Q4 2019 Office Report

District of Columbia

Tenant Expansion to Newly Delivered Buildings Drive Office Market

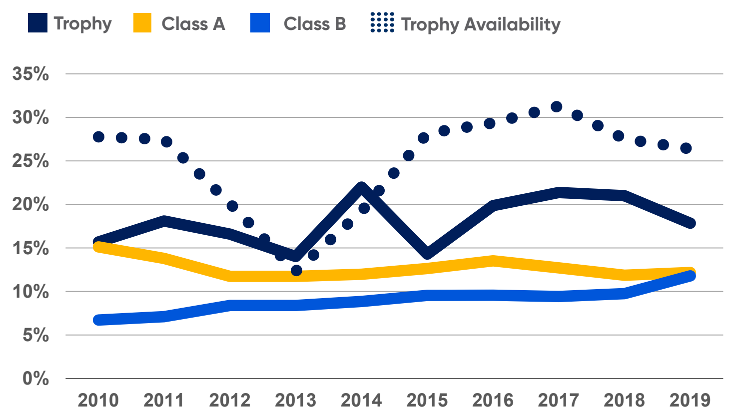
Executive Summary

The District of Columbia's (DC) office market exhibited stability in the fourth quarter (Q4) of 2019. Though occupancy was marginally negative in Q4, strong construction activity and large tenant renewals/relocations have been a point of encouragement for landlords. Net absorption was -77,843 SF in Q4, bringing the year-to-date total to 984,360 SF. A robust construction pipeline has supported occupancy growth, which has triggered several large-footprint relocations. New construction deliveries are also a contributing factor to DC's rising vacancy, which increased 150 basis points from year-ago levels to 13.9%.

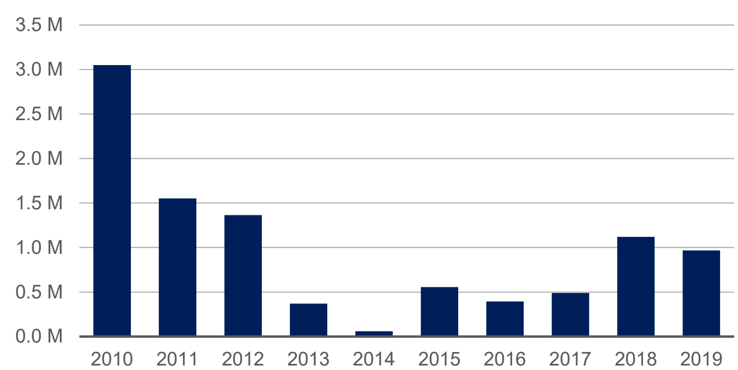
Core office submarkets in the East End and CBD continue to drive much of the leasing activity in DC. Some of the most significant lease signings include PriceWaterhouseCoopers at 655 New York Avenue NW (198K SF), and World Bank Group at 1776 G Street NW (161K SF).

DC added 5,700 new office-using jobs in the last twelve months, which breaks a period of relatively slow employment growth. This marks the first time since early 2017 that office-intensive job growth has exceeded 1%. Private sector office employment is chiefly responsible for this expansion, as the federal government shed 700 DC-based office jobs over the last year.

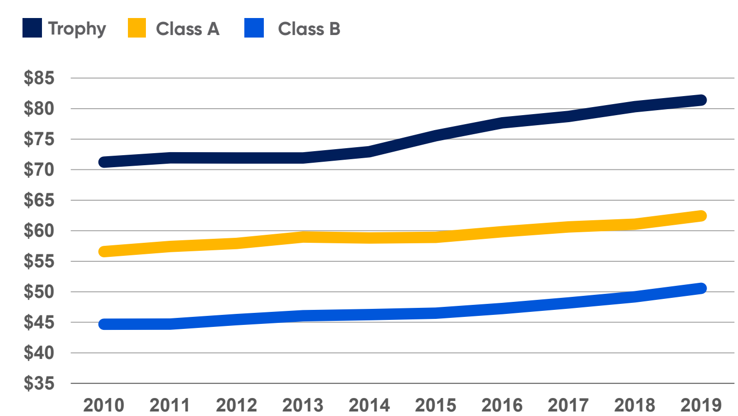
Average Vacancy Rate



Net Absorption



Average Asking Rent



Q4 Key Market Indicators

Total Vacancy	▲ 13.9%
Net Absorption	-77,843 SF
Rental Rate	▼ $57.88/SF
Deliveries (YTD)	3,956,378 (2,937,072 SF net new)

Rental Rates and Vacancy

Average asking rents rose by $0.98 year-over-year (YoY) to $57.88/SF in Q4. Class A and B rates increased to $63.02/SF (+$0.84 YoY) and $50.92/SF (+$2.55 YoY), respectively, while Trophy rates fell to $81.29/SF (-$0.83 YoY). Downtown's oversupply of commodity-grade office space has slowed asking rent growth in DC's traditional urban core, which has eroded some of the cost advantages of DC's emerging office markets, such as the Capitol Riverfront, NoMa and Southwest.

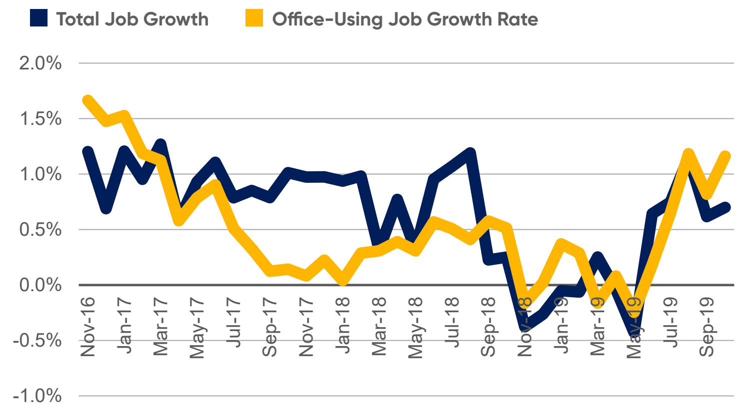
Quarterly vacancy rose to 13.9% in Q4, which marks a 150 basis point (bps) rise over year-ago levels. While occupancy gains have been strong over the last 24 months, widespread construction has added a substantial amount of new inventory to the market, effectively offsetting occupancy gains. Trophy, Class A and Class B vacancy were recorded at 18.4% (-540 bps), 13.3% (+80 bps), and 14.5% (+420 bps), respectively. Of the four office developments to deliver in Q4, roughly 40.6% of the 1.1 M SF developed remains vacant. These four projects have added 29 bps to DC's overall vacancy.

Supply and Demand

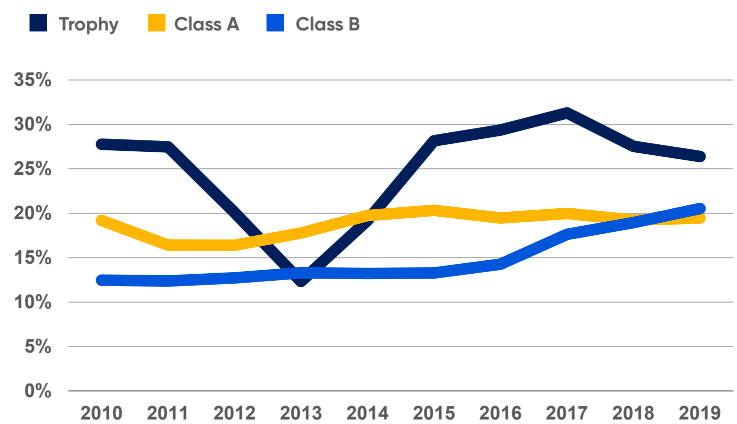
Quarterly net absorption was recorded at -77,843 SF, which brings the year-to-date total to a positive 984,360 SF. DC has registered positive occupancy gains for the last two years, partly supported by large-footprint relocations to newly-constructed buildings. Total leasing activity has been down in 2019, and has fallen short of 2 million SF in every quarter this year. From 2013 to 2018, DC failed to reach 2 million SF of quarterly leasing activity only three times. Slow tenant demand is not attributed to one particular industry; however, DC's largest tenant groups (the federal government and law firms) are exhibiting sustained low leasing activity. If weak demand continues into 2020, DC's office market will further soften, causing more significant concern among landlords.

Coworking tenants have made a significant impact on the office market in the past five years. The coworking industry accounts for an average of 4.8% of leasing activity in DC since 2015, hitting a yearly high of 13.1% in 2019. Though coworking has been a major occupancy driver locally, the industry's DC footprint is less than that of comparable urban markets. A key reason for coworking's lower DC market saturation can be attributed to the fact that DC's primary drivers of office tenancy (government and law firms) have not been adopters of coworking space.

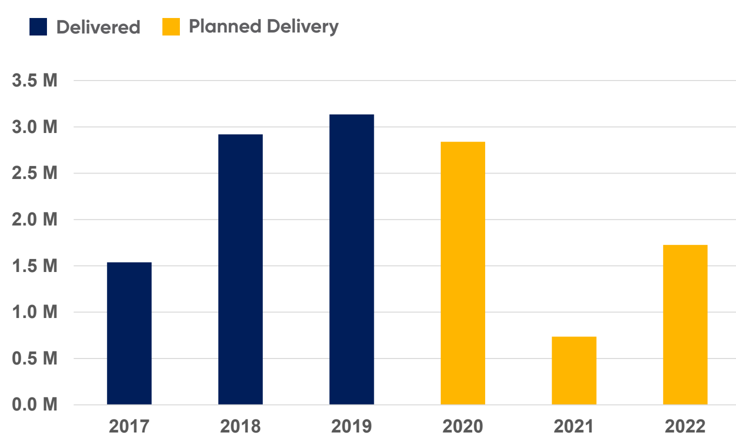
Annualized Employment Growth by Month



Availability Rate by Class

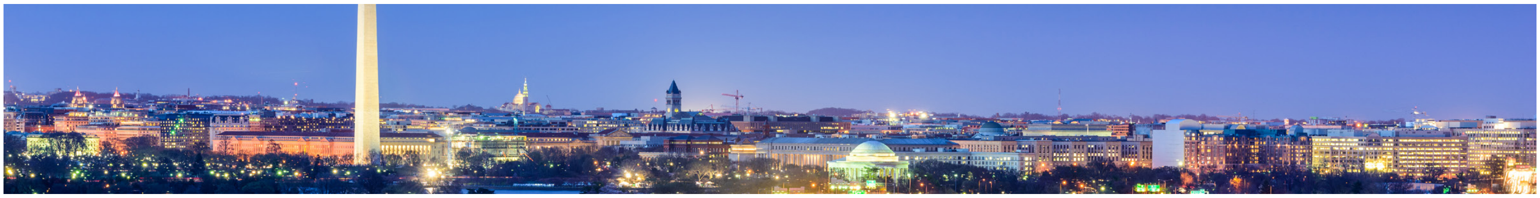


Construction Schedule



Market Outlook

Despite the recent boost in occupancy, Cresa expects the District of Columbia to remain relatively tenant-favorable through 2022. Despite optimism regarding the regional economic impacts of Amazon's HQ2, the magnitude and timing of this new demand driver are unknown. Aggressive construction activity through 2020 will add to DC's existing office supply and further exacerbate its supply/demand imbalance. Landlord concession packages are expected to remain generous, resulting in significantly reduced effective rents. Average landlord concession packages for new leases expect to include tenant improvement allowances of at least $110/SF and around 1.2 months of free rent per year of term.



Q4 Top Leases

Tenant	Submarket	Address	Size	Type
PricewaterhouseCoopers	East End	655 New York Ave NW	198,316	New
World Bank Group	CBD	1776 G St NW	161,100	Renewal
Perkins Coie	East End	700 13th St Nw	137,662	Renewal
CNN	NoMa	820 1st St NE	106,763	Renewal

Q4 Top Sales

Building	Submarket	Size	Price	Price (PSF)	Buyer	Seller
1625 Eye St NW	CBD	386,686	$259,000,000	$669.79	American Real Estate Partners	EDGE Fund Advisors
815 Connecticut Ave NW	CBD	216,786	$231,250,000	$1,066.72	Ponte Gadea USA	The Blackstone Group
901 15th St NW	East End	255,968	$209,100,000	$816.90	Northwestern Mutual Life Insurance	Abu Dhabi Investment Authority
1325 G St NW	East End	306,563	$175,000,000	$570.85	Westbrook Partners	Unizo Holdings Company
90 K St NE	NoMa	412,661	$174,900,000	$423.83	Boyd Watterson Asset Management	Utah State Retirement Services

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	204	35,764,989	811,362	7,829,404	5,006,921	▲14.0%	(21,826)	(26,828)	$70.13	$53.29	▲ $58.93	1,403,129	820,770	409,543
East End	216	47,280,886	1,212,489	10,860,320	7,938,651	▲16.8%	(55,403)	341,539	$65.49	$50.29	▼ $60.54	432,451	1,359,673	757,022
Downtown Core	420	83,045,875	2,023,851	18,689,724	12,945,572	▲15.6%	(77,229)	314,711	$66.84	$52.05	▲ $59.87	1,835,580	2,180,443	1,166,565
Capitol Hill	38	5,128,800	51,189	1,918,380	717,987	▲14.0%	(30,999)	(71,393)	$71.86	$55.14	▲ $63.47	1,083,252	968,157	937,957
Capitol Riverfront	12	2,848,992	33,480	639,586	424,415	▲14.9%	7,022	(17,047)	$56.06	N/A	▼ $56.06	352,876	-	-
Georgetown	42	3,270,869	87,532	508,590	369,714	▲11.3%	27,672	(109,040)	$52.83	$38.98	▼ $46.72	-	-	-
NoMa	35	10,002,247	20,087	1,051,962	585,221	▼ 5.9%	6,378	543,900	$52.47	$44.38	▼ $51.24	581,652	522,550	552,550
Southwest	35	11,983,389	50,564	1,609,316	1,014,795	▼ 8.5%	72,920	232,687	$49.34	$45.53	▲ $52.99	729,703	215,000	220,000
Uptown	121	7,184,948	218,146	1,572,917	1,128,873	▲15.7%	28,601	222,989	$51.50	$41.78	▼ $45.05	216,655	80,000	60,000
West End	20	3,274,797	160,554	722,764	391,669	▲12.0%	(112,208)	(132,447)	$55.02	$52.63	▼ $53.26	-	-	-
District of Columbia	723	126,739,917	2,645,403	26,713,239	17,578,246	▲13.9%	(77,843)	984,360	$63.02	$50.92	▼ $57.88	4,799,718	3,966,150	2,937,072

*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.

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