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Seattle Office Space News – July 2023

Below are comments and links to news articles and other topics relevant to the Seattle office space market from the month of July 2023.

OFFICE DEVELOPMENTS

In July it was reported that BioMed Realty filed plans to convert 1101 Westlake Ave. N for laboratory use, considering the hot market for life-science companies. The six-story, 143,600-square-foot building was recently vacated by Facebook, with employees consolidating at nearby Dexter Station in South Lake Union. The owner is experienced in such conversions, although it requires substantial investment. While there are no signs of leasing efforts or a general contractor yet, the developer is busy with other projects known as Innov8 and T6 in the Denny Triangle and Uptown/SLU area.

Safeco Plaza, a Space Age skyscraper that held the title of Seattle's tallest building for 15 years, is undergoing a significant renovation to honor its landmark status. The building, now owned by BXP, is 53 years old and has historical significance in the city. The renovation will focus on amenity spaces, with plans for a new boardroom, library, fitness club, and bike hub. The repositioning is inspired by the opulence and scale of the nearby Madison Centre, another property owned by BXP. Despite the ongoing impact of the pandemic on the office market, BXP remains optimistic about the region's economy and is actively seeking opportunities in Seattle and surrounding areas.

Before the pandemic, there were plans to renovate and expand the Korn Walker Block in Pioneer Square. Unico Properties, Lake Union Partners, and architect BuildingWork were involved in the effort to transform the old buildings into boutique offices over retail spaces. However, progress on the project has been stagnant since late 2021. Recently, leasing signs have started to appear, suggesting that the makeover may be on hold indefinitely. MaKensay Real Estate Services is offering the former Casco Antiguo space as a turnkey restaurant opportunity which was originally supposed to be vacated for the renovation project. Given Pioneer Square's pre-existing challenges and the ongoing recovery of downtown office demand, Unico might choose to delay the relaunch of the Korn Walker effort.

Unico Properties' plan to convert the historic Colman Building in Seattle into apartments is also facing significant financial challenges. The plan originated in 2021, but construction work has not commenced at the First Avenue property due to rising finance and construction costs. The investment's $22.4 million commercial mortgage-backed securities (CMBS) loan was handed over to a special servicer in February after facing an "imminent monetary default." Unico is struggling to keep up with its debt payments, and at least two draws from the loan's reserve funds were made to cover monthly payments. The property's annual cash flow has declined substantially, attributed partly to the impact of Covid on occupancy rates. Since early 2021, the Colman Building has been on a loan-servicer "watchlist" due to concerns about the borrower's ability to meet their mortgage obligations.

OFFICE LEASES

Electronic Arts (EA) is defying the trend of Big Tech companies scaling back their regional office presence by opening its second Seattle-area studio within a year, but the specific location has yet to be announced. The new studio, called Cliffhanger Games, will collaborate with Marvel Games to develop a third-person, single-player Black Panther game, among three Marvel games that EA has announced it will develop. The new studio will be a high-budget AAA studio, occupied by most of its founding members that are based in the Seattle area. EA's expansion comes in contrast to other tech companies shedding office space due to slowing demand, remote work, and inflation. Cliffhanger General Manager, Kevin Stephens, highlighted the unique opportunity the studio provides to form a new team that embraces shared values of diversity and collaboration.

Seattle-based caller ID startup, Hiya, has moved its office to the Columbia Center. Previously located near Pike Place Market at the Harold Poll Building, Hiya's new office provides more seating and desk space for its growing headcount, along with additional meeting rooms and amenities. Hiya specializes in blocking fraud and spam calls for telecommunications companies and works with businesses to label their calls, preventing them from being mistaken as spam. With global services reaching over 400 million consumers, Hiya's clients include major companies like AT&T, Samsung, T-Mobile, and Penske. The Seattle area's office availability rate has increased to 25% in the second quarter, reflecting the ongoing impact of the pandemic on leasing volumes despite return-to-work directives from major entities like Amazon, Meta, and Microsoft.

Insight Global, a North American staffing company, expanded its presence in the Puget Sound region and signed a long-term lease for a 75,000-square-foot at 2323 Elliott. Insight Global's deal marks the region's largest new office lease by a private company this year. The company is moving from a smaller location in Bellevue to the new Seattle building, while maintaining an existing satellite office in Bellevue. The specific rental rate for the new lease was not disclosed. The Seattle in-city office market has faced challenges during the second quarter, with an increase in vacancy rates and a decline in average asking rates for Class A space.

First Choice Health, a provider-owned insurance organization, will be the top-floor tenant in Martin Selig Real Estate's new 400 Westlake tower in South Lake Union. The company is moving from its current headquarters to occupy just over 10,300 square feet on the 15th floor, which is part of the 15-story, 230,000-square-foot tower. Known as the greenest building of its size in the country, the tower is designed to generate 105% of its energy needs, use 35% less energy than the average office building, and save and treat 100% of the rainwater it receives. The tower, developed on the site of the landmarked Firestone building, offers a shared rooftop terrace and ground-floor retail space.

Seattle-based tax software company Avalara is downsizing its physical footprint by four floors at its Pioneer Square headquarters in Hawk Tower. The company's spokesperson confirmed the downsize and stated they are continuously evaluating their office space needs for future in-office experiences. This move comes after former employees reported layoffs on LinkedIn in January. In fact, the Business Journal research shows a decrease in Avalara's workforce from 895 employees in Washington in 2022 to around 700 currently

OFFICE BUILDING SALES

The Nippon Kan/Kobe Park Building, located at 633 Yesler Way, was sold for a little over $9.7 million, as reported by King County records or $331 per square foot. The property was previously acquired by Casa Ballena LLC in 2019 for $11.5 million. The buyer, Kobe Park LLC, is associated with a local investor and life-science entrepreneur and secured a loan from First Security Bank of Washington for the purchase. The building, developed in 1909 with subsequent modifications, has approximately 29,454 square feet and includes an apartment and the Nippon Kan Theater.

RETURNING TO THE OFFICE

Amazon is ramping up efforts to bring corporate and tech employees back to the office by asking some workers to relocate to work in person with their teams. The relocation decisions are being made at a department level, and the exact number of impacted employees is not yet known. Unless they receive an exception, some employees are left with the choice of relocating or resigning. Amazon claims to have a process for exception requests and will consider them case-by-case, offering relocation benefits to those who are asked to move. The company implemented a return-to-office policy on May 1, requiring employees to be back in offices at least three days a week, which led to protests from some employees. Despite the challenges of adjusting to a new way of working, Amazon's CEO, Andy Jassy, highlighted the benefits of in-person collaboration and mentioned that only a small minority of roles would have exceptions to the return-to-office expectations.

DOWNTOWN RECOVERY

The Downtown Seattle Association reported a 4% month-over-month increase in worker traffic, reaching 54% of downtown-based employees back in the office. This is the highest percentage since the pandemic began. This rise in traffic is attributed to Amazon's return-to-office mandate, which was implemented in May, benefiting downtown businesses like restaurants and service providers as well. However, Seattle still lags behind most major U.S. cities in worker return rates as the future of office return remains unclear as companies adopt hybrid work policies. Despite this, downtown Seattle saw nearly 3 million visitors in June, the second-highest number since March 2020, and the hotel occupancy in the area was the highest among all U.S. markets during June 11-17.

Downtown Seattle is experiencing a surge in energy as the number of visitors and office workers increases. According to data from Placer.ai, 54% of downtown-based employees returned to the office in June, up from 50% in May. This marks the second consecutive month with 50% or higher worker return rates since the start of the Covid-19 pandemic and a significant improvement from June 2022 when only 38% of June 2019's workforce was back. The number of visitors in June reached nearly 3 million, accounting for 96% of the June 2019 count and marking the second-highest post-pandemic month for visitors. Hotel demand also surged, with June 2023 numbers surpassing June 2019 levels for the first time since the pandemic's onset. The revitalization is positively impacting restaurants, small businesses, and cultural venues. Additionally, residential units are seeing a post-pandemic climb, reaching over 56,500 occupied units for the first time ever in June.

The occupancy rate for offices in Seattle's central core is around 48% compared to 2019, with Amazon's return-to-office mandate contributing to this increase. However, remote work has still taken a toll on the office sector, Capital Economics, an independent research firm, estimates remote work will shave 35% from the value of the U.S. office sector. To adapt, many cities, including Seattle, are exploring ways to convert office spaces into residential or other uses, but this process faces challenges such as zoning restrictions and building codes. Mayor Bruce Harrell has proposed a plan to enhance the vibrancy of downtown Seattle by repurposing office spaces and creatively using retail space to attract small businesses. Despite the challenges, the article emphasizes the importance of a thriving downtown for the overall health of the city, especially as it accounts for the majority of business taxes and workers. Whether remote work continues or a gradual return to the office occurs, maintaining a healthy downtown is crucial for the city's success.

Downtown Seattle may avoid the "doom loop" as worker foot traffic has reached over 50% of pre-pandemic levels in May and June. In the Seattle Times, the loop was described as, “remote work reduced the value of office space, cutting real estate taxes to cities, while more affluent people able to work from home move away along with their spending on retail and paying tax dollars. Next restaurants and shops close, leaving empty storefronts. Cities, hard strapped for revenue, curtail services, while foot traffic also goes down except for rising homelessness.” While other cities suffer from the doom loop, Seattle's relatively strong performance can be attributed in part to Amazon bringing employees back to the office at least three days a week since May. Seattle also saw a 2.4% growth rate from 2021 to 2022 the highest among any of the 50 largest cities.

As part of Mayor Bruce Harrell's Downtown Activation Plan, architect Olson Kundig has employed AI tools and software to craft visionary images depicting the future of Seattle. These AI renderings, produced in collaboration with the city, depict concepts like a downtown sports facility with a canopy, giant screens at Westlake, and residential skyscrapers with tree-lined streets. They are not based on any planned or real projects but aim to spark community interest and discussions about defining Seattle's future civic projects, much like the Space Needle symbolizes the city today. The architect used AI as an exciting tool for brainstorming. They demonstrated the potential benefits, including greater diversity of voices engaging with the design process and the value of human authorship and input in creating unique AI images. The city is encouraging feedback and ideas from Seattleites about these futuristic visions for downtown.

INFLATION | RETAIL SALES

Inflation in June showed significant cooling, offering hope since the Federal Reserve initiated efforts to control surging price rises 16 months ago. The Consumer Price Index rose 3% in the year through June, down from 4% in May and far less than the 9% peak last summer. The core index, which excludes food and fuel costs, climbed 4.8% compared to the previous year, lower than the 5.3%. Slower inflation is positive for consumers, as it allows paychecks to stretch further. The White House celebrated the report, and investors reacted positively, expecting the Fed to be less aggressive in fighting inflation. However, policymakers remain cautious, considering the potential for lingering higher prices and the risk of rapid inflation becoming a permanent feature of the economy. While the Fed may raise interest rates in July, the pace of rate increases has slowed, and success in curbing inflation could become evident by November. The report showed declines in some key products and services, offering optimism that the cooling trend may be sustainable, particularly in areas like housing and car prices.

Inflation in the United States reached its lowest point since early 2021, with a rate of 3% in June compared to the previous year. This decline was attributed to easing prices for gasoline, airline fares, used cars, and groceries. While the Federal Reserve is still expected to raise its benchmark rate at its upcoming meeting, economists believe that further rate hikes in September could be reconsidered if inflation continues to cool. The overall inflation rate is down from 4% in May, and with prices slowing or falling in various sectors, hopes are rising for a successful transition to a sustainable 2% inflation rate without causing significant unemployment or a deep recession. A separate report showed wages and salaries grew more slowly in the April-June quarter, indicating less pressure on employers to boost pay. However, some economists caution that inflation may not continue to fall at such a rapid pace and certain factors, like auto insurance costs and rising restaurant prices, could keep core prices elevated. Used car prices have already begun to ease, contributing to a cooling of inflation, and rental costs are expected to decline as new apartment units become available. While overall inflation remains above the Federal Reserve's 2% target, the recent trend indicates progress toward stabilizing prices.

HOUSING

The US home turnover rate in the first half of 2023 has dropped to its lowest level in a decade due to high mortgage rates, which are discouraging homeowners from selling their properties. Redfin's report on housing turnover since the pandemic reveals that about 14 out of every 1,000 U.S. homes changed hands during this period, down from 19 in the same period in 2019. California, particularly the San Francisco Bay Area, faced the most limited housing availability among states, with only 6 out of 1,000 homes in San Jose changing hands this year. Overall, the housing turnover rate has significantly declined in major metropolitan areas across the country. Conversely, Newark, New Jersey, had the highest turnover rate, with 24 of every 1,000 homes changing hands.

In June, median single-family home sale prices in the central Puget Sound region continued to decline year-over-year, but the rate of decline was less severe than in previous months. In King County, the median price was $935,000, down only 0.3% from the previous year, contrasting with annual declines of up to 12% in previous months. However, since the beginning of the year, the median sales price has increased by 19.7% in King County, though it remains 6.4% below the high reached in May 2022 of $998,888. Snohomish and Pierce counties also experienced declines in median sales prices of around 3% and 4%, respectively, while Kitsap saw the steepest decrease of 8.3%. Despite double-digit decreases in closed sales in the four-county metro, demand for lower- to mid-priced homes remained strong, leading to higher prices. High mortgage rates and low inventory, as homeowners are hesitant to sell, remain significant challenges in the current housing market.

In June, King County home prices increased for the fifth consecutive month but showed relative flatness compared to the previous year. This trend reflected the local housing market's adjustment to higher mortgage rates and reduced buyer enthusiasm. The median home price in King County was $935,000 in June, a slight decrease of less than 0.5% from the previous year. The continuous surge in mortgage rates discouraged some sellers from listing their homes, leading to a shortage of available homes for sale. Despite the challenging market, some buyers found opportunities to negotiate on more affordable properties. However, the higher costs in Seattle pushed demand towards more affordable suburbs. While the market seemed more balanced due to increased negotiation possibilities, it still largely favored sellers. The limited number of new listings and increased demand from people moving to Seattle helped maintain home prices despite the rise in mortgage rates. Economists and real estate brokers suggested that significant drops in rates or a surge in new listings would be needed to stimulate the market. For now, the housing market in the Seattle area remains competitive but less frantic than in previous years.

INTEREST RATES

The average long-term U.S. mortgage rate increased to just under 7%, the highest level since November, creating further challenges for homebuyers in a tight housing market with limited homes for sale. Mortgage buyer Freddie Mac reported that the average rate on the 30-year home loan rose to 6.96% from 6.81% last week and was significantly higher than the rate of 5.51% a year ago. This marks the third consecutive week of higher rates and adds hundreds of dollars in monthly costs for borrowers, making housing affordability even more difficult for many Americans. The rise in rates is attributed to the recent sharp upward move in the 10-year Treasury yield, which reached above 4% for the first time since early March. High inflation has led the Federal Reserve to increase interest rates aggressively, and the average rate on a 30-year mortgage remains more than double what it was two years ago, impacting the housing market and discouraging homeowners from selling their properties. As a result, the low inventory of homes on the market and higher mortgage rates have contributed to the decline in home sales.

Lending activity from banks on commercial real estate has slowed down due to higher interest rates, an expected recession, and concerns about specific sectors. The collapse of three regional banks this spring has also caused commercial real estate investors to scrutinize lenders more closely. Established groups are receiving fewer quotes for deals than before, and the market for commercial real estate deals has declined by about 15%. The slowdown is driven by capital markets, but some underlying real estate fundamentals have performed well, except for high-rise office buildings in downtown San Francisco or New York. In response to slower lending from banks, other capital sources like life insurance companies are stepping in to fill gaps. Some capital sources see potential opportunities to invest in projects facing issues due to the recent surge in interest rates and debt costs. However, most lenders and equity sources are choosing deals, markets, and sectors expected to be safer during a downturn, focusing on senior loans and being more selective in their investments.

JOBS

The number of Americans applying for jobless benefits declined to its lowest level in five months, indicating that the U.S. labor market continues to remain strong. U.S. applications for unemployment benefits fell by 7,000 applications landing at 221,000 for the week ending July 22, the fewest since February. The four-week moving average of claims also decreased, suggesting a healthier labor market. Despite the fastest interest rate hikes since 1989, the unemployment rate has remained historically low at 3.6%. The U.S. economy has shown resilience, growing at a 2.4% annual pace in the second quarter. Though there have been notable layoffs in the tech sector, the overall labor market remains healthy.

In 2022, King County workers experienced a decline in wages, the first in at least a decade, despite a growing number of employed individuals and a tight statewide labor market. The slowdown in wage growth was influenced by shifts in consumer and business demands for tech products, leading to significant layoffs in high-paying tech companies like Microsoft and Amazon. Inflation also played a role, impacting real incomes and wage growth. Although the annual average wage in King County was the highest in Washington, it still experienced a 1% decline in average wages in 2022. While pay raise plans remain higher than pre-pandemic levels, employers are now being more cautious with pay as the job market softens. Larger companies previously saw higher wage growth during the pandemic, but that dynamic is fading as hiring slows down and smaller businesses can now compete better for talent. Employers are still budgeting healthy salary increases for 2024 due to anticipated hiring challenges.

OTHER NEWS

Venture capital activity in the Seattle area has been slower compared to the last two years. With startups securing $700 million across 100 deals in the second quarter, this created a drop from last year's $7.8 billion across 479 deals and 2021's $9.2 billion across 494 deals. The average investment per deal fell by 29% from the previous quarter, and prominent startups in the region have been laying off employees. Startups are cutting costs and focusing on revenue generation to extend their runway and reduce the need for fundraising. Although there have been some notable funding rounds, the overall funding environment remains challenging, impacting all sectors and stages of the venture ecosystem. Nationally, venture capital activity has also slowed compared to previous years.

As venture capital becomes scarce and investors prioritize profitable startups, some cash-strapped early-stage founders in the Seattle area are seeking buyers to avoid going out of business or raising funds on unfavorable terms. The challenging market conditions have forced many startups to consider mergers and acquisitions (M&A) as a way to exit or find a soft landing. The acquisition activity has declined in the Pacific Northwest, with larger tech companies cutting costs and showing less appetite for acquiring talent. Founders looking for M&A deals need to allocate significant time and identify potential buyers, but the smaller pool of buyers due to market conditions poses a challenge. Transparency and honesty throughout the process are crucial for founders to keep all stakeholders informed.