

## MARKET TRENDS

# SEATTLE OFFICE

*Q1 2023 marks 3 years since the onset of the pandemic and while it has essentially passed, we are still seeing lingering economic impacts on the office market.*

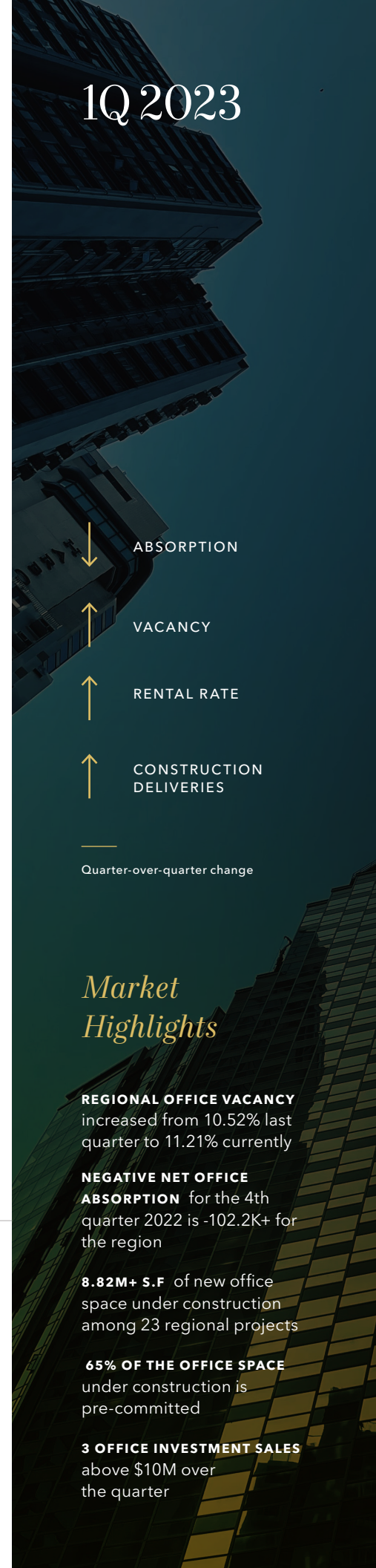
1Q 2023 office data shows another quarterly spike in regional vacancy going from 10.52% at year-end 2022 to 11.21% currently, a 69 bp jump. The office market has seen a rise in vacancy for 11 of the last 13 quarters with a 542 bp upward swing in vacancy since the 2nd quarter 2019's low mark of 5.79%. Surging regional vacancy is fueled by significant amounts of negative net office absorption in the region since the end of 2020. During the 1st quarter of 2023, the region posted negative net absorption of -692.7K+ s.f. following year-end 2022 negative net absorption of -1.442M+ s.f., on the heels of -1.534M+ s.f. in 2021. The percentage of sublet vacancy continues to be high at 18%, up from 16% last quarter but below its recent peak of 22%. For the two largest markets, Seattle continues to see vacancy spike with a 127 bp quarterly rise in vacancy jumping to 14.26%. The Eastside posts the lowest regional vacancy at 6.08%, although it is up 52 bps from last quarter's mark of 5.56%. Investment sales remain stagnant and the amount of new regional construction totals 23 major office projects, collectively 65% pre-committed.

Despite strong job growth in 2022, the regional economy faces a number of challenges in 2023 especially with regional inflation levels being above national averages and with high

interest rates. Per the Puget Sound Economic Forecaster, regional CPI for 2022 was 8.9% with forecast inflation of 4.6% in 2023 and 2.9% for 2024. The tech sector (which grew roughly 6.4% in jobs over 2022) has seen recent layoffs, hiring freezes and office closures by some firms leading to the halt in construction of several projects regionally. Total regional employment growth ended 2022 at 5.1% per the Economic Forecaster. Looking ahead, job growth is forecast at 0.4% in 2023 and 0.5% in 2024. The region also continues to struggle with staffing shortages thus far into 2023.

The regional office market is clearly struggling and highly volatile at present, particularly in Seattle. Looking forward, future office demand remains a big question. Vacancy continues to rise and net absorption has been substantially negative. 2023 will be telling as to how changing corporate requirements will dictate work from home/in office policies, office layouts and employee density ratios. Indices to monitor are vacancy (including percentage sublet vacancy), net office absorption, inflation and interest rates and pre-commitment levels for new construction (currently at 65% region wide) as well as future lending policy and underwriting changes.

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Quarter-over-quarter change

## Market Highlights

**REGIONAL OFFICE VACANCY** increased from 10.52% last quarter to 11.21% currently

**NEGATIVE NET OFFICE ABSORPTION** for the 4th quarter 2022 is -102.2K+ for the region

**8.82M+ S.F.** of new office space under construction among 23 regional projects

**65% OF THE OFFICE SPACE** under construction is pre-committed

**3 OFFICE INVESTMENT SALES** above \$10M over the quarter

Average Asking Annual Rent/SF 1Q 2023

**\$40.26**  
SEATTLE CLOSE-IN

**\$41.97**  
EASTSIDE

**\$32.83**  
SOUTH KING COUNTY

**\$27.32**  
PIERCE COUNTY

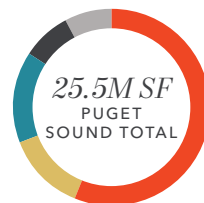
**\$28.94**  
SNOHOMISH COUNTY

Submarket Vacant Space 1Q 2023

**14.7M SF**  
SEATTLE CLOSE-IN

**3.4M SF**  
EASTSIDE

**1.85M SF**  
PIERCE COUNTY



**3.6M SF**  
SOUTH KING COUNTY

**1.87M SF**  
SNOHOMISH COUNTY

## SEATTLE CLOSE-IN

**SEATTLE OFFICE VACANCY** increased markedly over the quarter to 14.26%, up 127 bps from last quarter's mark of 12.99% and up 193 bps from 12.33% one year ago.

**THE AVAILABILITY RATE** shot up to 20.8% from 18.3% over the quarter indicating vacancy will likely rise above its current mark in early 2023.

**THERE ARE 12** major office construction projects underway in Seattle containing 2.66M+ s.f. with three projects scheduled for delivery next quarter; 24% pre-committed.

**NET OFFICE ABSORPTION** over the quarter was a substantial negative at -1.15M+ s.f. This compares to the year-end 2022 total of -1.50M+ s.f. and negative net absorption of -1.51M+ s.f. for 2021.

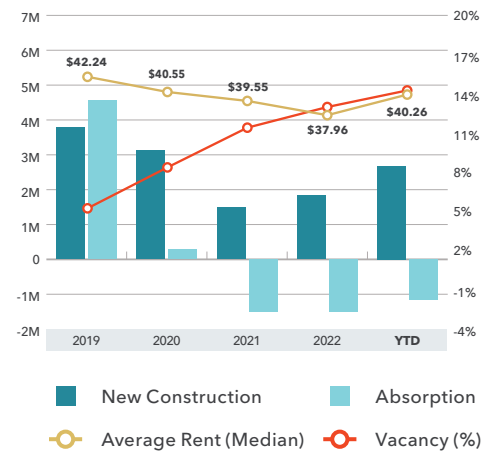
**LEASING ACTIVITY** was moderate over the quarter with CoStar reporting 89 total deals at a total volume of 531.8K+ s.f. The CBD accounted for about 41% of the total lease volume with 37 deals totaling 219.6K+ s.f.

**THERE OFFICE PROJECTS** planned for delivery in Q2 2023.

**AVERAGE RENT QUOTES** in the Seattle CBD increased to \$45.20/s.f./yr, from \$43.97/s.f./yr last quarter.

**PERIPHERAL SEATTLE SUBMARKETS** exhibited 1st quarter 2023 vacancy rates of 5.4% in Ballard/U District, 8.6% for Lake Union, 7.5% in S Seattle and 7.1% in N Seattle/Northgate showing mostly downward vacancy trends. Queen Anne/Magnolia remains the high mark at 15.9%.

**AVERAGE RENT** in Seattle is \$40.26/s.f./yr for the start of 2023, up from \$37.96/s.f./yr last quarter.



## EASTSIDE REVIEW

**THERE ARE 11 MAJOR** Eastside office projects under construction (excluding the 2.5M+ s.f. Microsoft campus expansion) collectively totaling 6.15M+ s.f.; with 83% pre-commitment.

**EASTSIDE OFFICE VACANCY** is 6.08% currently, up from 5.56% last quarter and down 58 bps from 5.50% a year ago. Eastside office inventory currently stands at 56.5M+ s.f.

**EASTSIDE AVAILABILITY** increased sharply from 11.70% last quarter to 13.20% currently, well above 8.60% from a year ago.

**NET EASTSIDE OFFICE ABSORPTION** over the quarter was positive at 379,482 s.f. This compares to year-end 2022 net absorption to negative -87.3K+ s.f., 842K+ s.f. for year-end 2021 and negative absorption of -155K+ s.f. in 2020.

**THE CURRENT AMOUNT** of available new Eastside office construction to absorb is 1.055M+ s.f., compared to historic annual net absorption of 475K+ s.f. over the last 10 years.

**EASTSIDE OFFICE LEASING** over the quarter per CoStar reports 90 deals totaling 405.7K+ s.f. in total volume.

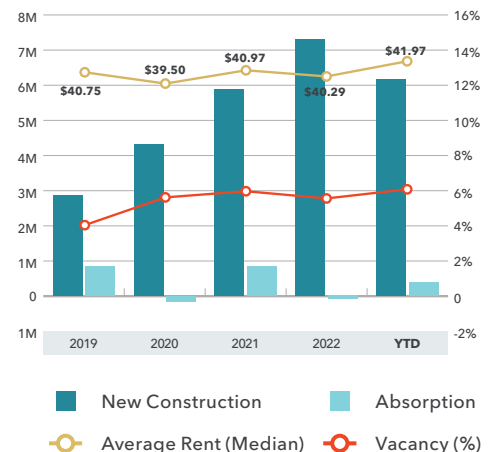
**BELLEVUE'S CBD OFFICE VACANCY** increased to 7.8% from 5.8% last quarter. The average CBD rent quote is \$54.60/s.f./yr currently, up 2.5% from \$53.25/s.f./yr last quarter.

**FOUR OFFICE PROJECTS** planned for delivery in Q1 2023.

**VACANCY RATES** in key peripheral Eastside office submarkets remain very low at 1.5% and 5.3%, for Redmond and Kirkland, respectively compared to 2.8% and 5.4% last quarter, respectively.

**ONE NOTEWORTHY 1Q 2023** Eastside office sale; the sale of Gateway One in Bellevue for \$35.M (\$313/s.f.) at reported 9.5% cap rate.

**THE AVERAGE RENT QUOTE** for the Eastside is currently \$41.97/s.f./yr, up \$1.68/s.f./yr from \$40.29/s.f./yr last quarter and up \$2.19/s.f./yr from \$39.78/s.f./yr a year ago.



## SOUTH KING COUNTY REVIEW

**OFFICE VACANCY** in South King County remains highest in the region at 15.66%, trending down over the quarter from 15.78% last quarter. It is 88 bps higher than the vacancy rate of 14.78% one year ago.

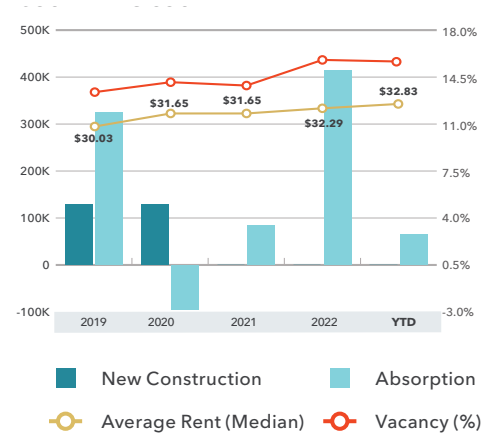
**OVER THE 1ST QUARTER 2023**, Southend net absorption was positive at 64,305 s.f. This compares to the year-end 2022 Southend net absorption total of 413.8K+ s.f. (highest of all five market areas in 2022) and above the year-end 2021 total of 84.2K+ s.f.

**CURRENT SUBMARKET VACANCIES** for Federal Way/Auburn and Renton/Tukwila remain high at 13.4% and 23.0%.

**47 OFFICE** lease transactions reported over the 1st quarter 2023 totaling 309K+ s.f., averaging just under 6,600 s.f. per deal. The average rent quote increased over the quarter from \$32.29/s.f./yr to \$32.83/s.f./yr.

**ONE** significant Southend sale of note in the 1st quarter 2023. It was the transfer of the Parkside Building in Tukwila for \$11.1M (\$261/s.f.).

**WITH 11.2% AVAILABILITY**, Southend vacancy is expected to continue declining near-term.



## SNOHOMISH COUNTY/NORTHEMEND REVIEW

**THE NORTHEMEND** office market has a current office inventory of 23M+ s.f. among 1,711 surveyed office buildings, an average size of 13.5K s.f.

**NORTHEMEND OFFICE VACANCY** decreased from 8.22% last quarter to 8.14% currently, a nominal change of 8 bps.

**41 OFFICE LEASE TRANSACTIONS** over the quarter, totaling 67.3K+ s.f., or a modest 1,643 s.f. average size.

**THE AVAILABILITY RATE** increased from 9.8% last quarter to 10.2% currently at the start of 2023.

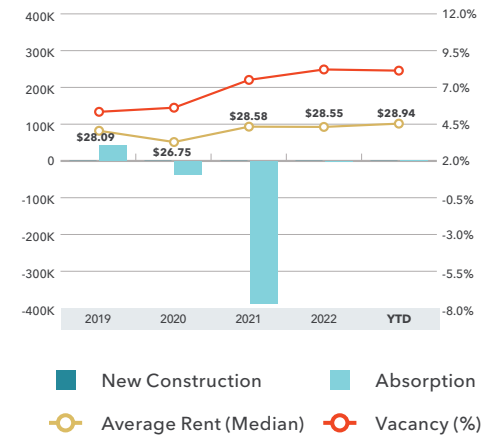
**AT THE CURRENT AVERAGE RENT QUOTE** of \$28.94/s.f./yr, this market is \$11.32/s.f./yr

more affordable than the current average Seattle rent quote of \$40.26/s.f./yr.

**ONE NOTEWORTHY 1Q 2023 OFFICE SALE:** View Ridge Plaza which was purchased for \$15.5M.

**BOTHELL/KENMORE** submarket decreased in vacancy over the 1st quarter to 12.6% from 14.2% last quarter. The Everett CBD saw vacancy decline slightly from 7.0% last quarter to 6.5% currently, a downward shift of 50 bps.

**THE NORTHEMEND** office market should see long-term growth considering its affordability and future light rail connectivity.



## PIERCE COUNTY REVIEW

**OFFICE VACANCY** in Pierce County is currently at 8.59%, up from 8.48% last quarter and from one year ago when vacancy was at 7.82%.

**ABOUT ONE THIRD** of the Pierce County office supply is in the Tacoma CBD which has a current 1st quarter 2023 vacancy rate of 10.6%, up from 9.8% last quarter. The CBD availability rate increased from 13.9% last quarter to 15.8% currently.

**THE OVERALL** Pierce County availability rate increased from 10.3% at year-end 2022 to 10.8% currently.

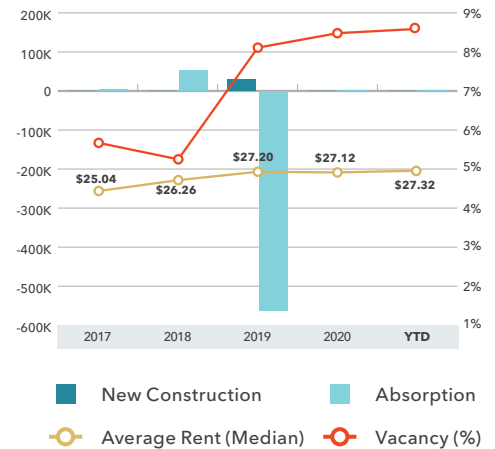
**NET ABSORPTION** for the 1st quarter 2023 was nominal at 12K+ s.f. This compares

to year-end 2022 net absorption total to 40.5K+ s.f. and the year-end 2021 negative net absorption of -561K+ s.f.

**LEASING ACTIVITY** over the quarter included 44 deals totaling 118.5K+ s.f. in total volume.

**THE AVERAGE** Pierce County rent quote increased from \$27.12/s.f./yr in the 4th quarter to \$27.32/s.f./yr currently.

**SUBMARKET VACANCY** for Suburban Tacoma remains low at 3.8%, unchanged from last quarter while vacancy in Gig Harbor decreased in the 1st quarter to 6.4%, from 6.9% last quarter.



## VACANT SPACE/RATE

At the end of the 1st quarter 2023, the Puget Sound region has a total office inventory of 227.4M+ s.f. For the fifth straight quarter, regional office vacancy has increased. At the end of 1Q 2023, regional office vacancy is at 11.21% compared to 10.52% last quarter and 9.94% one year ago. Office vacancy hit a low point for the region in the 2nd quarter 2019 at 5.79% and has generally been on the rise ever since. In the 2nd quarter 2022, regional vacancy exceeded the 10% mark for the first time since the end of 2013 and it continues to stay above this line peaking currently at 11.21%. Current vacancy is now 542 bps higher than the low mark in 2019. Of the current vacant inventory, 18% is from sublease space which is above the 16% mark last quarter, but essentially the same as year-end 2021. Three of the five regional market areas saw increases in vacancy over the 1st quarter. The Southend, which has the highest overall regional vacancy and the Northend both saw modest vacancy declines over the quarter dropping to 15.66% and 8.14%, respectively. Seattle vacancy increased from 12.99% last quarter to 14.26% currently, a 127 bp jump. The Eastside which remains the regional low mark at 6.08%, posted a 52 bp increase over last quarter's mark of 5.56%. Tacoma vacancy settled the quarter at 8.59%, up from 8.48% last quarter. The spike in regional vacancy over the quarter is the result of continued negative net regional absorption which totaled -692.7K+ s.f. in 1Q 2023. This is coming off negative net absorption of -1.44M+ s.f. in 2022 and -1.53M+ s.f. in 2021. Amplifying the affect are historically high levels of sublet vacancy. The regional availability rate ended the 1st quarter 2023 at 15.93%, up from 14.12% at the end of 2022 and above the 12.18% mark at the end of 2021.

## NEW CONSTRUCTION

At the end of the 1st quarter 2023, there are 23 major office projects under construction

in the region, all in the Seattle and Eastside markets. Over the past quarter, there were two notable deliveries on the Eastside with none in Seattle. Spring District-Block 5 and Meta Building X were completed adding a combined 681.3K+ s.f. of new inventory to the region. Another 8 office projects in the region are scheduled to deliver in 2Q 2023. Three new office construction starts over the quarter (all in Seattle) including the Station Building, 1120SLU 1 and The Chapter 2, about one-third pre-committed. Of the regional office projects under construction, 12 are in Seattle totaling 2.66M+ s.f. (24% pre-committed) and 11 on the Eastside adding 6.15M s.f. (83% pre-committed). The three largest regional projects remain Amazon committed towers in Bellevue including Vulcan's 555 Tower (940K s.f.), West Main (1.02M+ s.f.) and Bellevue 600 (999K+ s.f.), although Amazon put the brakes on occupancy/construction plans for a few other projects in Bellevue. Construction figures exclude Microsoft's nearly complete 2.5M s.f. campus office expansion and several large life sciences projects. Other office projects remain planned in both Seattle and the Eastside, but developers are hesitant to commence new speculative projects. Collectively, of the 23 office projects underway in the region totaling 8.82M+ s.f., 65% is pre-committed.

## RENT FORECAST

Despite rising vacancy, all five market areas saw increases in average office rent quotes over the 1st quarter 2023. The Eastside, which posts the highest average rent in the region at \$41.97/s.f./yr, saw the average quote increase by \$1.68/s.f./yr from \$40.29/s.f./yr last quarter. Seattle saw the average rent quote increase rather significantly from \$37.96/s.f./yr last quarter to \$40.26/s.f./yr currently, a 6.1% spike. The Southend average rent quote went from \$32.29/s.f./yr last quarter to \$32.83/s.f./yr while Tacoma inched up from \$27.12/s.f./yr last quarter to \$27.32/s.f./yr currently. The

Northend rent quote increased to \$28.94/s.f./yr from \$28.55/s.f./yr last quarter, a change of \$0.39/s.f./yr. The rent floor is currently Tacoma at \$27.32/s.f./yr. At the start of 2023, the Bellevue CBD continues to have the highest average rent quote of any submarket at \$54.60/s.f./yr. Comparatively, the average rent quote for Seattle CBD is \$45.20/s.f./yr. Tacoma CBD is at \$26.34/s.f./yr, less than half the current average Bellevue CBD quote.

## INVESTMENT MARKET

Over the last three quarters, regional office investment sale activity has been sparse. The 1st quarter 2023 is no exception as the region saw only 3 office investment sales closing above the \$10 million mark. Of these, there was one sale each in the Eastside, Southend and Northend markets. While there still appears to be demand for trophy office assets, there is reluctance on the part of sellers with few offerings compared to recent history. Many buyers are also taking a wait and see approach to evaluate the market and see how conditions play out. Rising interest rates, changing economic metrics and lingering effects of the 2020 REET increase have all hampered office sale volumes. The notable Eastside sale was the transfer of Gateway One in Bellevue for \$35M (\$313/s.f.) in February at a reported cap rate of 9.5%. In the Northend, it was the transfer of Everett's View Ridge Plaza for \$15.5M (\$705/s.f.). The third 1st quarter sale of note was in the Southend reflecting the transfer of Parkside Building in Tukwila for \$11.1M (\$261/s.f.). Although there are few sales to support it, cap rates are clearly pushing upward amidst rising rates and overall market risk. Total office sales volume for the quarter was extremely low at \$128.6M+ (among 39 transactions) following previous low volume quarters of \$264M+ and \$406M+, respectively. This compares to a collective \$2,976M+ in sales volume for the first half of 2022.

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