RESEARCH Q4 2021

Northern Virginia Office Market

Quarterly Leasing Activity Rises; Vacancy Remains Under Pressure

Northern Virginia's office market recovery was mostly steady on the quarter, recording a slight increase in vacancy and continued pressure on net absorption. Although occupancy contraction softened earlier in the year, that trend was broken in the fourth quarter. Quarterly net absorption measured negative 384,270 square feet, bringing the year-end absorption to negative 2,335,370 square feet. Continued occupancy losses resulted in greater pressure on Northern Virginia's vacancy rate. The overall vacancy rate measured 20.6% at the end of the fourth quarter, up 20 basis points from the previous quarter and up 170 basis points from one year ago. Asking rents averaged $34.49 per square foot; unchanged from the previous quarter but up 1.8% over the last 12 months.

Leasing activity rebounded in the fourth quarter, with 11 leases transacted greater than 50,000 square feet. The mix of lease types in the fourth quarter is particularly noteworthy, including a growing number of new leases, expansions, and relocations, in addition to renewals. While this supports the predicted loosening of pent-up demand accumulated in recent quarters, uncertainty among office occupiers remains and more leasing activity gains should be expected in 2022. A significant fourth quarter lease transaction was the Charles Koch Institute, which leased about 175,000 square feet at 4201 Wilson Boulevard in the Ballston submarket.

Current Conditions

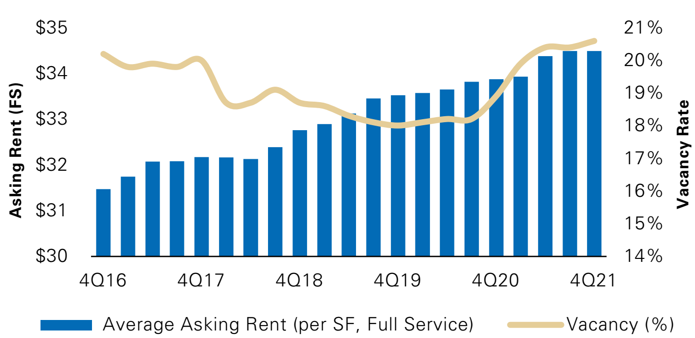
- Quarterly net absorption was negative 384,270 square feet, bringing the year-to-date absorption total to negative 2,335,370 square feet.
- The overall vacancy rate was 20.6% at the end of the fourth quarter, up 170 basis points from one year ago.
- Office space under construction, excluding renovations and owner-occupied buildings, totaled 2.2 million square feet at the end of the fourth quarter, with a pre-lease rate of 68.4%.
- Asking rents held steady at $34.49/SF on the quarter but are up $0.62 from one year ago.

Market Summary

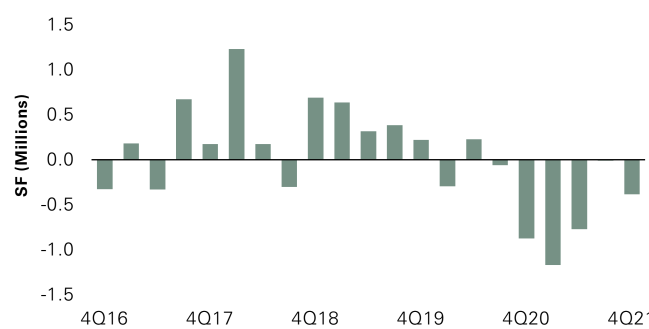
	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	164.7 M	164.7 M	164.1 M	↑
Vacancy Rate	20.6%	20.4%	18.9%	↑
Quarterly Net Absorption (SF)	-384,270	-8,850	-873,243	↑
Average Asking Rent/SF	$34.49	$34.49	$33.87	↑
Under Construction (SF)	2.2 M	2.2 M	2.7 M	↓
Deliveries (SF)	0	0	0	↑

Market Analysis

ASKING RENT AND VACANCY RATE



NET ABSORPTION



NEWMARK

Office space under construction in Northern Virginia, excluding renovations and owner-occupied buildings, totaled 2.2 million square feet at the end of the fourth quarter. The overall pre-lease rate of the buildings under construction is 68.4%. There were no new construction completions, renovations, or ground-breaks in the fourth quarter.

Growth in Technology Sector Outside the Beltway Bifurcates Market Fundamentals

Over the last decade, Northern Virginia has steadily established itself as a nationally-recognized technology hub. The region's tech acumen has historically been anchored by federal contractors, servicing a variety of government agencies including the Department of Defense. As the region's technology-based workforce has expanded, so too have private sector firms looked to capitalize on the region's strong tech resources and human capital.

While Amazon's investments command much of the discourse in Northern Virginia's tech sector growth, the industry's growth in recent years has largely been concentrated in the suburbs outside the Beltway. Despite the slow leasing environment of the pandemic and the higher prevalence of remote working among tech firms, Northern Virginia's suburban submarkets have continued to secure new lease commitments and expansions throughout the pandemic. This includes Microsoft (424,000 square feet at 11955 Freedom Drive) and Qualtrics (85,000 square feet at 1906 Reston Metro Plaza). Qualtrics announced plans in the fourth quarter to establish their East Coast hub in Reston, relocating from Downtown DC with plans to double their local employee headcount.

Northern Virginia's suburban submarkets have performed relatively well throughout the pandemic, in part due to the strength of private sector and government-related technology leasing demand. The geographic divide between market fundamentals is particularly noteworthy when comparing submarkets inside versus outside the Capital Beltway. While year-end net absorption was negative for both areas in 2021, occupancy contraction was significantly less severe outside the Beltway, measuring negative 369,022 square feet compared to negative 1,966,348 square feet inside the Beltway. Submarkets inside the Beltway have collectively recorded negative net absorption for the last six consecutive quarters. Alternatively, submarkets outside the Beltway have recorded modestly positive net absorption in three of the last six quarters, despite challenging demand headwinds presented by the pandemic.

Still, both geographies have recorded net-negative occupancy over the last 24-months, which has applied pressure on vacancy rates. Year over year, vacancy outside the Beltway has risen 78 basis points to 19.5%, while vacancy inside the Beltway has risen more significantly by 400 basis points to 23.2%. For many suburban submarkets along the Dulles Toll Road and Route 28, vacancy rates were largely controlled prior to the pandemic, which helped these areas to withstand the pandemic's impact on commercial leasing. Suburban submarkets have slightly less imbalance in supply and demand, which is evidenced by more stable rent growth. Outside the Beltway, asking rents have grown by 2.5% over the last year, compared to 0.3% inside the Beltway – a significant difference indicative of the relative strength of suburban tech and government contracting tenancy and existing supply-demand challenges.

Office Construction Activity Slows; Conversions Gain Momentum

Northern Virginia's construction pipeline is at a healthy level, although no office developments have broken ground since the beginning of the pandemic. While the lack of tenant demand has been the leading driver in suppressing development activity, significant oversupply has also highlighted the risks to developers. As the balance of supply and demand is further pressured, some owners are beginning to explore alternative ways to maximize the value of their outdated office assets. Conversions are becoming an increasingly attractive option to reposition office assets to a higher-value use, typically, multifamily.

Over the last two years, seven office-to-multifamily conversion projects began construction, removing 1.1 million square feet of under-performing office inventory, largely concentrated in the I-395 Corridor and Old Town submarkets, from the market.

Notable 4Q 2021 Lease Transactions

Tenant	Building	Submarket	Type	Square Feet
Charles Koch Institute	4201 Wilson Boulevard	Ballston	Direct Lease	175,000
CNA	3003 Washington Boulevard	Clarendon/Courthouse	Renewal	129,365
Qualtrics	1906 Reston Metro Plaza	Reston	Direct Lease	85,000
ID.me	1775 Tysons Boulevard	Tysons	Sublease	60,673
Appian	7950 Jones Branch Drive	Tysons	Expansion	58,808

Notable Recent Sales Transactions

Building	Submarket	Sale Price	Price/SF	Square Feet
Sequoia Plaza I, II & III	I-395 Corridor – Arlington	$206,500,000	$559	369,215
Founders Square	Arlington	$196,534,947	$553	355,530
Canal Center	Old Town	$156,000,000	$290	538,799
Three Ballston Plaza	Arlington	$118,000,000	$388	304,133

The conversion – or demolition – of office buildings for alternative uses will effect the market in several ways. It will subtly ease vacancy by removing low-occupancy assets from the market and foster a greater mix of use in office-intensive markets. Given the Washington metro area's housing needs and strength of multifamily investment sales over the last 12-months, sellers may be in a position to dispose of challenged assets for a relatively competitive price. In August 2021, Towngate Executive Offices at 625 & 635 Slaters Lane were sold for conversion for $18 million, or $222,222 per intended residential unit; not that much lower than Northern Virginia's average per-unit sale price for stabilized residential assets.

Despite this increased activity in the third quarter, investment volume was low in the fourth quarter, measuring $327.9 million. Depressed investment activity has resulted in increased pressure on pricing in Northern Virginia. The 12-month average price per square foot has been decreasing in each of the last four quarters, measuring $288/SF in the fourth quarter of 2021. The largest single transaction of the fourth quarter was the sale of Three Ballston Plaza at 1100 N Glebe Road for $118 million, or $388/SF. Monday Properties purchased the building from AEW Capital with the intent to renovate and invest. Another noteworthy transaction was the Willow Oak Corporate Center in Fairfax selling for $106 million, or $177/SF. This building from purchased by Bridge Investment Group from KBS REIT II.

Northern Virginia Outlook

Northern Virginia's office market showed modest signs of recovery in the fourth quarter. Leasing velocity for new leases increased slightly during in the quarter, and several significant long-term renewals were also executed, signaling that tenants are more confident in making long-term real estate decisions while also weighing future space needs. Despite leasing activity, tenant movement is likely to remain subdued until variants and the threat of COVID-19 are controlled; leasing activity should continue to modestly accelerate in early 2022.

Northern Virginia's overall vacancy rate has risen significantly over the past year, driven by negative absorption for the last six consecutive quarters. Although leasing activity is up, the vacancy rate will likely continue to rise in the near term, due to new construction deliveries and the lagging influence of net absorption. Newmark Research projects that the vacancy rate will reach 21.3% as of December 2023. The market's average asking rental rate rose 1.8% over the last year, but concessions remain elevated and effective rents are under downward pressure. Tenants have maintained considerable leverage through 2021. Given the magnitude of space availability in most markets, tenants should expect similarly generous concessions at least into mid-to-late 2022.

Northern Virginia's current development pipeline is 2.2 million square feet, with a pre-leasing rate of 68.4%. However, at 1.3% of the existing inventory, the construction pipeline is manageable. The market is unlikely to see a significant increase in groundbreakings within the next 12 months considering slow demand, and the high cost of construction due to supply chain issues.

Nonetheless, Northern Virginia maintains its reputation as a business-friendly environment and has effectively managed and deployed incentives to attract large office users, like Qualtrics, to the market. Steady gains to public health have set the foundation for a return-to-offices in 2022, which should accelerate the loosening of pent-up leasing demand. Still, many office occupiers will continue to reassess their office space needs in the coming years, considering the many changes likely in a post-pandemic workplace. Pandemic-induced occupancy losses could be a long-term challenge for the market, but growth in new industries, like technology, could insulate the market by boosting net-new occupancy growth.

For additional information on the Washington metropolitan area economy and 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)	4Q 2021 Absorption (SF)	YTD 2021 Absorption (SF)
Northern Virginia	**164,669,646**	**19.3%**	**20.6%**	**1,790,482**	**1,558,088**	**-1,000,073**	**-384,270**	**-2,335,370**
Class A	99,458,279	18.9%	20.3%	1,414,091	713,806	-150,566	-420,536	-1,383,104
Class B	44,667,028	21.5%	22.8%	399,206	673,899	-568,004	200,761	-858,835
Class C	20,544,339	16.6%	17.4%	-22,815	170,383	-281,503	-164,495	-93,431

Market Statistics By Class

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	4Q 2021 Deliveries (SF)	YTD 2021 Deliveries (SF)	Under Construction (SF)
Northern Virginia	**164,669,646**	**$36.85**	**$32.12**	**$34.49**	**0**	**679,000**	**2,214,057**
Class A	99,458,279	$36.85	NA	$36.85	0	679,000	2,214,057
Class B	44,667,028	NA	$32.12	$32.12	0	0	0
Class C	20,544,339	NA	NA	$29.46	0	0	0

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

Submarket Statistics—All Classes

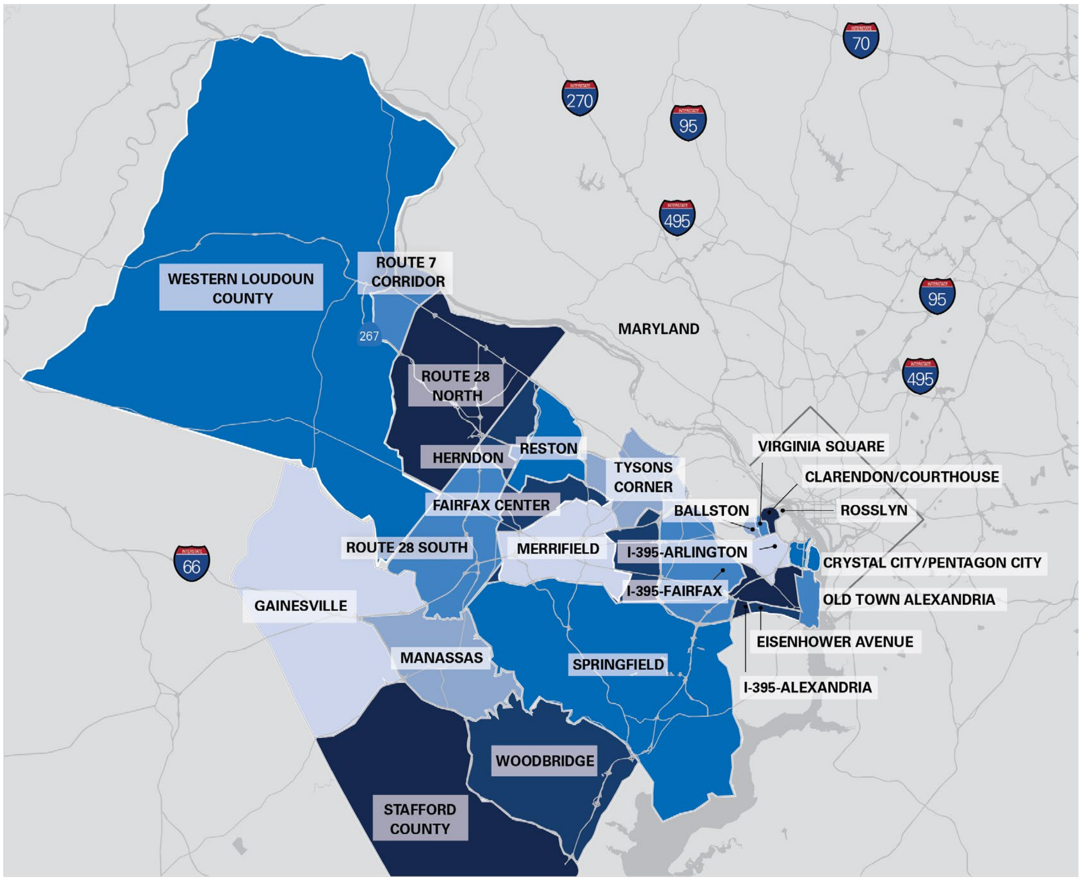
	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2018 Absorption (SF)	2019 Absorption (SF)	2020 Absorption (SF)	4Q 2021 Absorption (SF)	YTD 2021 Absorption (SF)
Northern Virginia	**164,669,646**	**19.3%**	**20.6%**	**1,790,482**	**1,558,088**	**-1,000,073**	**-384,270**	**-2,335,370**
Ballston	7,645,994	25.9%	27.4%	112,857	125,582	65,095	32,427	-180,352
Clarendon/Courthouse	4,550,562	24.3%	25.9%	26,287	8,428	-175,216	-20,805	-187,143
Crystal City/Pentagon City	12,585,674	23.2%	25.5%	383,529	282,070	-24,886	-80,935	-1,191,495
Eisenhower Avenue	1,313,328	54.0%	54.4%	-2,288	10,159	-3,135	1,486	-39,363
Fairfax Center	10,220,827	22.6%	23.7%	11,458	64,910	-344,522	39,114	6,592
Gainesville	247,772	7.9%	7.9%	0	-9,694	7,886	0	1,808
Herndon	11,589,113	21.7%	22.1%	87,664	245,642	-132,779	-90,544	-314,958
I-395 Corridor – Alexandria	2,021,964	24.6%	25.7%	-26,084	25,881	-60,099	37,045	30,520
I-395 Corridor – Arlington	1,595,158	6.6%	6.6%	16,180	26,795	7,576	8,315	-9,005
I-395 Corridor – Fairfax	4,747,633	31.8%	32.1%	-47,133	166,877	18,234	-12,173	-4,897
Manassas	2,802,379	5.3%	5.9%	112,066	5,752	-10,424	14,550	47,315
Merrifield	8,339,672	15.9%	18.3%	-5,648	-3,312	53,267	-45,596	-53,701
Old Town Alexandria	11,092,806	13.5%	14.9%	-61,426	26,115	-194,866	-2,099	-142,517
Reston	17,364,296	15.9%	18.1%	56,280	-189,954	-212,773	-175,048	-135,888
Rosslyn	9,304,192	21.7%	22.9%	667,690	271,222	100,643	-15,112	-166,948
Route 28 North	5,440,496	14.5%	14.7%	89,114	-88,244	13,826	-18,878	-35,656
Route 28 South	11,252,708	14.9%	15.5%	188,870	125,385	103,142	-8,954	15,627
Route 7 Corridor	5,190,314	12.2%	12.4%	111,620	41,444	38,906	32,960	-22,390
Springfield	5,066,811	21.5%	21.7%	-18,486	77,173	-67,116	-48,974	528,977
Stafford County	886,184	30.3%	30.3%	10,780	2,331	-33,147	8,909	46,386
Tysons	28,291,910	19.8%	21.2%	95,273	482,664	-129,377	-27,246	-445,135
Virginia Square	1,030,321	20.7%	27.4%	-84,672	-161,903	16,485	-17,456	-80,045
Western Loudoun County	795,188	2.6%	2.6%	42,285	-3,744	-13,650	16,661	2,256
Woodbridge	1,294,344	11.9%	12.5%	24,266	26,509	-23,143	-11,917	-5,358

Submarket Statistics—All Classes

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	4Q 2021 Deliveries (SF)	YTD 2021 Deliveries (SF)	Under Construction (SF)
Northern Virginia	**164,669,646**	**$36.85**	**$32.12**	**$34.49**	**0**	**679,000**	**2,214,057**
Ballston	7,645,994	$44.82	$40.20	$42.34	0	0	191,034
Clarendon/Courthouse	4,550,562	$43.95	$40.44	$43.49	0	0	0
Crystal City/Pentagon City	12,585,674	$41.09	$36.78	$39.12	0	0	0
Eisenhower Avenue	1,313,328	$30.04	$25.00	$29.81	0	0	0
Fairfax Center	10,220,827	$30.33	$27.88	$28.00	0	0	0
Gainesville	247,772	$31.07	$23.29	$26.25	0	0	0
Herndon	11,589,113	$36.02	$25.48	$33.95	0	0	0
I-395 Corridor – Alexandria	2,021,964	$31.73	$30.85	$31.11	0	0	0
I-395 Corridor – Arlington	1,595,158	$28.88	$20.00	$24.96	0	0	0
I-395 Corridor – Fairfax	4,747,633	$32.59	$29.48	$29.35	0	0	0
Manassas	2,802,379	$24.99	$21.62	$22.86	0	0	0
Merrifield	8,339,672	$33.52	$32.26	$31.21	0	0	0
Old Town Alexandria	11,092,806	$41.68	$31.85	$37.88	0	0	0
Reston	17,364,296	$35.59	$27.95	$33.14	0	0	1,322,000
Rosslyn	9,304,192	$53.93	$41.81	$42.16	0	0	0
Route 28 North	5,440,496	$28.72	$25.04	$26.56	0	0	0
Route 28 South	11,252,708	$29.08	$23.51	$28.02	0	0	350,000
Route 7 Corridor	5,190,314	$29.72	$22.17	$28.12	0	54,000	0
Springfield	5,066,811	$37.02	$25.61	$30.62	0	625,000	0
Stafford County	886,184	$26.06	$24.50	$26.00	0	0	0
Tysons	28,291,910	$40.40	$33.64	$36.52	0	0	351,023
Virginia Square	1,030,321	$43.41	NA	$43.41	0	0	0
Western Loudoun County	795,188	$31.08	$27.43	$29.70	0	0	0
Woodbridge	1,294,344	$25.72	$22.80	$24.66	0	0	0

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

Northern Virginia 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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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/research.