Q1 2020 Office Report

District of Columbia

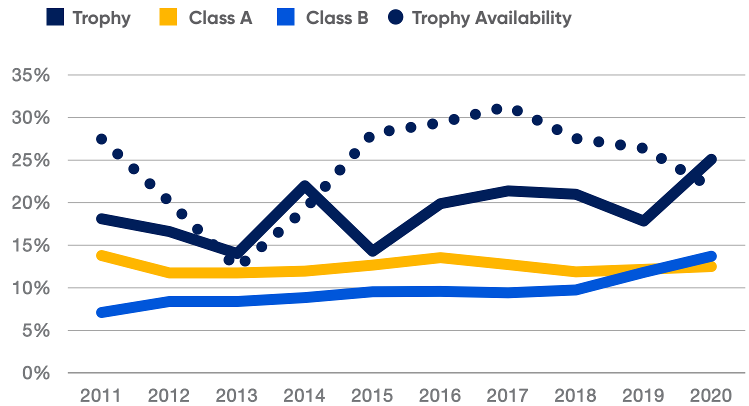
Slowed Demand and COVID-Related Uncertainty Foreshadows Softening

Office market fundamentals in the District of Columbia (DC) continued to cool in the first quarter of 2020. Though quarterly occupancy gains had been consistently large from mid-2016 to mid-2019, slow leasing has led to slack in the market. Further hampering momentum has been the rapid emergence of COVID-19. The impacts of the pandemic on the region's economy and real estate markets are uncertain; however, it is anticipated that COVID-19 will cause near-term market deceleration. 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 focus primarily on the real estate and market activities before the onset of COVID-19.

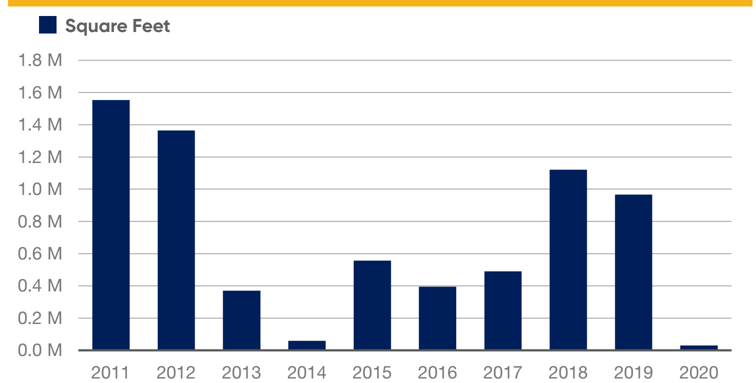
DC's supply and demand markets operated in opposition to one another in Q1. While 1.3 million SF delivered in Q1 (839,056 SF net-new), net absorption was barely positive at 30,732 SF, and vacancy jumped to 15.0%. Healthy preleasing in these newly-delivered buildings however will ensure that 744,000 SF of new occupancy is recorded in the coming months as tenants move into their new space. While a wide gap exists between much of DC's supply and demand, tenant demand for top-quality, and newly constructed buildings appears to be catching up to supply. Recent leasing activity has reduced Trophy availability to 21.8%, which is down from a high of 31.3% in 2017

Based on data through February 2020, DC's job market continued its growth trajectory. Annual non-farm employment expanded by an average of 8,200 jobs over the last year. Office-using jobs increased by an average of 9,000 jobs over the previous year, indicating that non-office-using employment is contracting. Following the development of COVID-19, labor expansion is unlikely to continue. COVID-19 will cause massive shifts in unemployment, particularly in industries such as retail, hospitality, and foodservice.

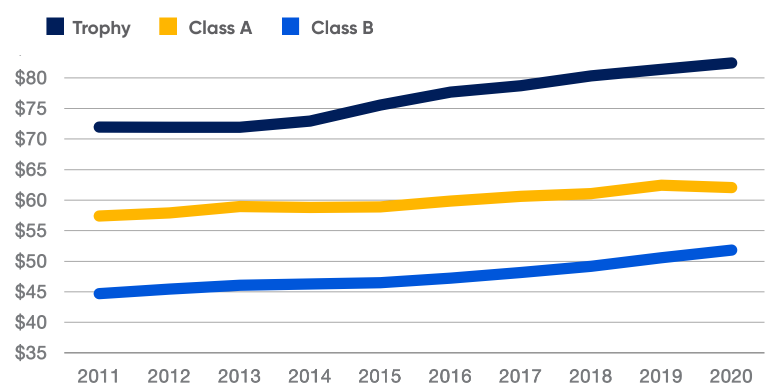
Average Vacancy Rate



Net Absorption



Average Rental Rates



Q1 Key Market Indicators

Total Vacancy	▼	**15.0%**
Net Absorption	▼	**30,732 SF**
Rental Rate	▲	**$59.20/SF**
Deliveries (YTD)		**1,328,641 SF (839,056 SF net new)**

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Vacancy and Rental Rates. Average asking rents in DC have been trending upward for several years. Full-service direct rents rose by $0.58/SF year-over-year (YoY) to $59.20/SF. Rents have been steadily increasing in Trophy and Class B buildings, reaching $82.46/SF (+$1.07 YoY) and $51.82/SF (+$1.40 YoY). While rents are rising on the "ends" of the office quality spectrum, Class A rents have ticked down $0.18 to $62.06/SF. While most available office space is concentrated in Downtown, newly developing submarkets, such as NoMa, Southwest, and Capitol Riverfront, have led DC in rent growth, each exceeding the overall annual growth rate of 1%.

Quarterly vacancy rose to 15.0% in Q1, which marks a 190 basis point (bps) increase over year-ago levels. Although this jump in vacancy is a point of concern, 2.7 million SF of the newly-added vacant space can be attributed to buildings constructed since 2019. In the coming quarters, these buildings will become occupied with prelease tenants, reducing vacancy by 850,000 SF, or 70 basis points (bps). Trophy, Class A and Class B vacancy were recorded at 26.5% (+480 bps), 13.7% (+20 bps), and 14.7% (+340 bps), respectively. The impacts of construction on DC's vacancy rate are not expected to relent, as several more buildings will deliver in the remainder of 2020.

Supply and Demand. Net absorption was recorded at 30,732 SF in the first quarter of 2020. Tepid occupancy growth has been the trend in DC over the last 9-months. Large-footprint relocations and consolidations have, in aggregate, softened the market, particularly in Downtown. Exacerbating this problem is slow leasing activity, particularly among DC's largest tenant groups (law firms and the federal government). Year-end leasing activity for Class A and B buildings in 2019 was exceptionally slow, hitting their lowest points in at least 7-years. Economic uncertainty related to COVID-19 will lead to below-average leasing activity as many firms delay major real estate decisions.

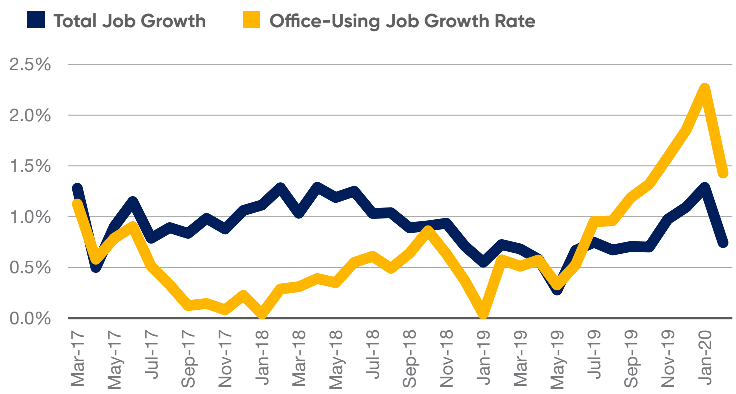
Although the DC had recorded steady occupancy expansion through mid-2019, its oversupply of office space relative to demand could become problematic if recessionary fears become widespread. Total office availability, measured at 26.7 million SF in Q1, and continues to hover near its all-time high. Elevated availability is partly the result of the current construction cycle, which has already added 1.3 million SF in deliveries in Q1.

Market Outlook

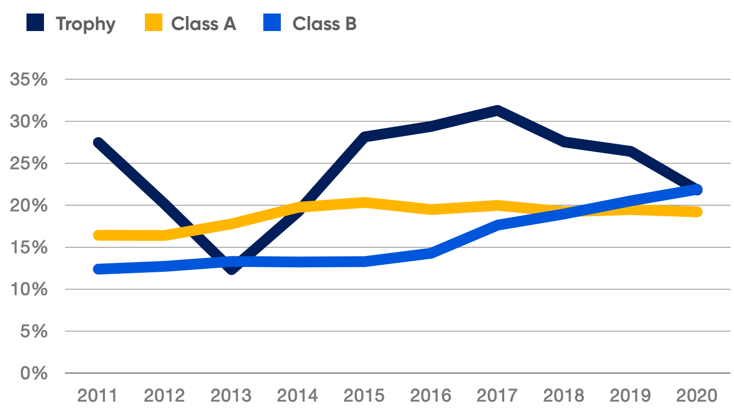
The District of Columbia's office market is anticipated to remain tenant-favorable for the foreseeable future. Underlying market fundamentals such as oversupply, waning demand, and the implications of COVID on real estate leasing are expected to weigh on DC's landlords. The rate of market softening could be lessened as DC's construction pipeline slows in 2021-2022, however significant market shifts would be required to constrain tenant negotiating power in the near term.

The COVID-19 pandemic has cast much uncertainty in the market and will greatly alter the region's economic future beyond 2020. The direct influence COVID-19 will have on real estate decision making, and workplace strategy is unknown, but it is likely to hamper DC's ability to tighten its market fundamentals over the next 12-months.

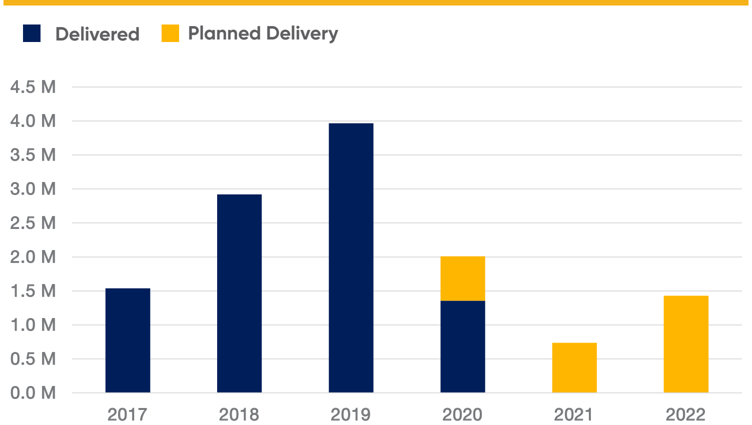
Annualized Employment Growth by Month



Availability Rate by Class



Construction Schedule



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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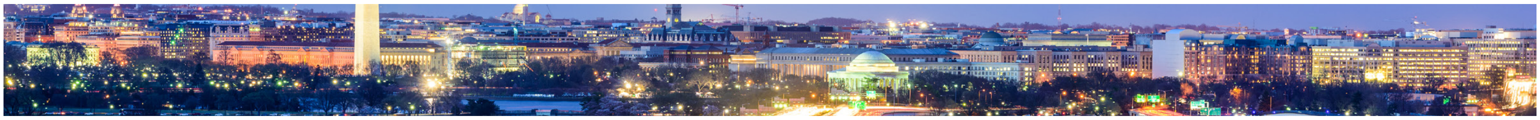

Q1 Top Leases

Tenant	Submarket	Address	Size	Type
Center for American Progress	East End	1333 H St NW	76,616	Renewal
Wells Fargo Bank	CBD	1700 K Street, NW	68,868	New
American Trucking Association	Capitol Riverfront	80 M Street, SE	59,526	New
Cogent Communications	West End	2450 N Street, NW	43,117	Renewal

Q1 Top Sales

Building	Submarket	Size	Price	Price (PSF)	Buyer	Seller
1200 New Jersey Ave, SE	Capitol Riverfront	1,470,000	$760,000,000	$517.01	U.S. General Services Administration	The JBG Companies
99 M St, SE	Capitol Riverfront	234,782	$163,019,413	$694.34	Polinger Co.	Skanska
1425 New York Avenue, NW	East End	287,053	$47,450,000	$165.30	Ares Real Estate/ Monument Realty	New York Common Retirement Fund/Liberty Property Trust
800 Maine Ave, NW (Condo)	Southwest	63,681	$45,002,410	$706.69	American Psychiatric Association	Hoffman & Associates

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	Net New SF Delivered
CBD	205	36,084,393	772,899	8,013,790	5,429,002	▲ 15.0%	(189,422)	(189,422)	$74.10	$53.77	▲ $62.06	827,901	575,228	275,860
East End	217	47,611,021	1,071,286	10,657,009	8,196,264	▲ 17.2%	(35,747)	(35,747)	$65.85	$51.97	▼ $61.13	254,722	177,729	4,041
Downtown Core	422	83,695,414	1,844,185	18,670,799	13,625,266	▲ 16.3%	(225,169)	(225,169)	$68.50	$52.93	▲ $61.53	1,082,623	752,957	279,901
Capitol Hill	39	5,678,514	61,398	1,579,121	1,184,085	▲ 20.9%	94,424	94,424	$68.99	$50.45	▲ $66.23	225,941	-	-
Capitol Riverfront	12	2,842,064	78,883	826,886	269,673	▼ 9.5%	88,641	88,641	$57.24	N/A	▲ $57.24	352,876	-	-
Georgetown	42	3,270,869	82,449	478,338	369,600	▼ 11.3%	(284)	(284)	$55.59	$39.34	▼ $46.73	-	-	-
NoMa	36	10,609,425	33,739	1,204,522	1,106,141	▲ 10.4%	24,903	24,903	$51.43	$44.91	▼ $52.47	35,829	545,823	545,823
Southwest	34	11,956,917	49,914	1,558,074	1,064,068	▼ 8.9%	(42,067)	(42,067)	$57.58	$45.67	▲ $54.18	729,703	-	-
Uptown	123	7,250,829	192,421	1,563,662	1,117,795	◀▶ 15.4%	25,796	25,796	$52.28	$43.17	▼ $46.28	261,745	29,861	13,332
West End	21	3,308,715	171,497	754,976	522,118	▲ 15.8%	64,488	64,488	$55.54	$54.04	▼ $55.44	-	-	-
District of Columbia	729	128,612,747	2,514,486	26,636,378	19,258,746	▲ 15.0%	30,732	30,732	$64.78	$51.82	▼ $59.20	2,688,717	1,328,641	839,056

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Cresa
1800 M Street NW, Suite 300 N
Washington, DC 20036
202.628.0300

2 Bethesda Metro Center, Suite 900
Bethesda, Maryland 20814
301.951.6500

7901 Jones Branch Drive, Suite 340
McLean, VA 22102
703.972.5799

For additional information, please contact Matt Kruczlnicki, Senior Research Manager, at 301.951.6500 or mkruczlnicki@cresa.com.