

Suburban Maryland

Strong Year-End Occupancy Growth Offsets Early Tenant Losses

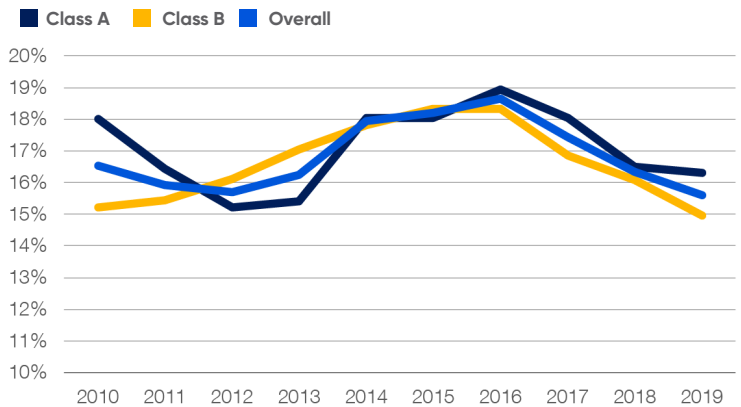


Executive Summary

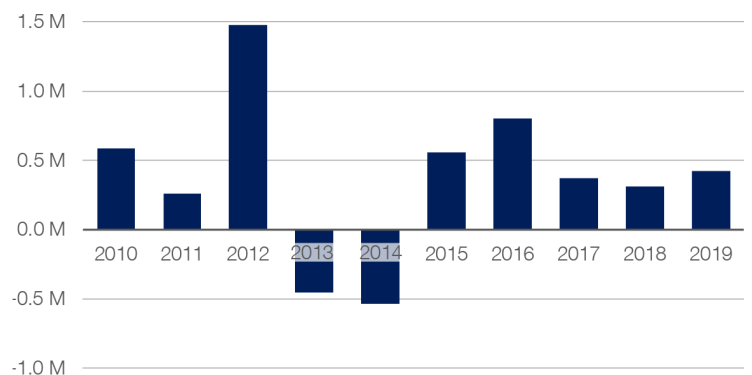
The second half of 2019 marked a significant shift in Suburban Maryland's office market fundamentals. After losing most of Discovery Communications in early 2019, significant late-year occupancy gains triggered modest market tightening throughout the region. Fourth-quarter net absorption was recorded at 347,246 SF, bringing the year-end total to 627,700 SF; the largest annual increase since 2016. Similarly, strong occupancy resulted in Suburban Maryland's lowest quarterly vacancy rate in a decade (15.2%). Although occupancy expansion has been positive over the last six months, leasing activity has been weak in 2019, which could foreshadow market softening in the coming months.

Suburban Maryland's job market continues to contract in 2019. Total employment fell by 4,800 jobs over the last year, of which 2,300 were lost office-using jobs. Sustained labor contraction is a leading indicator for future office demand, particularly when compared to DC and Northern Virginia, which both posted positive office-using job growth.

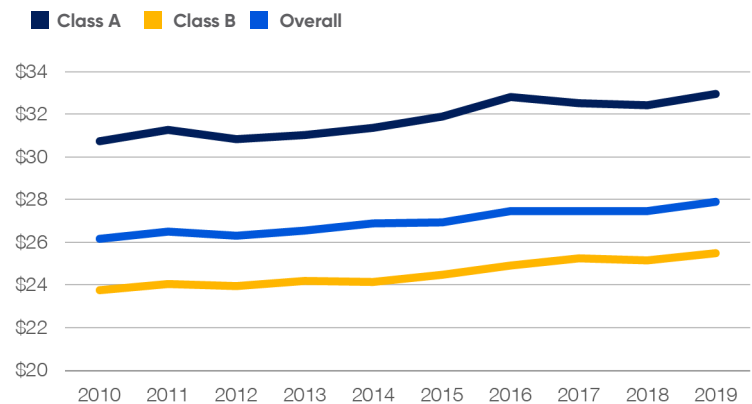
Average Vacancy Rate



Net Absorption



Average Asking Rent



Q4 Key Market Indicators

Total Vacancy	▼ 15.2%
Net Absorption	347,246 SF
Rental Rate	▲ \$2790/SF
Deliveries (YTD)	629,542 SF (528,272 SF Net-New)

Rental Rates and Vacancy

Above-average demand has put downward pressure on vacancy over the last year. Suburban Maryland's vacancy rate has fallen 120 basis points (bps) from year-ago levels to 15.2%. This marks the lowest vacancy rate recorded in the last decade.

Demand in both the I-270 Corridor and Downtown Bethesda have driven much of Suburban Maryland's new occupancy. The maturation of the life sciences and pharmaceutical industries, alongside continued federal investment in the National Institute of Health and associated research entities, has resulted in greater commercial leasing activity in Montgomery County. Vacancy in the I-270 Corridor has fallen from a high of 19.5% (2014) to a current rate of 14.9%. Tighter conditions are present for tenants seeking high-end laboratory space, for which vacancy is 8.8%.

Asking rental rates increased \$0.11 over the last year to \$27.90/SF. Class A asking rents increased by \$0.14 to \$32.78/SF, while Class B rents rose by \$0.10 to \$25.88/SF. New construction in Downtown Bethesda has driven some of this growth; however, other high-demand submarkets in Montgomery County have recorded organic rent appreciation as well. Conversely, both Prince Georges and Frederick Counties recorded annual rent depreciation in the fourth quarter.

Supply and Demand

Total availability fell by 153,000 SF from year-ago levels, reaching 16.8 million SF. Total availability has been on a slight decline through 2019; however, it remains well above 2017 levels. A wave of speculative construction activity in 2018 caused Suburban Maryland's Class A availability to rise by 1.5 million SF over 2017 levels. Conversely, the Class B availability market has tightened by 500,000 SF over the last two years.

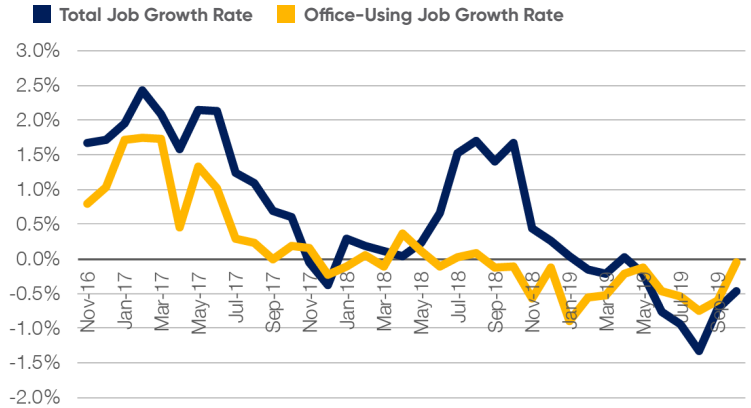
There is currently 3.3 million SF of office space under construction in Suburban Maryland, of which nearly 3.0 million will be net-new office inventory upon delivery. Urban infill projects dominate much of the construction pipeline with Bethesda/Chevy Chase accounting for 1.9 million SF of construction activity. Demand for newly-constructed projects has been robust in Suburban Maryland. Of the four projects to deliver in 2019, only 14.8% of space is currently available (78,000 SF). This trend is additionally true for buildings under construction, which collectively boast a prelease rate of ~80%.

Market Outlook

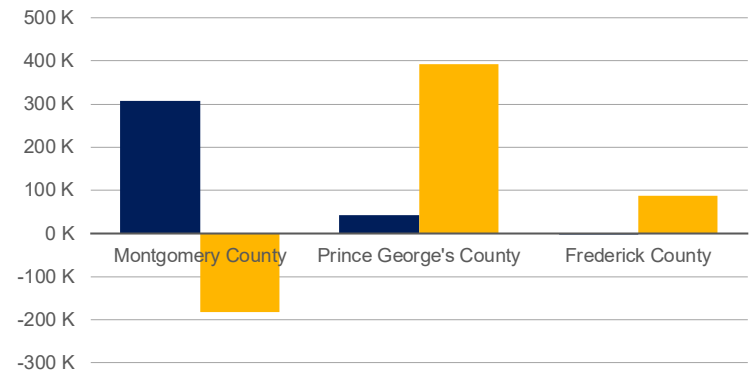
Suburban Maryland's office market is expected to continue its trend of modest tightening and relative stability. Despite Montgomery County's historical aversion to significant commercial development, the current construction cycle will supply the region with much-needed new inventory. Continued development activity is expected as the opening of the Purple Line comes into focus (planned 2022-2023). The development transformation of Bethesda is likely to cause market tightening as landlords leverage the transformed urban market to escalate rents and reduce concessions. The continued development of the life sciences and biotechnology industries will become an increasingly important economic driver for the region. The magnitude of growth will be constrained by the availability of high-quality laboratory space.

Although urban and lab-supportive office markets may tighten for tenants in the near-term, the majority of Suburban Maryland's inventory is concentrated in outdated, transit-inaccessible office complexes. This oversupply of commoditized, suburban Class B space will ensure that tenant negotiating power and landlord concessions remain strong throughout vast swaths of Suburban Maryland.

Annualized Employment Growth by Month



Net Absorption by County



Q4 Top Leases

Tenant	Submarket	Address	Size (SF)	Type
Congressional Bank	Bethesda	4445 Willard Ave	37,551	Renewal
Peraton	Greenbelt	7855 Walker Dr	32,322	New
AGM University	Silver Spring	1 Inventa Pl	28,500	New
Cellular Biomedicine	North Rockville	9605 Medical Center Dr	22,477	New

Q4 Top Sales

Building	Submarket	Size	Price	Price (PSF)	Buyer	Seller
7500 Old Georgetown Rd	Bethesda/Chevy Chase	338,844	\$133,750,000	\$394.72	Stonebridge Associates	Clark Enterprises
9737 Washingtonian Blvd	North Rockville	293,711	\$88,200,000	\$300.30	GMF Capital	James Campbell Company
7735 Old Georgetown Rd	Bethesda/Chevy Chase	125,108	\$45,400,000	\$362.89	Washington Capital Management	Stewart Bainum
5635 Fishers Ln	Rockville	184,956	\$33,150,000	\$179.23	Tritower Financial Group	Wealth Capital Management
2600 Tower Oaks Blvd	Rockville	179,421	\$22,700,000	\$126.52	Rubenstein Partners	Boston Properties

Submarket Statistics

Submarket	Total Bldgs	Inventory	Sublet Available	Total Available	Total Vacant	Vacancy Rate	Net Absorption (Q4 2019)	Net Absorption (YTD)	Class A Rent	Class B Rent	Total Direct Rent	Under Constr.	SF Delivered YTD
Bethesda/ Chevy Chase	81	10,146,577	492,131	2,641,948	1,424,215	▲ 14.0%	91,424	190,842	\$53.73	\$32.78	▼ \$47.56	1,907,274	291,414
North Bethesda	77	9,810,522	220,282	2,171,417	1,609,420	▼ 16.4%	57,988	72,155	\$31.91	\$28.43	▼ \$30.24	-	-
Rockville	80	8,450,307	39,174	1,481,413	1,018,994	▼ 12.1%	(5,873)	62,927	\$32.82	\$28.33	▲ \$30.95	-	-
North Rockville	114	11,403,465	213,185	2,358,492	1,690,452	▼ 14.8%	63,515	191,023	\$30.77	\$25.32	▲ \$28.30	258,904	-
Gaithersburg	80	3,894,725	21,946	691,293	436,131	▲ 11.2%	9,173	(3,149)	\$31.36	\$21.18	▼ \$21.86	121,674	-
Germantown	47	2,695,296	7,863	740,269	628,783	▲ 23.3%	(35,205)	(98,907)	\$28.82	\$23.41	▼ \$23.61	-	-
I-270 Corridor	398	36,254,315	502,450	7,442,884	5,383,780	▼ 14.9%	181,022	224,049	\$32.84	\$27.67	▲ \$30.54	380,578	-
Silver Spring	55	5,856,925	172,873	1,243,908	1,127,455	▲ 19.2%	25,856	(501,326)	\$33.45	\$28.32	▲ \$30.63	-	27,600
North Silver Spring	47	2,154,870	-	482,786	433,809	▲ 20.1%	10,333	(95,613)	\$29.61	\$24.66	▲ \$26.02	-	-
Montgomery County	635	57,333,632	1,330,601	12,157,955	8,521,552	▲ 14.9%	308,635	(182,048)	\$34.30	\$27.66	▲ \$30.06	2,483,572	319,014
Prince Georges County	345	19,219,018	125,176	3,693,901	3,291,901	▼ 17.1%	42,346	393,839	\$27.39	\$22.58	▼ \$22.16	882,767	310,528
Frederick County	137	5,525,862	18,322	948,511	682,111	▼ 12.3%	(3,735)	86,229	\$25.25	\$23.73	▼ \$22.52	-	-
Total	1,117	82,078,512	1,474,099	16,800,367	12,495,564	▼ 15.2%	347,246	627,700	\$32.78	\$25.88	▲ \$27.90	3,366,339	629,542

*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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