3Q23

Washington DC 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.
- 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 349,783 square feet, resulting in 686,381 square feet of negative net absorption year-to-date. Low leasing activity for much of the last 12 months should result in volatility in quarterly occupancy while limiting sustained gains.
- The construction pipeline remained at 514,613 square feet to end Q3 2023, with two properties currently under construction. 17XM is an 11-story, 334,000 square-foot Class A office building under construction in the CBD, with an estimated delivery of Q2 2024. 20 Mass is a 10-story, 192,156 square-foot Class A office building under construction in Capitol Hill, with an estimated delivery of Q4 2023.
- Vacancy grew to 19.7%, a 30-basis-point increase from the second quarter of 2023. Average asking rents measured $56.27/SF in the third quarter of 2023, an increase of $0.44 quarter-over-quarter. This is the first quarter of positive rent movement after the market experienced four straight quarters of rent decline.

Major Transactions

- The U.S. Securities and Exchange Commission renewed over one million square feet of space in the NoMa submarket during the quarter, providing optimism that leasing activity will improve going forward.
- Law firm, Kelley Drye & Warren LLP, is downsizing, moving from 100,000 square feet at the Washington Harbour in Georgetown to 65,000 square feet at 670 Maine Avenue in the Southwest submarket.
- 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.
- Investment sales activity should remain relatively quiet through the rest of 2023. The Federal Reserve interest rate hikes and limited access to debt will continue to be a factor through the rest of 2023.
- Although rents decelerated to begin the year, rents increased during Q3, ending the quarter at $56.27 per square foot, an increase of $0.44 quarter-over-quarter. This indicates a bifurcation of demand, as Trophy and Class A space outperform commodity office.

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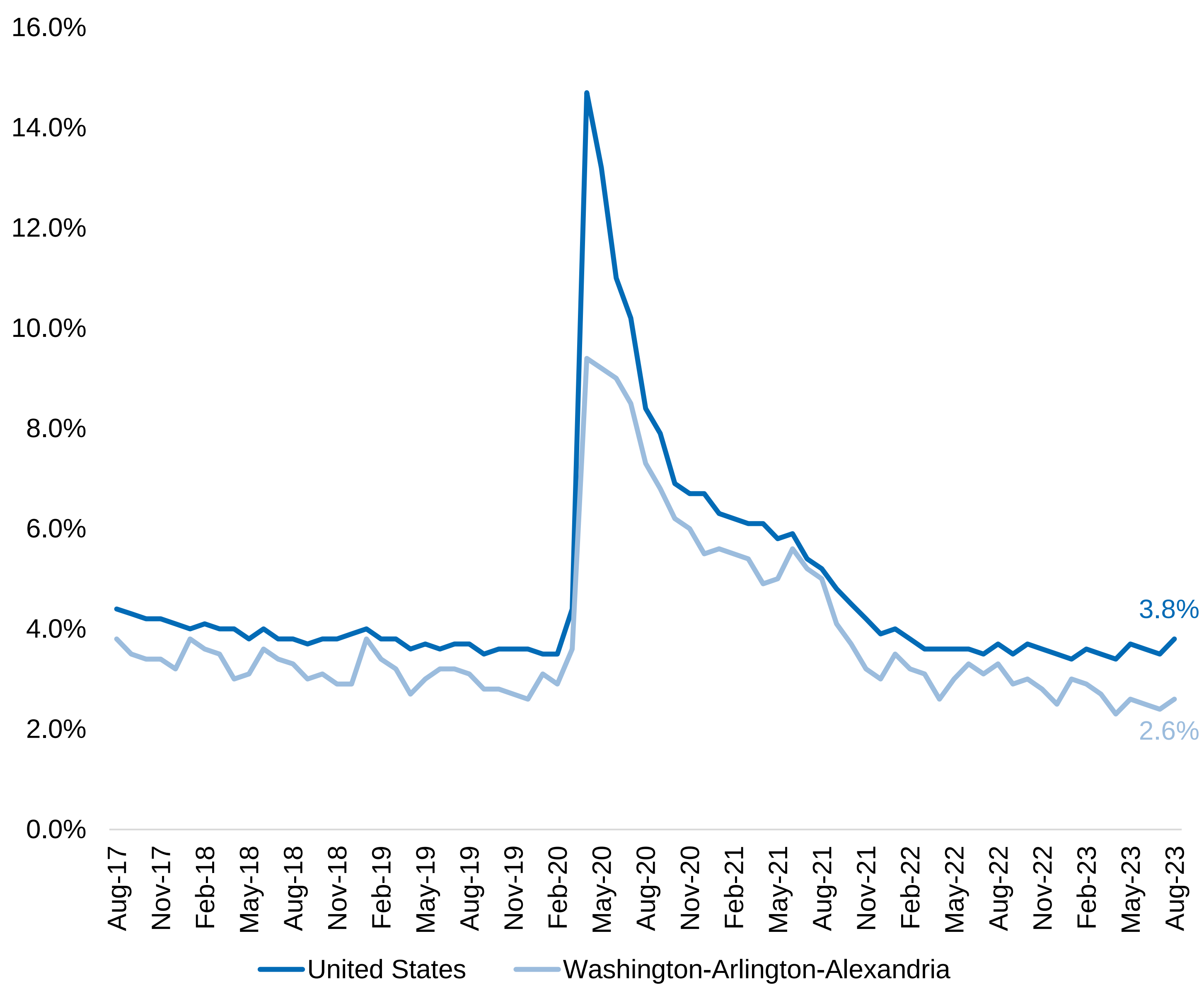
Economy

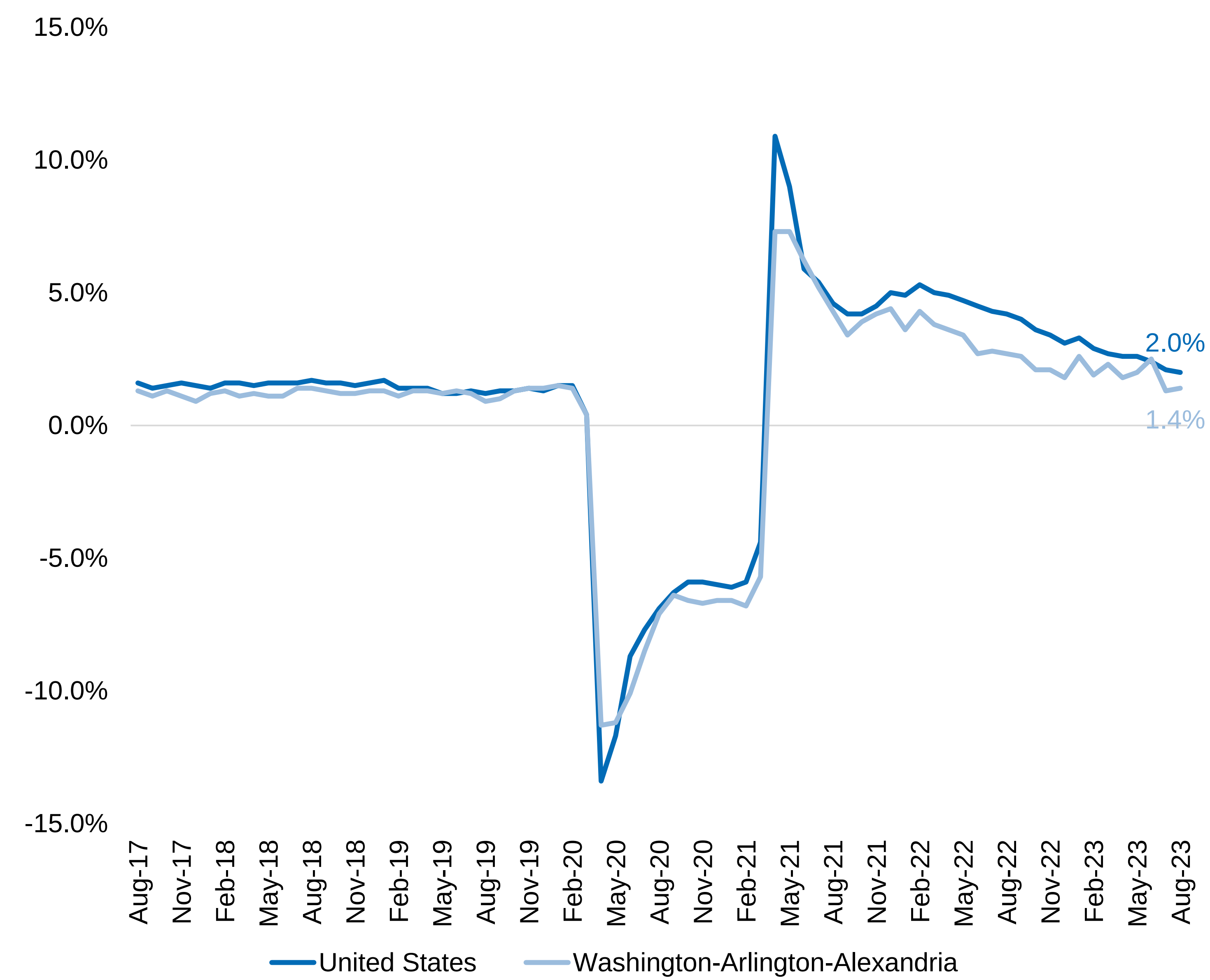
Metro Employment Growth Is An Encouraging Tailwind

The region's labor market currently is 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

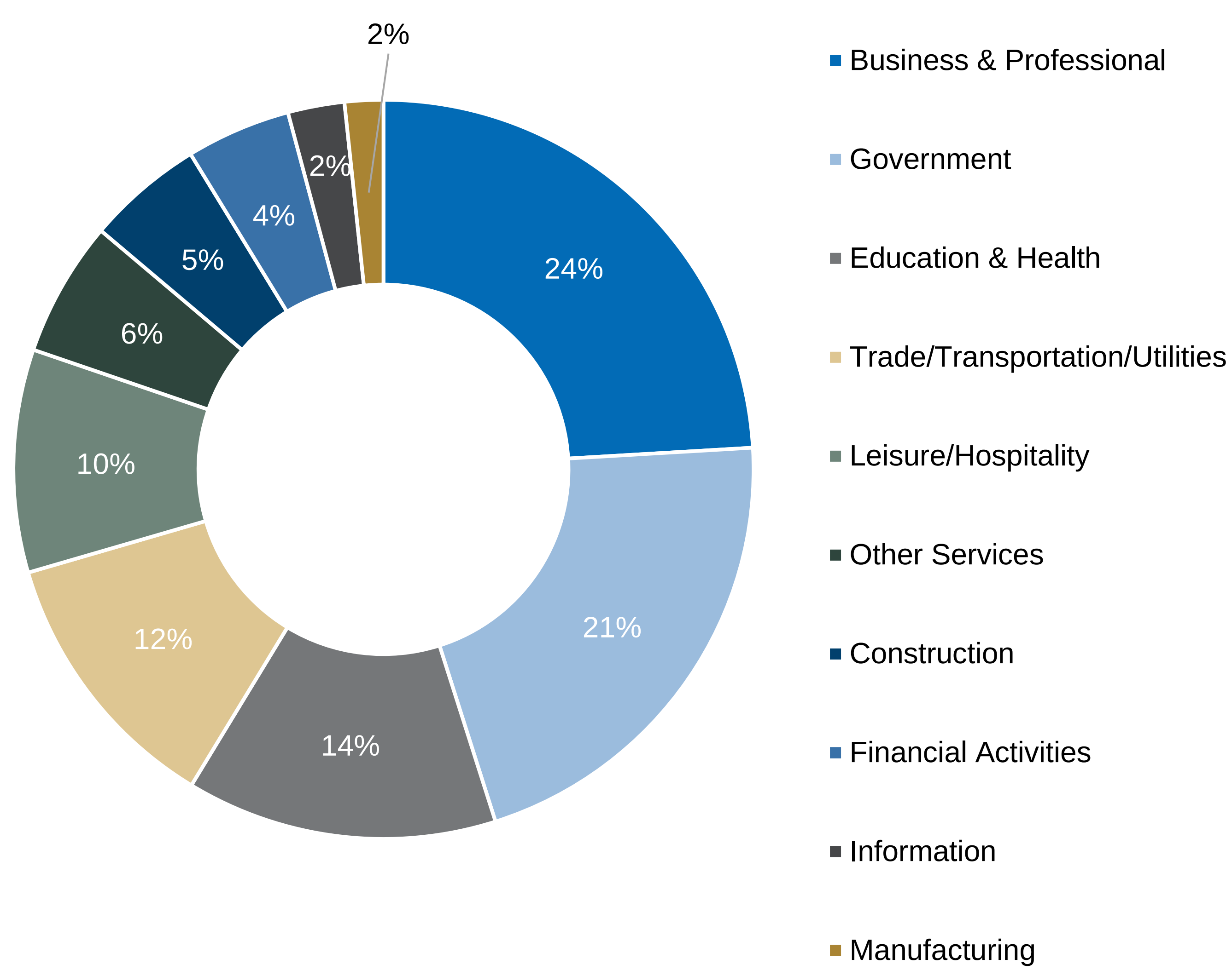


Source: U.S. Bureau of Labor Statistics, Washington-Arlington-Alexandria

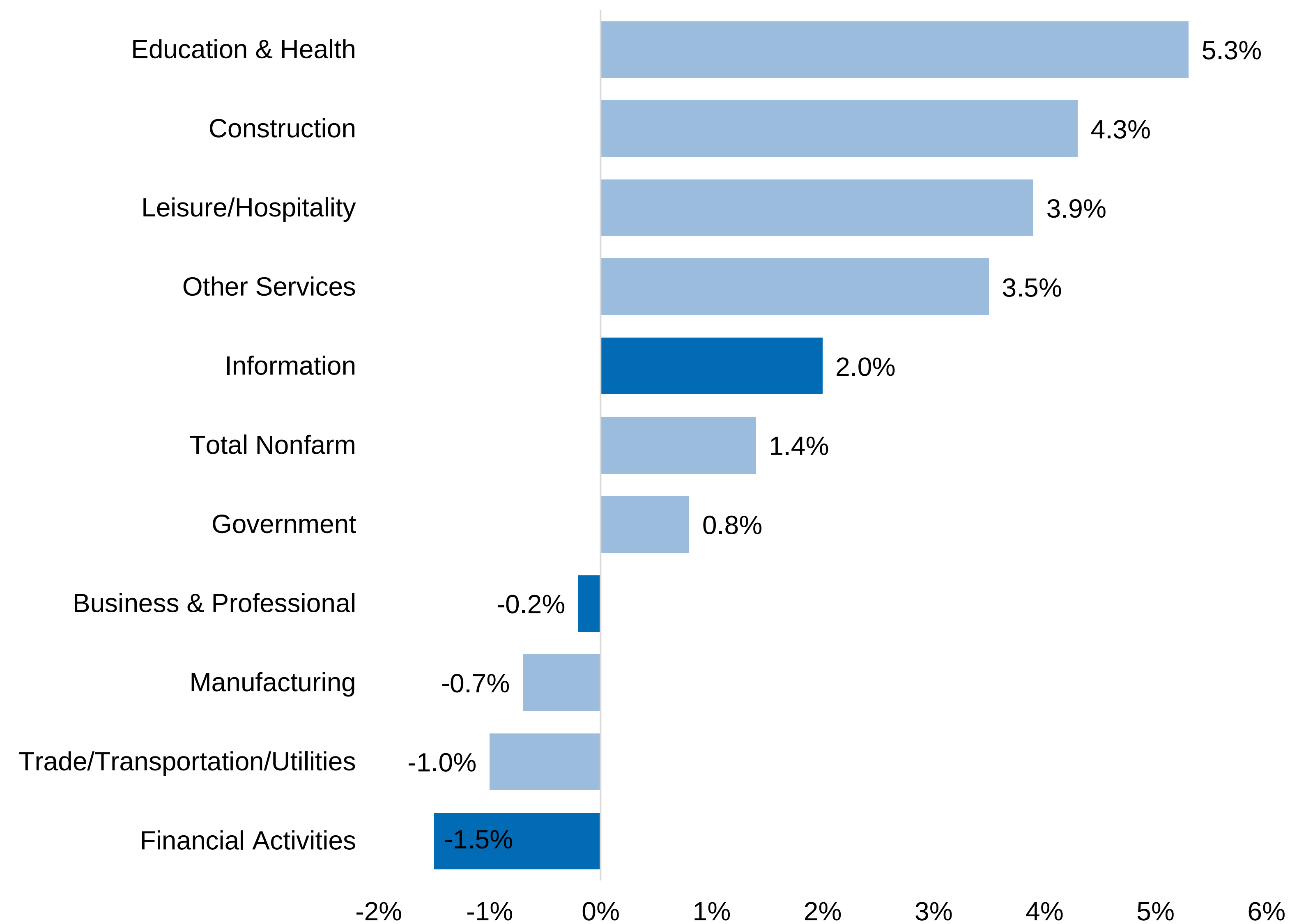
Job Growth Driven by Education & Health, Construction, and Hospitality Demand

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

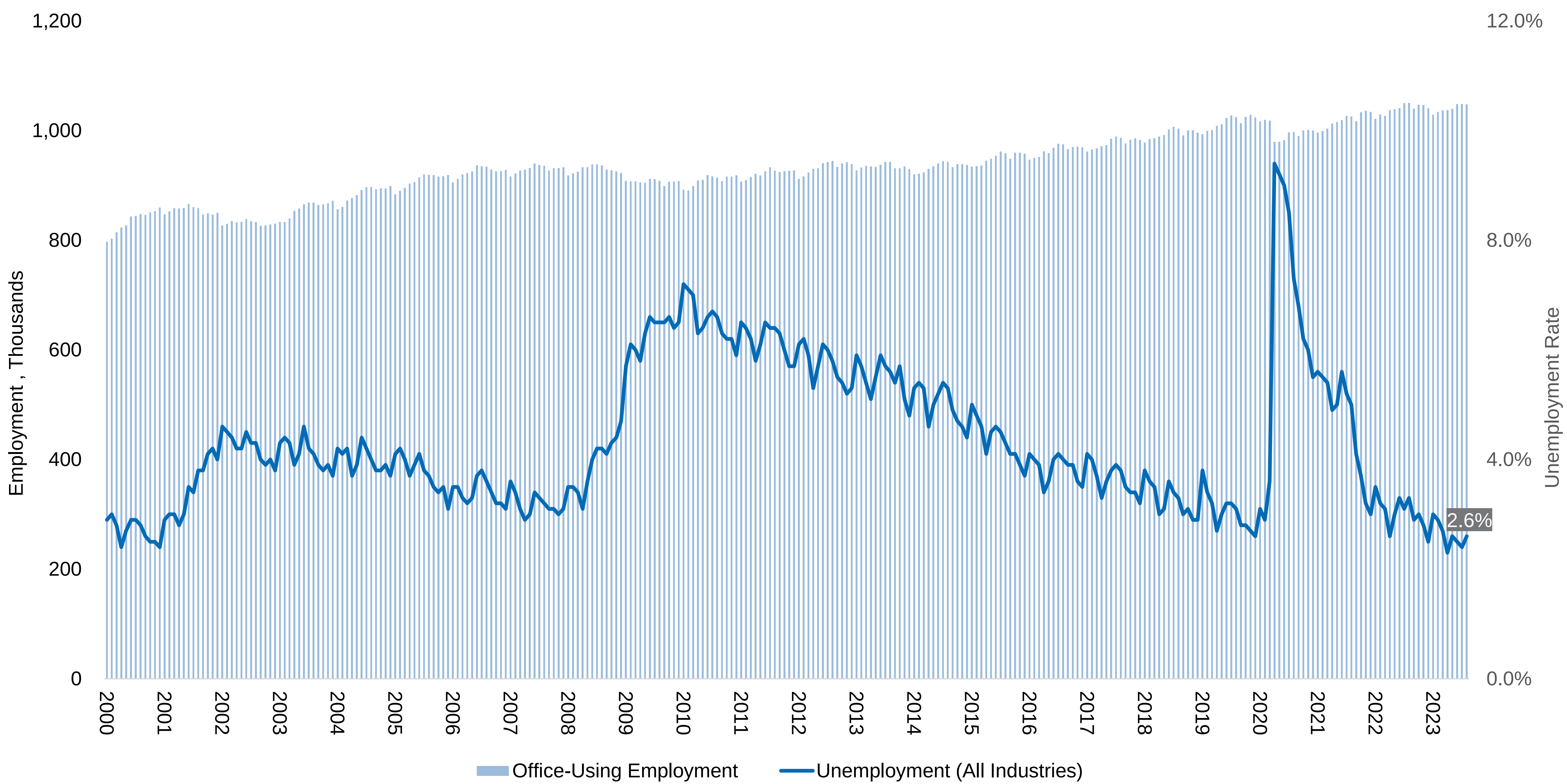


Source: U.S. Bureau of Labor Statistics, Washington-Arlington-Alexandria

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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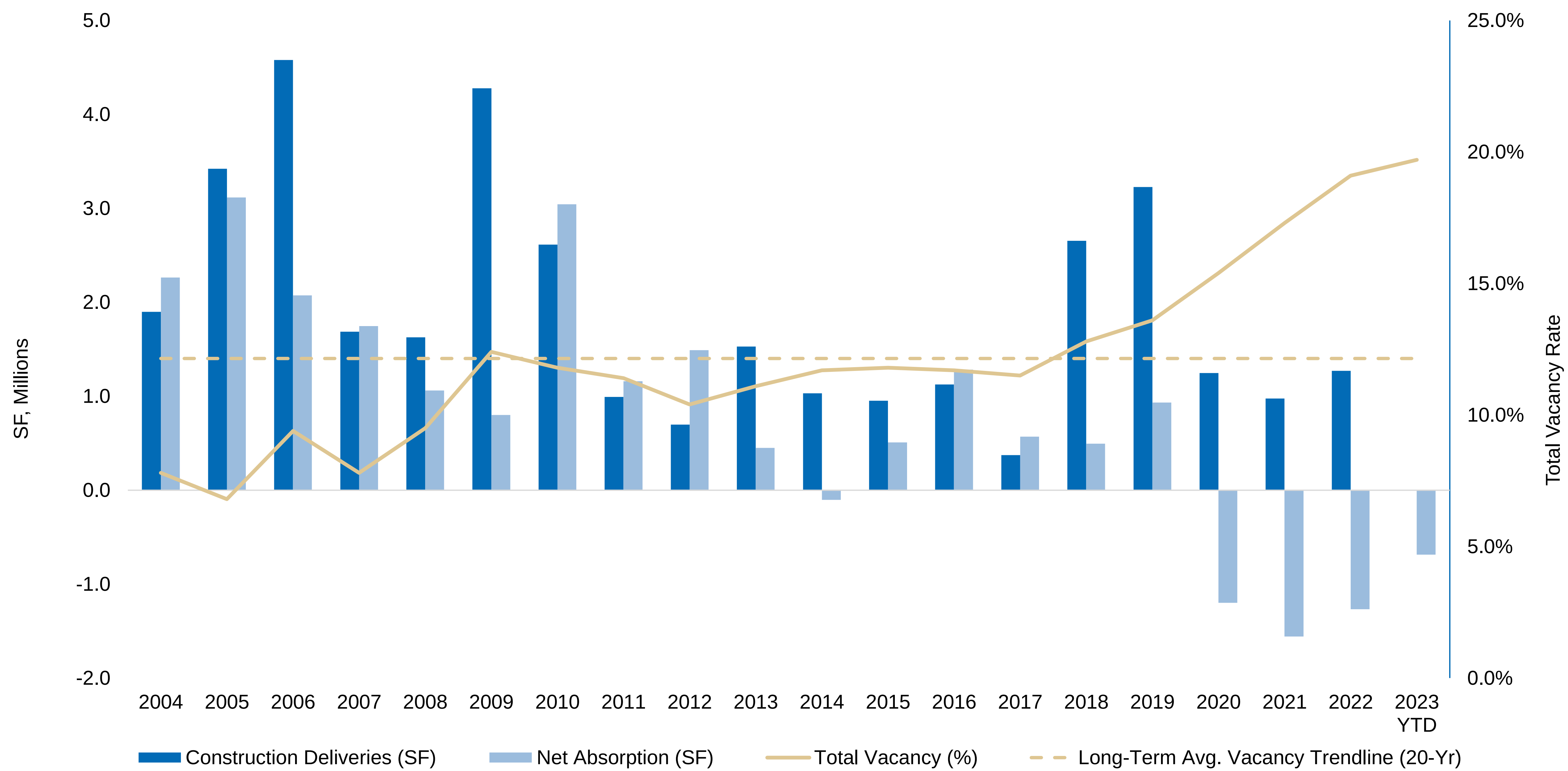
Leasing Market Fundamentals

Vacancy Rises But No New Deliveries Provide Balance

The vacancy rate increased to 19.7% in the third quarter of 2023, up 30 basis points quarter-over-quarter and 60 basis points year-over-year. The lack of new speculative office construction is advantageous in helping to balance supply with waning demand.

Historical Construction Deliveries, Net Absorption, and Vacancy

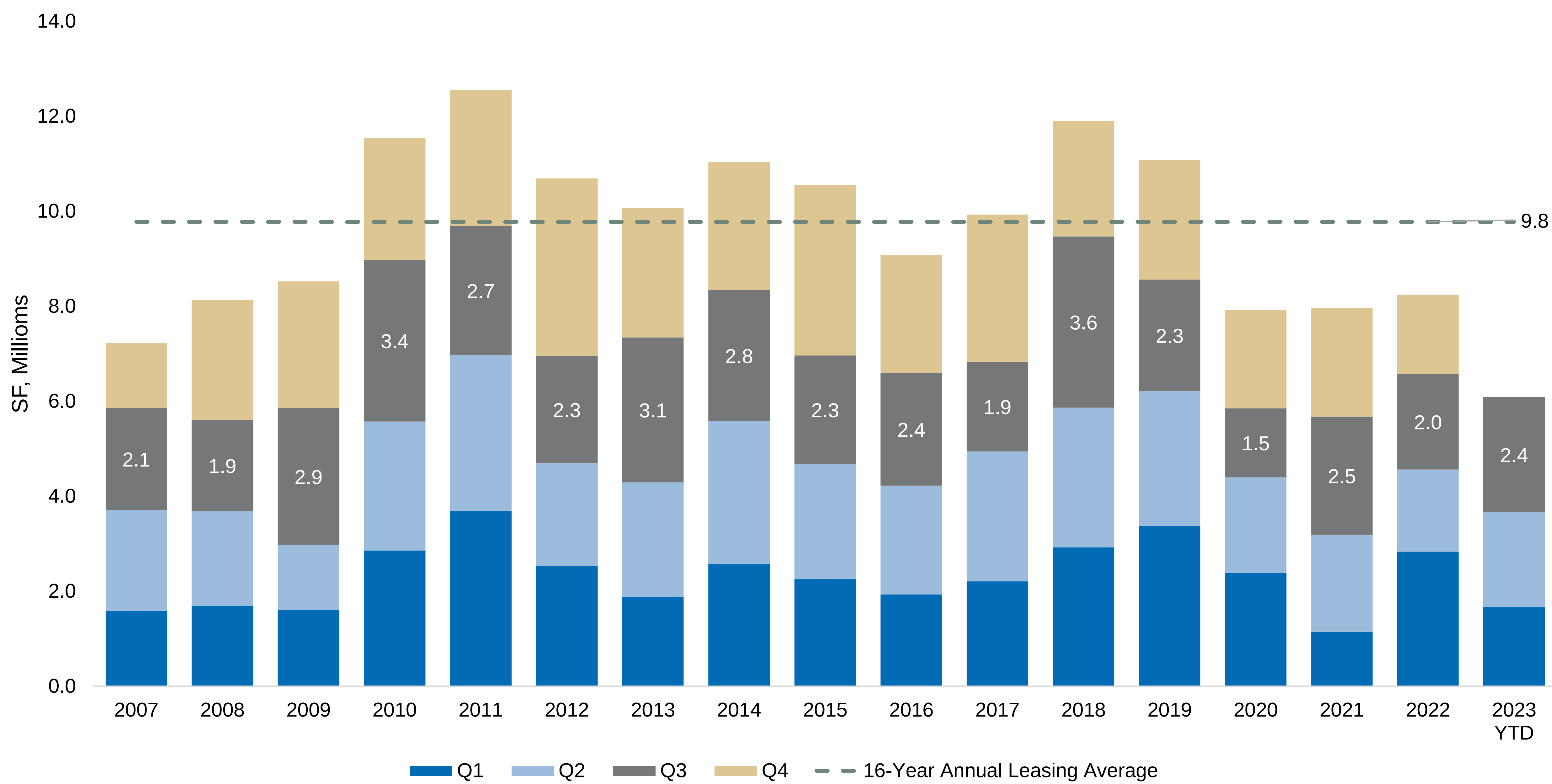


Source: Newmark Research

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 on par with transaction activity over the last three years.

Total Leasing Activity (tsf)

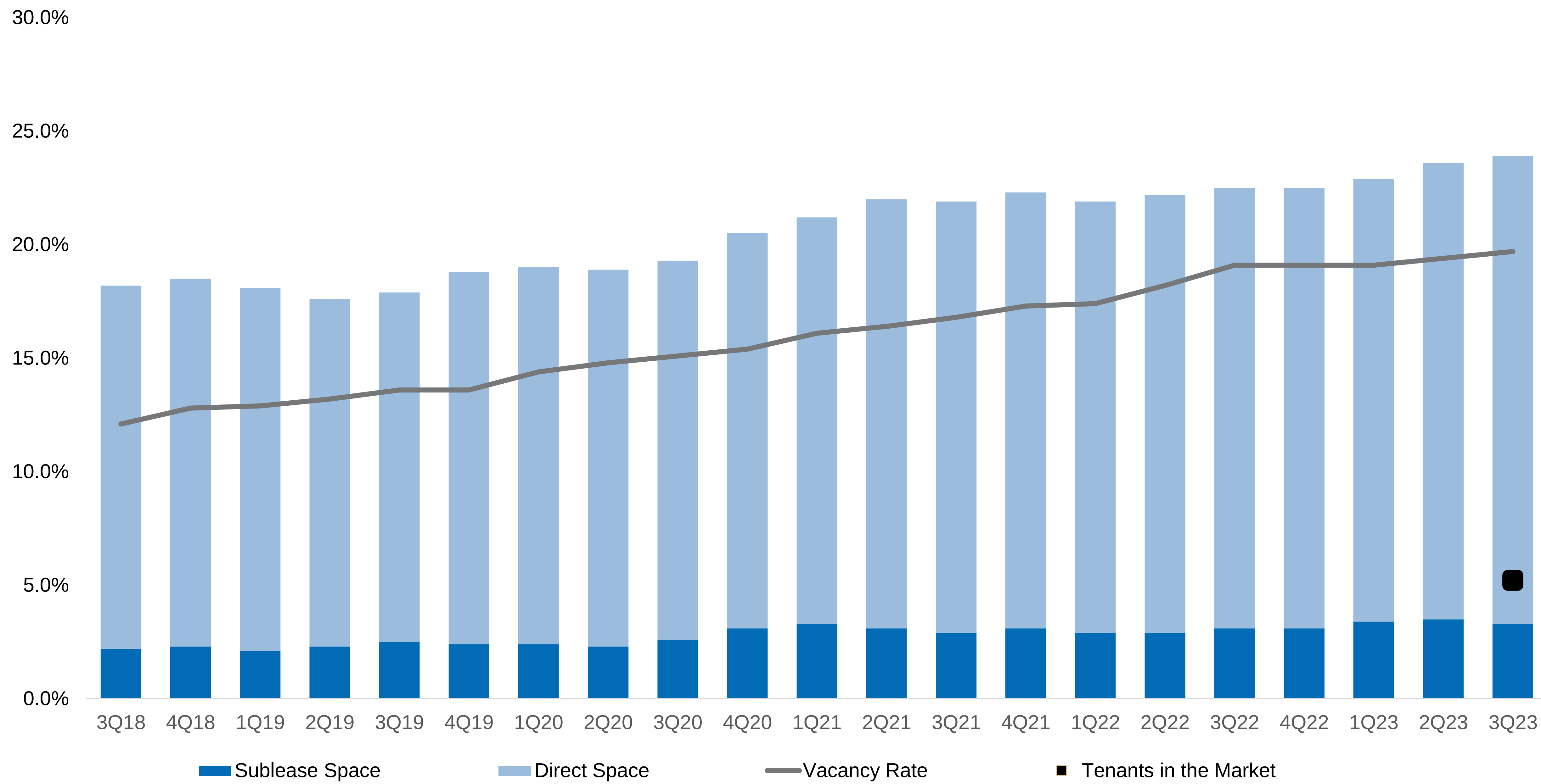


Source: Newmark Research, CoStar

Availability Continues to Increase While Tenant Demand Drops

Total availability continues to increase quarter-over-quarter, but this quarter it is direct space driving new available supply. The District of Columbia saw sublease space begin to escalate in 2020 and early 2021. In the first half of this year, even more sublease listings hit the market. However, this quarter, sublease availability actually declined 20 basis points due to some of the 2020-2021 sublease listings rolling over to direct listings, as well as some net positive sublease absorption.

Available Space and Tenant Demand as Percent of Overall Market

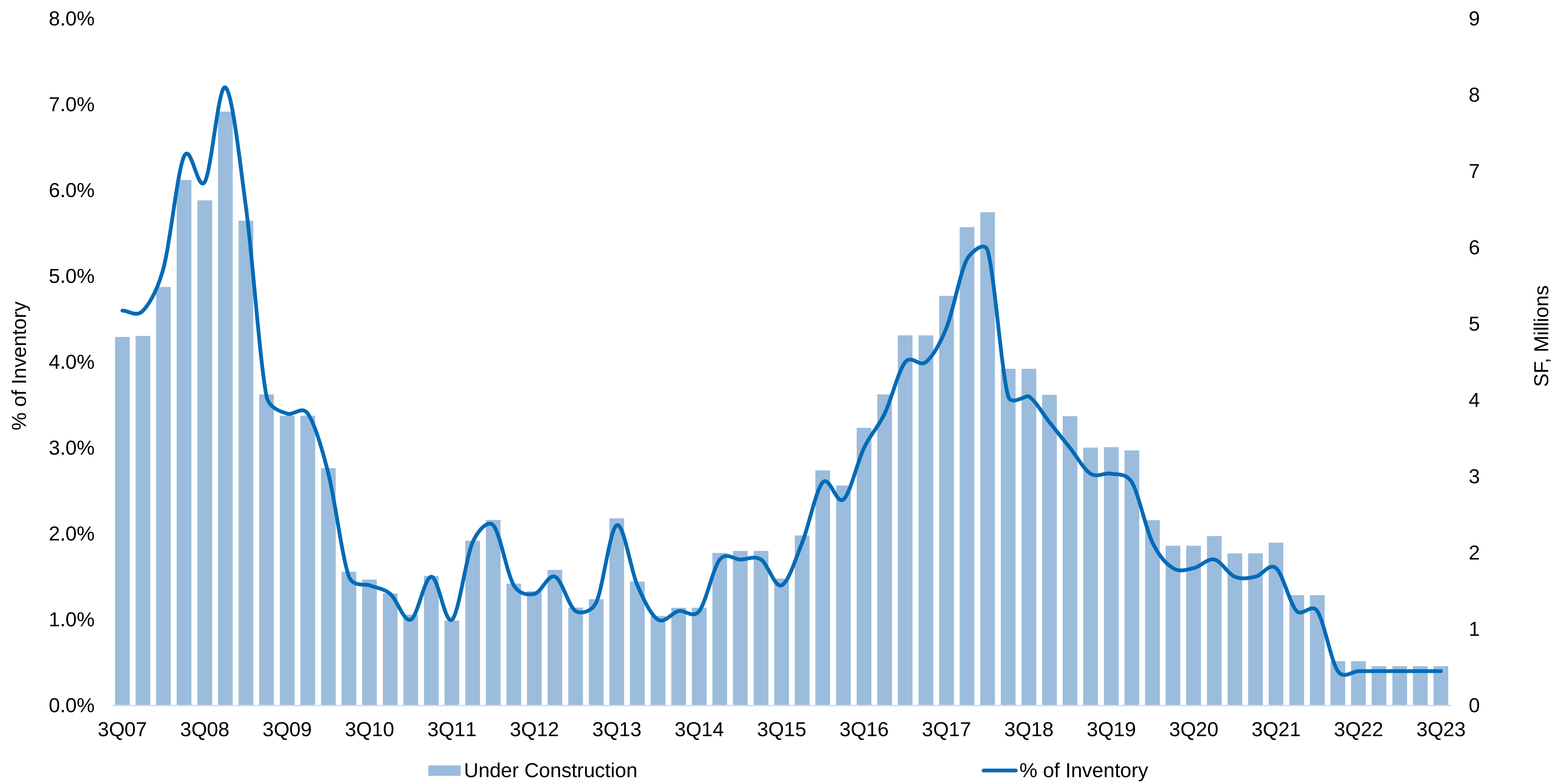


Source: Newmark Research

D.C.’s Construction Pipeline Will Deliver With Substantial Preleasing

Of the two major office projects currently under construction (20 Mass and 17XM), there is already substantial preleasing activity despite delivery dates that are years out. This speaks to unrelenting tenant demand for brand new trophy office in D.C.’s most distinguished submarkets.

Office Under Construction and % of Inventory

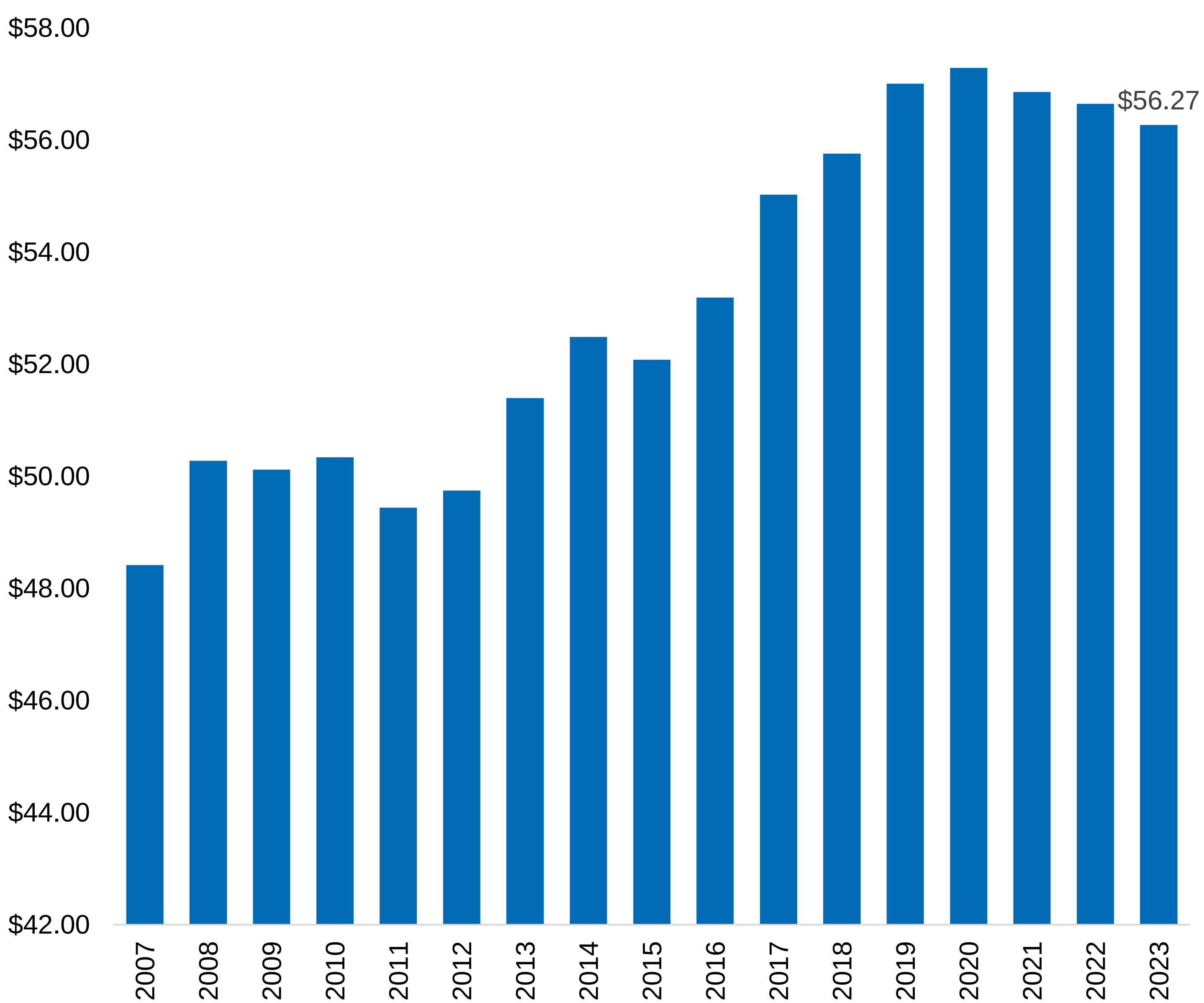


Source: Newmark Research, CoStar

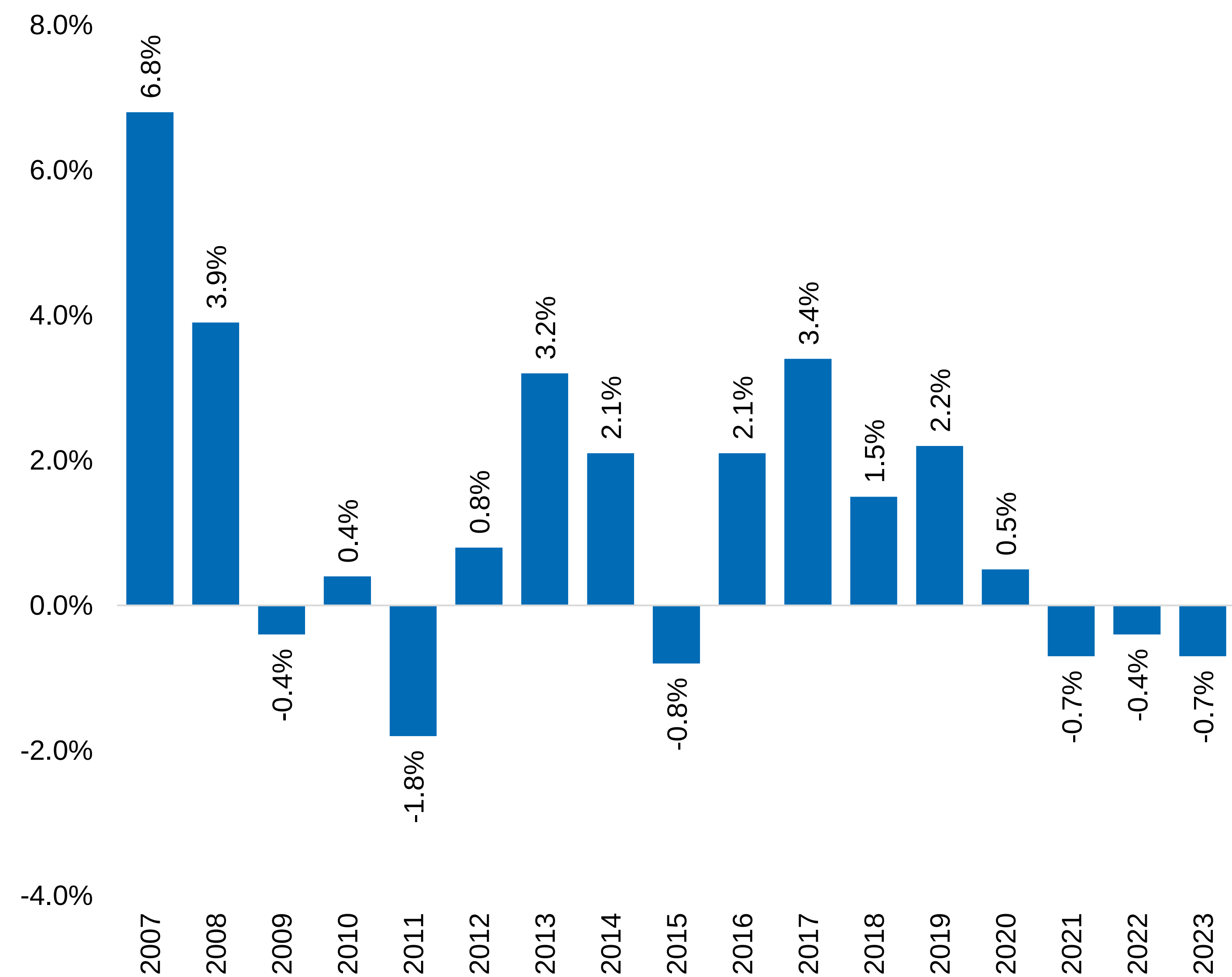
Rental Rates Decrease in D.C., But Metrowide Rates Are Still Growing

Class A and B rental rates have been decreasing year over year since 2021. The District of Columbia has not experienced sustained annual losses in asking rents since the Global Financial Crisis, but even then, it took two years for rates to noticeably drop in 2011.

Office Average Asking Rent, $/SF, FS



Year-over-Year Asking Rent Growth Rate

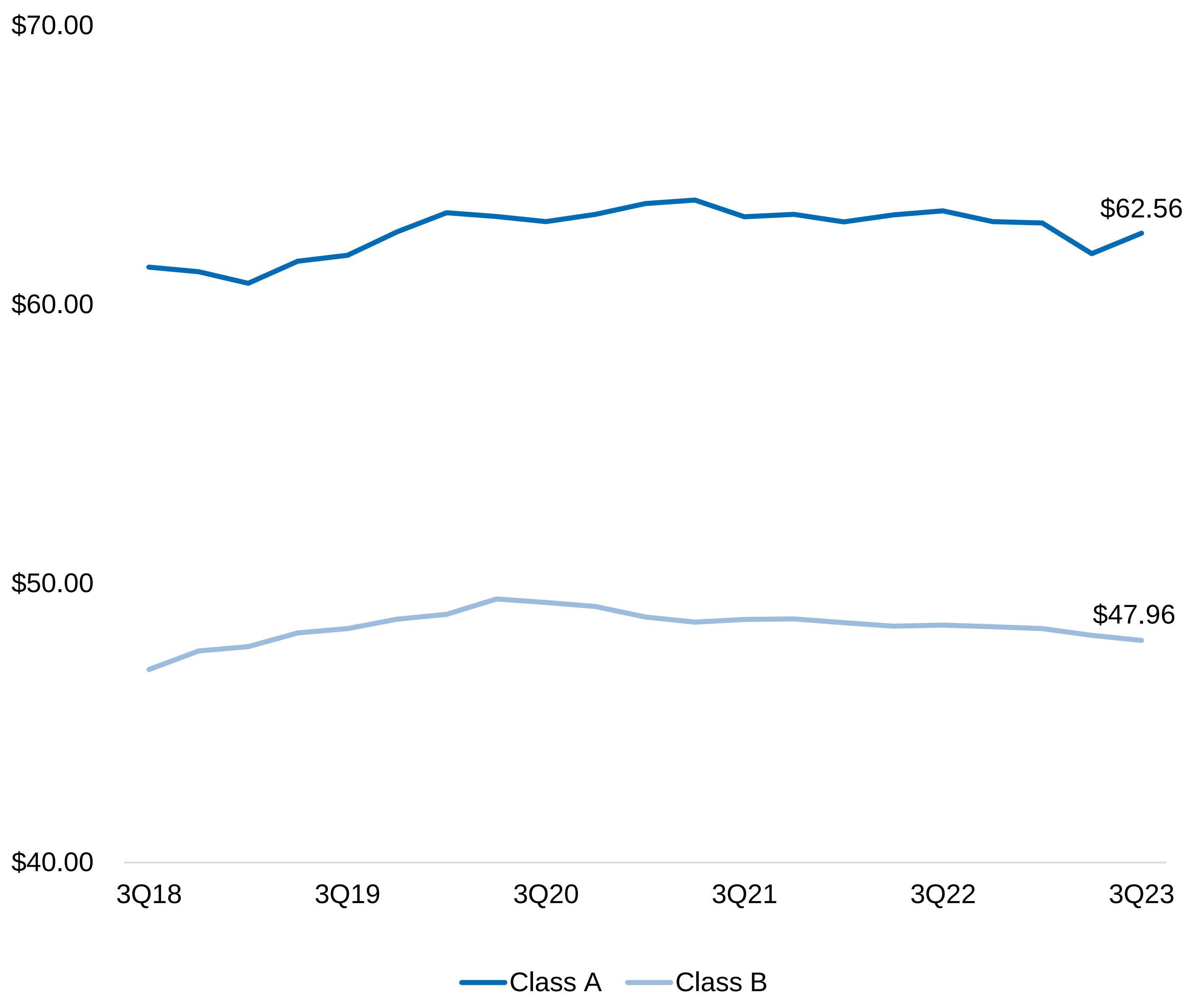


Source: Newmark Research, CoStar

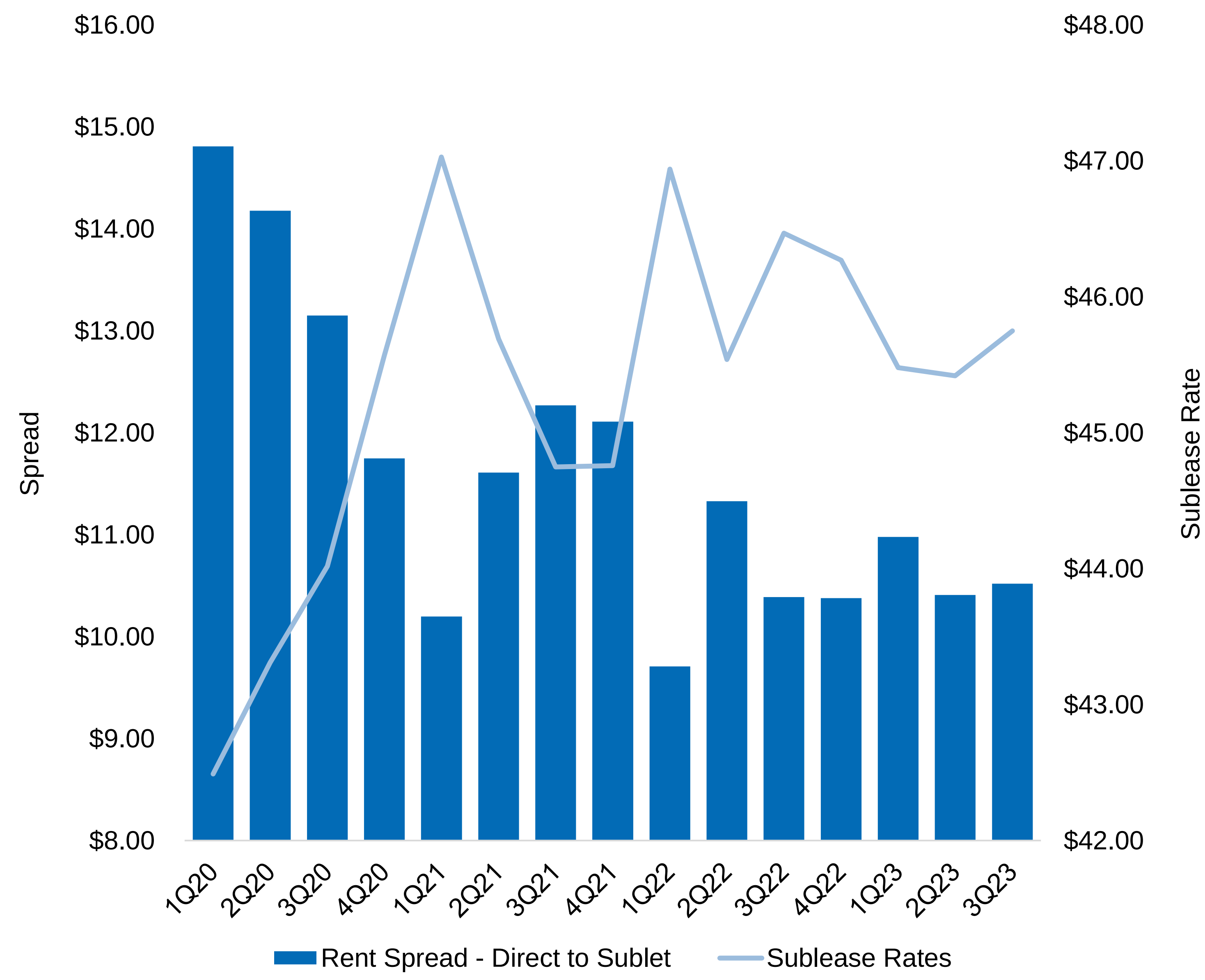
Asking Rents Increase in Class A Product

Both Class A and Class B rents continue to exhibit modest softening, however Class A product showed an increase in rents quarter-over-quarter. 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

Q3 Leasing Activity Improves Year-Over-Year

Leasing activity improved from the second quarter of 2023 despite an ongoing period of lower activity. The NoMa submarket was most active during the quarter, containing the three largest transactions which totaled over one million square feet.

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
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
Kelley Drye & Warren LLP	670 Maine Avenue, SW	Southwest	Direct Lease	65,000

Source: Newmark Research

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