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BENCHMARKS DC

TRENDS IN WASHINGTON METRO AREA COMMERCIAL REAL ESTATE

NOVEMBER 14, 2018

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HEADLINES

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1. A National Recession is Coming… What Will Trigger it and When?
2. The Regional Economy is More Diversified and Gaining Momentum
3. The Office Market is Making a Comeback; So is Production! It is a Matter of Finding Niches.
4. Multihousing Performing Well Despite Record Production; Increasingly a Challenge to Compete
5. Investment Sales Volume is Holding Up; Prices Continue to Rise

A NATIONAL RECESSION IS COMING…

WHAT WILL TRIGGER IT AND WHEN?

U.S. ANNUAL PAYROLL JOB CHANGE

1990 - 2018

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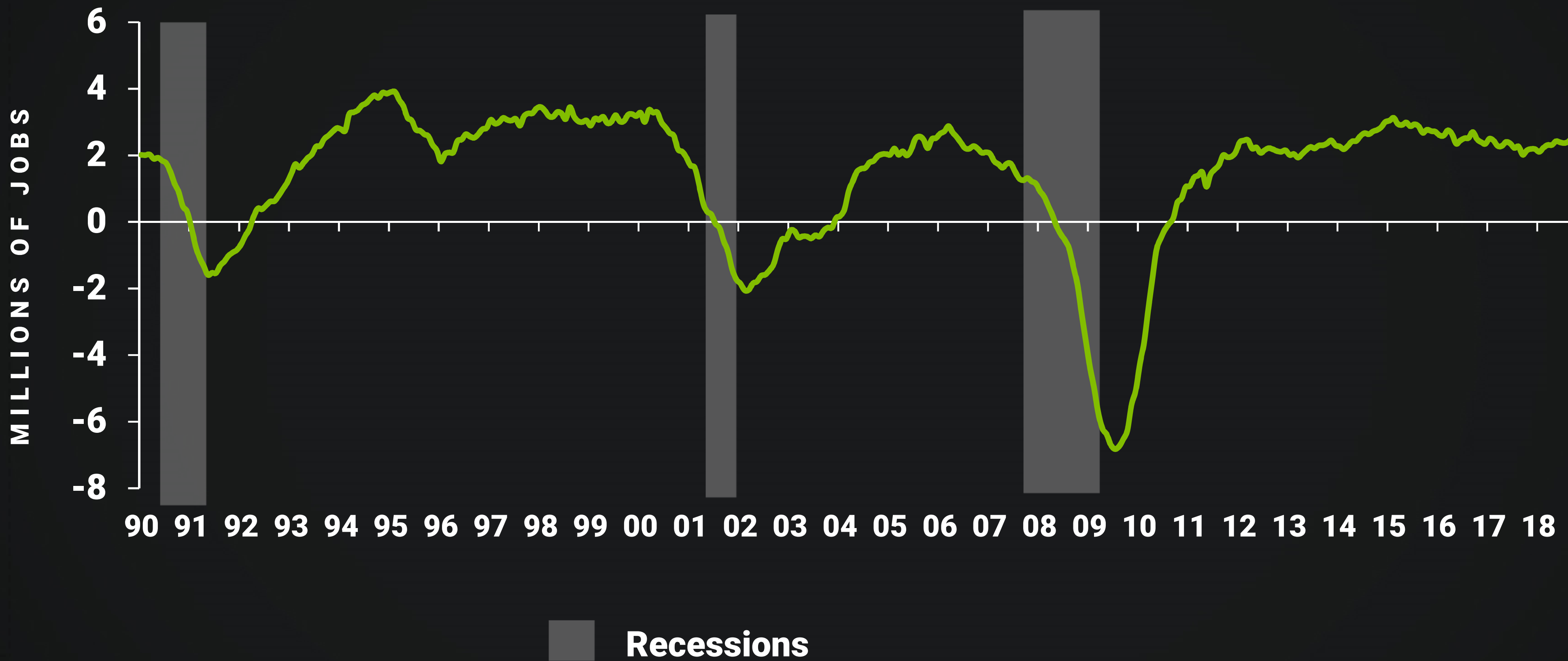

Source: U.S. Bureau of Labor Statistics, National Bureau of Economic Research, NKF Research; November 2018

CAUSES OF RECESSIONS
UNITED STATES

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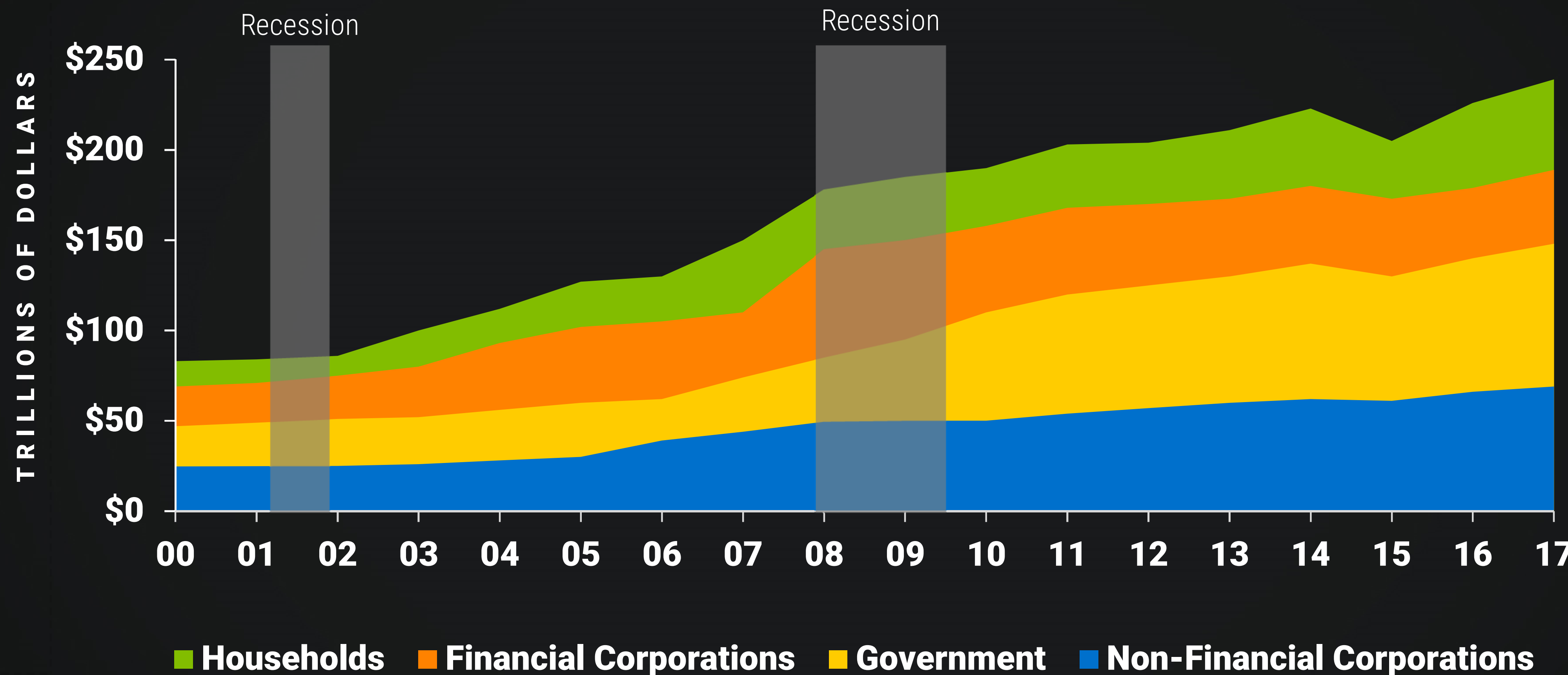
- Hyper-inflation
- Sharp rise in interest rates
- Financial or liquidity crisis
- Global crisis or war
- A cluster of entrepreneurial errors
- Trade war and barriers
- Lack of productivity gains
- Unsustainable debt levels

Source: NKF Research; November 2018

GLOBAL DEBT HAS HIT A RECORD

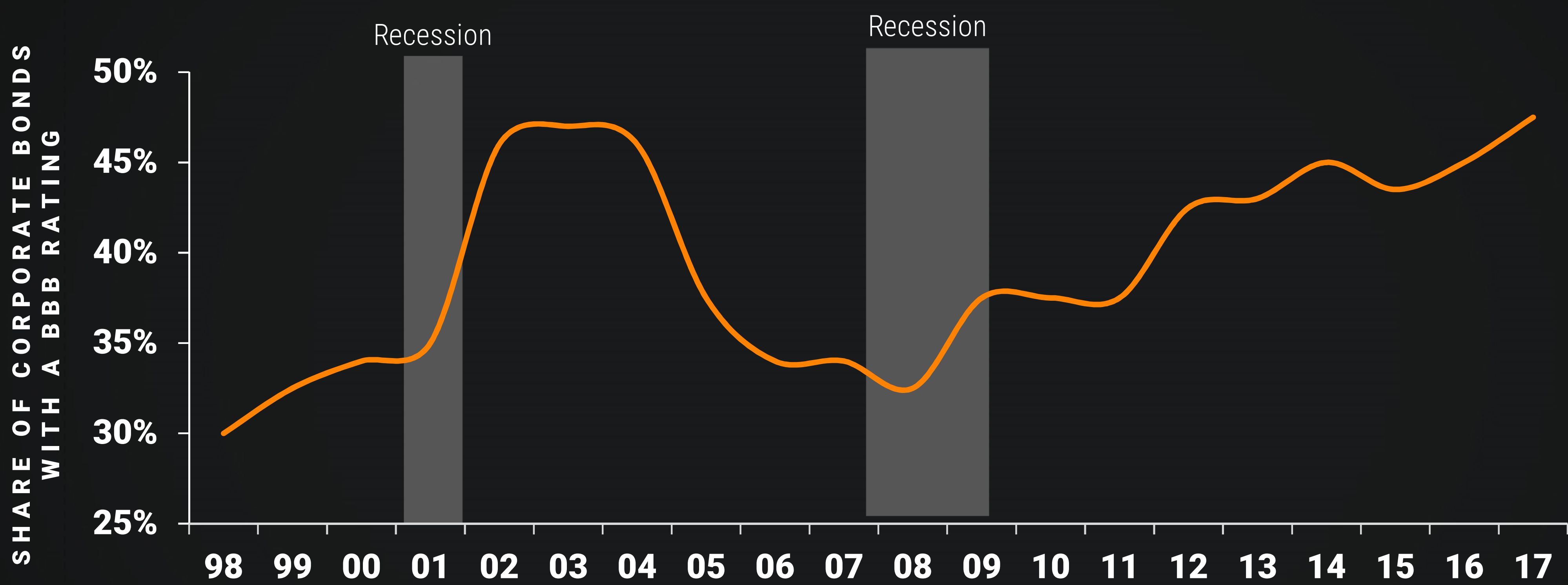
2000 - 2017



Source: Institute of International Finance, The Washington Post, NKF Research; November 2018

U.S. RISKY DEBT AT RECORD LEVELS

1998 - 2017



Note: Share of corporate bonds with a BBB rating: the lowest investment grade before junk
Source: Moody's Credit Rating Service, NKF Research; November 2018

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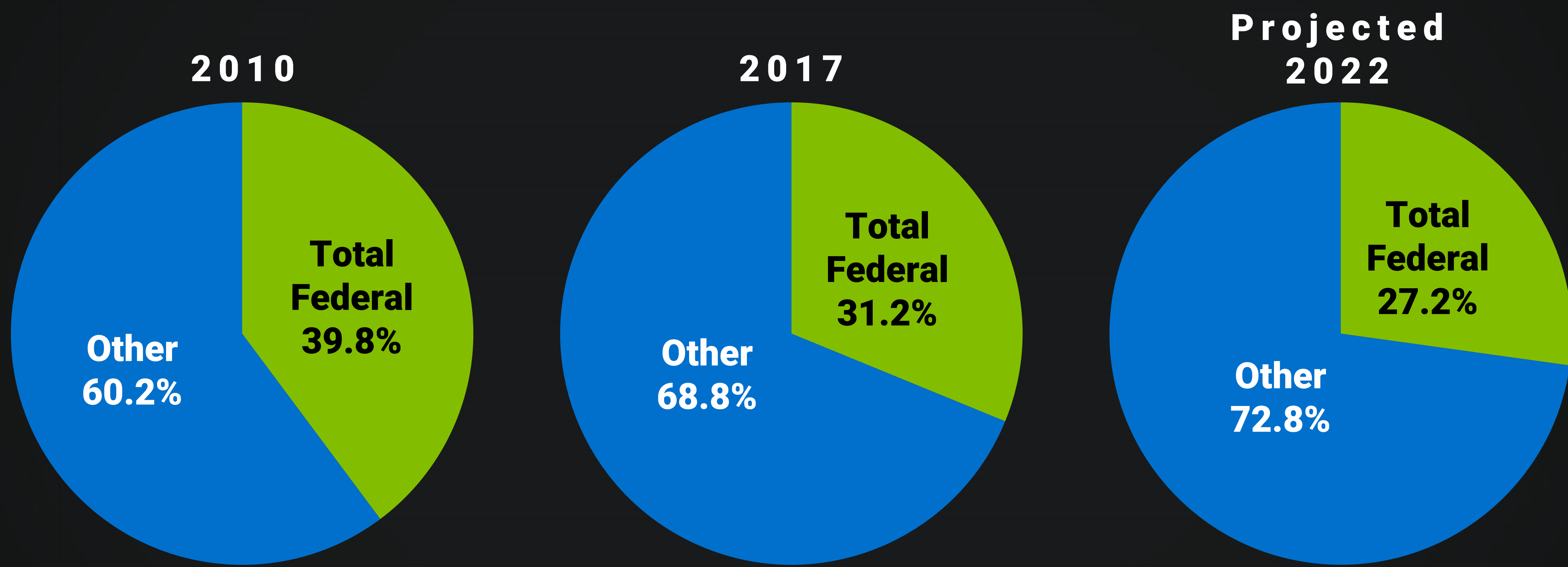
THE REGIONAL ECONOMY IS MORE DIVERSIFIED AND GAINING MOMENTUM

REGIONAL ECONOMY DIVERSIFYING

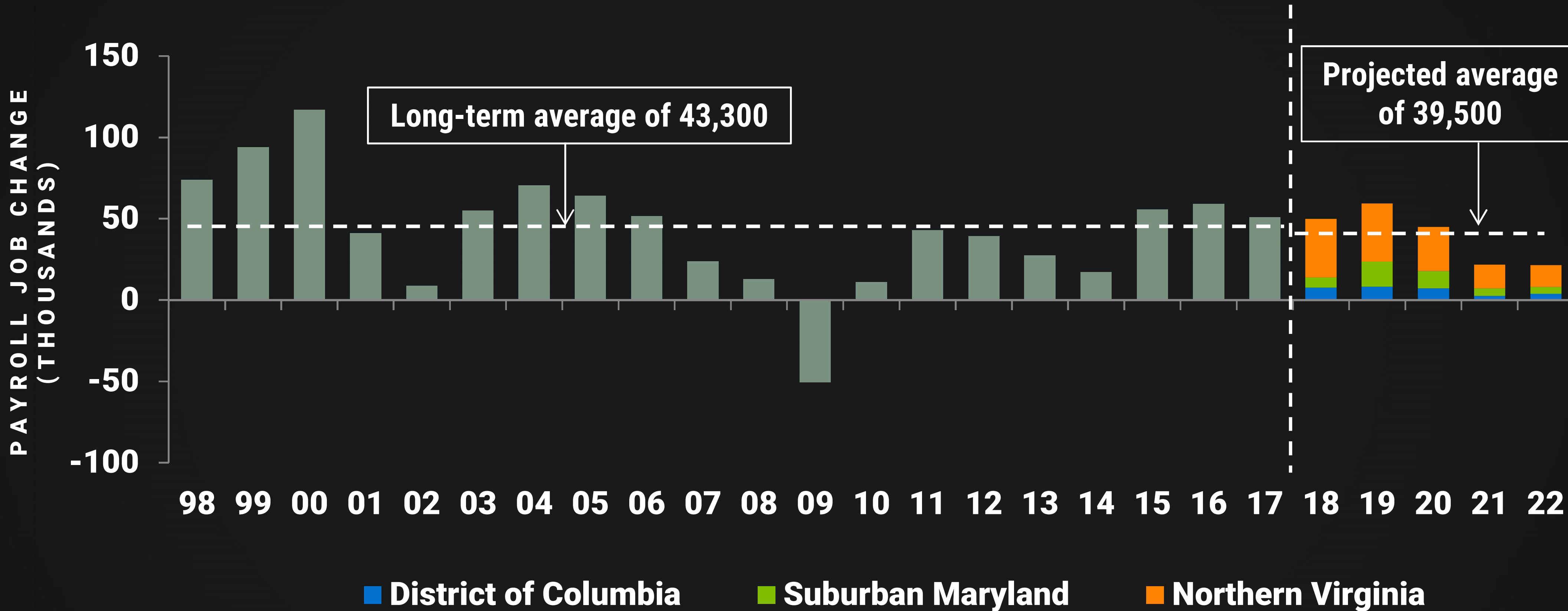
FEDERAL SHARE OF REGIONAL ECONOMY: 2010 VS. 2017 VS. 2022



Source: Stephen S. Fuller Institute, NKF Research; November 2018

JOB GROWTH PROJECTED TO CONTINUE

PAYROLL JOB CHANGE: WASHINGTON METRO AREA | 1998 - 2022



Source: U.S. Bureau of Labor Statistics, The Stephen S. Fuller Institute, NKF Research; November 2018

JOB GROWTH CREATES OFFICE AND APARTMENT DEMAND

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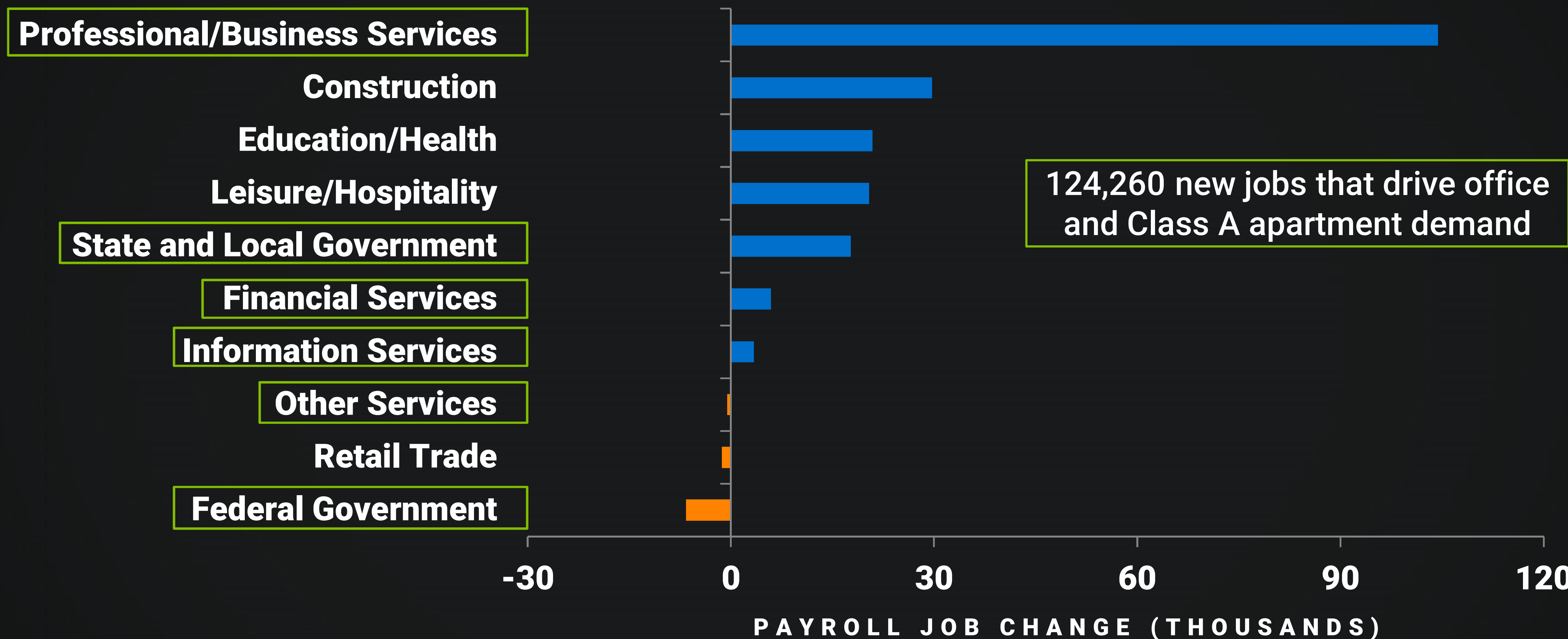
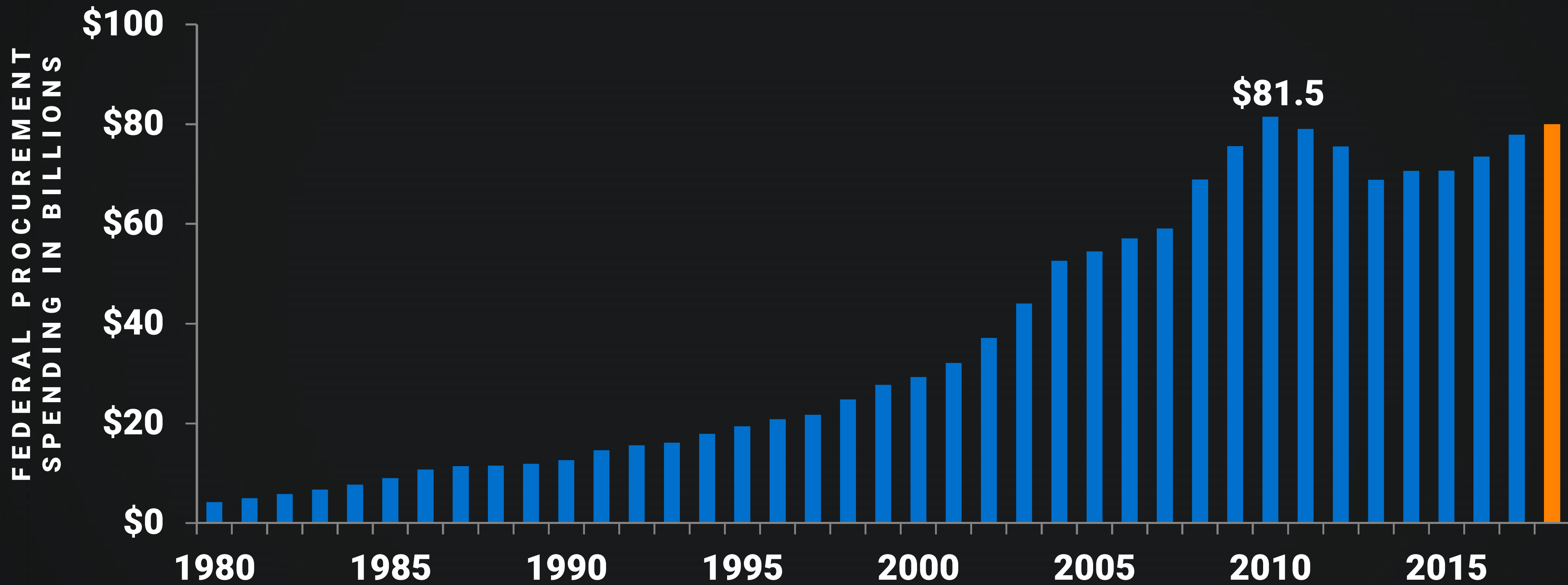
2018-2022 PROJECTED PAYROLL JOB CHANGE: WASHINGTON METRO PRINCIPAL SECTORS



Source: The Stephen S. Fuller Institute, NKF Research; November 2018

FACTOR #1 TO WATCH: FEDERAL PROCUREMENT
WASHINGTON METRO AREA: 1980 - 2018



Source: U.S. Census, Consolidated Federal Funds Report and USAspending.gov, The Stephen S. Fuller Institute, NKF Research; November 2018

FACTOR #2 TO WATCH: LEADING INDEX

WASHINGTON METRO AREA LEADING ECONOMIC INDEX: 1998 - 2018

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Note: 2015 = 100
Source: The Stephen S. Fuller Institute, NKF Research; November 2018

AMAZON HQ2

Source: Amazon, NKF Research; November 2018

THE OFFICE MARKET IS MAKING A COMEBACK; SO IS PRODUCTION!

IT IS A MATTER OF FINDING NICHES.

NEW SUPPLY TO OUTSTRIP DEMAND EXCEPT IN NOVA

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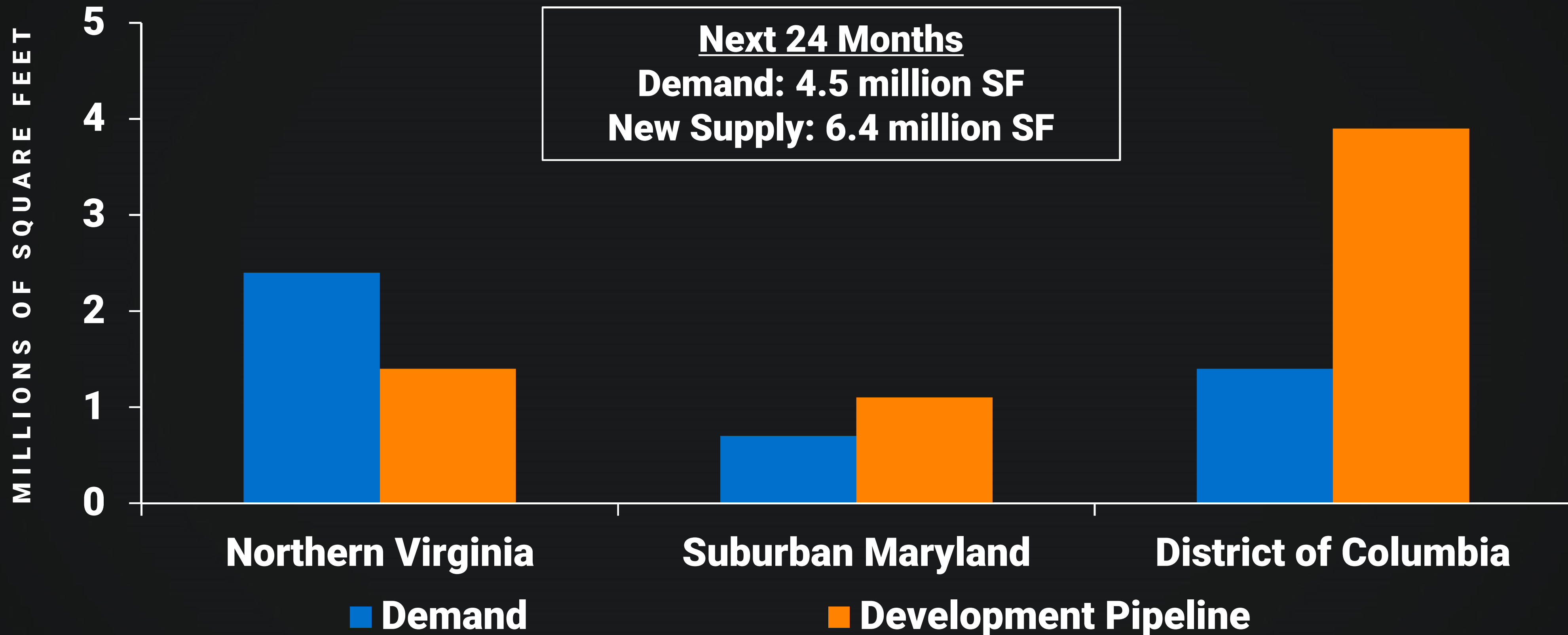
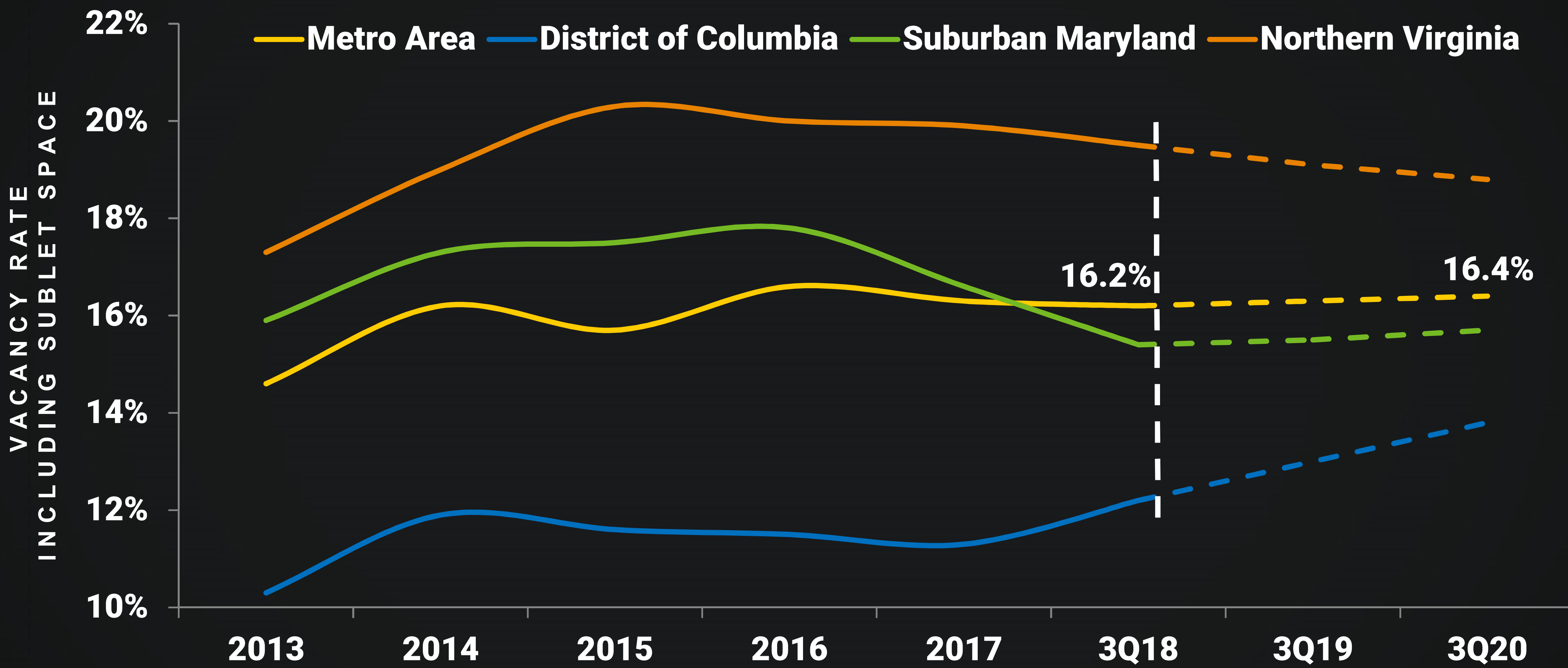
OFFICE MARKET SUPPLY/DEMAND FORECAST | 24 MONTHS ENDING 3Q 2020



Source: NKF Research; November 2018

WASHINGTON METRO VACANCY REMAINS ELEVATED

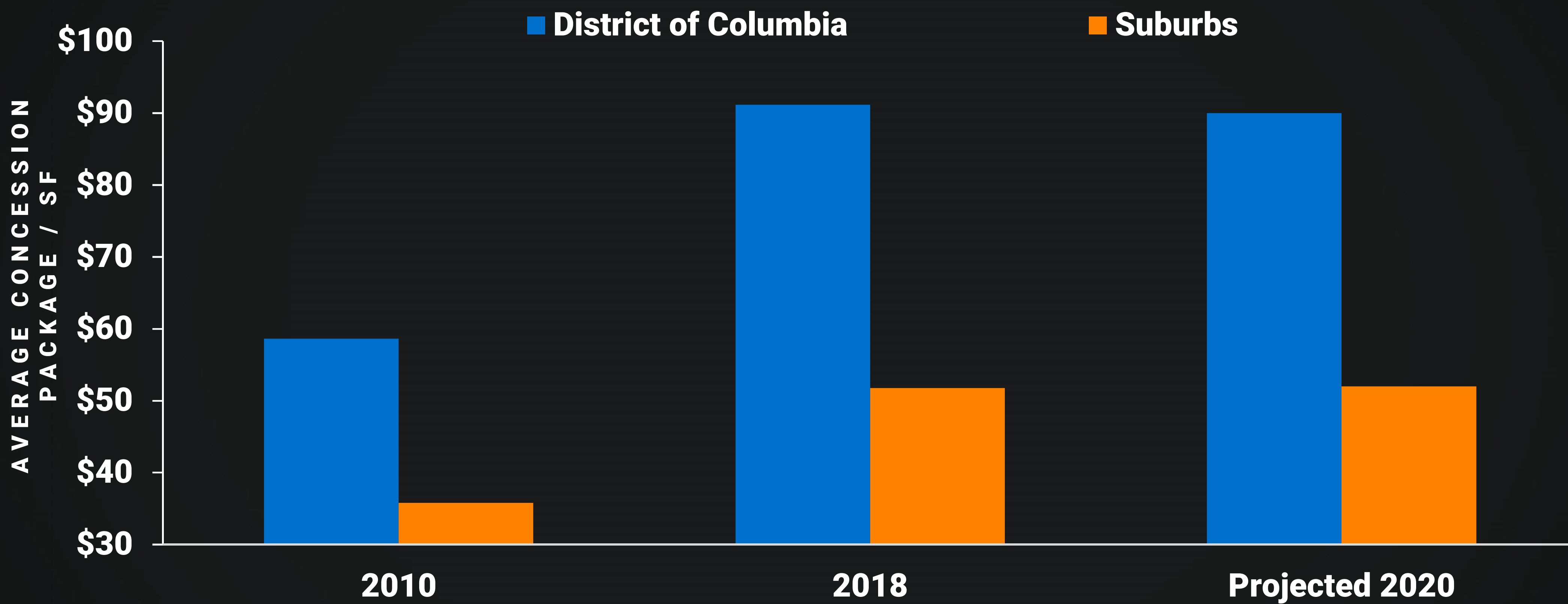
OFFICE VACANCY RATE 2013 – 3Q18 AND PROJECTIONS THROUGH 3Q20



Source: NKF Research; November 2018

TENANTS' MARKET CONTINUES IN WASHINGTON

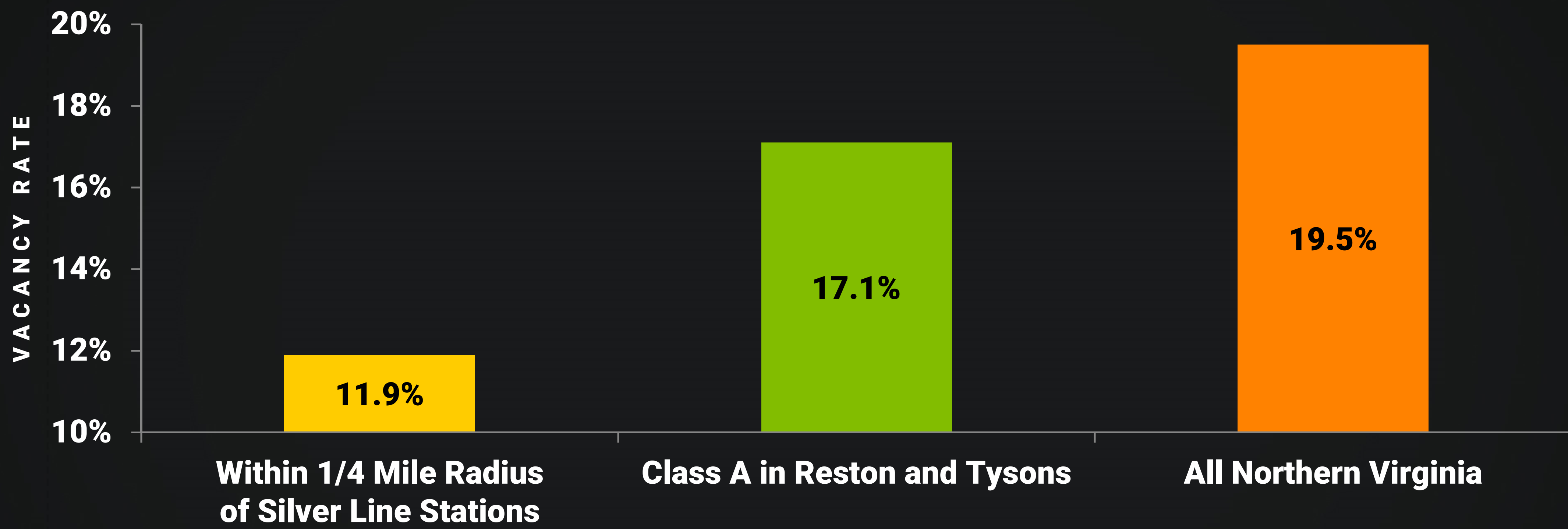
RISING OFFICE CONCESSIONS LEAD TO FLAT EFFECTIVE RENTS



Source: NKF Research; November 2018

OPPORTUNITY: METRO-ADJACENT OUTPERFORMING

OFFICE VACANCY RATE: NORTHERN VIRGINIA 3Q 2018



Source: CoStar, NKF Research; November 2018

OPPORTUNITY: DISTRICT CLASS B OFFICE

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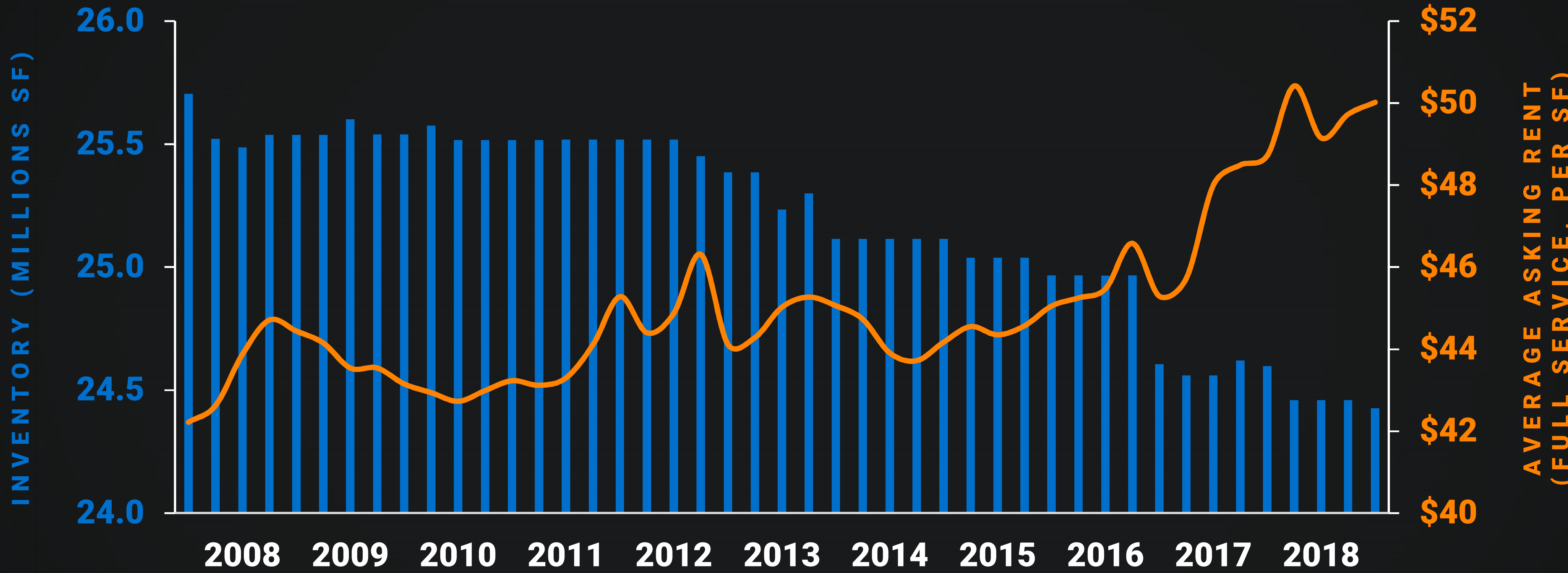
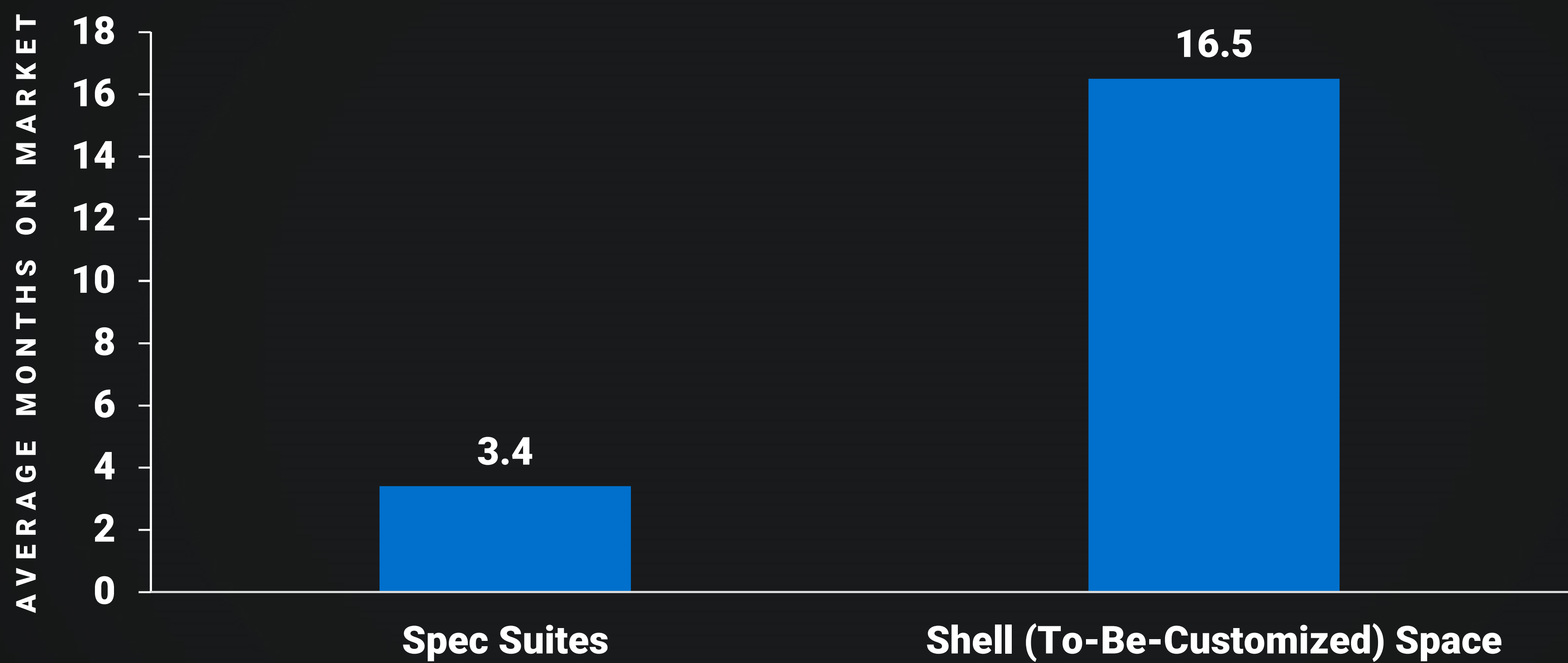
INVENTORY AND ASKING RENT: CBD AND EAST END CLASS B OFFICE



Source: NKF Research; November 2018

OPPORTUNITY: SPEC SUITES

TIME ON MARKET COMPARISON: SPEC SUITES VS. CUSTOMIZED SPACE



Note: Includes District of Columbia office spaces 7,500 SF and smaller from 2015-2018
Source: CoStar, NKF Research; November 2018

MULTIHOUSING PERFORMING WELL DESPITE RECORD PRODUCTION; INCREASINGLY A CHALLENGE TO COMPETE

MULTIHOUSING DEMAND AND DELIVERY PROJECTIONS

WASHINGTON METRO AREA | 4Q 2018 – 3Q 2021

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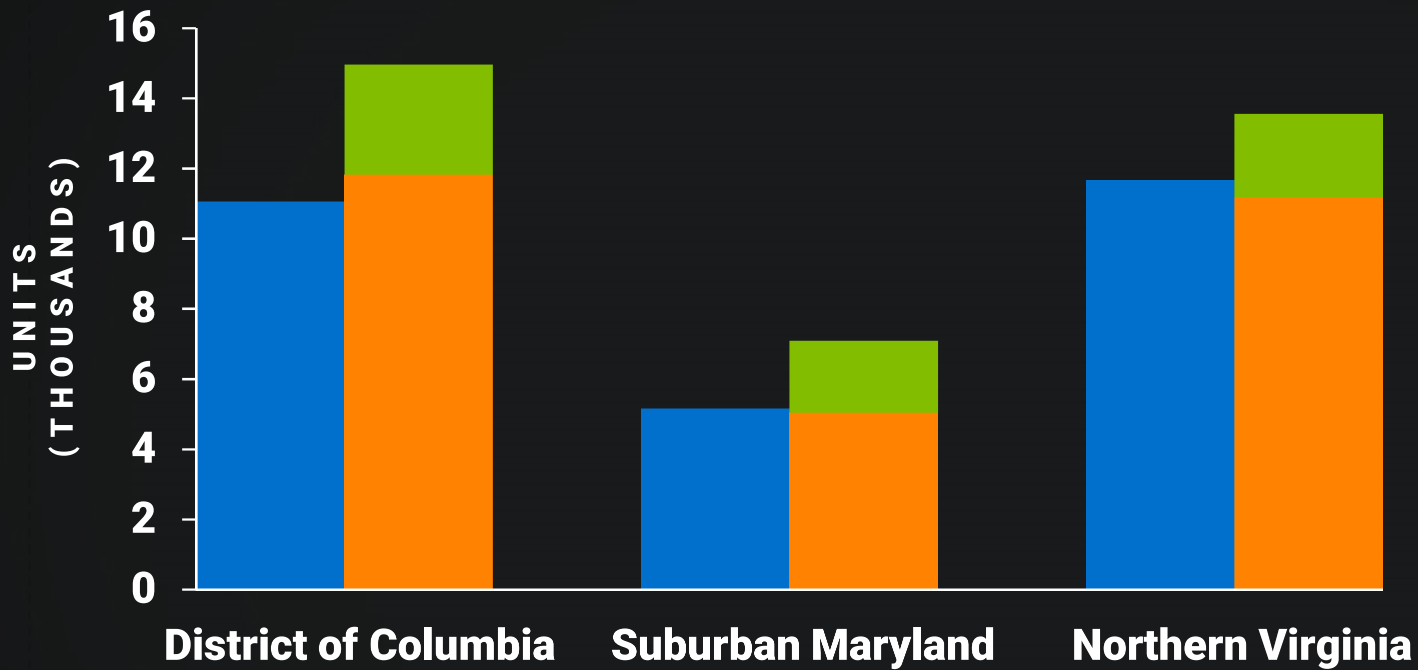


Demand

Net Absorption:
9,295 units/year = 27,884 units

Deliveries

Planned and may deliver by 9/21: 7,568 units

Under construction: 28,058 units

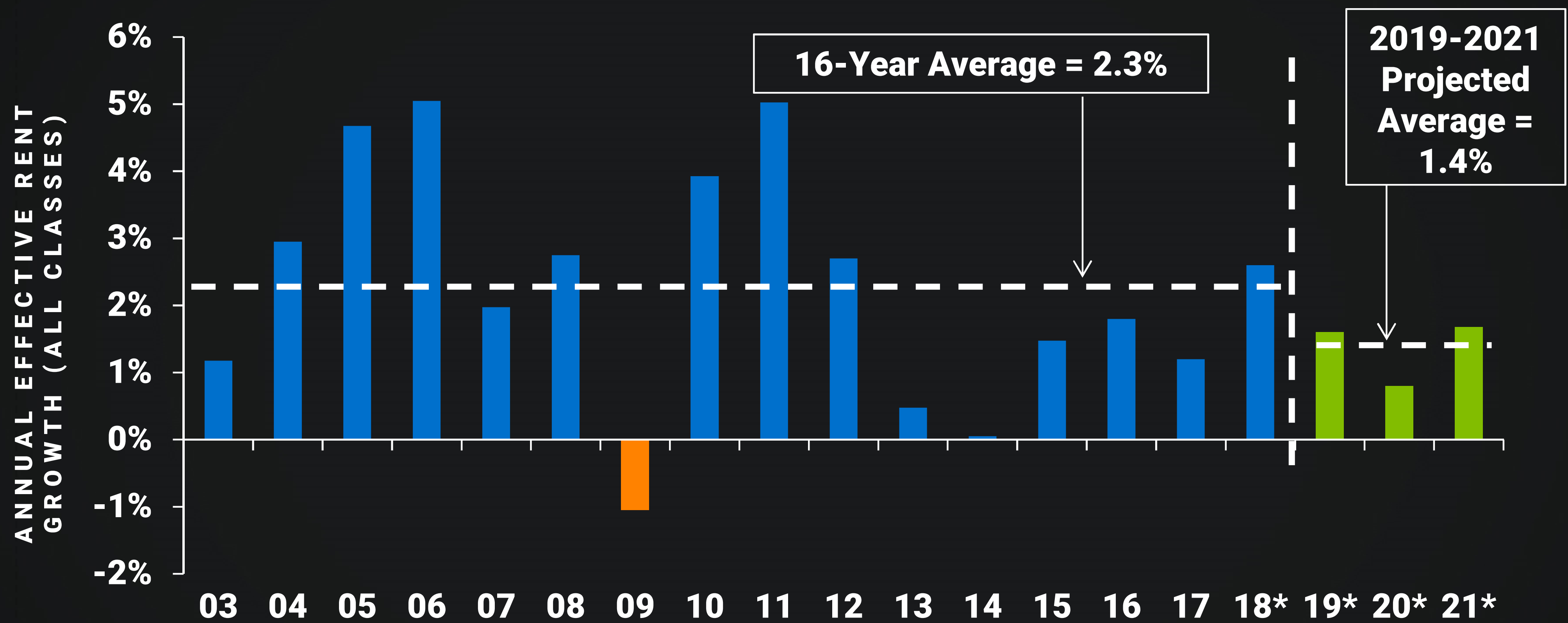
Total = 35,626 units

Occupancy at:	District of Columbia	Suburban Maryland	Northern Virginia	Metro
3Q 2018	96.2%	95.6%	96.1%	95.9%
3Q 2021	92.2%	94.7%	95.4%	94.5%

Source: Axiometrics, NKF Research; November 2018

ANNUAL EFFECTIVE RENT GROWTH

WASHINGTON METRO AREA MULTIHOUSING MARKET | 2003 - 2021



*12 months ending third quarter
Source: Axiometrics, NKF Research; November 2018

MULTIHOUSING RENT GROWTH POTENTIAL

NKF RANKING OF POTENTIAL FOR RENT GROWTH OVER THE NEXT TWO YEARS

■ District of Columbia ■ Suburban Maryland ■ Northern Virginia

STRONGEST RENT GROWTH POTENTIAL

1.	Frederick	10.	Southeast DC
2.	Landover/ Bowie	11.	Loudoun County
3.	South Prince George's County/ St. Charles	T-12.	West Alexandria
4.	Laurel/ Beltsville	T-12.	Reston/ Herndon
5.	Fredericksburg/ Stafford	T-14.	Woodbridge/ Dale City
6.	Suitland/ District Heights/ Capitol Heights	T-14.	Hyattsville/ Riverdale
7.	Northeast Montgomery County	16.	Manassas/ Far Southwest Suburbs
8.	Seven Corners/ Bailey's Crossroads/ Annandale	17.	Wheaton/ Aspen Hill
9.	South Fairfax County	18.	Tysons Corner/ Falls Church/ Merrifield

WEAKEST RENT GROWTH POTENTIAL

T-19.	East Silver Spring/ Takoma Park/ Adelphi	T-27.	North Arlington
T-19.	Gaithersburg	29.	Northwest DC/ Georgetown/ Friendship Heights
21.	West Fairfax County	30.	Columbia Pike
22.	North Central DC/ Columbia Heights/ Petworth	31.	Bethesda/ Chevy Chase
23.	College Park/ Greenbelt	32.	Northeast DC/ NoMa/ H Street
24.	Crystal City/ Pentagon City	T-33.	Downtown Silver Spring
T-25.	Navy Yard/ Capitol Hill/ Southwest	T-33.	Central DC/ West End/ Shaw/ Mt. Vernon Triangle
T-25.	Rockville/ North Bethesda	35.	East Alexandria
T-27.	Germantown	36.	Central Alexandria

Based on:

1. Past absorption versus current pipeline (2x weighting)
2. Historic rent growth
3. Current versus historic occupancy
4. Past two years' job growth (county level)
5. Axiometrics projected two-year rent growth

Source: Axiometrics, U.S. Bureau of Labor Statistics, NKF Research; November 2018

WASHINGTON AREA MULTIHOUSING MARKET

WHERE IS THE "SMART MONEY" FINDING OPPORTUNITIES?

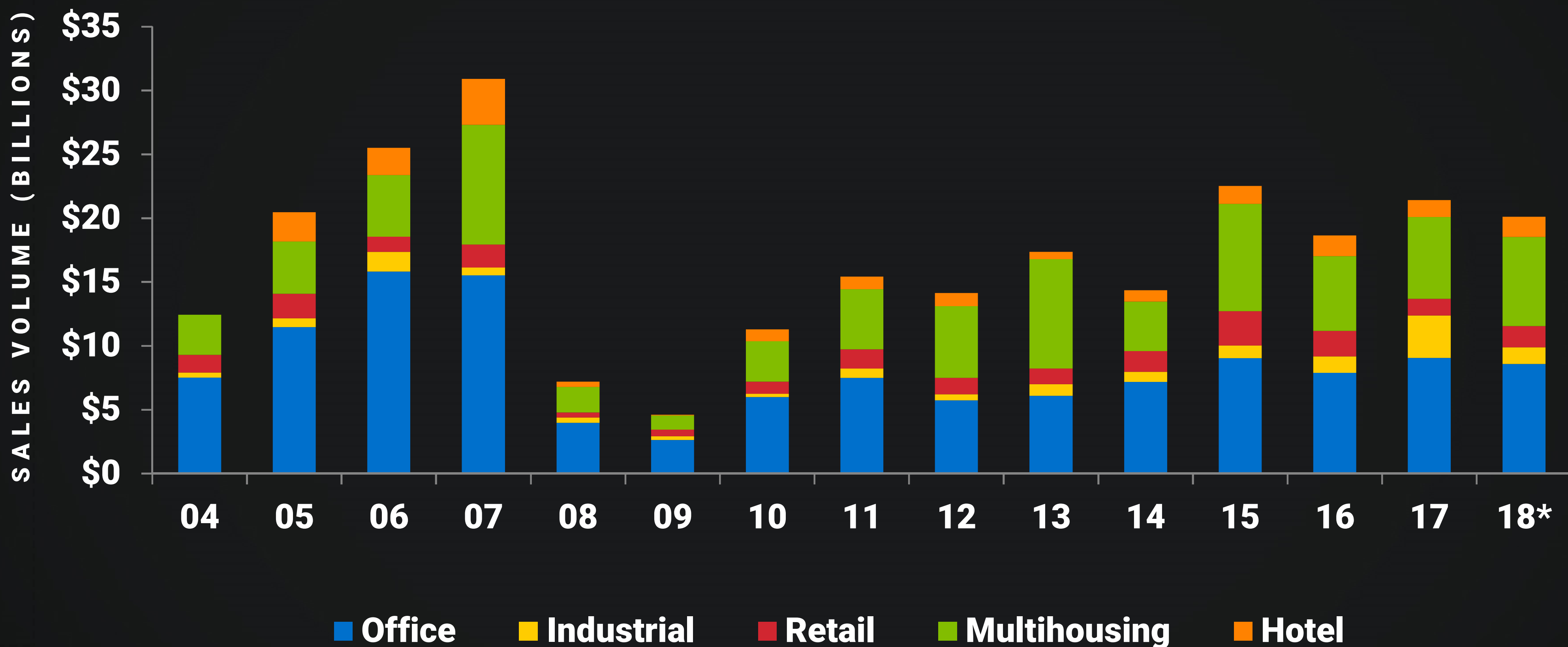
- Target submarkets with strongest rent growth potential
- More people are working from home—cater to those tenants
- If well-located, renovate Class C assets to B+
- Target empty nesters with larger units at locations they desire

Source: NKF Research; November 2018

INVESTMENT SALES VOLUME IS HOLDING UP; PRICES CONTINUE TO RISE

INVESTMENT SALES VOLUME REMAINS STEADY

WASHINGTON METRO INVESTMENT SALES VOLUME BY PROPERTY TYPE



*12 months ending 3Q 2018. Note: Includes transactions $10 million and larger. Hotel data not available for 2004.

Source: Data provided by Real Capital Analytics; Analysis by NKF Research; November 2018

WASHINGTON REMAINS INVESTMENT TARGET

WASHINGTON METRO AVERAGE CAP RATE: OFFICE AND MULTIHOUSING

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Cap Rates Today

	Office - Downtown	Office - Suburbs	Multihousing
Trophy	4.25%	5.50%	4.25%
Class A	4.50%	5.75%	4.75%
Class B	5.00%	7.00%	5.50%

Expected to increase 25 BPS over next 12 months

Source: NKF Research; November 2018

WASHINGTON AREA CAPITAL MARKETS

WHERE IS THE "SMART MONEY" FINDING OPPORTUNITIES?

- Buy well-located Class B office in the District and office in Northern Virginia, as that market recovers
- Buy well-located Class B multihousing in select suburban submarkets
- If a long-term holder, buy trophies if you can find them
- Although limited-scale inventory, look for opportunities in adaptive re-use, data centers, and industrial distribution
- Selectively search for yield in secondary markets

Source: NKF Research; November 2018

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