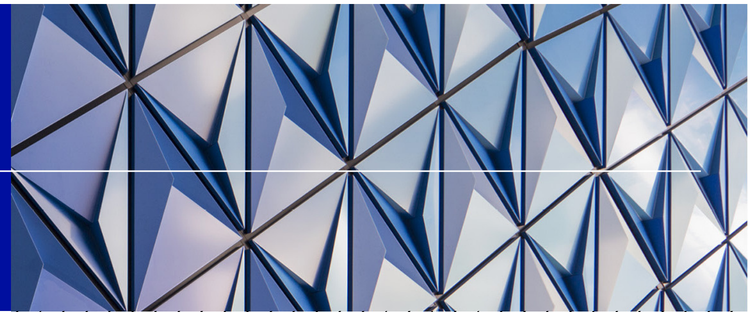


RESEARCH Q1 2021

District of Columbia Office Market

Slow Leasing Environment Results in Rising Vacancy Rate

The District of Columbia's office market continued softening in the first quarter of 2021. Although market activity modestly rebounded in the fourth quarter, the recovery's momentum stalled in the new year. Twelve months after the onset of the pandemic, occupiers largely remain paused regarding major real estate decisions—notwithstanding an anecdotal increase in tour activity—which has impacted office market indicators.

Net absorption registered -418,696 square feet during the first quarter of 2021. Slow leasing activity over the last 12 months has limited opportunities for occupancy gains. This trend may become increasingly apparent in 2021 as the market exhausts the pipeline of leases signed prior to the start of COVID-19. However, leasing activity may rebound in 2021, partly due to the efficacy and distribution of the coronavirus vaccines, which will generate more occupancy in 2022 and beyond.

Vacancy continued to rise steadily during the first quarter, reaching 15.7%, a 50-basis-point increase from the fourth quarter and a 120-basis-point increase from a year ago. The District of Columbia's development pipeline measures 2.1 million square feet excluding renovations and is 54.1% preleased. Relatively low preleasing rates indicates that these deliveries may apply upward pressure on vacancy as space delivers unoccupied. One new office building delivered in the first quarter at 250 M Street SE. This project added 227,948 SF to inventory and was immediately occupied by the DC Department of Transportation, which relocated from nearby 55 M Street SE. Office construction activity is expected to slow in the coming quarters as supply-and-demand conditions suppress appetite among developers to break ground.

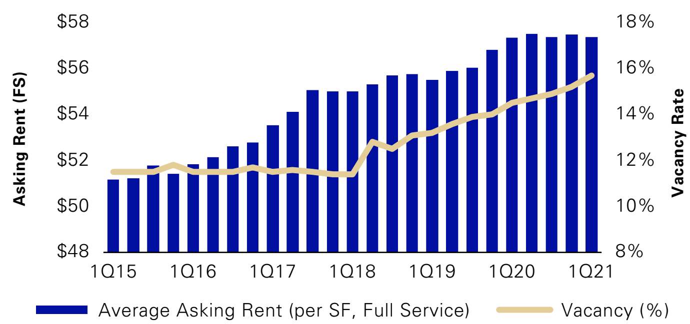
Asking rents declined in the first quarter to $57.37/SF, which offset the 12-cent gain measured in the fourth quarter of 2020. Although leasing conditions are expected to remain sluggish until public health conditions improve in earnest, asking rents are likely to hold fairly steady. Effective rents will be under downward pressure, as elevated vacancy yields generous concession packages for tenants in the market for new space.

Current Conditions

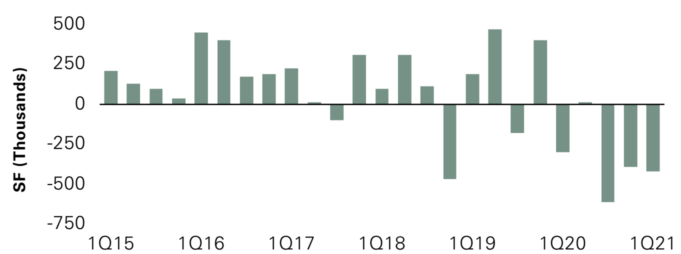
- The District of Columbia recorded -418,696 square feet of net absorption during the first quarter of 2021.
- The vacancy rate has risen 120 basis points from a year ago to 15.7%, as the continued pressure of COVID-19 has delayed real estate decision-making among office occupiers and led to an increase in sublease availabilities.
- Asking rents fell slightly in the first quarter as more supply and less demand is creating tenant leverage.

Market Analysis

ASKING RENT AND VACANCY RATE



NET ABSORPTION



Market Summary

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	130.5 M	130.2 M	129.7 M	↑
Vacancy Rate	15.7%	15.2%	14.5%	↑
Quarterly Net Absorption (SF)	-418,696	-389,812	-299,447	→
Average Asking Rent/SF	$57.37	$57.49	$57.36	→
Under Construction (SF)	2.1 M	2.1 M	2.4 M	↓
Deliveries (SF)	227,948	0	913,083	↑

NEWMARK

Bifurcated Market Conditions in District

Downtown (defined as the East End and CBD) has recorded steadily softening office fundamental in recent years. This trend continued in the first quarter of 2021, as vacancy increased by 40 basis points from last quarter, reaching 17.7%. Over the past two years, Downtown has recorded total occupancy losses of 2.3 million square feet. In contrast, non-Downtown submarkets measured 1.2 million square feet of growth.

Many factors contribute to the disproportionate softening of Downtown, but the timing of COVID-19 and Downtown's slipping competitive position have been drivers. In the 18 months prior to the pandemic, 2.6 million square feet of office space delivered in Downtown. While this indicates developer confidence, rapid inventory growth immediately preceding the pandemic intensified the impact of these deliveries on fundamentals. Still, investors see value. Although still pending as of late March, Carr Properties is expected to sell 49% ownership in Midtown Center at 1100 15th Street NW in a deal that will value the property at $980 million, or $1,120/SF.

The competitive position of non-Downtown submarkets has also presented challenges. Tenants searching for space have found the value proposition of non-core submarkets increasingly attractive. In the first quarter, non-Downtown submarkets held a collective vacancy rate of 12.2% and an average asking rent of $51.65/SF, which is 12.8% lower than the Downtown's average.

Downtown will remain tenant-favorable for some time, but the amount of available space and tenant "churn" presents an opportunity for asset owners to creatively accommodate the post-pandemic demands of tenants. Rising competition among asset owners also may place greater downward pressure on rents, eventually improving Downtown's cost competitiveness.

Law Firms Evaluate Space Options

Law firms, the private sector anchor for the District's office market, have largely remained paused with respect to undertaking any major real estate initiatives and lease signings. Law firms have been active in the sublet market, however, listing large blocks of unused space while employees work remotely. In total, 19 of DC's major law firms placed a collective 500,000 square feet on the sublease market in 2020. Although these listings appear to foreshadow significant industry contraction, this trend also may be attributed to opportunistic real estate strategies. Subleases allow firms to exercise a low-cost option to "test the market." Locally, law firms benefit from having spaces well-structured for subleasing, with many firms listing full floors for sublet. Tenant favorable conditions and an oversupplied availability market limit the likelihood of these law firms finding a sublessee, however.

While changes in office space utilization are expected post-pandemic, the scope of these changes is still unknown. Despite this uncertainty, the underlying strength of the industry has been a point of local encouragement. Employment in the District of Columbia's legal services sector is down 3.8% over the past 12 months, which is a slightly stronger position than the overall Professional/Business Services sector, which is down 5.5%.

To read more about how the pandemic has influenced law firms' real estate strategies, download Newmark's recent study, "U.S. Law Firm Real Estate Trends: Their Recent Evolution and What to Expect Post-Pandemic."

Biden Administration May Seek to Bring Back Relocated Federal Agencies

Under the Trump administration, efforts had been made to relocate some Washington-based federal agencies to new facilities outside of the Capital Region. Most prominent was the Bureau of Land Management (BLM), which moved its 328-person office from the District of Columbia to Grand Junction, Colorado. While moving west located the agency closer to the land it manages, operational challenges prompted the Biden administration to "understand the ramifications of the headquarters move and determine if any adjustments need to be made," per a Bureau spokesperson.

Notable 1Q 2021 Lease Transactions

Tenant	Building	Submarket	Type	Square Feet
DC Department of General Services	899 North Capitol Street NE	NoMa	Lease Renewal	205,860
BIO	1201 New York Avenue NW	East End	Direct Lease	60,809
Foley Hoag	1717 K Street NW	CBD	Lease Renewal	33,000
CACI	300 M Street SE	Capitol Riverfront	Lease Renewal	32,812
DC Department of Human Services	1207 Taylor Street NW	Uptown	Lease Renewal	26,568

Notable Recent Sales Transactions

Building	Submarket	Sale Price	Price/SF	Square Feet
1000 F Street NW	East End	$105,865,000	$1,118	94,655
1899 Pennsylvania Avenue NW	CBD	$92,196,364	$479	192,481
499 South Capitol Street SW	Southwest	$86,430,000	$424	204,000

While these evaluations are ongoing, the immediate repercussions of the federal relocations on Washington's local labor and office markets are tangible. In the case of the BLM relocation, internal reports state that 87% percent of workers elected either to retire or quit rather than move to Colorado. This left a large pool of seasoned federal workers seeking employment in the Washington region. It also has resulted in the loss of 104,385 square feet of tenancy at 20 M Street SE. While the BLM formally began operating in Colorado in 2020, the Bureau's District lease did not expire until the first quarter of 2021. This loss in tenancy is substantial for the District and the Capitol Riverfront submarket, where the BLM's relocation increased the submarket's vacancy rate by 240 basis points.

District of Columbia Outlook

The District of Columbia's office market will continue to face pandemic-induced headwinds throughout 2021, as supply and demand forces remain imbalanced. While the District's construction pipeline has slowed over the past two years, several new and renovated office buildings are still anticipated to deliver by the end of 2021. Any supply-side inventory expansion will apply upward pressure on vacancy, particularly given the current sluggish demand environment.

Tenant demand could be poised for growth in the coming quarters as the distribution and administration of the coronavirus vaccines represents a turning point in the global fight against the deadly virus. While total eradication of the virus may be impossible, the approved vaccines have all proven highly effective at preventing serious COVID-19 cases and thus easing concern about the office environment. As confidence grows among office occupiers, pent-up demand from months of delayed real estate activities may give a boost to leasing momentum.

Average asking rent growth has been effectively static over the past year. Although face rents are expected to remain steady in 2021, market forces will apply downward pressure on effective rents. Tenant demand for office space may increase in the second half of 2021, as vaccination rates permit the safe re-boarding of offices. It is yet to be seen how COVID-19 will impact office space utilization and lease structures in the future, but a range of outcomes is possible. One trend perpetuated by the uncertainty of the pandemic has been the rising importance of lease flexibility. The growing prevalence of spec suites indicates that some asset owners expect tenants will place greater value on shorter terms and greater flexibility, rather than maximizing financial value in a long-term lease.

Labor markets remained stalled in the first quarter of 2021; however, employment levels are typically lowest in the winter months, even in normal cycles. District unemployment is slowly trending down and was 7.9% in January 2021, although that is still up 290 basis points from a year earlier. The pace of employment recovery should accelerate in the coming months due to several encouraging factors, including the $1.9-trillion American Rescue Plan and the pace of vaccinations.

Investment sales volume in the District was quiet in the first quarter of 2021 after a relatively strong fourth quarter of 2020. Despite the slow beginning to the year, the District of Columbia remains a long-term target for institutional capital due to its reputation for consistent and sturdy returns.

For additional information on the Washington metro area's economy and its office market outlook, please visit the Mid-Atlantic Market Reports page at nmrk.com.

Market Statistics By Class

	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2018 Absorption (SF)	2019 Absorption (SF)	2020 Absorption (SF)	1Q 2021 Absorption (SF)	YTD 2021 Absorption (SF)
District of Columbia	**130,486,698**	**14.5%**	**15.7%**	**56,303**	**881,222**	**-1,287,341**	**-418,696**	**-418,696**
Class A	85,399,286	14.0%	15.2%	1,308,837	1,749,434	-139,699	-131,356	-131,356
Class B	39,538,520	15.1%	16.5%	-1,254,639	-587,272	-877,088	-222,928	-222,928
Class C	5,548,892	17.3%	18.1%	2,105	-280,940	-270,554	-64,412	-64,412

Market Statistics By Class

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	1Q 2021 Deliveries (SF)	YTD 2021 Deliveries (SF)	Under Construction (SF)
District of Columbia	**130,486,698**	**$62.29**	**$49.99**	**$57.37**	**227,948**	**227,948**	**2,052,344**
Class A	85,399,286	$62.29	NA	$62.29	227,948	227,948	2,052,344
Class B	39,538,520	NA	$49.99	$49.99	0	0	0
Class C	5,548,892	NA	NA	$48.93	0	0	0

Note: Asking rents are quoted on a full service basis.

Submarket Statistics—All Classes

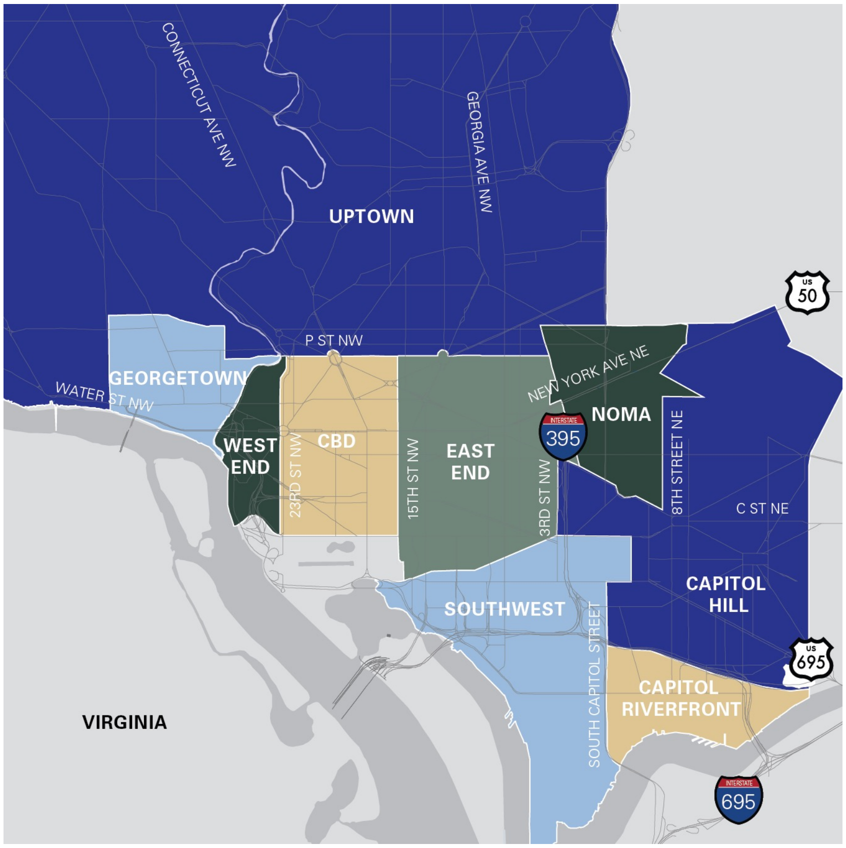
	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2018 Absorption (SF)	2019 Absorption (SF)	2020 Absorption (SF)	1Q 2021 Absorption (SF)	YTD 2021 Absorption (SF)
District of Columbia	**130,486,698**	**14.5%**	**15.7%**	**56,303**	**881,222**	**-1,287,341**	**-418,696**	**-418,696**
Capitol Hill	5,542,247	18.0%	19.1%	141,019	5,188	169,977	37,446	37,446
Capitol Riverfront	4,265,428	13.7%	14.4%	242,861	-835	93,635	-103,031	-103,031
Central Business District	41,274,369	15.0%	16.9%	494,740	-429,472	-930,675	-461,282	-461,282
East End	42,564,797	17.1%	18.5%	-170,534	-108,471	-521,328	215,693	215,693
Georgetown	2,851,274	11.8%	12.1%	-107,899	-77,883	-7,392	-11,108	-11,108
NoMa	12,089,080	6.0%	6.1%	39,048	750,211	592,186	-3,004	-3,004
Southwest	11,953,807	13.0%	13.2%	164,964	695,064	-568,116	-14,463	-14,463
Uptown	5,964,404	12.1%	14.0%	-750,950	215,990	-34,521	-101,223	-101,223
West End	3,981,292	12.1%	13.4%	3,054	-168,570	-81,107	22,276	22,276

Submarket Statistics—All Classes

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	1Q 2021 Deliveries (SF)	YTD 2021 Deliveries (SF)	Under Construction (SF)
District of Columbia	**130,486,698**	**$62.29**	**$49.99**	**$57.37**	**227,948**	**227,948**	**2,052,344**
Capitol Hill	5,542,247	$67.67	$53.04	$60.36	0	0	214,501
Capitol Riverfront	4,265,428	$53.39	NA	$53.39	227,948	227,948	457,633
Central Business District	41,274,369	$63.42	$51.81	$58.72	0	0	492,974
East End	42,564,797	$65.20	$50.80	$59.71	0	0	143,872
Georgetown	2,851,274	$59.56	$42.55	$44.73	0	0	0
NoMa	12,089,080	$52.91	$49.60	$51.36	0	0	38,191
Southwest	11,953,807	$50.07	$46.03	$49.11	0	0	639,703
Uptown	5,964,404	$52.39	$42.56	$45.15	0	0	65,470
West End	3,981,292	$67.21	$50.72	$61.41	0	0	0

Note: Asking rents are quoted on a full service basis.

District of Columbia Office Submarkets



Methodology

Market statistics are calculated from a base building inventory of office properties 20,000 SF and larger that are deemed to be competitive in the Washington Metro Area office market. Properties that are more than 75% owner-occupied and federally owned buildings are generally excluded from inventory.

Glossary

Asking Rental Rate: The dollar amount asked by landlords for direct available space (not sublease), expressed in dollars per square foot per year. Average asking rents are calculated on a weighted average basis, weighted by the amount of available space. Asking rents are quoted on a full service basis, meaning all costs of operation are paid by the landlord up to a base year or expense stop.

Class A: The most prestigious buildings competing for premier office users with rents above average for the area. Class A buildings have high-quality standard finishes, state-of-the-art systems, exceptional accessibility and a definite market presence.

Class B: Buildings competing for a wide range of users with rents in the average range for the area. Class B building finishes are fair to good for the area and systems are adequate, but the building cannot compete with Class A at the same price.

Class C: Buildings competing for tenants requiring functional space at rents below the area average.

Deliveries: Projects that have completed construction and received a certificate of occupancy.

Net Absorption: The net change in physically occupied space from one quarter to the next. **Year-to-Date (YTD) Net Absorption** is the net change in physically occupied space from the start of the calendar year to the current quarter. Net absorption is counted upon physical occupancy, not upon execution of a lease.

Sublease: Sublease space is offered and marketed as available by the current tenant, rather than directly from the owner.

Under Construction: Properties undergoing ground-up construction in which work has begun on the foundation. Properties that have only undergone grading or other site work are not included as under construction.

Under Renovation: Properties undergoing significant renovations that require all tenants to be out of the building. These properties are removed from inventory during the renovation period and delivered back to inventory upon completion of the renovations. These properties are not included in under construction totals.

Vacancy Rate: The amount of space that is physically vacant, expressed as a percentage of inventory. (Space that is being marketed as available for lease but is largely occupied is not included in the vacancy rate.) The **Overall Vacancy Rate** includes all physically vacant space, both direct and sublease, while the **Direct Vacancy Rate** includes only direct space.

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