JLL News Release

Mind the Gap: Bellevue's Trophy Office Rental Rates Hit Historic Highs

Limited availability of Trophy space and rising rents have led to a rush of spec construction but demand continues, according to JLL's 2015 Skyline Review

BELLEVUE, June 11, 2015 – There's no space like Trophy space. The premiere office towers that make up Bellevue's skyline boast—by far—the most expensive office space to rent, garnering a premium of 32.7 percent more than the Eastside office market as a whole, according to JLL's 2015 Digital Skyline. Average Skyline rates in the first quarter of 2015 were $44.51 per square foot compared to $33.53 per square foot in non-Skyline buildings. In the last three years, rent growth in Skyline properties has consistently outpaced the rest of the Class A market.

"The flight to quality in earlier recovery years coupled with an improving economy today and a strong desire among tech companies to have a presence here led to significant supply constraints in the Eastside office market, and the rent gap has widened significantly," said Alex Muir, senior research analyst, JLL Research.

Trophy tenants might expect a little respite in rental rates in the near future, however. JLL projects the market to move from landlord-favorable to neutral in 2017 as a result of more than 1.5 million square feet now under construction being delivered to the market. This, combined with Expedia's announced move to Seattle and Microsoft's plan to reduce its local footprint, will for the first time in several years provide a significant opportunity for tenants seeking large blocks of space on the Eastside.

For the time being, Bellevue remains one of the best markets in the country to be a landlord. Direct vacancy – which has been in single digits for the last four years – makes Bellevue one of the tightest Skyline office markets in the nation and currently stands at 2.5 percent, less than 100 basis points off its historic 2006 low of 1.6 percent. Besides the seven floors Microsoft is currently marketing for sublease in the Bravern, there are no existing blocks of space in Skyline buildings available larger than 30,000 s.f.

"The Bellevue CBD is a highly attractive market for companies looking to access talent and grow. It's the go-to neighbourhood for technology tenants on the Eastside and pent up demand is strong. This is reflected in the tight fundamentals within our Skyline buildings," said Riley Shephard, vice president, JLL. "For the last few quarters, many tech and other growth companies haven't been able to get space in downtown Bellevue because the availability of space just didn't exist. Companies like Concur Technologies and eBay have recently grown their footprint in the Bellevue Skyline and we anticipate other companies such as VMWare, Bungie, and Valve will now be able to find options thanks to new construction and space coming back to the market," he added.

JLL's proprietary 2015 Digital Skyline identifies and tracks micro-segments of 47 city centers across North America. The Skyline features Trophy and Class A buildings where tenants and investors alike focus demand for office space in a flight to quality and efficiency.

A diminishing "home-team" advantage

If office rental rates in Bellevue are fierce, the price tag to buy an office building is even more so. Economic growth, business expansion, and improving market fundamentals look set to give Bellevue its largest year in terms of office investment sales volume since 2008.

Two of the biggest sales of the year – The Summit I & II and Civica Office Commons – occurred in the Skyline set, with each trading for more than $200 million. Both transactions took place well after plans for new developments were announced indicating that investors remain confident in Bellevue's pulling power with tenants.

"Investors follow fundamentals and even though the Eastside is a much smaller market than neighboring Seattle it continues to attract major tenants and rents are on the rise. This will continue to bring institutional capital over the long term to the Skyline and CBD," said Lori Hill, managing director, JLL Capital Markets. Hill added that while investors who have looked to the suburbs for acquisitions will continue to look, they are liable to take a more cautious approach to investing there in the next 12 to 24 months, due to more high quality space becoming available in the CBD.

A redefined Skyline

As investors begin to diversify beyond the Trophies for investment opportunities, a growing segment of tenants are also turning away from Skyline buildings in favor of non-core Class A and Class B buildings, inside and outside of traditional Central Business Districts (CBDs). The perception of an "address" has been replaced by the desire for highly customized office space, particularly among fast growing tech and other creative companies.

But the trend does not stop there: today, many companies are trying to mimic tech whether through business strategy, people strategy or even real estate strategy. The growing millennial workforce and their employers are increasingly drawn to architecturally significant Class B buildings located in dense neighborhoods packed with amenities.

"Tech users and other creative firms want unique space – they're mostly indifferent to building quality as long as they are able to design attractive, creative environments for their employees," said Shephard. "They have shown a preference in recent years for leasing lower-cost space in well-located historic buildings or converted warehouses because they can spend more on their space's interior and less on rent. It allows them to create their own identity."

Shephard added, "A lot of these B-buildings are on the perimeter of the traditional high-rise CBDs in areas that have more of a neighborhood feel. In turn, they like the idea of adaptive reuse and contributing to neighborhood revitalization. As the gap between Trophy and non-Trophy space continues to grow over the short-term, we actually could be reaching a peak inflection point based on future demand patterns favoring space over building."

About the Skyline Review

For the first time, investors and tenants alike can now access JLL's Skyline Review via a digital platform. The fully interactive website will feature JLL's proprietary market insights regarding office supply, demand, rents, leverage and investment into 47 markets across the United States and Canada, with the ability to compare and contrast individual markets or multiples of markets. In addition, the site will offer videos and infographics. All information will also be available via mobile access. Users can also directly access information about Bellevue's Skyline.

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About JLL

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