Washington, DC office market report

Q2 2023
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.

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.

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.
The culmination of macroeconomic headwinds, and office demand fundamentals shifting, has resulted in not only suppressed investment volume, but softened pricing as well.
In a post-pandemic world, the trend of flight to quality is even more prevalent and will continue for the foreseeable future.
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.
Main Indicators

Let’s examine more leasing & capital markets trends.
Washington, DC Office Market Indicators

### Development (msf)
- **Deliveries**
- **Under development**

### Net absorption as a % of inventory
- 1Q16: 0.3%
- 3Q16: -0.6%
- 1Q17: -0.4%

### Direct asking rents (psf/FS)
- 1Q16: $58.27
- 3Q16: $58.22
- 1Q17: $58.14

### Availability (msf)
- **Direct**
- **Sublet**

### Availability
- Direct: 19.9%
- Sublet: 2.4%

### Investment sales
- Sale volume (millions)
- Sale price psf
- YTD 2023: $7,000M
- 2Q23: $314
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.

Source: AVANT by Avison Young
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.
Annual Net Absorption – Share of Inventory

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

### 2018 - 2020
- **Expansions**: 6.2%
- **Direct renewals**: 44.9%
- **New leases, direct relocations**: 48.8%

### 2020 - Present
- **Expansions**: 4.2%
- **Direct renewals**: 42.9%
- **New leases, direct relocations**: 52.9%

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

- 100k-200k: 5% (20 blocks)
- 200+: 6% (25 blocks)
- 50k-100k: 24% (96 blocks)
- 20k-50k: 65% (255 blocks)

Large blocks available by Class

<table>
<thead>
<tr>
<th>Class</th>
<th>Available</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>112</td>
</tr>
<tr>
<td>B</td>
<td>243</td>
</tr>
<tr>
<td>C</td>
<td>17</td>
</tr>
</tbody>
</table>

Source: AVANT by Avison Young
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.
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.
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.
Capital Flows

Institutional net acquisitions – First half of 2023

- $6.9mm

REIT/Listed net acquisitions – First half of 2023

$78.25mm

Source: AVANT by Avison Young, RCA
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.
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
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
## Washington, DC Office Market Activity

### Top Leases

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

### Top Sales

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

### Development

<table>
<thead>
<tr>
<th>Address</th>
<th>Owner</th>
<th>Building size</th>
<th>Delivery Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 Massachusetts Ave NW</td>
<td>OPI, RMR</td>
<td>183,515 sf</td>
<td>2023</td>
</tr>
<tr>
<td>1700 M St NW</td>
<td>Skanska</td>
<td>334,000</td>
<td>2024</td>
</tr>
<tr>
<td>600 5th St NW (Redevelopment)</td>
<td>Stonebridge, Rockefeller</td>
<td>399,617</td>
<td>2026</td>
</tr>
</tbody>
</table>
## Washington, DC Office Submarket Stats

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

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<tr>
<th>Class</th>
<th>Existing inventory sf</th>
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</thead>
<tbody>
<tr>
<td>Trophy</td>
<td>9,451,731</td>
<td>-</td>
<td>733,617</td>
<td>11.6%</td>
<td>1%</td>
<td>12.6%</td>
<td>-89,192</td>
<td>-11,932</td>
<td>$94.52</td>
</tr>
<tr>
<td>Class A</td>
<td>36,134,043</td>
<td>-</td>
<td>850,515</td>
<td>14.9%</td>
<td>1.4%</td>
<td>16.3%</td>
<td>26,915</td>
<td>-261,921</td>
<td>$70.32</td>
</tr>
<tr>
<td>Class B</td>
<td>92,106,845</td>
<td>-</td>
<td>171,451</td>
<td>16.9%</td>
<td>1.3%</td>
<td>18.1%</td>
<td>-503,298</td>
<td>-1,023,091</td>
<td>$53.65</td>
</tr>
<tr>
<td>Class C</td>
<td>11,413,778</td>
<td>-</td>
<td>-</td>
<td>14.5%</td>
<td>.4%</td>
<td>14.9%</td>
<td>-46,646</td>
<td>-111,899</td>
<td>$41.84</td>
</tr>
<tr>
<td>Market total</td>
<td>148,592,128</td>
<td>-</td>
<td>1,755,583</td>
<td>15.9%</td>
<td>1.2%</td>
<td>17.1%</td>
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<td>-1,408,843</td>
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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

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