

Washington, D.C. OFFICE

Economic Indicators

	Q3 18	Q3 19	12-Month Forecast
D.C. Metro Employment	3.31M	3.34M	▲
D.C. Metro Unemployment	3.2%	3.2%	■
U.S. Unemployment	3.8%	3.7%	▲

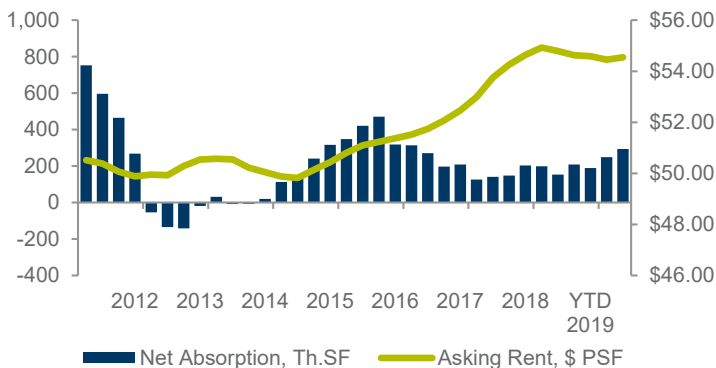
Market Indicators (Overall, All Classes)

	Q3 18	Q3 19	12-Month Forecast
Vacancy	14.1%	14.2%	▲
YTD Net Absorption (sf)	379k	945k	■
Under Construction (sf)	4.4M	3.7M	▼
Average Asking Rent*	\$54.41	\$54.69	▲

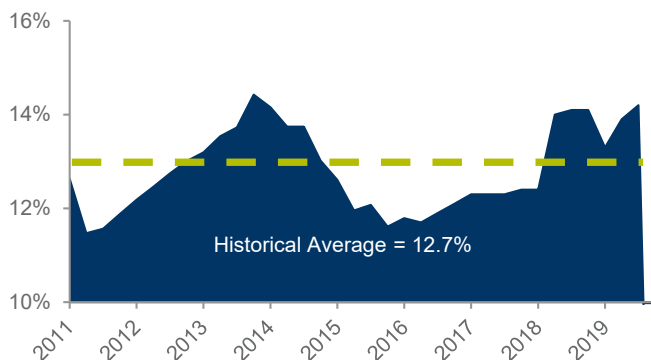
*Rental rates reflect gross asking \$psf/year

Overall Net Absorption/Overall Asking Rent

4-QTR TRAILING AVERAGE



Overall Vacancy



Economy

The government shutdown of late 2018/early 2019 had a pronounced negative impact and does not bode well for a federal sector that is likely to be faced with increasing gridlock in advance of the 2020 presidential election. While the headline job growth statistics in the region have slowed in late 2018/early 2019, the headline economic indicators remain relatively healthy. The labor markets remain very tight with a regional unemployment rate of 3.2%.

Market Overview

The District of Columbia (The District or D.C.) is nearing the end of its current development cycle in what will be a record amount of new office supply to hit the market. By the end of 2019, developers in the District will deliver over four million square feet (sf) of new and significantly renovated office development. With this flood of new space, vacancy in the Washington, D.C. market inched a bit closer to its highest point recorded in a decade, closing the quarter at 14.2%, up 30 basis-points (bps) from second quarter vacancy of 13.9% and up 10 bps from year-over-year (YOY) totals. In the third quarter, 700 & 800 K Street, NW and 888 16th Street, NW all delivered fully vacant. This elevated vacancy brought on by these new projects will be short lived however, as these assets are close to being fully occupied with the likes of law firm Baker Botts, tech giant Apple, and coworking group WeWork set to commence their leases at 700 & 800 K Street, NW by the close of 2019. Similarly, 888 16th Street, NW is rumored to be approaching fully leased with law firms McGuireWoods and Hausfeld set to take most of the remaining space. From a midterm perspective, development between 2020 and 2022 is projected to total about 2.1 million square feet (msf) with half of that backloaded in 2022 when 2100 Pennsylvania Avenue, NW and Phase II of the Wharf deliver. These buildings are already half preleased by law firms WilmerHale and Williams & Connolly, respectively. The drop in development post-2019 should give the market time to absorb this new supply into 2021 & 2022 and stabilize vacancy in the long run. At this point, there remains a significant amount of vacant space throughout the CBD and East End in 2018 & 2019 deliveries that is officially leased or at LOI. The space hasn't been moved into yet however and we are in the middle of a lag period propping up vacancy rates. At the end of the third quarter, the direct and overall vacancy rates in the CBD and East End combined were 14.4% and 15.6% respectively. However, with the likes of 888 16th Street, 655 New York Avenue, 1100 15th Street, 700 K Street, and 2001 K Street North just about fully occupied or rumored to be fully leased soon, direct and overall vacancy rates in the near term drop to 13.7% and 14.9%, respectively. Thus, it's not necessarily that this influx of new space isn't being leased but a portion of it being in a holding period until the space is taken up, causing a blip in vacancies.

Vacancy in the East End reached a high of 17.7% primarily triggered by the U.S. Department of Justice (DOJ) vacating 601 D Street, NW in favor of 150 M Street, NE, their new build-to-suit in NoMa. The building has since been re-leased with the D.C. Office of the Attorney General committing to about 200,000 sf and the DOJ to re-lease about 300,000 sf, both under 15-year terms. These two groups are set to take up their space in 2021. This scenario highlights the changing landscape regarding the federal leasing market. Until lately, the General Services Administration (GSA) was able to leverage new developments in emerging markets like NoMa to consolidate large requirements efficiently at below-prospectus rents. More recently, rising construction costs have lessened these options, leading to the GSA backfilling space that was previously occupied by other agencies. This bodes well for owners with large blocks of GSA-compliant class B space and incumbent GSA landlords, as well as overall market conditions in the midterm.

Vacancy in the Capitol Riverfront returned to sub-10% levels, closing the quarter at 9.8% - only submarket to do so. The market has seen this shift progress almost every quarter as the Riverfront, Southwest, and NoMa emerge as acceptable locations for both public and private sector users and migration to them takes tenants out of the CBD and East End in search of cheaper rates and often newer and highly amenitized offerings. Coworking registered a relatively quiet third quarter with just over 60,000 sf of new space leased between CommonGrounds's second location at 99 M Street, SE and WeWork's expansion at 1875 K Street, NW. This was the least amount of space leased by the coworking sector since the first quarter of 2018. It should be noted that WeWork executed a lease takeover of EAB's, the healthcare portion of the Advisory Board Company, leased space at 655 New York Avenue, NW, totaling about 150,000 sf, after the group chose to stay in place at 2445 M Street, NW in the West End. Despite minimal coworking activity this quarter, which has been the major driver of net new demand in the D.C. market as of late, new leasing activity was about 1.5 million sf for the quarter, average for the market on a quarterly basis. New leasing activity was anchored by the U.S. DOJ and D.C. Office of the Attorney General leases at 601 D Street, NW as well as EAB Global's 148,452 sf new lease at 2445 M Street, NW. EAB's lease was counted as new since the group became a new entity after the Advisory Board Company split. New and gross leasing activity continued well on pace, at about 4.5 million and 8.5 million sf for the year respectively, far exceeding historical averages.

Overall net absorption was below the quarterly market average of about 300,000 sf, closing the quarter at 123,702 sf. Convене's new space at 575 7th Street, NW was the primary contributor as well as the American Society of Nephrology moving into their 32,519 sf space at 1401 H Street, NW and vacating their owned condo space not included in inventory. Despite a less active quarter, net absorption also remains on pace to exceed the annual market average of about one million sf.

Outlook

Propelled by coworking and tech, activity across D.C. remains healthy, despite continued contraction by the traditional drivers in the legal and government sectors. However, the market is seeing a plethora of space come online and total net new demand remains a bit behind it. In the midterm, speculative development is likely to be limited as construction costs continue to skyrocket. Future projects with post-2022 delivery dates will need close to 50% preleasing commitments at high \$60's NNN rents before they break ground which should bring market fundamentals closer to equilibrium.

MARKETBEAT

Washington, D.C.

Office Q3 2019



SUBMARKET	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT (SF)	OVERALL VACANCY RATE	CURRENT QTR OVERALL NET ABSORPTION (SF)	YTD OVERALL NET ABSORPTION (SF)	YTD LEASING ACTIVITY (SF)**	UNDER CNSTR (SF)	OVERALL AVERAGE ASKING RENT (ALL CLASSES)*	OVERALL AVERAGE ASKING RENT (CLASS A)*
Capitol Hill/NoMa	14,605,281	24,432	1,524,723	10.6%	528,640	794,597	447,389	1,287,623	\$53.41	\$57.99
East End	39,251,977	407,962	6,542,603	17.7%	-441,637	48,780	1,644,167	137,797	\$56.48	\$62.67
CBD	34,259,228	504,390	4,016,562	13.2%	-94,885	50,949	1,270,535	1,558,770	\$55.81	\$65.22
West End/Georgetown	4,779,133	84,794	664,698	15.7%	31,015	-274,214	337,645	-	\$51.57	\$62.12
Uptown	3,188,523	66,080	325,234	12.3%	5,609	48,577	368,456	-	\$42.25	\$49.28
Southwest	11,644,799	18,961	1,308,524	11.4%	52,569	322,597	209,839	549,703	\$46.94	\$49.07
Capitol Riverfront	3,817,062	37,227	338,058	9.8%	42,391	-45,835	378,274	175,000	\$53.48	\$53.48
WASHINGTON, D.C. TOTALS	111,546,003	1,143,846	14,720,402	14.2%	123,702	945,451	4,656,305***	3,708,893	\$54.69	\$61.32

*Rental rates reflect gross asking \$psf/year **Does not include Renewals ***Not reflective of U.S. MarketBeat Table

	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT (SF)	OVERALL VACANCY RATE	CURRENT QTR OVERALL NET ABSORPTION (SF)	YTD OVERALL NET ABSORPTION (SF)	YTD LEASING ACTIVITY (SF)	UNDER CNSTR (SF)	DIRECT AVERAGE ASKING RENT*	OVERALL AVERAGE ASKING RENT*
Class A	63,109,207	552,035	7,767,369	13.2%	721,483	2,398,153	2,620,987*	3,708,893	\$63.05	\$61.32
Class B	29,012,534	397,216	3,712,799	14.2%	46,254	-592,465	686,624	-	\$53.98	\$52.13
Class C	19,424,262	194,595	3,240,234	17.7%	-644,035	-860,237	1,348,694	-	\$47.62	\$46.62

*Not reflective of U.S. MarketBeat Table

Key Lease Transactions Q3 2019

PROPERTY	SF	TENANT	TRANSACTION TYPE	SUBMARKET
601 D Street, NW	309,000	GSA – U.S. Department of Justice	New Lease	East End
601 D Street, NW	199,736	D.C. Office of the Attorney General	New Lease	East End
2445 M Street, NW	148,452	EAB Global	New Lease	West End/Georgetown
99 M Street, SE	44,182	CommonGrounds	New Lease	Capitol Riverfront
700 Pennsylvania Avenue, SE	18,109	Gilbert LLP	New Lease	Capitol Hill/NoMa

Key Sales Transactions Q3 2019

PROPERTY	SF	SELLER/BUYER	PRICE / \$PSF	SUBMARKET
815 Connecticut Avenue, NW	216,786	The Blackstone Group / Ponte Gadea	\$231,250,000 / \$1,067	CBD
1201 Connecticut Ave, NW	187,678	Unizo Holdings / Novel Coworking	\$73,590,000 / \$392	CBD
1701 Rhode Island Avenue, NW	103,908	Akridge / Exan Capital	\$119,000,000 / \$1,145	CBD

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