

Seattle Office

Market Forecast

	Current / Projection	
Vacancy	8.78%	↓
Construction	8.3 M sf	↑
Rental Rate	Varies*	↑
Absorption	242,737 sf	↑

* by submarket

Market Highlights

Regional vacancy rate ended the quarter at 8.78%, down 18 bps over the quarter. Net absorption was modest at 242,737 s.f.; however, announced leasing was very strong, promising better performance later in the year.

Construction activity continues to increase with 19 office projects underway; 15 in the Seattle CBD, two in the Bellevue CBD, one in Kirkland and one in Tukwila. Ten of the Seattle projects are speculative but with deals divulged in the quarter. Those buildings are 44% pre-leased.

Office property sales were very strong in the quarter and included properties in both CBDs and in suburban Eastside submarkets. Capitalization rates are stable across the categories.

Rental rates moved upwards in the Seattle and Bellevue CBDs in the quarter; the rest of the markets were mostly unchanged. ■

Spring came early to the Seattle area and nowhere was this more apparent than in the regions' office market. The first quarter of 2015 saw several long-awaited moves by tenants with large space requirements. First up was Facebook leasing most of the nearly completed Dexter Station project in early February. Amazon, not all that surprisingly, followed by taking both towers in the Troy Block project, underway adjacent to their campus. A long-rumored HBO deal in Hill7 was announced just before the quarter ended. Other tenants announcing significant leases in the quarter included Apple, Porch, PayScale, Dropbox, University of Washington and King 5 News. On the last day of the quarter, word was leaked that Expedia was planning to purchase Amgen's Helix campus, removing available space from the Seattle market, but opening up some space in the Bellevue CBD.

The investment side of the market was very busy this quarter with Hines picking up Civica Office Commons and The Summit in Bellevue, JP Morgan buying the Seattle Trade and Technology Center, and Metropolitan Park East and West trading hands for the third time in ten years. All this activity and the overall confidence shown in the market has further solidified the Seattle office market's nationwide top five ranking.

Vacant Space/Vacancy Rate

While all this leasing is encouraging, there was not much other activity that commenced in the first quarter, as is typical for this time of year. Absorption across the region was just 242,737 s.f. This is partially due to a lack of available larger spaces in the prime locations, but is mostly seasonal. The regional vacancy rate did continue to move downward, ending the quarter at 8.78%, down 18 basis points (bps) from the end of 2014. The availability rate, which includes space known to be available for lease but not actually vacant, increased slightly in the first quarter to 11.40% from 11.29%. This is due to the pending moves into new construction, such as the addition of Facebook's existing space to the available pool as they wait for Dexter Station to be completed later

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Area Review

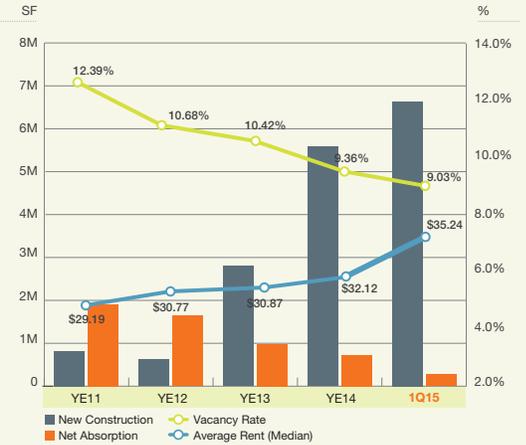
Seattle CBD/Surrounding Area Review

The Seattle submarket had net absorption of 270,385 s.f. in the first quarter, decent for the start of the year. This pushed the vacancy rate down to 9.03%, down 33 bps from the end of 2014. The availability rate popped up to 11.1% as some of the existing space of tenants moving to new construction was added to the pool of occupied but available space. Vacancy rates among the individual submarkets in the Seattle core range from 6.4% in the Lake Union submarket to 13.8% in South Seattle. The CBD core vacancy is 12.3%, a strong 150 bps improvement over the quarter, but the availability rate was flat at 15.0%. Asking rental rates in the core of the CBD increased by 20% through the first quarter, reflecting the falling vacancy and better progress attracting tech tenants to the legacy Class A buildings in the financial core. The Pioneer Square submarket has also been busy, with vacancy falling to 6.8%, a 130 bps decrease during the quarter. This submarket continues to solidify its attraction to tech and creative category tenants. Major leases signed in the quarter included 50,000 s.f. in the Cobalt Building with options on the remaining 110,000 s.f. to Porch, 40,000 s.f. to PayScale, and 70,000 s.f. to King 5 News. Most of these deals will be net absorption; King 5's existing South Lake Union buildings will be demolished for new multifamily development, for example. There are now 15 office buildings under construction in the Seattle market with a total of 6,637,911 s.f. Following the major leasing announcements this quarter, 70% of the space has been pre-leased, including 44% of the 3,541,761 s.f. of speculative space. The downward vacancy trend and upward pressure on rental rates in the Seattle market, and the Seattle CBD in particular, is expected to continue into 2015.

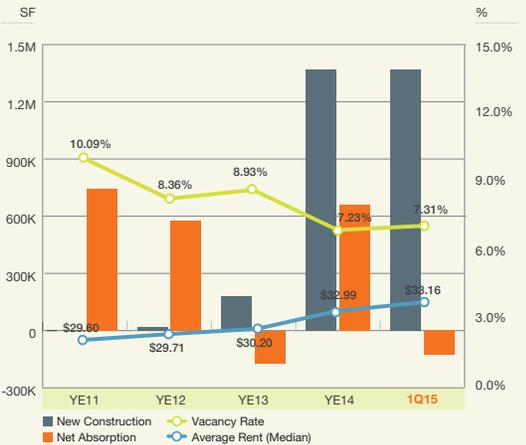
Eastside Review

The Eastside office market backslid a bit in the first quarter with negative 125,893 s.f. of net absorption. This is tied to the expiration of Microsoft leases of two Sammamish Park Place buildings totaling over 200,000 s.f.. This increased the vacancy rate slightly to 7.31%, up from 7.23% at the end of 2014. The availability rate is at 9.7%, compared to 9.2% at the beginning of the year. Vacancy in the Bellevue CBD has fallen to 7.70%, impressive in light of the return of a couple of large spaces to the market in the quarter, including the 172,000 s.f. One Twelfth at Twelfth East building. The availability rate did increase to 12.1%. Eastside office rents are poised for a major increase over the rest of 2015 as no new inventory will be delivered until 2016. The first new building delivered will be Trammell Crow's Nine Two Nine tower with 462,000 s.f., probably followed by Schnitzer West's Centre 425, a 16-story, 360,000 s.f. project that just started site work this quarter. These will be followed by Kemper Freeman's Lincoln Square II. Except for Steve Ballmer, former CEO of Microsoft, taking the top floor of Lincoln Square II, no other pre-leasing has been announced. There are a number of major tenants looking for larger spaces in the Eastside market, although one of those (Expedia) is apparently moving to Seattle and likely returning their Bellevue space back to the market. Looking forward, the Bellevue CBD will capture most of the new absorption as tech tenants expand into preferred locations with plentiful services and housing nearby.

SEATTLE CBD/SURROUNDING AREA



EAST KING COUNTY



South King County Review

The South King County market had a good first quarter, absorbing 67,962 s.f., dropping the vacancy rate to 11.04%, 36 bps lower than year-end 2014. The availability rate is still relatively high at 13.6%, a factor in the low and flat rental rates in this market. A small office building is nearing completion in Tukwila, being marketed to service tenants. Seco Development announced they intend to start their long-planned Southport Office complex in January of 2016. The three mid-rise buildings would add 725,500 s.f. to this project that already includes a hotel and two apartment buildings. No major changes are expected in the South King County market in the coming year as modest demand slowly shrinks the vacancy rate.

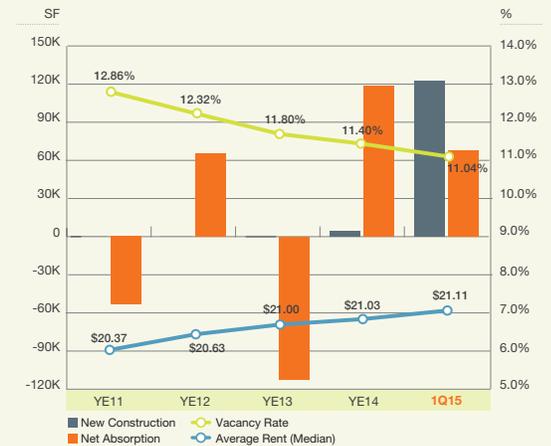
Northend Review

The vacancy rate in the Snohomish County office market continues to decline, ending the quarter at 8.30% after ending 2014 at 8.45%. Bothell has seen revived interest following Boeing's third quarter leasing. Vacancy in the Bothell submarket has fallen to 6.7% after starting the year at 7.3%, as interested tenants see the limited number of larger spaces remaining. Vacancy in Lynnwood has also trended downward, ending the quarter at 11.7% vacant, down from 13.2% a year ago. These submarkets continue to benefit from recovery in the finance sector and in companies related to the improving home building/buying market and expanding health care market. These businesses are attracted to the market by both lower cost office space and more affordable housing for their workforces. Total Northend net absorption in the first quarter was only 8,321 s.f., but the availability rate fell 60 bps to 10.90%, following a 120 bps decrease in 2014. Asking rental rates did not change significantly in the quarter, but are expected to start moving up in 2015.

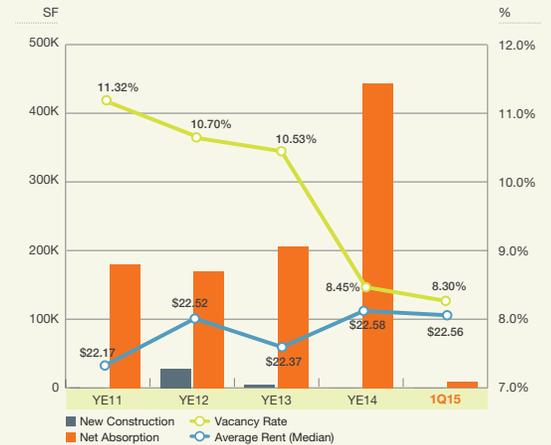
Pierce County Review

The Pierce County market vacancy rate was almost unchanged in the first quarter, ending at 9.62%. Net absorption was 21,962 s.f. in the quarter, nearly twice the total for all of 2014, while the availability rate was static at 14.9%. Asking rent was unchanged in the quarter. The Tacoma CBD vacancy is 10.1%, unchanged from the end of 2014 and the availability rate is 14.3%, also unchanged. Both of these figures are strongly affected by the amount of space in the CBD that is non-functional for most users. Sales in this market remain limited to smaller properties, primarily owner/user acquisitions in the past quarter.

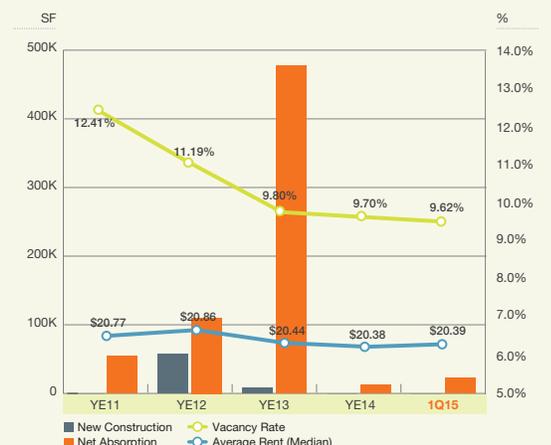
SOUTH KING COUNTY



SNOHOMISH COUNTY



PIERCE COUNTY



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Q1 2015 Seattle Office Sales

Name	City	Date	Price	SF	\$/SF
The Summit	Bellevue	15-Mar	\$319,800,000	524,130	\$610.15
Metropolitan Park East & West	Seattle	15-Mar	\$272,800,000	729,766	\$373.82
Civica Office Commons	Bellevue	15-Feb	\$205,100,000	323,562	\$633.88
Seattle Trade & Technology	Seattle	15-Mar	\$170,000,000	331,950	\$512.13

this year. All of the major markets, except for the Eastside, did have vacancy decline in the quarter. The peripheral submarkets have seen incremental, but consistent, improvement in demand by smaller local businesses. Those tenants were the last to recover from the recession and their recovery is key to the durability of the economic recovery. The forecast is for the vacancy rate to continue to decrease, perhaps at an even quicker pace, as these large signed leases begin to commence over the next few quarters.

New Construction Activity

There are currently 19 office buildings under construction in the region with a total of 8,009,095 s.f. Fifteen of these are in the Seattle CBD, including ten speculative buildings. Pre-leasing in those projects jumped to 44% on the strength of the deals signed in this quarter. Based on their recent success with their Hill 7 and Troy Block projects, Touchstone announced that work will begin on Tilt 49, a mixed-use project across the street from Hill 7 that includes an 11-story office building and 37-story multifamily tower. Outside of Seattle, the 180,000 s.f. second phase of Google's Kirkland campus is nearing completion and the Talon/Prudential partnership is finalizing plans for redevelopment of Kirkland Park Place with a downsized office element now at 650,000 s.f. In the Bellevue CBD, Trammell Crow's 929 Tower and Kemper Development's Lincoln Square II are well underway, while Schnitzer West has started site work on their 360,000 s.f. Centre 425 tower. No pre-leasing has been announced in any of the Bellevue projects.

Rent Forecast

The first quarter saw rental rates continuing upward in the Seattle and Eastside markets. At the core of those markets, rental rates are sufficient to justify new construction, with lease-up times being the major risk element. Brokers in the two CBD markets are anticipating a strong rent increase in the Class A market category, as that level has limited

inventory and the tech companies need to have the best space as part of their means to attract talent. The other three regional market's rents remained flat in the quarter, but should start to see some upward movement as the vacancy rates continue to slowly decline. The availability rates in South King, Snohomish and Pierce Counties are down a full 300 basis points from the depths of the recession, but that has not been enough to put pressure on rental rates. There is no major change in those area market trends seen near-term. Back in the core markets, the forecast is for Class A rent to increase by 5% or more in 2015.

Investment Market

The office investment market was very strong in the first quarter with over 60 transactions for a total sales volume of \$1.16 billion. The largest sale in the quarter was The Summit, a three property project in the Bellevue CBD with two existing buildings and a podium over a completed parking garage for another. Hines purchased this and Civica Commons, also in Bellevue, as they expanded their ownership in the region. Blanchard Plaza in the Seattle CBD was purchased by the AFL-CIO Building Investment Trust, attracted by a 5.2% return on a building fully leased to Amazon for 15 years. Two Eastside sales showed some growing confidence in the suburban locations. Talon Private Capital purchased the Sammamish Park Place complex from Vulcan. That acquisition was made with the anticipation that Microsoft would be leaving all three buildings, which they did, but one was quickly leased to Costco. In northwest Bellevue, Kennedy Wilson purchased the three building Corporate Campus East in a value-add play. Overall, Seattle continues to outperform the nation in terms of job growth and this is the base of the resulting strong dynamics in the office market.

Source: CoStar