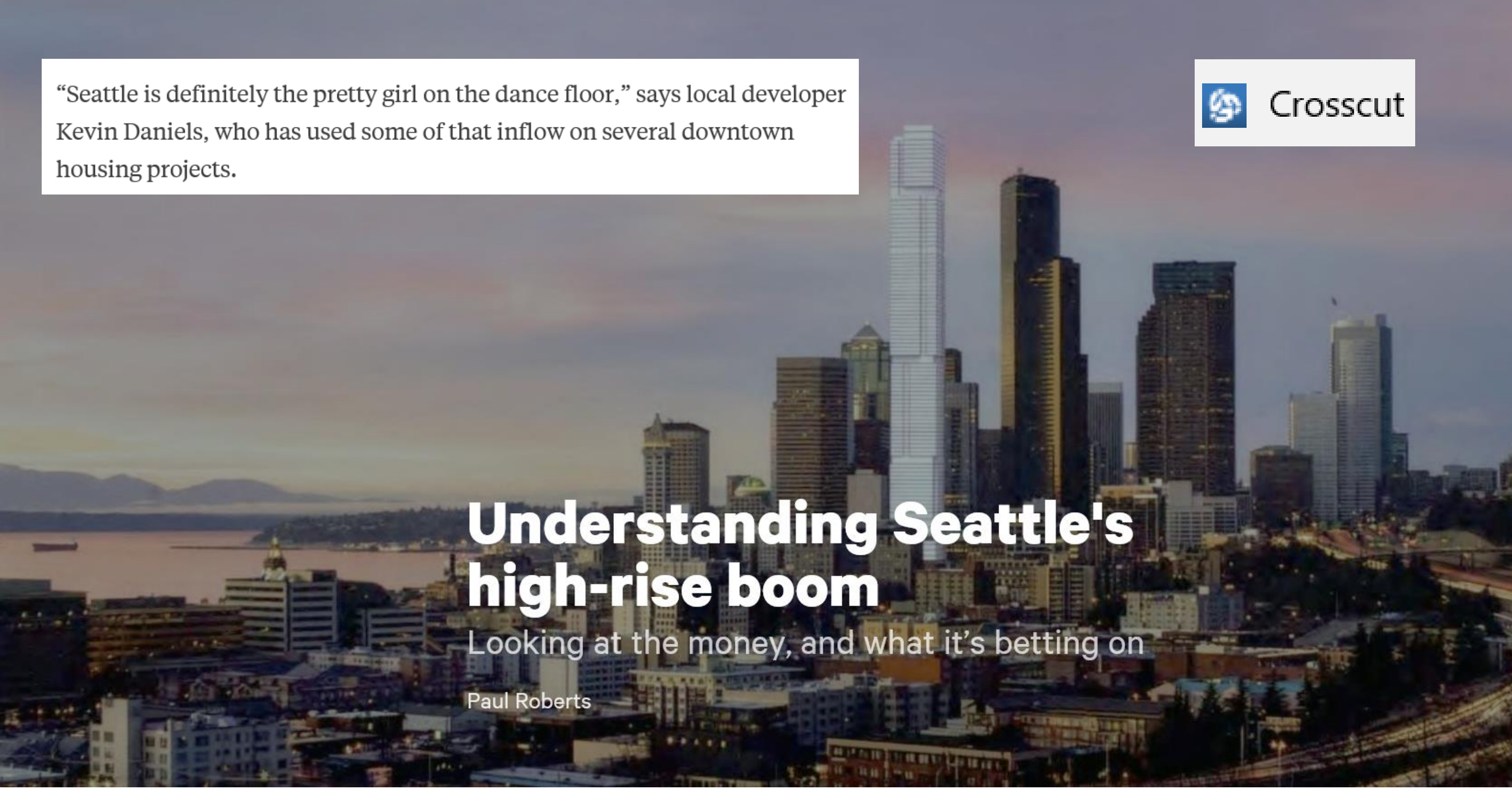


“Seattle is definitely the pretty girl on the dance floor,” says local developer Kevin Daniels, who has used some of that inflow on several downtown housing projects.

Crosscut

Understanding Seattle's high-rise boom

Looking at the money, and what it’s betting on

Paul Roberts

The strange saga of Sonny Kahn – the Miami developer who wants to build a 102-story apartment building in downtown Seattle – took a new twist last month.

On January 4, Kahn was told by the Federal Aviation Administration that his 1,117-foot high-rise would pose a risk for air traffic at Boeing Field and helicopters at Harborview Medical Center. Kahn’s company, Crescent Heights, responded Tuesday by lowering the tower, known as 4/C, to just 100 floors. But this minuscule concession will likely not satisfy the FAA, which has said the project won’t get “a favorable determination” unless it shrinks to 965 feet, or roughly the same height as the 76-story Columbia Center next door.

Yet even if Kahn does agree to make his tower small enough for the FAA, it’s hard not to wonder whether the enormous structure would be a good fit for Seattle. The building would be not merely one of tallest apartment high-rises on the West Coast. Judging from Crescent Heights’ other projects, 4/C would also be among the plushest — a vertical mansion offering everything from 24-hour concierges to personal shopping and dog-washing, all linked by “intelligent mobile technology” that allows staff to anticipate a tenant’s every need.

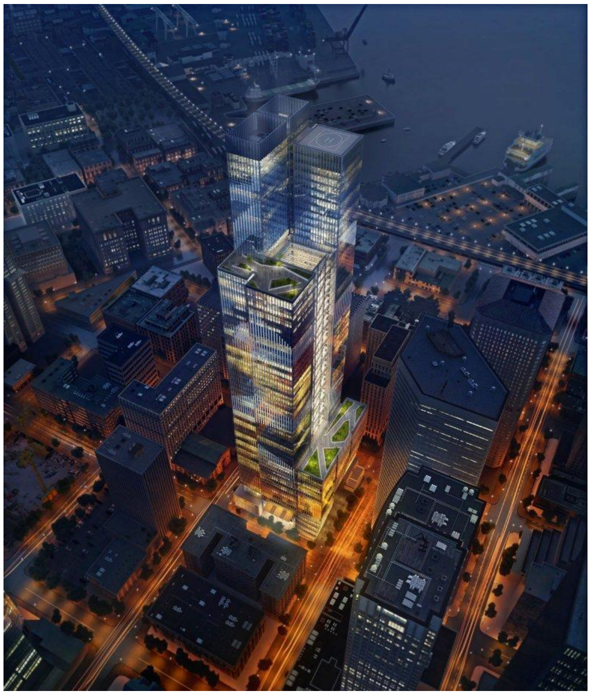
By 2015, the downtown housing market was growing twice as fast as during the early 2000s boom, and most of that growth was coming from luxury high-rise projects.

None of that will come cheaply. Although Crescent Heights has declined to discuss the project, local real-estate experts estimate that even a truncated building would cost upwards of $700 million, with rents for the larger, upper-floor units easily topping $15,000 per month — doubling Seattle’s existing luxury high-rise rates, and implying a clientele which might not actually exist in the city. Some speculate that Kahn will market his building to the global elite. Others say Kahn believes booming Seattle will soon have enough upscale tenants of its own.

Either way, says Jon Hallgrimson, a broker at the Seattle office of CBRE, 4/C "is definitely a big bet on where we're headed."

The same could be said for much of Seattle's high-rise apartment boom.

The 4/C project, for all its awesome scale, is just the logical extreme of a development tidal wave that is already testing the limits of the local housing market and raising questions about the community that is emerging downtown.



The proposed 888 2nd Avenue, so named for its height in feet. Sixteen of the tower's 88 stories will be for residential use. The tower will take up an entire block, stretching between Second and Third Avenues, and Marion and Columbia Streets.

Consider: there are currently 13 high-rise apartment or condo buildings of at least 24 stories in development or planning in the downtown area. The average is 39 stories. Another 24 high-rises are in the proposal pipeline, according to city and industry reports.

Not all the proposed towers will be built, of course, but those that are "launched" will represent a shift in downtown housing that is unprecedented not only in size but also in socioeconomics. Like 4/C, many are being "amenitized" for an upscale market. To be profitable, they will need rents of around fifty percent above the city average, according to several industry estimates. What's more, to judge by the heavy emphasis on studios and one-bedroom units, developers are anticipating a downtown population that is childless and even single.

Given the number of high-rise units expected by the end of the decade, this boom implies a downtown transformation that can strain even the most active imagination. While most of the debate around these towers has centered on familiar questions about affordability, inequality, traffic, and our urban character, we also might want to ask questions of another sort.

"Is someone here going to pay $20,000 a month to be up on the 80th floor?"

How realistic are the assumptions and expectations underlying all this frenetic construction? And how closely does the downtown we're building coincide with the downtown we're actually going to get — to say nothing of the one we might want? In other words, what is Seattle's high-rise apartment boom *really* telling us about where the city is headed?

Seattle's latest high-rise boom is driven by two powerful interrelated urban narratives.

The more familiar of the two concerns the recent arrival of tens of thousands of upper-income émigrés — tech workers and other "creatives," along with some suburb-weary retirees — who prefer the urban "core" to neighborhoods, and are OK renting instead of owning. Seattle isn't unique here: hot urban centers such as San Francisco, Atlanta, and Brooklyn are becoming magnets for what urban theorist Richard Florida calls the Creative Class.

But their arrival in Seattle has had a disproportionate impact, both because Seattle is a relatively small market (about a quarter the size of Brooklyn) and because the newcomers' spending power is so high. Total compensation for Amazon software engineers, to cite one example, averages $119,787.

For downtown real estate agents, the first hint of this demographic tsunami arrived in 2012, when one of the city's earliest upscale high-rises, the Alto, opened its doors — and leased its 183 units in just a few months. For developers, says Hallgrimson, "it was, 'OK, *that* is the formula we need to replicate.'"

Here is where the boom's second storyline kicked in. The surprisingly strong demand for upscale downtown apartments touched off a wave of project proposals, which in turn generated demand for a lot of outside capital.

Foreign investors, particularly from Asia, have grabbed most of the headlines, with everything from the $771 million acquisition of the Columbia Center (by Hong Kong-based Gaw Capital Partners) to a series of residential high-rise projects downtown. But foreign investments are a small part of a larger stream of outside capital flowing into the region's real estate market, especially from large-scale "institutionals," such as pension funds and insurance companies.

Prior to 2010, the number of rental units in Seattle's urban "core" was just 2,960. By 2020, the total is projected to be 16,543.

Seattle has seen plenty of outside capital before, but the scale of the current influx has been impressive. In 2015, the city's commercial real estate market — office, residential and industrial –took in more than $8 billion in investment from outside sources, according to JLL, a global real estate advisor. That's up from around $5 billion in 2013. Globally, Seattle now ranks 11th among cities for capital inflow, up from 18th in 2013.

"Seattle is definitely the pretty girl on the dance floor," says local developer Kevin Daniels, who has used some of that inflow on several downtown housing projects.

It's important to understand why Seattle's suitors are so excited.

One reason, clearly, is the hotness of the local market. With rents soaring and building values appreciating rapidly, developers of the current boom's first high-rise projects saw profits of as much as $100,000 per unit, says Brian O'Connor, a Seattle real-estate consultant. Investors were making better returns on Seattle high-rises than could be found in stocks, bonds, or other more traditional assets.

A proposed tower on 1015 2nd Avenue, which would add a 47 story addition on top of the currently empty Federal Reserve Bank building.

As important, Seattle's high-rise boom enabled investors to simultaneously place bets on a thriving urban area *and* a hot new demographic trend — the mass migration of young tech workers. Because the typical high-rise apartments can cost several hundred millions dollars, these projects represented just the sort of big, efficient vehicle that multi-billion-dollar institutionals prefer.

Demographically, geographically, and financially, Seattle's high-rise boom seemed made-to-order for outside capital. As Hallgrimson puts it, institutionals "look at Amazon and say, 'They're going to hire all kinds of very smart people and pay them a ton of money. And those people want to live downtown'. So they go to the developers and say, 'Tell you what: go find a high-rise site down near Amazon, or in Belltown or downtown, and we'll give you the money.'"

As Hallgrimson puts it, Seattle was going to have a housing boom one way or another, given the hiring rush by Amazon and other tech firms. But the eagerness of large outside investors ensured the boom took place in the form of a lot of very large projects downtown. Without outside money, says Daniels, "we couldn't have grown as fast as we have."

By last year, the downtown housing market was growing twice as fast as during the early 2000s boom, and much of that growth was coming from luxury high-rise projects.

Prior to 2010, the number of rental units in high-rise buildings – ten stories or more –in Seattle's urban "core" —the Central Business District, Belltown, First Hill/Yesler Terrace, Pioneer Square and South Lake Union— was just 2,960, according to Dylan Simon, a commercial real estate broker with Colliers International who closely follows Seattle apartment sales. By 2015, Simon notes, that number had nearly doubled, to 5,837.

That was only the start: by Simon's count, high-rise projects expected to hit the market between now and the end of the decade will push the new total to 16,543. Little surprise that downtown Seattle is not only the fastest growing neighborhood in the city, according to the Downtown Seattle Association (DSA), but also one of the fastest growing downtowns in the country.

"I've seen plans where they don't have *any* two-bedrooms," O'Connor says. "I tell architects we're building a city where everybody is living alone."

The pace of this capital-fueled boom has been unsettling to many. Yet proponents see it as an essential component of the city's future strategy.

Each new tower represents a huge increment of the density that city planners say is necessary to sustainably house the 120,000 newcomers expected in Seattle by 2035. As important, the towers are key to attracting a very specific category of newcomer — the “creatives” widely seen as the secret sauce for a hot urban economy.

The logic underlying the city’s optimism is simple, says Peter Orser, a former Seattle developer who now runs the University of Washington’s Runstad Center for Real Estate Studies: if Seattle can create the housing and other amenities that “creatives” want, the city’s economy will hit a critical mass and start attracting ever-larger steams of talent, business, and capital.

And “once all of this intellectual power and capital, and corporate talent comes together,” Orser says, “it just feeds on itself and now we’re exponentially growing, from what was once Bill Gates, Paul Allen and Bill Boeing… Now it’s a lot more guys like that.”

Because people like that can afford luxury, Seattle’s high-rise market has leaned steadily more upscale.

As new buildings have opened, they’ve featured evermore luxurious features and finishes: higher ceilings, quartz and marble kitchen countertops, high-end cabinets, tiled floors; soaking tubs and balconies, plus posh shared amenities like exercise and game rooms and rooftop terraces. Prices have followed suit. At the Martin, on 5th and Lenora, one-bedroom units rent for as much as $3,362, according to Apartment Insights Washington. A few blocks away at the Cirrus, a 700-square foot one-bedroom apartment goes for $4,000. Tenants must pay extra for parking, pet deposit, or climate-controlled wine storage.

This expanding demand for luxury living is clearly what Sonny Kahn and Crescent Heights hope to tap with their high-rise, however tall it ends up being. Although the company says 4/C will feature units for “all types of people and incomes,” the building will probably tilt way upscale. For one thing, according to local real estate agents and developers, it will need extremely high rents to recoup the costs associated with ultra-tall towers. This is say nothing of the $47 million paid for the parcel at 4th and Cherry, among the highest in city history.

For another, the company has a reputation for what might be called “creative luxury.” Crescent’s flagship apartment project in San Francisco, Nema, is essentially a vertical spa resort positioned next to Twitter, engineered for a demographic that is both wealthy and wired. In addition to all the concierging and personal shopping and dog-washing, residents have a proprietary phone app that lets them tailor these services to their individual tastes. It’s a package the company clearly believes will play well among Seattle’s growing tech-centric elite.

Just how well, of course, remains the subject of intense local speculation — and a fair degree of skepticism.

“Is someone here going to pay twenty thousand a month to be up on the 80th floor?” asks one Seattle area real estate insider, after estimating what she thought 4/C’s top rates might be. “There are people in Seattle right now who can afford that, absolutely. But are they actually going to pay that much, in rent, for something they won’t even own at the end of the day?”

Some of this head shaking and eye rolling clearly reflects local discomfort over the possibility that quiet, modest Seattle is already the kind of place where people drop such sums on an apartment. But it also reflects a not-entirely unreasonable speculation that Kahn is spending a lot of money on a building that doesn’t match the market it aims to serve.

The same skepticism could be directed at the rest of the downtown boom. High-rise developers are making very big bets on a future downtown resident who is not only wealthy, but also not interested in family life.

Studios and one-bedroom apartments account for at least 70 percent of the units in some of the biggest new upscale high-rises— Cielo, Cirrus, The Premiere on Pine, and the Martin — and 85 percent in the nearby Via6.

And based on proposed projects, says O’Connor, the studio/one-bedroom ratio for new towers will likely hover between 80 percent and 85 percent. That’s well above the current downtown average of 72.8 percent, according to the Downtown Seattle Association.

“I’ve seen plans where they don’t have *any* two-bedrooms,” O’Connor says. “I tell architects we’re building a city where everybody is living alone.”

“Light rail will be a game-changer,” says O’Connor. “It’ll be like, ‘I can move to a house or a cheaper apartment in Northgate and I can still walk to the station and be downtown in six minutes.”

This tilt toward single isn’t surprising, exactly. It reflects downtown as it exists today – according to the DSA, 68 percent of downtown residents live alone, compared with 42 percent citywide. It also reflects the dominant narrative about the downtown we should expect, as Seattle continues to attract people inclined toward smaller apartments: empty nesters, who don’t have kids; and millennials, who don’t want them—or, at least, don’t want them nearly as much as their parents did.

But there are a couple of problems with this picture. The first is that it isn’t necessarily the sort demographic the city really *wants* downtown exclusively. Truly vibrant downtowns are those with more age diversity, and, in particular, more families with kids and the special energy and social capital they bring.

Second, while it’s unquestionably true that Millennials haven’t mimicked Boomers’ interest in the family track, it’s not clear this disdain is permanent. Recent research suggests that millennials may not be rejecting things like “household formation” so much as merely delaying them, thanks in part to the recession. As Phil Orlando, chief equity strategist at Federated Investors, told Reuters last year, “Now that the economy is starting to improve for [millennials], household formations have literally gone vertical.” Research by economist Jed Kolko, formerly of Trulia.com, has found that millennials’ preferences for urban over suburban actually tops out in their mid- to late 20s, then gradually declines as millennials hit their thirties and start coupling up—and thinking about families.

Exactly how this latent yearning for the suburbs might play out in Seattle's downtown high-rise market isn't yet clear. But the data do suggest that the downtown picture is shifting. For example, the decades-long trend toward single-life in downtown Seattle may have actually peaked a few years ago. According to Census data, the percentage of single-occupant rentals in four of five downtown zip codes fell by between two and six percent from 2011 to 2014. Even the outlier, Belltown, saw an increase in single-occupant rentals of less than one percent.

This shift away from single-dom may be relatively modest, but it fits with anecdotal accounts. Although young newcomers continue to pour into downtown to be near work and urban attractions, real estate agents are also keenly aware of how newcomers' sentiments shift with age. "When they're in their twenties and single, they're chasing after that downtown lifestyle," O'Connor says. "But five years later, they've partnered up, and what will they want to do?"

Certainly, some of these aging Millennials are trying to form households downtown, according to statistics from the Downtown Seattle Association. But one could also make a pretty good case that a millennial downtowner who is considering "household formation" — or starting a family — might also decide to leave downtown entirely. Although downtown Seattle has a relatively large number of apartment units with two or more bedrooms, that supply likely isn't keeping up with the supply of smaller units. And downtown has a serious shortage of other amenities important to families, including parks and a downtown elementary school.

What's more, millennials who are tired of paying rent now struggle to find opportunities to buy downtown. Thanks in part to a recently enacted state liability law, which makes it easier to sue condo developers for construction problems, fewer developers are willing risk a condo project downtown, which translates into fewer opportunities to buy. Lawmakers may be persuaded to revisit the law — and, tellingly, many of the new high-rise apartments have been finished to condo standards, in case the law is changed. But in the meantime, only a handful of the new high-rise projects downtown are condos. That suggests that the percentage of downtowners who rent (currently 80 percent, or twice the citywide rate, according to the Downtown Seattle Association) isn't like to change soon.

The lack of condos, parks, and schools downtown isn't something Seattle will solve overnight. Yet until the city finds a way to supply the amenities important to the "demographic middle", aging millennials will likely feel the lure of the neighborhoods and suburbs. And presumably, this temptation will only intensify once the long-awaited transit projects start making commuting easier.

"Light rail will be a game-changer," says O'Connor. "It'll be like, 'I can move to a house or a cheaper apartment in Northgate and I can still walk to the station and be downtown in six minutes."

This isn't to suggest that downtown will soon be full of empty "ghost" towers, as it was when the building market tanked in the 1980s: assuming that Amazon and other big downtown employers can keep creating jobs, many of those leaving the downtown will be replaced by a fresh crop of young millennials and, to a lesser extent, empty nesters.

But the departures of aging millennials do pose challenges. Without the prospect of a demographic middle, developers will continue to lean heavily on the studios and one-bedroom units they know they can lease today, thereby resulting in a downtown housing sector that the demographic middle will find even less attractive tomorrow.

By betting so heavily on a fairly narrow demographic, developers run the risk of substantially overshooting the mark.

Several real estate insiders I've spoken to worry that without some means to retain more of the demographic middle, this burgeoning supply of rental units engineered for singles may ultimately exceed the demand. Even if Seattle's tech boom remains strong, says one banker who works closely with developers, it's not clear that the arrival of fresh millennials alone can produce "the quantum of people necessary to fill up a bunch of these buildings. I'm not sure that in this particular city, just because we've filled up four or five high rises, we can fill up forty more."

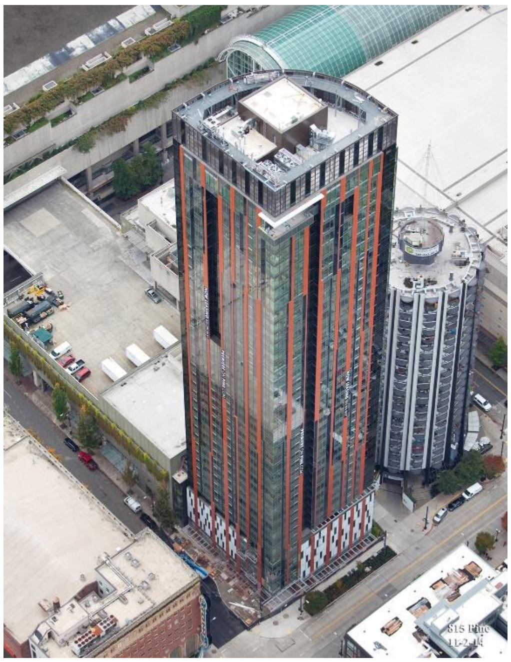
Although many observers expect some sort of correction in the Seattle high-rise sector, the timing and severity are anyone's guess.

Some would argue that this concern is already percolating through the city's apartment market. Rents in Seattle have flattened somewhat, and vacancy rates have climbed. Some players have begun exiting the game. Vulcan, one of the biggest developers in the area, sold off three apartment complexes last year, including a 274-unit building in South Lake Union. Others are buying up apartment buildings in areas well outside the urban core.

And investors' returns are falling. Construction costs are now rising so much faster than rents, O'Connor says, that, "we're starting to see deals where value and cost are almost equal."

For that reason, there is a mounting anxiety among developers to get projects done as fast as possible, "while there's still demand," says Dennis Meier, with Seattle Department of Planning and Development. Daniels, the developer, puts it more bluntly: "I see, in my personal opinion, a higher possibility of overbuilding in the apartment sector in downtown, especially in South Lake Union, than I have seen there since the whole concept of South Lake Union was created 15 years ago."

Developers are always in a race — against costs, against other developers, against the changing demographics, and the dreaded end of the building "cycle". But in this cycle, the race has been made even more intense by the eagerness of outside investors who, to paraphrase Richard Gere in "An Officer and a Gentleman," have nowhere else to go. Because stocks and other traditional assets are doing so poorly, big investors have been willing to keep making big bets on high-rise projects even as costs rise and returns slip.



The extreme example are investors from China, where the Shanghai stock market lost more than half its value since June of last year, and who have been willing to invest in American real estate projects that promise only small returns, or no returns at all.

But even big institutionals have been willing to bet on real-estate projects with prospective returns that would have been unacceptable earlier in the boom. Given the way that the availability of capital can act as a powerful inducement for developers, investors' willingness might be extending the boom past where it otherwise would have already tapered off. As a Seattle financial consultant with close ties to the development sector told me, "So whereas that same development a year ago might never have gotten built, now it is getting built, and ten others like it, because that capital that before wasn't willing to invest there, is now willing to invest there."

Although many observers expect some sort of correction in the Seattle high-rise sector, the timing and severity are anyone's guess. The correction might be so modest that most of Seattle doesn't really notice. Or it might be deep enough that late-arriving buildings get sold at a loss—and ambitious projects still on the drawing board simply melt away. Certainly, more than a few Seattle insiders wonder whether Sonny Kahn is getting cold feet about his own monumental project.

Still, even a brief break in the downtown building race might have at least one upside — at least, for those worried about the direction of the downtown demographics. Some might see it as a moment to lobby state lawmakers to rewrite condo regulations. Or redouble efforts to build a downtown elementary or K-8. Were the Seattle School District serious about buying property downtown for a school, it might find a bargain or two during a correction.

Whether these sorts of fixes are possible is hardly clear. What is, however, is that without some sort of pause in the downtown boom, it's hard to see how Seattle can address the mismatch between the city many want, and the one the market seems determined to build.