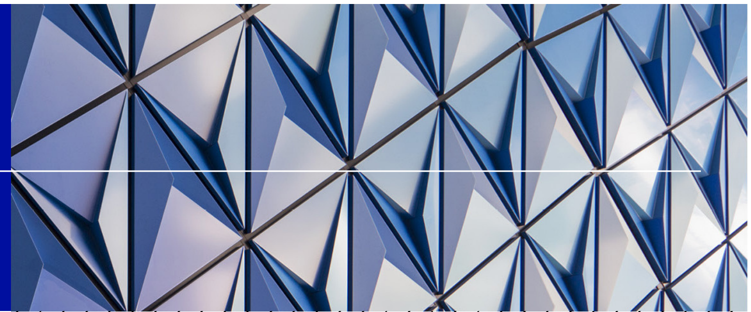


RESEARCH Q2 2021

District of Columbia Office Market

Softening of Fundamentals Persists, but Tenant Reboarding is Accelerating

The District of Columbia's office market fundamentals continued to soften in the second quarter, despite the region's slowly accelerating economic and public health recovery. Since the onset of the pandemic, commercial real estate markets have been particularly cool; however, some momentum began to build in the second quarter, as more firms re-engaged in real estate planning, market touring and reboarding of offices.

Net absorption registered -836,866 square feet during second-quarter 2021. Occupancy losses were predictably pronounced due to the move of the U.S. Citizenship and Immigration Services (CIS), which relocated to Maryland. Slow leasing activity throughout of the pandemic has limited opportunities for occupancy gains; however, pent-up demand is anticipated to loosen and drive activity in the second half of 2021. Leasing velocity increased slightly in the second quarter, illustrating that a momentum shift may be underway.

Vacancy rose in the second quarter, reaching 16.6%, a 70-basis-point increase from the first quarter and a 180-basis-point increase from one year ago. While this increase is substantial, much of it can be attributed to the loss of more than 620,000 square feet of occupancy from the U.S. CIS. Although the GSA had been a ballast for leasing activity throughout the pandemic, some federal agencies have been looking to consolidate operations for many years. The District's development pipeline measures 2.1 million square feet, excluding renovations, and is 50.3% preleased. Two building renovations were completed in second-quarter 2021. 1222 22nd Street NW and 1771 N Street NW each delivered about 52,000 square feet and are collectively 16.7% preleased. Office construction activity is expected to slow in the coming quarters as a supply-demand imbalance temporarily suppresses developers' appetite to break ground.

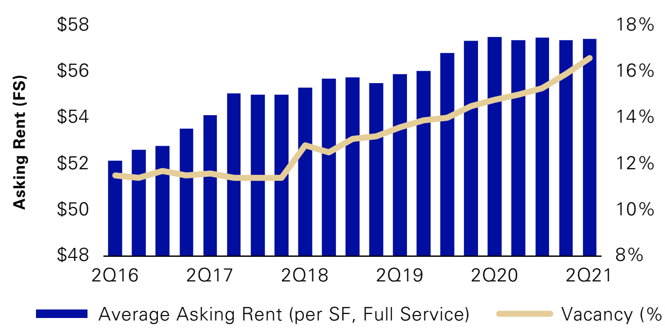
The average asking rent rose in the second quarter to $57.43/SF but remains $0.09 below second-quarter 2020 rents. Asking rents have held relatively steady despite the uncertainty of the past year. Effective rents will remain under downward pressure, as elevated vacancy yields generous concession packages for tenants in the market for new space.

Current Conditions

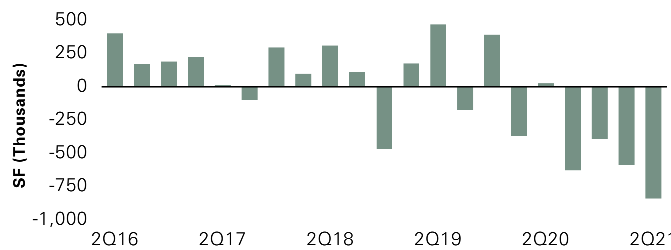
- The District of Columbia recorded -836,866 square feet of net absorption during the second quarter of 2021.
- The vacancy rate has risen 180 basis points from a year ago to 16.6%, driven by the lagging influence of slow leasing activity throughout the COVID-19 pandemic.
- Asking rents rose slightly in the second quarter to $57.43/SF as optimism regarding improved public health conditions supported a modest rebound.

Market Analysis

ASKING RENT AND VACANCY RATE



NET ABSORPTION



Market Summary

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	130.6 M	130.5 M	130.6 M	↑
Vacancy Rate	16.6%	15.9%	14.8%	↑
Quarterly Net Absorption (SF)	-836,866	-590,861	27,376	↑
Average Asking Rent/SF	$57.43	$57.37	$57.52	→
Under Construction (SF)	2.1 M	2.1 M	2.1 M	↓
Deliveries (SF)	0	227,948	335,063	↑

NEWMARK

Market Fundamentals Diverge Along Class Lines

The District of Columbia's Class B market has experienced a particularly noteworthy shift in market fundamentals over the last 12 months. The influence of slow leasing activity, dwindling quality product and cost competition among commodity-grade Class A assets have worn on Class B fundamentals.

Over the last year, Class A vacancy has risen 100 basis points to 15.3%, which contrasts with the Class B market where vacancy has risen 340 basis points to 19.2%. For both classes, this is a high-water mark for vacancy rate and spread since the Global Financial Crisis in 2009. Class B occupancy losses over the past 12 months have been pronounced, with net absorption recording -1,782,206 square feet over the period. Class B net absorption was particularly weak in the second quarter of 2021, measuring -806,330 square feet. This was largely due to the relocation of the U.S. CIS.

Further challenging the Class B market is the trend of renovating or repositioning aging Class B assets to higher quality or new uses. Since the relocation of the U.S. CIS from 20 Massachusetts Avenue NW, plans are already in motion to begin a renovation and repositioning of the building into a multi-use hotel and office building. This project highlights the value of well-positioned Class B assets; however, extracting peak value from these buildings will come at the cost of existing Class B inventory.

Soft market conditions in the District of Columbia and oversupply of commodity-grade Class A space have narrowed the cost differences between Class B and lower-end Class A space. Given tenant demand for quality, particularly following the pandemic, owners of Class B assets have had to be aggressive with rents to compete. Over the past 12 months, average Class B asking rents have contracted by 1.5%, while Class A asking rents have risen by 0.1%. Over time, commodity Class A buildings will age into the Class B segment. Until then, quality Class B space may become particularly scarce—making what remains highly desirable for cost-conscious occupiers.

Vaccinations to Accelerate Reboarding Downtown

The second quarter marked a turning point for vaccination access in the Washington region. Vaccine eligibility was expanded to all District residents in mid-April, and the rapid improvements in vaccination rates allowed Mayor Bowser to lift most indoor occupancy restrictions by late May. Given these public health improvements, office occupiers across all industries began to design and implement their reboarding plans.

Although many reboarding efforts are likely to come after Labor Day, many of the District's largest private sector anchors (including some law firms) are encouraging a "soft" or part-time return to the office this summer. Modest increases in commuter activity were already evident in the Downtown, beginning as early as March 2021. Ridership growth at Metrorail's two downtown transfer hubs, Gallery Place-Chinatown and Metro Center, has outperformed systemwide recovery since vaccine distribution began in December 2020. These two stations have also gained an average of 900 daily riders in both March and April 2021, indicating a steady uptick in Downtown commuting activity. Ridership in Downtown remains just 11.1% of the February 2020 level, and historical precedent suggests slow Metrorail usage during the summer. However, a rebound in Downtown transit use is underway.

Sublease Availability Falls to Lowest Level Since October

The availability of sublet space has ballooned nationally during the past year, as pandemic pressures forced tenants to reassess the value of their office space. However, in the District, the total sublet availability has been trending down since October 2020 and reached 3.4 million square feet, or 2.6% of inventory, in mid-June 2021. Overall sublease availability is still above the pre-pandemic level, which averaged 2.7 million square feet in the 12 months preceding the onset of the pandemic. Still, a reduction in sublet availability over the past eight months is a sign that firms are beginning to remove sublet listings, and this could be an early indicator that more office reboarding is imminent.

Notable 2Q 2021 Lease Transactions

Tenant	Building	Submarket	Type	Square Feet
Boston Consulting Group	655 15th Street NW	East End	Direct Lease	97,779
Patient Centered Outcomes Research Institute	1333 New Hampshire Avenue NW	CBD	Direct Lease	96,092
Enovational	1400 L Street NW	East End	Direct Lease	95,619
American Bankers Association	1333 New Hampshire Avenue NW	CBD	Direct Lease	87,000
Pacific Architects and Engineers (PAE)	1099 14th Street NW	East End	Direct Lease	77,285

Notable Recent Sales Transactions

Building	Submarket	Sale Price	Price/SF	Square Feet
1015 Half Street SE	Capitol Riverfront	$215,700,000	$552	391,000
77 P Street NE	NoMa	$201,756,250	$589	342,411
1000 F Street NW	East End	$105,865,000	$1,118	94,655

Not all tenants will immediately remove their sublease listings as reboarding commences, however. Real estate demand drivers in a post-pandemic environment are different than those in pre-pandemic times, particularly regarding lease flexibility. Viewed from this perspective, subleases offer several desirable qualities such as shorter-term lengths, below-average rents and furnished space. Tenant demand for flexibility may elevate the desirability of competitively positioned subleases. The volume of executed subleases has grown in the District since the beginning of 2021, but still falls far short of current supply. A significant share of the District's sublet availability comes from law firms, so the legal industry will have a strong influence on the duration and depth of the current excess of sublet space.

District of Columbia Outlook

Public health conditions have improved rapidly in the District of Columbia throughout the second quarter. While the District's office market is likely to continue to face some long-term challenges related to the pandemic, conditions are aligning to permit recovery throughout the second half of 2021.

Pent-up demand is anticipated to loosen in the coming quarters as high vaccination rates and fewer business restrictions permit office reboarding in earnest. However, office market metrics such as absorption and vacancy are lagging indicators and therefore may remain challenged, despite the increased activity that is coming. While the District's construction pipeline has slowed over the last two years, supply and demand will remain imbalanced for some time. Newmark Research projects the vacancy rate in the District to rise to 18.6% by the end of second-quarter 2023. Consolidations among law firms and the federal government, as well as the impact of remote working, will drive this increase in office vacancy in the coming quarters.

Average asking rents have oscillated slightly over the past 12 months but are anticipated to remain flat for the remainder of 2021. Although demand is expected to increase in the coming quarters, the amount of available supply will ensure concessions remain elevated. One trend underscored by the pandemic has been the rising importance of flexibility, both with respect to lease terms and space use. Spec suites have been growing in popularity over the past year as an alternative to traditional leases. Since spec suites are generally pre-constructed and offer more flexible terms, asking and effective rents for such spaces will be higher than a traditional long-term lease.

Labor markets have been steadily improving in 2021, fueled by fewer restrictions and the return of some business activities. The District's unemployment rate has been trending down for four months, reaching 7.5% in April 2021. While total employment is trending up in the District, the labor force participation rate remains suppressed, indicating that not all pre-pandemic workers are returning to the market; challenges specific to the pandemic remain hurdles for boosting the local labor force. The ongoing threat of the virus, childcare obligations and WMATA's limited hours of operation are keeping some former workers out of the market until full normalcy is regained.

Investment sales volume in the District was fairly quiet in the second quarter of 2021. Non-Downtown submarkets captured the notable sales activity. Although investment activity Downtown has been quiet in 2021, 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)	2Q 2021 Absorption (SF)	YTD 2021 Absorption (SF)
District of Columbia	**130,574,856**	**15.4%**	**16.6%**	**56,303**	**859,390**	**-1,358,509**	**-836,866**	**-1,427,727**
Class A	85,484,713	14.1%	15.3%	1,308,837	1,749,434	-143,586	-2,843	-157,885
Class B	39,541,251	17.9%	19.2%	-1,254,639	-609,104	-944,369	-806,330	-1,177,737
Class C	5,548,892	17.6%	18.6%	2,105	-280,940	-270,554	-27,693	-92,105

Market Statistics By Class

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	2Q 2021 Deliveries (SF)	YTD 2021 Deliveries (SF)	Under Construction (SF)
District of Columbia	**130,574,856**	**$62.26**	**$49.81**	**$57.43**	**0**	**227,948**	**2,052,344**
Class A	85,484,713	$62.26	NA	$62.26	0	227,948	2,052,344
Class B	39,541,251	NA	$49.81	$49.81	0	0	0
Class C	5,548,892	NA	NA	$48.15	0	0	0

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

Submarket Statistics—All Classes

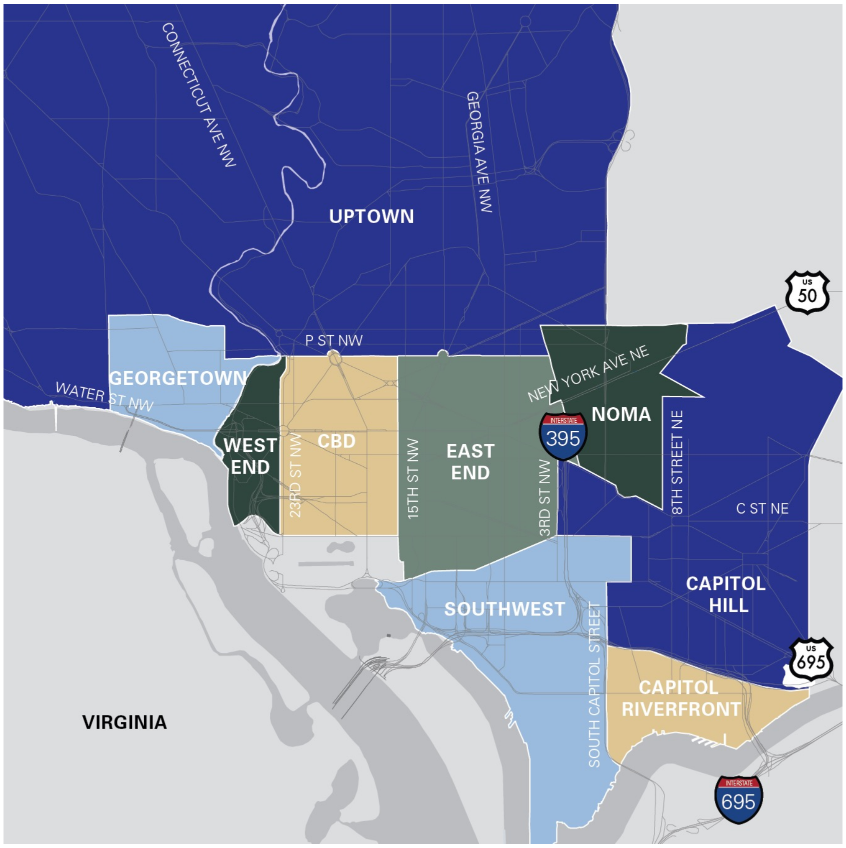
	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2018 Absorption (SF)	2019 Absorption (SF)	2020 Absorption (SF)	2Q 2021 Absorption (SF)	YTD 2021 Absorption (SF)
District of Columbia	**130,574,856**	**15.4%**	**16.6%**	**56,303**	**859,390**	**-1,358,509**	**-836,866**	**-1,427,727**
Capitol Hill	5,542,247	22.3%	23.4%	141,019	5,188	169,977	-242,691	-205,245
Capitol Riverfront	4,265,428	14.5%	15.0%	242,861	-835	93,635	-26,073	-129,104
Central Business District	41,310,735	16.2%	17.9%	494,740	-443,715	-908,750	-360,892	-877,849
East End	42,564,797	18.0%	19.3%	-170,534	-116,060	-614,421	-245,186	-29,493
Georgetown	2,851,274	12.4%	13.4%	-107,899	-77,883	-7,392	-36,096	-47,204
NoMa	12,089,080	8.8%	9.1%	39,048	750,211	592,186	-356,654	-359,658
Southwest	11,953,807	8.9%	9.0%	164,964	695,064	-568,116	502,394	487,931
Uptown	5,964,404	16.2%	17.1%	-750,950	215,990	-34,521	-69,833	-287,546
West End	4,033,084	12.2%	13.4%	3,054	-168,570	-81,107	-1,835	20,441

Submarket Statistics—All Classes

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	2Q 2021 Deliveries (SF)	YTD 2021 Deliveries (SF)	Under Construction (SF)
District of Columbia	**130,574,856**	**$62.26**	**$49.81**	**$57.43**	**0**	**227,948**	**2,052,344**
Capitol Hill	5,542,247	$67.68	$52.75	$60.36	0	0	214,501
Capitol Riverfront	4,265,428	$53.12	NA	$53.12	0	227,948	457,633
Central Business District	41,310,735	$63.34	$51.71	$58.46	0	0	492,974
East End	42,564,797	$65.45	$50.14	$60.48	0	0	143,872
Georgetown	2,851,274	$59.19	$43.42	$45.58	0	0	0
NoMa	12,089,080	$50.89	$50.61	$50.78	0	0	38,191
Southwest	11,953,807	$50.58	$46.07	$49.25	0	0	639,703
Uptown	5,964,404	$50.76	$44.50	$46.01	0	0	65,470
West End	4,033,084	$66.65	$51.21	$60.54	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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