

Suburban Maryland Office Market

Demand Softens; Upcoming Deliveries Will Boost Occupancy Rebound

Suburban Maryland's office market recovery remained static in the fourth quarter of 2021. Net absorption totaled negative 185,190 square feet on the quarter; marginally less negative than last quarter, but still largely flat. The overall vacancy rate was 16.8% at the end of the fourth quarter, an increase of 40 basis points from the previous quarter and an increase of 160 basis points from a year ago. The average asking rental rate measured \$30.26/SF, an increase of 4.2% from fourth-quarter 2020.

Currently, 1.3 million square feet of office space is under construction, excluding renovations and owner-occupied buildings. The pipeline is approximately 63.4% pre-leased. The most notable projects currently under construction are scheduled to deliver in early 2022. Avocet Tower at 7373 Wisconsin Avenue is roughly 380,000 square feet with no space pre-leased. The lower six floors of the building will be a Marriott hotel, with office space in the floors above. Also anticipated to deliver in early 2022 is Marriott's new headquarters at 7750 Wisconsin Avenue. Marriott has fully leased the 726,000 square-foot building, but the pandemic caused company leadership to reconfigure their intended layout and prioritize more communal spaces. Flexible work schedules have lowered the time employees are expected to be in-office. Variants have forced tenants to evolve their corporate footprint alongside their employees' schedules to maximize office space value, without losing talent.

Current Conditions

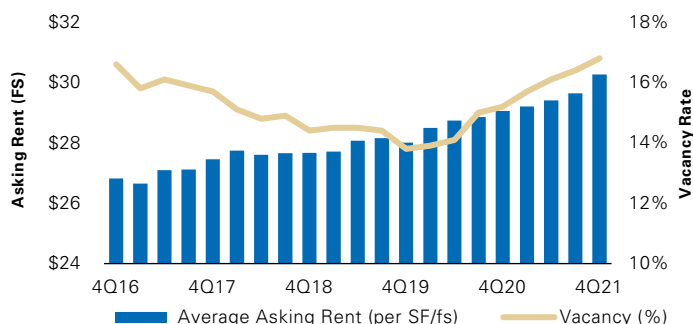
- Suburban Maryland registered negative 185,190 square feet of absorption during the fourth quarter. Year-end net absorption recorded negative 414,935 square feet.
- The vacancy rate increased 40 basis points from last quarter and is also up 160 basis points from one year ago, to 16.8%. Demand is likely to remain modest in the early months of 2022 before accelerating around mid-year, dependent on variant spread.
- Over 1.3 million square feet is under construction; groundbreakings are limited given less demand for office space and cost of resources.
- Asking rents continued to steadily increase in the fourth quarter, rising 4.2% over the last year to \$30.26/SF.

Market Summary

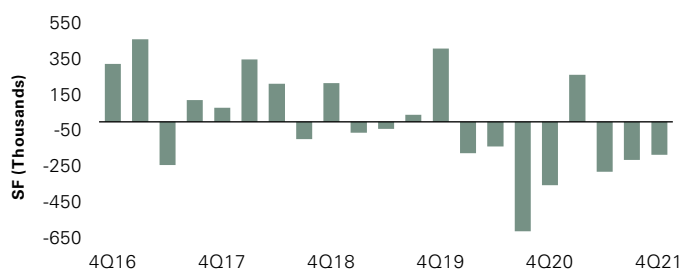
	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	74.4 M	74.9 M	74.1 M	↑
Vacancy Rate	16.8%	16.4%	15.2%	↑
Quarterly Net Absorption (SF)	-185,190	-213,840	-355,307	↓
Average Asking Rent/SF	\$30.26	\$29.64	\$29.05	↑
Under Construction (SF)	1.3 M	1.3 M	2.1 M	↓
Deliveries (SF)	0	0	0	↑

Market Analysis

ASKING RENT AND VACANCY RATE



NET ABSORPTION



Class A Supported by Tenant Demand for Quality, but Challenged by Occupancy Contraction

The current slow-demand environment has been a challenge for all asset classes; however, the existing demand in Suburban Maryland has largely been concentrated within the Class A market. Despite this, Class A net absorption was negative in the fourth quarter, registering negative 107,605 square feet. Although Class A occupancy growth was strong in the first quarter of 2021, each successive quarter has measured negative net absorption. Occupancy losses have applied pressure to Class A vacancy rates, which measure 17.0% in the fourth quarter, increased by 130 basis points over the past year. Suburban Maryland's Class B market measures comparable vacancy of 17.3%, but the rate of growth over the last year is significantly higher, at 260 basis points. The bifurcation of market optimism is most apparent in asking rent growth. Class A asking rents averaged \$32.80/SF, up 6.0% from one year ago. Alternatively, Class B rents have contracted by 1.4% over the year and measure \$27.58/SF in the fourth quarter of 2021.

Suburban Maryland's construction pipeline is 1.3 million square feet, which will expand the supply of Class A inventory. Demand should follow suit, albeit slowly, depending on the mitigation of Omicron and other variants. Still, some tenant requirements will shrink compared to pre-pandemic needs as office design evolves.

Bethesda-Chevy Chase Area Captures Much of the Market's Activity and Growth

The Bethesda and Chevy Chase markets are seeing increased activity recently, headlined by PGIM Real Estate putting 6901-6905 Rockledge Drive on the market for sale. The three buildings that make up the Democracy Center could be one of the largest sales for the area in several years. Nonetheless, the Suburban Maryland office market is still challenged as a result of the pandemic and variants, but this potential sale is another sign of increasing investor confidence. Overall sales volume has been exceptionally slow in Suburban Maryland since the onset of the pandemic, particularly for large, investment grade office buildings.

The Bethesda area is soon to see a big boost as Marriott's long-awaited new headquarters is set to deliver, along with Avocet Tower

at 7373 Wisconsin Avenue. These projects in combination indicate increasing confidence in the popularity of office market momentum in downtown Bethesda. Currently, though, there is some uncertainty regarding the impact of the Omicron variant on office occupancy. Like Delta, Omicron has the potential to disrupt or set back office and market activity, but the true effects remain to be seen.

Suburban Maryland Outlook

Soft office market fundamentals in Suburban Maryland are likely to slowly tighten over the next two years; leasing activity is increasing slowly, but the Omicron variant and continued management of public health are why leasing remains limited as tenants remain cautious in assessing office needs. Leasing activity should continue slowly accelerating in 2022, as tenants reboard and consider office needs for the next year. Many office tenants are focusing on communal workspace, as opposed to smaller individual offices, which reflects a common change in work preferences; many people prefer a hybrid work schedule in which traditional offices are used more frequently for meetings and collaborative work.

Marriott's and Choice Hotels' growing and renewed presence in the area is a boon, especially as it shows confidence that with the improvement of the public health situation, Suburban Maryland will be an even greater destination for work and personal travel. As the pandemic and variants are further controlled and vaccination rates increase, there is an opportunity for the hospitality industry to see a relative boom by attracting people to travel more for work and pleasure in a safe way. Suburban Maryland's concentration of active federal agencies, such as the NIH, will help to support this recovery.

Suburban Maryland's construction pipeline is greater than last quarter, measuring 1.8% of inventory. Future new deliveries will be concentrated in Bethesda, with a 63.4% pre-lease rate overall. Newmark Research projects that Suburban Maryland's overall vacancy rate will increase to 17.9% by the end of the fourth quarter of 2023, a consequence of the long-term workplace changes caused by COVID-19.

For additional information on the Washington metropolitan area economy and office market outlook, please visit the [Mid-Atlantic Market Reports](https://www.newmark.com/mid-atlantic-market-reports) page at nmrk.com.

Notable 4Q 2021 Lease Transactions

Tenant	Building	Submarket	Type	Square Feet
Choice Hotels International	915 Meeting Street	North Bethesda	Direct Lease	105,000
Spirent Communications	5280 Corporate Drive	Frederick	Lease Renewal	40,000
Viavi Solutions	20250 Century Boulevard	Germantown	Lease Renewal	35,792
Kiewit	7850 Walker Drive	Greenbelt	Lease Renewal	30,807
Caring Cross	910 Clopper Road	Gaithersburg	Direct Lease	25,738

Notable Recent Sales Transactions

Building	Submarket	Sale Price	Price/SF	Square Feet
9737 Washingtonian Boulevard	Gaithersburg	\$119,000,000	\$415	287,000
Shady Grove Biotech Park	Rockville	\$116,500,000	\$259	450,000

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)
Suburban Maryland	74,423,591	15.7%	16.8%	680,170	345,945	-1,281,027	-185,190	-414,935
Beltsville	1,457,852	24.4%	25.1%	77,319	-1,062	-19,452	45,510	49,657
Bethesda	11,172,394	16.5%	19.1%	-152,116	187,647	-459,758	-91,402	-44,801
Bowie	1,229,062	16.3%	16.3%	45,968	4,239	-30,591	5,181	-13,250
College Park	3,344,450	12.3%	12.3%	66,443	197,669	-152,144	16,423	37,062
Gaithersburg	3,115,480	10.8%	11.0%	30,598	-226	-83,535	7,797	-3,712
Germantown	2,232,399	21.3%	22.1%	-68,967	-42,624	-28,895	27,189	-37,167
Greenbelt	2,869,682	23.0%	23.4%	43,056	130,707	-49,391	-17,559	-30,366
Landover/Lanham/Largo	4,597,337	14.1%	14.3%	166,268	5,221	21,612	1,072	-6,165
Laurel	1,842,894	20.7%	21.2%	26,511	-95,067	-15,004	23,347	-34,012
North Rockville	11,693,189	16.7%	17.8%	243,161	296,245	-381,707	-112,264	-282,522
North Bethesda	9,977,622	16.1%	17.4%	221,345	131,710	22,231	78,076	-132,870
Rockville	8,334,684	14.4%	15.4%	-113,513	94,590	-78,405	-9,683	-316,790
Silver Spring	9,646,127	14.3%	15.3%	128,883	-639,090	-1,496	-164,044	-198,098
Southern Prince George's	2,910,419	8.6%	8.7%	-34,786	75,986	-24,492	5,167	598,099

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)
Suburban Maryland	74,423,591	15.7%	16.8%	680,170	345,945	-1,281,027	-185,190	-414,935
Class A	41,477,211	15.6%	17.0%	533,517	342,676	-827,373	-107,605	182,256
Class B	23,064,396	16.5%	17.3%	171,921	115,306	-268,737	-118,437	-534,880
Class C	9,881,984	14.6%	14.7%	-25,268	-112,037	-184,917	40,852	-62,311

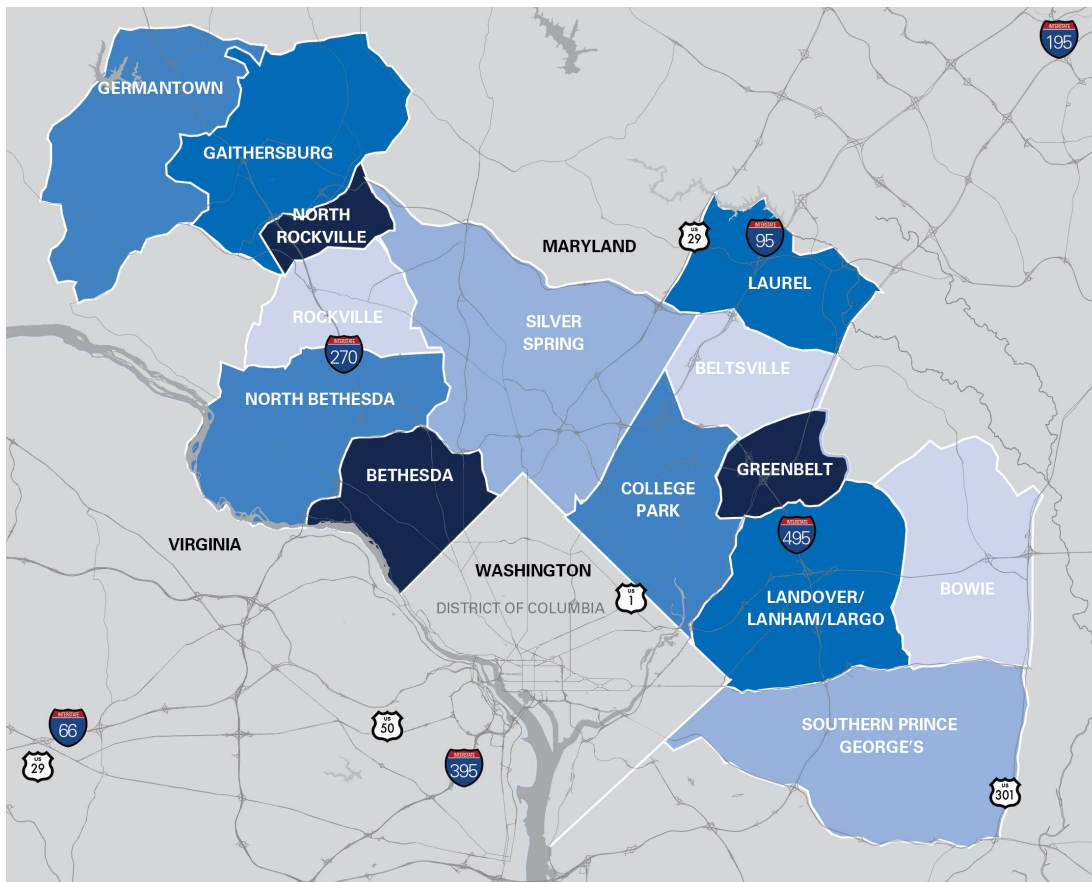
Submarket Statistics—All Classes

	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)
Suburban Maryland	74,423,591	\$32.80	\$27.58	\$30.26	0	932,767	1,305,860
Beltsville	1,457,852	\$22.65	NA	\$22.60	0	0	0
Bethesda	11,172,394	\$47.31	\$38.90	\$43.41	0	358,000	1,108,664
Bowie	1,229,062	\$25.90	\$15.95	\$25.37	0	0	0
College Park	3,344,450	\$27.83	\$24.00	\$25.68	0	0	0
Gaithersburg	3,115,480	\$31.11	\$16.68	\$27.54	0	0	0
Germantown	2,232,399	\$27.18	\$24.30	\$25.33	0	0	0
Greenbelt	2,869,682	\$23.47	\$22.51	\$22.94	0	0	0
Landover/Lanham/Largo	4,597,337	\$22.12	\$21.63	\$21.71	0	0	100,000
Laurel	1,842,894	\$22.50	\$20.95	\$21.14	0	0	0
North Rockville	11,693,189	\$29.44	\$24.34	\$27.74	0	0	97,196
North Bethesda	9,977,622	\$29.71	\$28.57	\$29.03	0	0	0
Rockville	8,334,684	\$33.26	\$25.96	\$30.53	0	0	0
Silver Spring	9,646,127	\$30.93	\$26.10	\$27.86	0	0	0
Southern Prince George's	2,910,419	\$29.00	\$16.25	\$22.16	0	574,767	0

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)
Suburban Maryland	74,423,591	\$32.80	\$27.58	\$30.26	0	932,767	1,305,860
Class A	41,477,211	\$32.80	NA	\$32.80	0	932,767	1,305,860
Class B	23,064,396	NA	\$27.58	\$27.58	0	0	0
Class C	9,881,984	NA	NA	\$25.09	0	0	0

Suburban Maryland 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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