MARKETBEAT

Washington, D.C.

Office Q3 2023

	YoY Chg	12-Mo. Forecast
20.3% Vacancy Rate	▲	▲
-225K Net Absorption, SF	▼	▼
$54.90 Asking Rent, PSF	▼	▬

(Overall, All Property Classes)

ECONOMIC INDICATORS Q3 2023

	YoY Chg	12-Mo. Forecast
3.4 M D.C. Metro Employment	▲	▲
2.3% D.C. Metro Unemployment Rate	▼	▲
3.7% U.S. Unemployment Rate	▲	▲

Source: BLS

Economy

After four rate hikes throughout 2023, the Federal Reserve signaled in late September that it is holding the federal funds rate at 5.5%, but also indicated they are open to another increase this year. This additional rate hike remains likely as the labor markets continue to outpace expectations. This will further impact commercial real estate markets, especially office building owners and developers. In DC, developers are struggling with the viability of new projects in this challenging financial environment marked by rising debt and pricey labor and material costs. This has driven the cap rate and rents needed to justify new projects to be elevated well above previous peaks. Liquidity and competitive financing for office buildings remains scarce and has become increasingly challenging to procure. After several notable buildings sold last quarter, there was less than $20 million in sales across two buildings in Q3 which is evidence of this challenging financial environment.

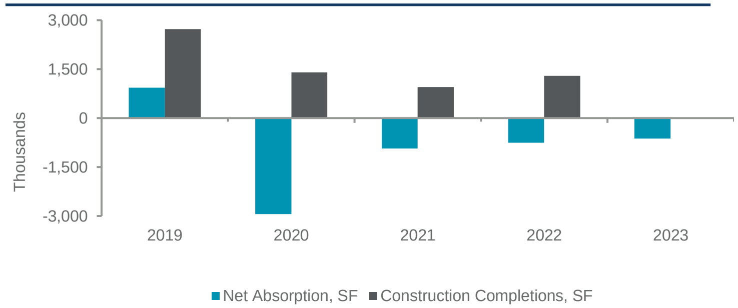
Market Segments

New leasing decreased 27% year-over-year (YOY) to 568,000 square feet (sf) while renewal activity increased 95% YOY to 1.5m sf in the third quarter. This brings year-to-date (YTD) gross leasing to 5.5 msf with new leasing just under 2.5 msf and renewal activity at 3 msf. Tenants continue to flock to quality options in the core submarkets and most new Class A product. East End registered 244,000 sf of new deals while the CBD followed with 170,000 sf inked, which is 71% of all new leasing in the District. In Q3, Class A represented over 76% of new leasing activity while Class B and Class C made up 12% and 11%, respectively.

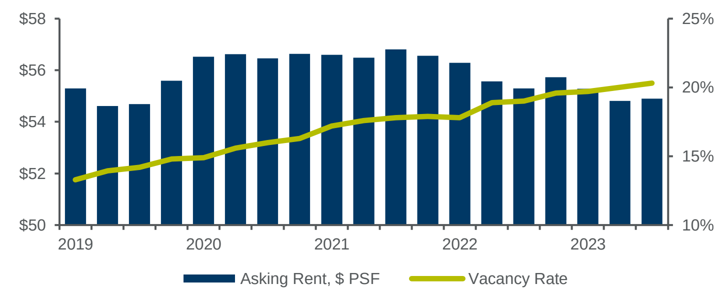
American Chemistry Council signed the largest deal of the quarter for 93,000 sf at 655 New York Ave, NW- a slight expansion from their 87,000 sf Capitol Hill office at 700 2nd St, NE. Non-profits and associations made up 47% of new leasing and nearly 33% of all deals in the third quarter. Other notable associations inking new deals included American Clean Power Association signing 42,405 sf at 1299 Pennsylvania Ave, NW, American Enterprise Institute taking 27,581 sf at 11 Dupont Cir, NW, and the Center for a New American Security signing 18,510 sf at 1701 Pennsylvania Ave, NW. With only 115,000 sf recorded, law firm leasing activity is significantly lower compared to the previous quarter which registered 425,000 sf of gross leasing. Kelley Drye & Warren LLP inked the largest law firm deal for 65,000 sf at 670 Maine Ave, SE but will leave 107,000 sf at 3050 K St, NW in Georgetown in their 2026 move. Government leasing accounted for just over 1.2 msf in the third quarter after Court Services & Offender Supervision Agency (CSOSA) renewed 93,000 sf at 800 North Capitol St, NW. The SEC renewed a total of 1.1 msf at Station Place I and II at the end of September for a five-year term further signaling that construction at 60 New York Ave, NE is not likely to break ground.

As has become the norm, several large block tenants renewed and downsized this quarter. CareFirst BlueCross BlueShield (BCBS) signed a renewal for 62,010 sf which allowed the healthcare company to shed over 140,000 sf, or two-thirds of its space, at 840 1st St, NE. Amtrak also downsized after giving back two floors, going from over 106,000 sf to 33,289 sf at 10 G St, NE.

SPACE DEMAND / DELIVERIES



OVERALL VACANCY & ASKING RENT



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Supply and Demand

Vacancy rates increased 20 basis points (bps) from the previous quarter to 20.3% in Q3. Class A decreased 20 bps from Q2 to 17.6% while Class B increased 120 bps to 23.8% and Class C rose 50 bps to 25.5%. YOY vacancy rose 130 bps with Class A increasing 30 bps, Class B rising 250 bps and Class C jumping 340 bps. Vacancy will remain elevated as companies continue to reevaluate their space needs and two renovated buildings- 20 Massachusetts Ave, NW and 1401 Massachusetts Ave, NW- come to the market.

Absorption for DC was negative for the seventh straight quarter registering negative 225,000 sf. Class B buildings pushed absorption negative with 301,000 sf registered after BCBS gave back 142,000 sf in Capitol Hill/NoMa and the Australian Embassy moved out of 120,000 sf of temp space at 1145 17th St, NW in CBD for their newly constructed embassy. CBD recorded 182,000 sf of negative absorption after AT&T left over 60,000 sf at 1120 20th St, NW and international consultant DT Global vacated 31,000 sf at 1625 Eye St, NW in a move to Arlington, VA. At 1401 H St, NW, the Investment Company Institute moved out of over 33,000 sf of swing space and into newly renovated space on the top two floors. The flight to quality trend continued in Q3 as Class A posted 171,000 sf of positive absorption. East End drove Class A absorption with 118,000 sf recorded after Sterne Kessler took 80,773 sf at 1101 K St, NW, Barnes & Thornburg moved into 31,555 sf at 555 12th St, NW and Regus opened a 33,000-sf location at 600 Massachusetts Ave, NW. Net new moves included Boston Consulting Group's expansion in Met Square by 28,659 sf and TikTok into its new 70,000 sf office at 1255 Union St, NE. In the CBD, FHI 360 moved into 60,000 sf at 2101 L St, NW. As new trophy vacancy approaches zero by 2025, an average of 475,000 sf of trophy demand will pass onto legacy trophy assets. Legacy trophy will quickly tighten as new options are scare and are leased quickly.

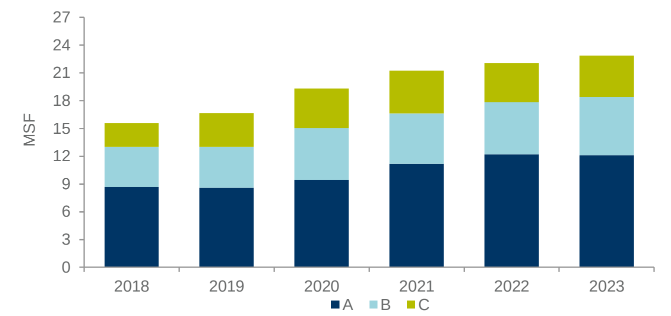
Since the pandemic, rents have been relatively flat in core submarkets going from $62.27 psf in 2020 to $62.10 psf in 2023. While rents have remained consistent, concessions packages have increased dramatically. TIs grew from and average $111 in 2020 to $140 psf in 2023 and abatement increased from 1.2 months to 1.7 months per year of term for deals in core submarkets over 10,000 sf with five years or more of lease term. However, concessions are off their highs of $145 psf in TIs and 2 months free per year of term and show signs of further declines. In this tough financial environment, future concessions are expected to fall as landlords are more willing to trade lower rents for concession packages because they do not have the funding to support these larger packages.

Development Pipeline

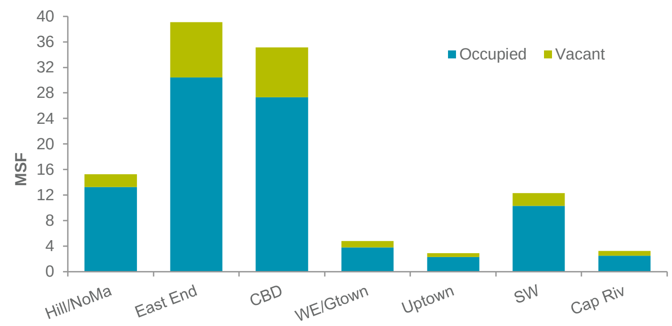
In the East End, 1401 Massachusetts Ave, NW completed renovations and delivered 50,000 sf of vacant office space in the heart of Thomas Circle. In Capitol Hill/NoMa, 20 Massachusetts Ave, NW will deliver 178,000 sf at the beginning of Q4 with no preleasing in place. Washington D.C.'s pipeline continues to shrink with only two projects under construction for a total 700,782 sf. These two projects combined are 56% pre-leased- Gibson Dunn took 164,000 sf in 2021 and UBS Financial signed for 24,000 sf in Q1 2023 at 1700 M while Crowell & Moring signed 198,877 sf at 600 5th St NW last quarter. The increased cost of capital, construction, and labor have stunted the development pipeline. The previous return on cost for a project to break ground was around 6%-6.5% prior to the increase in interest rates and now it's north of 9%. This has also driven rents up for new trophy projects to $80-$90 NNN, up from the mid-$60's NNN for the last several preleases signed in the market.

Office-to-residential conversion remains an attractive option to transform DC's obsolete office inventory into new housing. Currently, there are 20 office buildings totaling 4 msf under conversion or planned to be converted into nearly 4,000 apartments with another 14 buildings totaling 3 msf that could meet the same fate. In this challenging environment, some of these office-to-residential projects may struggle to secure the financing to break ground on their conversions. In addition, it remains to be seen what rents these projects will achieve in areas that until very recently were dominated by office product.

VACANT SPACE BY CLASS



SUBMARKET COMPARISON



SUBMARKET ASKING RENT

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MARKET STATISTICS

SUBMARKET	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT (SF)	OVERALL VACANCY RATE	CURRENT QTR OVERALL NET ABSORPTION	YTD OVERALL ABSORPTION (SF)	YTD LEASING ACTIVITY (SF)	UNDER CNSTR (SF)	OVERALL AVG ASKING RENT (ALL CLASSES)*	OVERALL AVG ASKING RENT (CLASS A)*
Capitol Hill/NoMa	15,252,483	38,673	1,966,781	13.1%	-92,257	-10,427	116,003	0	$53.11	$54.59
East End	39,103,107	309,660	8,382,592	22.2%	57,347	9,245	1,123,095	380,000	$56.58	$64.11
CBD	35,128,719	464,132	7,340,165	22.2%	-182,333	-509,232	976,434	320,782	$55.07	$63.26
West End/Georgetown	4,806,248	140,396	898,652	21.6%	22,924	-132,376	98,111	0	$50.60	$56.16
Uptown	2,896,111	66,821	548,767	21.3%	-38,457	41,183	21,093	0	$45.84	$49.13
Southwest	12,284,502	10,586	1,981,330	16.2%	8,354	-21,217	94,909	0	$49.84	$52.28
Capitol Riverfront	3,225,932	117,435	607,557	22.5%	-537	-7,946	65,436	0	$61.15	$61.15
DOWNTOWN TOTALS	**112,697,102**	**1,147,703**	**21,725,844**	**20.3%**	**-224,959**	**-630,770**	**2,495,081**	**700,782**	**$54.90**	**$61.58**

Rental rates reflect full service asking

KEY LEASE TRANSACTIONS Q3 2023

PROPERTY	SUBMARKET	TENANT	RSF	TYPE
655 New York Avenue NW	East End	American Chemistry Council	93,000	New Lease
800 North Capitol Street NW	Capitol Hill/NoMa	Court Services & Offender Supervision Agency	92,638	Renewal*
670 Maine Avenue SW	Southwest	Kelley Drye & Warren LLP	65,308	New Lease
840 1st Street NE	Capitol Hill/NoMa	CareFirst BlueCross BlueShield	62,010	Renewal*
1299 Pennsylvania Avenue NW	East End	American Clean Power Association	42,405	New Lease
10 G Street, NE	Capitol Hill/NoMa	Amtrak	33,289	Renewal*
11 Dupont Circle, NW	CBD	American Enterprise Institute	27,581	New Lease

Renewals not included in leasing statistics

KEY SALES TRANSACTIONS Q3 2023

PROPERTY	SUBMARKET	SELLER / BUYER	SF	PRICE / $ PSF
1411 K Street NW	East End	TA Realty / Douglas Legum Development	89,172	$9,100,250 / $102.05
816 Connecticut Avenue NW	CBD	Greenstone Realty Advisors / MetTel	29,446	$7,873,250 / $267.38

KEY UNDER CONSTRUCTION

PROPERTY	SUBMARKET	MAJOR TENANT	SF	OWNER / DEVELOPER
600 5th Street, NW	East End	Crowell & Moring	380,000	Stonebridge JV Rockefeller Group
1700 M Street, NW	CBD	Gibson Dunn	320,782	Skanska

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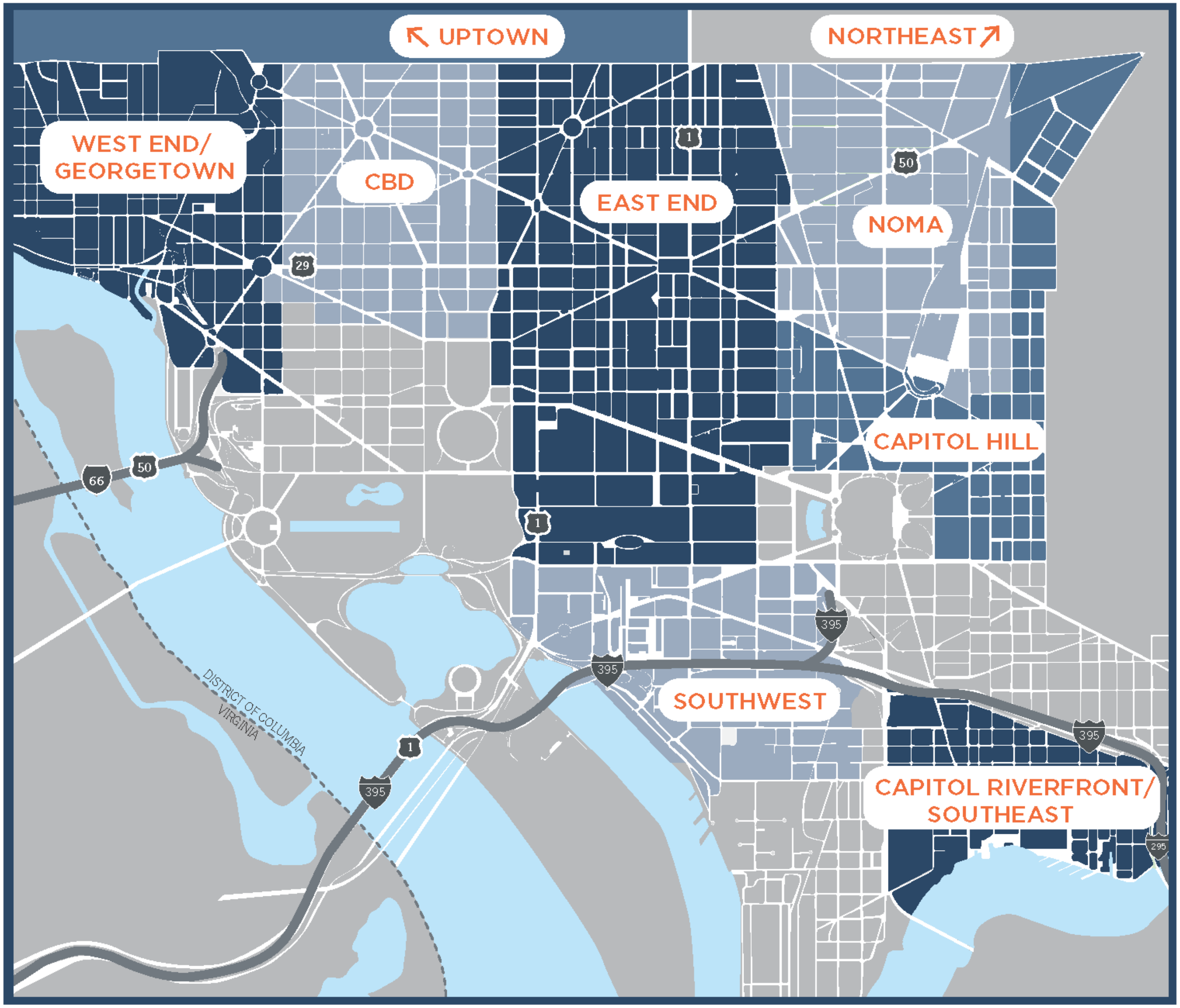
OFFICE SUBMARKETS



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