

MARKETBEAT

Washington, D.C.

Office Q2 2019



Washington, D.C. OFFICE

Economic Indicators

	Q2 18	Q2 19	12-Month Forecast
D.C. Metro Employment	3.30M	3.33M	▲
D.C. Metro Unemployment	3.4%	3.3%	▼
U.S. Unemployment	3.9%	3.6%	▼

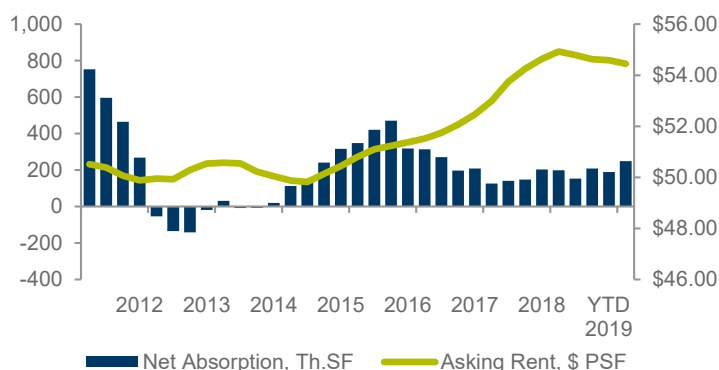
Market Indicators (Overall, All Classes)

	Q2 18	Q2 19	12-Month Forecast
Vacancy	14.0%	13.9%	▲
YTD Net Absorption (sf)	390k	817k	■
Under Construction (sf)	3.6M	2.9M	▼
Average Asking Rent*	\$55.01	\$54.61	▲

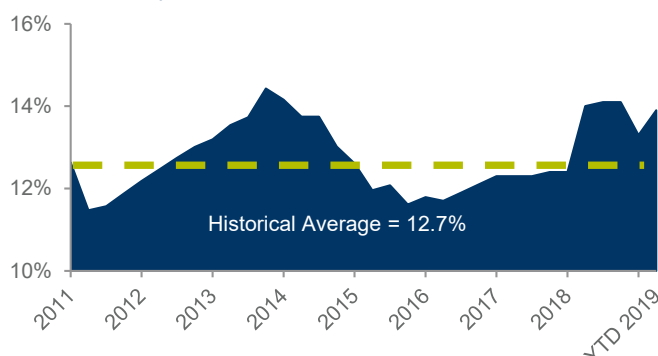
*Rental rates reflect gross asking \$psf/year

Overall Net Absorption/Overall Asking Rent

4-QTR TRAILING AVERAGE



Overall Vacancy



Economy

Year end 2018 net new job growth in the Washington, DC metropolitan region was revised sharply downward in the second quarter of 2019, falling from the initial reporting of 54,000 new jobs to 36,000. This possibly indicates that 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. This is reminiscent of the "Tea Party Wave" of 2010 in which a conservative House of Representatives came into the majority that was diametrically opposed to the incumbent executive branch and the friction between the two branches mired the federal government in shutdowns, budget sequestration and gridlock. 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 3.3% and year-to-date, the DC region has added 20,800 jobs led by gains in Professional and Business Services, Leisure and Hospitality and Retail (6,500, 5,800 and 3,100 jobs, respectively).

Market Overview

The first deliveries scheduled for 2019 with significant vacancies came online and, as expected, ticked up the vacancy rate in the District of Columbia in the second quarter of 2019. Just over one million square feet (sf) of vacant space was added to the Washington, DC market in the second quarter resulting in a 13.9% overall vacancy rate, up 60 basis points (bps) from 13.3% in the first quarter but down slightly from the 14.0% year-over-year (YOY). In the East End, 655 New York Avenue, NW, delivered with approximately 64% of its 756,000 sf of rentable building area (RBA) vacant. The Advisory Board—which signed an initial prelease for 522,776 sf in 2015, has split into two companies: United Healthcare Group moved into its 272,149 sf of space upon delivery this quarter. EAB—the second entity of the Advisory Board, has not yet occupied its 200,589 sf as of the close of the second quarter. In NoMa, 150 M Street, NE delivered entirely vacant during the quarter, adding 522,550 sf of vacant space to the market. The U.S. Department of Justice, however, is consolidating its District of Columbia locations into 475,100 sf as part of a phased move-in and should occupy almost the entire building by the end of 2019 or early 2020. That move will mitigate the impact of this vacant space on market fundamentals. Still, for the time being, vacancy rates have been inching upward, closer to their historical post-recession high of 14.5%, registered in the first quarter of 2010.

United Healthcare Group's relocation was also the largest move-in of the second quarter of 2019 with Ankura Consulting's move and expansion into 91,398 sf at 2000 K Street, NW—following its purchase of Navigant Consulting—the second largest. Rounding out the District of Columbia's largest move-ins and positive net new demand drivers were The Carlyle Group's expansion into 69,784 sf of new space at 1001 Pennsylvania Avenue, NW and Verizon's 25,684 sf expansion at 1300 Eye Street, NW. Overall, Washington, DC registered 302,402 sf of net absorption in the second quarter, down from the 514,257 sf in the first quarter of the year. Even so, the District of Columbia is on pace to surpass its 10-year historical annual average absorption of approximately 915,000 sf. While demand has remained steady in Washington, DC, the sheer amount of new construction coming online in the market continues to spur vacancy rates upward. Another 1.9 million sf is scheduled to come online by the end of 2019, primarily in Capitol Hill, NoMa and the CBD, with only about half of the space preleased. The question remains if net demand will stay elevated at least enough to offset a significant portion of the new construction and anchor vacancies.

On a separate note, Kirkland & Ellis's relocation and contraction from 655 15th Street, NW into its 187,834 sf of new space and Carlyle's expansion significantly lowered overall vacancy for trophy product in Washington, DC—from 14.2% at the close of the first quarter of 2019 to 10.9% in the second quarter, well below the market average. While vacancy rates are expected to rise overall, DC is historically a "flight to quality" market and that is likely to keep Class A+ and Trophy rates in check while unrenovated commodity A space softens. Trophy, along with the Capitol Riverfront submarket, are the two tightest subsets in the District, both posting 10.9% overall vacancy rates at the close of the second quarter.

The legal sector was particularly active in the second quarter of 2019 as some law firms continued to rightsize and others expanded. As mentioned, Kirkland & Ellis shed almost 22% of its footprint in the relocation to Pennsylvania Avenue. King & Spaulding also executed its renewal in the second quarter at its 1700 and 1730 Pennsylvania Avenue, NW locations. The law firm renewed 147,000 of its 189,843 sf of space and will shrink their footprint by about 23% when the renewal commences. Meanwhile, Miles & Stockbridge moved into its new 26,051 sf space at 1201 Pennsylvania Avenue, NW, vacating 1500 K Street, NW, and expanding its footprint by about 42%. Goodwin Procter signed for a 12,000 sf expansion at its soon-to-be new office at 1900 N Street, NW, still under construction. This expansion followed an initial relocation and rightsize. Winston & Strawn also expanded at a property still under construction, 1901 L Street, NW, after the firm's initial prelease to relocate and downsize. This development could very well be the beginning of a welcomed trend in the legal sector that these firms initially leaned out too aggressively and are now beginning to take back space. Overall net new leasing activity of 1,099,294 sf in the second quarter of 2019 was down a bit relative to the first quarter—1,685,058 sf—as well as the 10-year historical quarterly average of 1,353,378 sf. Even so, 2019 annual new leasing activity is on pace to hit the 10-year historical annual average of about 5.4 million sf. Coworking group WeWork signed the largest new lease of the quarter, taking 111,273 sf at Capitol Crossing's 200 Massachusetts Avenue, NW. The coworking sector was particularly active in terms of leasing activity in the second quarter with CommonGrounds, Mixer and WeWork all signing leases for over 20,000 sf (WeWork having signed two). However, no coworking firms moved into space during the quarter to help support absorption numbers. It should be noted eight of the top ten largest leases during the quarter were renewals. These were largely government extensions: 10 of the top 15 leases in the District of Columbia during the second quarter were renewals, mostly government extensions: i.e. the U.S. Securities and Exchange Commission renewing almost 1.3 million sf across its Station Place I, II, and III locations in NoMa. This led to an extremely strong gross leasing activity figure of approximately 3.5 million sf, but about average in terms of new leasing totals.

Outlook

With another 1.9 million sf of space set to deliver across Washington, DC, and only about 50% having been preleased at the close of the second quarter of 2019, we could see another one million sf of vacant space hit the market by year's end. However, with about 550,000 sf of coworking space set to be taken up by the end of 2019 and demand fundamentals remaining steady, this empty space's effects on vacancy rates will soften.

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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	19,320	2,058,475	14.2%	-14,986	265,957	299,681	1,287,623	\$53.78	\$57.38
East End	38,888,297	388,715	5,719,554	15.7%	482,919	527,396	779,496	386,854	\$56.98	\$62.74
CBD	34,108,947	429,162	3,846,624	12.5%	25,761	145,834	929,263	1,076,770	\$55.36	\$63.85
West End/Georgetown	4,779,133	82,768	739,798	17.2%	-214,152	-347,288	165,430	-	\$49.10	\$53.97
Uptown	3,188,523	61,954	334,969	12.4%	14,836	42,968	122,908	-	\$42.53	\$47.38
Southwest	11,644,799	20,476	1,359,578	11.9%	82,477	270,028	178,533	-	\$46.50	\$49.00
Capitol Riverfront	3,817,062	17,601	400,075	10.9%	-74,453	-88,226	309,041	175,000	\$53.59	\$53.59
WASHINGTON, D.C. TOTALS	111,032,042	1,019,996	14,459,073	13.9%	302,402	816,669	2,784,352	2,926,247	\$54.61	\$60.56

*Rental rates reflect gross asking \$psf/year **Does not include Renewals

	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	62,595,246	497,521	8,071,464	13.7%	405,939	1,634,611	1,911,165	2,926,247	\$62.65	\$60.56
Class B	29,012,534	356,198	3,763,092	14.2%	-48,328	-601,740	412,189	-	\$54.89	\$53.19
Class C	19,424,262	166,277	2,624,517	14.4%	-55,209	-216,202	460,998	-	\$47.44	\$46.53

Key Lease Transactions Q2 2019

PROPERTY	SF	TENANT	TRANSACTION TYPE	SUBMARKET
100 F Street, NE / 600 & 700 2 nd Street, NE	1,276,156	U.S. Securities and Exchange Commission	Renewal	Capitol Hill/NoMa
1700 & 1730 Pennsylvania Avenue, NW	146,994	King & Spalding	Renewal	CBD
200 Massachusetts Avenue, NW	111,273	WeWork	New Lease	Capitol Hill/NoMa
475 School Street, SW	62,254	Richard Wright PCS for Journalism & Media Arts	New Lease	Southwest
1140 3 rd Street, NE	39,137	Pact	New Lease	Capitol Hill/NoMa

Key Sales Transactions Q2 2019

PROPERTY	SF	SELLER/BUYER	PRICE / \$PSF	SUBMARKET
1319 F Street, NW & 1612 K Street, NW	122,320	EDG Corporation / Modell Family	\$48,000,000 / \$392	East End / CBD
1666 Connecticut Avenue, NW	71,764	Jones Foundation / Lincoln Property Company & ASB Capital	\$30,500,000 / \$425	Uptown
1401 Massachusetts Avenue, NW	58,000	National City Christian Church / Rock Creek Property Group	\$6,000,000 / \$103	East End

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