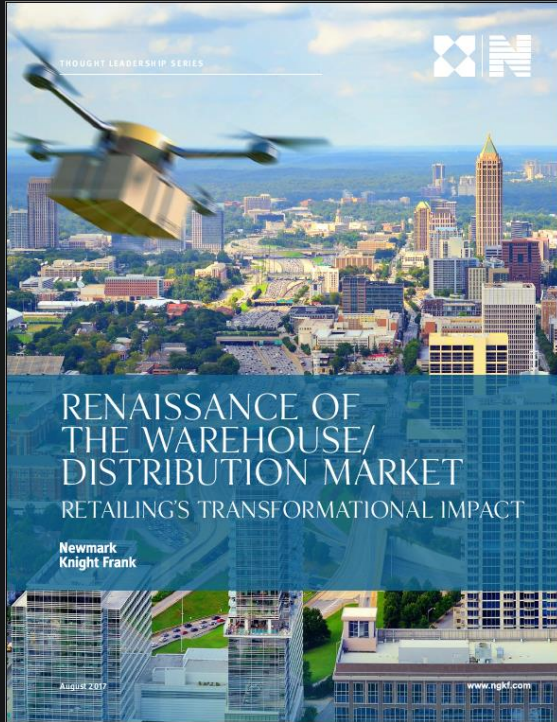




TRENDS IN WASHINGTON METRO AREA COMMERCIAL REAL ESTATE

NOVEMBER 9, 2017





NGKF.com

STATE OF THE INDUSTRY

U.S. Headlines of 2017

1. U. S. economic expansion continues sturdy in spite of geo-political and weather shocks; however, consensus of economists is the next recession, likely shallow, will be in +/- 2019.
2. In the meantime, wage growth is challenged while unemployment reaches new lows, creating some labor market shortages which are not aided by immigration turmoil.
3. Leasing metrics have peaked for this cycle across nearly all property types in most markets; industrial is an exception, benefitting from the transformative impact of retailing.
4. Commercial real estate sales appear to have peaked for this cycle; however, due to abundant capital, volume and pricing remain high, especially for trophy properties.
5. Commercial real estate returns (excluding industrial) continue to edge lower, but are still a better alternative to other asset classes.
6. Challenges for 2018:
 - Geopolitical: North Korea, Iran, Isolationism
 - Economic: Interest rate hikes, low productivity, high P/E ratio



BENCH  **MARKS** DC

WASHINGTON AREA MEGATRENDS

A SELECTION OF PAST WASHINGTON MEGATRENDS

- Sequestration / Federal Government Right-Sizing
- Private Sector Growth and Diversification
- Tenant Flight to Quality
- Office Tenant Densification
- A More Competitive Office Marketplace
- Demographic Shifts Impacting the Apartment Market
- Commercial Real Estate is Now an Experience, Not Just a Location
- Accelerating Office Obsolescence
- Lagging Worker Productivity
- Transformation of Retailing
- Commercial Real Estate Investor Thirst for Yield
- Recovery of the Regional Economy

MEGATRENDS 2017 / 2018

Please Download our Recent White Paper



MegaTrend #1: The regional economy continues to expand but at a decelerated pace.

MegaTrend #2: Investment capital is growing more cautious but there is a continued focus on Washington.

MegaTrend #3: The sharing economy both benefits and disrupts our marketplace.

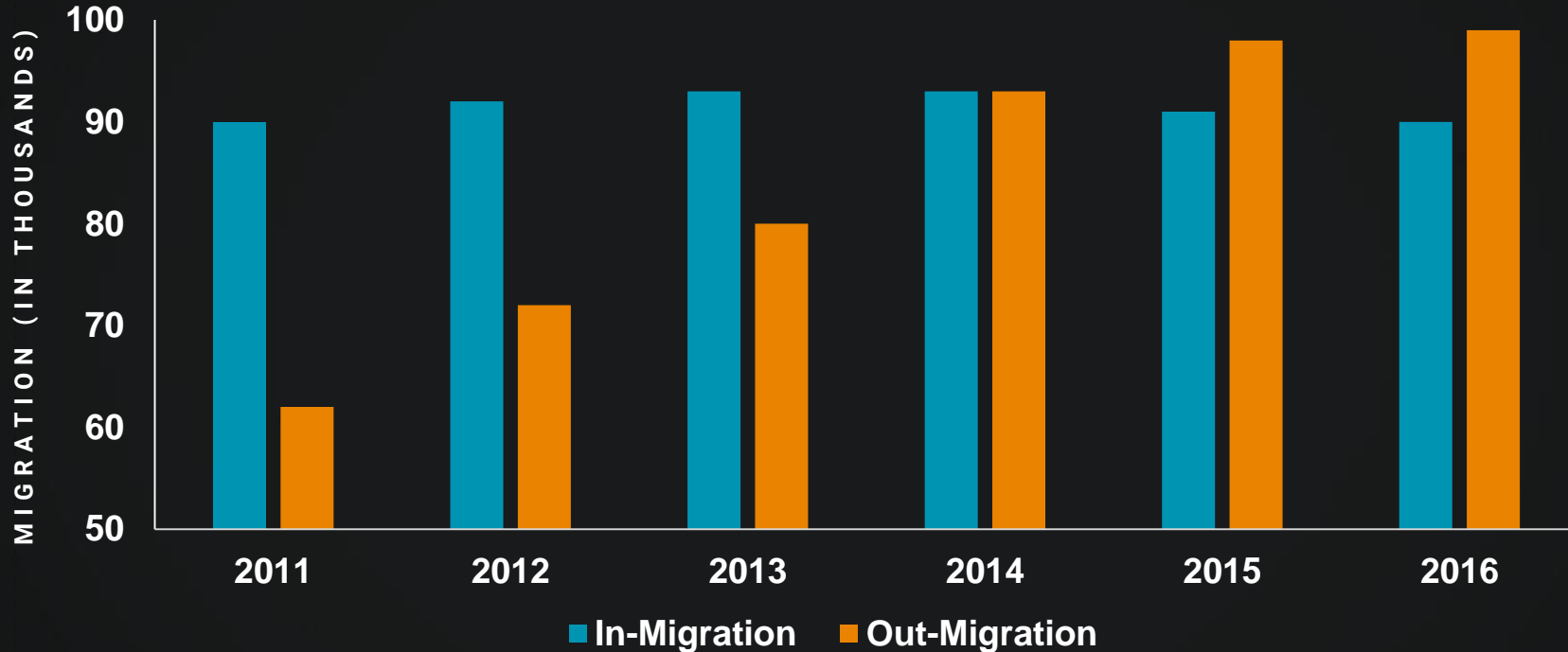
MegaTrend #4: The Trump Administration's policies have had a modest effect on Washington area commercial real estate – so far.

MegaTrend #5: Commodity Class A office space will remain oversupplied for several more years.

MegaTrend #6: We are experiencing a net out-migration of millennials

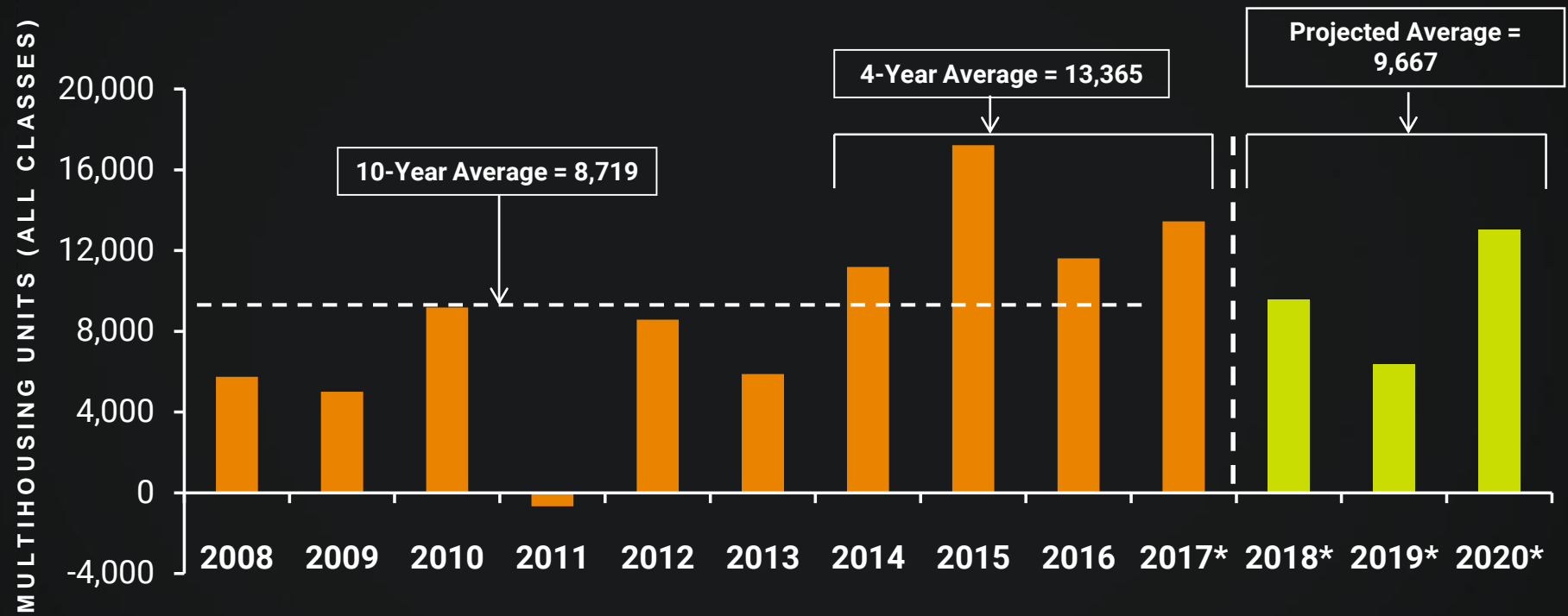
2017 / 2018 MEGATREND: MILLENNIAL MIGRATION

Movers to/from the Washington Metro Area Aged 25-34 Years Old



ANNUAL MULTIHOUSING ABSORPTION

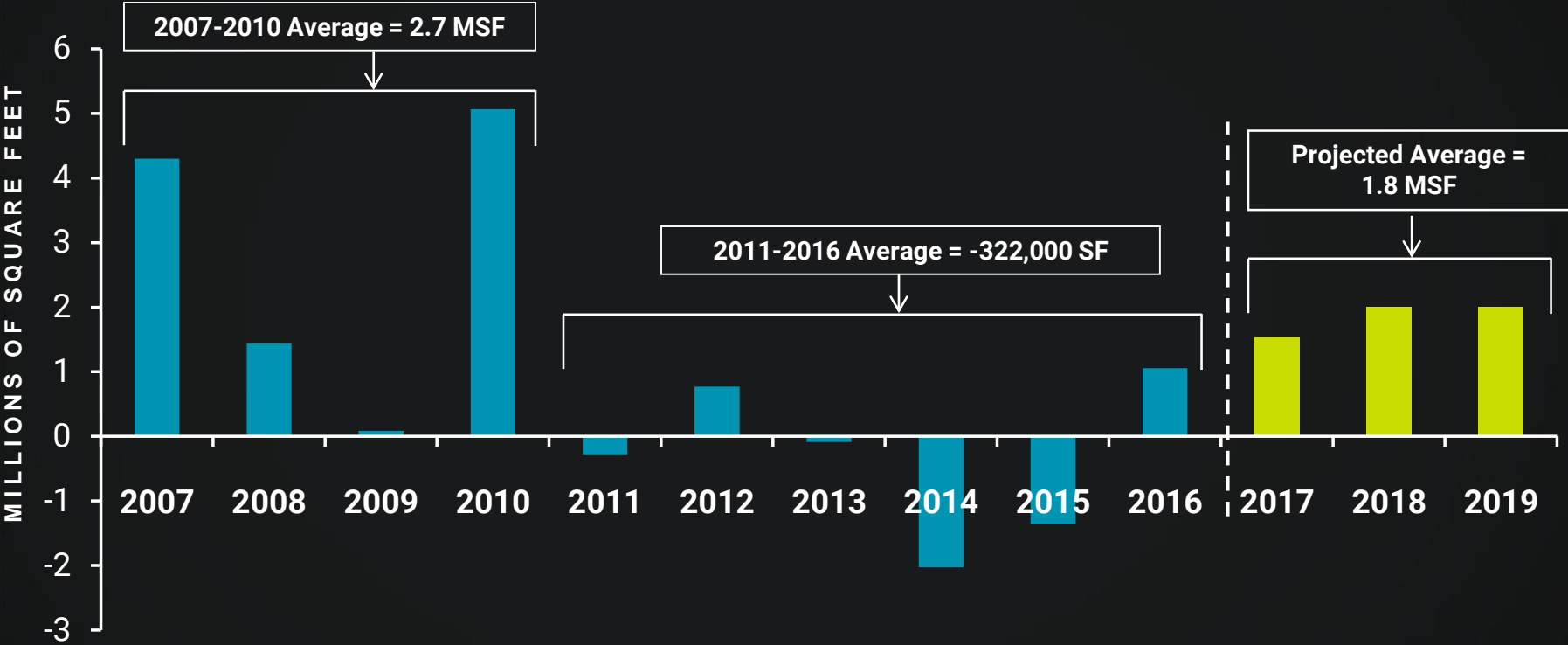
Washington Metro Area: All Classes



*12 months ending September
Source: Axiometrics, NKF Research; November 2017

ANNUAL OFFICE NET ABSORPTION

Washington Metro Area: All Classes



THE WASHINGTON AREA OFFICE MARKET

What is Driving Demand?

1. Job growth in office-using sectors
2. Plateauing of densification
3. Shadow space and sublet space have declined to near cyclical lows



BENCH  **MARKS** DC

REGIONAL HEADLINES

REGIONAL HEADLINES

The State of the Economy and Our Industry

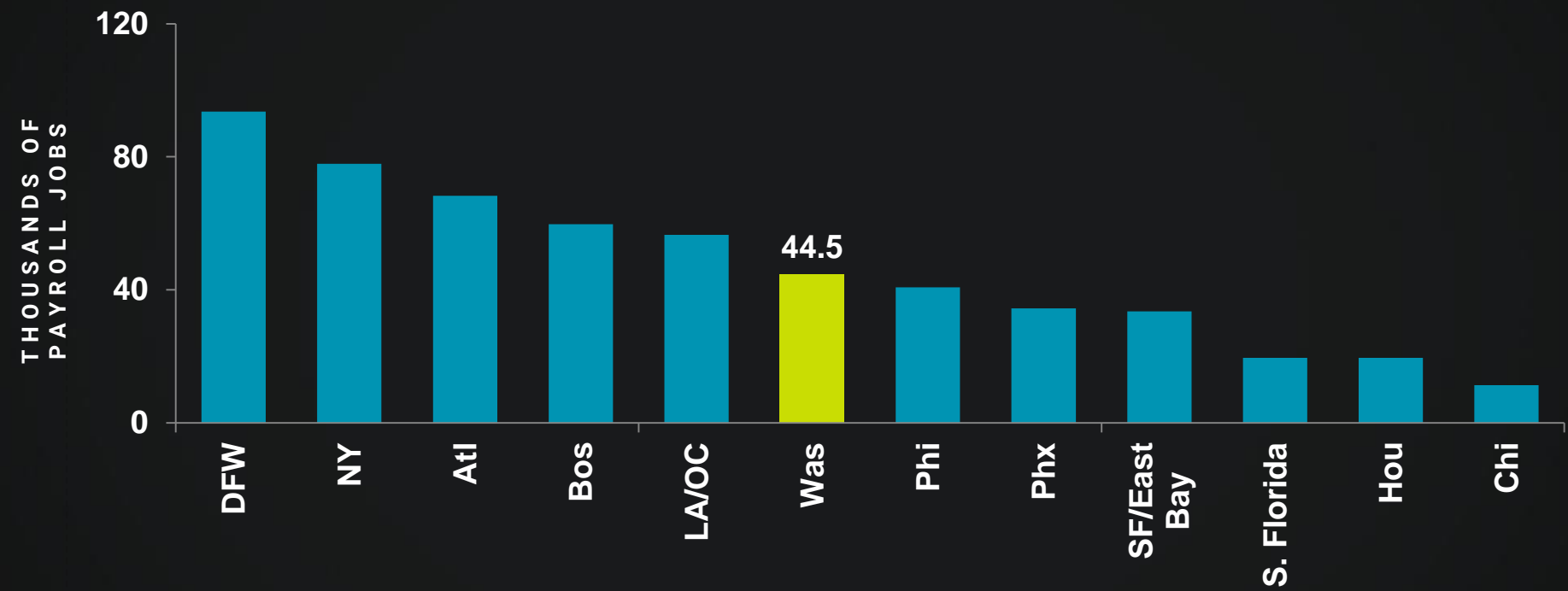
1. The regional economy has gained strength, and will likely outperform the nation over the next 5 years.
2. Office leasing demand is slowly rising, but supply may be rising faster. Investors must find niches.
3. The multihousing market is fully stocked. Demand will continue at robust levels, but insufficient to avoid a very competitive marketplace.
4. The investment sales market is in the midst of a prolonged cycle; expect a rounder peak and shallower valley.



**REGIONAL ECONOMY WILL OUTPERFORM THE NATION
OVER THE NEXT 5 YEARS**

PAYROLL JOB GROWTH – LARGEST METRO AREAS

12 Months Ending September 2017

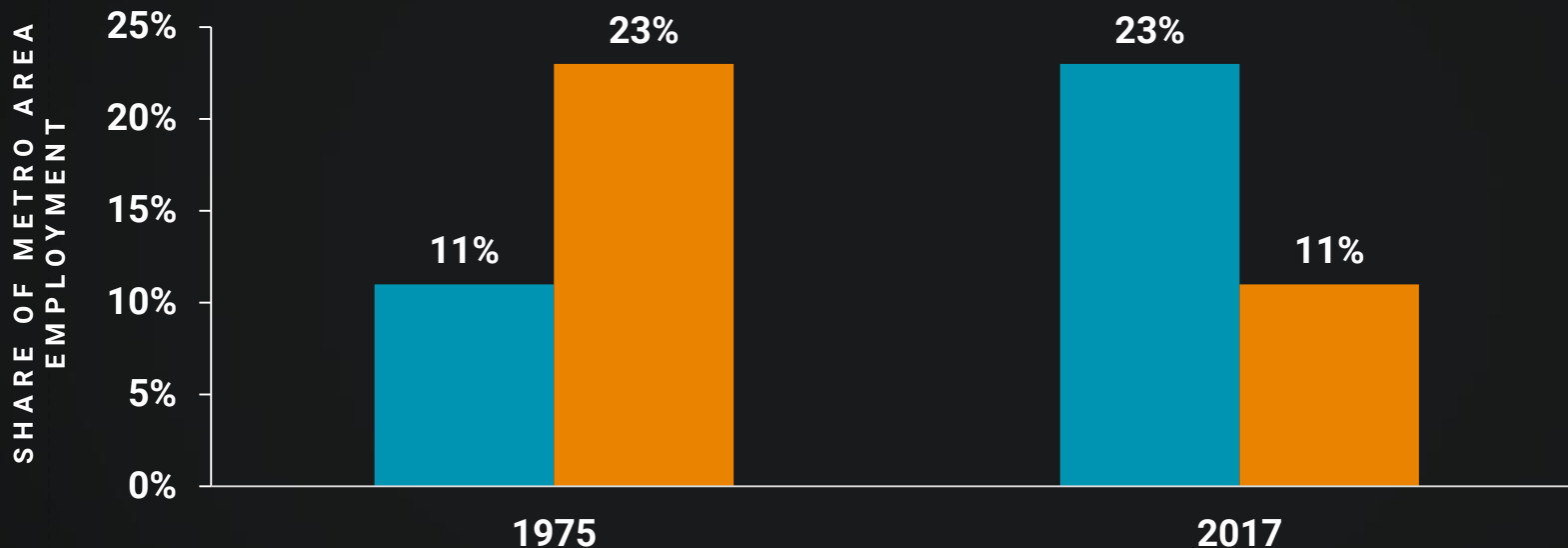


PROFESSIONAL SERVICES REPLACING GOVERNMENT

Share of Metro Area Employment

Washington Metro Area: 1975 VS. 2017

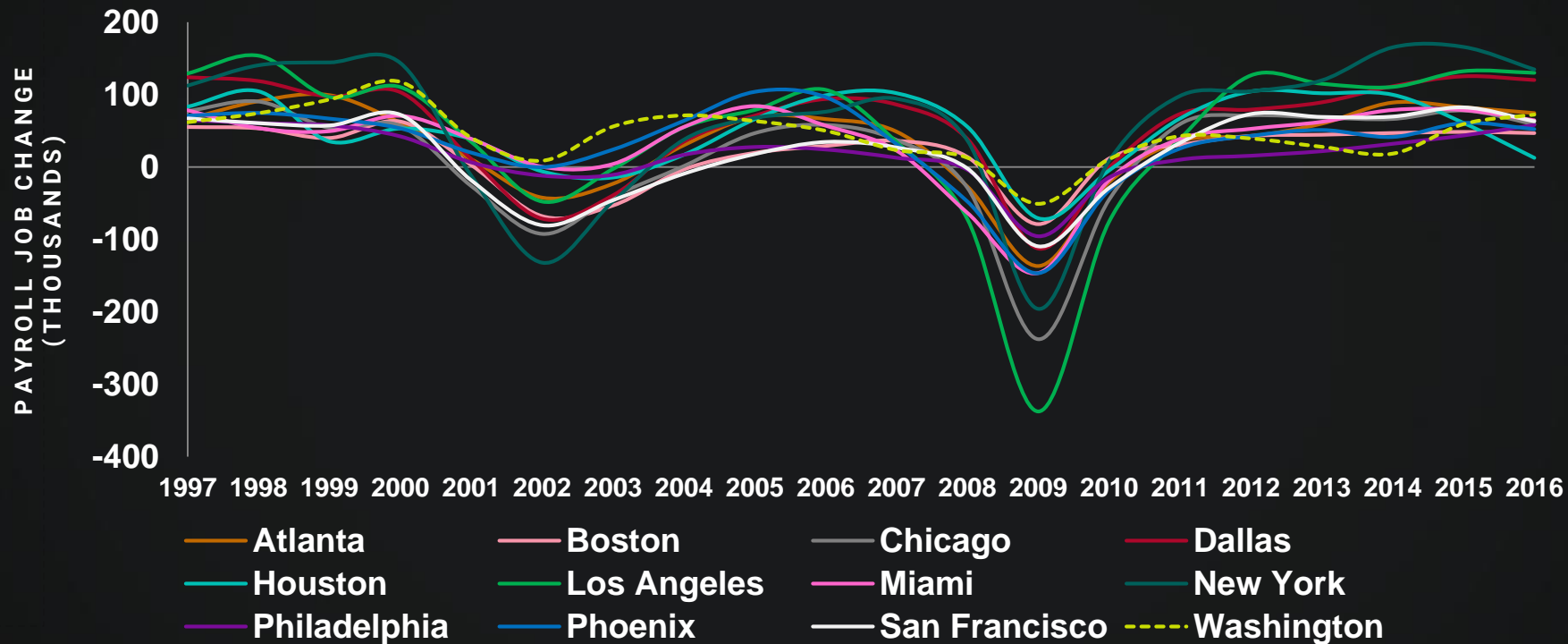
■ Professional and Business Services ■ Federal Government



LONG-TERM JOB CHANGE IN MAJOR METROS

Annual Average Payroll Job Change

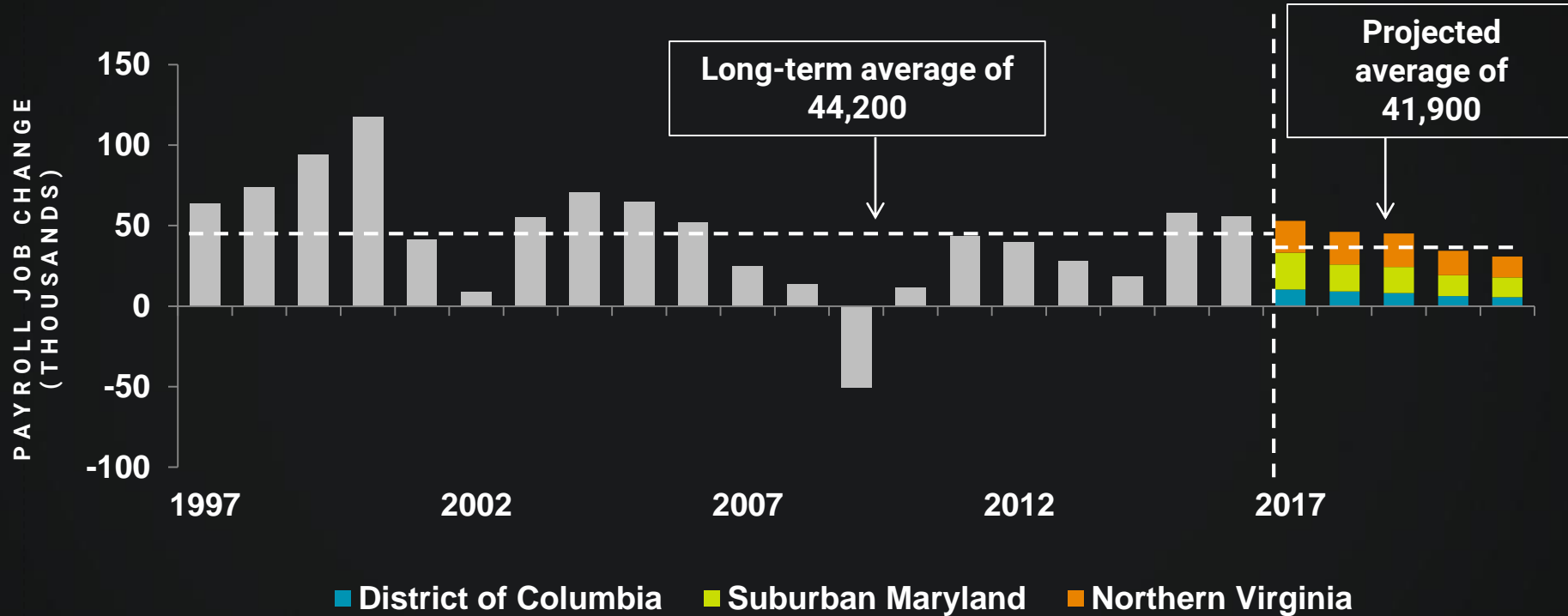
12 Largest Metro Areas



STURDY JOB GROWTH PROJECTED TO CONTINUE

Payroll Job Change

Washington Metro Area: 1997 – 2016 and Forecast 2017 - 2021



JOB GROWTH PROJECTION BY INDUSTRY

Five-Year Projected Payroll Job Change: Washington Metro Area | 2017 - 2021

Job Growth Leads to Office and Multihousing Demand

Professional/Business Services

Education/Health

Leisure/Hospitality

Construction

State and Local Government

Transportation/Trade/Utilities

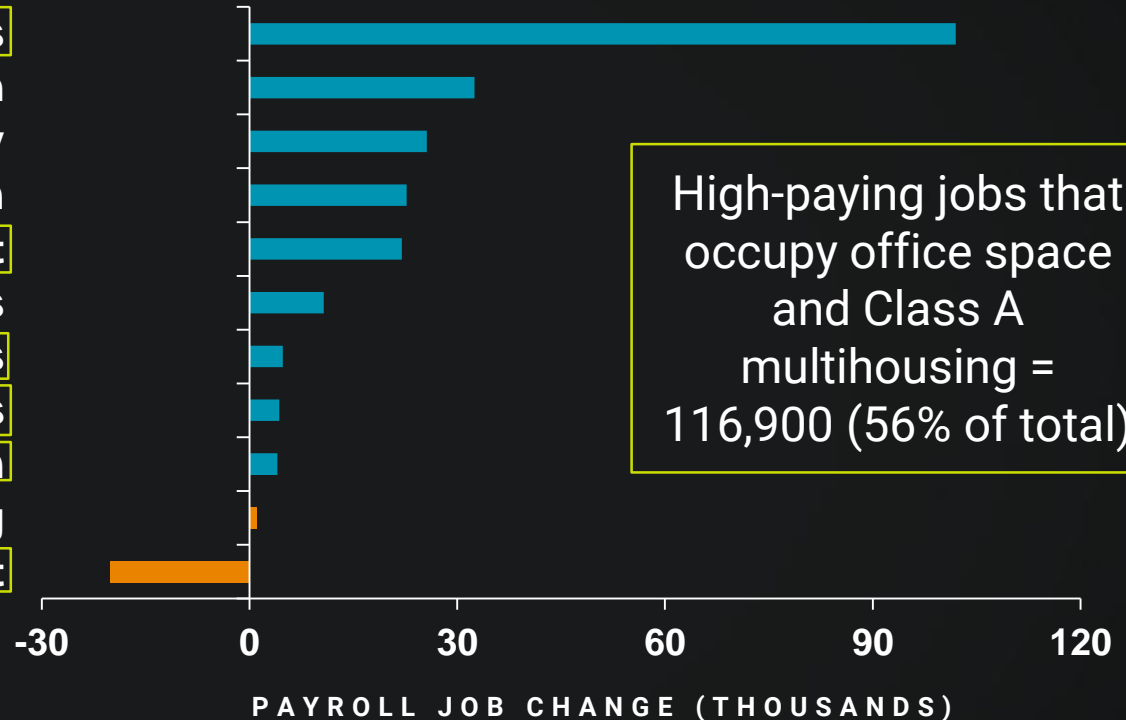
Other Services

Financial Services

Information

Manufacturing

Federal Government

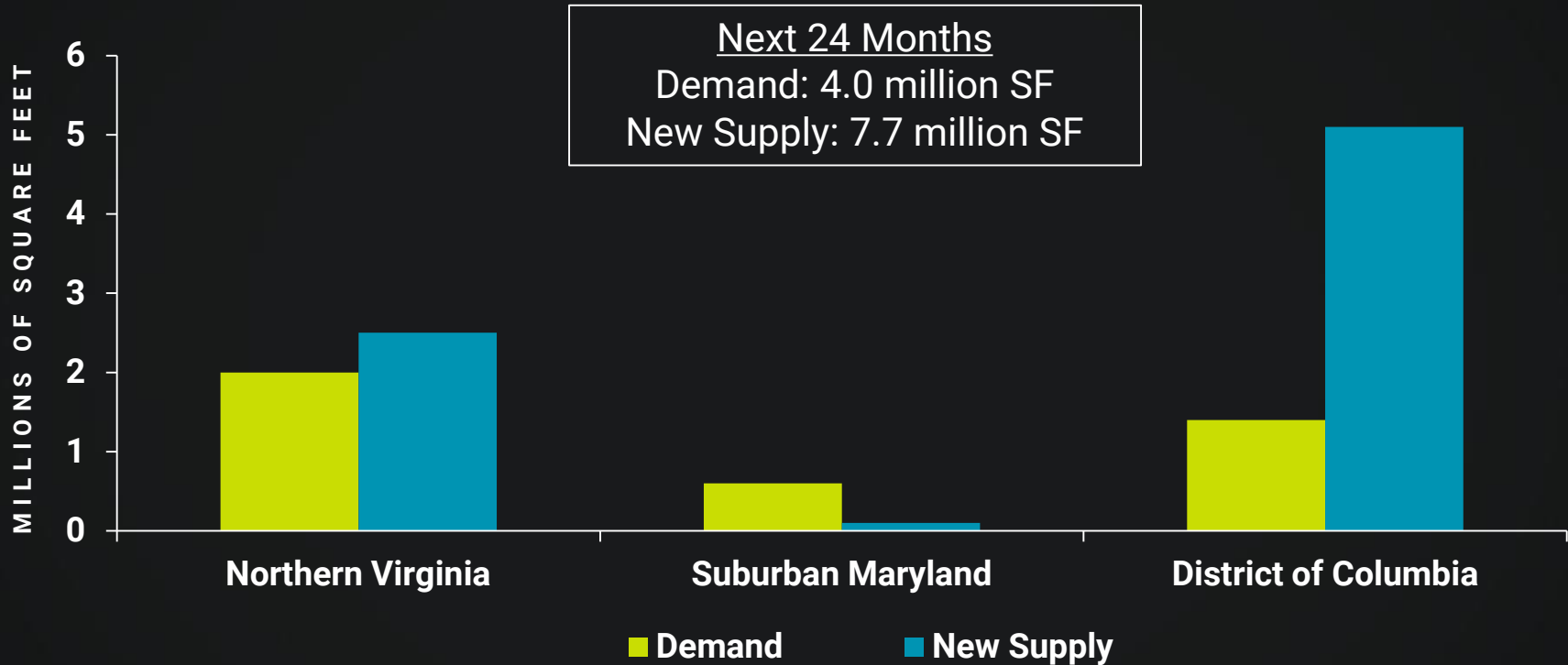




OFFICE DEMAND RISING, SUPPLY RISING
FIND YOUR NICHE

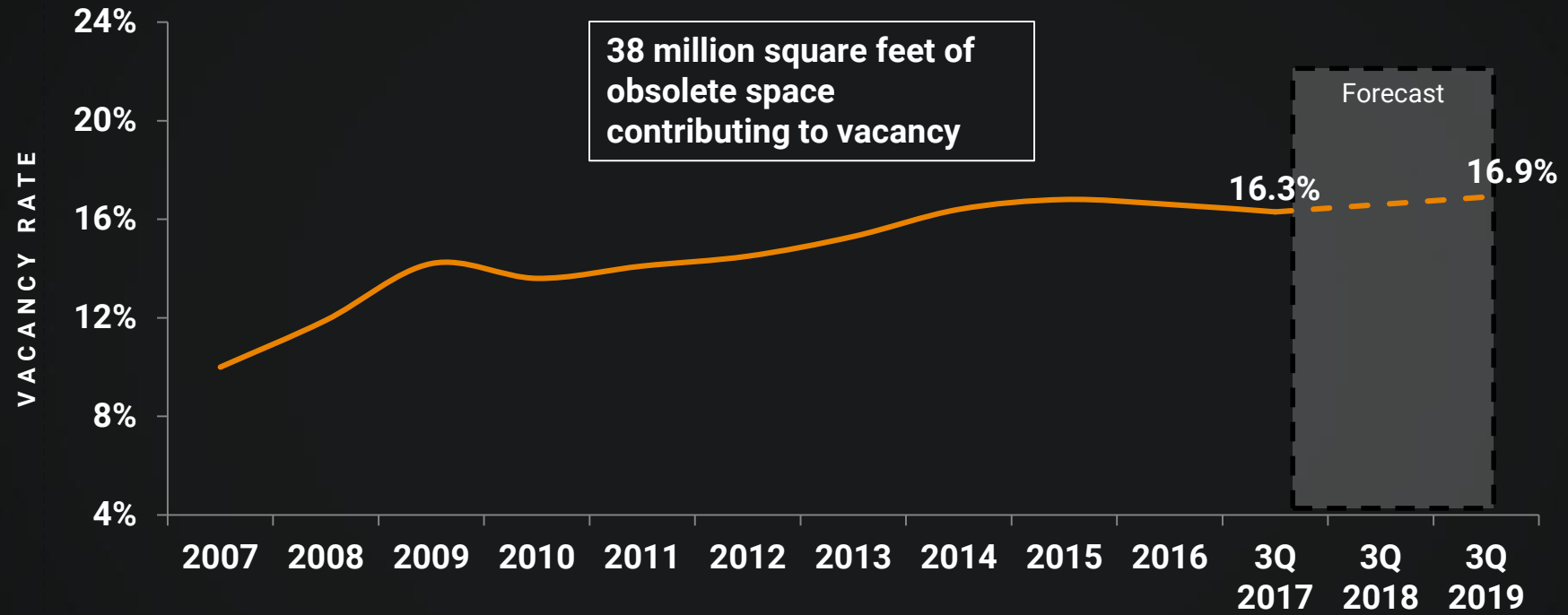
OFFICE MARKET SUPPLY/DEMAND FORECAST

Washington Metro Area – 24 Months Ending September 2019



OFFICE VACANCY PROJECTION

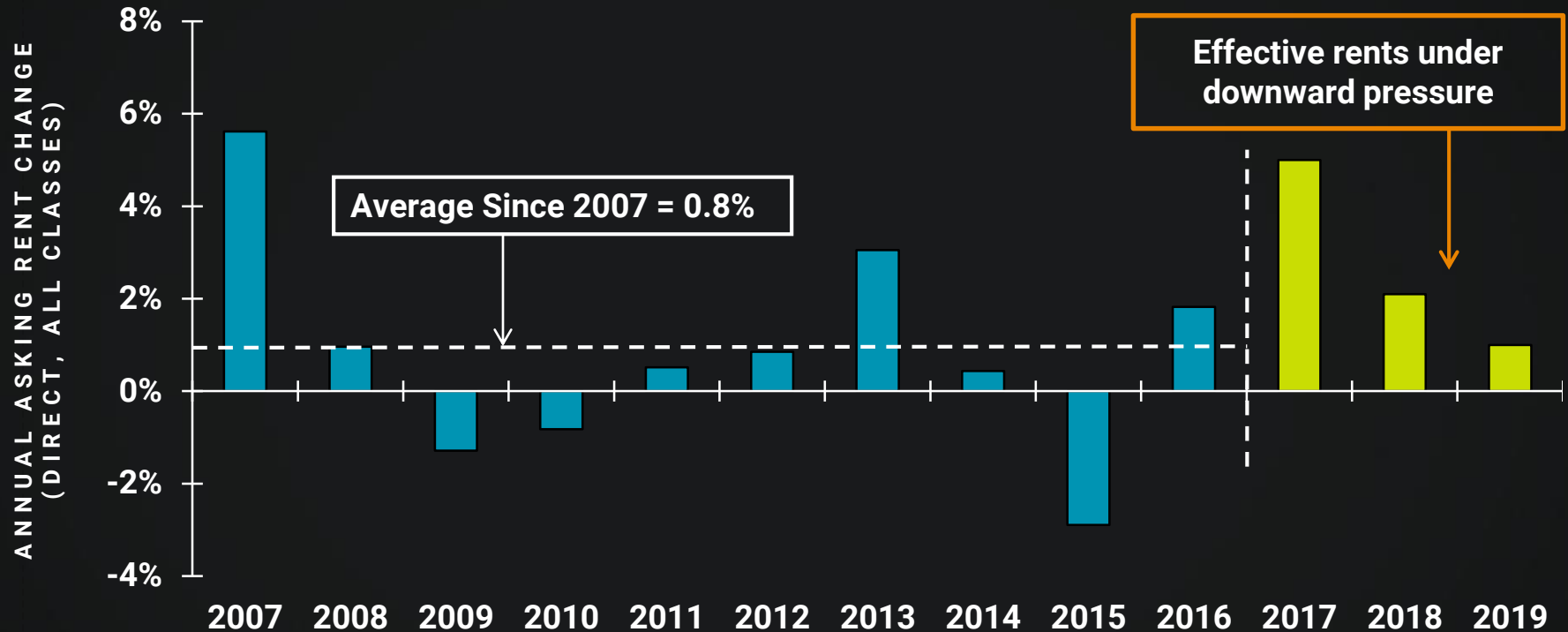
Washington Metro Area



Source: NKF Research; November 2017

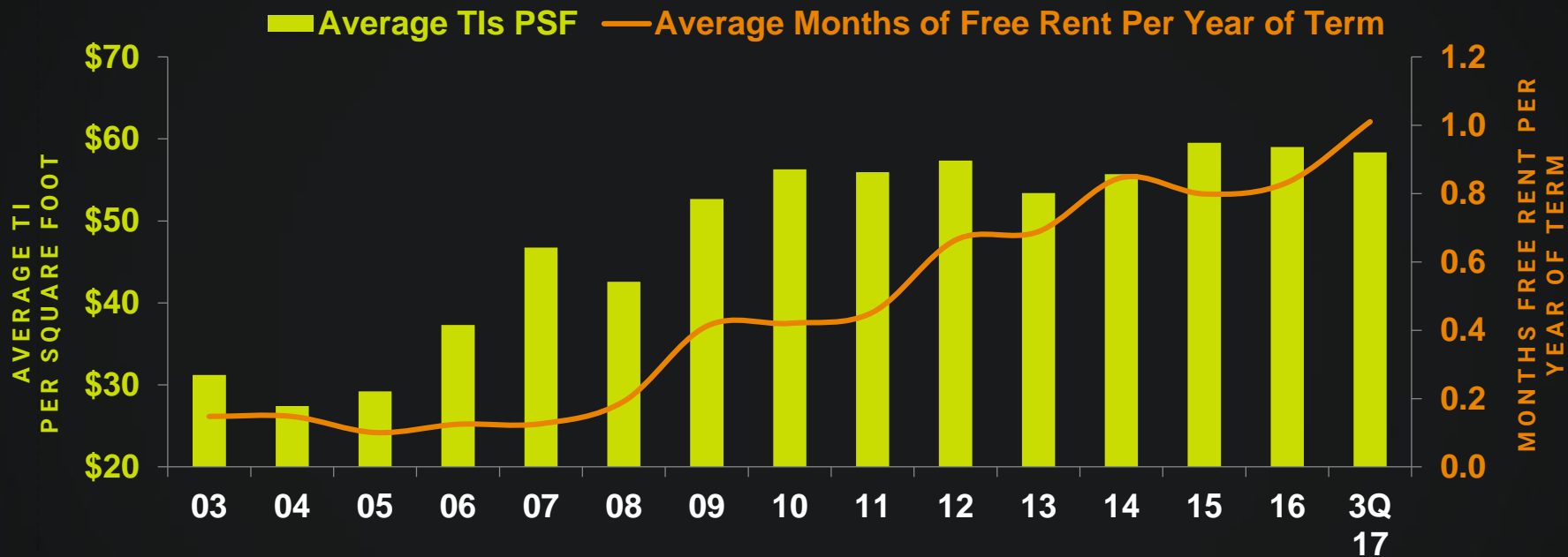
OFFICE ASKING RENT CHANGE AND FORECAST

Washington Metro Area | All Classes | Direct Weighted Average Asking Rent



CLASS A OFFICE CONCESSIONS

Washington Metro Area Average Concessions

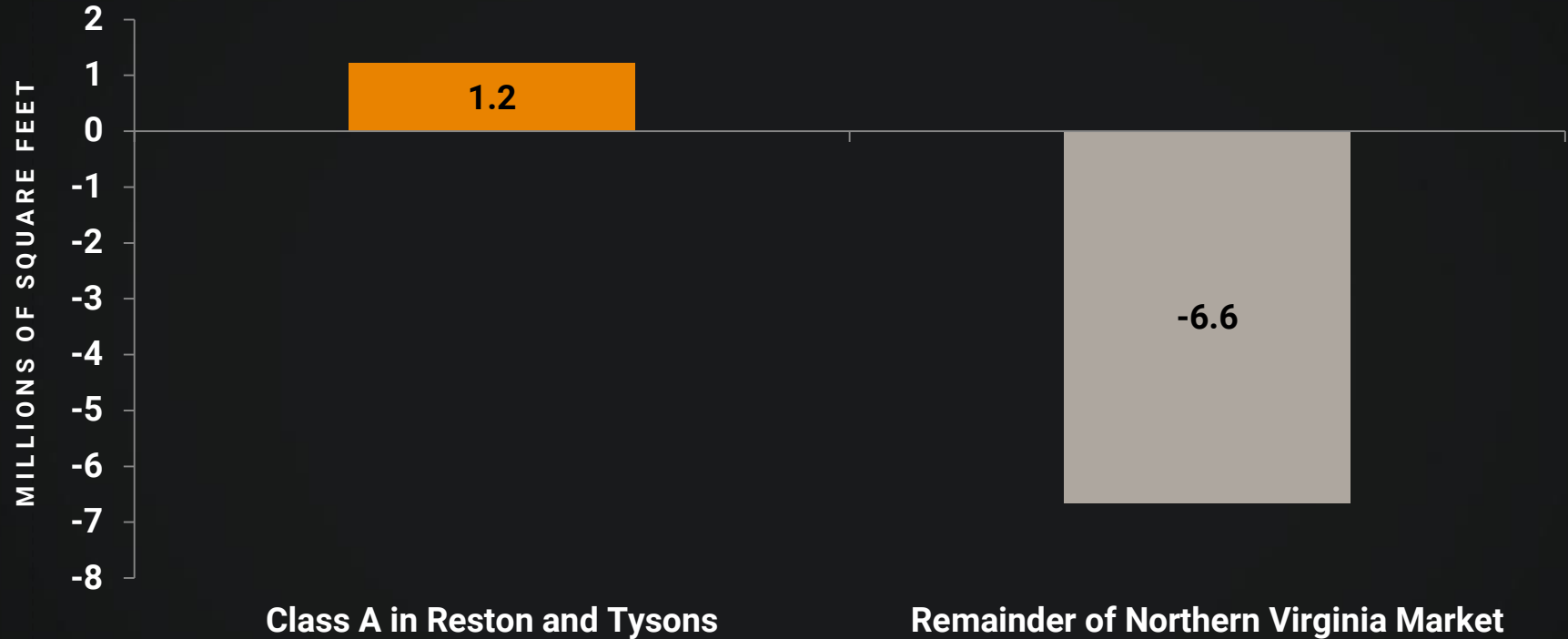


Note: Data based on sample set of lease transactions that contained concessions. Data includes only Class A properties and direct lease transactions with a minimum term of 5 years.
Source: NKF Research; November 2017

FIND YOUR NICHE

Silver Line Class A Outperforms Broader Market

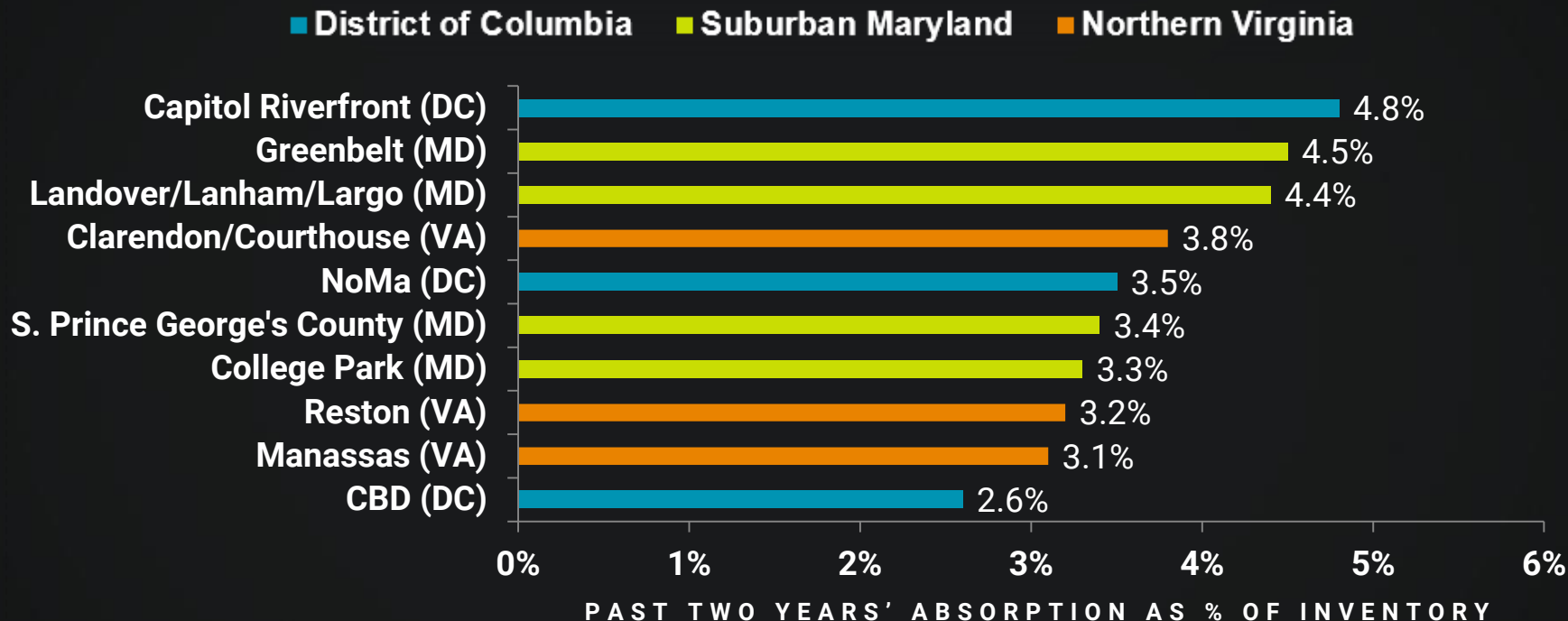
Total Net Absorption Of Office Space | Northern Virginia | 2011 – 3Q 2017



FIND YOUR NICHE

Top Performing Office Submarkets*

Past Two Years' Absorption as Percent of Inventory



THE WASHINGTON AREA OFFICE MARKET

What's Next? Where is the "Smart Money" Finding Opportunities?

- Consider low vacancy, high absorption submarkets
- Clean up well-located Class B- assets:
 - To clean Class B in the District
 - To high Class A in select suburban submarkets
- Repurpose obsolete assets to another use
- Focus development in strong submarkets to attract the modern tenant



BENCHMARKS DC

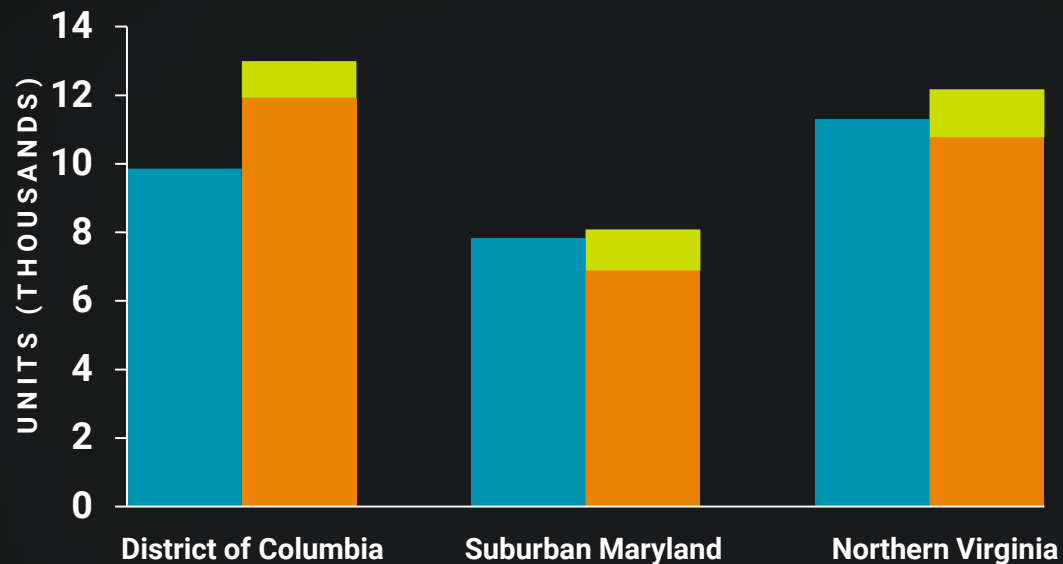


**MULTIHOUSING MARKET FULLY STOCKED;
COMPETITIVE MARKETPLACE AHEAD**

THE WASHINGTON AREA MULTIHOUSING MARKET

Demand and Delivery Projections


Washington Metro Area | 4Q 2017 – 3Q 2020



 Demand

Net Absorption:
9,667 units/year = 29,000 units

Deliveries

 Planned and may deliver by 9/20: 3,677 units

 Under construction: 29,582 units

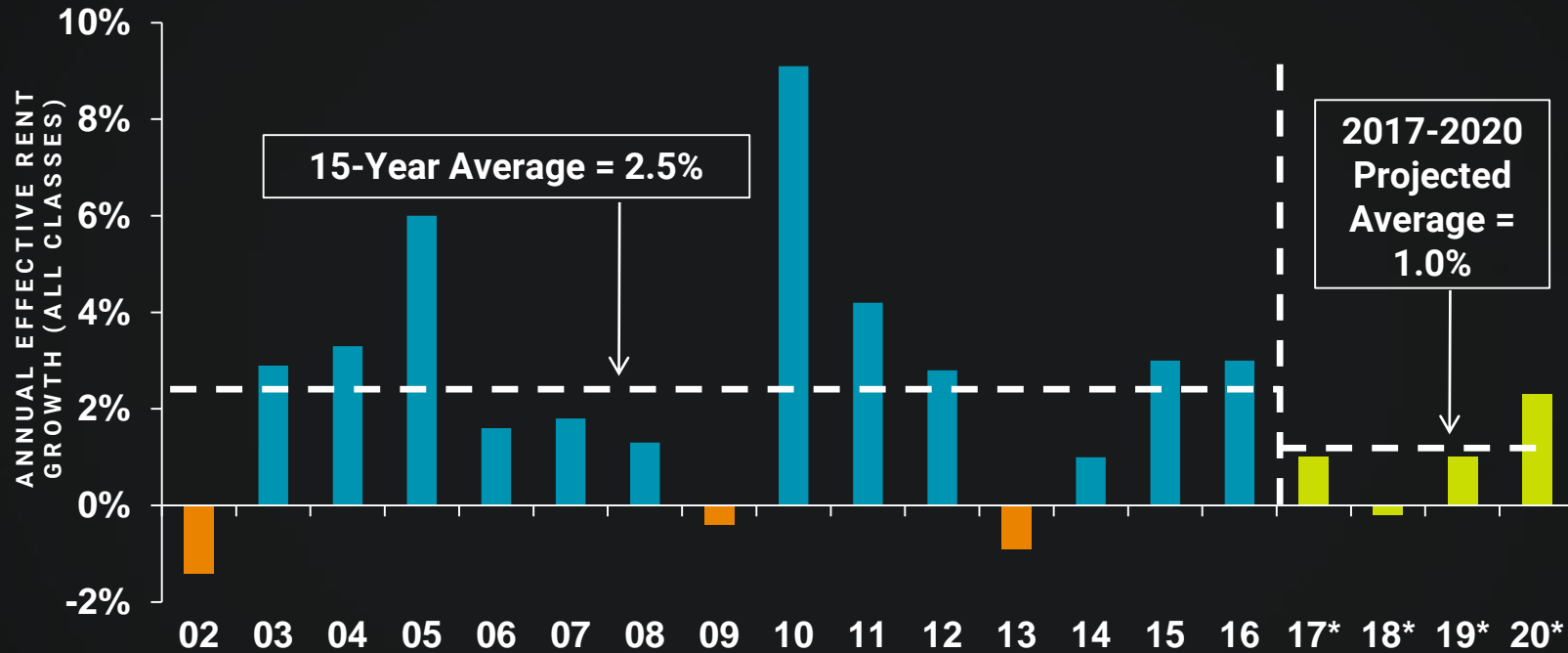
Total = 33,259 units

Occupancy at:

	District of Columbia	Suburban Maryland	Northern Virginia	<u>Metro</u>
3Q 2017	95.5%	95.0%	95.6%	95.3%
3Q 2020	91.8%	95.1%	95.4%	94.6%

THE WASHINGTON AREA MULTIHOUSING MARKET

Annual Effective Rent Growth Washington Metro Area



THE WASHINGTON AREA MULTIHOUSING MARKET

Ranking of Potential for Rent Growth over the Next Two Years

As of 3Q 2017

STRONGEST RENT GROWTH POTENTIAL

- | | |
|----------------------------|---------------------------------------|
| 1. Culpeper County | T-11. Dupont Circle/Adams Morgan |
| 2. District Heights | T-11. Spotsylvania County |
| 3. Brookland/Ft. Totten | T-13. Pentagon City/Crystal City |
| 4. Stafford County | T-13. Outlying Prince George's County |
| 5. Capitol Hill/Southwest | T-15. Rosslyn/Ballston |
| 6. Bethesda/Chevy Chase | T-15. Forest Heights/Oxon Hill |
| T-7. Landover | 17. Columbia Pike/Shirlington |
| T-7. Fredericksburg City | 18. Rockville |
| 9. Hyattsville | T-19. Northwest D.C./ Georgetown |
| 10. College Park/Greenbelt | T-19. Charles County |
| | T-19. Anacostia/Northeast DC |

WEAKEST RENT GROWTH POTENTIAL

- | | |
|---|--|
| 22. Frederick County | 33. Laurel |
| 23. Foggy Bottom | 34. Seminary Road/Landmark |
| 24. Loudoun County | 35. Howard U./Mt. Pleasant/ Brightwood |
| 25. Woodley Pk./Cleveland Pk./ Van Ness | 36. Silver Spring |
| 26. Prince William County | 37. Tysons Corner/Fairfax City |
| 27. Downtown/Logan Circle | 38. Gaithersburg/ Germantown |
| T-28. NE Alexandria/Glebe Road | 39. Montgomery County/Other |
| T-28. Western Fairfax County | 40. Kensington/Wheaton |
| 30. Falls Church/ Annandale | 41. Takoma Park |
| 31. Old Town | 42. Northeast Montgomery County |
| 32. SE Fairfax County | |

■ District of Columbia ■ Suburban Maryland ■ Northern Virginia

Based on:

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

THE WASHINGTON AREA MULTIHOUSING MARKET

What's Next? Where is the "Smart Money" Finding Opportunities?



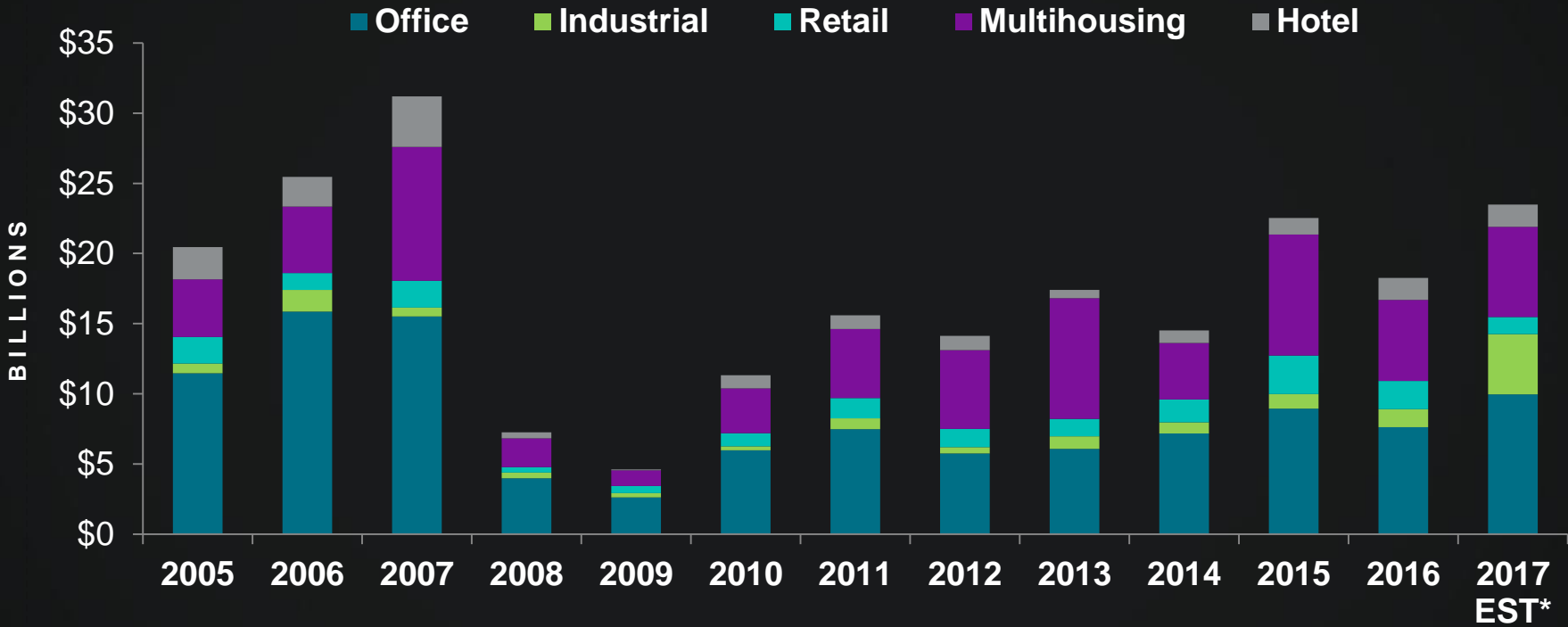
- Build units that target empty nesters
- Cater to work-at-home tenants
- Renovate well-located Class B- and C assets to B+
- Develop price-sensitive gardens at select locations in suburban submarkets
- Build in select urban submarkets with strongest rent growth potential



**INVESTMENT SALES IN PROLONGED CYCLE;
EXPECT ROUNDER PEAK AND SHALLOWER VALLEY**

INVESTMENT SALES VOLUME BY PROPERTY TYPE

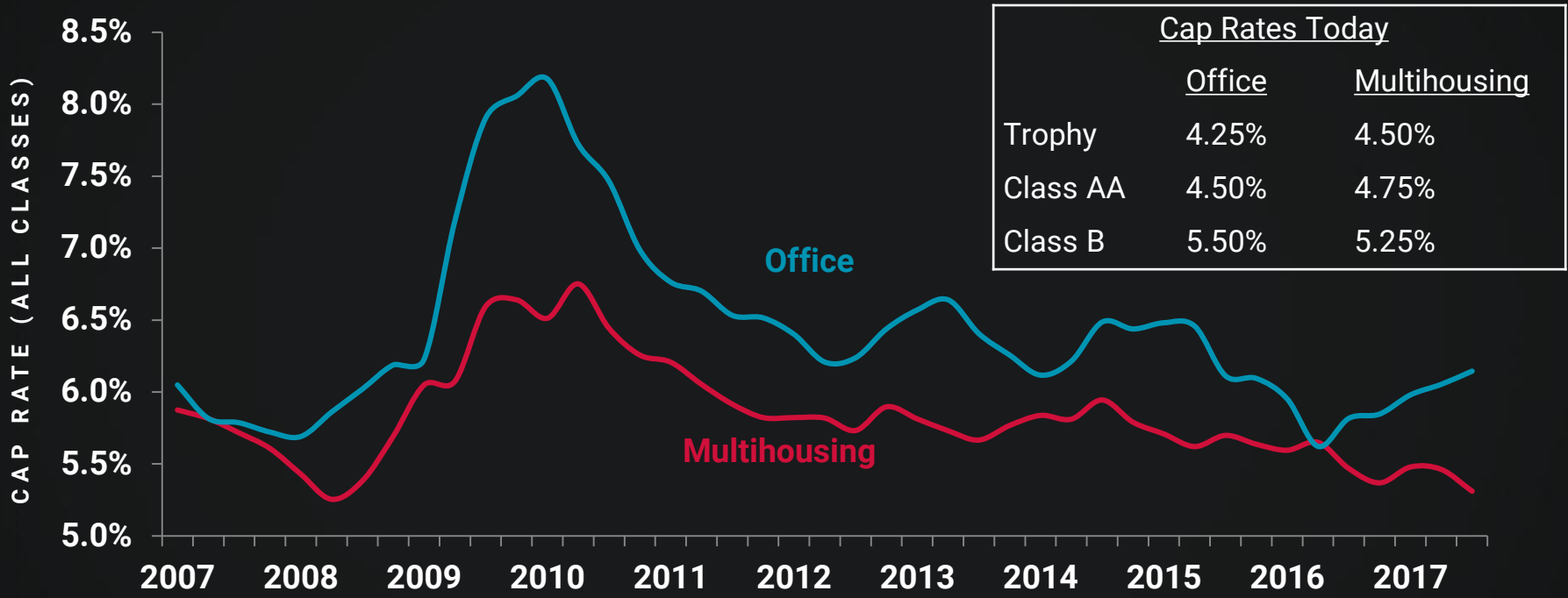
Washington Metro Area | Transactions \$10 Million and Larger



*2017 YTD through 3Q annualized and seasonally adjusted
Source: Real Capital Analytics, NKF Research; November 2017

WASHINGTON REMAINS INVESTMENT TARGET

Average Cap Rate, Office and Multihousing: Washington Metro Area
12-Month Rolling Average



WHAT'S NEXT?

The “Smart Money” and Capital Markets

- Overweight industrial distribution
- Buy well-located Class B office in the District
- Buy well-located Class B multihousing in select suburban submarkets
- Buy trophies if you can find them
- Selectively search for yield in secondary markets



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