

2011 Eastside Market Overview

While the overall vacancy rate for the Eastside Office Market remains relatively high (just under 16%) at the end of Q2, there has been considerable absorption of Class A office space. The tightening market is particularly evident for tenants in need of large amounts of contiguous space. Running a search for 70,000 SF and up in Bellevue, Kirkland, Issaquah and Redmond results in fewer than 10 options, and only three that would be considered "Class A" buildings. With few choices, and over 12 active requirements for 70,000 SF and up in 2012-2013, we expect the best of these options to be spoken for by early 2012.

The long term market is difficult to forecast given the uncertainty surrounding the AT&T – T-Mobile merger. The proposed \$39 billion merger is caught up in regulatory review, but the transaction is expected to close in March 2012. There is sure to be some redundancy between the two carriers and the impact on the local real estate market could be profound considering AT&T and T-Mobile are the second and third largest space users on the Eastside.

T-Mobile USA headquarters is located at Newport Corporate Center in the I-90 Corridor submarket, where it leases about 850,000 SF. The lease has staggered expirations, of which the majority do not expire for five years. Any surplus space would likely manifest as deeply discounted sublease space.

To the extent AT&T decides to dispose of the entire Newport Campus, the flood of sublease space on the market would put tremendous competitive pressure on landlords of comparable Class A space.

Market Trends

- Modest decrease in overall vacancy rate, but rapid decrease in the vacancy rate for high quality space options
- Investment activity remains brisk: Kilroy Realty purchased Key Center (CBD) and Plaza at Yarrow Bay (Kirkland) in the first half of 2011, and is actively pursuing other Class A investments in Bellevue and Seattle
- Google is expanding, and there is talk of a requirement for over 500,000 SF in the area
- Microsoft continues to consolidate to its main campus and downtown Bellevue – it declined to exercise a renewal option on 180,000 SF that it leases from Vulcan (Paul Allen) in Issaquah

Recent Notable Deals

**ArenaNet-
New Lease**
64,000 SF
Sunset North



**Bellevue College-
Purchase**
45,720 SF
Liberty II

**Demand Media-
New Lease**
34,146 SF
Lake Washington Park



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Major Transactions for Q2 2011

Tenant	Size (SF)	Submarket
ArenaNet	64,000	I-90 Corridor
Bellevue College	45,720	520 Corridor
Demand Media	34,146	Kirkland
Tableau Software	23,852	Kirkland
Esterline	22,835	Bellevue CBD
Waste Management	22,312	Kirkland

Average Rental Rates

CBD	Q3 2010	Q4 2010	Q1 2011	Q2 2011
Class A	\$34.35	\$34.41	\$34.52	\$34.19
Class B	\$27.43	\$27.18	\$27.09	\$26.76
Suburban	Q3 2010	Q4 2010	Q1 2011	Q2 2011
Class A	\$29.72	\$30.39	\$30.10	\$29.10
Class B	\$24.82	\$24.61	\$24.80	\$24.60

Leasing Activity on the Eastside

Demand for sublease space over the past 24 months has been relatively high as companies have emphasized cost control and term flexibility.

Trends & Opportunities

Signs indicate the market has "bottomed-out" - rental rates are low and concessions are high. When adjusted for inflation, economic terms available to tenants are nearly identical to market conditions in the 2001-2002 recession.

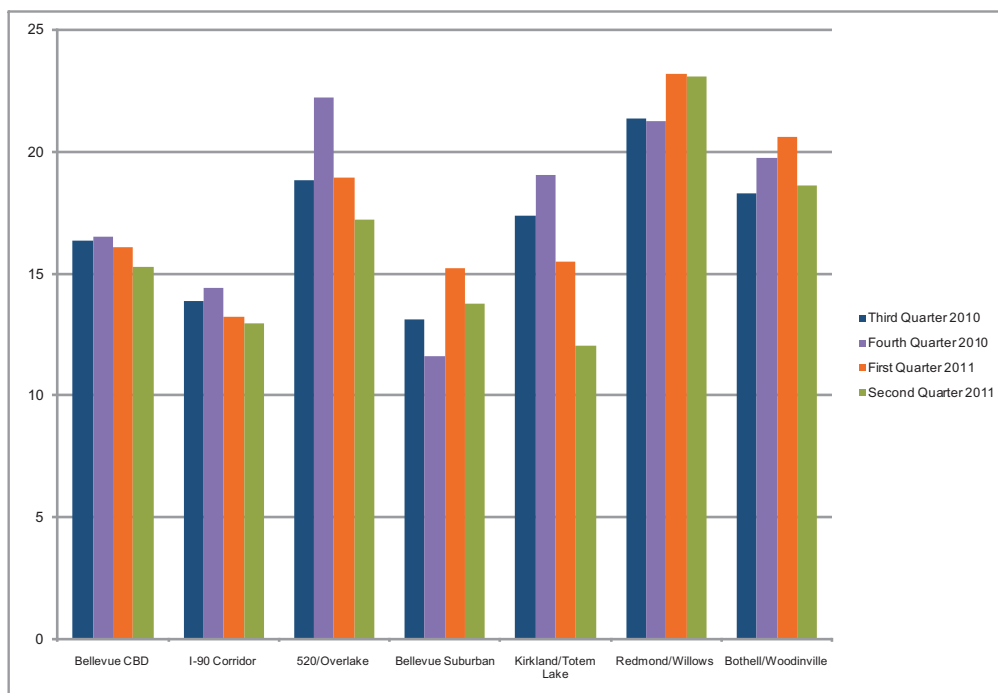
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Tenants Perspective

- As the inventory of high quality options becomes more limited, it is expected that rental rates will grow in the Eastside's best buildings over the next 12 months
- Once the dust settles from the AT&T - T-Mobile merger, a surplus of inventory could hit the market

Vacancy Rates by Submarket (%)



CresaPartners

WASHINGTON
Partners
Corporate Real Estate

701 Pike Street, Suite 1650
Seattle, WA 98101
Tel: 206.621.1996

601 108th Ave NE, Suite 1510
Bellevue, WA 98004
Tel: 425.455.2200

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Seattle Advisors

Adam Chapman, Larry Almeleh, Ed Curtis, Mark Fox, Doug Hanafin, Steve Hiskin, Lisa McCabe, Clay Neilsen, Patrick Pendergast, Blair Stern, Mark To, Kevin Harris

Bellevue Advisors

Eric Postle, Leo Backer, Craig Levine, Eric Lonergan, Brian Kelly, Cody Morrison, Kelley Sigl, Adam Mihlstin, Conor Curtis, Neil Bergquist