JLL News Release

Mind the Gap: Seattle's Trophy Office Rental Rates Outpace Market

Demand for Trophy buildings remains high but tightening fundamentals could draw attention to other asset classes, according to JLL's 2015 Skyline Review

SEATTLE, June 11, 2015 – There's no space like Trophy space. The premiere office towers that make up Seattle's skyline boast—by far—the most expensive office space to rent, garnering rents almost 14 percent higher than typical Class A and B space in downtown Seattle, according to JLL's 2015 Digital Skyline. Average Skyline rates in the first quarter of 2015 were $39.51 per square foot compared to $34.68 per square foot in non-Skyline buildings. This rent delta is the widest since the end of 2012. The Trophy subset of the Skyline has an even more impressive premium, with average asking rates currently at $42.39 per square foot.

"With available space in the traditional tech markets of South Lake Union, Ballard, Belltown and Pioneer Square harder to come by, we've seen a migration of sorts by tech companies to the CBD and skyline properties in particular," said Alex Muir, senior research analyst, JLL.

Trophy tenants can expect little relief in rental rates in the near future, in spite of nearly 1.5 million square feet of new office space under construction in the Seattle market. Although this represents the highest level of speculative construction in 10 years in the city, developers have clearly been swayed to move ahead by the fact that half of all leasing activity in the first quarter was accounted for by tech tenants preleasing space in projects currently under construction in South Lake Union.

Total vacancy in skyline properties is down almost 15 percent since the recession and average asking rents have increased 13.1 percent in the last two years, further encouraging skyline development.

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

Office rental rates are fierce, and that fact is also pointing to signs the price tag to buy an office building is on the rise. Economic growth, business expansion and improving market fundamentals have resulted in an increase in investor interest in the Seattle market and, while the pace of sales has been slow in the last two years, that could change in 2015.

"In the first quarter we saw $1.6 billion is prime office assets change hands in Seattle, but none of that was in the skyline set," said Lori Hill, managing director, JLL Capital Markets. "Just this month, however, news reports indicated that Hong Kong-based investors have put a key skyline asset -- Columbia Center – under contract and this could represent the beginning of a few trends within the market in general and the skyline, in particular," she said. While Seattle's skyline assets are generally appealing to foreign investors, to this point they have generally been less competitive than their domestic rivals for the few assets that have come to market, according to Hill. But Seattle's appeal is rising and Hill believes a more competitive period is developing in the institutional investment market that is likely to demonstrate record pricing levels and tightening cap rates, especially in well leased skyline assets.

"International capital is making a long-term impression on the U.S. Skyline and, with $50 billion poised to invest in U.S. commercial real estate in 2015, foreign investors appear to be buying for the duration. This could have a major impact on future Skyline liquidity, particularly for Trophy assets in primary markets like Seattle," Hill said, adding: "Going forward, domestic institutional investors will be forced to evolve their strategies, increasingly partnering with foreign investors and diversifying into non-core and non-CBD assets."

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. Among scientific and technical companies over the past three quarters nationally, Class B office leasing surged above Trophy leasing, representing 25 percent of total office leases over 20,000 square feet. Those same companies only leased six percent of Trophy space during that same time period.

"Tech users and other creative firms want unique space. Of course they want building quality, but as long as they are able to design attractive, creative environments for their employees within those buildings they are content," said Joe Gowan, vice president, JLL. "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. This intensified competition for tenants has seen more skyline and non-trophy landlords put capital into their buildings to turn seemingly outdated product into hip space with strong curb appeal," Gowan said.

"A lot of B-buildings are on the perimeter of the traditional high-rise CBDs in areas that have more of a neighborhood feel. In turn, tenants 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," Gowan asserted.

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 Seattle's Skyline.

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About JLL

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