Washington, DC office market report

Q2 2023

AVISON YOUNG

Washington, DC office market trends

$353mm

Investment volume 2023 YTD

The inflection point between structural shifts in the office market and a rising interest rate environment is manifesting itself in extremely suppressed investment volume in the office sector.

$353mm through the first half of the year is roughly **4.78x lower** than the average investment volume through the first half of 2018-2022. Given that many holders of maturing loans aren't equipped to own or operate a property, look to see increased activity in distressed sales.

12.6%

Vacancy rate in trophy buildings

Despite the troubles facing the office market, trophy quality buildings have continued to outperform their peers, capturing an outsized portion of demand relative to inventory. With a limited construction pipeline, this number should continue to drop as the limited available trophy space gets leased at a much higher rate than it is being constructed.

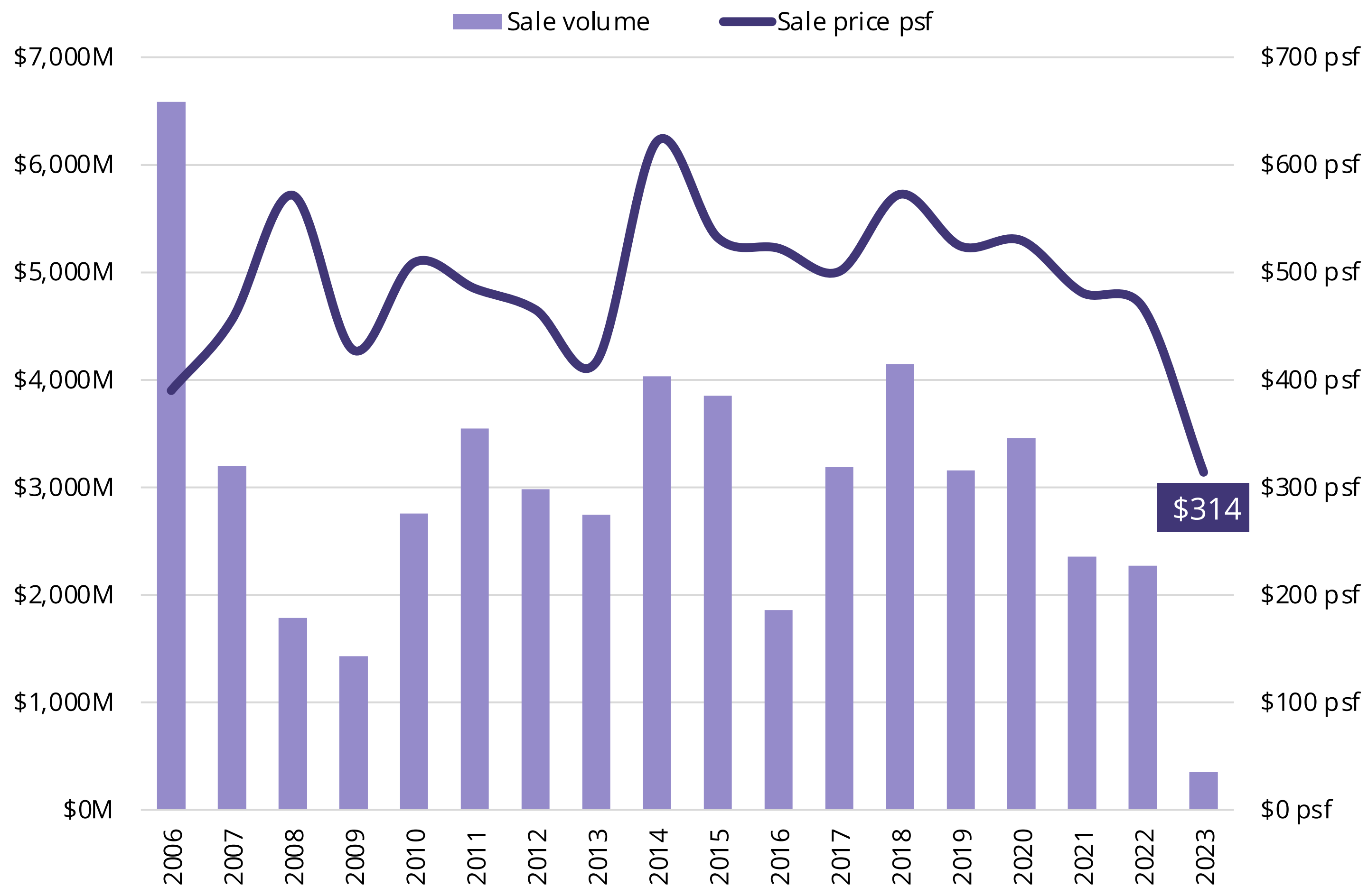
74%

YTD leasing volume attributable to the CBD or East End

Despite the rise of more mixed-use submarkets such as NoMa or Navy Yard, the CBD and East End remain the preferential location of DC office tenants. While transaction volume is down, it has not been impacted in the same way as Capital Markets transactional volume. The core submarkets have always been the lifeblood of the DC office market, but in recent years tenants have broken norms and moved out of the core, such as Williams & Connolly moving from the East End to the Wharf in 2022.

Source: AVANT by Avison Young, CoStar

Yearly Investment Volume



The culmination of macroeconomic headwinds, and office demand fundamentals shifting, has resulted in not only suppressed investment volume, but softened pricing as well.

Source: AVANT by Avison Young, CoStar

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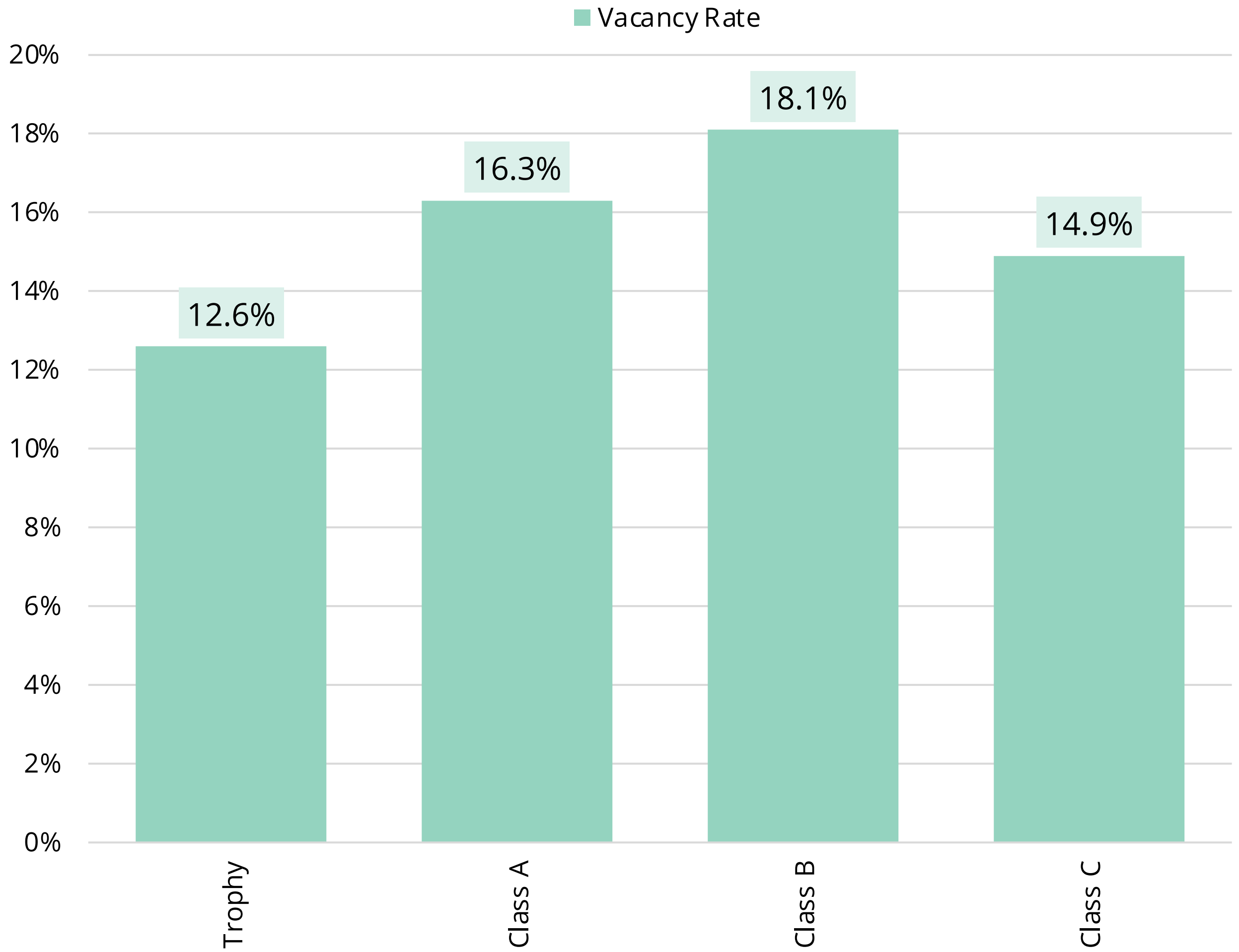
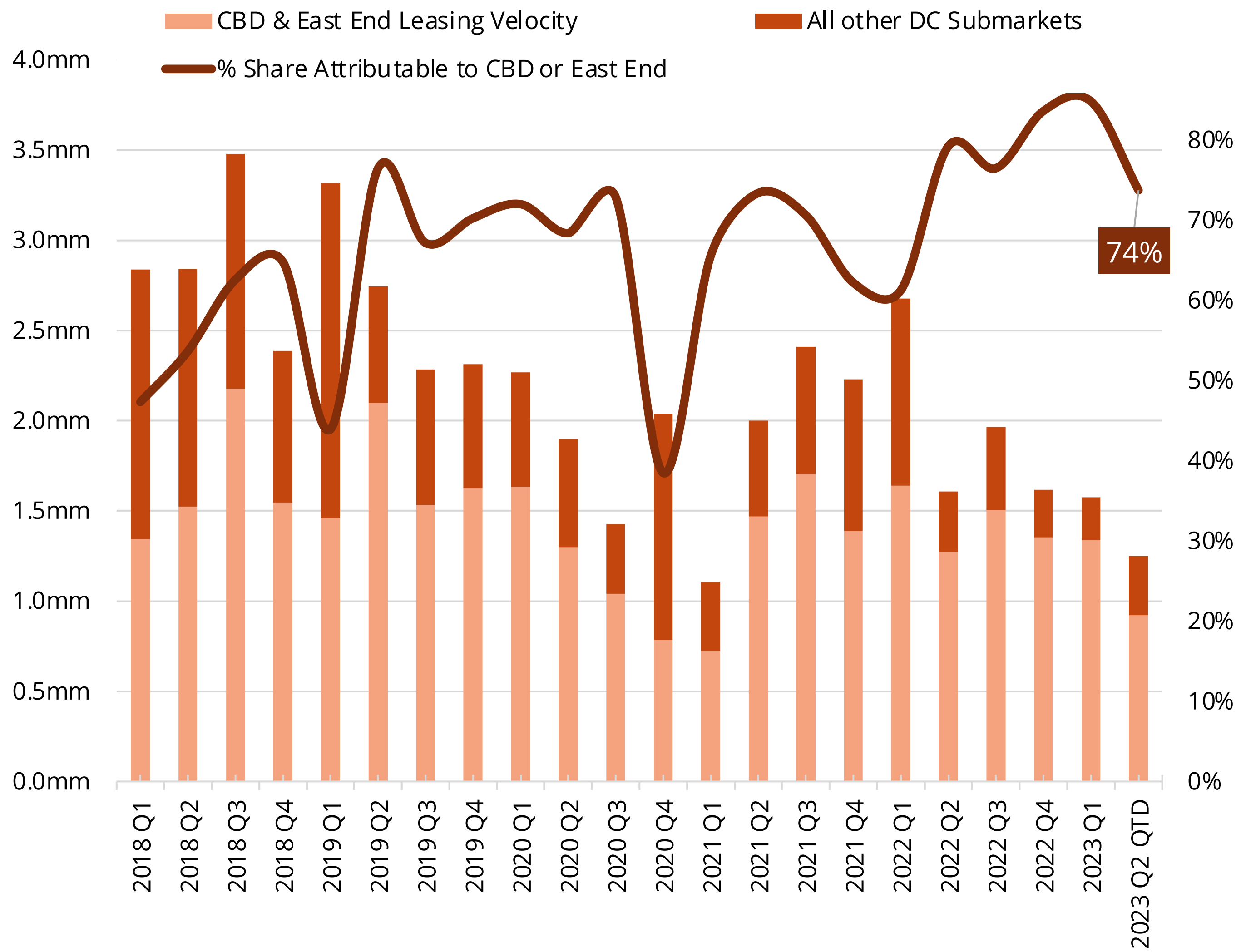
Vacancy by Class



In a post-pandemic world, the trend of flight to quality is even more prevalent and will continue for the foreseeable future.

Source: AVANT by Avison Young, CoStar

Leasing velocity - Core vs. Non-Core Submarkets



Source: AVANT by Avison Young, CoStar

Even though the CBD and East End represent roughly a third of the DC inventory, they still are able to capture and outsized share of demand, despite the rise of newer, more mixed-use neighborhoods that offer more copious amenities.

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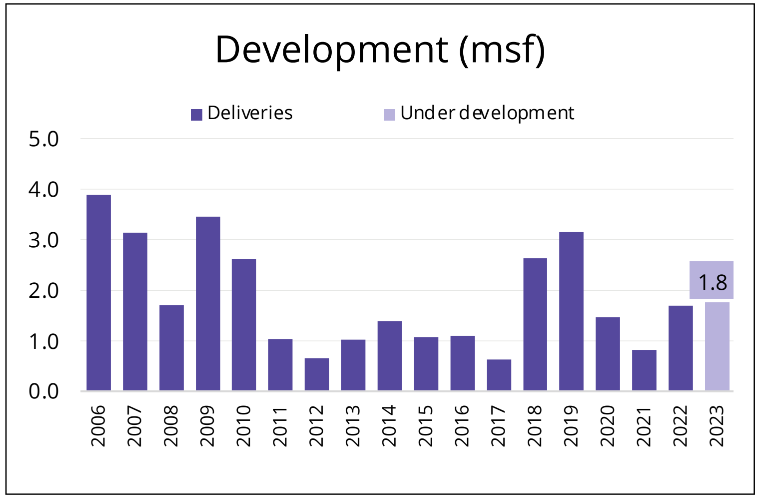
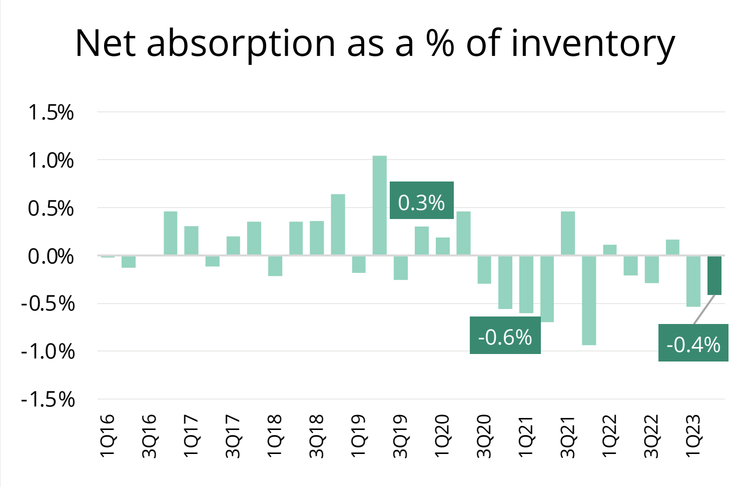
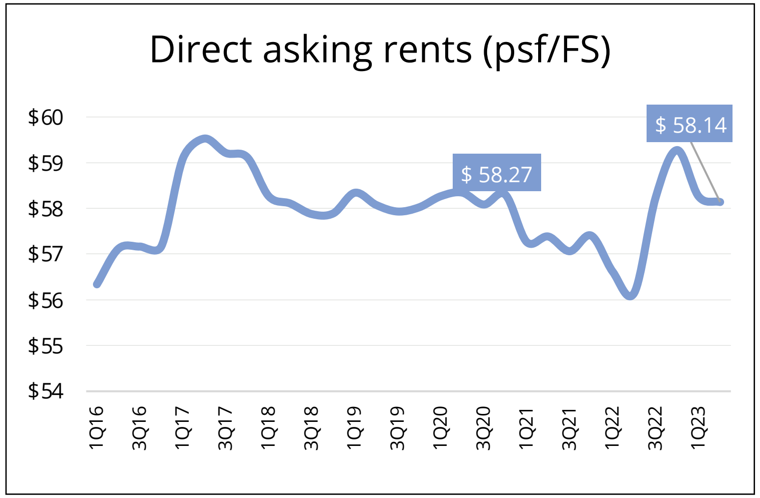
Main Indicators

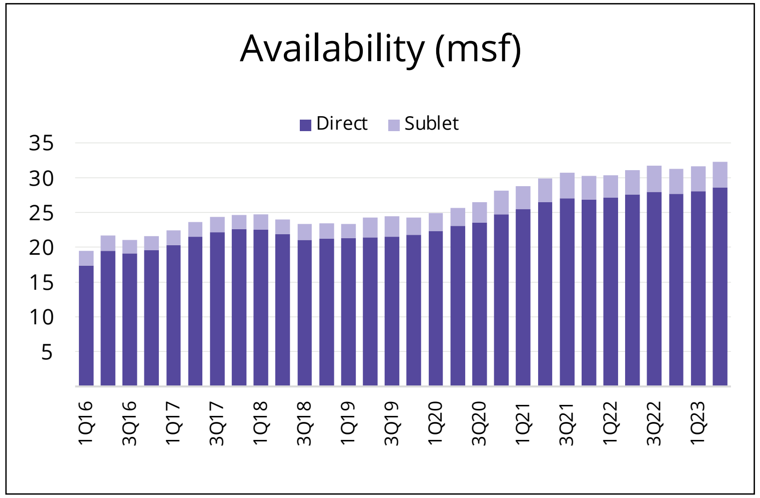
Let's examine more leasing
& capital markets trends.

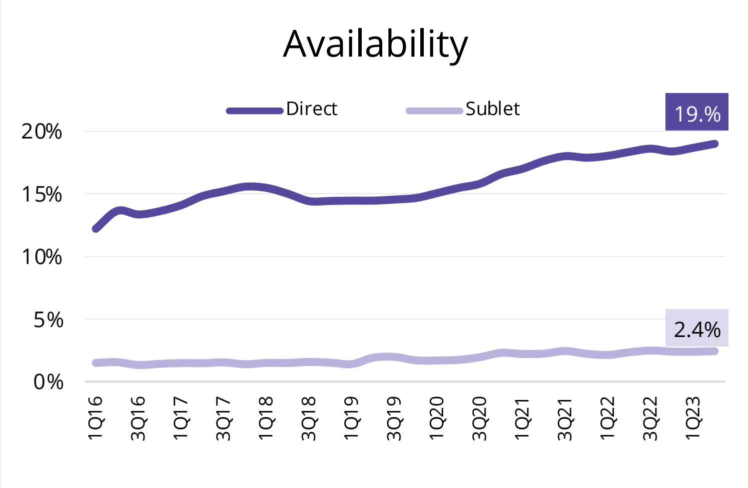
Washington, DC Office Market Indicators

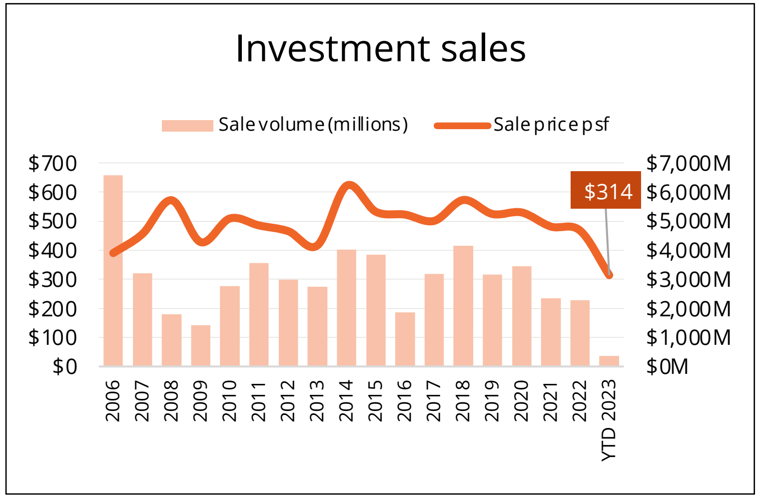






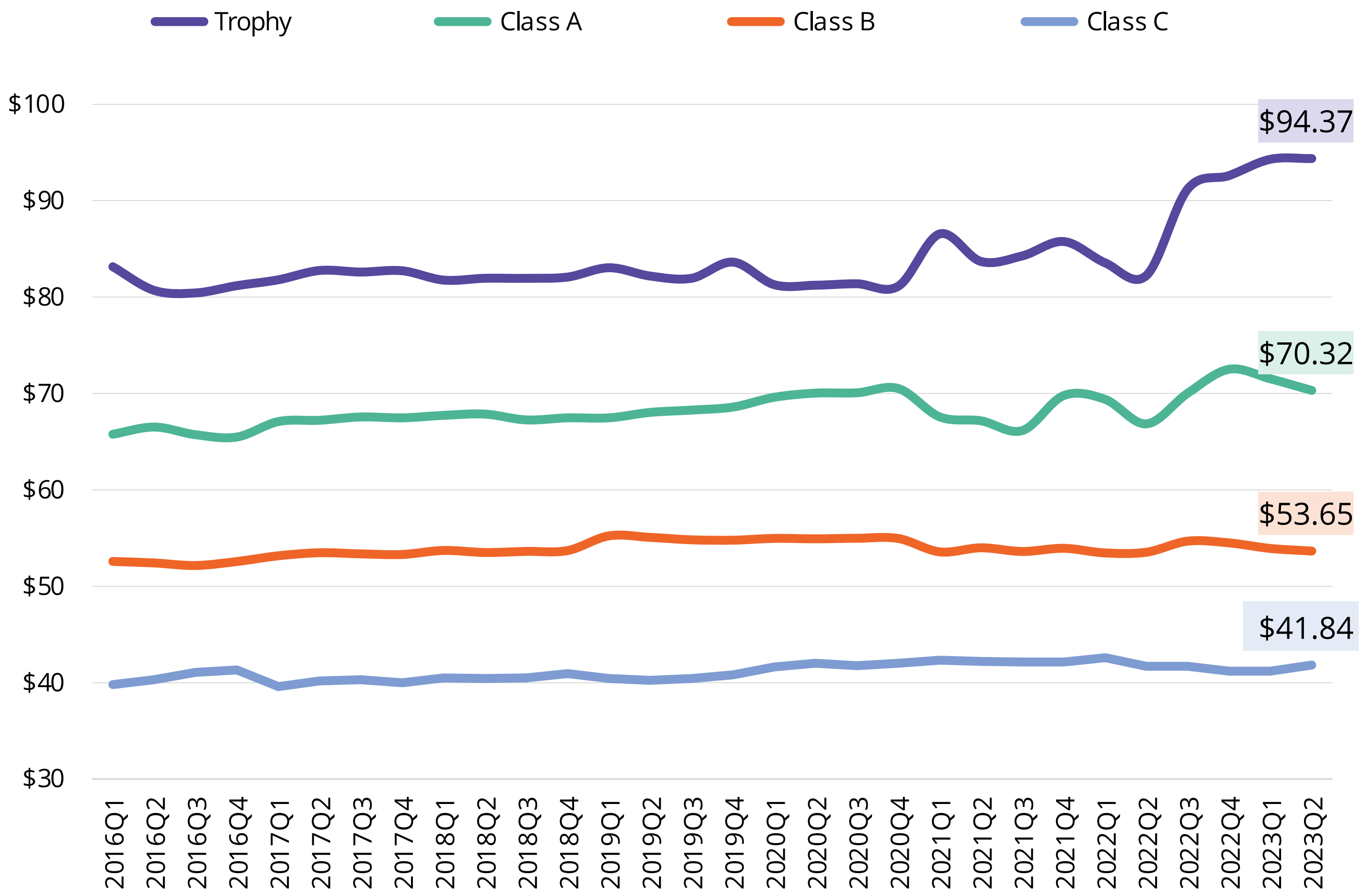






Source: AVANT by Avison Young, CoStar

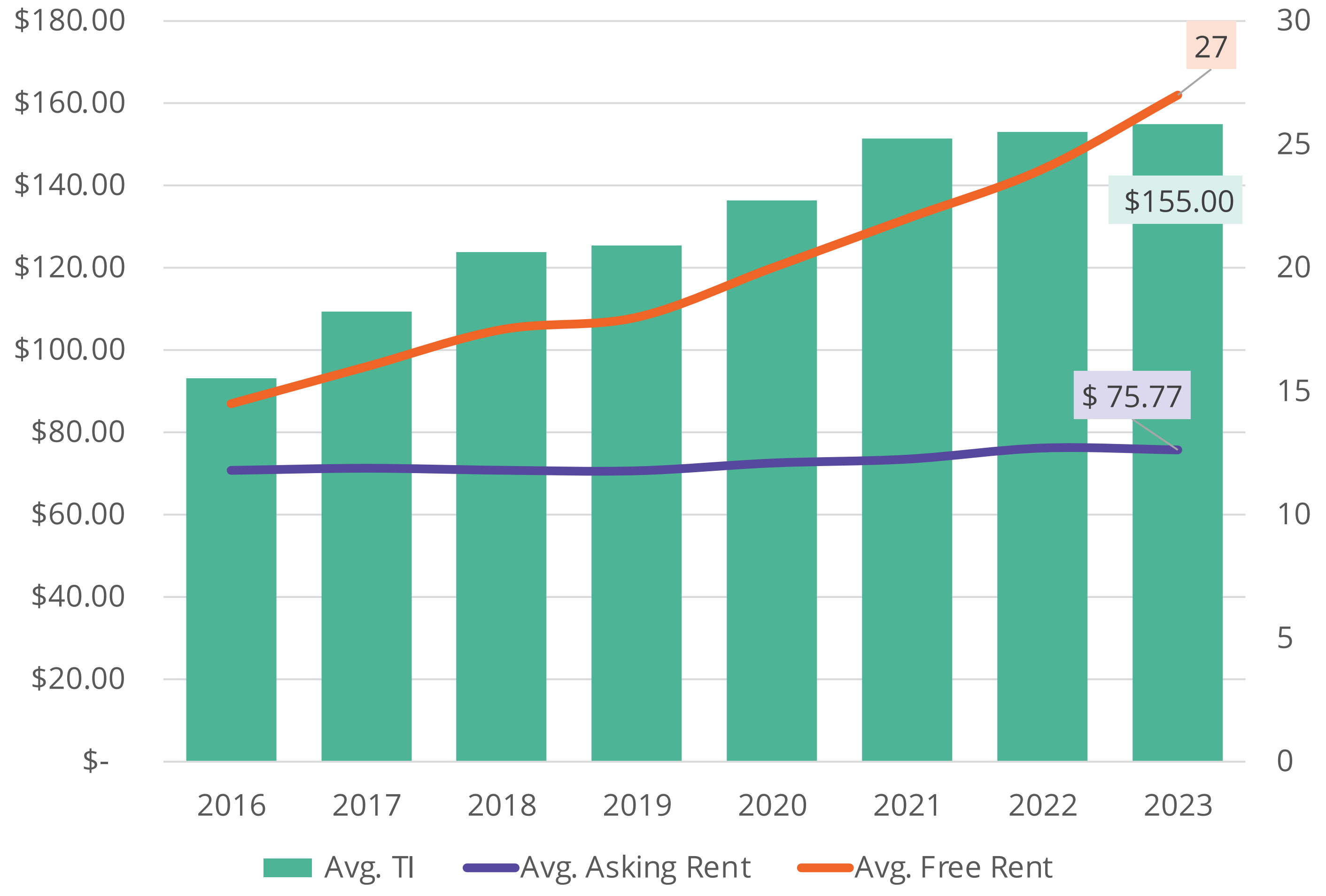
Average Asking Rent FS by Class



Source: AVANT by Avison Young

With the flight to quality trend enhancing demand in the higher quality segments of the market, the trophy segment is the only one to experience real asking rent growth over the past few quarters.

Asking Rents vs. Concessions (Trophy & Class A)



Even in the upper segments of the market, rents have remained relatively stagnant while concessions have continued to increase, resulting in falling net effective rents.

Source: AVANT by Avison Young
Note: concessions inclusive of only direct relocations >20k rsf, concessions normalized for a 10-yr term

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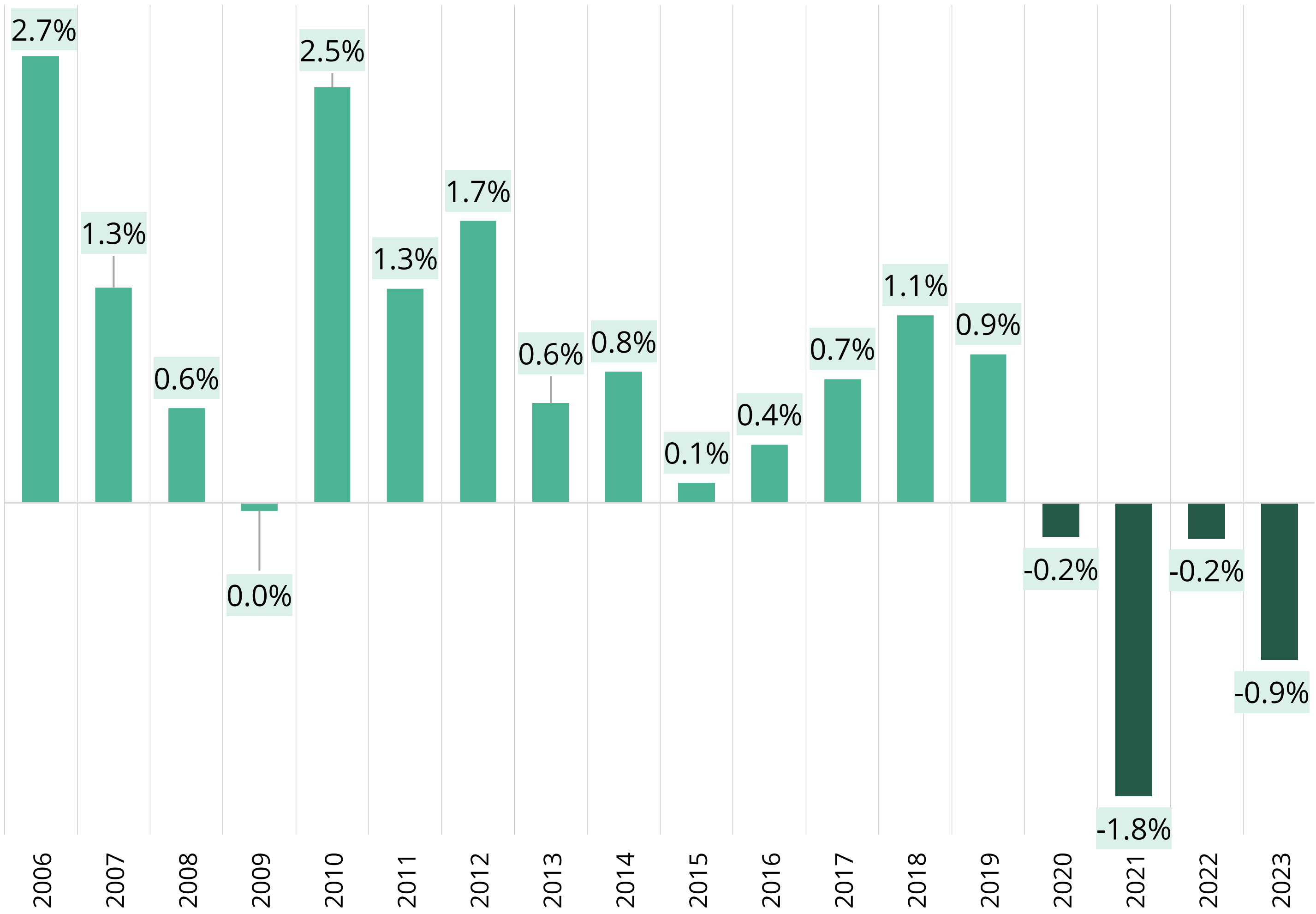
Annual Net Absorption – Share of Inventory



Source: AVANT by Avison Young, CoStar

Even in 2023, many employers are continuing to utilize hybrid or remote working models that have resulted in large amounts of unused office space. Tenants with expiring leases have generally opted to take less space, while tenants with more distant lease expirations have turned to the sublease market to offload unneeded space.

Both have resulted in more vacant space hitting the market, resulting in continued negative absorption.

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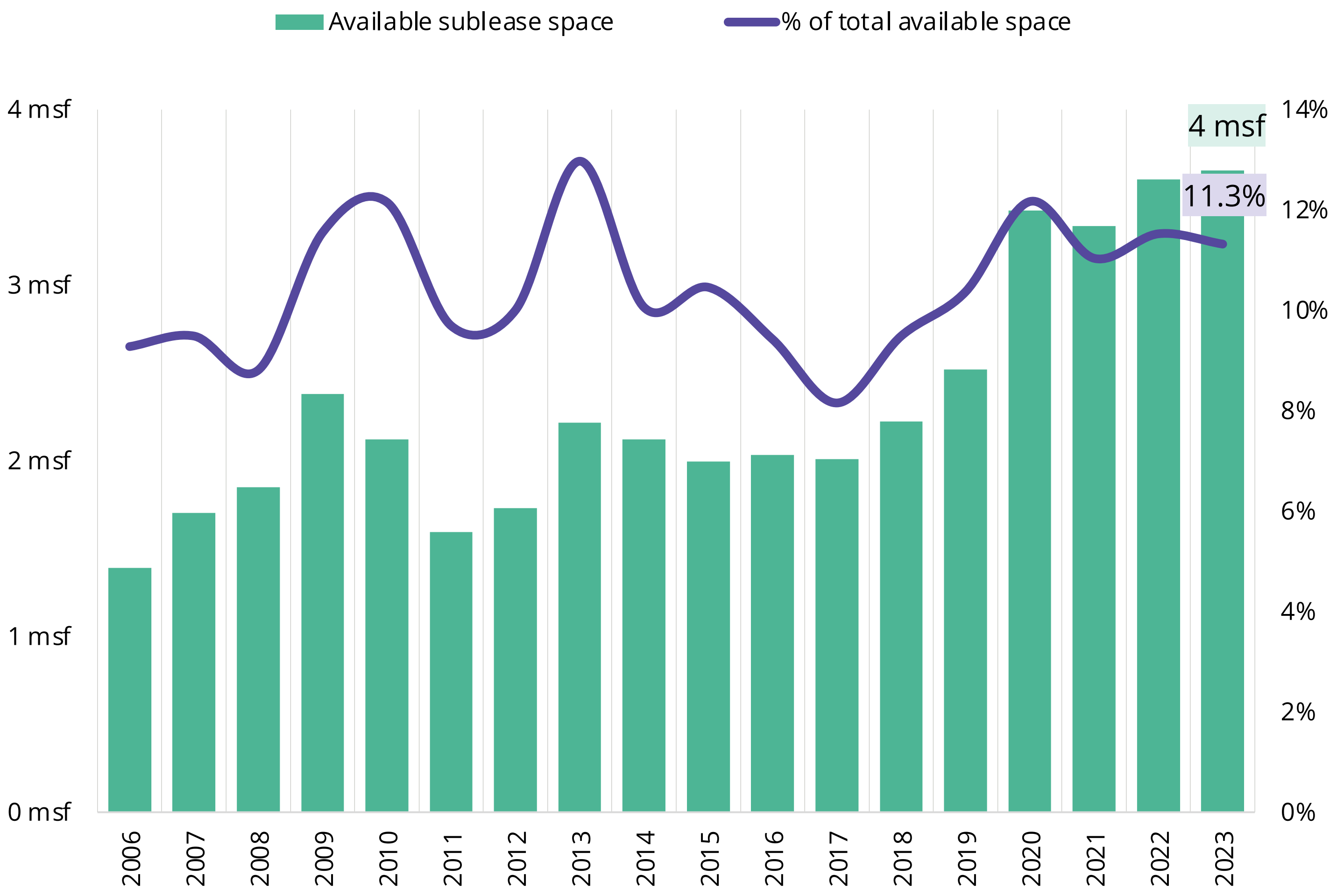
Available Sublease Space

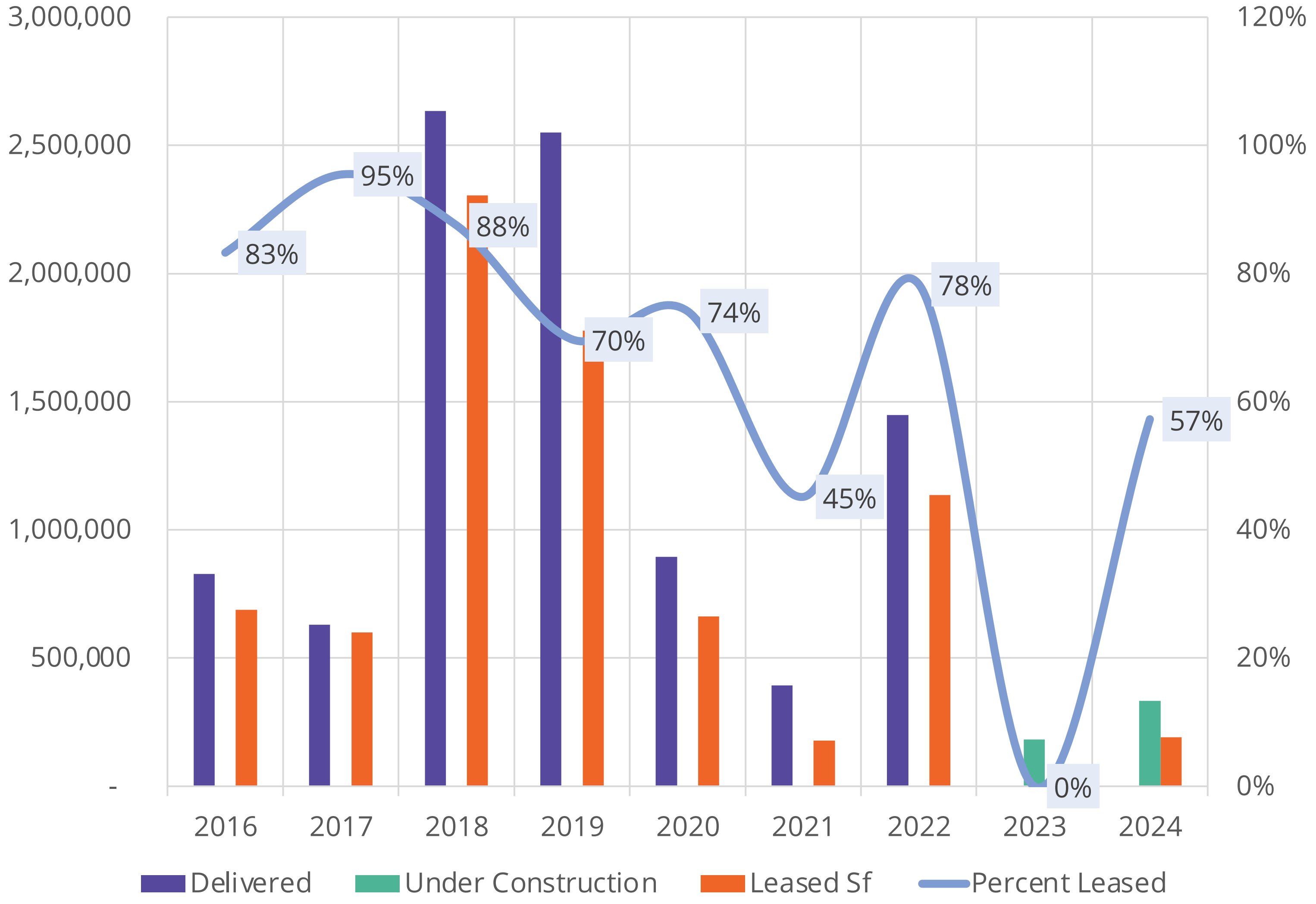


Source: CoStar

A principal cause of rising availability is tenants adding sublease space to the market, which comprises roughly 11.3% of total vacancy.

This is especially prevalent with tenants having more distant lease expirations.

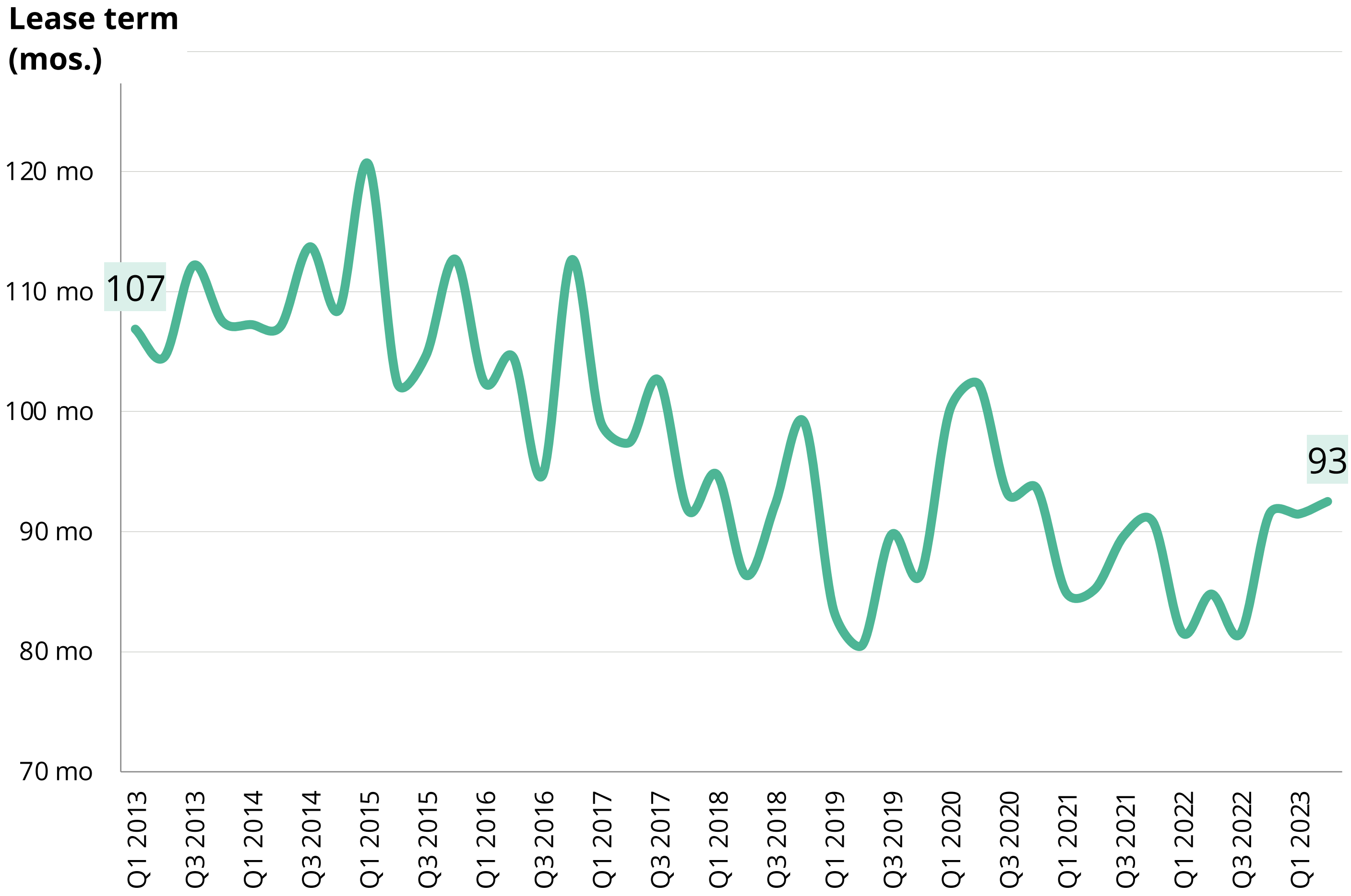
New Construction



Despite increased vacancy, and decreased tenant demand, DC faces a near-term supply constraint at the top segment of the market.

Source: AVANT by Avison Young

Average Term Length



Source: AVANT by Avison Young

As tenants have preferred flexibility regarding their leases in recent years, average term length has decreased.

However, as a result of transaction volume being heavily concentrated amongst industry segments that prioritize office utilization, average term length has begun to slightly increase.

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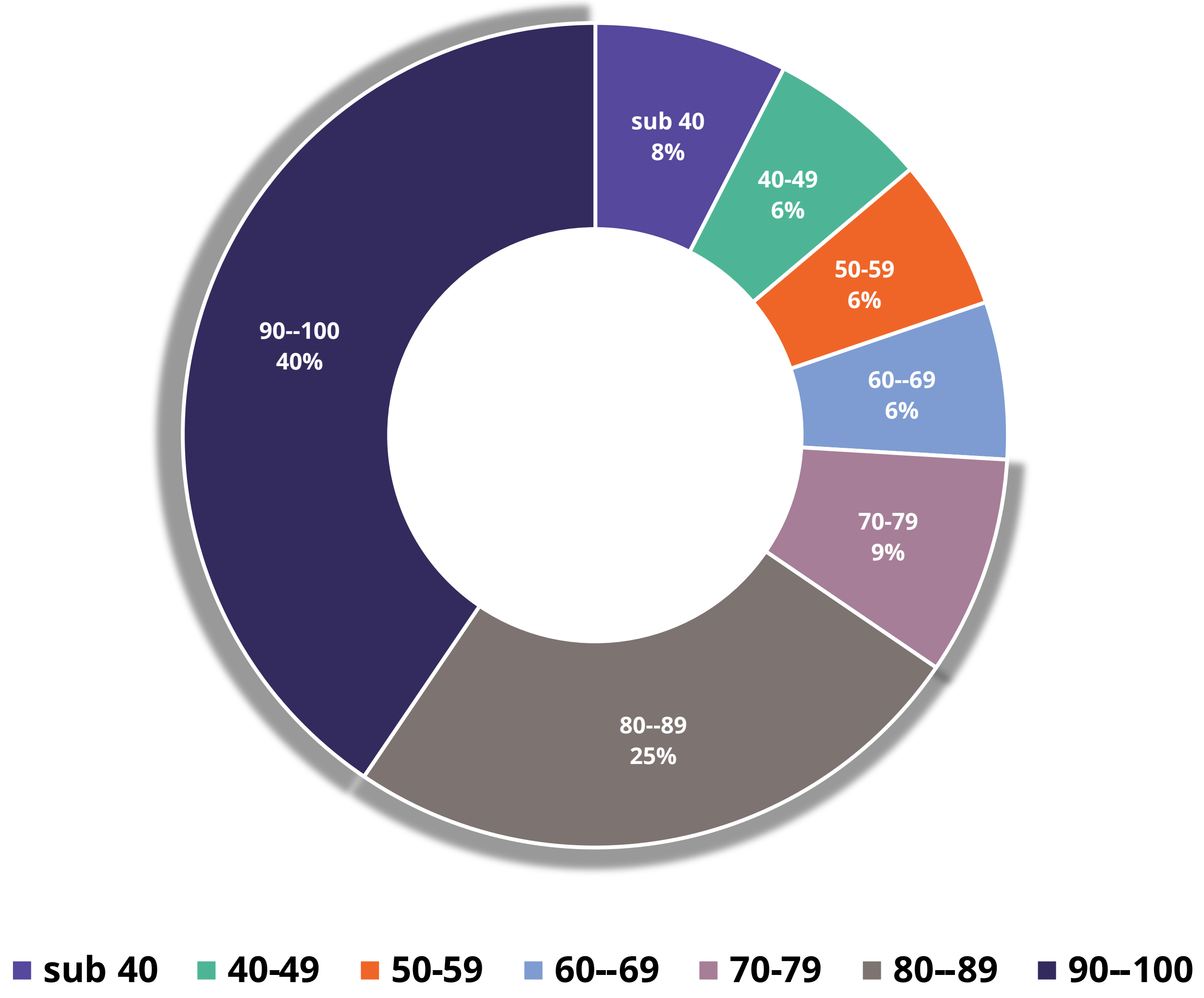
Flight to Quality (2021-2023 YTD)



Since 2021 in Washington, DC, office leasing has been concentrated at the top of the market. Avison Young has developed a proprietary scoring model, that assigns buildings a score based on –

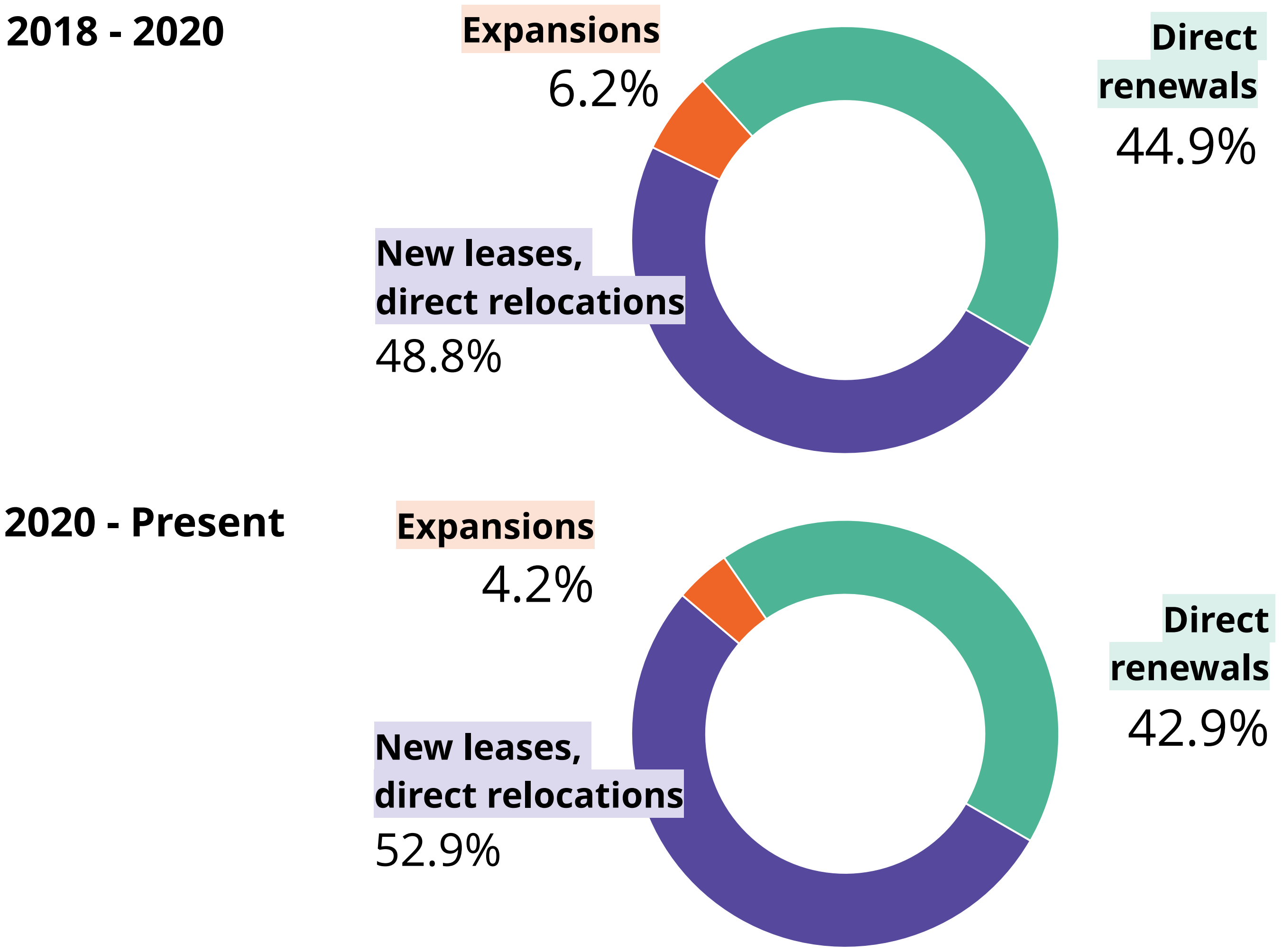
- Rent
- Year built
- Presence of a conference center
- Presence of a tenant lounge
- Presence of a roof terrace
- Presence of a private terrace

Based on the scoring output of the model, the top third of the market is responsible for roughly 74% of leasing since 2021. This includes all transaction types (i.e. new leases and renewals).

Note, the scoring outputs are uniformly distributed i.e. if there are 10 properties, one is going to be 100%, one is 90%, one is 80%, etc.

Note – excludes gov. leases

Relocations vs. Renewals (by sf leased)



In a post-pandemic world, tenants are taking advantage of record high concessions to increase their building quality, while often reducing their footprints.

Source: AVANT by Avison Young

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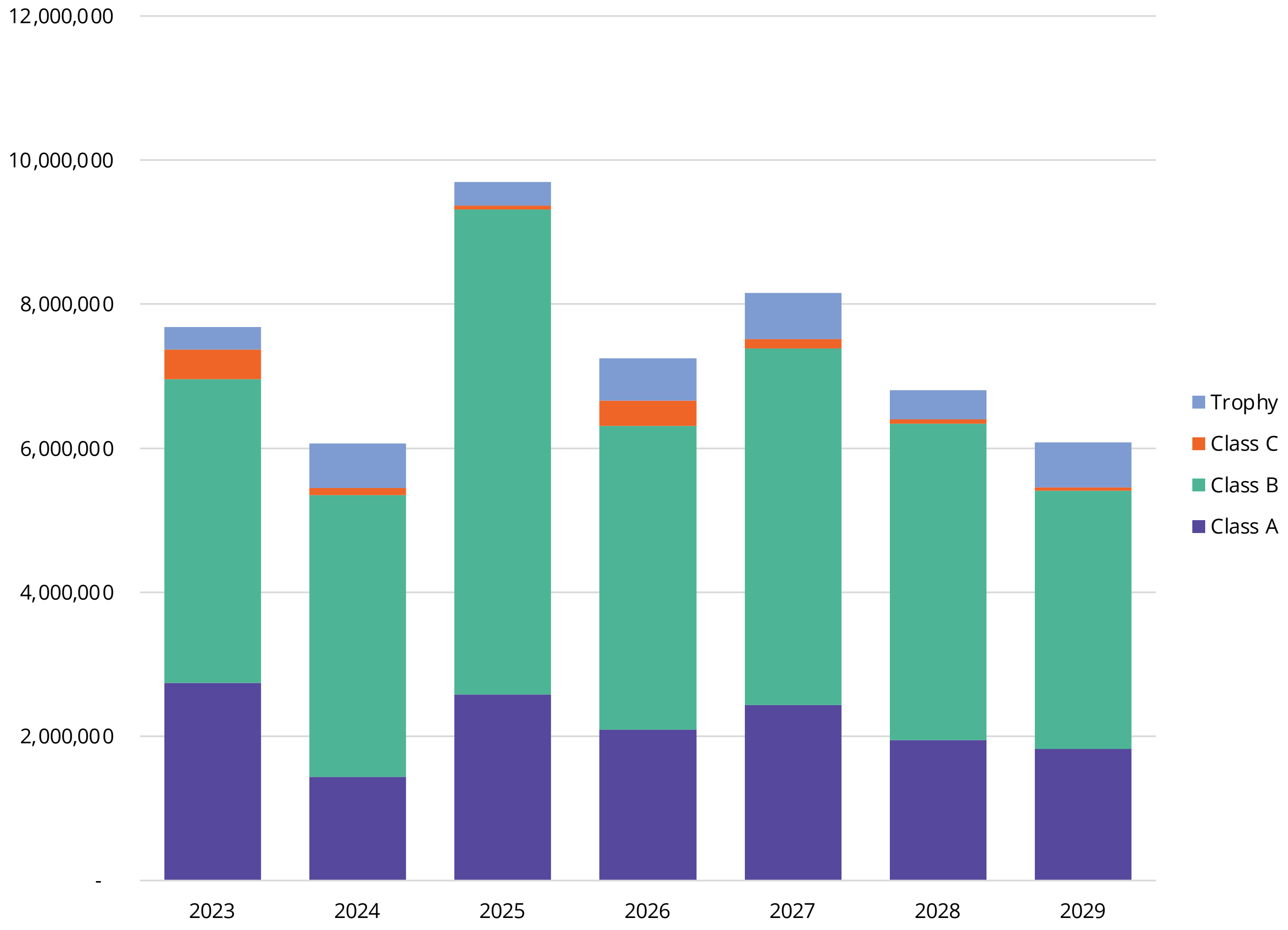
Lease Expirations

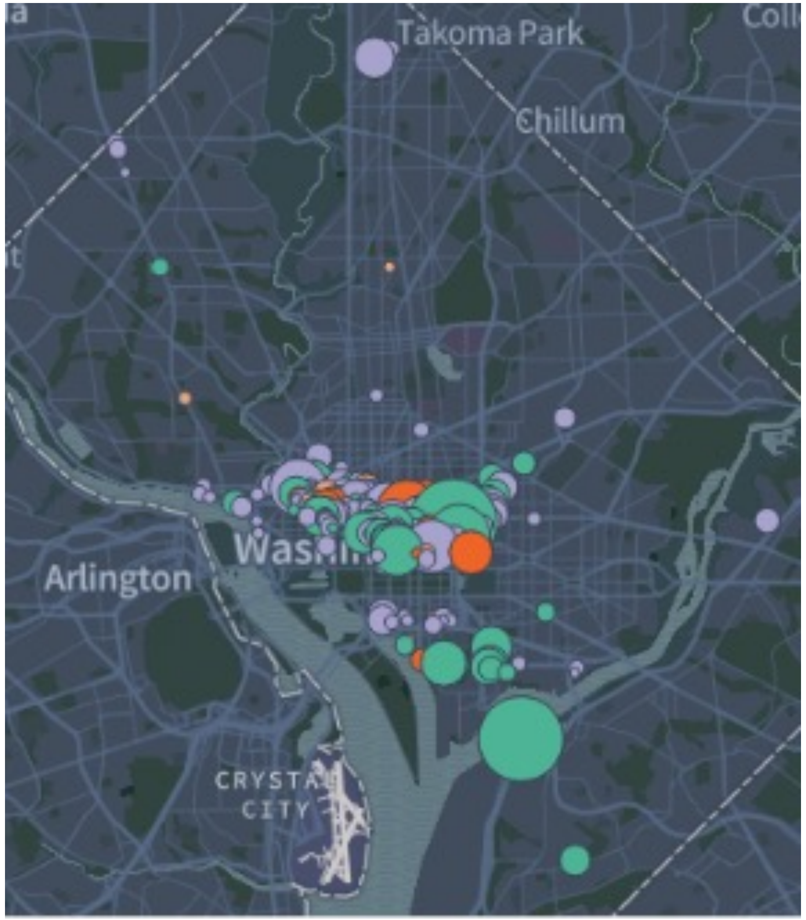


Source: AVANT by Avison Young

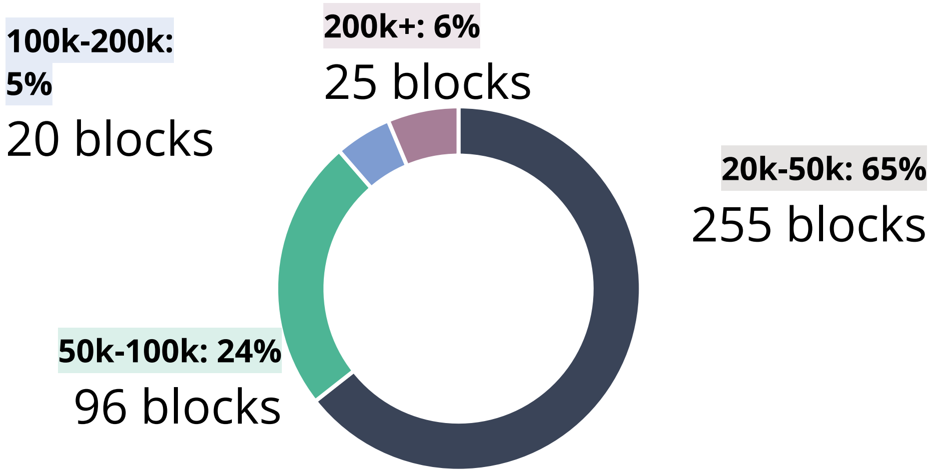
DC has over 6 million sf per year of expiring leases until 2029, most of which in the Class B segment of the market.

With the flight to quality trend continuing, we anticipate that the Trophy and Class A segments will continue to absorb the majority of the leasing velocity.

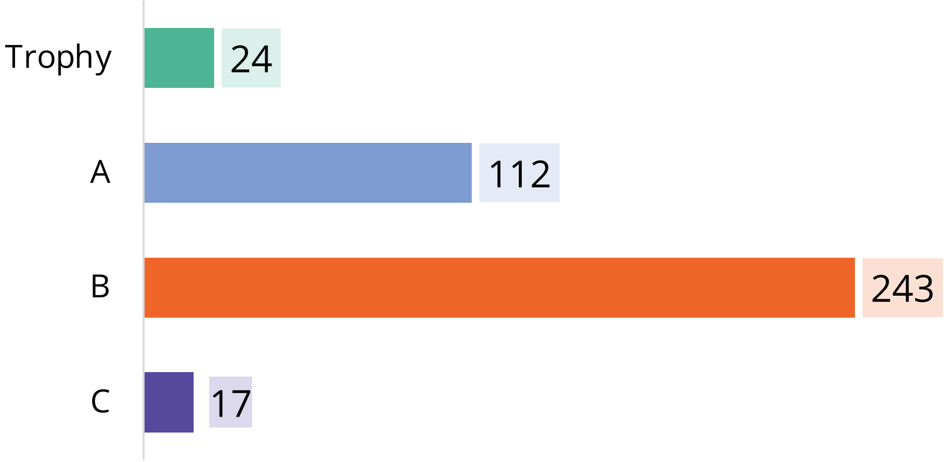
Office Large-Block Availabilities



Large-block space size ranges

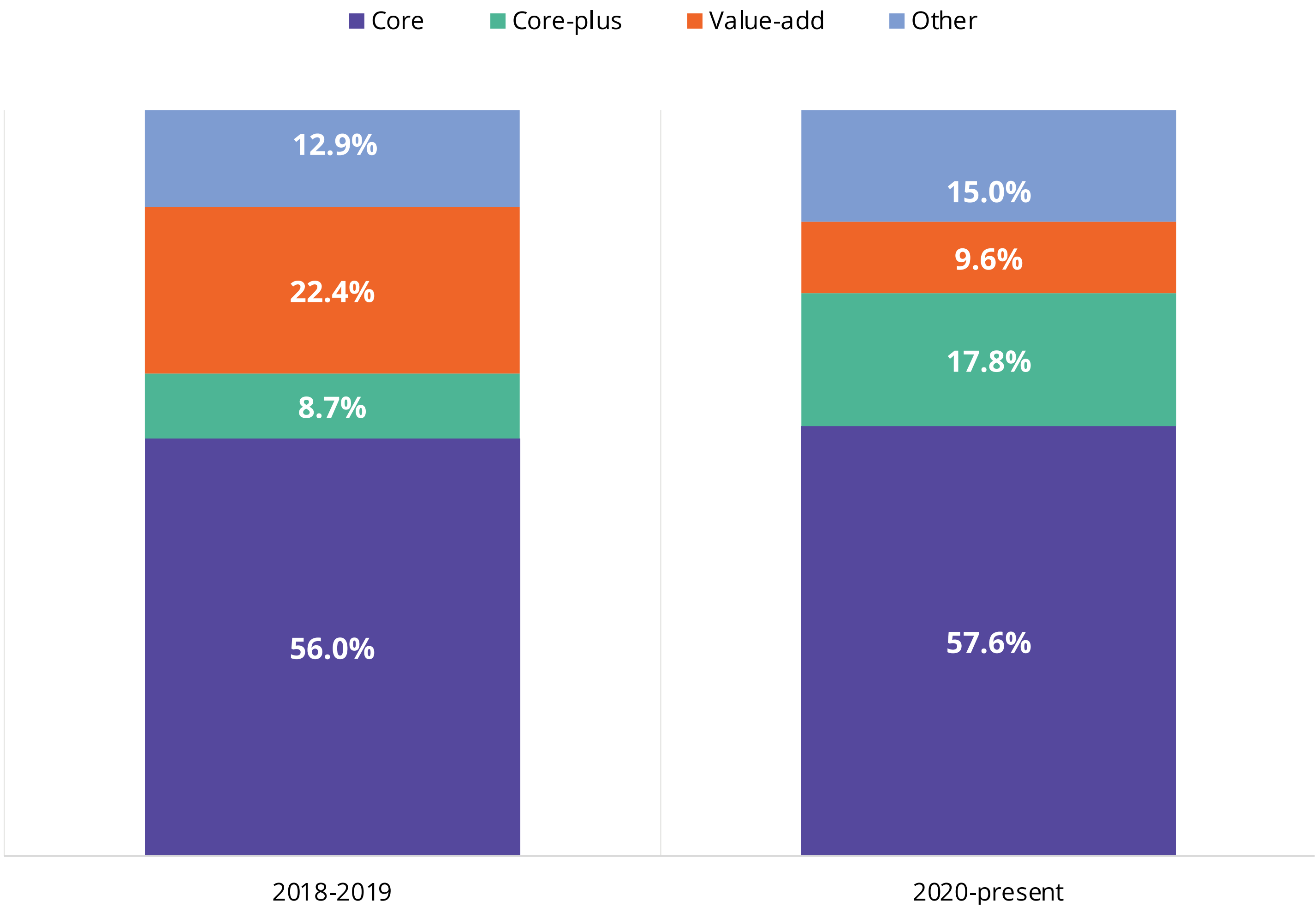


Large blocks available by Class



Source: AVANT by Avison Young

Investment Volume by Asset Profile



With structural shifts continuing to affect the office market, investors have gravitated away from value-add investments, in favor of more core opportunities. In addition, investors have explored residential conversion as a way to unlock value in obsolete office product.

 Source: AVANT by Avison Young, RCA

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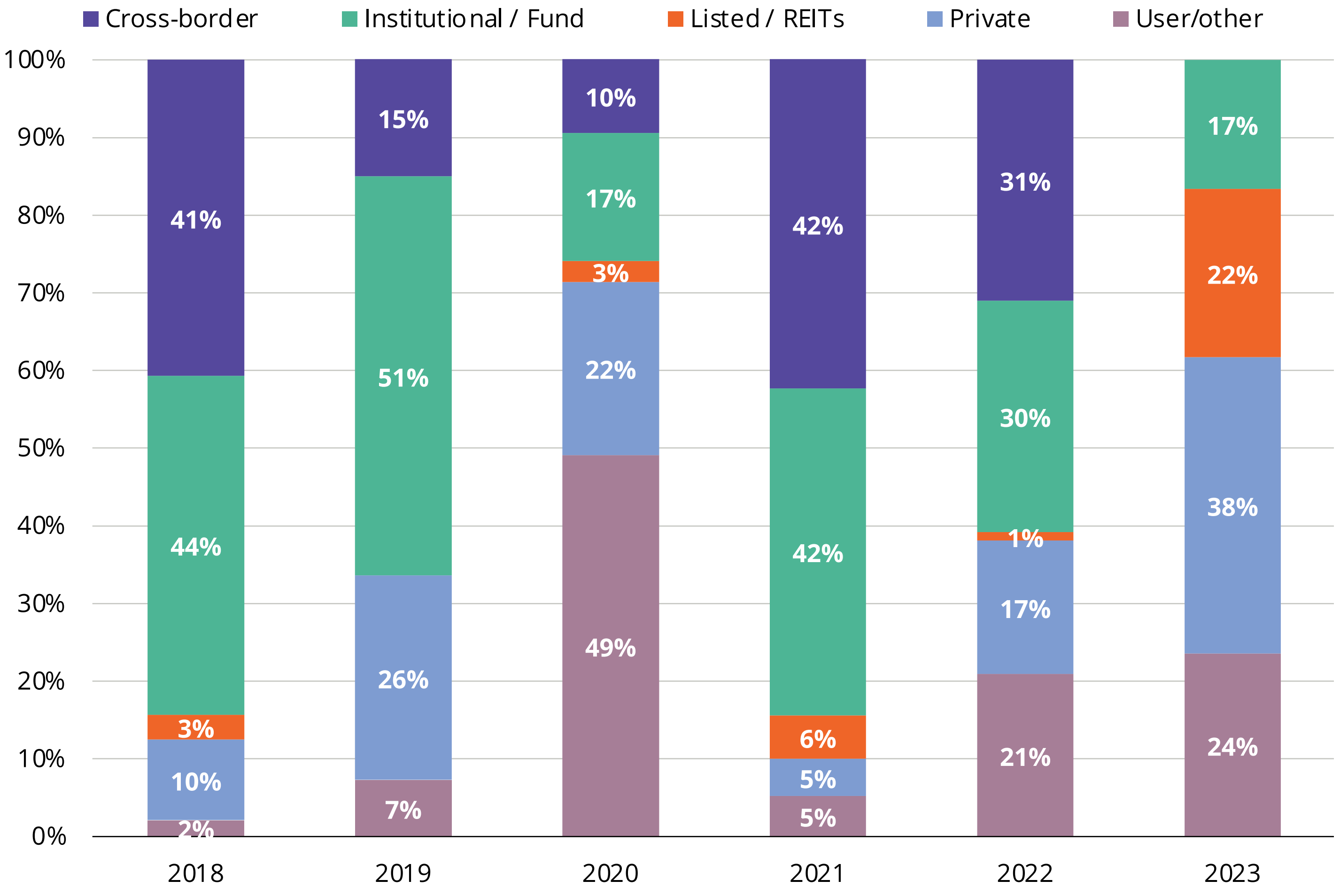
Buyer Profiles

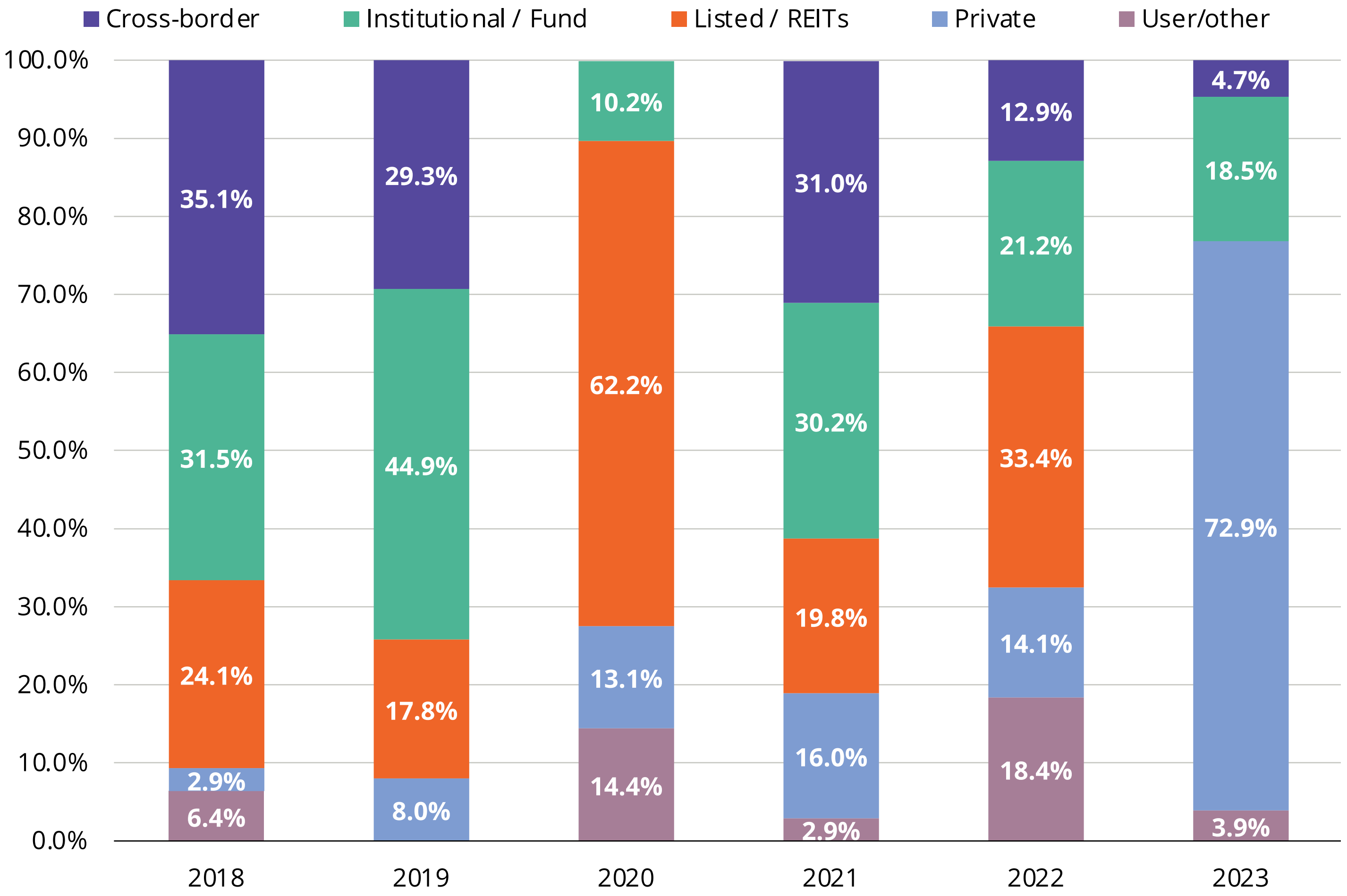


As pricing has softened and distressed assets are hitting the market, private buyers have entered the fold, while institutional capital has pulled back. Foreign buyers also tend to enter the mix in times of economic distress overseas.

Examples of this include Mori Trusts' acquisition of 601 Massachusetts Ave NW and Commerz Real's acquisition of 1900 N St NW in 2022.

 Source: AVANT by Avison Young, RCA

Seller Profiles



With turbulent debt markets making refinancing assets difficult, private investors have been forced to dispose of assets at a much higher rate than past years.

 Source: AVANT by Avison Young, RCA

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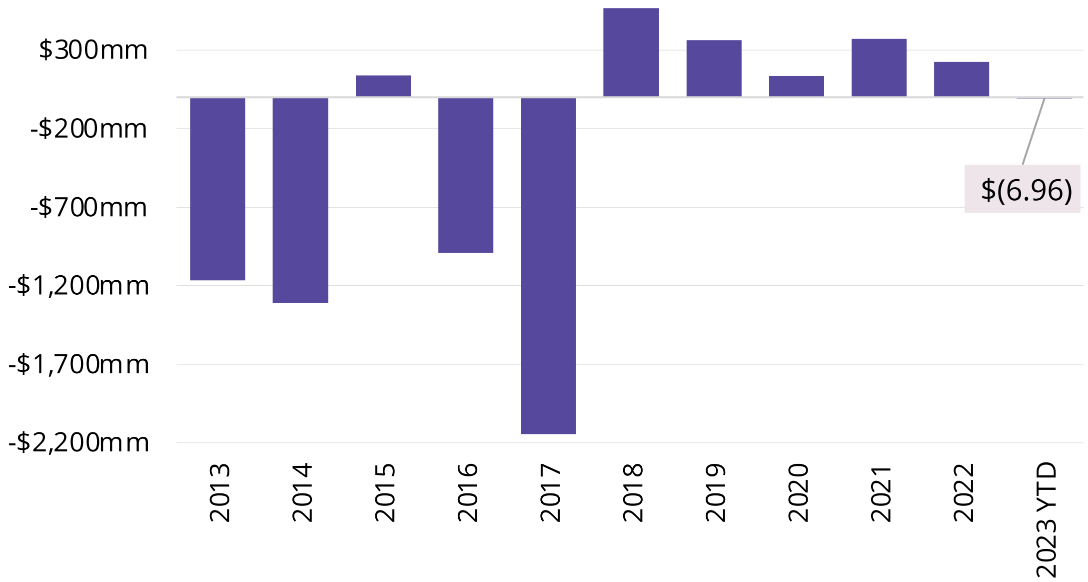
Capital Flows

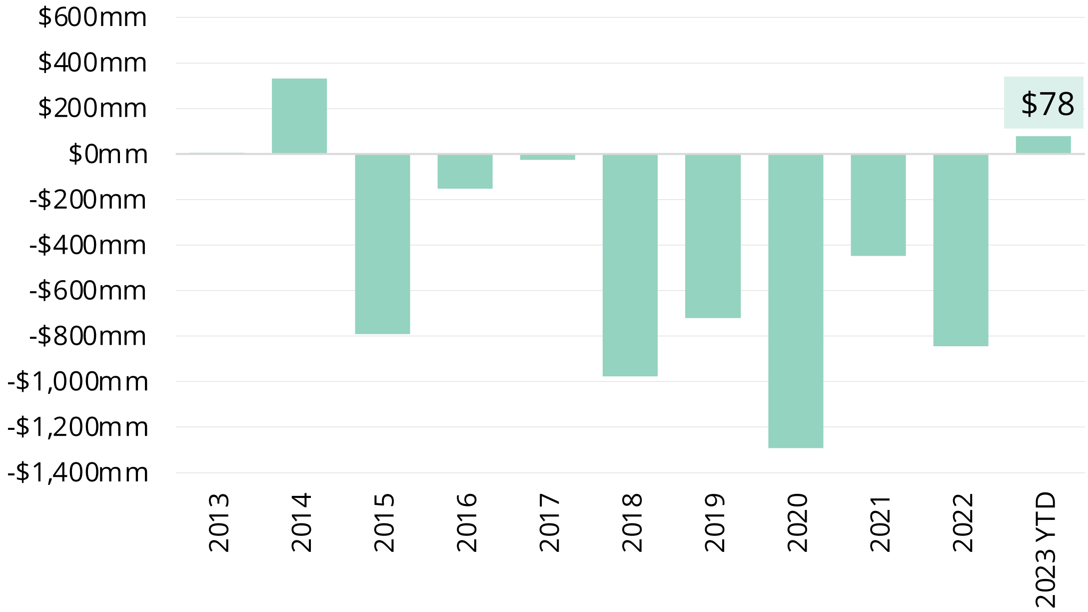
-$6.9mm

Institutional net acquisitions – First half of 2023



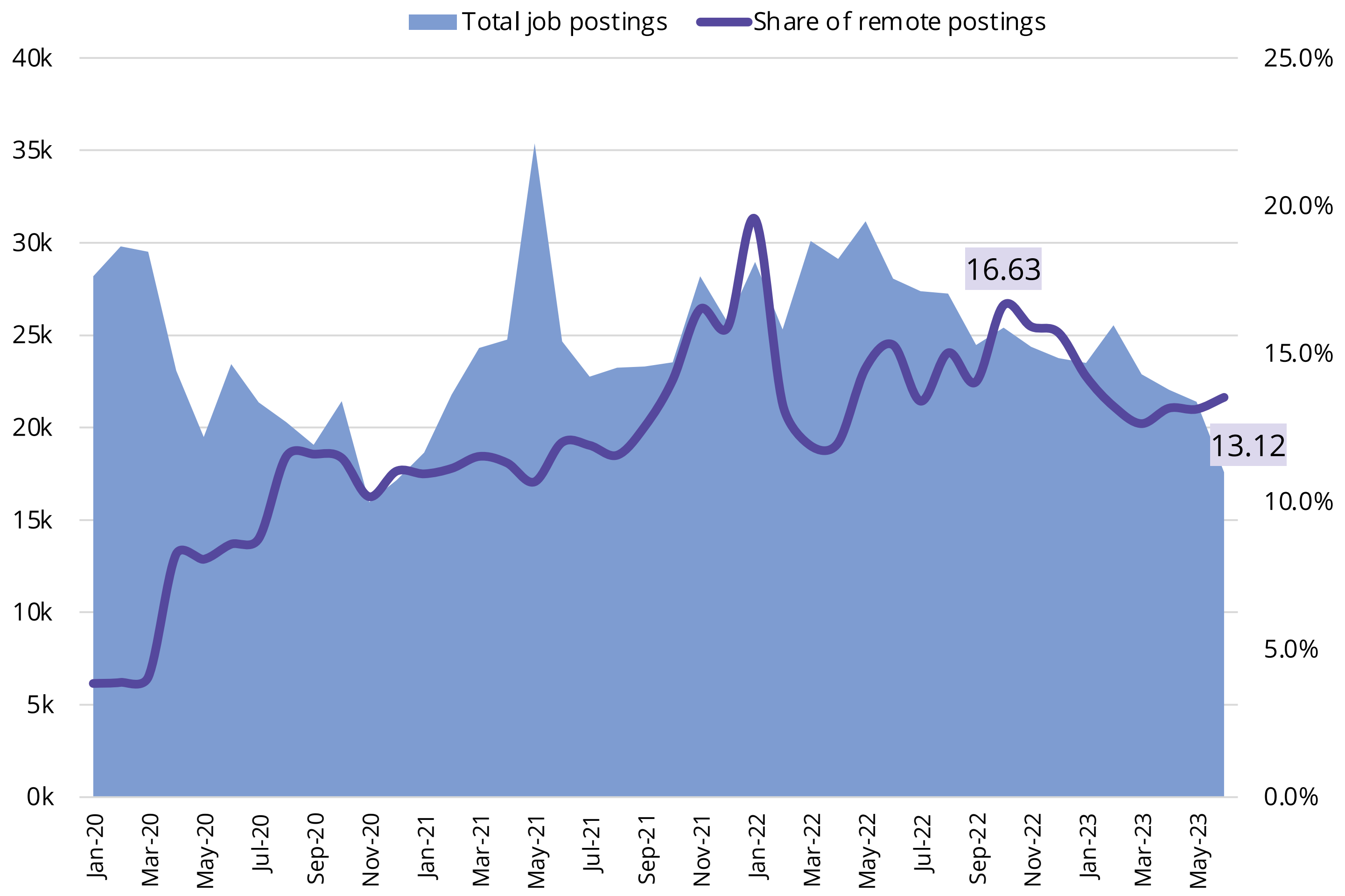
$78.25mm

REIT/Listed net acquisitions – First half of 2023



Source: AVANT by Avison Young, RCA

Office Job Postings



While DC has recovered most of the office using jobs it lost as a result of the pandemic, the share of remote postings continues to sit at double digits.

Note: Total job postings includes remote and non-remote jobs
Source: AVANT by Avison Young, Lightcast
Note: remote postings defined as fully remote

Office to Residential Conversions

35 properties

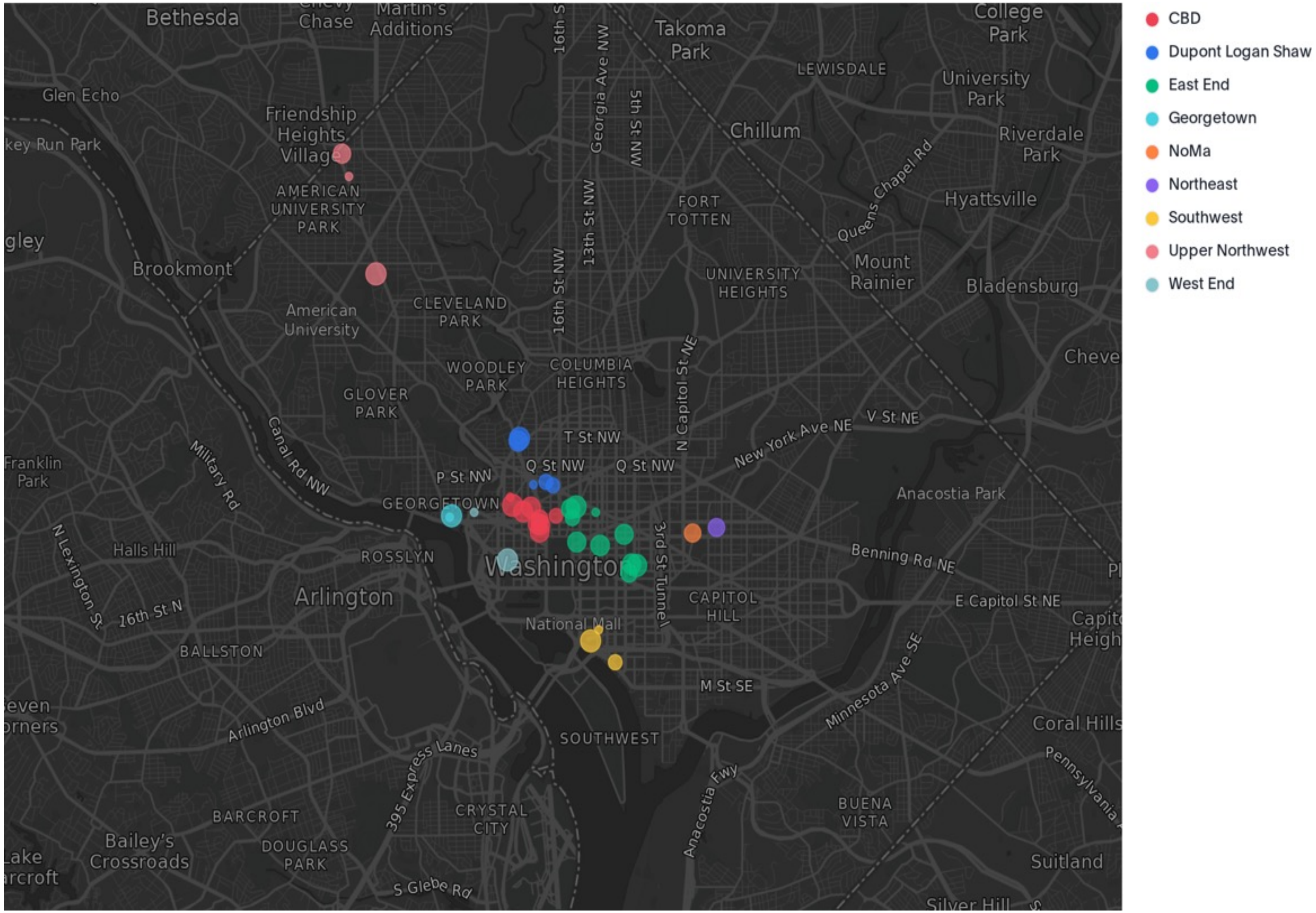
Proposed for conversion or in the process of being converted

6.66 msf

Proposed for conversion or in the process of being converted

4.4%

share of office inventory



Source: AVANT by Avison Young

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Office Development Pipeline

13 properties

Under construction or renovation

1.755 msf

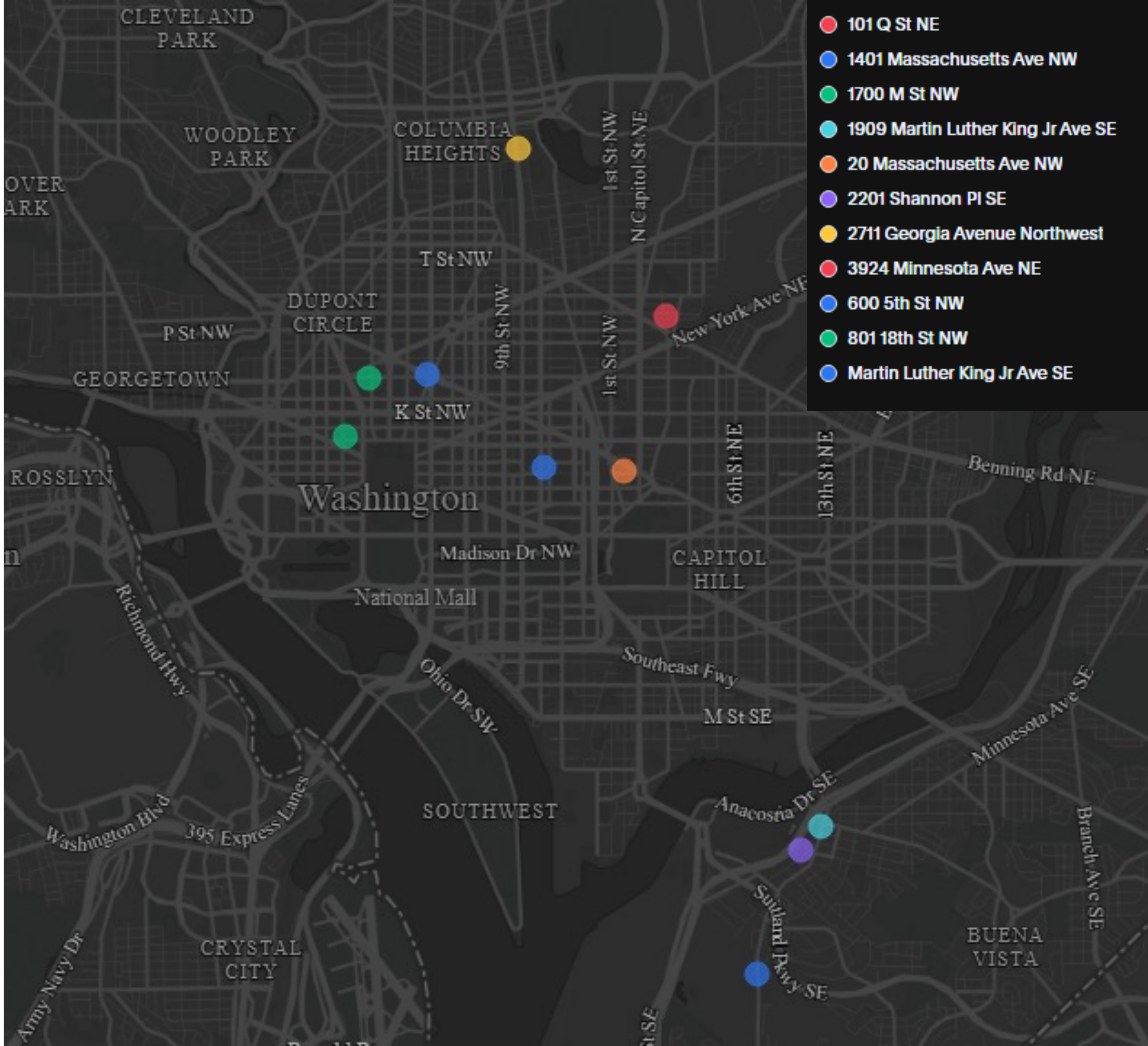
Under construction or renovation

1.1%

share of office inventory

1968

average delivery date of existing DC offices



Source: AVANT by Avison Young

Washington, DC Office Market Activity

Top Leases

Tenant	Address	Lease Type	Transaction Type	Lease Size	Sign Date	Commencement Date	Term (Mos)
Crowell & Moring	600 5th St NW	Direct	New	199,965	May 2023*	August 2026	180
US Court Services and Offender Supervision Agency	633 Indiana Ave NW	Direct	Renewal	151,000	May 2023	September 2020*	72
Fried Frank	801 17th St NW	Direct	Renewal	103,000	April 2023	April 2023	170

Top Sales

Address	Sale Date	Buyer	Price ($)	Price psf (S)	Occupancy	Seller
2100 M St NW	May 2023	Post Brothers	$66,765,868	$158	0%	Network, Meadow Partners
2121 Ward Ct NW	May 2023	Gerald Waldman Property Trust	$20,500,000	$342	65%	Ronald Paul
600 5th St NW	June 2023	Stonebridge, Rockefeller	$125,553,950	$296	Ground Lease	WMATA

Development

Address	Owner	Building size	Delivery Date
20 Massachusetts Ave NW	OPI, RMR	183,515 sf	2023
1700 M St NW	Skanska	334,000	2024
600 5th St NW (Redevelopment)	Stonebridge, Rockefeller	399,617	2026

Source: AVANT by Avison Young

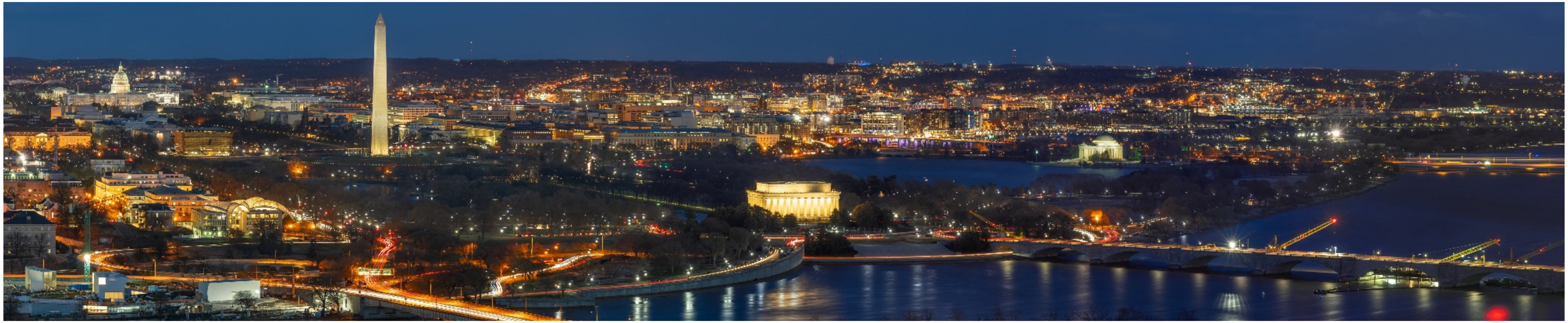
Washington, DC Office Submarket Stats

Submarket	Existing inventory sf	Deliveries sf (YTD)	Under development sf	Direct vacancy	Sublet vacancy	Total vacancy	Net absorption sf (Q2 2023)	Net absorption sf (YTD)	Direct asking rent FS
East End	52,152,106	-	399,617	16.7%	1.1%	17.7%	-307,803	-365,249	$ 60.13
CBD	38,940,739	-	334,000	18.3%	1.8%	20.1%	-359,660	-704,317	$ 57.67
Southwest	13,350,606	-		13.2%	.1%	13.3%	8,119	-83,187	$ 54.90
Capitol Hill	8,821,557	-	183,515	13.1%	1.1%	14.1%	4,753	-4,160	$ 68.74
NoMa	7,998,680	-		11.9%		11.9%	-70,485	-117,450	$ 51
Dupont Logan Shaw	6,308,141	-		15.3%		15.3%	73,843	39,012	$ 54.63
Upper Northwest	5,746,569	-	41,000	14.1%	1.3%	15.4%	8,228	-12,643	$ 46.56
Navy Yard	4,782,590	-		15.3%	2.7%	18.%	-3,746	-80,207	$ 59.40
West End	4,670,298	-		12.8%	4.9%	17.6%	-326	-18,951	$ 52.71
Georgetown	2,971,316	-		18.6%	1.3%	19.9%	-78,666	-197,845	$ 49.39
Northeast	2,165,360	-	32,251	12.1%		12.1%	118,078	140,710	$ 50.74
Southeast - East of the River	684,166	-	765,200	.7%		.7%	-4,556	-4,556	$40.89
Market total	**148,592,128**	**-**	**1,755,583**	**15.9%**	**1.2%**	**17.1%**	**-612,221**	**-1,408,843**	**$58.14**

Source: AVANT by Avison Young, CoStar

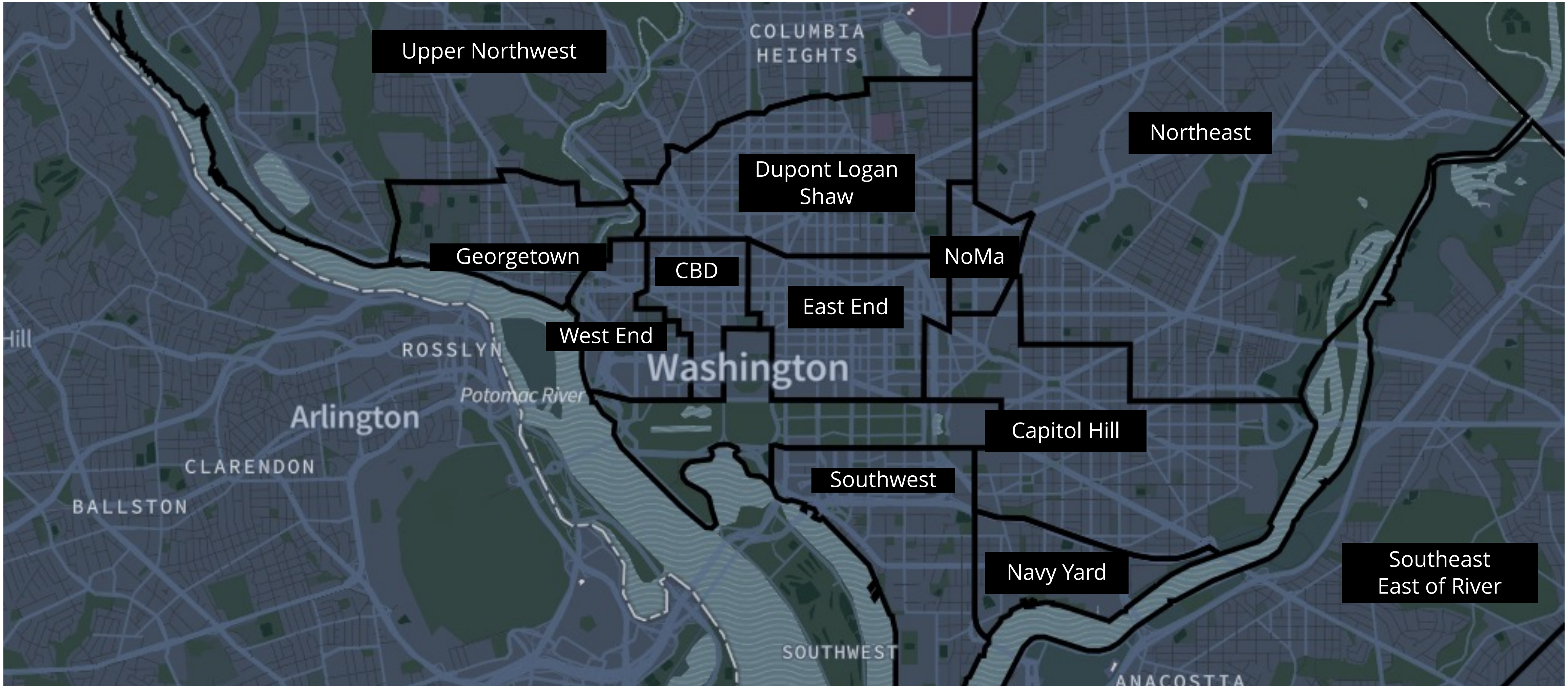
Washington, DC Office Market Stats by Class

	Existing inventory sf	Deliveries sf (YTD)	Under development sf	Direct vacancy	Sublet vacancy	Total vacancy	Net absorption sf (Q2 2023)	Net absorption sf (YTD)	Direct asking rent FS
Trophy	9,451,731	-	733,617	11.6%	1%	12.6%	-89,192	-11,932	$94.52
Class A	36,134,043	-	850,515	14.9%	1.4%	16.3%	26,915	-261,921	$70.32
Class B	92,106,845	-	171,451	16.9%	1.3%	18.1%	-503,298	-1,023,091	$53.65
Class C	11,413,778	-	-	14.5%	.4%	14.9%	-46,646	-111,899	$41.84
Market total	**148,592,128**	**-**	**1,755,583**	**15.9%**	**1.2%**	**17.1%**	**-612,221**	**-1,408,843**	**$58.14**



Source: AVANT by Avison Young, CoStar

Washington, DC Submarket Map



Source: AVANT by Avison Young

Office Insights Glossary of Terms

Demand

- **Leasing activity:** total square footage of relocations, renewals, expansions and subleases expressed when the leases are signed, not when tenants take physical occupancy of the space
- **Absorption:** period-over-period change in occupied square footage

Supply

- **Direct vacancy rate:** space operated by landlords that is ready for immediate occupancy
- **Sublease vacancy rate:** space operated by sublandlords that is ready for immediate occupancy
- **Total vacancy rate:** sum of direct vacancy rate and sublease vacancy rate
- **Availability rate:** space that is vacant plus space that will become vacant over an indefinite time horizon, including spaces that are occupied by vacating tenants and under-construction properties

Office rents and concessions

- **Asking rents:** pricing guidance provided by landlords to tenants for available space expressed as full service (FS)
- **Base rents:** fair market value of market-level lease pricing based on representative executed leases, expressed as full service (FS)
- **Free rent period:** months of free rent that are typically provided upfront by landlords to tenants as a concession to offset the total cost of a lease and/or the construction timeline of an office suite
- **Tenant improvement allowance:** an allowance expressed in dollars per square foot provided from landlords to tenants to offset build-out, engineering, space planning and related permit costs
- **Net effective rent:** base rents discounted by the dollar values of tenant improvement allowance and free rent concessions expressed as full service (FS)

Capital markets

- **Investment volume:** office sales dollars expressed when the transactions close and based on inventory thresholds; partial-interest sale dollar amounts are not grossed-up to reflect the 100% value of the sale
- **Asset pricing:** unweighted average per-square-foot asset pricing of market-level closed sales
- **Cap rate:** net operating income divided by sale price; this measurement of market-level investment returns is calculated as an unweighted average based on closed investment sales

For more market insights and information visit **avisonyoung.com**

Alex Ern

Mid-Atlantic Lead
Market Intelligence
Alex.ern@avisonyoung.com

Jessica Mistrik

Senior Analyst
Market Intelligence
Jessica.mistrik@avisonyoung.com

Will Dunkel

Data Analyst
Market Intelligence
Will.dunkel@avisonyoung.com