

# Suburban Maryland

## Occupancy Expansion In Early 2020 Likely To Be Offset by Coronavirus Market Shock

### Executive Summary

Suburban Maryland's office fundamentals were relatively strong in Q1 2020, led by occupancy expansion in all three counties. While conditions modestly tightened through February, the rapid development of the coronavirus (COVID-19) dramatically changed the region's economic outlook. COVID-19's long term impact on the economy and real estate markets are uncertain, however it will undoubtedly cause near term slowdowns. Given mandated social distancing measures, business closures, and suspensions of large gatherings, business activity will grind to a halt in Q2. Although COVID-19 will likely be the most influential economic event of 2020, this report will primarily focus on the market activities of Q1 preceding COVID-19.

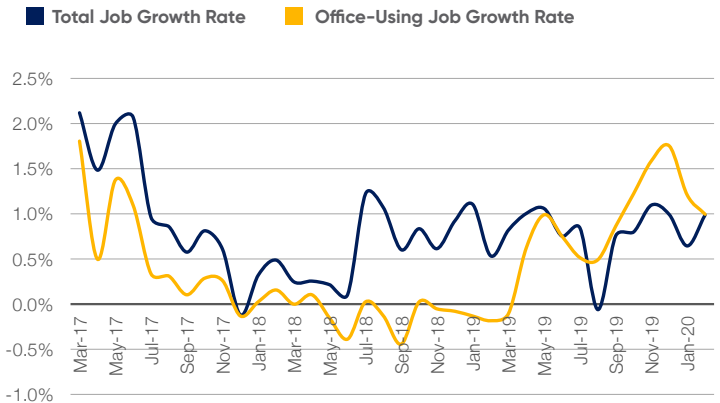
Occupancy growth in Suburban Maryland has exceeded 200,000 SF in four of the last six quarters. First-quarter net absorption was recorded at 254,276 SF. Sustained positive gains have helped to continue the region's downward-trending vacancy, which reached 15.5% in Q1. Although occupancy has recently been expanding, leasing activity has been weak over the last 18-months. Combined with an anticipated deceleration in real estate activity, Suburban Maryland experience softening in the coming quarters.

Based on data through February 2020, Suburban Maryland's job market maintained its long-term growth of roughly 1%. Annual non-farm employment has expanded by an average of 8,900 jobs over the last year, of which about 5,000 were office-using jobs. The labor market is expected to contract in Q2 as the repercussions of COVID-19 are quantified in labor statistics. Labor shrinkage will be more pronounced for non-farm employment due to the disproportionate impacts of COVID on hospitality, food service, and retail workers.

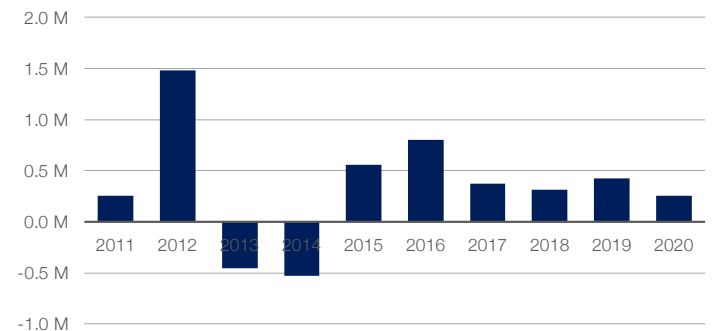
### Rental Rates and Vacancy

Suburban Maryland's total vacancy rate fell 30 basis points (bps) over the last year to 15.5%. Though the overall numbers indicate market tightening, conditions vary based on submarket, building quality, and space use. The region's most rapidly tightening market is the I-270 Corridor, where vacancy has fallen by over 400,000 SF over the last year. Anchored by the NIH this Corridor is supported by the federal government as well as the rapidly-growing life science industry. For biotech and pharmaceutical firms seeking high-quality, lab-supportive office space along the I-270 Corridor, vacancy rates are even lower, recorded at 4.2% in Q1.

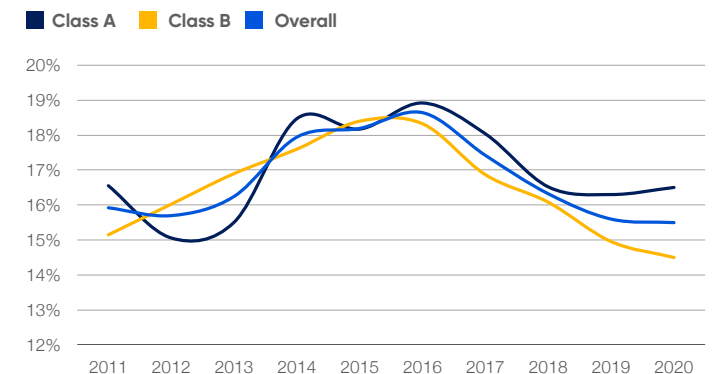
### Annualized Employment Growth by Month



### Net Absorption



### Average Total Vacancy

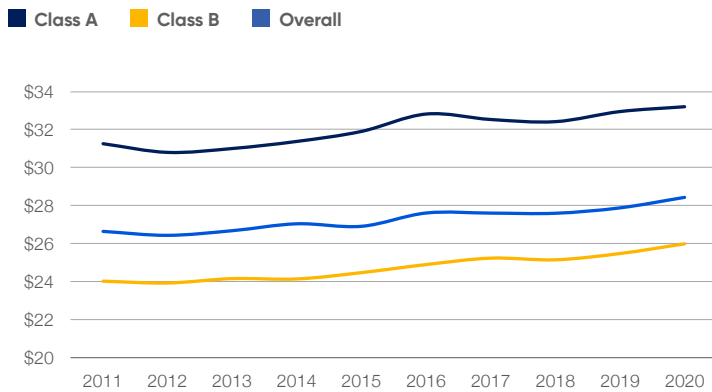


### Q1 Key Market Indicators

Total Vacancy	▼ 15.5%
Net Absorption	254,276 SF
Rental Rate	▲ \$28.44/SF
New Deliveries (YTD)	0 SF (0 SF Net-New)

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### Average Direct Rental Rates



In contrast, Silver Spring and North Silver Spring collectively added nearly 700,000 SF of vacancy over the last year. Although Discovery Communications added 457,000 SF of vacancy in the first half of 2019, over 118,000 SF of that space has been backfilled. Small and mid-sized tenant losses comprise the remainder of the new vacancy.

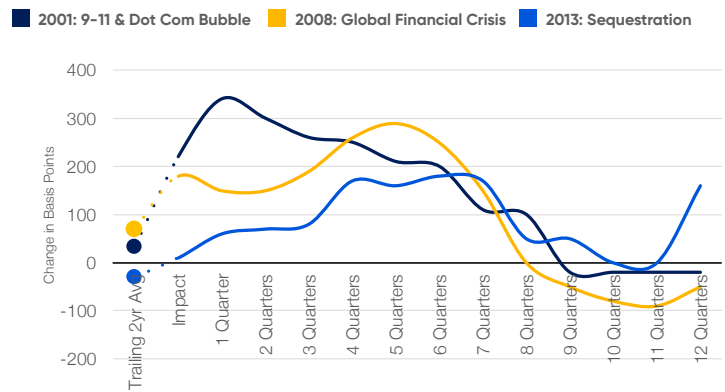
Asking rental rates increased \$0.78 over the last year to \$28.44/SF. Trophy/Class A asking rents increased by \$0.43 to \$33.18/SF, while Class B rents rose by \$1.00 to \$25.97/SF. New construction in Downtown Bethesda has driven much of this growth; however, the relative scarcity of quality space in Prince George's and Frederick Counties has resulted in above-average rent increases of \$0.59 and \$0.68, respectively.

### Supply and Demand

Total availability fell by 271,000 SF from year-ago levels, reaching 16.5 million SF. Availability fell by 109,000 SF for Suburban Maryland's Class A market, while Class B availability fell by 50,000 SF. Despite the increased speculative development in Bethesda, total availability for existing Class A buildings has been static at 1.3 million SF for much of the last 24-months.

There is currently 3.3 million SF of office space under construction in Suburban Maryland, of which nearly 3.0 million SF will be net-new upon delivery. Of these projects, about 1.2 million SF is expected to deliver in 2020, mostly in Montgomery County. Preleasing among the six projects anticipated to deliver in 2020 has been mixed. Four properties are at least 75% preleased while two others, including 909 Rose Avenue, are nearly 100% available.

### Economic Shock Recovery



### Market Outlook

Suburban Maryland's office market has been showing signs of incremental tightening. Increased activity among federal tenants, life science firms, and the healthcare industry have helped to stabilize the office market. The continuity of this progress is likely to be halted in 2020 as the repercussions of COVID-19 materialize. Recessionary-like conditions could be commonplace as tenants delay major real estate decisions, landlords increase competition, and development pipelines slow. Suburban Maryland's business environment will look notably different in the coming quarters, however the region's relatively high concentration of knowledge-based industries, as well as pharmaceutical and healthcare-related firms, could assist in a post-pandemic recovery.

The anticipated slowdown in leasing activity will likely soften the office markets in the near term. More damaging however, tepid activity could emphasize Suburban Maryland's oversupplied and outdated Class B market. Between structural oversupply and the anticipated reaction to COVID-19, tenant negotiating power and landlord concessions will remain strong throughout much of Suburban Maryland.

# Suburban Maryland

## Submarket Statistics

Submarket	Total Bldgs	Inventory	Sublet Available	Total Available	Total Vacant	Vacancy Rate	Net Absorption (Q1 2020)	Net Absorption (YTD)	Class A Rent	Class B Rent	Total Direct Rent	Under Constr.	SF Delivered YTD
Bethesda/Chevy Chase	81	10,249,117	412,726	2,628,199	1,608,766	▲ 15.7%	41,533	41,533	\$55.45	\$37.63	▲ \$48.99	1,742,274	-
North Bethesda	77	9,894,504	172,600	2,062,558	1,561,403	▼ 15.8%	79,399	79,399	\$31.49	\$28.63	▲ \$30.43	-	-
Rockville	80	8,241,842	43,613	1,495,957	1,008,650	▼ 12.2%	3,424	3,424	\$32.23	\$28.41	▲ \$30.85	-	-
North Rockville	114	11,391,555	176,942	2,155,207	1,838,831	▼ 16.1%	(39,290)	(39,290)	\$30.60	\$25.58	▲ \$29.55	258,904	-
Gaithersburg	78	3,625,900	1,100	707,155	474,956	▲ 13.1%	12,344	12,344	\$28.59	\$23.13	▲ \$26.99	121,674	-
Germantown	47	2,693,397	10,589	760,641	668,451	▲ 24.8%	(18,964)	(18,964)	\$28.55	\$23.74	▼ \$23.31	-	-
I-270 Corridor	396	35,847,198	404,844	7,181,518	5,552,291	▼ 15.5%	78,446	78,446	\$37.39	\$29.56	▲ \$34.47	2,122,852	-
Silver Spring	55	5,875,428	175,570	1,263,224	1,044,634	▲ 17.8%	87,811	87,811	\$33.35	\$26.44	▼ \$30.85	-	-
North Silver Spring	47	2,154,870	-	429,664	423,342	▲ 19.6%	(25,462)	(25,462)	\$29.85	\$25.18	▲ \$26.23	-	-
Montgomery County	634	57,048,321	1,158,087	11,849,301	8,789,739	▲ 15.4%	140,795	140,795	\$34.40	\$27.83	▲ \$30.76	2,483,572	-
Prince Georges County	345	19,220,659	147,957	3,460,229	3,134,233	▼ 16.3%	86,220	86,220	\$27.49	\$22.62	▲ \$22.37	882,767	-
Frederick County	137	5,531,161	41,030	1,204,548	719,141	▲ 13.0%	27,261	27,261	\$28.96	\$24.57	▲ \$23.03	-	-
<b>Total</b>	<b>1,116</b>	<b>81,800,141</b>	<b>1,347,074</b>	<b>16,514,078</b>	<b>12,643,113</b>	<b>▼ 15.5%</b>	<b>254,276</b>	<b>254,276</b>	<b>\$33.18</b>	<b>\$25.97</b>	<b>▲ \$28.44</b>	<b>3,366,339</b>	<b>-</b>

## Q1 Top Sales

Building	Submarket	Size (SF)	Price	Price (PSF)	Buyer	Seller
5454 Wisconsin Avenue	Bethesda/Chevy Chase	293,852	\$160,000,000	\$544.49	Starwood REIT	Carr Properties
77 Upper Rock Circle	North Rockville	235,210	\$34,300,000	\$145.83	Bridge Investment Group	DSC Partners LLC
7500 Standish Place	North Rockville	113,730	\$30,000,000	\$263.78	Boyd Watterson Asset Management	PS Business Parks
50 Citizens Way	Frederick	50,532	\$11,750,000	\$232.53	FH Properties LLC	Real Estate Teams LLC
12210 Plum Orchard Drive	North Silver Spring	65,163	\$9,608,000	\$147.45	ATEC Industries	Guardian Realty Investors

## Q1 Top Leases

Tenant	Submarket	Address	Size (SF)	Type	Buyer	Seller
GSA - NIH	North Bethesda	6701 Rockledge Drive	247,414	Renewal	Starwood REIT	Carr Properties
Social & Scientific Systems	Silver Spring	8757 Georgia Ave	57,934	Renewal	Bridge Investment Group	DSC Partners LLC
BAE Systems	North Rockville	520 Gaither Road	49,080	Renewal	Boyd Watterson Asset Management	PS Business Parks
Digital Management Inc.	North Bethesda	6550 Rock Spring Drive	43,952	Renewal	FH Properties LLC	Real Estate Teams LLC

\*Availability refers to all office space being actively marketed for lease – including both vacant space and spaces anticipated to be vacant ahead of tenant move-out.

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