	9,175,765	683,765	-94,078	-217,770	21.8%	1.0%	22.8%	\$23.04
Tacoma	7,100,949	-	72,031	150,415	10.0%	0.0%	10.0%	\$22.08
SEA Office Market Total	106,958,431	4,330,953	872,300	2,350,774	10.4%	0.8%	11.2%	\$31.20

MAJOR LEASE ACTIVITY

PROPERTY	TENANT	SF	TYPE	MARKET	SUBMARKET
411 Union St	Amazon	738,902	Class A Pre-Lease	Downtown Seattle	Seattle CBD
300 Pine St	Amazon	475,000	Class B New Lease	Downtown Seattle	Seattle CBD
325-327 Eastlake Ave E	Amazon	186,250	Class A New Lease	Downtown Seattle	Lake Union
255 S King St	WeWork	74,228	Class A New Lease	Downtown Seattle	Pioneer Square/Waterfront

MAJOR SALES ACTIVITY

PROPERTY	PRICE	PRICE PSF	BUYER	MARKET	SUBMARKET
425 106th Ave NE	\$313,000,000	\$877	Tristar Capital & RFR Holding	Eastside	Bellevue CBD
1812 Boren Ave	\$268,500,000	\$924	Takenaka Corporation	Downtown Seattle	Belltown/Denny Regrade
720 Olive Way	\$185,958,745	\$616	Morgan Stanley Real Estate	Downtown Seattle	Seattle CBD
719 2nd Ave	\$119,884,000	\$595	TH Real Estate	Downtown Seattle	Seattle CBD

DEVELOPMENT ACTIVITY

PROPERTY	SF	TYPE	DEVELOPER	MARKET	SUBMARKET
Rainier Square (411 Union St)	762,802	Class A	Wright Runstad	Downtown Seattle	Seattle CBD
2+U (1201 2nd Ave)	665,000	Class A	Skanska USA	Downtown Seattle	Seattle CBD
Kirkland Urban (469 Central Wy - 3 bldgs)	660,000	Class A	Talon Private Capital	Eastside	Kirkland
333 Dexter (333 Dexter Ave N)	650,000	Class A	Kilroy Realty Corp.	Downtown Seattle	Lake Union

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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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