

# PUGET SOUND OFFICE MARKET

## MARKET BEGINNING TO THAW

Despite the region's COVID-related shutdown, which began early in the second quarter of 2020, the Puget Sound office market experienced another strong quarter. Average asking rents rose slightly to \$42.34/SF, a 0.06% increase from the first quarter. Net absorption was 109,858 square feet for the quarter, bringing the year-to-date total to 498,177 square feet. Second-quarter vacancy was 6.9%, more or less flat from the first quarter and down 60 basis points year over year. There is over 9.038 million square feet of office space currently under construction in Puget Sound.

The Eastside had negative net absorption of 26,156 square feet in the second quarter and rents edged lower, down 0.7% to \$43.69/SF. The negative absorption marks the first such quarter for the Eastside since 2017 and can be attributed to the shutdown, which prevented move-ins and hampered deal progress. Vacancy increased 10 basis points on the quarter, from 4.8% to 4.9%, due to a small amount of sublet space hitting the market, but the direct vacancy rate remained at 4.2%, unchanged from the previous quarter.

The Eastside statistics reflect a market that largely pushed the pause button for a quarter, with landlords and tenants attempting to assess when and where the market will stabilize. In the biggest lease of the quarter, Amazon took 111,368 square feet at a former Macy's department store in Redmond Town Center. It will be difficult for Microsoft to miss Amazon's venture into its home turf, since Microsoft currently occupies four buildings in Redmond Town Center. Redmond Town Center is the second local example of Amazon office space succeeding a Macy's department store, the other being 300 Pine in the Seattle CBD, where Amazon occupies roughly 640,000 square feet. Amazon's office footprint in the region now exceeds 18 million square feet, including future space commitments.

Downtown Seattle saw negative net absorption in the second quarter of 55,056 square feet, lowering year-to-date net absorption to 30,767. The negative absorption was the result of several large subleases, including Leafly at 333 Elliott in the Queen Anne/Magnolia submarket, Rover at 8th and Olive and GE Healthcare at 4th and Madison, both in the Seattle CBD. Available sublet space in Downtown Seattle has increased by 17.8% since April 1st, and that number is expected to increase in the third quarter. Average asking rents dropped to \$48.15/SF, down 0.5% from the previous quarter but up 6.9% year over year. Direct vacancy remained the same as the first quarter at 4.6%, while sublet vacancy increased, pushing the overall vacancy rate up 10 basis points to 5.7%. Several large leases were signed in Downtown

## CURRENT CONDITIONS

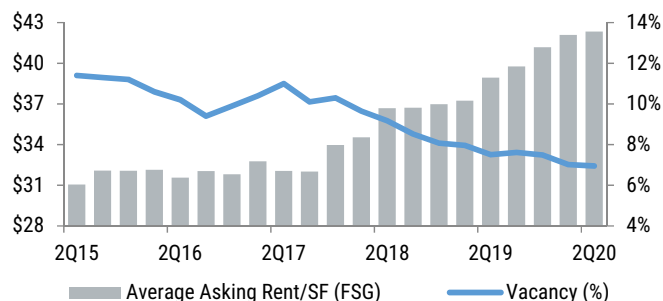
The Eastside's direct vacancy rate remained at 4.2%, unchanged from the previous quarter.

The Puget Sound has the highest percentage of FAANG square footage of any market tracked by NKF (15.2%).

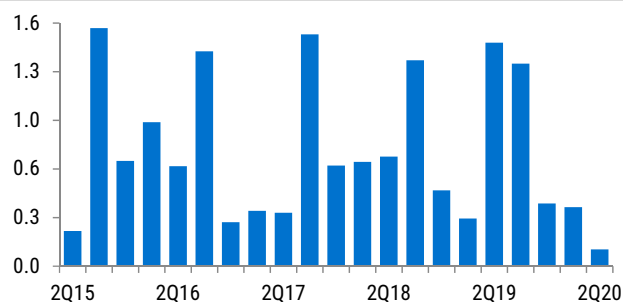
The vacancy rate in the Southend fell to 19.7%, a drop of 110 basis points compared with Q1.

## MARKET ANALYSIS

### Asking Rent and Vacancy



### Net Absorption (SF, Millions)



## MARKET SUMMARY

|                          | Current Quarter | Prior Quarter | Year Ago Period | 12 Month Forecast |
|--------------------------|-----------------|---------------|-----------------|-------------------|
| Total Inventory          | 127M SF         | 127M SF       | 124M SF         | ↑                 |
| Vacancy Rate             | 6.9%            | 7.0%          | 7.5%            | ↑                 |
| Quarterly Net Absorption | 110K SF         | 388K SF       | 1.5M SF         | ↑                 |
| Average Asking Rent      | \$42.34         | \$42.09       | \$38.93         | ↓                 |
| Under Construction       | 9.0M SF         | 7.8M SF       | 7.8M SF         | ↓                 |
| Deliveries               | 66,400 SF       | 1.0M SF       | 980K SF         | ↑                 |

Seattle, including: UW Medicine taking 40,000 square feet at 1001 4th Avenue (Liberty Mutual sublet); Goldman Sachs taking 15,000 square feet in the top floor of Rainier Square (Amazon sublet) in the Seattle CBD; and Adobe expanding into 31,840 square feet in the Waterfront Building in the Fremont neighborhood, located in the Ballard/U District submarket. Fremont was also the location of a significant second-quarter construction delivery, where Stephen C. Gray and Hess Callahan Partners completed the 66,400-square-foot Watershed building. Current tenants include the Schultz Family Foundation and Take-Two Interactive, who leased 21,806 square feet and 11,950 square feet, respectively.

The Southend market was a notable bright spot during the second quarter. Vacancy fell to 19.7%, a drop of 110 basis points on the quarter. This marks the first quarter that the Southend vacancy rate has been below 20% since Southport delivered in the Renton/Tukwila submarket during the second quarter of last year. Net absorption in the Southend was 115,984 square feet during the first quarter and 196,457 square feet for the year to date. Life science and engineering companies have contributed to this increased demand, with Cellnetix occupying 45,677 square feet at Building B of The Offices at Intergate, which it leased in fourth-quarter 2019, and WSP USA renewing and expanding into 34,807 square feet in the ABAM Building in Federal Way. In the Seatac/Burien submarket, Alaska Airlines completed The Hub, a 129,000-square-foot owner-user office development, which is the first phase of a campus planned on the 6.8-acre parcel Alaska purchased in January 2018 for \$32.0 million.

## NOTABLE TRANSACTIONS AND DEVELOPMENT

The region's largest recent transaction, the sale of Tower 333 from Equity Commonwealth to KKR, fits the well-established theme of an

Amazon-leased building trading at or near record levels. Other Amazon-leased buildings that have traded recently include the Troy Blocks and Amazon Phase 8 in the Lake Union Submarket and Summit III in the Bellevue CBD. The Mercer Island submarket had one of its largest office sales ever when Ryan Companies purchased the 155,000-square-foot former Farmers Insurance building for \$46.5 million, or \$300/SF. Ryan Companies will put the property through a significant renovation, which will modernize the structure built in 1982.

In the Seattle CBD, Intercontinental RE secured a partial interest in 400 University @ Rainier Square from owner Wright Runstad for \$81.0 million, or \$664/SF. The price reflects a full valuation. The Fana Group of Companies completed a long-anticipated sale for a development site in the Bellevue CBD. West77 sold the corner development site known as Washington Square Block to The Fana Group for \$26.9 million. Fana has released plans to develop a 20-story, 692,000-square-foot office tower with space for 2,000 employees. The Fana Group has another proposed development in the Bellevue CBD, the 550,000-square-foot Four106, which is projected to deliver in 2025.

Seattle-based Vulcan has been among the most active developers in the Region. Last quarter they broke ground on the 970,000-square-foot 555 108th development in the Bellevue Central Business District. At 600 feet tall and 42 stories, 555 108th will be Bellevue's largest building upon delivery, which is projected for 2023. Vulcan's Bellevue Plaza, a 3.4-acre parcel assemblage acquired in 2016 for \$45.6 million, broke ground in the second quarter. Plans call for a three-tower development to be built in phases, with office space approaching 900,000 square feet. Vulcan is also developing Block 38 in the Lake Union submarket as a build-to-suit for Google. When including proposed projects, Vulcan's current development pipeline exceeds 3.0M square feet of office space.

### SELECT LEASE TRANSACTIONS

| Tenant               | Building                  | Submarket          | Type              | Square Feet |
|----------------------|---------------------------|--------------------|-------------------|-------------|
| Amazon               | Redmond Town Center       | Redmond            | Direct Lease      | 111,368     |
| UW Medicine          | Safeco Plaza              | Seattle CBD        | Sublease          | 55,000      |
| WSP USA, Inc         | ABAM Bldg                 | Federal Way/Auburn | Renewal/Expansion | 34,807      |
| Monolith Productions | Touchstone Kirkland       | Kirkland           | Direct Lease      | 33,096      |
| Nvidia               | Quadrant Willows - Bldg A | Redmond            | Direct Lease      | 27,370      |

### SELECT SALES TRANSACTIONS

| Building                        | Submarket     | Sale Price    | Price/SF | Square Feet |
|---------------------------------|---------------|---------------|----------|-------------|
| Tower 333                       | Bellevue CBD  | \$401,486,667 | \$968    | 414,964     |
| 400 University @ Rainier Square | Seattle CBD   | \$81,000,000  | \$664    | 122,000     |
| 3003 77th Avenue Southeast      | Mercer Island | \$46,450,000  | \$300    | 155,000     |
| I-90 Corporate Campus           | I-90 Corridor | \$19,000,000  | \$433    | 43,833      |
| Columbia Building               | 520 Corridor  | \$15,332,333  | \$216    | 71,000      |

## SUBMARKET STATISTICS

|                               | Total Inventory (SF) | Under Construction (SF) | Total Vacancy Rate | Qtr Net Absorption (SF) | YTD Net Absorption (SF) | Average Direct Asking Rent (Price/SF, FSG) |
|-------------------------------|----------------------|-------------------------|--------------------|-------------------------|-------------------------|--|
| <b>Downtown Seattle</b>       | <b>64,987,769</b>    | <b>4,836,165</b>        | <b>5.7%</b>        | <b>-55,056</b>          | <b>61,534</b>           | <b>\$48.15</b>                             |
| Ballard/University District   | 3,287,563            | 43,350                  | 5.4%               | 10,485                  | 63,408                  | \$46.57                                    |
| Belltown/Denny Regrade        | 5,638,292            | 892,008                 | 5.6%               | -15,307                 | -47,578                 | \$41.38                                    |
| Capitol Hill/Central District | 1,749,883            | 0                       | 2.0%               | 2,461                   | 80,489                  | \$38.46                                    |
| Lake Union                    | 10,139,216           | 1,971,678               | 1.7%               | -13,207                 | 22,954                  | \$45.27                                    |
| Pioneer Square/Waterfront     | 6,270,440            | 135,866                 | 4.9%               | 12,856                  | -53,287                 | \$45.50                                    |
| Queen Anne/Magnolia           | 4,241,458            | 49,012                  | 14.0%              | -41,822                 | -126,158                | \$42.60                                    |
| South Seattle                 | 2,820,026            | 0                       | 6.9%               | -378                    | 7,591                   | \$36.12                                    |
| Seattle CBD                   | 30,840,891           | 1,744,251               | 6.3%               | -10,144                 | 114,115                 | \$52.54                                    |
| <b>Eastside</b>               | <b>34,127,088</b>    | <b>3,977,741</b>        | <b>4.9%</b>        | <b>-26,156</b>          | <b>161,740</b>          | <b>\$43.69</b>                             |
| 520 Corridor                  | 3,107,442            | 246,638                 | 7.8%               | 15,796                  | 51,996                  | \$43.30                                    |
| Bellevue CBD                  | 9,646,698            | 2,943,070               | 2.7%               | 2,552                   | -22,497                 | \$55.77                                    |
| Bothell/Kenmore               | 3,375,909            | 0                       | 8.6%               | -24,279                 | 16,914                  | \$37.00                                    |
| Coal Creek/Issaquah           | 1,799,307            | 68,570                  | 1.1%               | 5,001                   | -2,525                  | \$41.70                                    |
| I-90 Corridor                 | 4,876,396            | 0                       | 3.2%               | 1,131                   | 19,343                  | \$42.01                                    |
| Kirkland                      | 2,411,939            | 50,500                  | 2.4%               | -3,406                  | 106,460                 | \$44.89                                    |
| Mercer Island                 | 575,995              | 0                       | 27.7%              | 1350                    | 2090                    | \$41.96                                    |
| Redmond                       | 3,512,099            | 0                       | 7.0%               | -26,203                 | 17,238                  | \$40.04                                    |
| Suburban Bellevue             | 3,883,485            | 668,963                 | 5.3%               | -1,994                  | -39,780                 | \$41.58                                    |
| Totem Lake                    | 937,818              | 0                       | 2.9%               | 3,896                   | 12,501                  | \$38.53                                    |
| <b>Southend</b>               | <b>11,249,840</b>    | <b>150,000</b>          | <b>19.7%</b>       | <b>115,984</b>          | <b>196,457</b>          | <b>\$36.88</b>                             |
| Federal Way/Auburn            | 3,315,577            | 0                       | 22.9%              | 8,717                   | 2,112                   | \$27.19                                    |
| Kent Valley                   | 1,610,503            | 0                       | 4.0%               | 6,039                   | 23,850                  | \$27.67                                    |
| Renton/Tukwila                | 5,129,341            | 150,000                 | 25.7%              | 71,752                  | 159,126                 | \$43.70                                    |
| Seatac/Burien                 | 1,194,419            | 0                       | 6.7%               | 29,476                  | 11,369                  | \$30.18                                    |
| <b>Northend</b>               | <b>7,766,194</b>     | <b>0</b>                | <b>4.8%</b>        | <b>-38,540</b>          | <b>21,803</b>           | <b>\$31.34</b>                             |
| <b>Tacoma</b>                 | <b>8,933,307</b>     | <b>75,000</b>           | <b>9.3%</b>        | <b>113,626</b>          | <b>56,643</b>           | <b>\$27.98</b>                             |
| <b>Puget Sound Market</b>     | <b>127,064,198</b>   | <b>9,038,906</b>        | <b>6.9%</b>        | <b>109,858</b>          | <b>498,177</b>          | <b>\$42.34</b>                             |

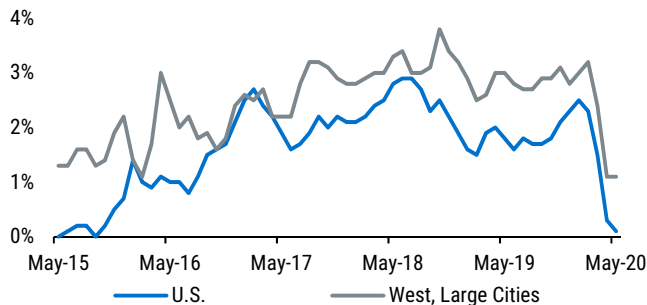
## ECONOMIC CONDITIONS

The national economy picked up in June after a disastrous end to the first quarter. The Consumer Confidence Index rose by 14.2% from May to June, and pending home sales jumped by 44.3% between April and May, the largest increase on record. The Dow is down 11.7% for the year but up 39.0% after sinking in late March. The U.S. unemployment rate fell by 140 basis points from April to May, dropping to 13.3%. While there are reasons to be optimistic, Federal Reserve Chairman Jerome Powell recently cautioned that the country is not out of the woods yet. A surge of COVID-19 cases in the South and West have many concerned about the harm a second outbreak could cause to the nascent recovery.

Locally, the Puget Sound region may have weathered the eye of the storm after becoming a COVID-19 epicenter in February. The Seattle metro area added 62,300 employees in May, dropping the unemployment rate to 15.2%, a decrease of 140 basis point for the quarter. Employment was down 11.8% year over year for May, but that number is an improvement over April's 14.1% decline. Only the information sector, which includes technology companies, gained jobs year over year, which is a positive indicator. Puget Sound has the highest percentage of FAANG office square footage of any market (15.2%). Expansion plans for the region's major tech firms remain on track, which bodes well for future employment growth.

## CONSUMER PRICE INDEX (CPI)

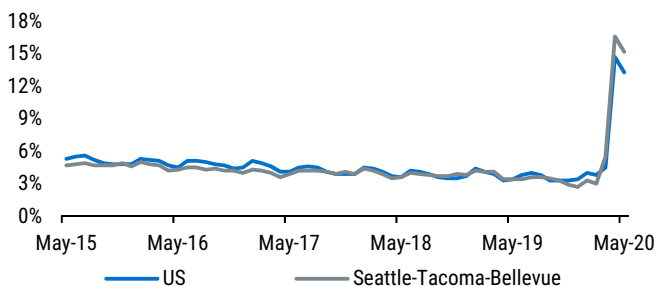
All Items, 12-Month % Change, Not Seasonally Adjusted,



Source: U.S. Bureau of Labor Statistics

## UNEMPLOYMENT RATE

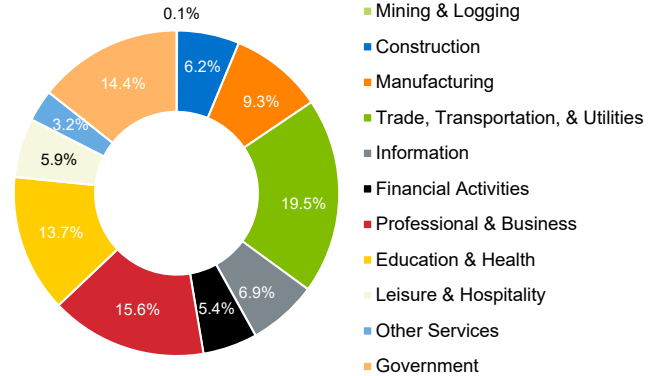
Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

## EMPLOYMENT BY INDUSTRY

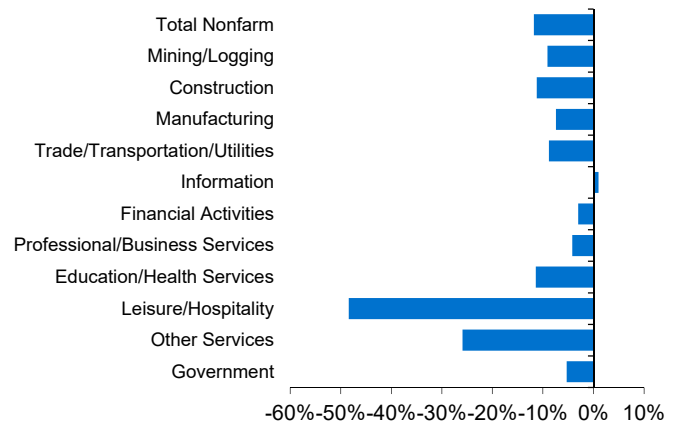
Seattle-Tacoma-Bellevue, May 2020



Source: U.S. Bureau of Labor Statistics

## EMPLOYMENT GROWTH BY INDUSTRY

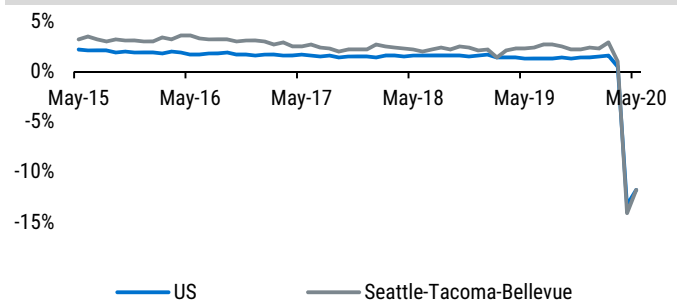
Seattle-Tacoma-Bellevue, 12-Month % Change, Not Seasonally Adjusted, May 2020



Source: U.S. Bureau of Labor Statistics

## PAYROLL EMPLOYMENT

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



Source: U.S. Bureau of Labor Statistics

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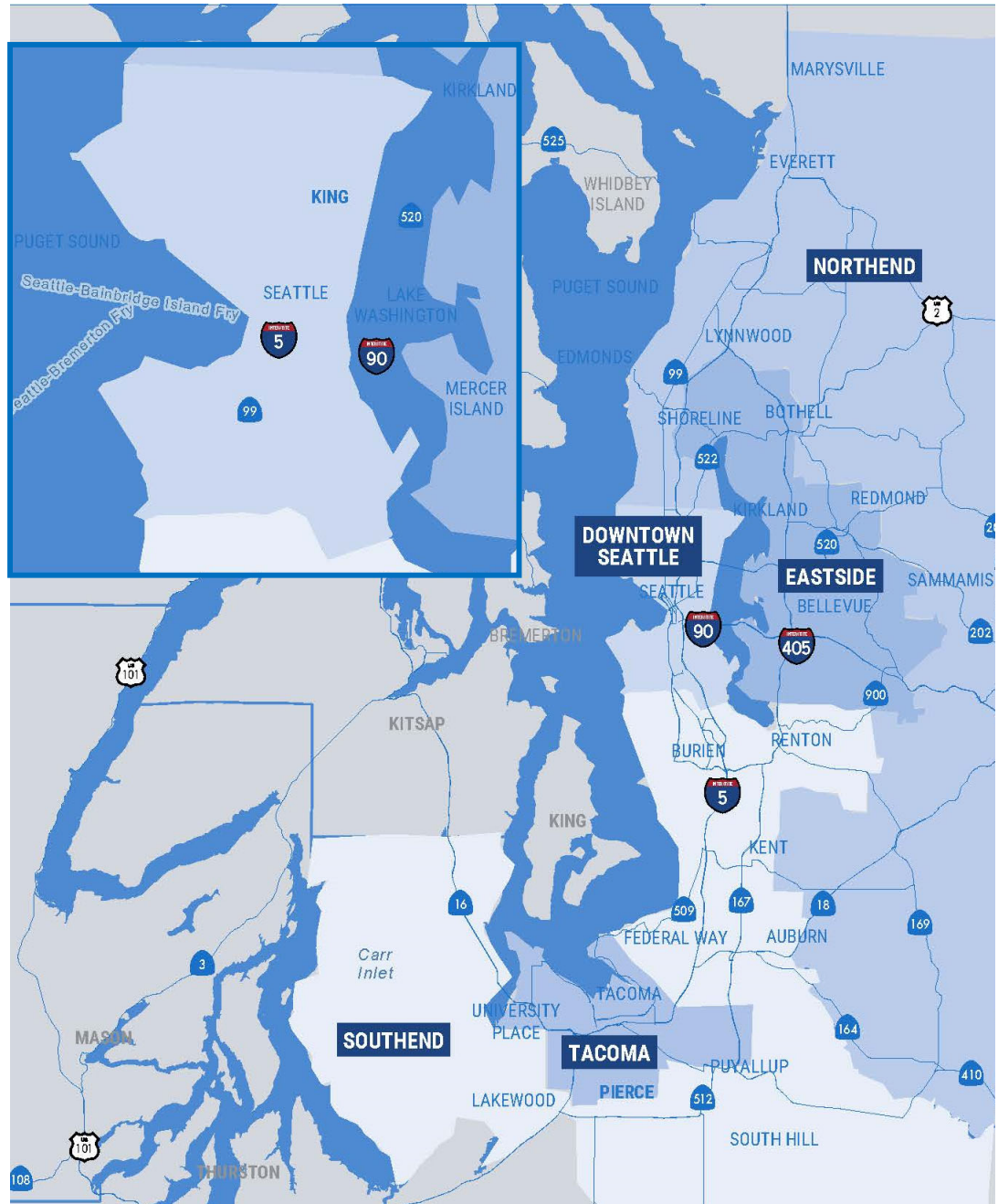
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Sources: The Seattle Times, Costar, The Wall Street Journal, Puget Sound Business Journal, The Registry, and Daily Journal of Commerce.

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