

PUGET SOUND OFFICE MARKET

DEVELOPERS RACE TO EASE CONSTRAINED SUPPLY

The Puget Sound office market continued its relentless expansion in the third quarter of 2019, with asking rent and vacancy rates maintaining or surpassing recently established record levels. Average asking rents in the region increased by 1.7% on the quarter and by 7.5% year over year, up to \$39.45/SF. The overall vacancy rate remained at 7.6%, the same as last quarter, but down 110 basis points compared with the third quarter of 2018. The region experienced 1,391,343 square feet of net absorption in the third quarter, bringing the year-to-date total to 3,151,521 square feet, the most of any market tracked by NKF research. This quarter's absorption was largely driven by new construction projects, many of which delivered fully leased, such as Google's Lakefront Blocks and Facebook's Arbor Blocks, both of which are located in the Lake Union submarket.

The vacancy rate in Downtown Seattle dropped to 5.6%, down 30 basis points compared with the second quarter and down a remarkable 180 basis points year over year. Average Downtown full service asking rents jumped to \$45.61/SF in the third quarter, up 1.9% compared with the second quarter and up 9.3% compared with the same period last year. Among Downtown Seattle submarkets, Lake Union had the strongest third quarter, showing that Amazon's decision to expand in the Bellevue Central Business District has not adversely impacted Lake Union's upward trajectory. Rather than being dominated by one tenant, the demand for Lake Union office space is now spread among a host of tenants, predominantly technology and life science firms looking to establish or expand their presence in the Pacific Northwest. Asking rents in Lake Union averaged \$46.88/SF in the third quarter, with Class A space going for \$51.34/SF. Vacancy is a scarce 2.8%; Class A space is even tighter, with a vacancy rate of 0.9%. Lake Union is also the epicenter of construction activity in the region, with more than 1.0 million square feet delivered in 2019 and another 2.9 million square feet currently under construction.

On the surface, the Eastside appears to have had a modest third quarter. However, a closer look at the numbers reveals the true condition of the market, which has been heating up for months now. Average Eastside asking rents decreased from the second quarter, and vacancy in the Kirkland submarket spiked to 16.9%, causing the overall Eastside vacancy rate to increase by 40 basis points from the second quarter, from 5.4% to 5.8%. The vacancy figures can be discounted, however, because they account for the newly delivered Kirkland Urban buildings, which have been spoken for by Tableau and Google (though Google has yet to occupy). Adjusting for this decreases vacancy on the Eastside to 4.9%, 50 basis points lower than in the second quarter. The decrease in average asking rents can largely be ascribed to the lack of Class A space available on the Eastside, the supply of which was down 4.1%.

CURRENT CONDITIONS

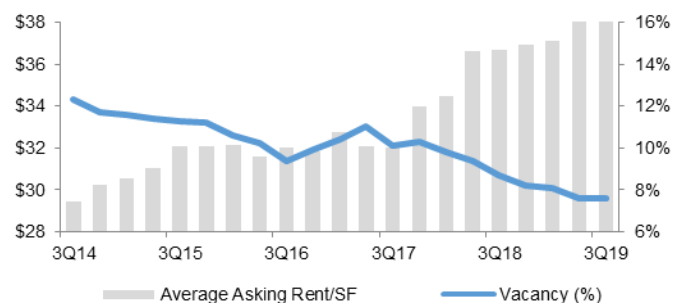
The Puget Sound ranks third nationally with 7.0 million square feet of office space currently under construction, trailing only Manhattan and Washington D.C.

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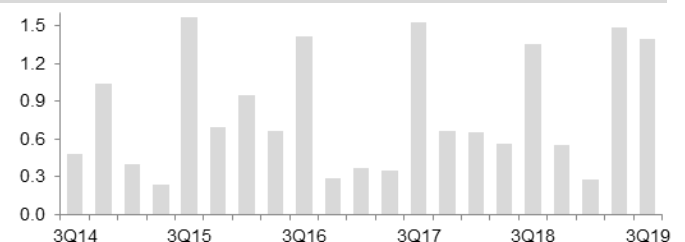
With Skanska's 2+U set to deliver next quarter, among other projects, the Puget Sound could potentially establish a new high by exceeding four million square feet of deliveries in 2019.

MARKET ANALYSIS

Asking Rent and Vacancy



Net Absorption (SF, Millions)



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	12 Month Forecast
Total Inventory	125 MSF	123 MSF	122 MSF	↑
Vacancy Rate	7.6%	7.6%	8.7%	↓
Quarterly Net Absorption	1,391,343	1,481,357	1,350,297	↓
Average Asking Rent	\$39.45	\$38.78	\$36.71	↑
Under Construction	7.0 MSF	7.5 MSF	7.3 MSF	↓
Deliveries	1,471,902	980,449	38,640	↓

One of the Eastside's focal points for future growth is the Suburban Bellevue submarket, which continued to build momentum in the third quarter. The submarket's vacancy dropped to 4.7%, down 10 basis points from the previous quarter and down 100 basis points from the third quarter of 2018. Rents in Suburban Bellevue increased to \$39.56/SF, up 1.4% compared with the second quarter and up 15.4% since the third quarter of 2018. Suburban Bellevue leads all Eastside submarkets with 988,000 square feet under construction, accounting for 58.9% of all office construction on the Eastside. Construction is concentrated in the Spring District, a transit-oriented development that will be served by the Link light rail extension beginning in 2023. Developed through the partnership of Wright Runstad, Shorestein Properties and the city of Bellevue, The Spring District will be anchored by Facebook, which has leased two full buildings that are currently under construction: the 337,996-square-foot Block 16 and the 210,000-square-foot Block 24, which was the second-largest lease signed this quarter.

DELIVERIES AND CONSTRUCTION ACTIVITY

Kirkland Urban Central Delivers

The Puget Sound construction boom remains in full swing, delivering 1.5 million square feet of new office space in the third quarter and 2.5 million square feet year to date. Despite the past two quarters' massive deliveries, there remains plenty of inventory in the development pipeline. The Puget Sound ranks third nationally with 7.0 million square feet of office space currently under construction, trailing only Manhattan and Washington, DC, which have market inventories that are

more than twice as large. One notable project that broke ground this quarter is Hines' 377,000-square-foot Summit III, which is fully leased by Amazon.

The Eastside's most significant delivery this quarter was the previously mentioned Kirkland Urban Central. The 198,070-square-foot project is being developed through the partnership of Talon Private Capital, Ryan Companies and Prudential. Google purchased Kirkland Urban this quarter and will eventually occupy the entire Central Building and roughly 110,000 square feet in the North Building, with a built-in growth option for a proposed third building, the 217,473-square-foot Kirkland Urban South. In the Southend, SECO Development's 213,221-square-foot Southport Office Campus Building 3 delivered in the Renton/Tukwila submarket, although the project has yet to land a tenant.

With Skanska's fully leased 2+U development, among others, set to deliver next quarter, the Puget Sound may exceed 4.0 million square feet of deliveries, which would set a record for square feet delivered in a single year. This blistering expansion pace should continue at least for another year, as there are currently 4.9 million square feet under construction and more than 40 proposed office projects in Downtown Seattle alone, including four from developer Urban Visions. Those proposed projects include The Jack and S Phases 1 & 2, which are located in the Pioneer Square/Waterfront submarket, and The Net, located in the Seattle CBD. These projects are expected to add more than 2.0 million square feet to the Downtown Seattle inventory.

SELECT LEASE TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
Qualtrics	2+U	Seattle CBD	Direct	275,000
Facebook	Spring District Block 24	Suburban Bellevue	Direct	210,000
WeWork	110 Atrium	Bellevue CBD	Direct	71,316
Assurance	Madison Centre	Seattle CBD	Direct	44,612
WeWork	2601 Elliott	Belltown/Denny	Direct	35,640

SELECT SALES TRANSACTIONS

Building	Submarket	Sale Price	Price/SF	Square Feet
4 th & Madison <small>(partial sale; Clarion is purchasing 49% interest)</small>	Seattle CBD	\$605,000,000	\$716	845,533
Sunset North	I-90 Corridor	\$227,000,000	\$490	463,182
Medical Dental Building	Seattle CBD	\$112,848,500	\$380	297,000
Corporate Campus East III	520 Corridor	\$55,250,000	\$359	153,506
Crown Pointe	Kirkland	\$47,750,000	\$364	131,053

SUBMARKET STATISTICS

	Total Inventory (SF)	Under Construction (SF)	Vacancy Rate	Qtr Absorption (SF)	YTD Absorption (SF)	Average FS Direct Asking Rent (Price/SF)
Downtown Seattle	63,039,860	4,930,764	5.6%	1,193,707	2,089,160	\$45.61
Ballard/University District	3,079,089	109,750	6.6%	124,760	95,094	\$47.69
Belltown/Denny Regrade	5,147,063	0	5.8%	7,717	91,742	\$41.72
Capitol Hill/Central District	1,749,883	0	6.7%	-7,087	-20,966	\$44.34
Lake Union	9,810,988	2,933,100	2.8%	1,075,520	1,112,113	\$46.88
Pioneer Square/Waterfront	6,270,440	0	4.3%	-108,673	-59,428	\$39.91
Queen Anne/Magnolia	4,241,458	49,012	12.6%	78,464	-134,930	\$41.87
South Seattle	2,614,634	0	8.0%	-65,631	-22,638	\$35.52
Seattle CBD	30,126,305	1,838,902	5.4%	88,637	1,028,173	\$48.89
Eastside	33,355,433	1,678,570	5.8%	67,738	958,521	\$42.66
520 Corridor	2,807,471	245,000	8.4%	-6,701	30,758	\$42.82
Bellevue CBD	9,839,521	377,000	3.2%	12,304	269,447	\$51.78
Bothell/Kenmore	3,312,732	0	8.0%	-29,899	192,440	\$37.34
Coal Creek/Issaquah	1,799,307	68,570	0.7%	-852	-4,184	\$41.46
I-90 Corridor	4,555,918	0	3.3%	77,102	436,899	\$40.85
Kirkland	2,558,328	0	16.9%	-32,490	67,607	\$51.84
Mercer Island	575,995	0	27.8%	1,473	-155,305	\$41.87
Redmond	3,365,858	0	4.5%	6,415	52,953	\$37.68
Suburban Bellevue	3,602,485	988,000	4.7%	1,977	41,786	\$39.56
Totem Lake	937,818	0	5.4%	38,409	26,120	\$37.36
Southend	11,384,318	279,000	22.8%	53,390	307,871	\$34.20
Federal Way/Auburn	3,315,577	0	23.2%	14,318	124,170	\$26.73
Kent Valley	1,464,006	0	4.1%	20,265	31,712	\$27.57
Renton/Tukwila	5,410,316	150,000	30.8%	17,781	147,958	\$38.40
Seatac/Burien	1,194,419	129,000	7.9%	1,026	4,031	\$29.02
Northend	7,836,268	0	5.2%	52,344	111,784	\$30.35
Tacoma	8,933,307	75,000	11.0%	24,164	-315,815	\$27.56
Puget Sound Market	124,549,186	6,963,334	7.6%	1,391,343	3,151,521	\$39.45

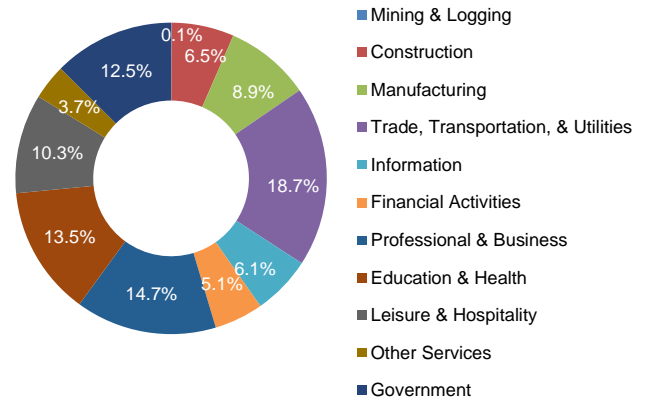
ECONOMIC CONDITIONS

The Fed lowered interest rates by 25 basis points in September to a new target range of 1.75 to 2.0% and hinted strongly at another interest rate cut in the fourth quarter. This marks the second consecutive quarter with a rate cut, after more than 40 quarters without one. The cuts were precipitated by weaker than expected business investment and U.S. exports. There were also a host of negative headlines during the quarter, as the yield curve inverted again, Brexit loomed, tariffs increased in the China-U.S. trade dispute, and oil prices spiked after attacks on oil production facilities in Saudi Arabia. Despite the tumultuous undercurrents, the domestic economy continues to hum along, unemployment remains near historic lows at 3.7% and the FOMC increased projected GDP growth from 2.1% to 2.2% in the September meeting.

Locally, the Puget Sound economy is in overdrive and does not appear to be slowing any time soon. The regional unemployment rate is 3.6%, 10 basis points lower than the national rate, and employment increased by 3.1% year over year. The information sector led all employment categories with an increase of 6.2% year over year, thanks to tech giants like Amazon, which increased its online job postings in the region by nearly 50.0% compared with August 2018.

EMPLOYMENT BY INDUSTRY

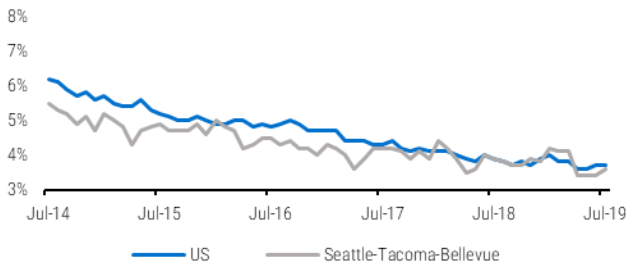
Seattle-Tacoma-Bellevue, Aug 2019



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

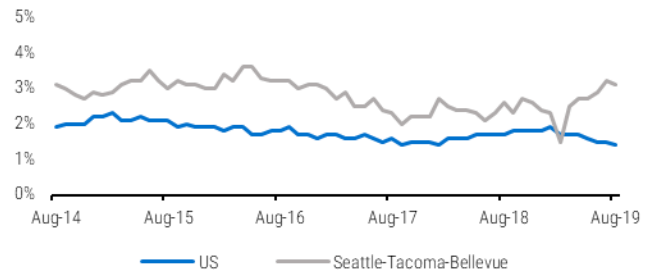
Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

PAYROLL EMPLOYMENT

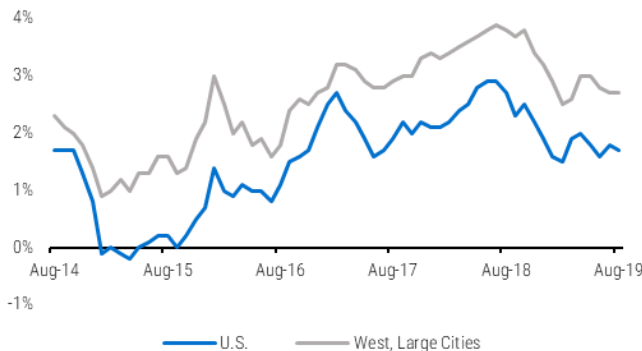
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

CONSUMER PRICE INDEX (CPI)

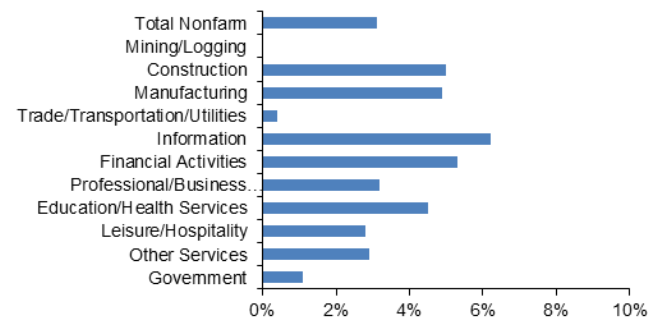
All Items, 12-Month % Change, Not Seasonally Adjusted,



Source: U.S. Bureau of Labor Statistics

EMPLOYMENT GROWTH BY INDUSTRY

Seattle-Tacoma-Bellevue, 12-Month % Change, Not Seasonally Adjusted, Aug 2019



Source: U.S. Bureau of Labor Statistics

Seattle

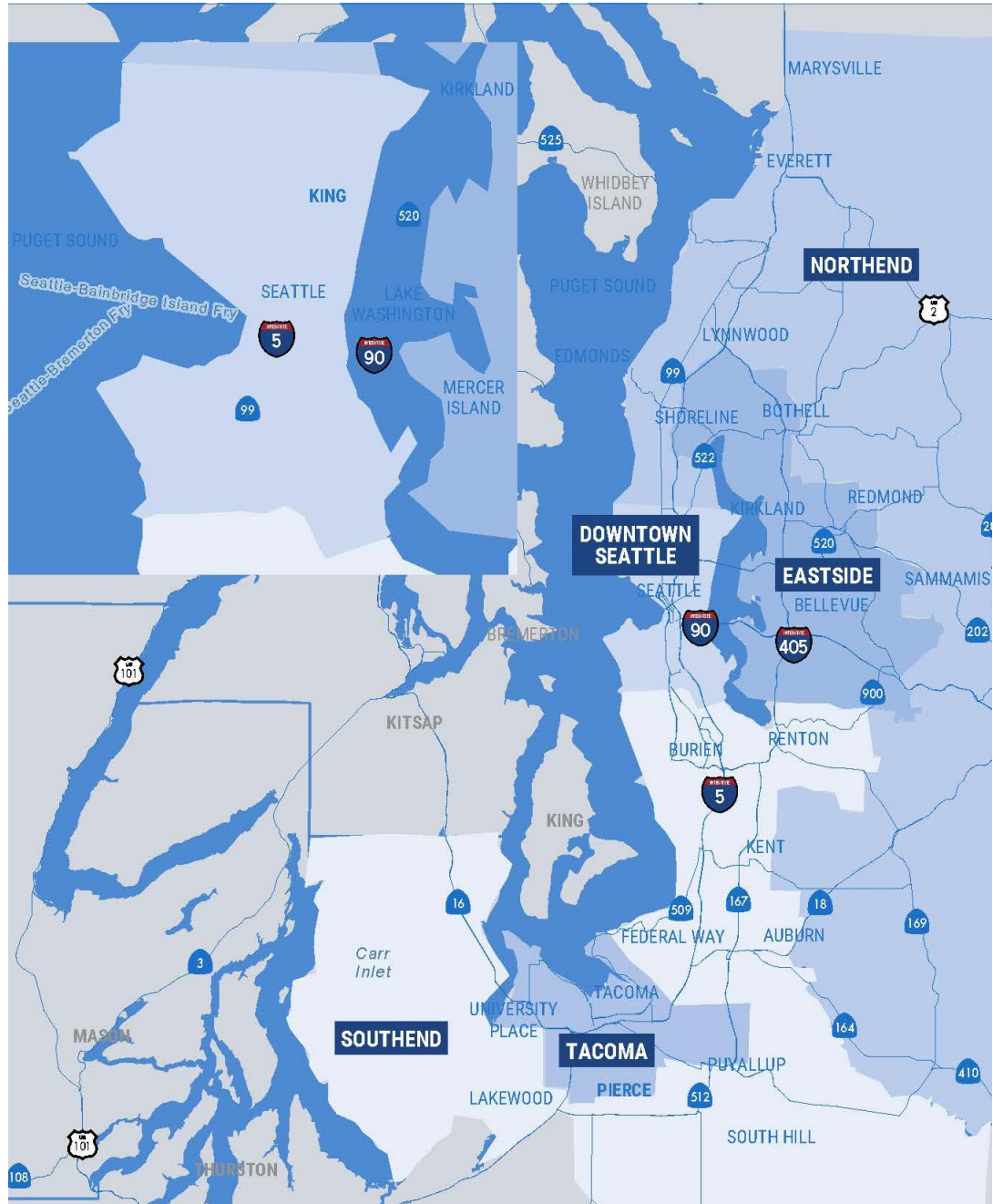
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Sources: The Seattle Times, Costar, The Wall Street Journal, Puget Sound Business Journal, The Registry, and Daily Journal of Commerce.

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