Washington Metro Area Market Overview

Occupancy Contraction Softens Fundamentals; Top Quality Assets Capture Majority of Leasing and Investment Activity

Economic conditions in the Washington metro area have been unsteady in 2022. Global economic headwinds have resulted in a deceleration of recovery since late 2021. The high inflationary environment has necessitated a steadfast effort by the Federal Reserve to swiftly and incrementally raise interest rates. The repercussions of these actions on economic markets are mixed; however, it has the potential to hamper labor and wage growth and create some recessionary pressures.

The Washington region's labor market expanded relative to year-ago levels, but its pace of growth has slowed in the summer of 2022. Total nonfarm employment has expanded by 73,800 jobs in the 12 months since August 2021, of which 13,400 were in office-using sectors. Regional employment has been relatively static across all three substate area since June 2022, coinciding with mounting macroeconomic headwinds. Still, the region boasts strong economic drivers, which are anticipated to support labor markets despite challenges such as inflation, rising cost of capital, and recessionary fears. Newmark forecasts a net gain of 84,500 jobs by year-end and anticipates an average of 44,150 net new jobs gained per annum from 2022 to 2025. The region's unemployment rate has decreased 170 basis points over the last year to 3.6%. Predicted seasonality resulted in a modest contraction in the region's labor force participation rate in August 2022.

Economy

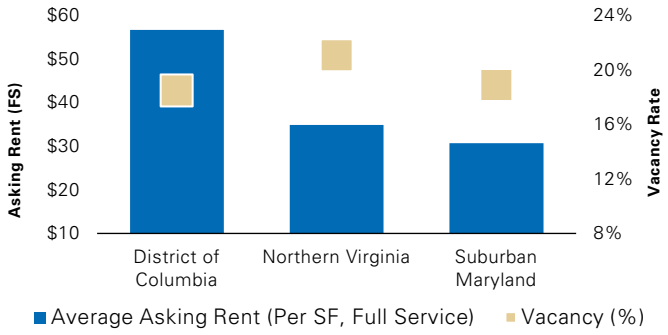
- **Historical Job Change:** 73,800 jobs were gained in the 12 months ending August 2022. The rate of employment growth has generally slowed in 2022; however, the annualized growth rate has increased 10 basis points between July and August 2022, currently measuring 2.3%.
- **Projected Job Growth:** Newmark forecasts a net gain of 84,500 jobs in 2022 as post-pandemic employment recovery moderates and economic pressures slow momentum. Job gains are expected to average 44,150 per annum from 2022 through 2025.
- **Unemployment Rate:** The regional unemployment rate measured 3.6% in August 2022, a decrease of 170 basis points from August 2021, but an increase of 10 basis points from July 2022.

Market Summary

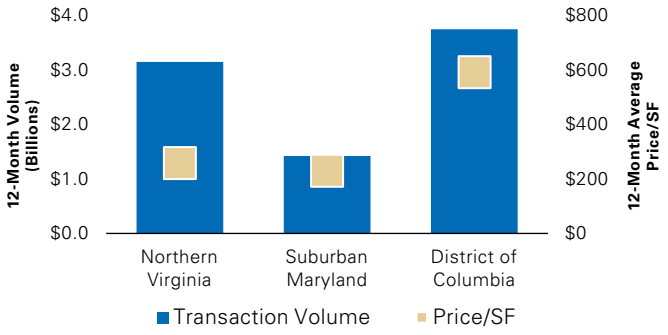
	District of Columbia	Northern Virginia	Suburban Maryland	Metro Area
Total Inventory (SF)	132.0 M	165.7 M	75.8 M	373.5 M
Vacancy Rate	18.5%	21.1%	18.9%	19.7%
Quarterly Net Absorption (SF)	-252,305	55,031	-197,341	-394,615
Average Asking Rent/SF	$56.74	$34.90	$30.75	$42.09
Under Construction (SF)	580,083	1.4 M	414,746	2.4 M
Deliveries YTD (SF)	1.2 M	1.4 M	726,000	3.3 M

Market Analysis

ASKING RENT AND VACANCY RATE



OFFICE INVESTMENT SALES VOLUME AND PRICING



Source: Newmark Research, September 2022

NEWMARK

Fundamentals Unsteady in Recovery; Return-to-Office Momentum Encourages Normalcy

Quarterly net absorption measured negative 394,615 square feet in the third quarter of 2022, representing a relative improvement from the second quarter. Unlike past quarters, most of the occupancy losses in the third quarter were concentrated in the District of Columbia, which measured negative 252,305 square feet. Suburban Maryland recorded occupancy contraction measuring negative 197,341 square feet. Conversely, Northern Virginia recorded modestly positive net absorption of 55,031 square feet. Northern Virginia's recovery over the last 18 months has been uneven, noted by quarters of alternating positive and negative net absorption. As a result of the ebbs and flows of occupancy, year-to-date net absorption is the least severe in Northern Virginia, measuring negative 121,938 square feet. Year-to-date net absorption measured negative 870,708 square feet and negative 290,774 square feet in Suburban Maryland and the District of Columbia, respectively.

New construction deliveries were a strong driver of occupancy in the region in the first half of 2022. However, low demand has significantly decreased new project starts, leading to a shrinking development pipeline. The only building to deliver in the third quarter was Marriott's 726,000 square-foot headquarters in downtown Bethesda. This delivery resulted in a large boost to occupancy in Bethesda, but also created 900,000 square feet of vacancy at Marriott's former headquarters in North Bethesda.

This vacancy will be a weight on North Bethesda's fundamentals in the short term, but in a growing trend among owners of high-vacancy office assets, Marriott's former headquarters is slated for conversion to a non-office use, in this case senior housing. Over the last year, over 3.5 million square feet of office space has been removed from inventory due to conversion, and just under 7.5 million square feet is proposed to be converted. While all these projects may not come to fruition in the near term, their potential impact on taming vacancy and oversupply could be noteworthy for the market.

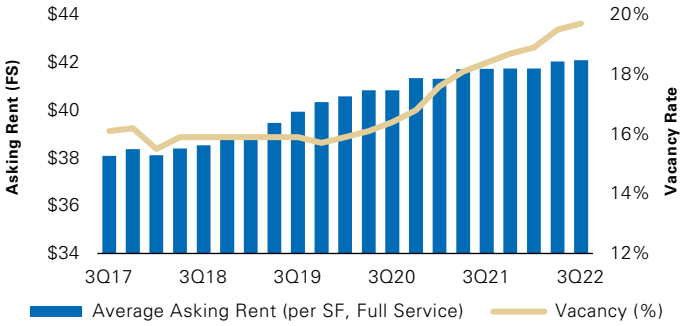
Vacancy continued to rise in the third quarter, increasing by 130 basis points over the last 12 months, to 19.7%. The market-wide trends of flight-to-quality and downsizing have been key in applying continued upward pressure on vacancy. Inventory expansion due to new construction deliveries have caused Class A vacancy to rise 140 basis points over the last year to 19.2%, despite net positive occupancy during that time. Class B vacancy has increased 170 basis points over the last year to 22.1%. As noted, the region's construction pipeline has contracted to its lowest level in eight years and 660,322 square feet is expected to deliver by year-end. The region's total construction pipeline boasts a prelease rate of 69.9%, which indicates that the deliveries may not have as adverse an impact on overall vacancy as the deliveries in early 2022 did.

Current Conditions

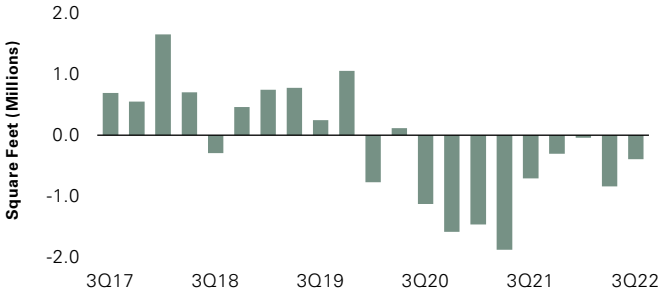
- The region registered negative 394,615 square feet of net absorption during the third quarter. Year-to-date absorption measured negative 1,283,420 square feet. Occupancy losses in 2022 have been less severe than in 2021 but are significant relative to historical levels and are continuing to soften the market.
- Vacancy continued to rise in the third quarter, reaching 19.7%. Most vacancy growth over the last year is concentrated in the region's Class B market; however, new construction deliveries in 2022 have applied a greater weight on Class A vacancy as well.
- Despite elevated vacancy, average asking rents increased modestly in the third quarter to $42.09/SF. Asking rent growth has been decelerating precipitously over the last two years and measured 0.9% annualized growth in the third quarter.

Market Analysis

ASKING RENT AND VACANCY RATE



NET ABSORPTION



Market Summary

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	373.5 M	373.1 M	371.1 M	↓
Vacancy Rate	19.7%	19.5%	18.4%	→
Quarterly Net Absorption (SF)	-394,615	-844,574	-711,235	↑
Average Asking Rent/SF	$42.09	$42.04	$41.73	→
Under Construction (SF)	2.4 M	2.5 M	5.3 M	↓
Deliveries YTD (SF)	3.3 M	2.6 M	2.3 M	↓

Despite the region's elevated vacancy and supply and demand imbalance, average asking rents continue to hold value. Average asking rents have increased 0.9% over the last year, to $42.09/SF. In the third quarter, Class A and B rents measured $45.96/SF and $37.65/SF, respectively. Although rents continue to appreciate, the pandemic's lasting impact on slow demand has resulted in a precipitous reduction in the growth rate of asking rents. Further, the slow demand environment has weakened landlord leverage and has resulted in greater downward pressure on effective rents. Significant concession packages as incentives to relocate remain common in most submarkets. Yet, inflationary pressure on construction materials and supply chain delays are resulting in significant increases in the total cost to build and furnish space. Despite high tenant improvement allowances, tenants may still need to contribute a noteworthy share to outfit new space.

Suburban Growth Drives Market Optimism

The suburban markets in the Washington metro area face a variety of challenges but have also served as the economic upside engines for the region. Suburban sprawl over several decades has left both Northern Virginia and Suburban Maryland overweight with uncompetitive office space. Collectively, these markets boast an overall vacancy rate of 20.4%; however, for office assets constructed since 2010, a market sized at 19.8 million square feet, the collective vacancy rate is just 13.3%. This differential is supported by flight-to-quality trends and the relatively high prelease rates achieved in new construction over the last decade. This also supports the idea that certain nodes within suburban markets are desirable and can be competitive in the market, despite the more common narrative that all suburban assets face significant challenges.

Quarterly net absorption tipped positive in Northern Virginia for the second time in 2022, confirming volatility in the market but also upside potential. Suburban Maryland's occupancy remained contractionary in the third quarter, but losses were partly driven by the large relocation and consolidation of Marriott into its new headquarters in downtown Bethesda. This relocation emphasizes the market-wide trend of flight-to-quality and the preference among suburban tenants to relocate to higher-density live-work-play communities with strong transportation access. The unique segmentation of suburban office market conditions is further heightened by the green chutes of economic momentum in the markets. As the delivery of Amazon's HQ2 approaches in early 2023, the spillover impacts could drive net-new tech demand, potentially resulting in even greater tightening in high-end, newer assets in high-density markets inside the Beltway. Despite oversupply challenges, availability for top-of-market space may justify new construction activity, should demand develop.

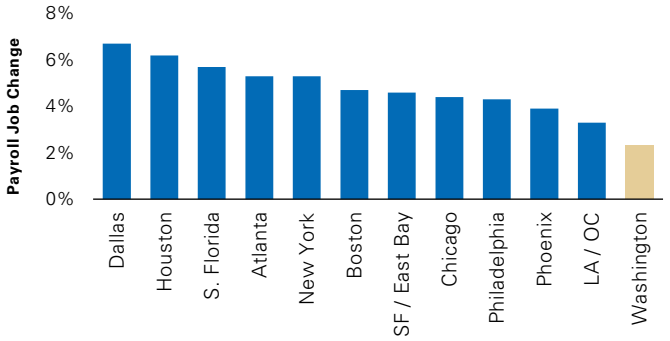
Rising Importance of Lenders in Uncertain Market

The prolonged softness of office market fundamentals and the relatively dry pipeline of new demand has been wearing on some building owners' financial positions. For high-vacancy buildings carrying significant debt, current market conditions could drive debt above distressed property values and force intervention by lenders. This phenomenon has been sparse but evident in 2022, as a handful of distressed commercial assets in gateway markets, including New York and Chicago, have fallen under lender control. In late third-quarter, Hines relinquished control of 700 11th Street, NW to its lender, Allianz Real Estate, following the relocation of Williams & Connolly earlier in the year. This forced sale highlights that commodity-grade Class A assets can exhibit serious symptoms of distress and that flight-to-quality is damaging more than just the Class B market. While it is not anticipated that lender takeovers will be pervasive in the market, current conditions in both leasing and investment markets will challenge high-vacancy buildings carrying significant debt.

Consistent with the market's trend toward office repositioning, Allianz is marketing the property for sale as a residential conversion. Since 2000, 5.0 million square feet of conversion projects have broken ground in the region, equating to a significant reduction in office inventory. The current pipeline of proposed conversion projects measures 6.5 million square feet and is likely to grow as office asset pricing remains under downward pressure and the alternative uses of office buildings show greater value to owners.

Payroll Job Change – Largest Metro Areas

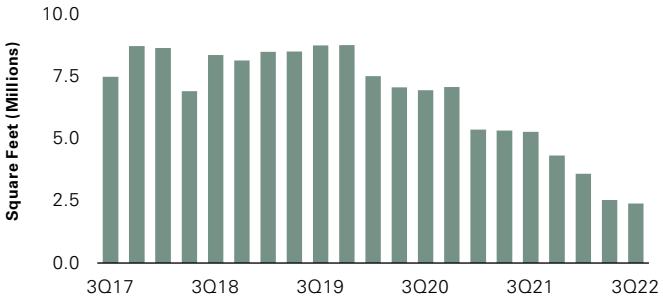
12 MONTHS ENDING AUGUST 2022



Source: U.S. Bureau of Labor Statistics, Newmark Research; September 2022

Office Market Construction Pipeline

WASHINGTON METRO AREA | SQ. FT. UNDER CONSTRUCTION



Source: U.S. Bureau of Labor Statistics, Newmark Research; September 2022

Washington Area Economic Outlook

Economic recovery slowed in the third quarter of 2022, due to global macroeconomic volatility. Labor market expansion moderated through the summer, particularly among office-using employment sectors. This is a point of concern for Washington's office demand recovery and for its competitive position among other large metro markets. The region added 73,800 jobs in the 12 months since August 2021, of which 13,400 jobs were in office-using sectors. Newmark projects that labor expansion will average 44,150 jobs per annum from 2022 to 2025. Growing economic uncertainty has resulted in a modest downward adjustment to this forecast, relative to early-year projections.

Washington's diversified economy will create green chutes for growth in the period ahead. Most noteworthy is the region's growing reputation as a technology hub, noted by its highly educated workforce and growing presence of globally-recognized technology firms. Long-term investments by respected academic institutions to solidify the region's tech-trained talent pipeline will further bolster economic opportunities and the labor supply necessary to attract more firms to the area.

Though there is optimism for significant future employment growth, headwinds are present. The Fed's use of monetary policy has been successful at slowing inflation domestically, but it has come at a cost of slowing employment and GDP growth. Though a recession is not a foregone conclusion, it is important to note that the Washington metro area's labor market has performed well during periods of economic uncertainty, due to the insulating effect of the federal government and associated federal activities. While the region's labor force has diversified over the last 20 years, Washington is still likely to benefit from its outsized share of federal activities during periods of uncertainty.

Office Market Outlook

Washington's office market fundamentals continued to soften in the third quarter of 2022 but marked an improvement from the prior quarter. As anticipated, market fundamentals remain challenged, as the pressure of low demand and early-year inventory expansion weigh on the market. Though challenges resulting from the pandemic persist, some green chutes have begun to emerge. Leasing activity, while still low relative to pre-pandemic expectations, increased in the third quarter, particularly among small and mid-sized firms. Several large renewals were additionally encouraging, as locally significant firms reaffirmed their commitments to office space.

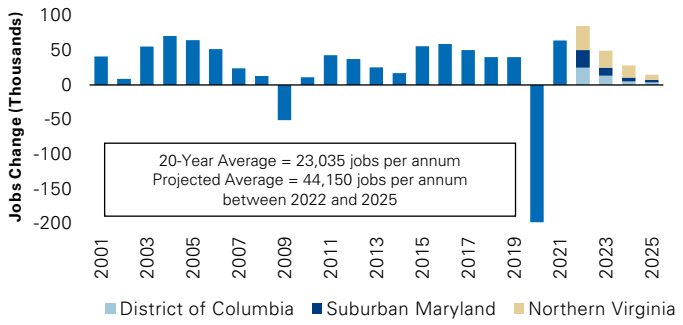
Leasing activity may modestly improve in the period ahead, particularly given accelerating return-to-office momentum following Labor Day. According to Kastle Systems data through mid-September, office occupancy rates in the Washington region accelerated at the fastest month-over-month rate since the start of the pandemic and eclipsed 50% of the pre-pandemic baseline. This movement back to offices is being supported both by public and private entities. While hybrid schedules are anticipated to remain a staple for many office workers, some in-office occupancy is expected for most firms. The period ahead will be a critical time for real estate decision makers to test the appropriate balance between workspace needs and operational efficiency.

Overall office market fundamentals are anticipated to remain soft in the period ahead; however, bifurcation will exist among certain subsets in the region. Oversupply will continue to pressure large swaths of the market, but flight-to-quality will direct much of the new leasing activity to the top of the market, tightening fundamentals for high-end Class A and Trophy-grade assets. This distribution of demand will apply an outsized pressure on older assets with high vacancy, and subsequently will challenge owners given uncertain financial and lending markets. Newmark estimates that over the next 24 months, regional net demand will measure about 450,000 square feet, much of which will be in higher quality assets. Increased demand and a rebalancing of inventory, by way of conversions, are anticipated to result in modest vacancy contraction to 19.2% by September 2024.

For additional information on the District of Columbia, Northern Virginia, and Suburban Maryland office markets, please visit Newmark's website: Mid-Atlantic Market Reports.

Payroll Job Growth Forecast

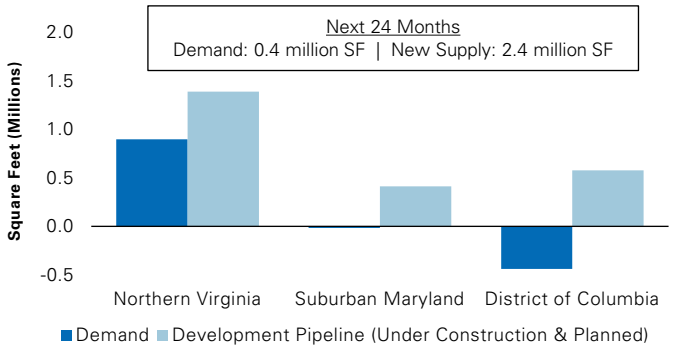
WASHINGTON METRO AREA | 2001 - 2025



Source: U.S. Bureau of Labor Statistics; Forecast by Newmark Research, Stephen S. Fuller Institute and Moody's Analytics; September 2022

Supply/Demand Forecast

WASHINGTON METRO AREA | 24 MONTHS ENDING SEPT 2024



District of Columbia Office Market

The District of Columbia's office market fundamentals continued to soften through the third quarter of 2022. Net absorption measured negative 252,305 square feet in the third quarter, its most contractionary level over the last year. Absorption had been supported by new deliveries from late 2021 to mid-2022; however, as the construction pipeline has slowed, its positive influence on occupancy has lessened.

Quarterly vacancy measured 18.5%, up 20 basis points from second-quarter 2022 and up 150 basis points in the last year. Class A vacancy, aided by positive net absorption, decreased by 10 basis points on the quarter, measuring 16.7% in the third quarter. The District construction pipeline measured 580,083 square feet in the quarter, unchanged from the second quarter and at its lowest level in decades. Buildings currently under construction are 56.1% preleased, and 113,126 square feet is expected to deliver by year-end.

Average asking rents in the third quarter of 2022 measured $56.74/SF, a $0.02/SF decrease from last quarter and a $0.17/SF decrease from one year ago. Continued slow demand has caused downward pressure on asking rents since the onset of the pandemic, but overall asking rent contraction moderated in 2022. Additionally, there is optimism in the Class A market, which recorded year-over-year rent growth of 0.3%, an 18-month high.

District of Columbia Outlook

The District's office market softened modestly in the third quarter as market fundamentals continue to be steered by the slow leasing environment. Growing economic headwinds have dampened activity among both investors and occupiers. Despite market uncertainty, Newmark Research projects modest tightening over the next 24 months, resulting in the vacancy rate decreasing to 18.4% by September 2024.

Flight to quality will remain the strongest market driver and newly constructed buildings are likely to attract much of the demand in the period ahead. The impact of oversupply and pricing competition will present challenges to commodity-grade and Class B assets. Yet, low-quality Class A buildings may face more lasting threats, given the popularity of Class B conversions. Contracting Class B inventory could tighten fundamentals for the most cost-effective buildings. Slow leasing in the third quarter should temper expectations for strong occupancy gains in the near term. Asking rents may modestly appreciate in high-quality assets, but low demand will ensure that generous concession packages remain common.

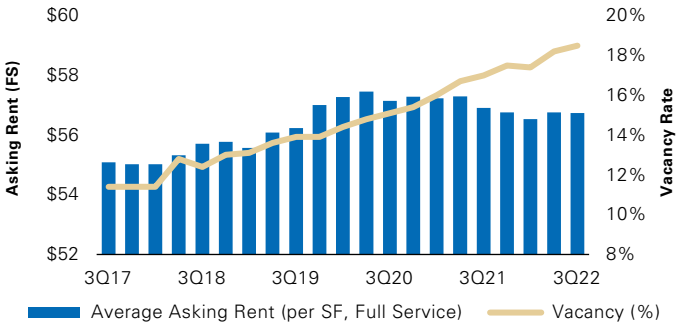
Like occupiers, investors have similarly exhibited an imbalanced appetite for office space. Office sales volume is heavily concentrated in top-quality assets, which generally feature large footprint tenants and high WALT. Uncertainty in financial markets will likely slow investment activity in the near term, particularly for value-add investments. Although headwinds persist, the District of Columbia's reputation as a strong investment market has supported noteworthy inbound foreign capital over the last year.

Current Conditions

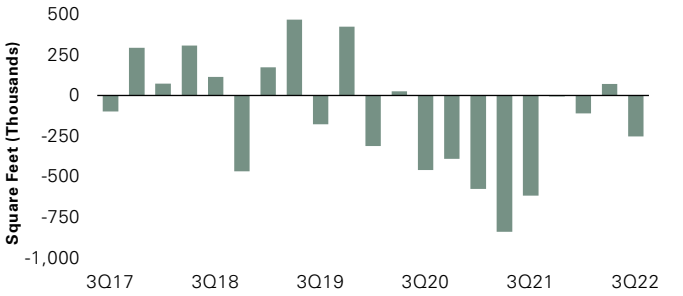
- The District of Columbia recorded negative 252,305 square feet of net absorption in the third quarter of 2022. Year-to-date net absorption measures negative 290,774 square feet.
- The vacancy rate rose 150 basis points over the last year to 18.5%. This is reflective of steady occupancy contraction; however, DC's construction pipeline has fallen to just 580,083 square feet, which will reduce the effect of inventory expansion on rising vacancy.
- Average asking rents measured $56.74/SF in the third quarter and have been relatively stable in 2022. Still, low leasing activity is driving rent compression in lower-class and commodity-grade spaces, and effective rents are similarly under downward pressure.

Market Analysis

ASKING RENT AND VACANCY RATE



NET ABSORPTION



Market Summary

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	132.0 M	132.1 M	130.7 M	→
Vacancy Rate	18.5%	18.3%	17.0%	→
Quarterly Net Absorption (SF)	-252,305	71,191	-616,797	↑
Average Asking Rent/SF	$56.74	$56.76	$56.91	→
Under Construction (SF)	580,083	580,083	2.1 M	→
Deliveries YTD (SF)	1.2 M	1.2 M	266,139	↑

Northern Virginia Office Market

Northern Virginia's office market modestly accelerated in the third quarter of 2022. Net absorption measured 55,031 square feet in the third quarter, offsetting some of the occupancy lost in the previous quarter. Year-to-date net absorption measured negative 121,938 square feet. Positive quarterly occupancy resulted in a slight reduction to vacancy, which decreased 10 basis points from last quarter to 21.1%. However, over the last 12 months, vacancy has increased by 80 basis points, driven by low demand and a healthy construction pipeline

Despite the moderate decrease in vacancy and uneven recovery in net absorption, average asking rents continue to increase. Average asking rents appreciated by 1.1% over the last 12 months, reaching $34.90/SF. Leasing activity has been on the rise through the third quarter, but this activity is not equitably distributed among all Northern Virginia's submarkets. Leasing activity was supported by large footprint renewals in the third quarter and was headlined by Hilton's 220,000 square-foot renewal at 7930 Jones Branch Drive. This was the second-largest lease signed in Northern Virginia since the start of the pandemic.

Northern Virginia Outlook

Northern Virginia's office market showed modest recovery in the third quarter of 2022, registering positive absorption for the second time this year. Relatively strong leasing activity in the third quarter of 2022 is a positive indicator for the Northern Virginia market, but pressure among many employers to reduce real estate footprints is expected to result in net occupancy loss for many firms when negotiating new leases. Newmark Research projects that Northern Virginia's vacancy will decrease from 21.1% to 20.4% by the third quarter of 2024.

Throughout Northern Virginia, the average asking rent increased by 1.1% over the last year and marks the third consecutive quarter of increase. Modest rent appreciation is likely to sustain, despite oversupply challenges that will continue in the market. While rent growth is promising given low demand, concessions remain high regionally and effective rents continue to be under downward pressure.

Northern Virginia's construction pipeline measures 1.4 million square feet, with a prelease rate of 86.6%. Prior to the delivery of Tysons Central, which was completed without any leases signed in the second quarter, Northern Virginia's overall prelease rate was just 40.3%. At less than 1% of the existing inventory, the construction pipeline is modest. Given tenant preference for high-quality office space, Northern Virginia's market could support new development, especially if owners can attract strong preleasing rates.

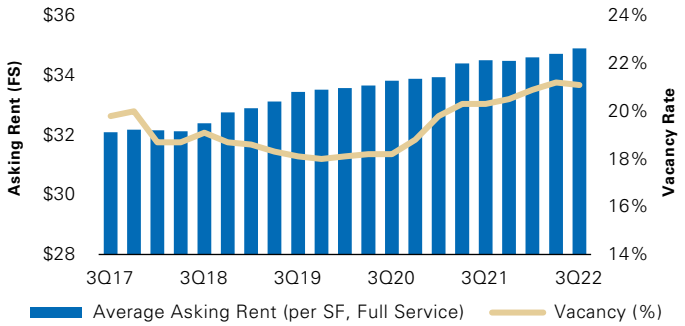
Northern Virginia continues to build on its reputation as a hub for technology, government contractors, and cybersecurity firms. The ability to keep luring top-tier firms within these industries, in part due to the relatively friendly business environment in Northern Virginia, has been a driving factor for the area and present strong atmosphere to foster long-term tenants and growth within these industries.

Current Conditions

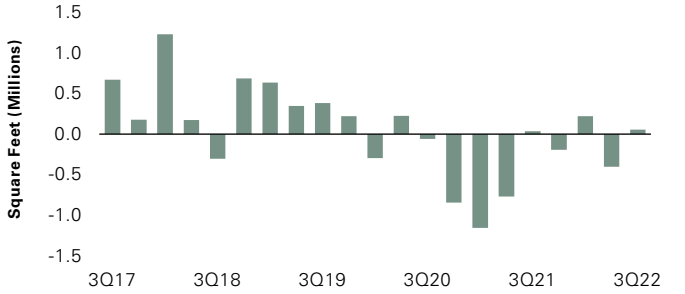
- Quarterly net absorption measured positive 55,031 square feet in the third quarter. This offsets some of the occupancy lost from the second quarter, resulting in year-to-date net absorption of negative 121,938 square feet
- The overall vacancy rate was 21.1% at the end of the third quarter, up 80 basis points from one year ago
- Office space under construction, excluding renovations and owner-occupied buildings, totaled 1.4 million square feet at the end of the third quarter.
- Asking rents rose to $34.90/SF on the quarter and are up 1.1% from one year ago

Market Analysis

ASKING RENT AND VACANCY RATE



NET ABSORPTION



Market Summary

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	165.7 M	165.7M	164.4 M	↓
Vacancy Rate	21.1%	21.2%	20.3%	↓
Quarterly Net Absorption (SF)	55,031	-399,932	35,731	↑
Average Asking Rent/SF	$34.90	$34.72	$34.51	↑
Under Construction (SF)	1.4 M	869,414	2.2 M	↓
Deliveries YTD (SF)	1.4 M	1.4 M	679,000	↑

Suburban Maryland Office Market

Suburban Maryland's office market recovery softened in the third quarter of 2022. Net absorption totaled negative 197,341 square feet on the quarter, about half of the contraction registered in the second quarter. Few examples of net positive occupancy enabled the accumulation of significant negative net absorption. The overall vacancy rate registered 18.9% at the end of the third quarter, an increase of 100 basis points from second quarter due to Marriott's relocation, and an increase of 240 basis points from a year ago. The average asking rental rate measured $30.75/SF, an increase of 3.5% from the third quarter of 2021.

Suburban Maryland's construction pipeline shrank to its lowest level since 2017, measuring 414,746 square feet in the third quarter of 2022. The pipeline is approximately 36.7% preleased, indicating potential increases in vacant square footage in the coming quarters. Marriott's new headquarters at 7750 Wisconsin Avenue delivered this quarter. The 726,000 square-foot building marks a notable contraction from its over-900,000 square-foot headquarters at 10400 Fernwood Road. This delivery and occupancy is influential for Suburban Maryland statistics this quarter, as it resulted in more than 700,000 square feet of inventory growth and positive absorption in downtown Bethesda, but it also resulted in about 900,000 square feet of new vacancy at Marriott's old headquarters. There are two properties set to deliver in the remainder of 2022, but generally, relative scarcity of office leasing activity will keep construction activity low.

Suburban Maryland Outlook

Soft market fundamentals in Suburban Maryland should gradually tighten in the next year as markets further normalize. As this year's most notable delivery, Marriott's presence in downtown Bethesda boosts the strength of Maryland's denser, surrounding office markets. Yet, this move may serve to offset the loss of Clark Construction, which will relocate from Bethesda to Tysons in late 2022. Suburban Maryland remains in competition with Northern Virginia for regional economic growth. Prince George's County is seeking more private and government investment to support its growing technology and quantum computing industries, in addition to its office/medical demands, to complement the region's status as a life science hub. Increased investment in Gaithersburg, Germantown, and throughout Montgomery and Prince George's Counties bodes well for the continued necessity of diverse commercial and multi-use space throughout the region.

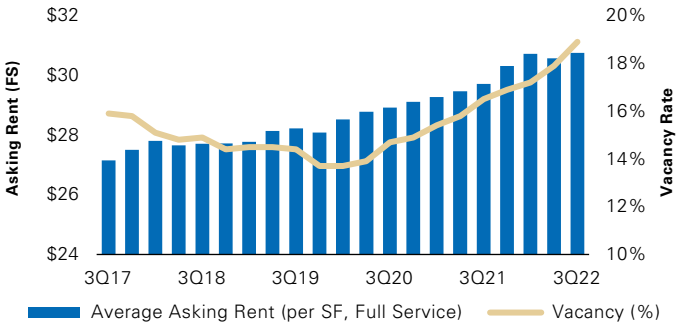
Suburban Maryland's construction pipeline declined from last quarter, measuring less than 1.0% of inventory. For a change, future new deliveries will be concentrated in submarkets outside of Bethesda. Newmark Research projects that Suburban Maryland's overall vacancy rate will decrease to 18.2% by the end of the third quarter of 2024.

Current Conditions

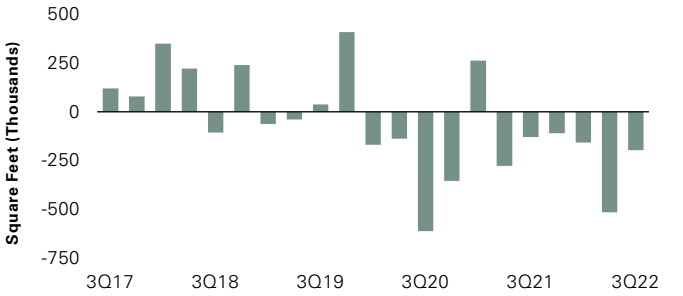
- Suburban Maryland recorded negative 197,341 square feet of net absorption in the third quarter, an improvement from the second quarter.
- Office demand has been muted, despite several deliveries in 2022.
- Vacancy has increased 240 basis points from last year, to 18.9%.
- 414,746 square feet is under construction; groundbreakings remain limited given low demand and cost of resources.
- Asking rents increased 3.5% over the last year, to $30.75/SF.

Market Analysis

ASKING RENT AND VACANCY RATE



NET ABSORPTION



Market Summary

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	75.8 M	75.3 M	76.1 M	↑
Vacancy Rate	18.9%	17.9%	16.5%	↑
Quarterly Net Absorption (SF)	-197,341	-515,833	-130,169	→
Average Asking Rent/SF	$30.75	$30.57	$29.71	↑
Under Construction (SF)	414,746	1.1 M	923,196	→
Deliveries YTD (SF)	726,000	0	1.3 M	↑

Market Statistics – Vacancy and Absorption

	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2019 Absorption (SF)	2020 Absorption (SF)	2021 Absorption (SF)	3Q 2022 Absorption (SF)	YTD 2022 Absorption (SF)
Washington Metro Area	**373,527,900**	**18.5%**	**19.7%**	**2,795,951**	**-3,376,041**	**-4,371,002**	**-394,615**	**-1,283,420**
District of Columbia	132,031,725	17.2%	18.5%	890,479	-1,131,361	-2,037,381	-252,305	-290,774
Suburban Maryland	75,796,753	17.6%	18.9%	347,384	-1,274,582	-253,457	-197,341	-870,708
Northern Virginia	165,699,422	19.8%	21.1%	1,558,088	-970,098	-2,080,164	55,031	-121,938

Market Statistics – Vacancy and Absorption By Class

	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2019 Absorption (SF)	2020 Absorption (SF)	2021 Absorption (SF)	3Q 2022 Absorption (SF)	YTD 2022 Absorption (SF)
Washington Metro Area	**373,527,900**	**18.5%**	**19.7%**	**2,795,951**	**-3,376,041**	**-4,371,002**	**-394,615**	**-1,283,420**
Class A	232,931,794	17.9%	19.2%	2,890,036	-1,010,799	-1,022,021	-10,140	763,316
Class B	105,687,259	20.6%	22.1%	128,509	-1,628,268	-3,046,560	-368,100	-1,979,192
Class C	34,908,847	15.7%	16.4%	-222,594	-736,974	-302,421	-16,375	-67,544

Market Statistics – Rents and Development

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	3Q 2022 Deliveries (SF)	YTD 2022 Deliveries (SF)	Under Construction (SF)
Washington Metro Area	**373,527,900**	**$45.96**	**$37.65**	**$42.09**	**726,000**	**3,216,906**	**2,385,371**
District of Columbia	132,031,725	$62.01	$48.32	$56.74	0	1,077,883	580,083
Suburban Maryland	75,796,753	$33.44	$27.77	$30.75	726,000	726,000	414,746
Northern Virginia	165,699,422	$37.18	$32.26	$34.90	0	1,413,023	1,390,542

Market Statistics – Rents and Development By Class

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	3Q 2022 Deliveries (SF)	YTD 2022 Deliveries (SF)	Under Construction (SF)
Washington Metro Area	**373,527,900**	**$45.96**	**$37.65**	**$42.09**	**726,000**	**3,216,906**	**2,385,371**
Class A	232,931,794	$45.96	NA	$45.96	726,000	3,216,906	2,385,371
Class B	105,687,259	NA	$37.65	$37.65	0	0	0
Class C	34,908,847	NA	NA	$31.38	0	0	0

Note: Asking rents are quoted on a full service basis

Investment Sales Market

The Washington region registered $8.3 billion in office sales volume for the 12 months ending in third-quarter 2022. Quarterly sales volume measured $2.3 billion in the third quarter; the highest quarterly level reached in 2022. Despite this upward trend in activity, macroeconomic headwinds are present and suppressing investment activity among a large share of office assets. Portfolio transactions and top-of-market sales have been boosting overall office investment activity for much of 2022. Although total transaction volume suggest pre-pandemic normalcy in investment markets, demand is inconsistent and concentrated in the highest value and most stable assets. Factors including increased cost of capital, elevated interest rates, and unsteady economic growth have dampened investor interest for most office assets. Continued uncertainty regarding the utility of office space, is creating additional pause among investors, despite available dry powder.

Investment Activity Concentrated in Top-of-Market

The key drivers of office investment uncertainty are not unique to the Washington metro area. Nationally, office investors have practiced a similar degree of caution. Investors seeking both safety and upside may find Washington's historically strong performance during periods of economic uncertainty enticing. Despite the headwinds of hybrid work, the importance of in-office occupancy among the federal government and its contractors will serve as a relative anchor for long-term office utility in the region.

Foreign investors have been most active in the region through 2022, focused on new and high-quality assets. Among non-portfolio sales through the third quarter, foreign capital measured 44.3% of investment activity in the region. Most recently, Mori Trust, a notable Japanese developer, acquired 601 Massachusetts Avenue, NW for $531.0 million, or $1,109/SF. This marks the region's largest sale of the year, exceeding 1900 N Street, NW, which sold in June for $265.0 million to Commerz Real AG, a German firm.

While flight-to-quality has driven investors to the top of the market, lower quality assets with high vacancy are challenged. There are opportunities for less risk-averse investors to buy low, or for institutional investors and owner-users to purchase with long-term holding strategies. Additionally, converters remain active; however, the cost of conversion and access to financing are restricting some growth of this trend. Over the last year, Newmark has tracked 18 properties that have sold with the intent of conversion and nine conversion projects have commenced construction.

Office Investment Sales Outlook

Hard assets, such as commercial real estate in a primary market such as Washington, can serve as a strong investment vehicle for investors seeking safety. Washington's historically stable returns during periods of uncertainty will ensure it remains a competitive investment market for both domestic and foreign office investors. Structural challenges to national office investment markets will persist in the near term; however, well-positioned assets will provide the greatest degree of safety. Opportunistic investors are likely to see more potential targets as pricing further settles.

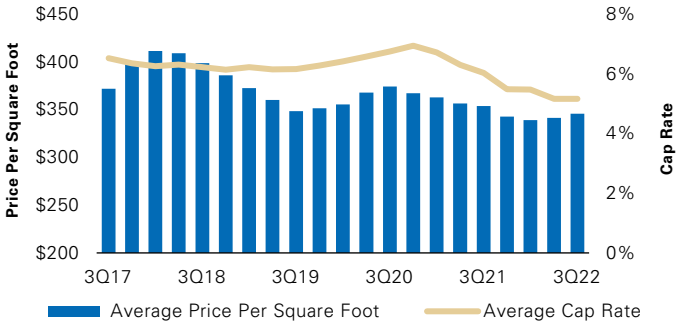
Market Summary

	Washington Metro Area
12-Month Transaction Volume at 3Q 2022	$8.3 B
12-Month Transaction Volume at 3Q 2021	$5.5 B
12-Month Trailing Average Price PSF at 3Q 2022	$346/SF
12-Month Trailing Average Cap Rate at 3Q 2022	5.2%

Note: Values are trailing 12-month averages
Source: Real Capital Analytics, Newmark Research

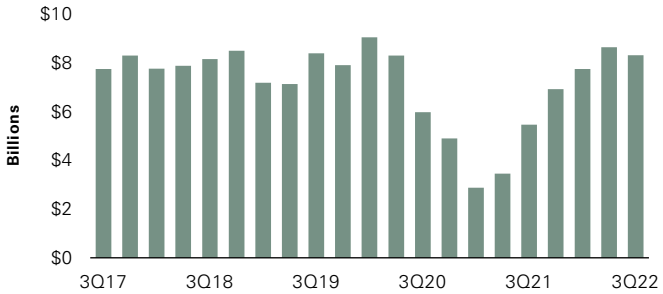
Market Analysis

AVERAGE OFFICE CAP RATE AND PRICE PER SQUARE FOOT



Note: Values are trailing 12-month averages

TRAILING 12-MONTH OFFICE TRANSACTION VOLUME



Notable Recent Office Sales Transactions

Address	Sale Price	Price Per SF	Substate Area
601 Massachusetts Avenue, NW	$531.0 M	$1,033	DC
655 New York Avenue, NW Partial Interest Stake of 49%	$388.7 M	$1,033	DC
Quantum Park 22001 Loudoun County Parkway	$330.0 M	$268	VA
Sentinel Square III 45 L Street, NW	$305.0 M	$560	DC
1900 N Street, NW Leasehold	$265.0 M	$976	DC
Commonwealth Tower 1300 Wilson Boulevard	$245.0 M	$714	VA

Source: Real Capital Analytics, Newmark Research

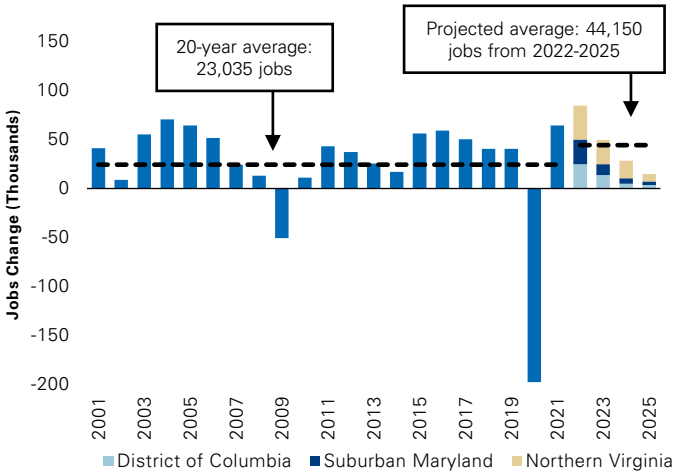
Economic Conditions

The Washington region's unemployment rate registered 3.6% in August 2022; the most recent data available at report production. The local unemployment rate is 10 basis points lower than the national rate of 3.7%. Washington's unemployment rate has been volatile in 2022, partly driven by economic uncertainty in the form of elevated inflation, rising interest rates, and concerns for impending recessionary pressures. The metro area is projected to gain 84,500 net new jobs in 2022, a downward revision from early-year forecasts, which had not anticipated the depth and duration of current global economic headwinds.

The region gained 73,800 jobs over the last year ending in August 2022. Though annualized employment grew at 2.3%, that rate has generally slowed since late 2021. Office-using employment growth has also decelerated during the year, measuring 13,400 new jobs, or 0.7% growth, over the last 12 months. Among office-using sectors, Information employment has grown most rapidly, likely an indicator of the region's growing strength in technical fields. Professional & Business Services – the largest regional office-using sector – has been steadily growing in 2022, registering 1.5% growth over the last year and adding 11,800 net-new jobs to the market.

Employment Forecast

WASHINGTON METRO AREA | PAYROLL JOB CHANGE 2001-2021 AND FORECAST 2022-2025

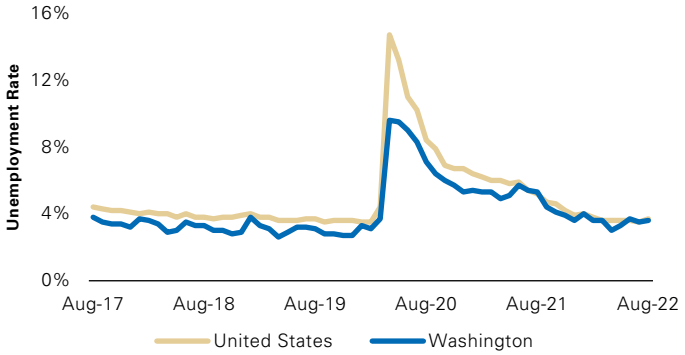


Note: Previous projections have been revised due to COVID-19 and are subject to further revision as conditions change.

Source: U.S. Bureau of Labor Statistics, Moody's Analytics, Newmark Research; September 2022

Unemployment Rate

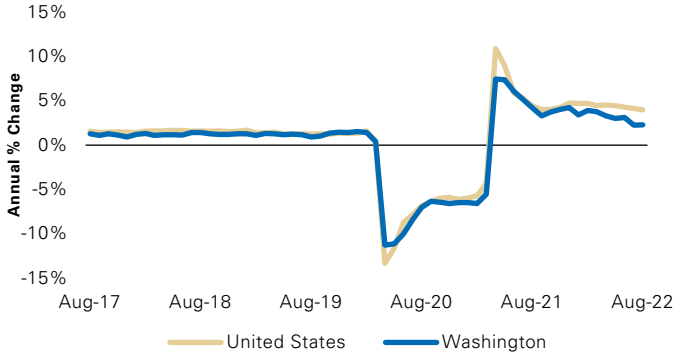
U.S.—SEASONALLY ADJ.
WASHINGTON—NOT SEASONALLY ADJ.



Source: U.S. Bureau of Labor Statistics, Newmark Research; September 2022

Payroll Employment

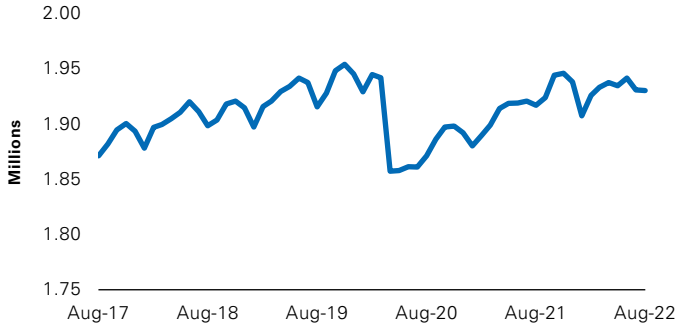
TOTAL NONFARM, U.S.—SEASONALLY ADJ.
WASHINGTON—NOT SEASONALLY ADJ., 12-MO. % CHANGE



Source: U.S. Bureau of Labor Statistics, Newmark Research; September 2022

Office-Using Employment*

WASHINGTON, OFFICE-USING EMPLOYMENT (000'S), NOT SEASONALLY ADJ.

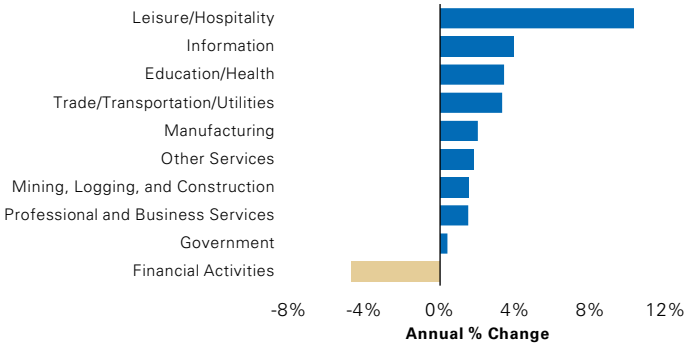


*Identified as Financial Activities, Government, Information, Other Services, and Professional and Business Services

Source: U.S. Bureau of Labor Statistics, Newmark Research; September 2022

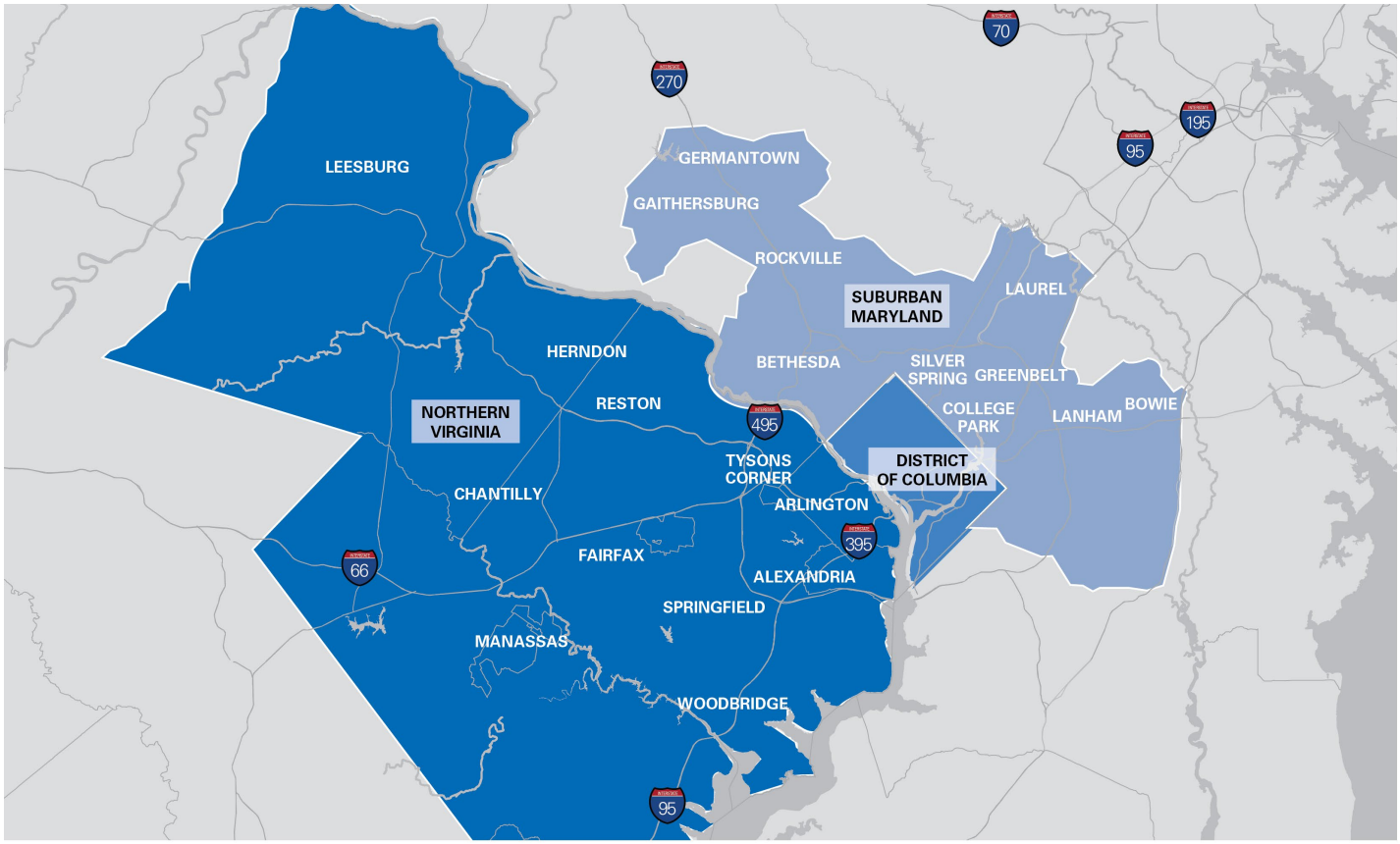
Employment Growth By Industry

WASHINGTON, % CHANGE, 12 MONTHS ENDING AUG 2022, NOT SEASONALLY ADJ.



Source: U.S. Bureau of Labor Statistics, Newmark Research; September 2022

Washington Metro Office Markets



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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