RESEARCH Q4 2022

District of Columbia Office Market

Positive Occupancy and Inventory Contraction Moderate Vacancy Growth

The District of Columbia's office market exhibited modest tightening in the fourth quarter of 2022, noted by positive net absorption and a leveling of overall vacancy. This marks the District's largest quarterly net occupancy gain in three years. Leasing activity has increased modestly over the last six months. Although leasing remains low relative to historical expectations, pent-up demand is loosening and the slow but steady return of workers to offices is encouraging companies to reengage in real estate planning. Average asking rents have been trending downward over the last six months and are currently tied with the lowest average rates recorded since 2019. Rent compression has been experienced in all building classes but has been most pronounced in the Class B market. In addition to relatively low demand, high availability and landlord competition are applying downward pressure on both asking and effective rents.

Although the fourth quarter of 2022 showed signs of modest recovery, prolonged stress in the office market has created long-term challenges. Tenant downsizing of real estate needs had been a trend predating the pandemic and remains a driver of net demand, independent of hybrid work dynamics. While recent leasing data does not explicitly suggest that firms are downsizing purely due to the impact of hybrid work, less overall demand due to general rightsizing still limits the potential of a swift recovery to the District's nearly record-high vacancy. Continued low leasing activity will apply increased financial pressure on owners of high vacancy assets, particularly those with troubled debt balances.

Current Conditions

– The District of Columbia recorded 200,465 square feet of net absorption in the fourth quarter of 2022. Year-end net absorption measured negative 302,767 square feet. Despite positive absorption on the quarter, low leasing activity for much of the last year should result in volatility in quarterly occupancy and limit sustained gains.

– The vacancy rate rose 100 basis points over the last year to 18.5% but is down 10 basis points from the third quarter of 2022. Positive quarterly occupancy has helped to slow vacancy growth, but a moderating construction pipeline and inventory contraction by way of office conversions are stabilizing supply.

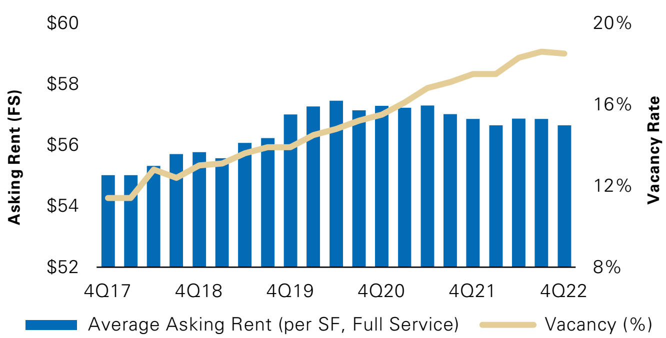
– Average asking rents measured $56.65/SF in the fourth quarter. Modest quarter-over-quarter rent contraction was measured, signaling further softening in the market.

Market Summary

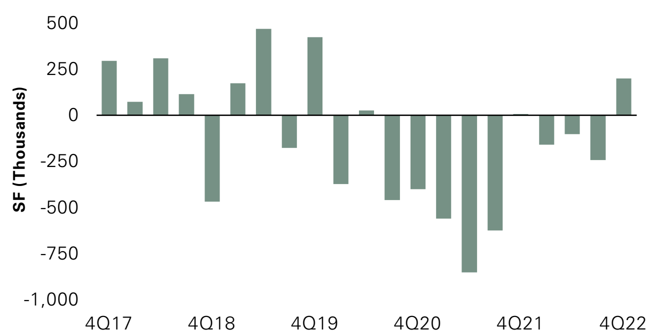
	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	130.2 M	131.1 M	131.4 M	→
Vacancy Rate	18.5%	18.6%	17.5%	→
Quarterly Net Absorption (SF)	200,465	-241,901	8,322	↓
Average Asking Rent/SF	$56.65	$56.86	$56.86	→
Under Construction (SF)	514,613	580,083	1.4 M	→
Deliveries YTD (SF)	1.3 M	1.2 M	976,215	↑

Market Analysis

ASKING RENT AND VACANCY RATE



NET ABSORPTION



NEWMARK

Net absorption measured 200,465 square feet in the fourth quarter of 2022, nearly offsetting the negative 241,901 square feet measured in the prior quarter. Year-end 2022 net absorption measured negative 302,767 square feet, as early-year occupancy losses weighed on the market. The District's occupancy gains remain heavily bifurcated by class, with Class A reaping nearly all the positive quarterly occupancy gains. In the fourth quarter of 2022, Class A net absorption measured 198,424 square feet and Class B and C assets measured a marginally positive 2,041 square feet. Class A net occupancy has been expanding for five consecutive quarters, highlighting the sustained demand for higher quality assets. Year-end 2022 net absorption measured 1.1 million square feet for Class A assets and negative 1.4 million square feet for the Class B and Class C markets.

Quarterly vacancy measured 18.5%, down 10 basis points from the third quarter and up 100 basis points in the last year. Class A vacancy, aided by noteworthy positive net absorption, decreased by 10 basis points on the quarter, measuring 16.5%. Class A vacancy has been relatively stable over the last year, hovering around 16.5%. Although this segment of the market has recorded noteworthy positive net absorption, inventory expansion by way of deliveries has moderated the impact of net absorption on vacancy. Conversely, Class B vacancy has risen by 40 basis points over the last quarter and 340 basis points over the last year. As Class A market fundamentals have generally benefitted from new construction and large footprint relocations, the Class B market has seen significant softening as legacy space remains structurally uncompetitive in an oversupplied market.

Oversupply and continued low demand has cooled the District's construction pipeline, which, excluding renovations and owner-occupied developments, measured 514,613 square feet in the fourth quarter of 2022. This marks the District's lowest construction pipeline in decades. The only building to deliver in the quarter was 14 Ridge Square, NW, a 60,969 square-foot office building in the City Ridge development in the Uptown submarket. Buildings currently under construction hold a prelease rate of 34.9%, which is low by relative standards, but the similarly low construction pipeline will minimize the impact of significant vacancy shocks upon building deliveries.

Average asking rents in the fourth quarter measured $56.65/SF, a $0.21/SF decrease from both last quarter and last year. Asking rents have been oscillating around $56/SF over the last year but have decreased each of the last two quarters. Asking rent compression has been experienced market-wide but has been slightly less in the Class A market, falling by 0.4% over the last year. In comparison, Class B rates have fallen by 0.6%. Effective rents remain under downward pressure, as elevated vacancy and overall low demand yield generous concessions for tenants looking for new space. Challenges in financial markets and with lenders are limiting the ability of some owners to pencil aggressive concession packages, despite market softness.

Leasing Activity Supported by Anchor Industries

Overall leasing activity in the District remains notably below its pre-pandemic levels across nearly all industries. While significant recovery in leasing activity did not materially accelerate in 2022, there was a redistribution of the composition of occupiers active in the market. Historically, the District's leasing demand has been anchored by the government and the law firm industry. That held true in both 2021 and 2022. Among tenants in excess of 25,000 square feet, these two industries commanded over 50% of the total square footage leased over the last two years.

While these core occupiers continue to anchor the leasing market, other industries recorded noteworthy leasing gains in 2022, relative to 2021, including nonprofits and associations. Among tenants larger than 25,000 square feet, the total square footage leased by nonprofits and associations increased by 29.9% in 2022, measuring over 600,000 square feet.

Notable 4Q 2022 Lease Transactions

Tenant	Building	Submarket	Type	Square Feet
Orrick Herrington & Sutcliffe	2100 Pennsylvania Avenue, NW	CBD	Direct Lease	67,000
National Fish and Wildlife Foundation	1625 Eye Street, NW	CBD	Direct Lease	62,039
Allen & Overy	1101 New York Avenue, NW	East End	Renewal	41,914
American Bar Association	1050 Connecticut Avenue, NW	CBD	Renewal	34,348
National Retail Federation	1101 New York Avenue, NW	Northeast	Renewal	31,115

Notable Recent Sales Transactions

Building	Submarket	Sale Price	Price/SF	Square Feet
601 Massachusetts Avenue, NW	East End	$531,000,000	$1,109	478,883
1900 N Street, NW	CBD	$265,000,000	$976	271,433
2115 Wisconsin Avenue, NW	Uptown	$91,500,000	$495	184,822
111 Massachusetts Avenue, NW	Capitol Hill	$85,000,000	$333	254,890

*Square footage representative of the share of interest purchased in building

Furthermore, nonprofits and associations lead all industries in total leases signed in 2022, at 28.3%. While increased leasing activity in this sector is an encouraging sign for more diversified demand for office space, these tenants have been contracting at a relatively strong rate. Noteworthy recent contractions include the Paralyzed Veterans of America (72.8% contraction), NeighborWorks (34.0% contraction), and Special Olympics (25.6% contraction). It should be noted that there are examples of firms across many industries expanding their real estate footprints, as well. However, many of these expanding firms are smaller in size, therefore, despite growth, their impact on curbing District-wide oversupply is somewhat muted.

Office Investment Markets Frozen; Financial Stress of Vacancy Builds for Levered Assets

Economic headwinds and high inflation have persisted throughout the fall, resulting in further interest rate increases from the Federal Reserve. The Fed's December meeting reaffirmed that it will be steadfast in its approach to reduce inflation and cool the economy in 2023. Continued upward pressure on interest rates is likely to extend the reluctance among real estate investors to undertake large office investments. Sellers are presented with distinct challenges, including a limited market of buyers and growing financial challenges resulting from high vacancies and debt maturities.

Investment activity was tepid in the fourth quarter of 2022, with effectively no traditional office sales at the writing of this report. Two office properties sold in the quarter, but both are planned for residential conversion. 1735 K Street and 1010 Vermont Avenue sold for $276/SF and $239/SF, respectively. Additionally, George Washington University exercised a repurchase option on 600 19th Street, NW. The price of this sale was not known at the writing of this report but is unlikely a market rate sale.

District of Columbia Outlook

The District's office market exhibited modest tightening in the fourth quarter, attributed to loosening of pent-up demand and fewer space give backs. Despite this positive trajectory, economic headwinds are likely to slow this momentum in 2023. Over the next 24 months, Newmark projects modest tightening, resulting in the vacancy rate decreasing to 18.1% by December 2024. The top of market has been performing well, but the commodity-grade and Class B markets will struggle to attract tenancy. Stable but low leasing activity should temper expectations for strong occupancy gains in early 2023. Asking rents may modestly appreciate in high-quality assets, but low demand will ensure generous concessions remain common.

The financial burdens of the prolonged underperformance in certain assets will present distinct challenges for some owners and lenders. Office conversions still present exit opportunities for well-positioned buildings, though the pipeline for proposed conversions is already large, at 3.5 million square feet. Conversion-focused investment activity is relatively low, and only three office assets sold with intent of conversion in the second half of 2022. If proposed projects begin breaking ground, office conversion activity could moderate Class B market fundamentals.

Investment sales activity should remain quiet in early 2023. The Federal Reserve raised interest rates again in December, despite cooling inflation in November. Investors are likely to focus on safe assets featuring high WALT and elite quality. Value opportunities do exist for investors seeking riskier assets and given the District's reputation for safety in periods of uncertainty, could be a benefit when investors begin re-entering the market.

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	2019 Absorption (SF)	2020 Absorption (SF)	2021 Absorption (SF)	4Q 2022 Absorption (SF)	YTD 2022 Absorption (SF)
District of Columbia	**130,221,824**	**17.1%**	**18.5%**	**890,479**	**-1,204,657**	**-2,027,247**	**200,465**	**-302,767**
Class A	82,767,481	15.3%	16.5%	1,799,698	-114,861	-125,517	198,424	1,142,072
Class B	43,380,604	21.3%	22.9%	-628,279	-819,242	-1,725,051	-30,321	-1,476,724
Class C	4,073,739	10.2%	10.8%	-280,940	-270,554	-176,679	32,362	31,885

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 2022 Deliveries (SF)	YTD 2022 Deliveries (SF)	Under Construction (SF)
District of Columbia	**130,221,824**	**$62.98**	**$48.45**	**$56.65**	**65,470**	**1,270,986**	**514,613**
Class A	82,767,481	$62.98	NA	$62.98	65,470	1,270,986	514,613
Class B	43,380,604	NA	$48.45	$48.45	0	0	0
Class C	4,073,739	NA	NA	$42.19	0	0	0

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

Submarket Statistics—All Classes

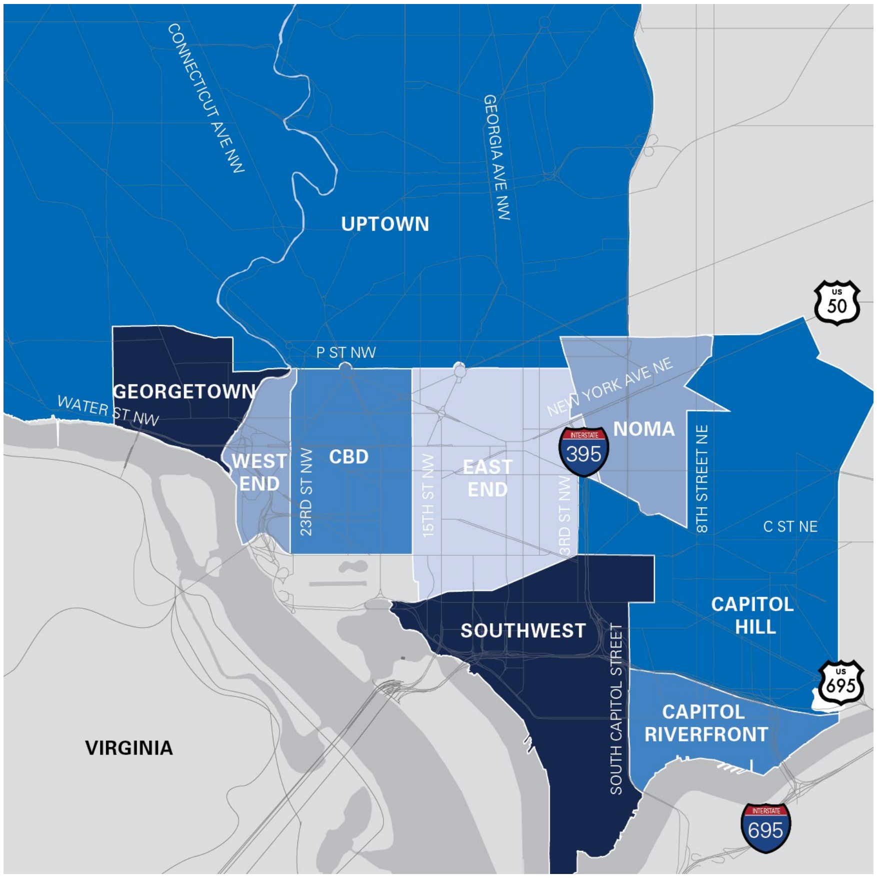
	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2019 Absorption (SF)	2020 Absorption (SF)	2021 Absorption (SF)	4Q 2022 Absorption (SF)	YTD 2022 Absorption (SF)
District of Columbia	**130,221,824**	**17.1%**	**18.5%**	**890,479**	**-1,204,657**	**-2,027,247**	**200,465**	**-302,767**
Capitol Hill	5,286,037	21.7%	22.8%	5,188	169,977	-156,782	15,705	-41,307
Capitol Riverfront	4,723,061	14.2%	16.2%	-835	82,717	99,060	27,587	86,483
Central Business District	40,606,288	19.0%	21.3%	-443,715	-738,606	-1,062,582	25,893	-311,333
East End	42,655,970	19.3%	20.2%	-67,881	-619,795	-518,345	98,223	-16,430
Georgetown	2,810,774	16.0%	16.4%	-94,973	-7,392	-126,538	45,932	16,712
NoMa	11,798,008	8.2%	8.7%	750,211	592,186	-366,110	24,504	-166,439
Southwest	12,566,510	12.7%	12.9%	695,064	-568,116	373,321	8,872	208,838
Uptown	5,742,092	17.6%	18.2%	215,990	-34,521	-379,174	21,564	84,145
West End	4,033,084	12.2%	16.1%	-168,570	-81,107	109,903	-67,815	-163,436

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 2022 Deliveries (SF)	YTD 2022 Deliveries (SF)	Under Construction (SF)
District of Columbia	**130,221,824**	**$62.98**	**$48.45**	**$56.65**	**65,470**	**1,270,986**	**514,613**
Capitol Hill	5,286,037	$73.31	$53.66	$63.80	0	0	178,324
Capitol Riverfront	4,723,061	$60.80	$47.25	$59.34	0	127,633	0
Central Business District	40,606,288	$63.34	$49.23	$56.70	0	438,180	336,289
East End	42,655,970	$64.53	$48.24	$59.08	0	0	0
Georgetown	2,810,774	$58.63	$44.96	$50.09	0	0	0
NoMa	11,798,008	$51.37	$48.75	$50.36	0	0	0
Southwest	12,566,510	$53.83	$48.04	$49.21	0	639,703	0
Uptown	5,742,092	$51.12	$42.09	$43.92	65,470	65,470	0
West End	4,033,084	$58.01	$51.11	$54.04	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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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.