3Q23

Washington Metro Office Market Overview

Market Observations

Economy

- The region's labor market remained historically strong amid shifting macroeconomic conditions. August's 2.6% unemployment rate was significantly lower than the 4.2% 10-year historical average. The Washington DC metro was tied for the 3rd lowest unemployment rate nationwide.
- Year-over-year, job gains have been most pronounced in the education and health industry with 5.3% growth, followed by construction with 4.3% growth, and leisure/hospitality with 3.9% growth.
- Business and Professional services remains the largest industry in the region, containing almost 25% of the regional workforce, following closely by the Government at 21%.

Leasing Market Fundamentals

- Net absorption in the third quarter of 2023 totaled negative 600,000 square feet. Despite this significant amount of negative net absorption, it was the least amount of negative net absorption in a third quarter since 2019.
- The 2.1 million square-foot construction pipeline remained untouched for the fourth consecutive quarter as interest rates remain high and there is limited access to debt.
- Vacancy grew to 20.1%, up 30 basis points from 12 months ago. Average asking rents have increased over the past two quarters after stagnating in 2021 and 2022.
- The U.S. Securities and Exchange Commission renewed over one million square feet of space during the quarter, providing optimism that leasing activity will improve going forward.

Major Transactions

- Investment sales continue to lag and reach historic lows as landlords work to re-valuate their properties in hopes of enticing investors, despite high interest rates and limited access to debt.
- The largest sale of the quarter was 1411 K Street NW, purchased by Douglas Legum Development Inc from TA Realty. The fourteen-story, 89,000 square-foot office building was purchased for $9.1 million, or $102.05 per square foot.

Outlook

- Uncertainty reigns in the macroeconomic outlook. Occupiers and investors alike will approach deals with greater caution as a result, which will impact leasing and investment activity.
- Rent growth has begun to creep back up over recent quarters after stagnating since 2021, increasing 0.3% year-over-year. This rent growth may continue due to a lack of supply-side pressure with a limited development pipeline throughout the market.
- Fewer landlords appear to have capital for concessions in order to entice tenants, contributing to the recent slowdown in deal volume. This trend is likely to continue in the short-term.

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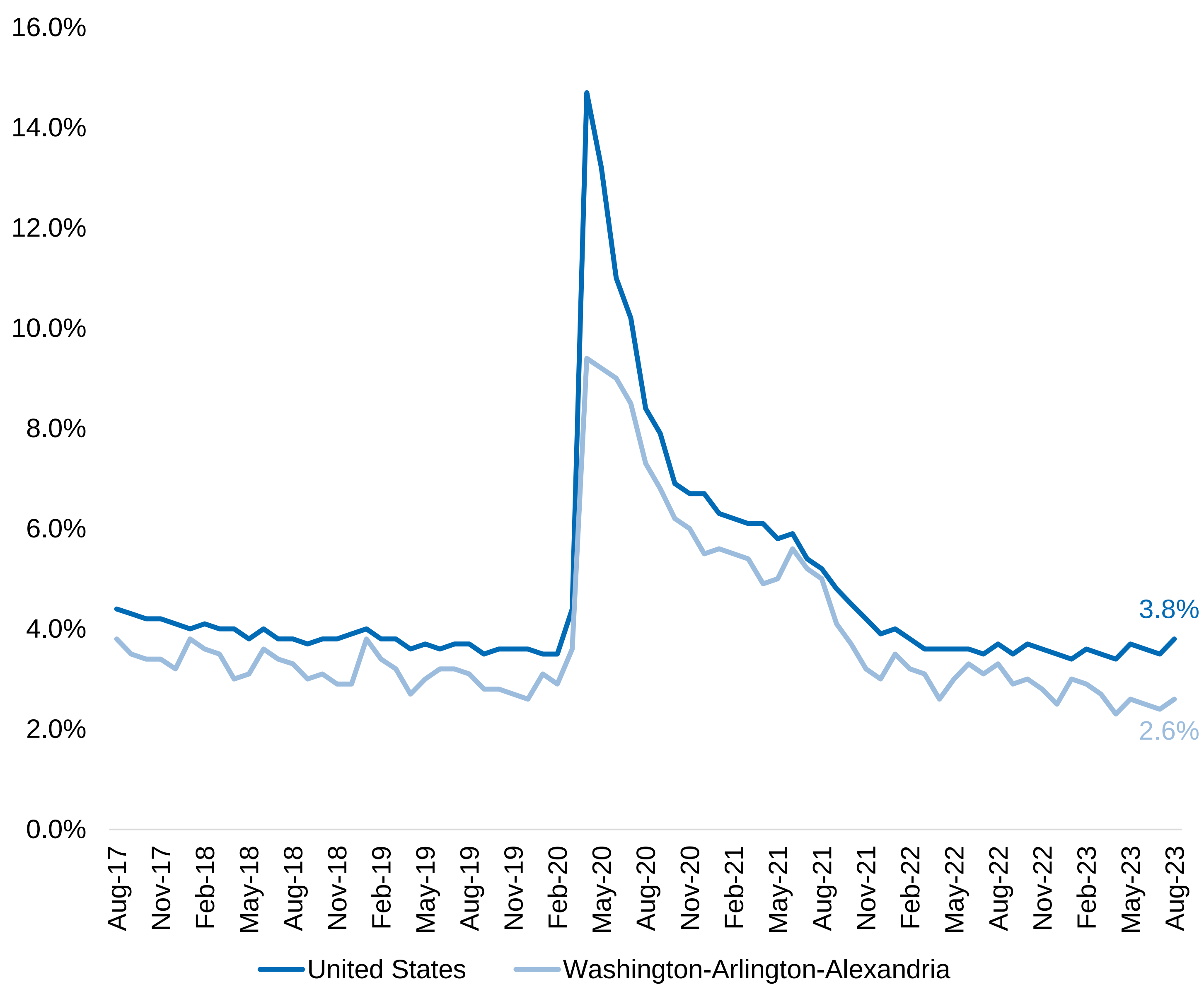
Economy

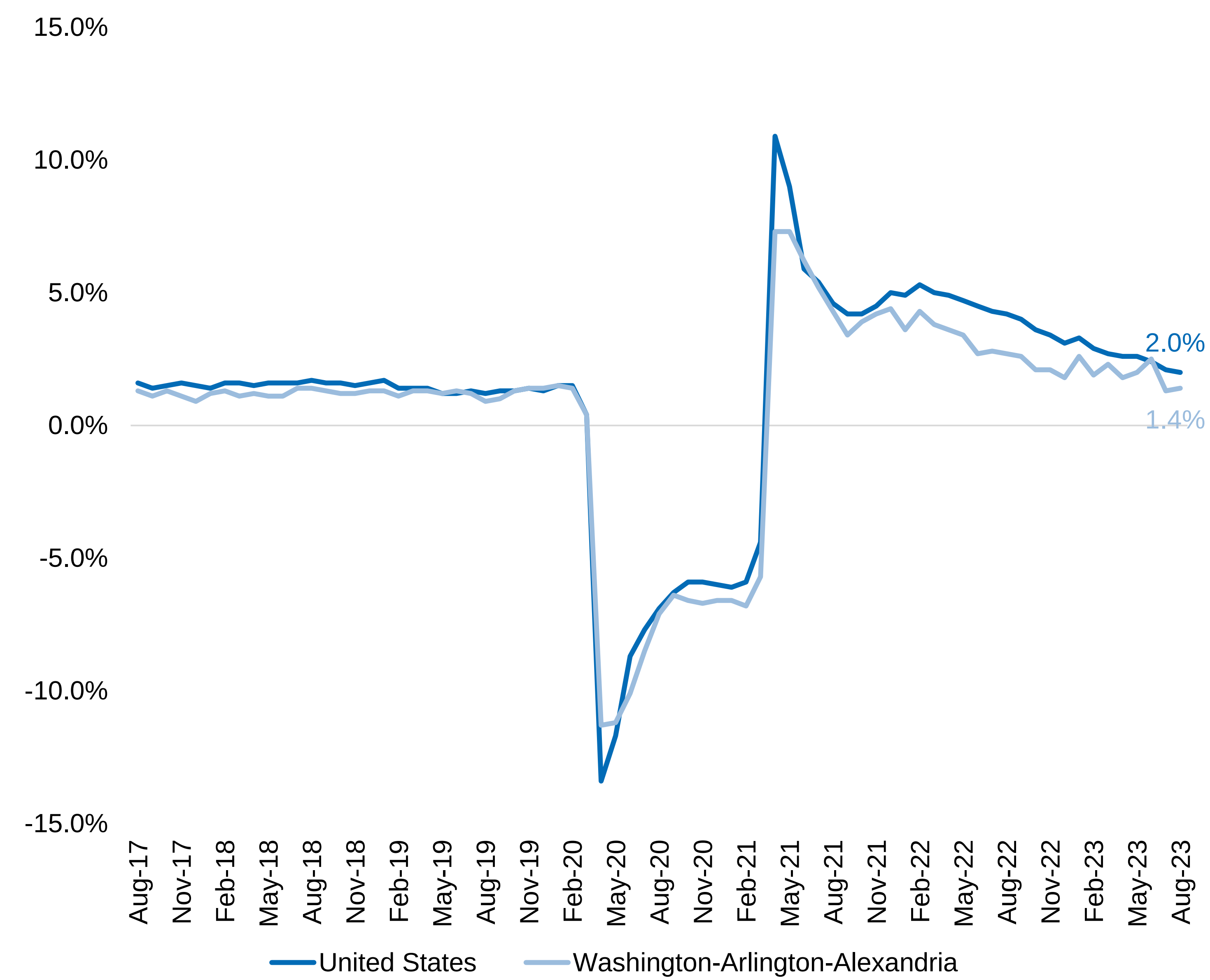
Metro Employment Growth Is An Encouraging Tailwind

The region's labor market is currently tied for 3rd lowest unemployment rate among all large U.S. metros. Washington, D.C.'s metro unemployment rate is 120 basis points below the national rate.

Unemployment Rate, Seasonally Adjusted



Nonfarm Payroll Employment, Non-Seasonally Adjusted, 12-Month % Change

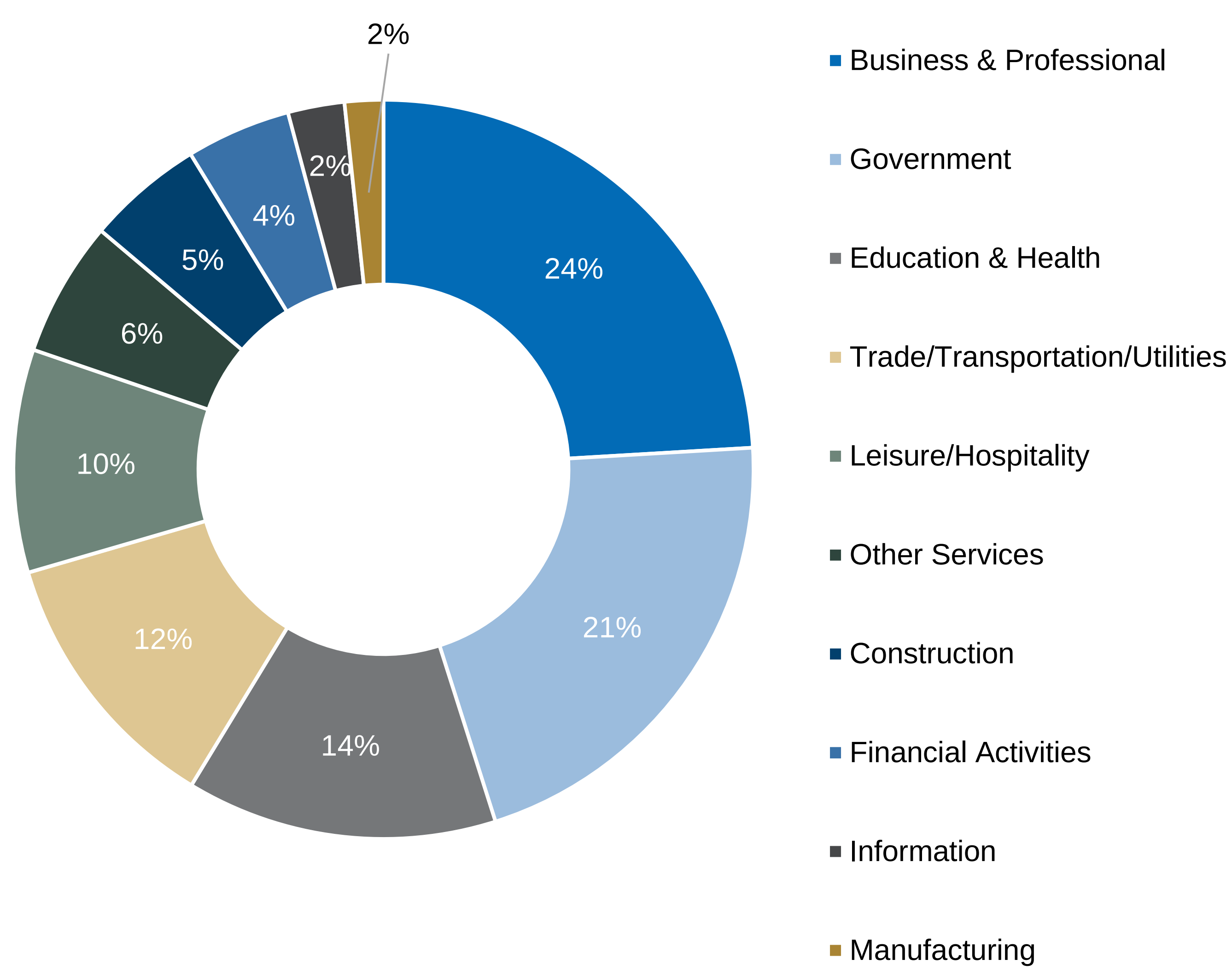


Source: U.S. Bureau of Labor Statistics, Washington-Arlington-Alexandria

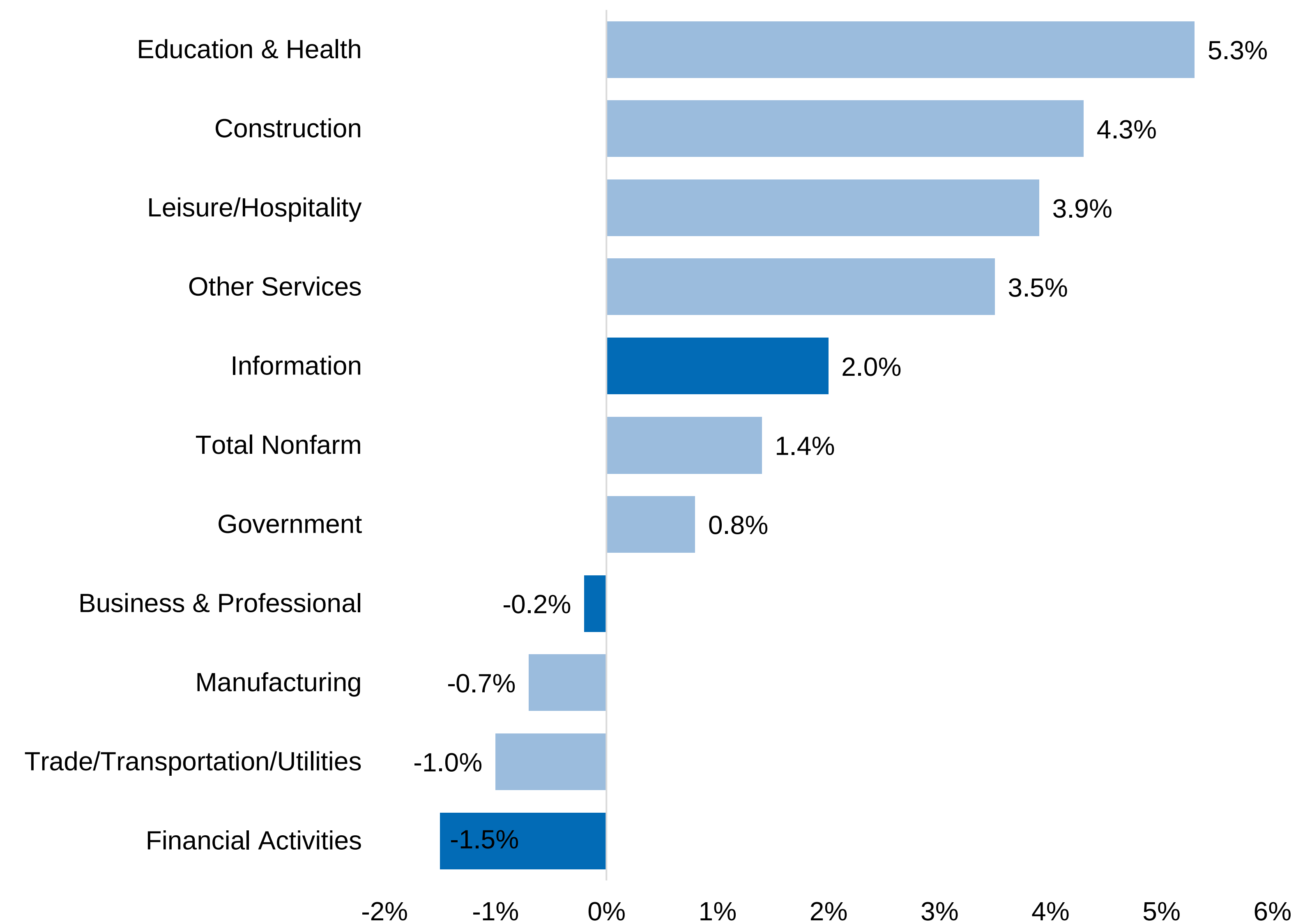
Job Growth Driven by Education & Health, Construction, and Hospitality Demand

The Business/Professional and Government industries remain the top regional industries, constituting almost half of the employees in the region. With both industries being large office-users, this provides optimism for the stability of the office market going forward.

Employment by Industry, August 2023



Employment Growth by Industry, 12-Month % Change, August 2023

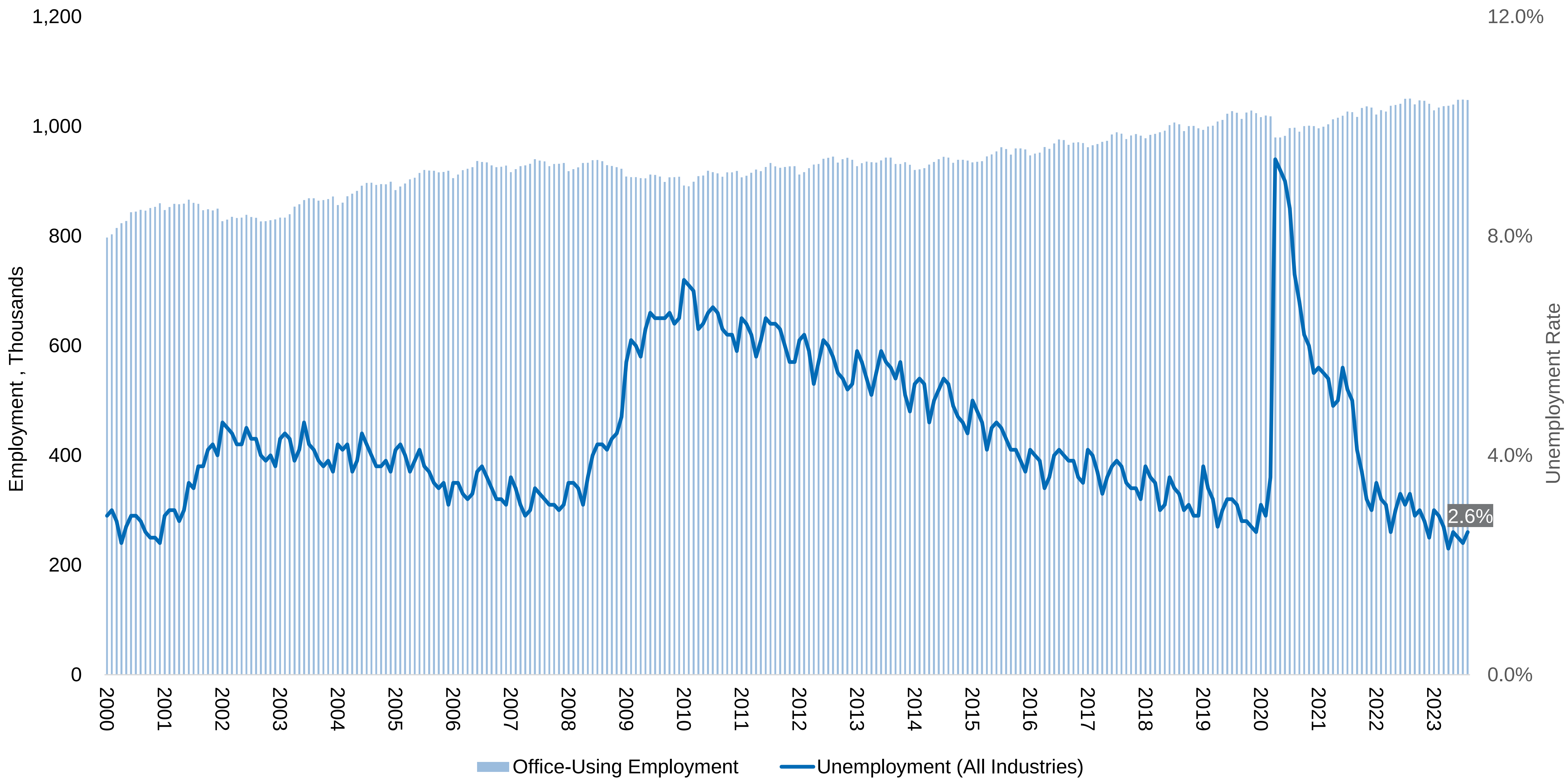


Source: U.S. Bureau of Labor Statistics, Washington-Arlington-Alexandria

Overall Office-Using Employment Has Rebounded

The number of office-using jobs has rebounded and even exceeded pre-pandemic levels. Total office-using job totals are currently 2.3% greater than office employment in summer 2019 and 7.0% greater than the pandemic-induced employment trough in April 2020.

Office-Using Employment* and Unemployment Across All Industries



Source: U.S. Bureau of Labor Statistics, Washington-Arlington-Alexandria
Note: August 2023 data is preliminary.
*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

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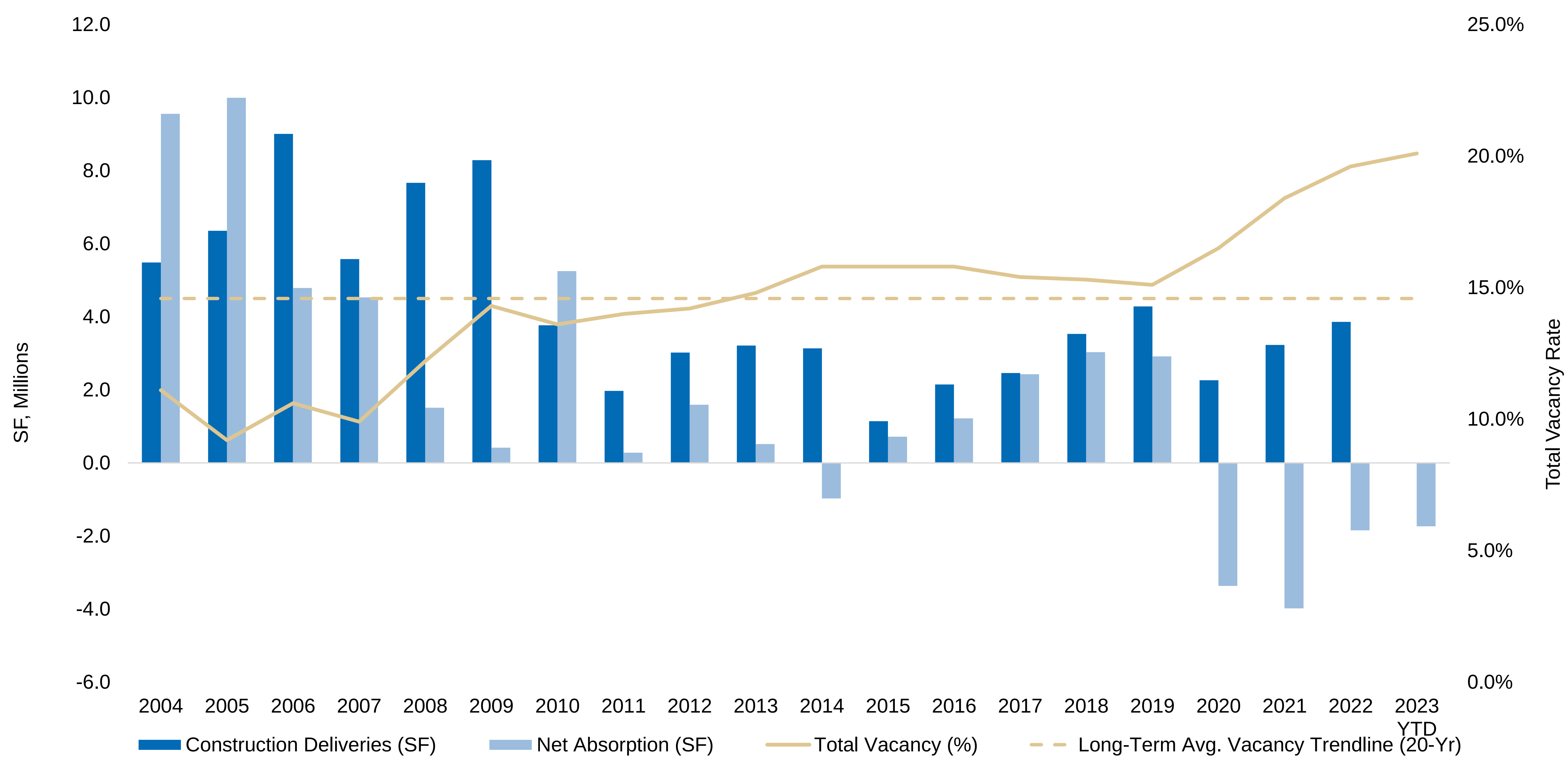
Leasing Market Fundamentals

Vacancy Rises But No New Deliveries Provide Balance

The vacancy rate increased to 20.1% in the third quarter of 2023 from 19.9% in the second quarter of 2023. The lack of new speculative office construction is advantageous in helping to balance supply with waning demand.

Historical Construction Deliveries, Net Absorption, and Vacancy

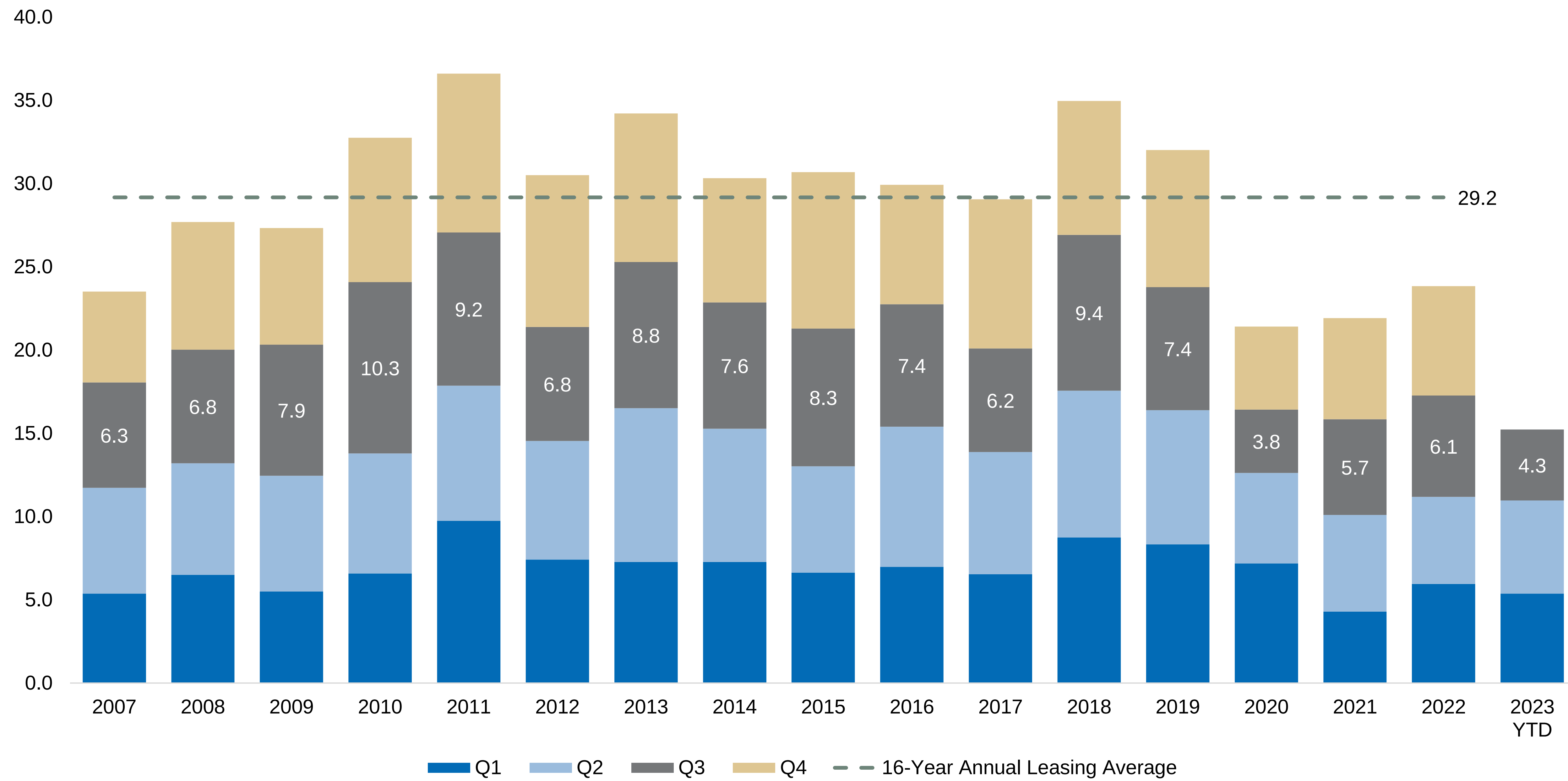


Source: Newmark Research

Leasing Activity Down From 2022, Still Driven by Renewals

A cloudy economic outlook and the higher cost of capital has prompted many companies to pause, assess current conditions and enact cost-cutting measures where applicable. Year to date, 2023's leasing volume is slightly lower than transaction activity over the last three years.

Total Leasing Activity (msf)

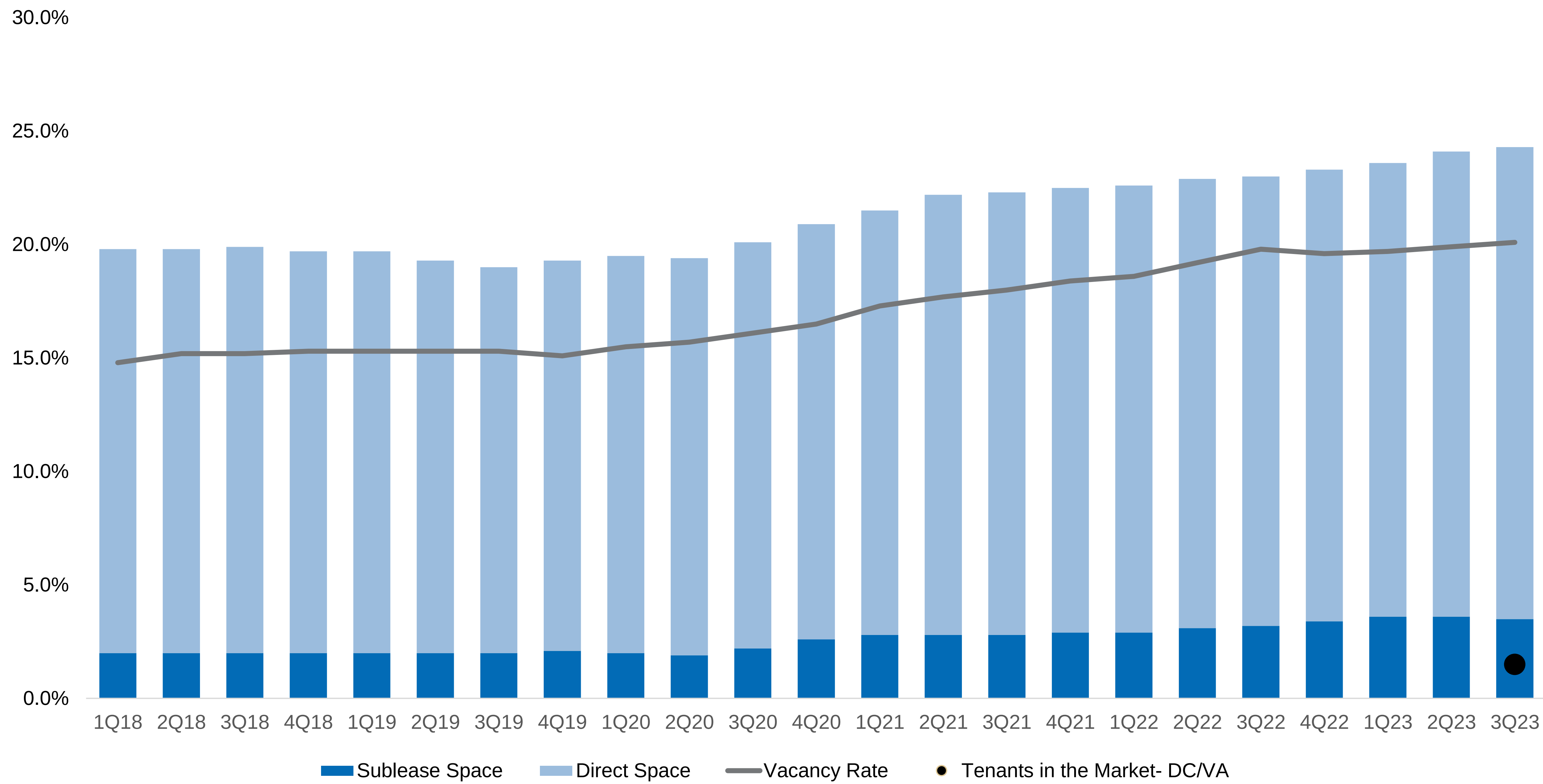


Source: Newmark Research, CoStar

Availability Continues to Increase While Tenant Demand Drops

Available space currently sits at a historical high, both in terms of direct space and sublease space. Historical averages land at 15.8% direct space available and 2.4% sublease space available, a total availability of 18.2%. The market currently shows 20.8% direct space available and 3.5% sublease space available, a total availability of 24.3%. This expansion of available space is likely to continue as companies plan long-term office strategies.

Available Space and Tenant Demand as Percent of Overall Market

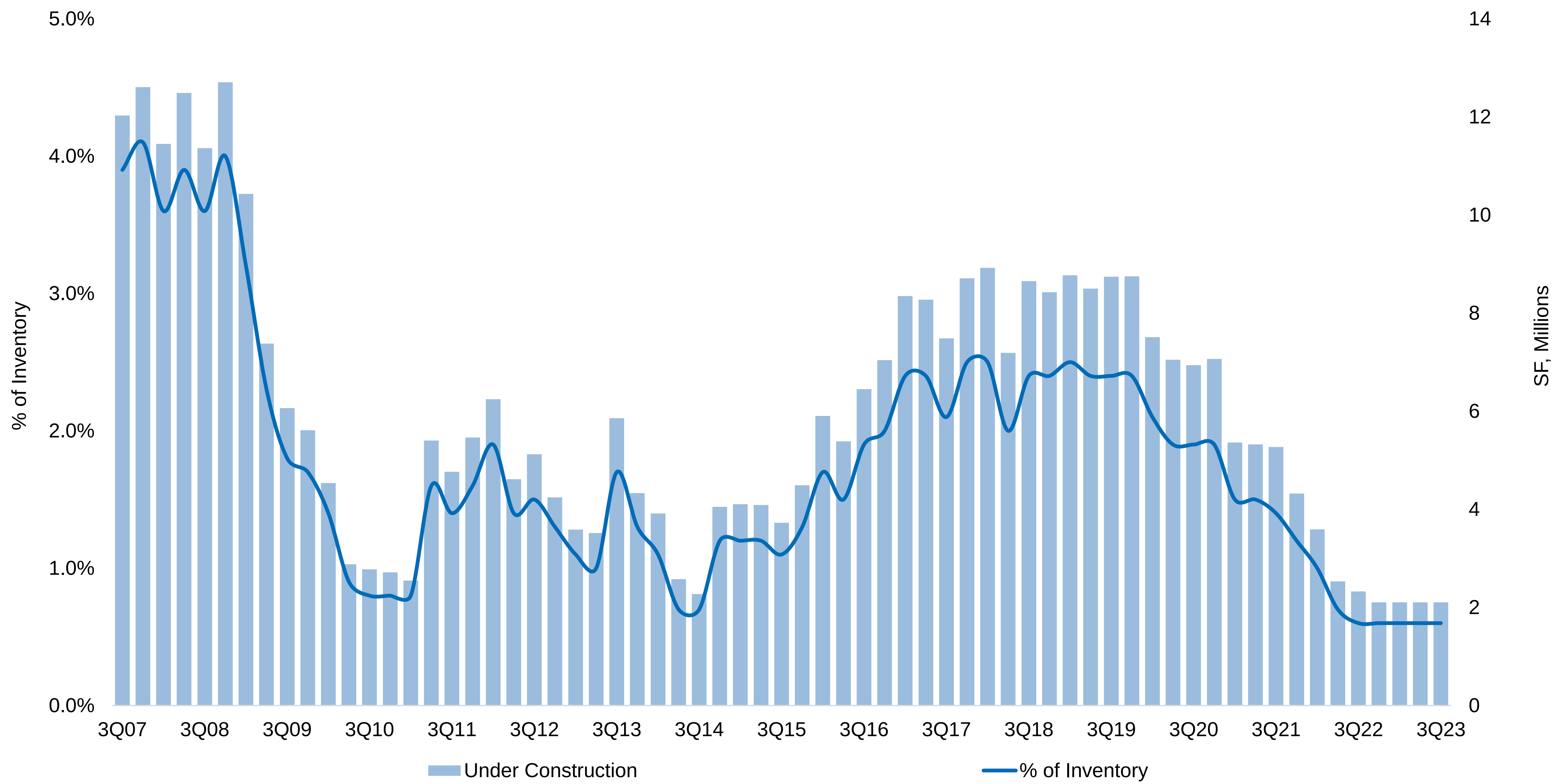


Source: Newmark Research

Deliveries and New Construction Soften in 2023

The Washington Metro area development pipeline remains historically low, with no new projects breaking ground or delivering this quarter. There are currently 11 properties under construction, well below the historical average of 29 properties under construction.

Office Under Construction and % of Inventory

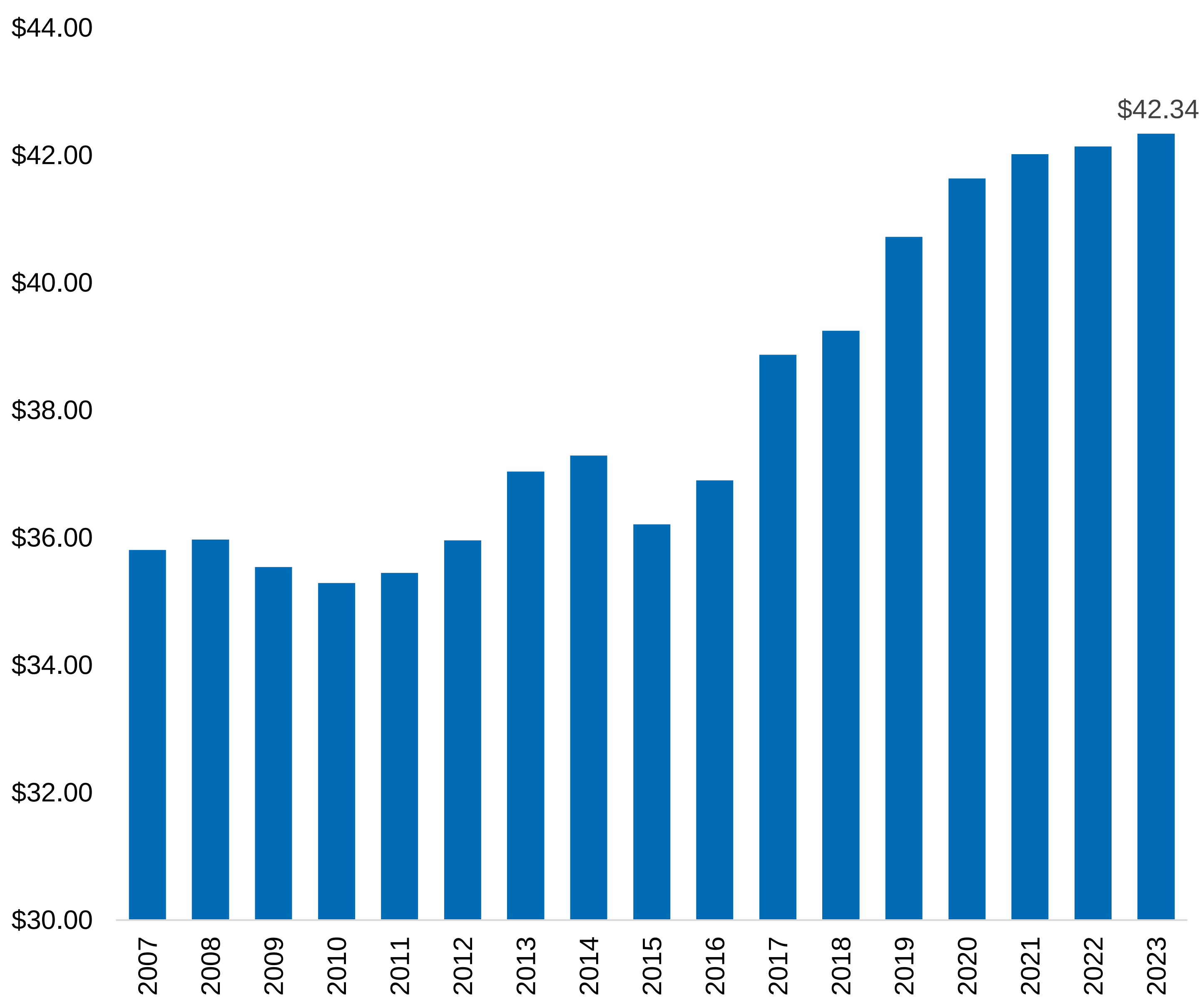


Source: Newmark Research, CoStar

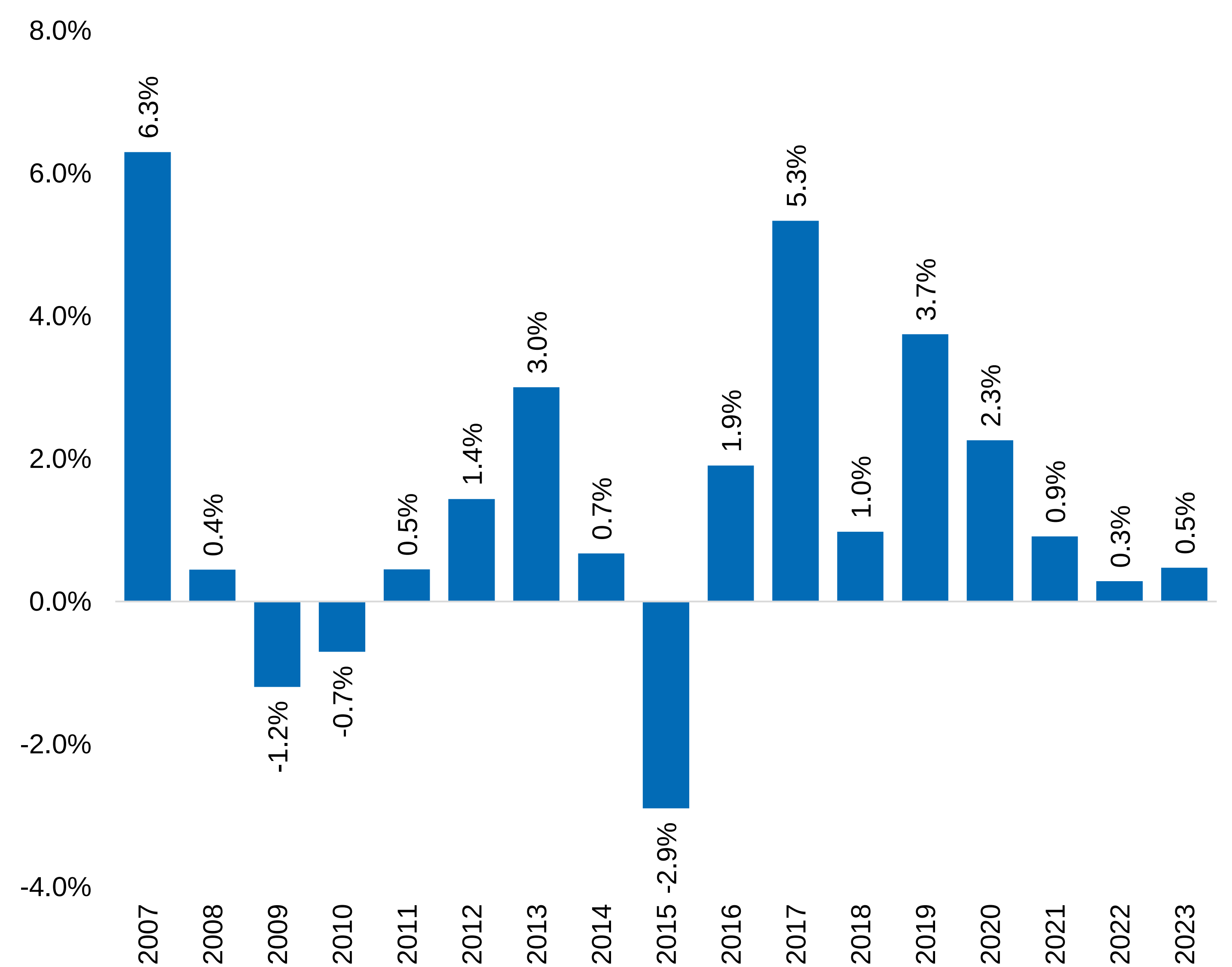
Rents Continue to Climb

In past cycles, asking rents have adjusted downward to account for depressed demand, but it often takes many quarters or even years for rates to fall. Year-over-year rental rate growth decelerated in 2023 to 0.5%, a remarkable decrease from the 2.0% YOY average since 2016.

Office Average Asking Rent, $/SF, FS



Year-over-Year Asking Rent Growth Rate

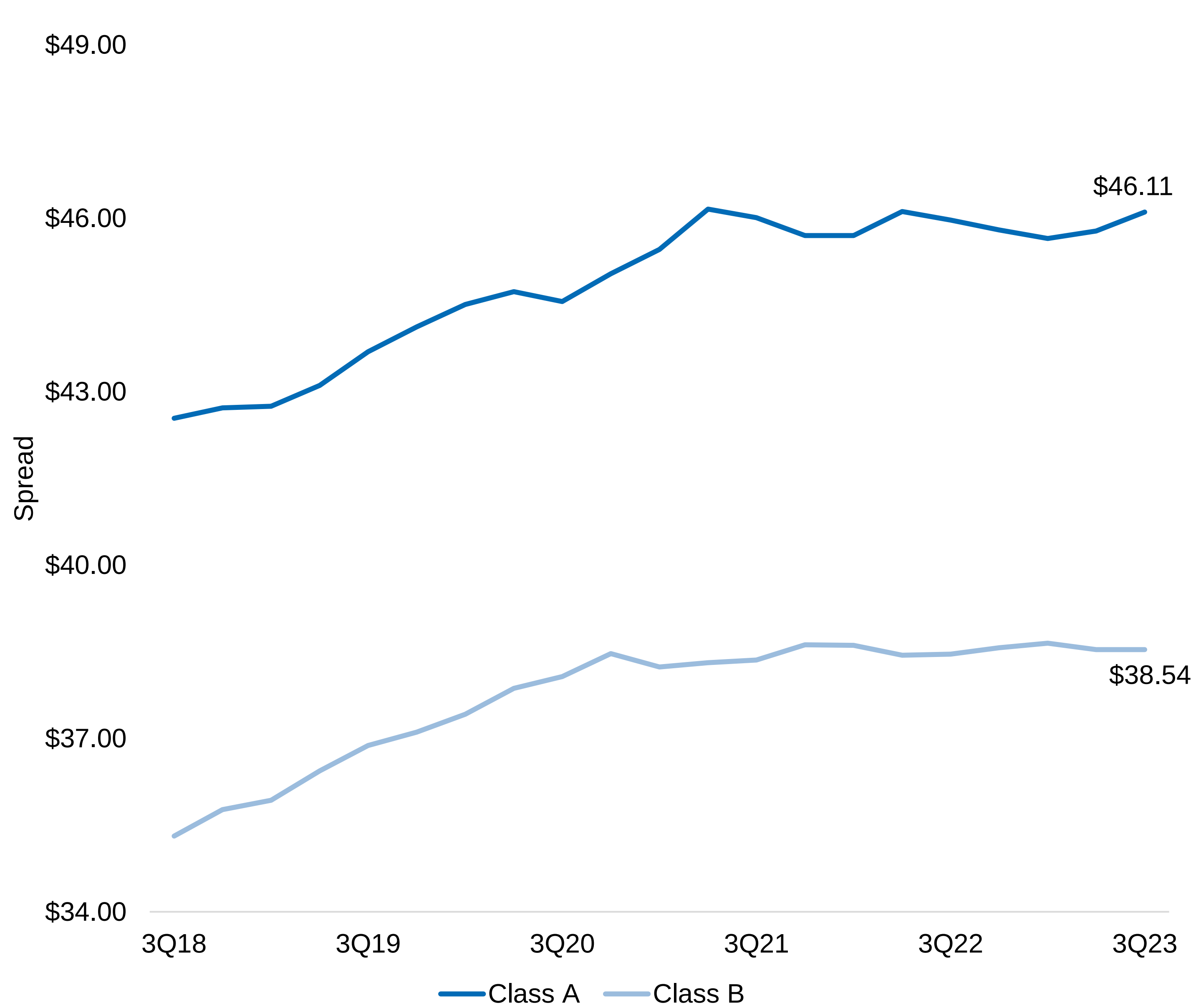


Source: Newmark Research, CoStar

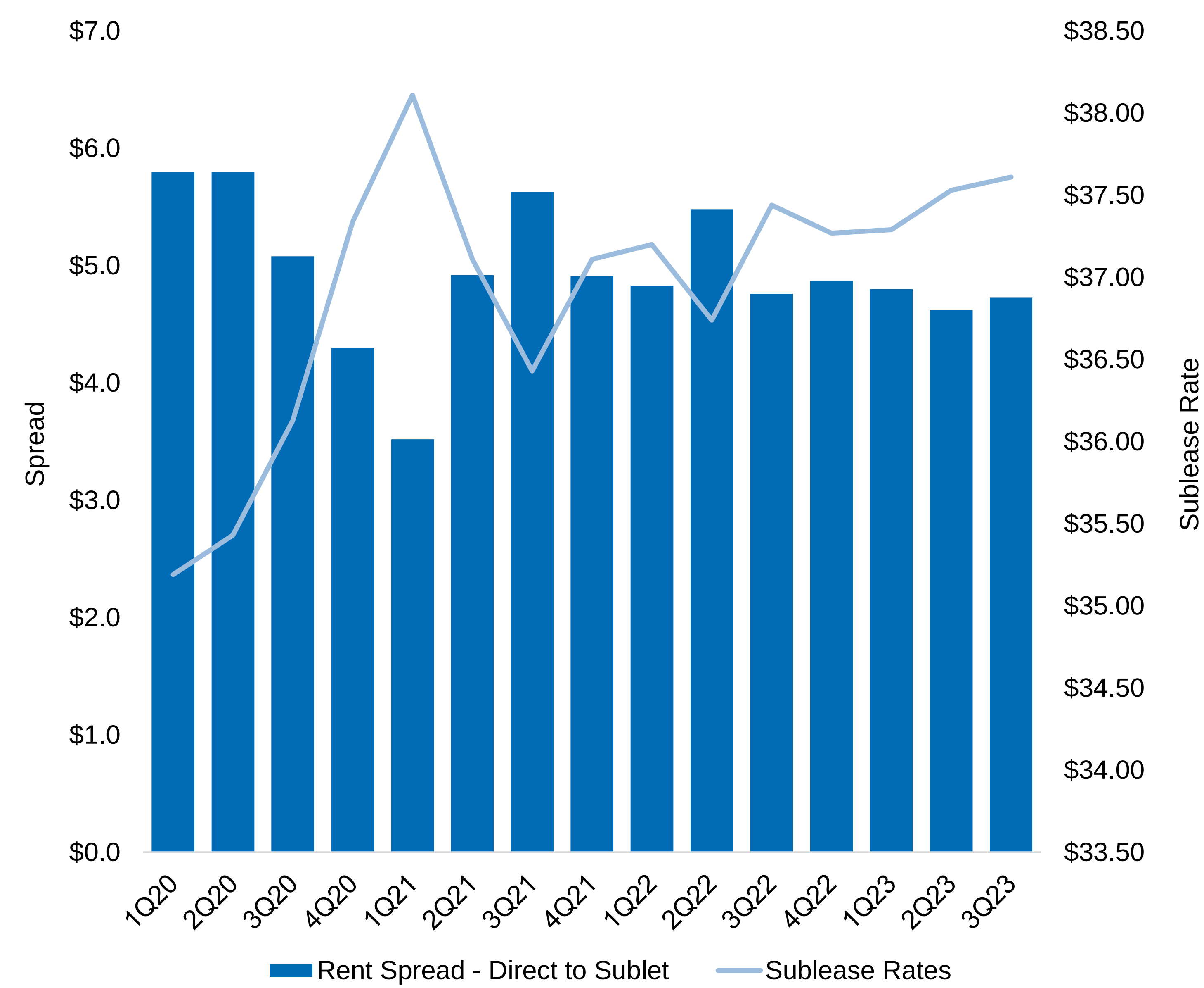
Asking Rents Bifurcate Between Class A Growth and Class B Declines

Class A asking rates have increased the past two quarters after remaining stagnant since 2021, reaching $46.11 PSF. This is indicative of the bifurcation of office user demand. Trophy is outperforming all Classes, while Class B and Class C rates will continue to drop as user demand also drops.

Class A and Class B Asking Rents



Sublease Rates



Source: Newmark Research, CoStar

Leasing Activity Slows

Despite a third consecutive quarter of negative absorption, leasing activity continues, albeit at a slower pace. Several significant large renewals were executed signaling that tenants continue to remain confident in making long-term real estate decisions while also weighing future needs and hybrid work models.

Notable 3Q23 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
U.S. Securities and Exchange Commission	100 F Street, NE	NoMa	Lease Renewal	712,000
U.S. Securities and Exchange Commission	600 2nd Street, NE	NoMa	Lease Renewal	356,994
The United States (Government)	15010 Conference Center Drive	Rt. 28 South	Direct Lease	174,913
Court Services and Offender Supervision Agency	800 N Capitol Street, NW	NoMa	Lease Renewal	92,638
United States Secret Service	1100 L Street, NW	East End	Lease Renewal	78,722

Source: Newmark Research

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Newmark has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents. Newmark Research Reports are available at nmrk.com/insights.

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