

Real Estate Market Review

Seattle Office

After another solid performance for the regional office market during 2018, the 1st quarter 2019 office metrics are somewhat lackluster in comparison as the Puget Sound braces for more office construction. Over the quarter, the regional office market saw vacancy increase to 6.48%, up from 6.10% at year-end 2018. The regional availability rate also jumped by 43 bps over the quarter to 8.57%.

Four of the five major markets saw vacancy increases over the first quarter with Snohomish County posting the only vacancy decline. Despite the slight jump in vacancy, it is currently at the second lowest mark in the last 10 years. One of the fundamentals of the vacancy uptick over the first quarter was the nominal net absorption amount of just 6,095 s.f. region-wide, marked by negative net absorption in the Eastside and Pierce County market areas. The highest net absorption was in Seattle at 209,681 s.f. The primary driver in the market remains the push from tech companies continuing to expand their Puget Sound footprint. This, coupled with growth from some of the newer tech firms such as Tableau, Valve, Indeed and WeWork are encouraging developers to take notice, and they have. Meanwhile, Microsoft, Facebook, Costco and REI are all self-developing new office product at their Eastside locations.

Demand, especially for larger spaces in the Seattle and Bellevue CBDs, has pushed rental rates upward for the first quarter. The CBDs are seeing rents in the low \$40's per square foot per year NNN for new construction. The competition for space and new product have sent the average rent quote for regions office space upward to \$24.26/s.f. per year gross, a \$1.57/s.f./year increase from the end of 2018. The Eastside continues to draw attention of Amazon, which pre-leased all of the 17-story Summit III Towers bringing their Bellevue CBD presence to about 1.2 million s.f. Facebook also committed to Bellevue with their pre-leasing of the Spring

District-Block 16 building. With several eminent office projects in the downtown Bellevue pipeline, it will be interesting to see how much appetite remains for the tech companies. Looking forward, employment growth is anticipated to slow in 2019 which will eventually also factor into demand levels.

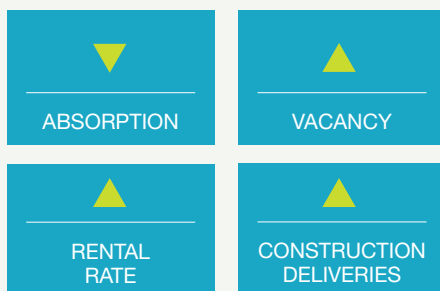
Developers continue to take notice of the durability and depth of the tech expansion. There are 19 major office projects under construction in the region. These total 7.3 million s.f. with 62% of the new space being pre-leased. There are an additional seven planned projects with first half 2019 start dates. Five of those buildings totaling 1.15 million s.f are located in the Eastside market area as new office construction in Bellevue has been modest. So far, no pre-leasing has been announced in any of these planned spec projects.

Vacant Space / Vacancy Rate

At the end of 1st quarter 2019, the region has a total standing office supply of 204.9 million s.f., per CoStar, up about 3.4 million s.f. from the inventory a year ago. Current office vacancy for the region is 6.48% with 13,286,087 sq ft of total vacant space including sublet vacancy. In the 1st quarter 2018, office vacancy started the year at 7.15%, then dropped each consecutive quarter to year-end 2018 vacancy of 6.10%. The current rate is a 38 bps increase over last quarter. Two of the region's major markets

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Market Forecast Trends



YEAR-TO-YEAR BASIS

Market Highlights

There are 19 major office projects under construction in the Puget Sound region totaling 7.3 million s.f.

Of the two major office projects under construction in Bellevue, Amazon has committed to leasing all of Summit III and Facebook has pre-leased all of Spring District-Block 16.

Regional vacancy increased to 6.48% over the quarter, which still remains the second lowest regional vacancy rate in past 10 years.

Of the projects currently under construction in the region, 62% is pre-committed in announced deals.

Seattle remains high on the list of desirable office investment markets for institutions, highlighted by the first quarter sales of Troy Block Towers and 800 5th Ave.

Rents continue to increase for Class A office inventory in the Seattle and Bellevue CBD's, especially for large block space which remains at a premium.

Area Review

Seattle CBD / Surrounding Area Review

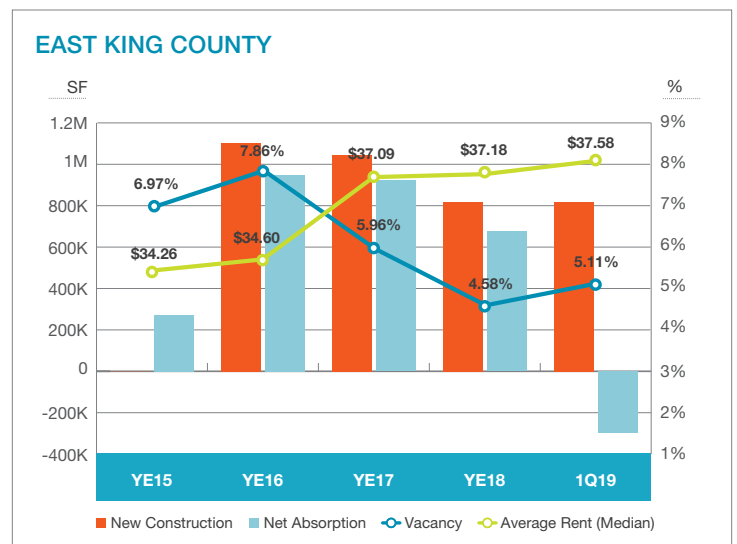
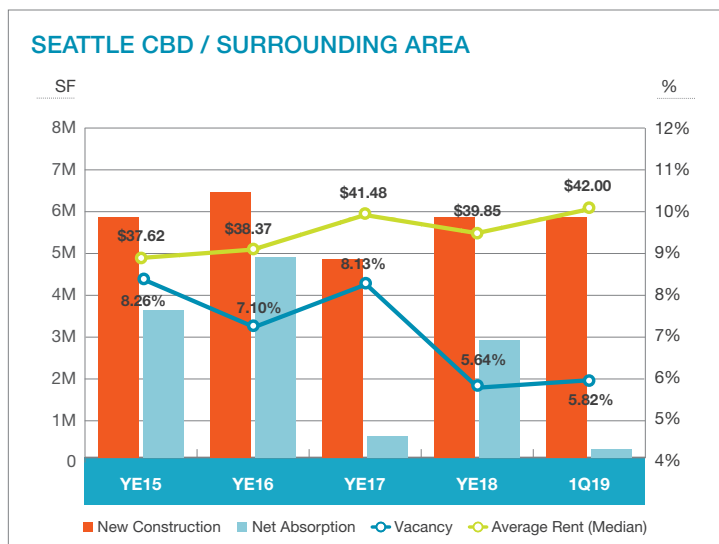
Net absorption in the Seattle market area for the 1st quarter 2019 was 209,681 s.f., slowing some from the torrid pace in 2018 where net absorption totaled 2,820,288 s.f. for the year. Seattle office vacancy also bucked the downward vacancy trend by increasing slightly to 5.82%, compared to 5.64% last quarter and 7.29% a year ago. The availability rate also increased over the quarter by 40 bps to 8.80%. Leasing activity in the Seattle market moderated with CoStar reporting 117 total deals comprising about 695,000 s.f. The CBD accounted for the majority of new leases highlighted by WeWork's leasing of about 73,000s.f. at Fourth & Madison and Sonos' lease of 40,000s.f. at 800 5th Avenue. Asking rates in the Seattle CBD increased to \$47.52/s.f./year at year end, up from \$46.44/s.f./year at the end of 2018, a \$1.08/s.f./year increase. Vacancy in the Seattle CBD submarket ended the first quarter 2019 at 8.1%, unchanged from last quarter and down 260 bps from a year ago. Most of the peripheral Seattle submarkets also performed well over the first quarter with vacancy rates of 3.4% in Ballard/U District, 1.4% for Capital Hill/Central district and 5.3% in South Seattle. Vacancy in the Queen Anne/Magnolia submarket is higher at 8.6% as a number of its larger buildings at the northwest corner of Queen Anne have been vacated by repositioning tenants.

There are fifteen major office projects under construction in Seattle at the end of the first quarter. There was also one new delivery in the first quarter, the Facebook-leased Arbor Blocks East project at 196,208 s.f. There are 15 major office projects under construction comprising 5.74 million s.f. The Seattle market accounts for 79% of all new construction in the region. Three of these projects are fully pre-leased to Facebook, Google and Amazon. Including preleased buildings, the new projects are about 64% preleased overall, although the 722,000 s.f. leased by Amazon at Rainier Square is entirely available for sublease. Considering the Seattle market has historically absorbed about 1.7 million s.f. annually, this is a manageable amount of new inventory. During the first quarter, the 66,400 s.f. Watershed Building in Fremont broke ground on construction of its spec office building. Urban Visions has approvals for their 1.2 million s.f. five building campus "S" project in the SoDo neighborhood at the south end of the CBD, and Amazon is set to start on their 388,000 s.f. Block 17 project. There are several major office sales to report or the first quarter in Seattle including the transfers of 800 5th Avenue at \$540,350,000 (\$568/s.f.), the Dexter Horton Building at \$151,000,000 (\$451/s.f.) and the Amazon leased Troy Block for \$740,000,000 (\$905/s.f.).

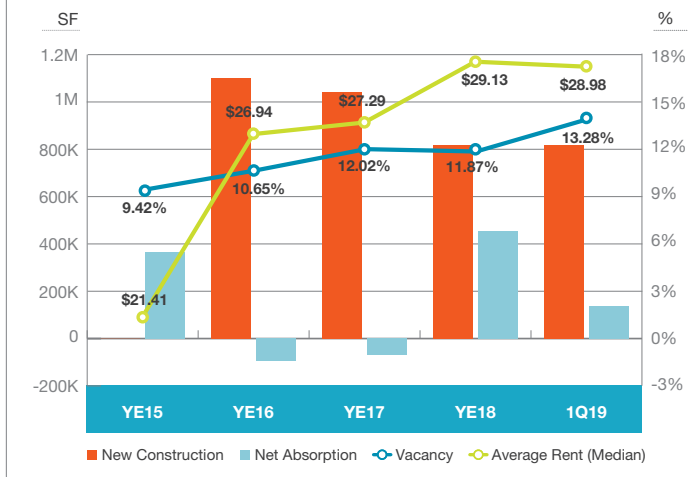
Eastside Review

Eastside office market inventory stands at just over 50.6 million s.f., or 24% of the region's office total. The Eastside continues to have the lowest office vacancy of all market areas at 5.11% at the end of the 1st quarter 2019. This is up 53 bps from the year-end 2018 vacancy of 4.58%, but 66 bps down from one year ago when vacancy was 5.77%. The availability rate trended down over the quarter to 6.40% currently, compared to 6.90% at year-end 2018. Net absorption during the first quarter was negative at -298,606 s.f. in contrast to net absorption of nearly a half million sq ft last quarter. Bellevue's CBD office vacancy dropped from to 5.8% to 5.2% over the quarter, while the CBD availability rate remained stable at 5.6%. A wave of new construction is on its way. At the end of the 1st quarter 2019, there remains only two major Eastside office projects under construction. Kirkland Urban (Phase I) and Spring District-Block 16. According to the developer, all the office space at Kirkland Urban North and Urban Central buildings has been pre-leased. A third office building at this project will break ground in 2020. Wright Runstad's Spring District-Block 16 is 11 stories and 338,000 s.f. is fully pre-leased by Facebook with a 1st quarter 2020 delivery planned. The previously mothballed Summit III office tower in the CBD is the next major Eastside office project on the horizon. The 17-story tower contains 377,000 s.f. and is fully pre-leased to Amazon. The project is permitted, and has yet to break ground.

These three projects are expected to be joined by as many as six office projects with potential 2019 start dates. All are speculative developments located in, or adjacent to, the Bellevue CBD and ranging in size from 66,370 s.f. to 630,000 s.f. Vulcan has plans for two Bellevue CBD development sites, a three-tower project with 850,000 total s.f. at the northwest quadrant of 106th Ave NE and Main St., with an estimated 2020 start. Vulcan's other site is at the Bellevue Transit Center where the Link light rail station is under construction. A 42-story office tower is being planned for that site. Omni Group has also announced plans for a three tower mixed-use development at the Barnes & Noble site which would include a 900,000 s.f. office tower. Most of the peripheral Eastside submarkets continue to perform well, ending the first quarter with vacancy rates of 4.0% and 4.7% respectively for Kirkland and Redmond. Vacancy in the I-90 Corridor remains high at 9.0% but showed improvements from 12.7% a year ago. T-Mobile's lease at 90 North for 163,000 s.f. has helped stabilize this submarket. Additionally on the Eastside, REI is underway in the Spring District with their new headquarters project and Costco is moving forward with plans for a nine-story, 620,000 s.f. expansion of their headquarters in Issaquah. Major



SOUTH KING COUNTY



Eastside office sales for the quarter include the purchase of Kirkland's Lake Washington Park for \$53,000,000 (\$613/s.f.) and the sale of Kyle Development's Sammamish View building for \$11,331,386 (\$378/s.f.). The current rent quote for the Eastside is \$37.58/s.f./year, up \$0.40/s.f./year from last quarter. The current rent quote for the Bellevue CBD is significantly higher at \$46.15/s.f./year at the end of the first quarter.

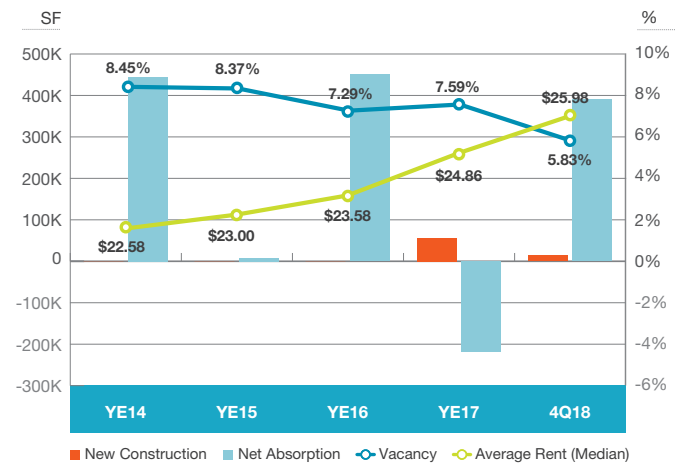
South King County Review

South King County finished the 1st quarter 2019 with a continued trend of positive net absorption at 138,269 s.f. This follows net absorption of 452,296 s.f. for all of 2018, its best annual result since 2005. Also occurring over the quarter, the Southend vacancy rate increased sharply from 11.87% at year-end 2018, to 13.28% currently, by far the highest in the region. The availability rate for this market also spiked to 15.30%, up from 11.90% at the end of 2018, but below 16.60% at year-end 2017. There were two office construction deliveries totaling 499,531 s.f. in South King County during the first quarter, which included two of the three Southport Office Campus towers which will total 688,147 s.f., at completion. All three buildings remain fully available for lease. Building 3 of Southport remains under construction along with the 129,000 s.f. headquarters expansion building for Alaska Airlines, just north of SeaTac International Airport. The only significant Southend office sale over the past quarter is the purchase of East Campus Corporate Park V at 97,216 s.f. in Federal Way which was bought by the Federal Way School District for \$13,000,000, or \$134/s.f. Overall, the South King County market is expected to see only modest changes and continued high vacancy level for the remainder of 2019.

Snohomish County/Northend Review

The Northend office market finished the first quarter of 2019 with another 107,520 sq ft in net absorption, a solid effort considering the market absorbed 390,749 s.f. for all of 2018. CoStar reported 50 new lease deals over the quarter compressing the vacancy rate down to 5.38% from 5.83% last quarter, and down 148 bps from a year ago. The availability rate increased to 7.90% from 7.20% at year-end 2018, up 70 bps over the quarter, foreshadowing a potential increase in vacancy later in 2019. The Bothell/Kenmore submarket ended the quarter at a vacancy rate of 6.2% after a healthy 145,289 s.f. of net absorption. Everett CBD reports vacancy of 5.4%, down from 6.0% a year ago. The Edmonds/Lynnwood submarket contains about 5 million s.f. of office space with vacancy of 5.9%, up from 5.1% at year-end 2018. The Northend submarket continues to attract smaller office tenants looking for housing proximity and affordability. With a current average rent quote of \$26.74/s.f./year, it is 30-35% more affordable than the average rent quotes for Seattle and the Eastside. The largest Northend office sale this

SNOHOMISH COUNTY

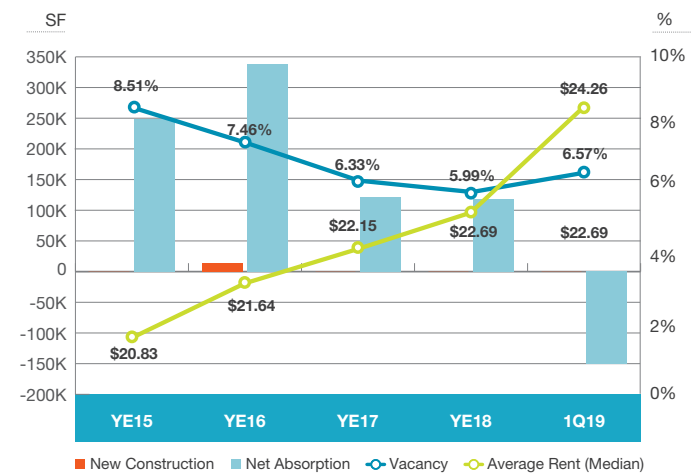


quarter was for the T Mobile leased Canyon Pointe (Buildings A & B) for \$51 million, or \$292/s.f. Overall, this is a stable market that continues to show incremental improvement as smaller businesses expand and new construction remains in check.

Pierce County Review

The Pierce County office market is spread out over a wide geographic area with a third of the office supply located in the Tacoma CBD. At the end of the 1st quarter 2019, the vacancy rate is 6.57%. This is an increase over the previous quarter vacancy of 5.99% and slightly above the 6.36% vacancy from a year ago. Conversely, the availability rate of 6.50% is an improvement over the 7.20% market last quarter, and a far greater improvement over the 11.2% availability rate from the 1st quarter 2018 after the State Farm departure. The Tacoma CBD vacancy rate stands at 9.5% compared to 6.0% last year simply with more vacant space to backfill. Of near-term concern, is the sharp increase in the CBD availability rate by 380 bp over the availability rate last quarter, which was 7.3%. Despite the rise in vacancy and availability rates, rental rates in Pierce County spiked up to \$24.26/s.f./year, a \$1.57/s.f./year increase over the average rent quote last quarter. Sale activity was slow over the quarter with no office investment sales over \$10 million and only one over \$2 million (Schwartz Bldg - \$2,100,000). Comparatively for all of 2018, there were only ten sales over \$2 million. Despite the upward shift in Pierce County vacancy over the quarter, the longer term outlook remains positive with a resurging CBD, aided by retail, residential and convention center expansion and no new office projects.

PIERCE COUNTY



posted negative absorption for the first quarter, including the Eastside at -298,606 s.f. and Pierce County at -150,769 s.f., with both markets seeing vacancy increases over the quarter as well. Overall, regional net absorption for the quarter was a net gain of 6,095 s.f., or basically breakeven. Absorption in 2018 was quite healthy at 4.46 million s.f., compared to 1.26 million s.f. for all 2017. Currently, there are few office existing building spaces over 50,000 s.f. listed for lease and even fewer existing building vacancies larger than 100,000 s.f., particularly in the Seattle and Bellevue CBDs. The next round of 2019 construction starts and new deliveries in the second half of 2020 should help balance demand. The regional availability rate, which tracks space being marketed but not necessarily completed or physically vacant, showed an increase over the first quarter, ending at 8.57%, compared to 8.14% at the end of 2018, and 10.40% at year-end 2017.

New Construction Activity

There were two major regional office deliveries in the first quarter including the Arbor Blocks East (Facebook) project at 196,208 s.f. in Seattle, and two of the three buildings in Renton's Southport Office development totaling 499,531 s.f. Combined, first quarter deliveries totaled 695,739 s.f. The only major start was in Seattle for the 66,400 s.f. speculative Watershed building. There are currently 14 major speculative office projects underway in the region. Twelve are in Seattle and collectively contain 3.5 million s.f. Of this, 41% is pre-leased which could rise soon considering speculative leases. In the Eastside market, the first two buildings of the speculative Kirkland Urban project are now fully leased according to the developer, with the third spec office building scheduled to break ground in 2020. In Bellevue, Spring District Block 16 at 338,000 s.f. is under construction and fully committed to Facebook. There are another seven projects poised to get underway in 2019 including the Summit III tower which is fully pre-leased by Amazon. The only other major speculative project outside of the Seattle and Eastside markets is the third building at Southport Office Campus. For the region as a whole, the 19 major office buildings under construction will collectively add about 7.3 million s.f. of new office supply over the next few years. Of this amount, 62% has been pre-leased.

Rent Forecast

Rental rates in the Seattle and Eastside markets increased over the quarter. The reported average asking rent quote is up in both areas with some of the new space coming on line in addition to the leasing of lower quality existing space. Rents in the other market areas fluctuated moderately upward and downward in the Northend and Southend markets, respectively. For Pierce County, the average rent quote increased from \$22.69/s.f. last quarter to \$24.26/s.f. currently. The upper end of the office market continues to outperform the overall market and it is anticipated that the remainder of 2019 will see increases for new space of 5%, or more. Current rent quotes in the Seattle and Bellevue markets set the bar at \$47.52/s.f./year and \$46.15/s.f./year, respectively. Looking further out, slowing economic and employment growth, and increased delivery of space will moderate rent growth. These factors have led investors to remain cautious in their long-term rent growth projections, but with expectations that the top of the submarkets in the Seattle and Bellevue CBDs will see increases at the top of the range as tenants compete for the limited supply in those submarkets.

Investment Market

Sales activity was moderate again over the first quarter, closing with 20 office sale transactions totaling just over 3 million square feet and total investment of \$1,852,000. Although the number transactions were low, the dollar amount was high. The majority of significant properties were sold occurred in the Seattle market, highlighted by the \$740 million purchase of the Troy Block Towers which contains 818,000 sq ft fully leased to Amazon. Other notable Seattle sales this past quarter include the Dexter Horton Building for \$151 million (\$451/s.f.) and 800 5th Avenue for \$540,350,000 (\$568/s.f.). There were two major office sales in Kirkland for the quarter including the Lake Washington Park for \$53 million (\$613/s.f.) and Kirkland 405 Corporate Center, Buildings A-1 and A-2, for \$35,750,000 (\$274/s.f.). In Bothell, Canyon Pointe Buildings A & B traded for \$51 million, or \$292/s.f. for the 174,546 s.f. project. Also occurring in the first quarter was Unico's January 2019 portfolio sale (Unico Partners I Fund) of 11 office assets (27 buildings) totaling 1.8 million s.f. in Seattle and Denver to Goldman Sachs for \$710 million. Year-end office investment in 2018 included 288 transactions, comprising \$2.08 billion in total sales volume. This was down slightly from \$3 billion in 304 sales in 2017 and the historical record of \$3.03 billion in 2016. Overall, there remains very strong investor confidence and interest across the region at all levels including increasing interest in the non-CBD submarkets as well.

Data Source: CoStar

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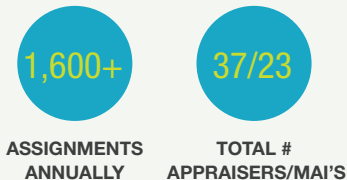
COMMERCIAL BROKERAGE



PROPERTY MANAGEMENT



VALUATION ADVISORY



Contact

Brian Hatcher
Regional President, Brokerage
Northwest
206.296.9600
bhatcher@kiddermathews.com

The information in this report was composed by the Kidder Mathews Valuation Advisory Group.

Chris Berger, MAI
425.450.1175 | cberger@kiddermathews.com

kiddermathews.com



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