Commercial Real Estate Vacancy Trends

Introduction

Examining the amount of space that is occupied or vacant in commercial real estate markets within an area provides insights into the health of the local economy. When the economy is growing rapidly, the demand for commercial real estate increases, vacancy rates fall, and prices are pushed upward—all of which tend to spur new development. Trends in specific types of real estate markets also offer clues into how industries that use these spaces have been doing over time.

This chapter looks at recent trends in vacancy rates in Bellevue's office, industrial, and retail real estate markets and also compares vacancy rates in Bellevue to other localities in the Puget Sound region.[1] These recent trends provide perspective on how these markets fared both during the boom of the late 1990s and the subsequent recession from which the economy is now emerging. Analysis is also included on the long term outlook for office vacancy rates in Downtown Bellevue.

A number of sources were used in compiling the information in this chapter including market reports prepared by several commercial real estate companies, and analyses by reporters following local commercial real estate trends. The primary source for the vacancy figures is CB Richard Ellis, an international commercial real estate service and brokerage company that maintains estimates of office and industrial real estate vacancy rates in the major markets of the U.S. Discussions with analysts at CB Richard Ellis and Colliers International, also a full-service provider of commercial real estate services, provided useful insights. The chapter also benefits from perspectives that Berk & Associates provided as part of the analysis the firm did for the profile.

In this chapter, the geographies of the real estate markets, e.g., Eastside, Puget Sound region, I-90 corridor, Downtown Bellevue, and Bellevue suburban are defined as they are by the data source referenced. These definitions may not correspond exactly with those used elsewhere in the profile.

KEY FINDINGS AND IMPLICATIONS—Commercial Real Estate Vacancy Trends

Office Vacancy Rates

Downtown Bellevue has almost 5 million square feet of Class "A" office space concentrated in 24 buildings, representing almost a quarter (23.5 percent) of the Eastside's square footage in this premier class of office space. Hundreds of thousands of square feet of office space also exist in Bellevue along the SR 520, I-405, and I-90 corridors and scattered elsewhere in the city.

During the economic boom in the late 1990s and early 2000, office vacancy rates in both King County's Eastside as a whole and in Bellevue reached unprecedented low levels. At the height of the boom, vacancy rates in the downtowns of Bellevue and Seattle were only about 2 percent, with rates just slightly higher in the Eastside as a whole and in the Puget Sound region as a whole.

As the economy entered recession in 2001, office vacancy rates regionwide jumped sharply. The recession affected Bellevue especially hard, due in part to the many technological and other companies that folded, downsized, or stopped growing leaving large amounts of empty office space empty. In Downtown Bellevue, major office buildings were completed just as the economy weakened, causing vacancy rates to climb much more steeply in Downtown Bellevue than in both the Eastside as a whole and other regional markets including Downtown Seattle. In the second quarter of 2002, office vacancy rates in Downtown Bellevue peaked at more than 25 percent. The fact that vacancy rates in Downtown Bellevue rose significantly faster than in other local markets, however, can be viewed in many ways as a "perfect storm" and is likely not predictive of future trends.

The recently commenced office market recovery in Downtown Bellevue picked up pace dramatically between the second and third quarter of 2004. This drop in the vacancy rate came with Symetra Financial's agreement to lease over 250,000 square feet to move its headquarters to Downtown Bellevue. By the last quarter of 2004, real estate analysts estimate that Downtown Bellevue's office vacancy rate had fallen to 10 or 11 percent.

Other indications that Downtown Bellevue's commercial real estate market is emerging from the recession include developers' renewed confidence in the market, which has prompted resumption of construction projects such as Lincoln Square and the second-phase of the Summit A building.

Real Estate analysts are projecting that vacancy rates in Bellevue will continue to decline in the near future as the regional and local economies continue to improve. Cushman and Wakefield projects that vacancy rates in Downtown Bellevue will fall further to about 7 percent by 2006.

The attractiveness to new economy firms that Bellevue demonstrated during the tech boom of the late 1990s generally bodes well for the future vitality of Bellevue's office space market as the Information sector resumes expansion. Bellevue's appeal to large companies, as demonstrated with Symetra's recent decision to move to Downtown Bellevue, will likely attract other large firms that will help to provide more long-term stability to local office and job markets as Downtown Bellevue matures.

Industrial and Retail Vacancy Rates

The recession had less of a negative impact on the industrial and retail real estate markets than on the office real estate market. These markets have also been less subject to swings in vacancy rates because the amount of space needed for industrial and retail tenants is not as sensitive to economic cycles. The fact that annual growth in consumer spending remained positive during the most recent recession also helped to keep retail vacancy rates from climbing steeply in major retail markets such as Downtown Bellevue.

Industrial Vacancy Rates

Overall, the Eastside's 10 percent share of the regional Puget Sound industrial space market is much smaller than that of Seattle or the Kent Valley, which together comprised over 80 percent of the regional industrial market. The Bellevue submarket and the I-90 corridor submarket (which includes parts of Bellevue but also extends further east along that interstate) together make up less than 20 percent of the square footage in the Eastside industrial market.

During the recent recession, quarterly industrial vacancy rates within the Puget Sound region as a whole peaked at about 8 percent late in 2003. This was, however, only half as high as the regional 16 percent peak that office vacancy rates reached earlier that year.

The Eastside industrial real estate market, which had generally been weaker than that of the region during the recession, is beginning to respond to a strengthening economy. Bellevue's industrial vacancy rate has generally been below the industrial vacancy rate for the Eastside as a whole but above that for the region. In the third quarter of 2004, the industrial vacancy rate in Bellevue was 10.5 percent versus the 15.3 percent industrial vacancy rate for the Eastside as a whole.

Retail Vacancy Rates

Downtown Bellevue is one of the region's most concentrated retail hubs. With almost two million square feet of retail space—Bellevue's Downtown contains nearly 60 percent as much retail space as Downtown Seattle. However, the Eastside retail submarket with the largest overall number of square feet is the I-90 Corridor, which includes both areas within Bellevue bordering the interstate as well as areas extending further along I-90 to North Bend.

Retail remains the strongest of the commercial real estate markets with generally low vacancy rates in Bellevue and throughout the Puget Sound region. In the fourth quarter of 2004, Downtown Bellevue had a retail vacancy rate of just 1.5 percent, which was below Downtown Seattle's also low rate, as well as below the retail vacancy rates for the Eastside and region as a whole. Nationally, smaller and older neighborhood shopping centers were harder hit by the recent recession than were larger retail markets, and many are still struggling with relatively high vacancy rates. This is also true of several neighborhood shopping centers in Bellevue.

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Office Vacancy Rates

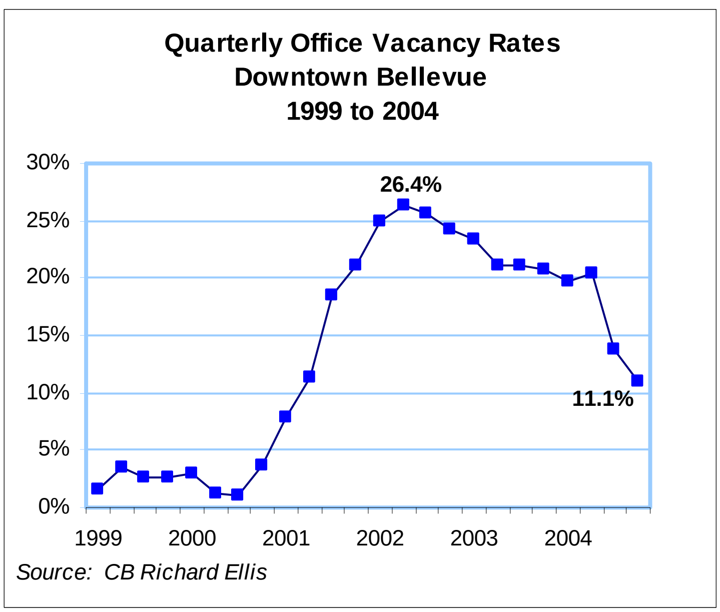
General economic conditions have a direct impact on vacancy rates for commercial real estate, with local markets for office space tending to track regional and national economic indicators. Variations in vacancy rates within the Puget Sound region also provide insights into how local real estate markets and levels of economic activity differ within the region.

As noted in earlier chapters, a large part of Bellevue's economy is based upon knowledge-based industries such as financial, real estate, and business services. Office buildings represent a prominent part of the city's identity and are necessary to accommodate jobs in these industries. According to CB Richard Ellis' most recent figures, Downtown Bellevue has almost 5 million square feet of Class "A" office space concentrated in 24 buildings—this represents almost a quarter (23.5 percent) of the Eastside's square footage in this premier class of office space. Several million additional square feet of office space also exist in Bellevue along the SR 520, I-405, and I-90 corridors and scattered elsewhere in the city. **Looking at local office vacancy rates reflects how these industries boomed in Bellevue in the late 1990s and likely have recently started to recover from the recession that began nationally in 2001.**

Office Vacancy Trends in Downtown Bellevue

As the economy soared in the late 1990s and in early 2000, office space vacancy dropped nationally to its lowest rates in two decades. Office vacancy rates in the Puget Sound region also fell to levels that were deemed unprecedented. Office vacancy rates in the Eastside and in Bellevue were also dipping at that time. As the economy peaked, vacancy rates in the downtowns of Bellevue and Seattle were only about 2 percent, with rates just slightly higher in the Eastside as a whole and in the Puget Sound region generally. **Around the time of the height of the boom, Bellevue specifically was the tightest Class "A" office market in the country**, according to the *National Real Estate Investor,* an industry journal.[1]

CB Richard Ellis' quarterly reports track trends in office space for multi-tenant buildings with 10,000 or more square feet. The chart below is based on this brokerage's quarterly figures, with the chart showing the detailed vacancy rate trend line by quarter in Downtown Bellevue. **The chart reveals the 26 percent peak in Downtown Bellevue's vacancy rate in the second quarter of 2002.** (Quarterly figures are also shown in the table below.)



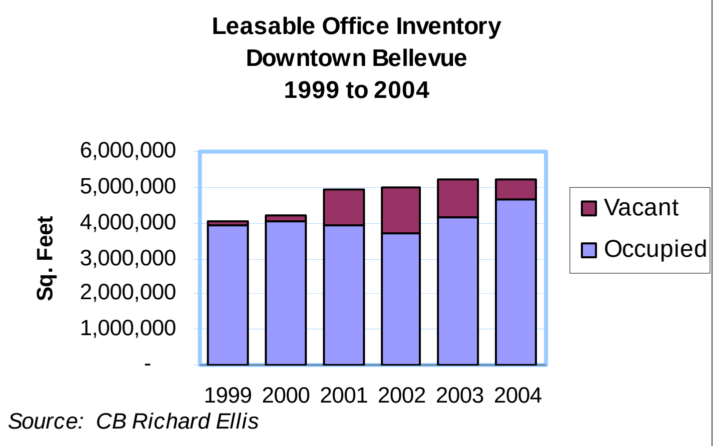
Quarterly Office Vacancy Rates
Downtown Bellevue
1999 to 2004

	Q1	Q2	Q3	Q4
1999	1.63%	3.47%	2.58%	2.53%
2000	2.98%	1.22%	1.06%	3.66%
2001	7.90%	11.29%	18.48%	21.18%
2002	24.94%	26.36%	25.71%	24.29%
2003	23.33%	21.16%	21.12%	20.75%
2004	19.68%	20.39%	13.76%	11.07%

Source: CB Richard Ellis

A gradual decline in Downtown Bellevue's office vacancy rate turned into a very sharp drop between the second and third quarter of 2004. This drop came with the completion of Symetra's agreement to lease over 250,000 square feet in the adjacent Rainier Plaza and Key Center towers, an event that the towers' landlord, Equity Office Properties Trust, called "market-charging."[2] **Estimated at about 11 percent as of the 4th quarter of 2004, the office vacancy rate in Downtown Bellevue is still higher than it was in 1999 or 2000, but is currently lower than the current rate in the Eastside generally (13 percent), Downtown Seattle (15 percent) and the Puget Sound region as a whole (16 percent).**

As illustrated in the following chart and accompanying sidebar, the addition of space with new office buildings completed between 2000 and 2003 was a key driver in making Bellevue's increase in vacancy rates during that period steeper than that in the Puget Sound region as a whole. Several new projects under construction stalled or were capped due to this increase in available office space. These included Lincoln Square, which once had half a million square feet of office space planned as a component of this mixed use development, and the Bellevue Technology Tower with another 390,000 square feet of office space.



By the time Cushman and Wakefield prepared their 2003 year-end analysis, signs had begun to point to a strengthening market for office space in downtown Seattle and Bellevue. Both areas were among the top 10 markets nationally with respect to the amount of office space absorbed in direct leases that year.[3] By the first quarter of 2004, brokerages were reporting that asking rates had started to stabilize and the generous landlord concessions offered to attract new tenants in Bellevue and elsewhere had begun to wane. By late spring of 2004, Pacific Real Estate Partners was indicating that large consolidated spaces of office space in Downtown Bellevue were becoming scarce so that smaller tenants had to be displaced to accommodate larger tenants who wanted big blocks of space.

Recent Volatility and Dot-Com Effects— Economic expansion in the 1990s included technology company spin-offs and employment growth concentrated in Bellevue and other places on the Eastside. As Berk & Associates observe, because the city had little new office space construction during this period, space in this market was absorbed rapidly, resulting in very low vacancy rates. New construction followed, as would be expected, but the recession hit at the same time. New office space on the market combined with declines in employment resulted in escalating office vacancy rates.

The dot-com Internet start-ups of the late 1990s brought venture capital funding that went toward leasing more space than companies ended up needing, further tightening office space without necessarily filling the space with staff. The downturn in the economy then led to tech firms abandoning their space, creating very high vacancies throughout the region, particularly in Bellevue.

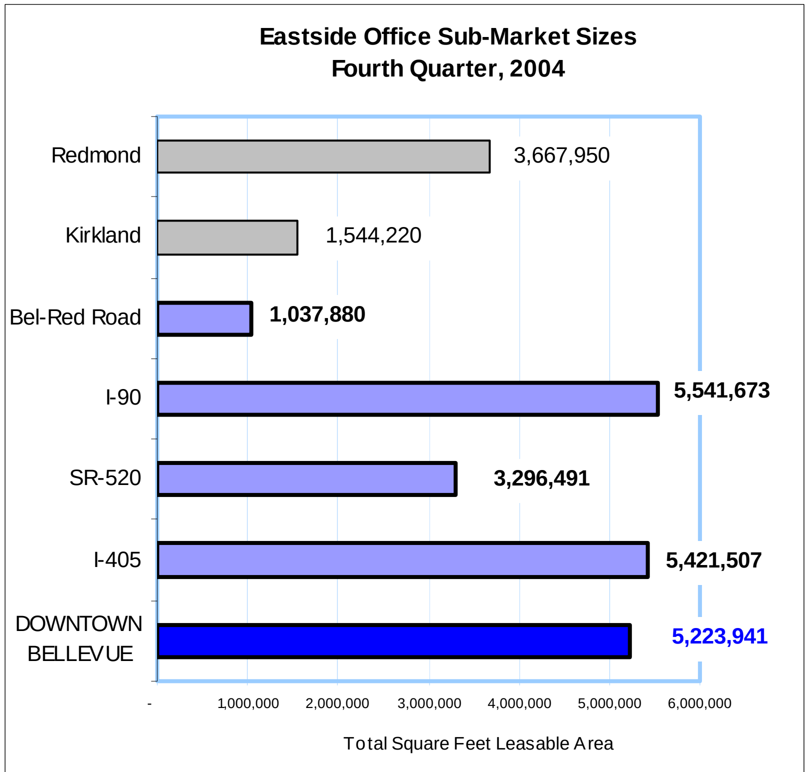
During the summer and fall of 2004 several large companies announced their decisions to lease office space in Downtown Bellevue, directly impacting the area's office vacancy rate. Puget Sound Energy, drugstore.com Inc., and Symetra Financial, all signed leases in 2004 to occupy large amounts of office space. These large leases, along with a number of recent smaller ones, have lowered the vacancy rate and put upward pressure on rents. This prospect of rising rents is giving developers a reason to continue construction on some of the projects in Downtown Bellevue that came to a halt during the downfall of the dot-com industry in 2001. According to reports in the *King County Journal,* companies are choosing to move their headquarters to Bellevue to take advantage of such benefits as reasonable rents, amenities, transportation options, central location and the easy access to freeways all available in Bellevue. [4]

Work has resumed on Lincoln Square and other major Downtown Bellevue mixed-use projects that were stalled or otherwise interrupted during the recession. (The original developer of the Lincoln Square project had halted construction on the project in 2002. Kemper Development Co. restarted the project after purchasing it in 2003. Kemper Development Co. is also the owner of the Bellevue Square shopping mall next to which Lincoln Square is being built.) Lincoln Square, the city's largest mixed-use development among those already built or under construction, is ultimately planned to include 330,000 square feet of retail, a 41-story hotel/condominium tower, 27-story office tower, 12-screen movie theatre, health club and a 2,100-stall underground parking garage. The office portion is, however, being built in a later phase of construction. Construction has also resumed on the second-phase expansion of the Summit "Building A." (During the recession a decision had been made to cap the building short of its originally planned height.) This 11-story 235,000 square-foot building is now expected to be completed in mid 2005 and is entirely committed to Puget Sound Energy Corporation. Also planned for Bentall's three-acre Summit site is a third building of 14 towers to replace the existing Summit Ridge.[5] Media reports also indicate that Wright Runstad and Equity Office Properties are once again planning to build City Center II, which is currently envisioned to rise 34 stories and contain 700,000 square feet of office space, 5,700 square feet of retail space, and 580,000 square feet of underground parking.[6] Additionally, in January 2005, plans were unveiled for a $1 billion project called the Wasatch Super-Block to be built around the corner from Bellevue Square. The residential component is being built first, but once completed in approximately ten years, the development will span the equivalent of nine city blocks, and will include an office tower or towers in addition to an athletic club, town homes, a number of condominium towers, and possibly a grocery store.

Another clear sign that the Downtown Bellevue office real estate market has turned around is the Civica Office Commons complex sale in March of 2005 for what was a record price in the Pacific Northwest. Local real estate brokers interviewed by the press indicate that this complex, which is leased by tenants that include Microsoft Corp., Morgan Stanley, and Infosys, sold for such a high price because of its premium quality, excellent location, and tenant base. Also, reports the *King County Journal,* major investors are now "snapping up" commercial real estate in places such as Downtown Bellevue.[7]

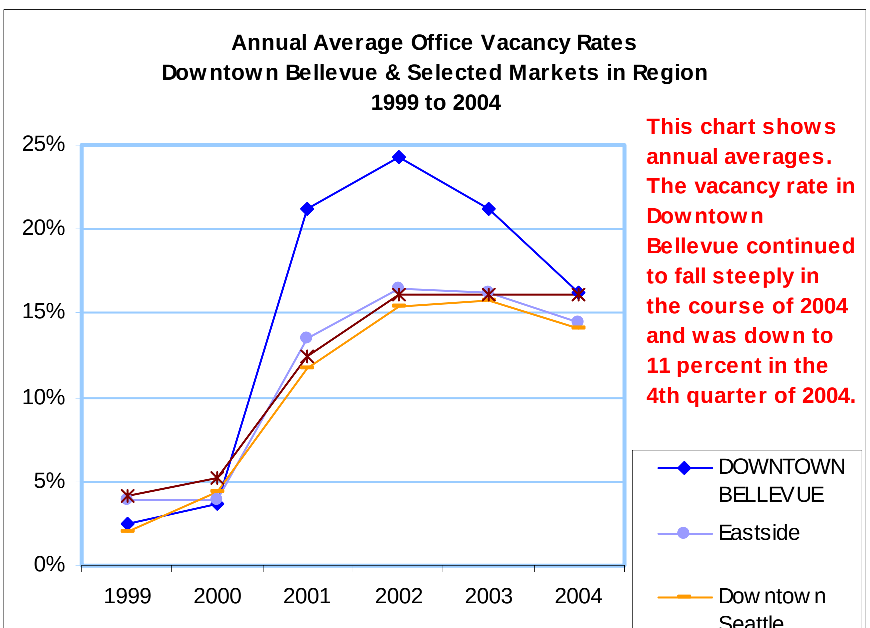
Downtown Bellevue's Office Market and Vacancy Rates in Regional Context

Almost one-third of the office space in the Puget Sound region is on the Eastside, according to CB Richard Ellis' fourth quarter 2004 figures. The chart to the right shows the amount of office space for Eastside submarkets defined by this brokerage. **Downtown Bellevue comprised 20 percent of the Eastside's total office space in** multi-tenant buildings with 10,000 or more square feet, and a slightly higher percentage of the Eastside's Class "A" office space as previously noted. **Other office submarkets in which Bellevue space is the majority or at least a sizable part (I-405, SR-520, I-90, and Bel-Red Road) together made up another 59 percent of the office square footage on the Eastside.**



Source: CB Richard Ellis

The chart below and table on the following page show *annual average* office space vacancy rates between 1999 and 2004 to facilitate comparison between Downtown Bellevue and other selected markets in the region. More detailed trends for Downtown Bellevue by quarter appear on the previous pages.



Puget Sound region includes key markets in King, Pierce, and Snohomish Counties.
Source: CB Richard Ellis

As the national and regional economies entered recession in 2001, office vacancy rates jumped sharply. By 2002, annual average office vacancy rates in the Puget Sound region, the Eastside, and the Seattle central business district had all risen to about 16 percent. As noted in the introduction to this chapter, real estate market geographies are defined in this chapter based on the way they are defined by the source, in this case CB Richard Ellis.

The vacancy rate for office space increased especially steeply in Downtown Bellevue, rising to an average annual vacancy rate of 24 percent in 2002. **A significant part of the increase in vacancy rates, especially in Downtown Bellevue and on the Eastside, had to do with technology companies** folding, downsizing or just simply not filling newly leased office space with employees, then subleasing space for which they no longer had a need. **However, since 2002, the office vacancy rate in Downtown Bellevue has declined much more quickly than have the vacancy rates at the regional level. As reflected in its falling vacancy rate, Downtown Bellevue has become one of the brighter spots in the region's economic recovery.**

Annual Average Office Vacancy Rates
Downtown Bellevue and Selected Markets in Puget Sound Region
1999 to 2004

	1999	2000	2001	2002	2003	2004
DOWNTOWN BELLEVUE	**2.53%**	**3.66%**	**21.18%**	**24.29%**	**21.16%**	**16.22%**
I-405 Corridor	7.52%	7.91%	13.00%	16.93%	17.40%	18.15%
520 Corridor	1.48%	3.13%	15.41%	14.40%	16.04%	15.77%
I-90 Corridor	3.29%	1.63%	12.87%	15.38%	15.40%	11.52%
Bel-Red Road	1.79%	6.38%	9.79%	11.63%	9.97%	11.76%
Eastside	3.93%	3.88%	13.52%	16.49%	16.20%	14.48%
Seattle Downtown	2.07%	4.34%	11.78%	15.44%	15.81%	14.15%
Puget Sound Region	4.10%	5.23%	12.50%	16.12%	16.15%	16.14%

Total vacancy including space available for both direct leases and subleases, for all multi-tenant buildings 10,000 square feet and greater.
Puget Sound region includes key markets in King, Pierce, and Snohomish Counties.
Source: CB Richard Ellis

Outlook for Downtown Bellevue's Office Space Market

Real Estate analysts are projecting that vacancy rates in Bellevue will continue to decline in the near future. Cushman and Wakefield's most recent analysis, which estimated vacancy at 9.8 percent in the fourth quarter of 2004, projects that office vacancy rates in Downtown Bellevue will fall further to about 7 percent by 2006.[8]

The steep increase in vacancy rates that occurred in Downtown Bellevue as large office buildings were completed just as the economy weakened can be viewed in many ways as a "perfect storm" and is not likely to re-occur. However, the additional space that will become available as Downtown matures and as major projects are completed will cause some temporary increases in vacancy rates from time to time.

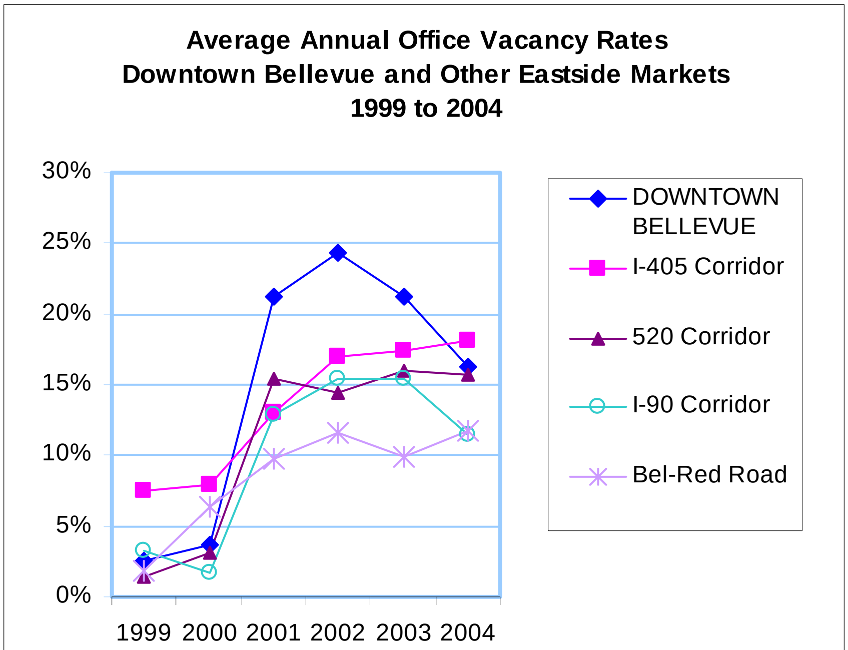
While well-established and very large occupants can stabilize a local office market as have major companies headquartered in Seattle, Bellevue's base of office space occupants consists primarily of hundreds of mid-size and smaller companies. These companies may be more vulnerable to downturns in the regional economy or buyouts by larger companies, which commonly are accompanied by layoffs. Smaller firms, particularly technology start-ups, are prone to turnover and buyouts. However, **Symetra's lease of more than 250,000 square feet and upcoming move to Bellevue is likely to help anchor the Downtown Bellevue office market.**

Bellevue's attractiveness to new economy firms, as demonstrated during the recent tech boom, also generally bodes well for the future vitality of the local office space market and economy.

The shopping and entertainment opportunities associated with the new mixed-use developments coming to Bellevue's Downtown will also enhance the marketability of office space in nearby buildings, and may help attract additional large tenants and employers.[9] New developments such as these also reflect the capacity of this maturing city to accommodate new economic growth in the future.

Office Vacancy Trends in Other Eastside Submarkets

The chart to the right shows *annual average* office space vacancy rates in Eastside submarkets from 1999 through the 4th quarter of 2004.



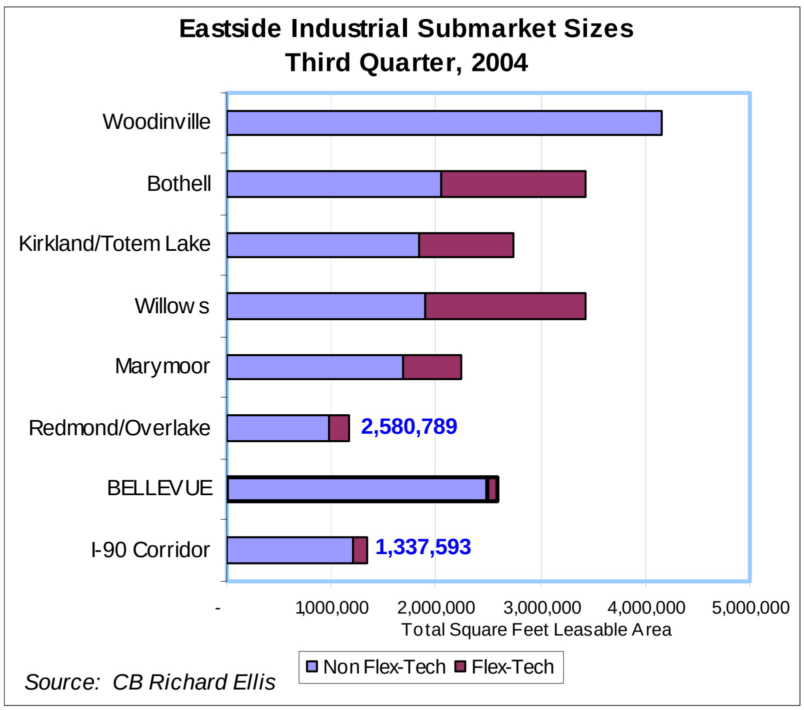
Source: CB Richard Ellis

Office vacancy rates in all of these submarkets rose with the recent recession, although rates in some submarkets not limited to Downtown Bellevue have declined more recently. The vacancy rate along the State Route 520 corridor, in Bellevue and Redmond continued to rise after 2002 but dropped significantly during the second half of 2004. The annual average office vacancy rate in 2004 along the 520 corridor is about equal to that of Downtown Bellevue. The vacancy rate along Bel-Red Road has remained fairly steady since 2002 and is in 2004 was lower than that for the Eastside as a whole and several other Eastside submarkets. An observation worth noting is that at least two large leases to occupy Downtown Bellevue office space that were signed by companies in 2004 involve moving companies' locations from other subareas listed in the previous chart: (i.e., drugstore.com is moving from the I-90 Corridor and Symetra Financial is moving its headquarters from the Redmond portion of the 520 corridor). However, these moves do not seem to be preventing the vacancy rates in these corridors from continuing to decrease.

Industrial Vacancy Rates

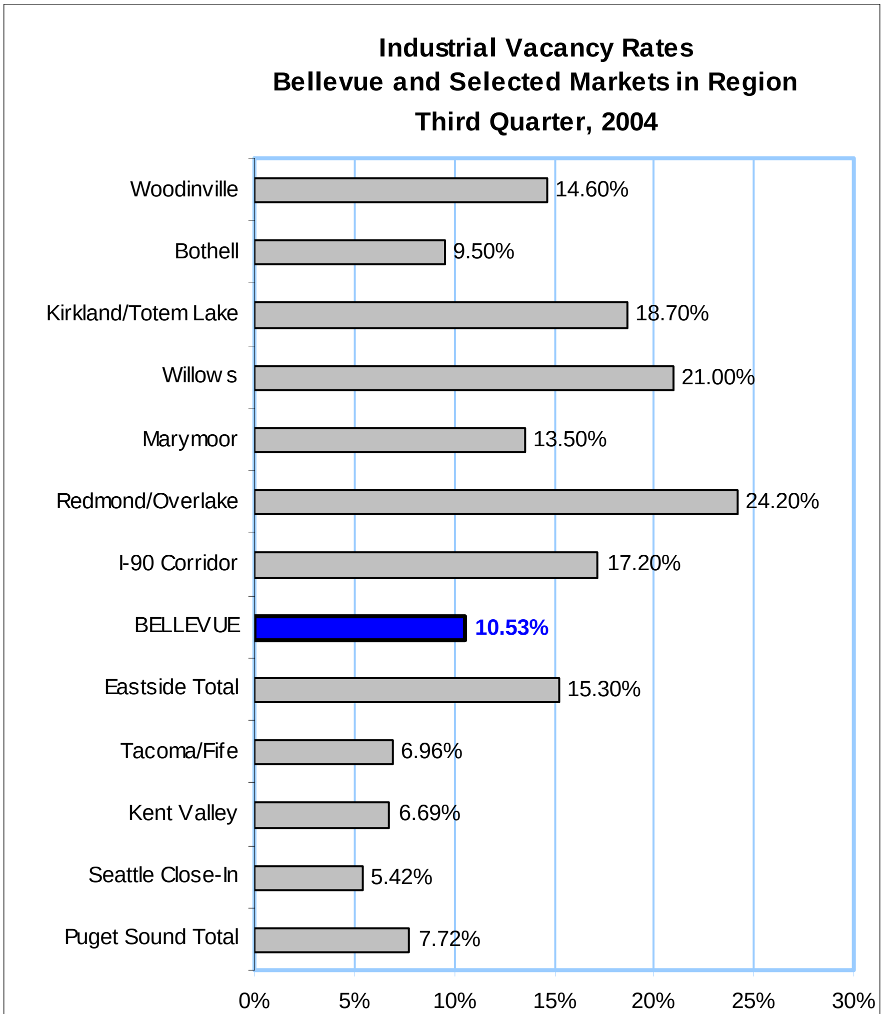
The health of the industrial real estate market is not as strongly tied to employment as the office sector is. Per Colliers International, orders for manufactured and durable goods, import/export activity, and wholesale and retail activity tend to be the main driving factors in industrial real estate markets.[10] According to Colliers and other real estate analysts, industrial and retail real estate markets generally tend to be more stable during economic downturns than do office space markets. **The amount of space needed for users of industrial and retail properties to have a place to put their products are not as sensitive to economic cycles as is the space needed for employees in office spaces. In addition, industrial buildings can usually be constructed more quickly than office buildings, allowing industrial developers to react more quickly to market conditions and avoid overbuilding.**

The brokerage CB Richard Ellis reports quarterly on industrial vacancy rates for buildings 10,000 square feet and greater in size. This includes "pure industrial" space, which the brokerage defines as warehouse, distribution and manufacturing buildings with less than 25 percent office build out, as well as "flex-tech," which stand three stories or less and have between 25 and 75 percent office use. Third quarter figures are presented in the adjacent chart because fourth quarter 2004 detail was unavailable for some Eastside submarkets as of the printing of this profile. (CB Richard Ellis' more general Industrial *MarketView* reports of the Puget Sound region indicates that vacancy rates for the Eastside market in the fourth quarter of 2004 was 16.17 percent, a slightly higher figure shown for the 3rd quarter of 2004.)



In the third quarter of 2004, the Bellevue submarket comprised about two and a half million square feet of industrial space, or about 12 percent of the Eastside market. The I-90 Corridor submarket, which included parts of Bellevue along I-90, comprised somewhat over one million square feet for about 6 percent of the Eastside market. **The entire twenty-one million square foot Eastside market made up only about 10 percent of the Puget Sound industrial market**, and was much smaller than the Seattle close-in and Kent Valley markets, which together totaled over one hundred and sixty-five million square feet or 80 percent of this regional market.

In the Puget Sound region, vacancy rates for industrial space rose as the recent recession took hold. However, industrial rates did not increase as steeply as did office vacancy rates.



Total vacancy including space available for direct leases and subleases for industrial buildings 10,000 SF or greater.
Source: CB Richard Ellis

The peak regional industrial vacancy rates in the fallout from the recession were only about 8 percent regionally, compared to 16 percent regionally for the highest office vacancy rates. Also, while office vacancy rates reached near peak levels in 2002, industrial vacancy rates did not do so until 2003.

Within the last few years, the Eastside industrial real estate market has generally been weaker than that of the region as a whole. However, real estate analysts see the industrial market on the Eastside beginning to respond to a strengthening economy. **Bellevue's industrial vacancy rate has generally been below the industrial vacancy rate for the Eastside as a whole but above that for the region.**[11]

As indicated on the chart to the right, in the third quarter of 2004, the industrial vacancy rate in Bellevue was about 10.5 percent. Bellevue's industrial vacancy rate was below the 15.3 industrial vacancy rate for the Eastside as a whole, and much lower than several individual Eastside submarkets.

Brokers have commonly regarded the I-90 corridor as one of the most desirable Eastside industrial locations largely due to easy freeway access needed for shipping. However, CB Richard Ellis indicates that vacancy rates along the I-90 corridor since the second half of 2003 have generally been higher than rates seen in 2000. The brokerage reports that the 2004 third quarter industrial vacancy rate along I-90 was 17.20 percent. By contrast, Colliers International, which defines the I-90 submarket more broadly, reports a third quarter 2004 total vacancy rate of just 10.82 percent, placing I-90 along with Bellevue close-in (with a 11.43 percent total vacancy rate) among the healthiest industrial space submarkets on the Eastside.

Close-in Seattle was the tightest industrial market in the Puget Sound with a vacancy rate of 5.42 percent in the third quarter of 2004.

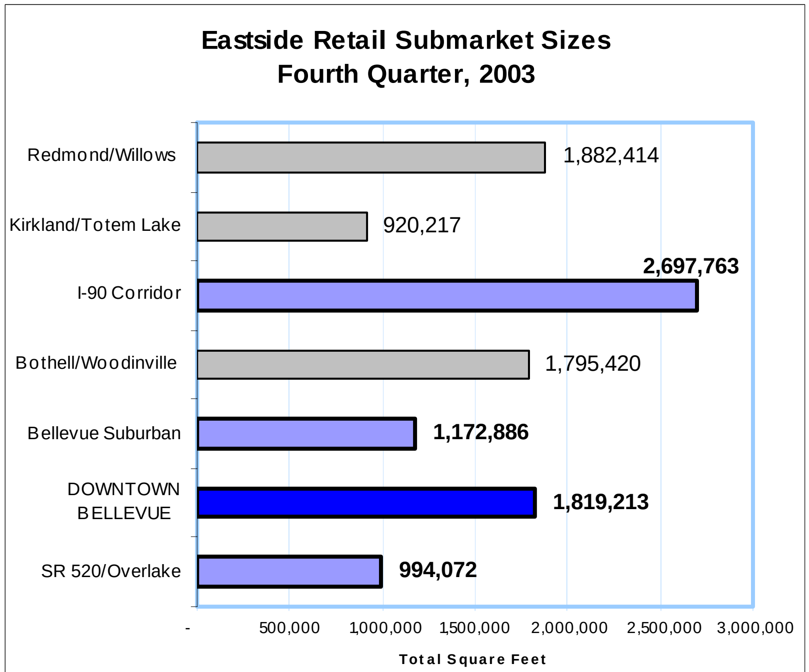
The submarkets in the southern part of the market provide large warehouses with good transportation access, conditions which national industrial market trends currently favor and which also lead these areas to have relatively low vacancy rates. CB Richard Ellis notes that the slight decrease in Puget Sound industrial vacancy rates from 8.27 percent to 7.72 percent between the last quarter in 2003 and the third quarter in 2004 was largely attributable to activity in the southern (i.e., Kent Valley and Tacoma/Fife) submarkets, which are nearest to the Port of Seattle.

Retail Vacancy Rates

At both a national scale and at a regional level, vacancy rates in major retail markets have been less affected by the economic slump following the turn of the economy in 2001 than have vacancy rates for other types of commercial property. This is partly because annual growth in consumer spending, which very directly fuels the health of the retail sector, remained positive during the recession.[12]

With regards to the Seattle metropolitan area, the general wisdom given in market reports and referenced in the media is that retail real estate remained strong. This is partly because this metropolitan area has not been overbuilt unlike many other U.S. markets. As a result, while retail markets in the region have suffered some effects from the general economic downturn, the impact has been buffered. Figures published by Gardner/Johnson in their Seattle Area Market Strategist show that Seattle metropolitan area retail vacancy rates increased after a low of around 2.75 percent in 2000; however, with a vacancy rate of 5.2 percent by early 2003, these rates did not reach the 6 percent plus rates that existed in 1997 and 1998.[13] **Puget Sound brokerages indicate that retail real estate, particularly *well-anchored* retail, continued to appreciate despite the recession, and national tenants' demand is reported as still being strong for retail space in this region. Key factors include the region's affluent demographics and consideration that the market is "under-retailed" given the areas' demographics.**

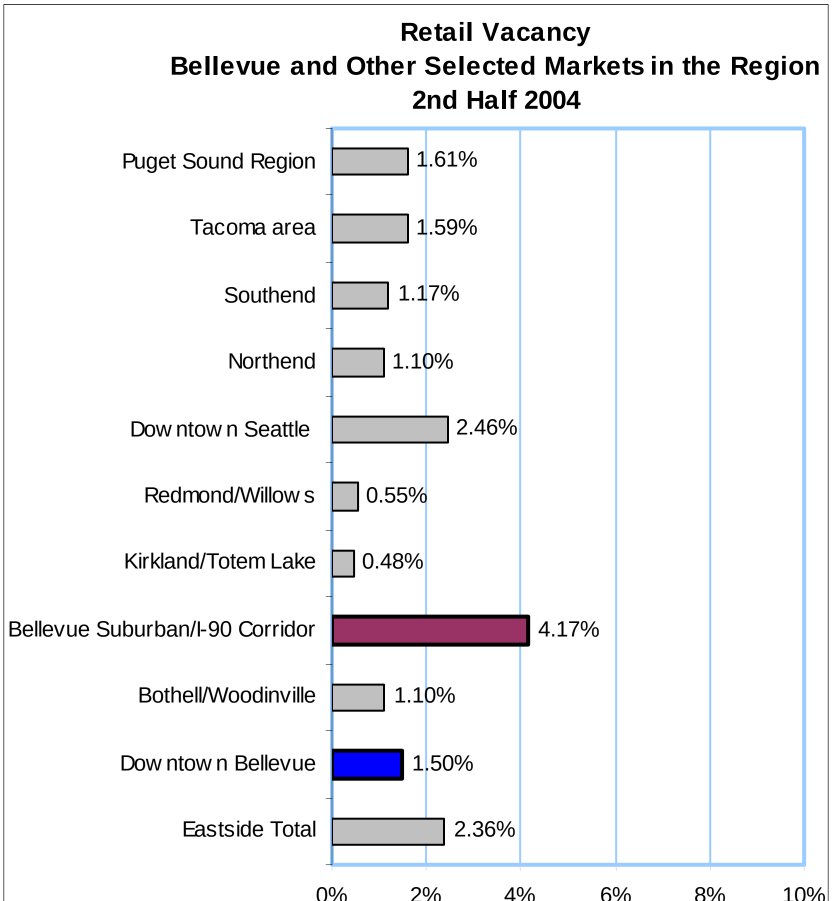
The size of the Eastside retail submarket, based on figures from CB Richard Ellis, is depicted in the accompanying chart. Figures from the fourth quarter of 2003 are used because these are the most recent figures available on the size of Bellevue area submarkets.



Note: 4th Q. 2003 provides most recent data at a detailed submarket level within Bellevue.
Source: CB Richard Ellis

The Eastside comprised about 28 percent of the Puget Sound region's retail at the end of 2003. **Downtown Bellevue—with almost two million square feet of retail space—contained almost 60 percent as much retail space as did Downtown Seattle. As a regional retail hub, Downtown Bellevue also has the highest density of retail jobs in the Eastside**, as shown in the retail employment density map in the Employment Chapter. **However, the Eastside retail submarket with the largest overall number of square feet is the I-90 Corridor, which includes both areas within Bellevue as well as areas extending eastward for another 20 miles along I-90 to North Bend.**

The most recent vacancy rate estimates from CB Richard Ellis, which were for the second half of 2004 as this is written, show Downtown Bellevue with a retail vacancy rate of just 1.5 percent. Downtown Bellevue's retail vacancy rate was below Downtown Seattle's rate of 2.5 percent as well as below rates for the Eastside and Puget Sound region as a whole, but higher than rates in some markets.[14] Per CB Richard Ellis, the region's retail vacancy rate fell to 1.6 percent, which was down from about 3.3 percent in the first half of 2004. Vacancy declined in every submarket during the second half of 2004. The Puget Sound region has not seen retail vacancy rates this low since the tech boom. CB Richard Ellis analysts suggest that the scarcity of prime retail locations is leading retailers to position themselves in existing retail locations as well as prompting developers to search for opportunities to build new retail centers.



Total vacancy including space available for direct leases and subleases on all multi-tenant buildings 50,000 SF or greater, freestanding buildings 20,000 SF and greater, and Downtown buildings 25,000 SF and greater.
Source: CB Richard Ellis

The contrast in retail vacancy rates between Downtown Bellevue and the suburban Bellevue market reflects a national phenomenon in which the smaller and older neighborhood shopping centers were harder hit by the recent recession, and are still recovering in many areas. The retail vacancy rate for the Bellevue suburban submarket in the fourth quarter of 2003 was 12.75 percent, which was significantly higher than rates in other Bellevue submarkets. The "Bellevue Suburban" submarket includes neighborhood shopping centers such as Kelsey Creek and Lake Hills and other retail space in Bellevue not located in Downtown, or the I-90 or 520 corridors.

The vacancy in the former K-mart building in the Kelsey Creek Shopping Center was the largest single vacancy in this submarket and was a key factor in the high vacancy rate for the submarket. In 2004, CB

Richard Ellis began to combine the "Bellevue suburban" submarket into the "Bellevue Surburban/I-90 Corridor" for reporting purposes, and no longer tracks vacancy trends specifically for this submarket. Since 2003, Costco has signed a lease to occupy the former K-mart building (although the company's plan to create a shopping center there has since fallen through). Additionally a number of ethnic businesses opened up in the Lake Hills Shopping Center area after the opening of the Asian grocery store, Pal Do World, which came to this neighborhood shopping center in 2003.

Another retail real estate trend that industry analysts cite is the shift by developers into building more mixed use retail projects. *The National Real Estate Investor* observes that this trend is being driven in part by the scarcity of land for retail construction. In Bellevue, a preeminent example of a missed use project is Kemper Freeman's aforementioned plans for Lincoln Square, which will make it one of the largest mixed use projects in the United States. The 1.4 million square foot Lincoln Square mixed-use project includes 330,000 square feet of space for retail--shops, entertainment, and restaurants--as well as residential, office, and hotel components. The evolution of the Lincoln Square project into a phased development with retail being among the first portions of the development to be built highlights the health of the retail market. The redesign of the plans for Lincoln Square's retail space into a street-facing, more pedestrian friendly retail environment featuring high-end home furnishing and accessories also illustrates several aspects of the new trend toward "lifestyle center" retail developments.

ENDNOTES

[1] Unless otherwise indicated, vacancy rates discussed in this chapter refer to total vacancy for leasable office space and include both direct lease and sub-lease space. Figures do not reflect property that is directly owned and/or available for purchase.

[1]"Seattle Trudges Toward Recovery," Jeanne Lang Jones, *National Real Estate Investor*, March 1, 2004.

[2] "Market Switch: The deal that turned Bellevue's office market back on," Jeanne Lang Jones, *Puget Sound Business Journal*, February 14, 2005.

[3] "Survey says Seattle real estate market has hit the bottom," Mark Stiles, *Seattle Daily Journal of Commerce*, December 24, 2003.

[4] "Rental ripple effect-Symetra's Bellevue move changes shape of office space market," Clayton Park, *King County Journal*, August 16, 2004 and "Crosstown move for web retailer-drugstore.com to Relocate HQ to Downtown Bellevue," Clayton Park, *King County Journal*, August 19, 2004.

[5] Website of Bentall Investment Management, http://www.bentall.com/keyprojects/keyprojects_current_summit.xml

[6] "Region again hears sound of building boom," J. Martin McOmber, Seattle Times, November 08, 2004;

"More towers for Bellevue's core," Kristina Shevory, *Seattle Times*, January 26, 2005

[7] "Building's sale shows Bellevue economy has bounced back," David A. Grant, *King County Journal*, March 29, 2005; "Bellevue building sells at record price," John Cook, *Seattle Post-Intelligencer*, March 29, 2005.

[8] "Bellevue office market hot; Seattle still waits for jump-start," J. Martin McOmber, *Seattle Times*, December 29, 2004.

[9] "Downtown Bellevue landlord sees positive signs – Equity predicts vacancy rates will drop in the next few years," Clayton Park, *King County Journal*, October 23, 2003.

[10]Colliers International *US Real Estate Review*, 2004, http://www.colliers.com/Corporate/MarketReports/UnitedStates/

[11]*Press Release: "4th Quarter Puget Sound Industrial Market Overview*," Colliers International, December 2004.

[12]Bureau of Labor Statistics, consumer expenditure survey reports for 2001 and 2002, http://www.bls.gov/cex/home.htm.

[13] Gardner/Johnson, *Seattle Area Market Strategist*, Economic Trends and Forecasts, 1st Quarter, 2003.

[14] CB Richard Ellis' *MarketView* report for the Puget Sound indicates that during the 2nd half of 2004, the inventory being tracked was limited to "institutional-grade" shopping centers 50,000 square feet or greater and freestanding retail 20,000 square feet or greater.

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