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District of Columbia Office Insight Report

Q2 2021

AVANT

by AVISON YOUNG

AVISON YOUNG

Key takeaways

Economic conditions

- Reopening efforts and higher vaccination rates have allowed the DC unemployment rate to rebound from a high of 10.6 percent to **6.6 percent**.
- Office-using jobs have declined by **1.7 percent** since February 2020, a relatively small loss thanks to the large presence of the federal government, which actually gained jobs to the tune of 1.9%.

Recovery rate

- Activity across the region at workplaces, shopping centers, universities, and other areas of interest is **48.7 percent** of pre-COVID levels, as measured by extrapolated cell phone location data.
- Looking at office locations specifically, visitor traffic is only **33.3 percent** of pre-COVID levels, suggesting that some office employees are opting to work remotely even as they return to normalcy in other aspects of life.

Office demand

- Leasing activity has paused, decreasing by **52.9 percent** in the first half of 2021 compared to the first half of 2020.
- While many of the city's cost-conscious occupiers, such as nonprofits, were sidelined during the pandemic, the federal government continued to transact and accounted for **48.0 percent** of Class B and C office leasing post-COVID.

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Key takeaways

Office supply

- Direct and sublease vacancy have achieved all-time highs, totaling **14.2 percent**.
- Sublease vacant space has reached **1.9 million sf**, eclipsing the peaks seen in either of the past two recessions.
- 18 projects totaling **2.8 million sf** are under construction, largely located in non-core submarkets.

Pricing trends

- Net effective rents decreased by **9.8 percent** from peak-to-trough as landlords competed for a dwindling pool of tenants via high concessions rather than reduced base rents.
- Concessions, already soaring before the pandemic, have spiked dramatically, with average TI allowance rising **11.4 percent** and the average free rent period rising by a whopping **58.1 percent** during the pandemic.

Capital markets

- After falling **37.6 percent** between 2019 and 2020, DC office investment volume is on pace to have a fairly typical year in 2021.
- While value-add purchases had been on the rise for years prior to 2020, pandemic-driven uncertainty has pushed investors back toward safer, long-term-stabilized core investments, which accounted for **80.2 percent** of sale volume in 2020-2021.

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01.

Economic and demographic trends

Typically resilient in recessions, the Washington, DC economy experienced an unusually severe shock when faced with pandemic-driven restrictions.

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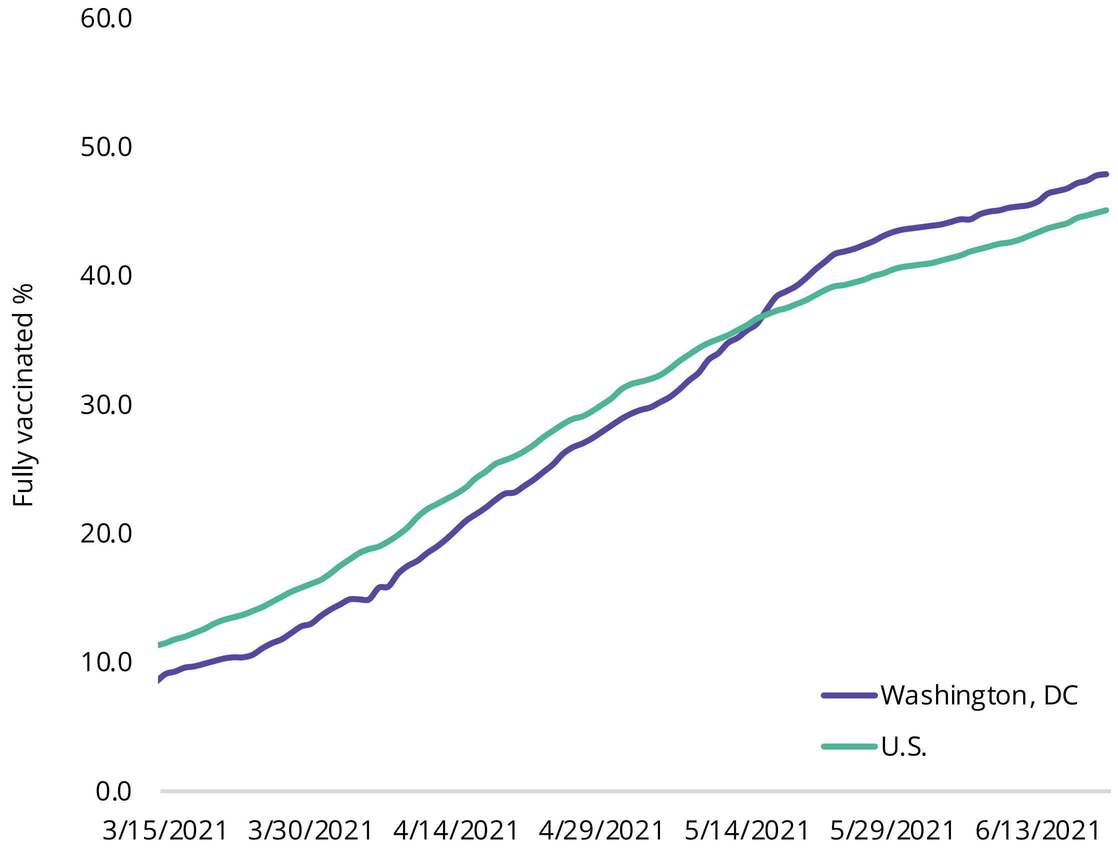
Vaccination rates

47.9%

Share of total District of Columbia population that is fully vaccinated

DC proportionate vaccination rates have surpassed U.S. averages, an important metric that will allow the city to loosen restrictions and resume normal economic activity.



Source: CDC

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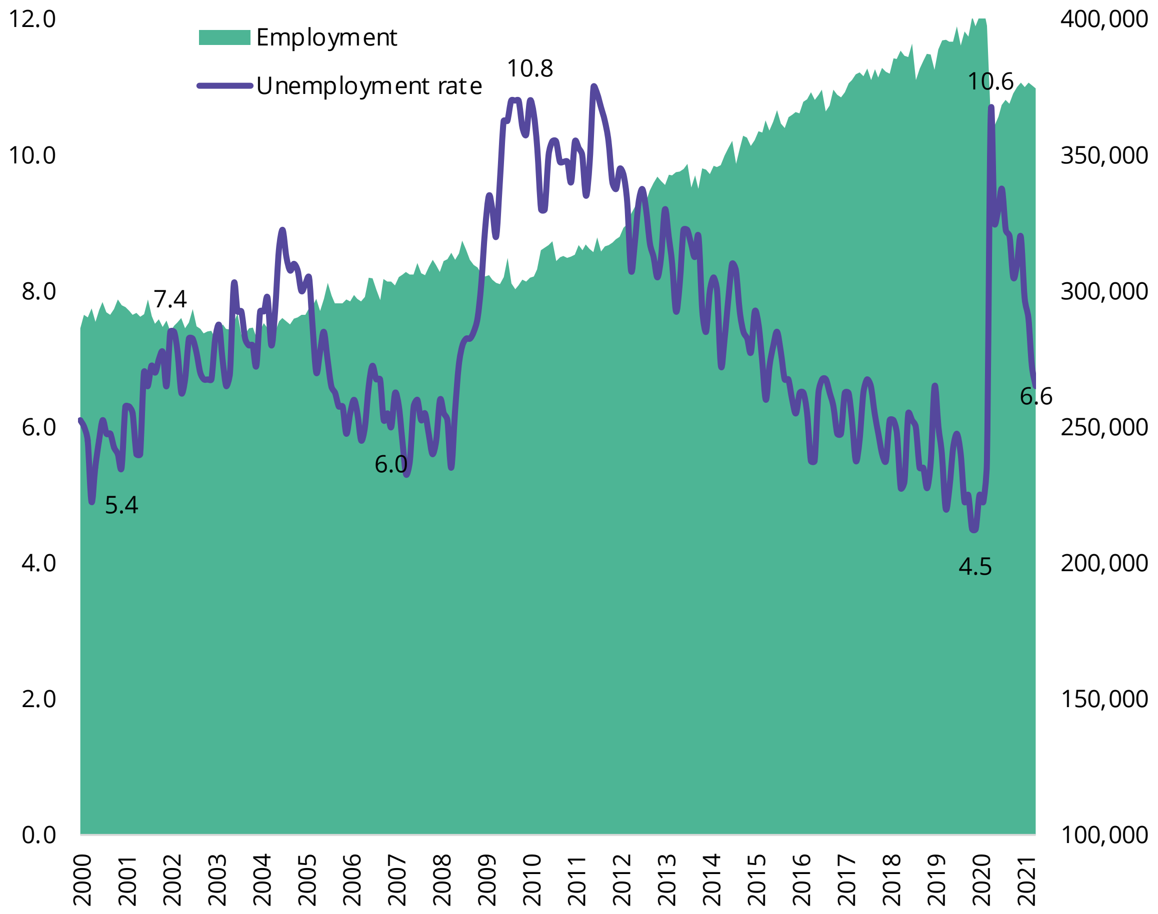
Employment and unemployment rate

6.6%

DC unemployment rate as of April 2021 after recovering from a lockdown-induced spike.

Consistently tightening labor market conditions were halted by the pandemic, with nearly 43,000 job losses between February and May 2020. However, reopening efforts enabled employment to recover by 3.8% since May 2020, though it remains 22,949 jobs behind pre-pandemic levels



Note: Not seasonally adjusted data.
Source: Bureau of Labor Statistics

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Office-using job gains and losses

-1.7%

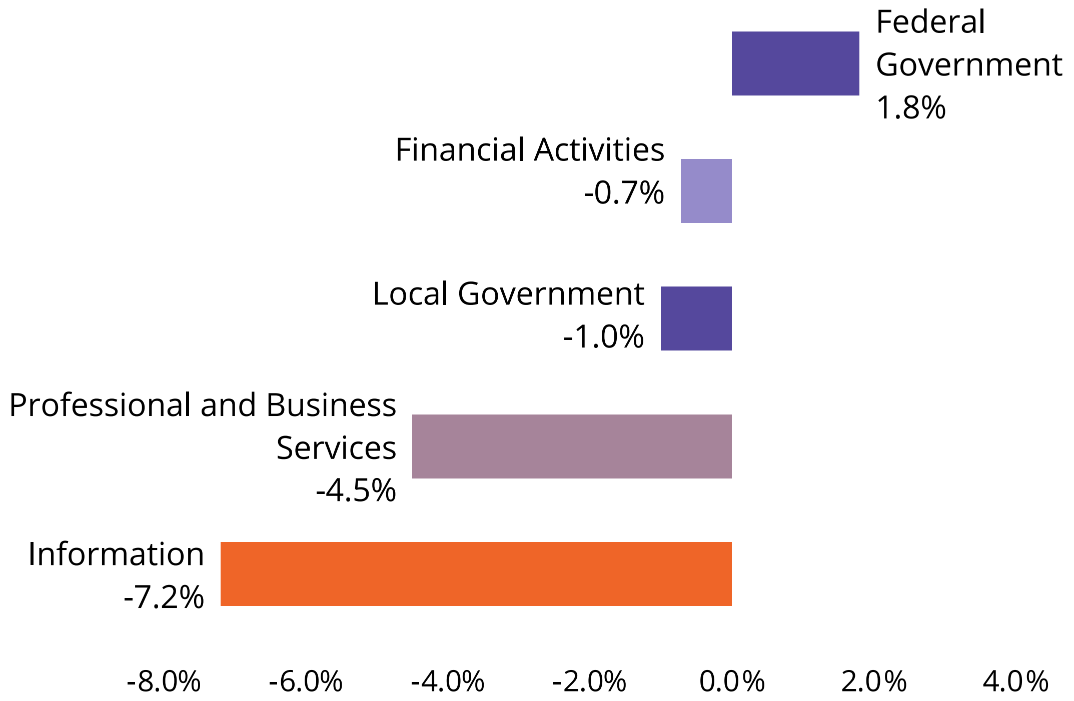
Change in office-using employment during the pandemic

Most office-using sectors of the DC economy suffered greatly, with employment still down as much as 7.2% (Information). However, the large presence of the federal government, which gained jobs in the pandemic, counteracted much of these losses in the aggregate.

VIEW DASHBOARD

Total change in DC MSA* job gains/(losses)

February 2020 to April 2021



Note: Not seasonally adjusted data for Washington, DC.
Source: Bureau of Labor Statistics

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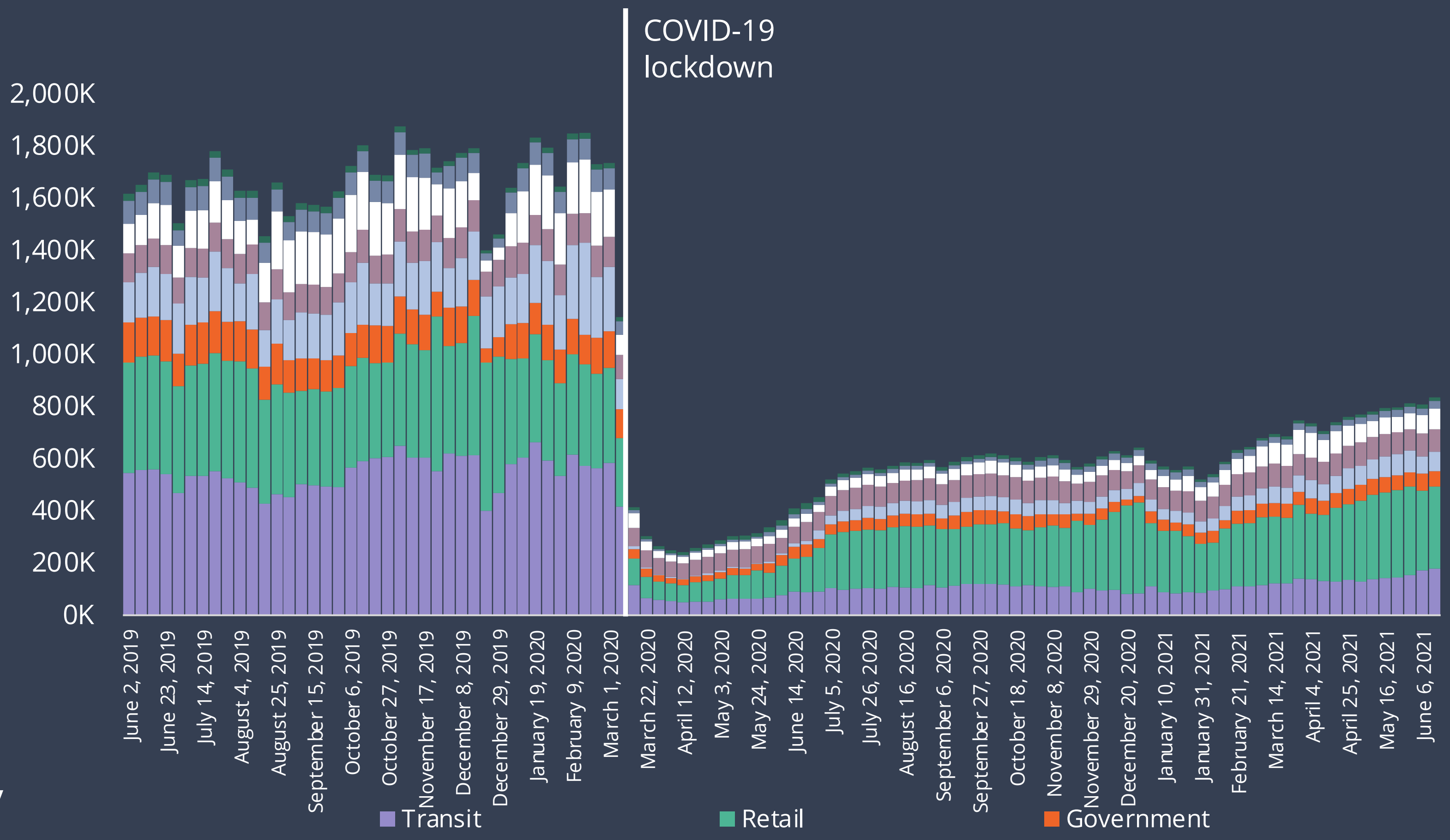
Recovery index

48.7%

Regional activity in past 6 weeks compared to the 6 weeks before lockdown

After remaining stagnant for all of 2020, visitor traffic to regional areas of interest has begun to increase slowly in 2021. Across all sectors, these locations have averaged nearly half of pre-COVID activity over the past 6 weeks.



Note: Representative areas of interest. Weekdays only.
Source: Orbital Insights, AVANT by Avison Young

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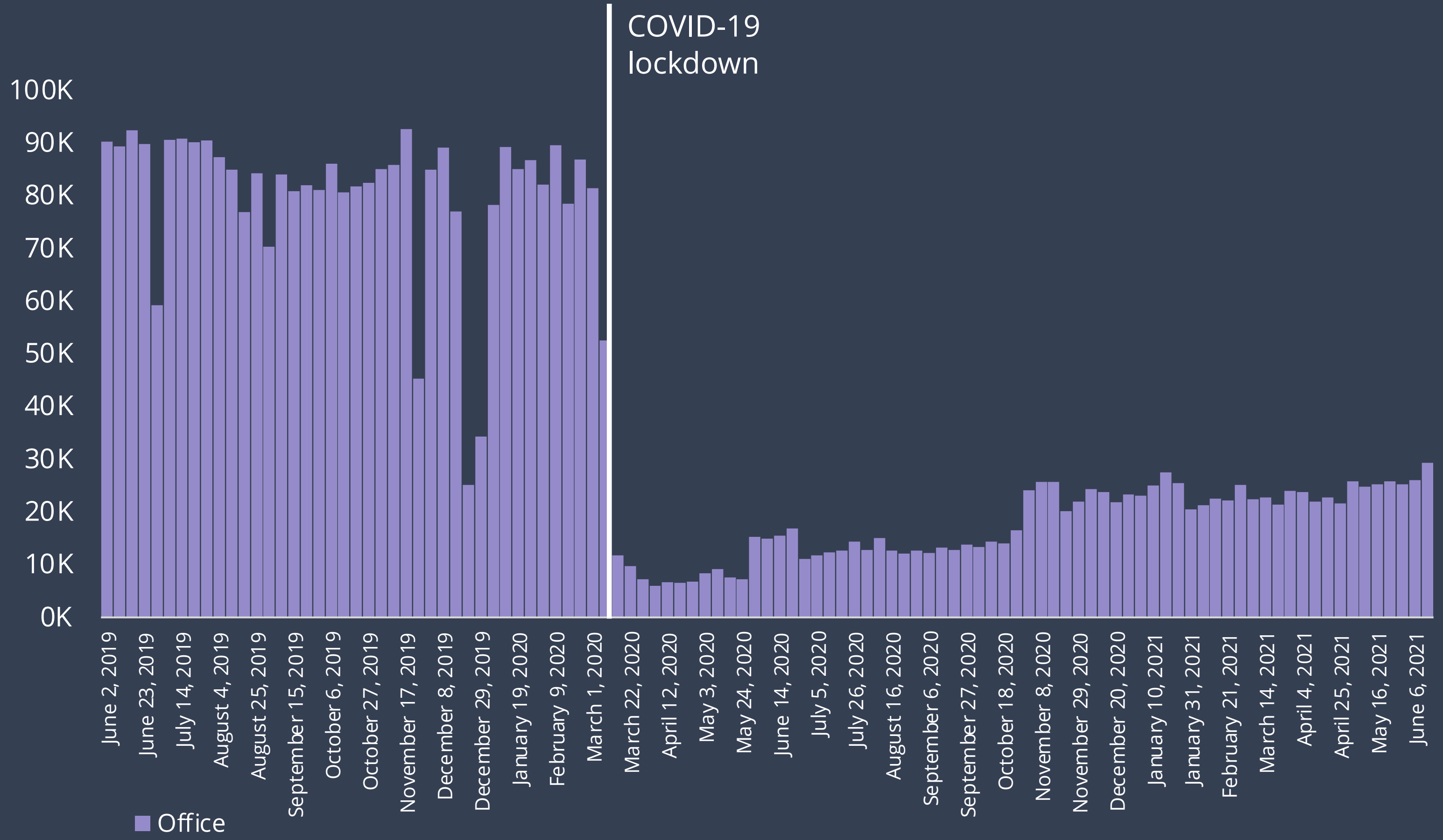
Recovery index

33.3%

Regional office activity in past 6 weeks compared to the 6 weeks before lockdown

Office buildings haven't seen quite the resurgence in activity that the region overall has experienced, with just one third of pre-COVID weekly traffic returning.



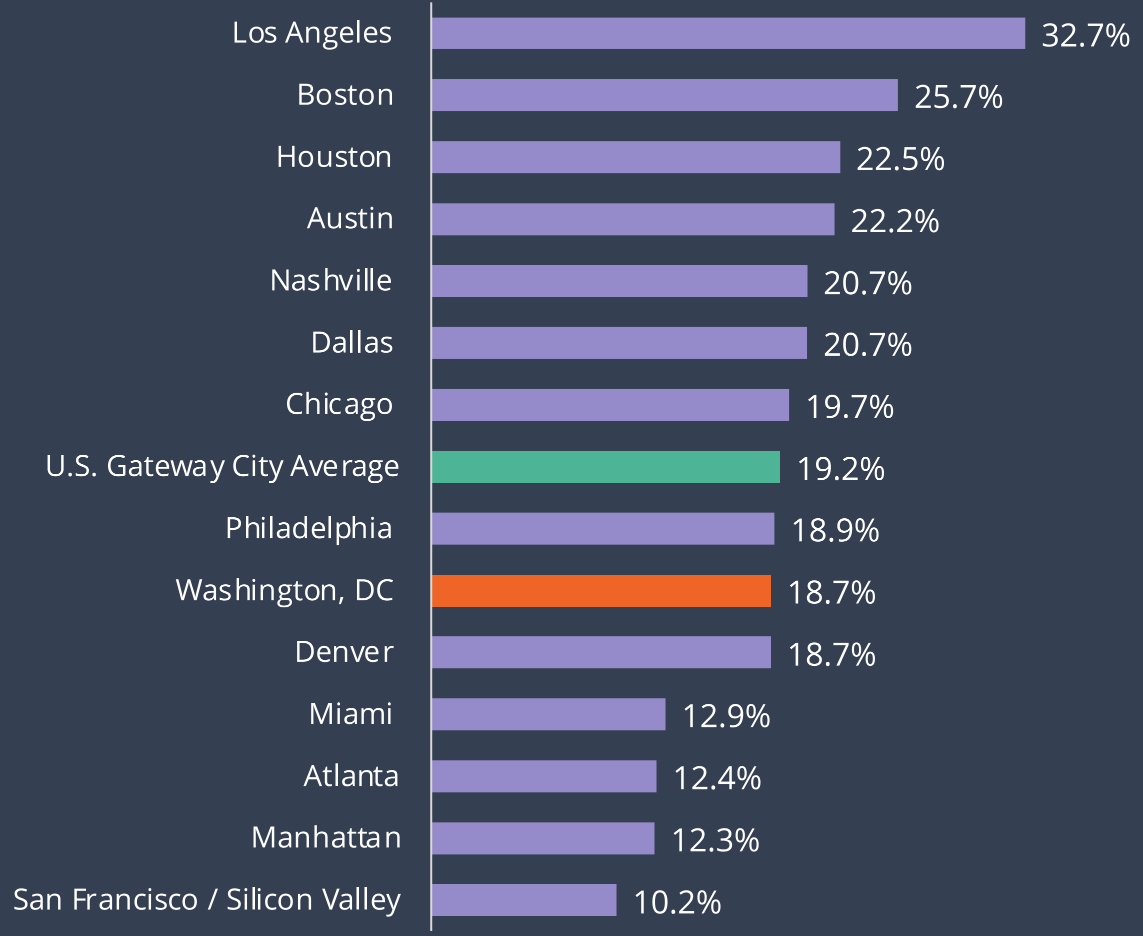
Note: Representative areas of interest. Weekdays only.
Source: Orbital Insights, AVANT by Avison Young

Office recoveries across U.S. gateway cities

18.7%

Average weekly activity since March 2020 in comparison to pre-pandemic levels

Looking over the course of the entire pandemic (including the immediate lock-down phase at the outset), Washington, DC has averaged less than one fifth of its normal activity, creating a tremendous drag on the local economy.



Note: Select, representative occupiers only. Weekdays only.
Pre-COVID period measured as 6/1/2019 to 3/14/2020.
Post-COVID period measured as 3/15/2020 to 6/20/2021.
Source: Orbital Insights, AVANT by Avison Young

02.

Office occupier conditions

Barring a strong second-half resurgence, tenant activity in 2021 is shaping up to finish even lower than in 2020 despite a recovering economy and loosened pandemic restrictions.

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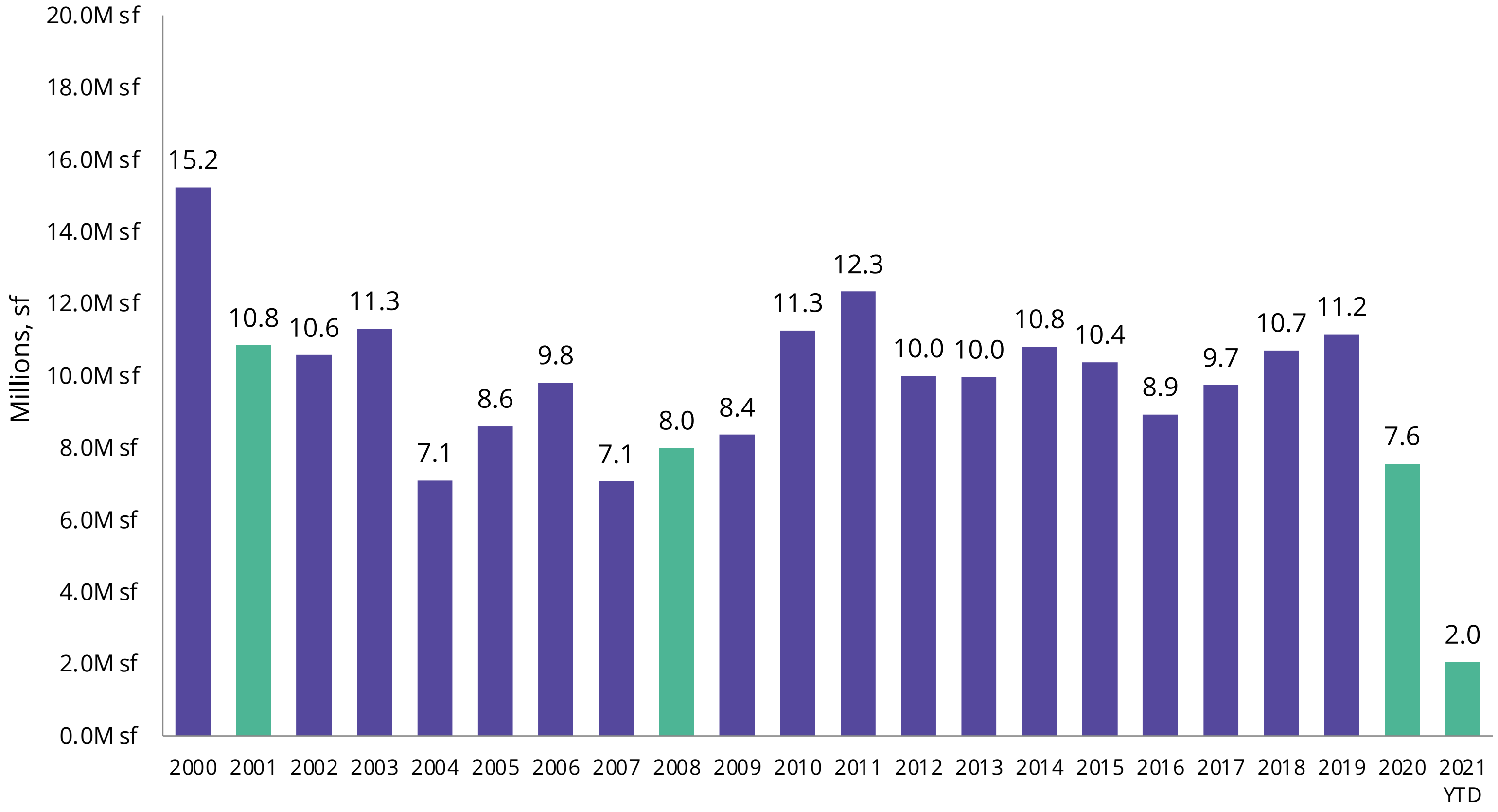
Office leasing activity

-52.9%

First half 2021 leasing activity vs. first half 2020 leasing activity

Unlike past recessions, in which DC's office market was relatively unimpacted or even positively impacted, pandemic-related fears and restrictions have dramatically suppressed office leasing activity.



Source: AVANT by Avison Young

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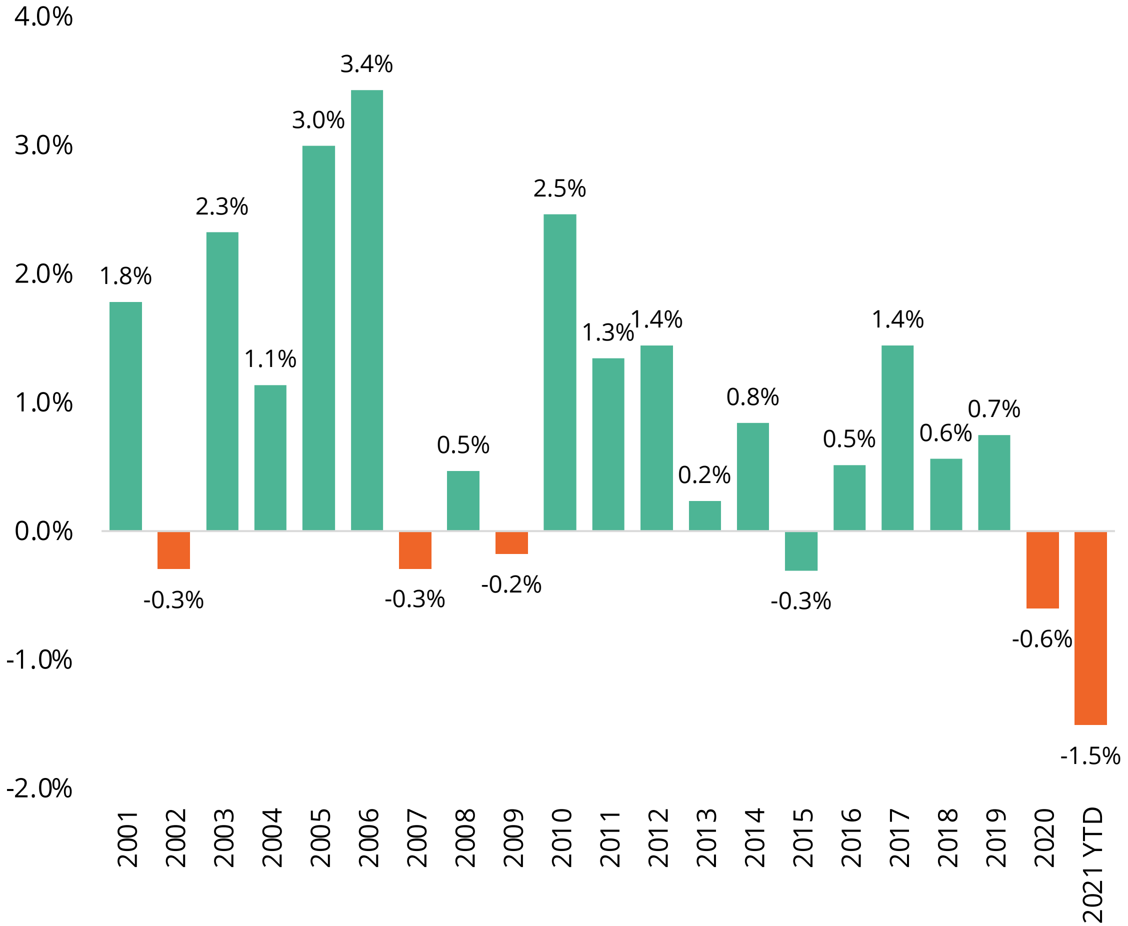
Absorption

-2.1%

Net absorption as a percentage of inventory, 2020 through Q2 2021

Negative absorption from 2020 to 2Q21 has totaled 3.2 million sf, or -2.1% of the existing office inventory. This constitutes far more harm than was caused in the past two recessions, as tenants were prevented from going to the office regardless of their companies' financial health.



Source: AVANT by Avison Young

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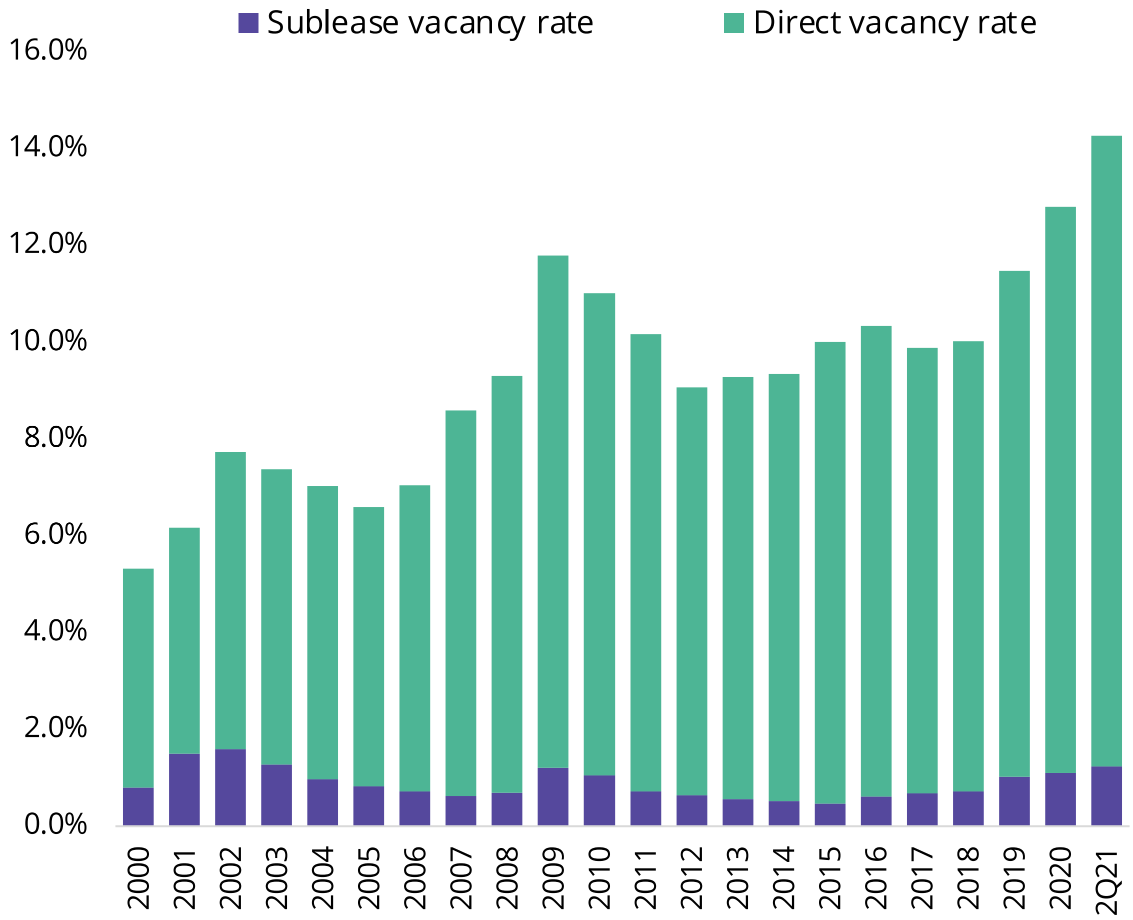
Vacancy rate

14.2%

Record high DC vacancy as of Q2 2021

The Q2 2021 total vacancy rate has reached a record high, though sublease vacancy in particular is only slightly higher than in the past two downturns.



Source: AVANT by Avison Young

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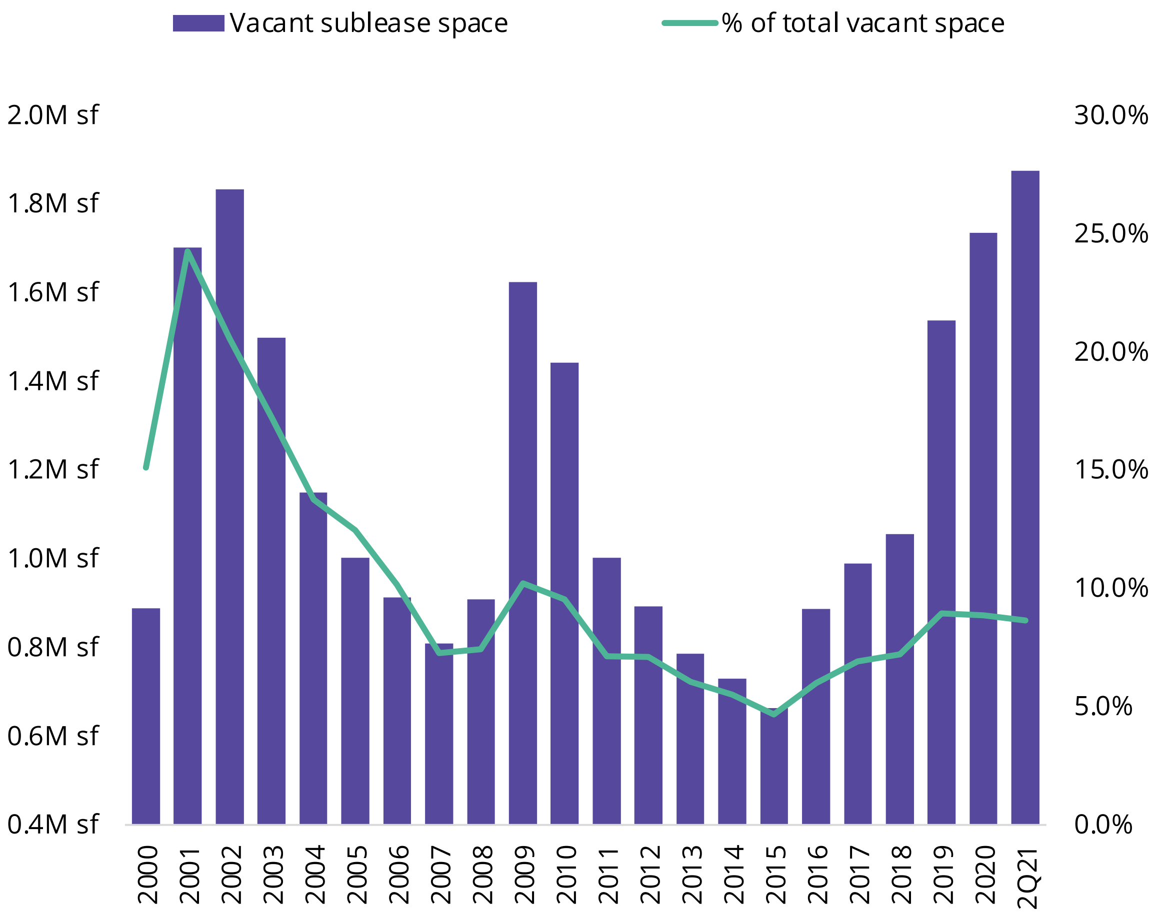
Vacant sublease space

1.9 msf

Record level of sublease vacant space

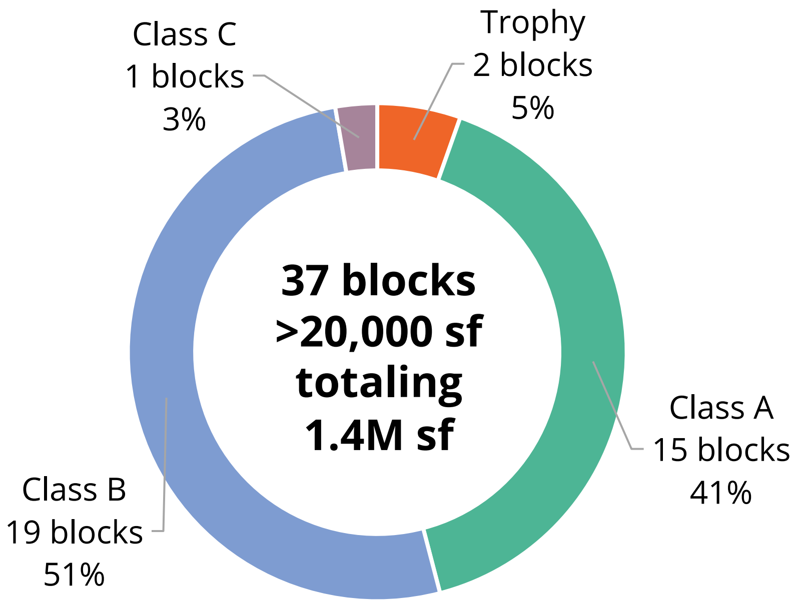
Vacant sublease space has reached 1.9 million sf (1.2% or inventory), slightly surpassing the levels seen in either of the past two economic downturns.



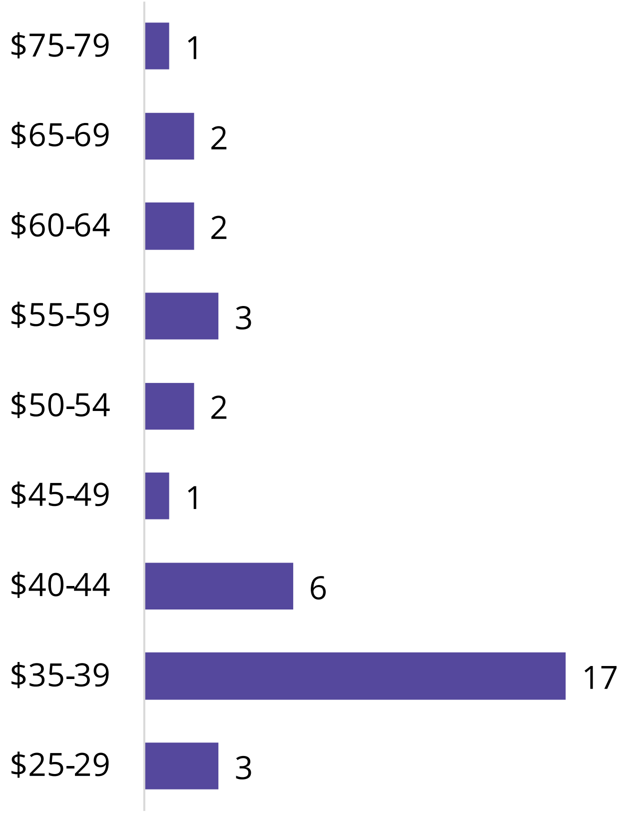
Source: AVANT by Avison Young

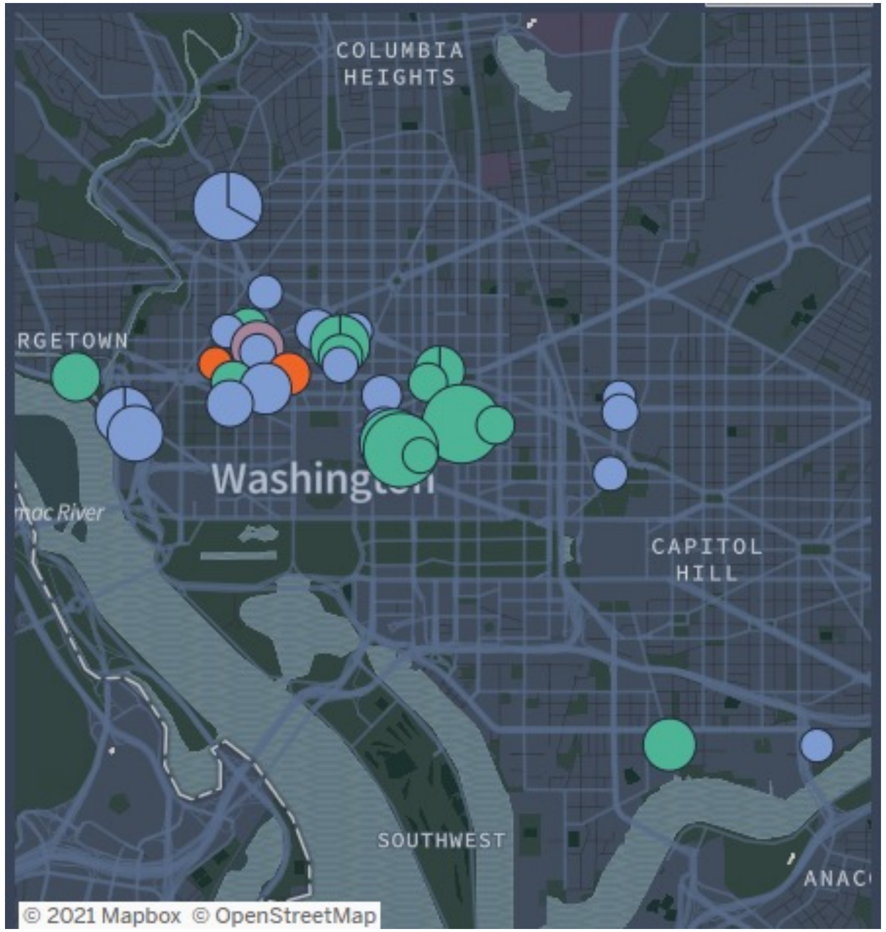
Sublease supply pipeline

Building classification



Asking rent FS per square foot





Source: AVANT by Avison Young

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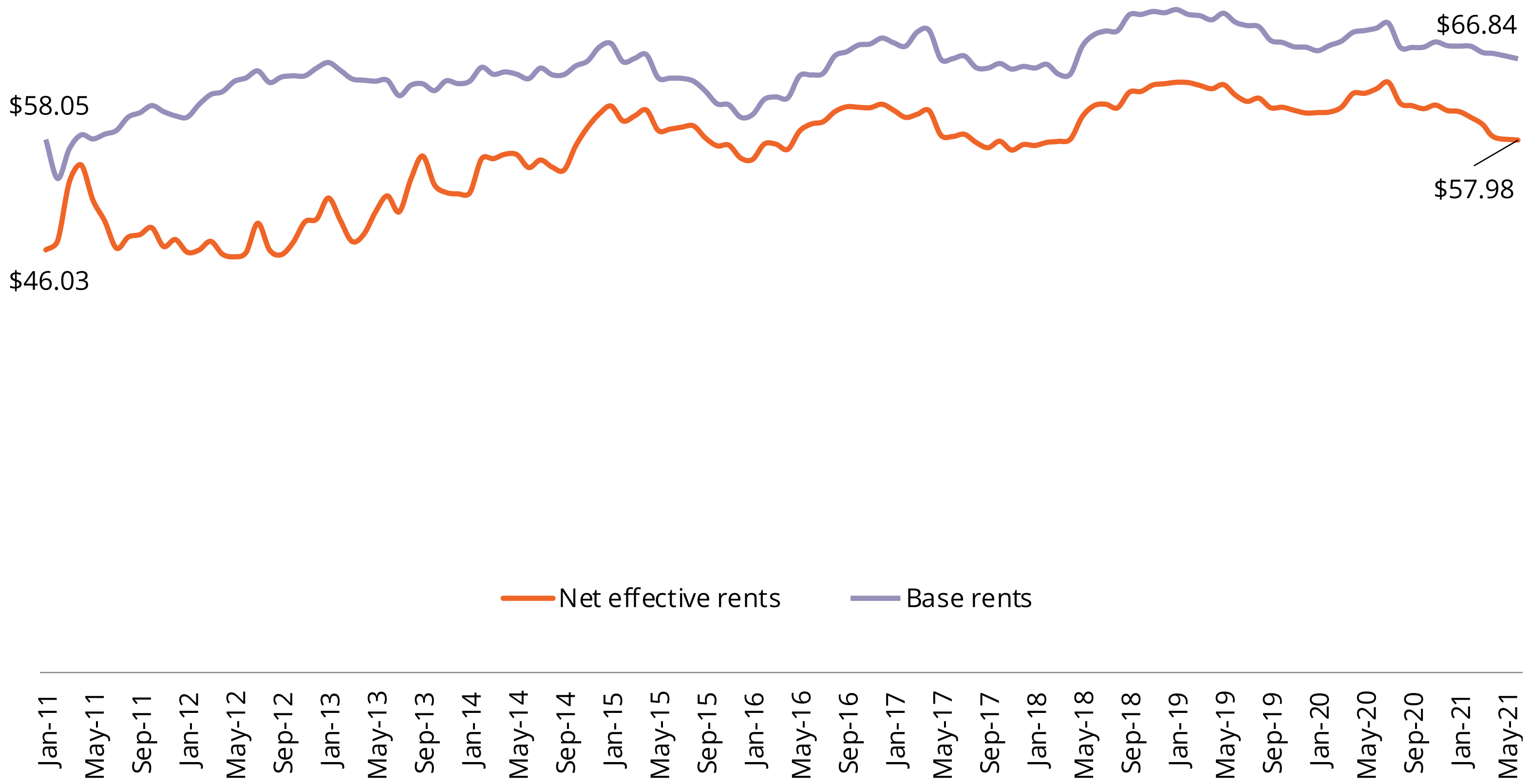
Net effective rents and base rents

-9.8%

YoY change in DC net effective rent, Class A relocations

Though base rents have remained relatively flat, spiking concessions have led to a sharp decline in net effective rents.



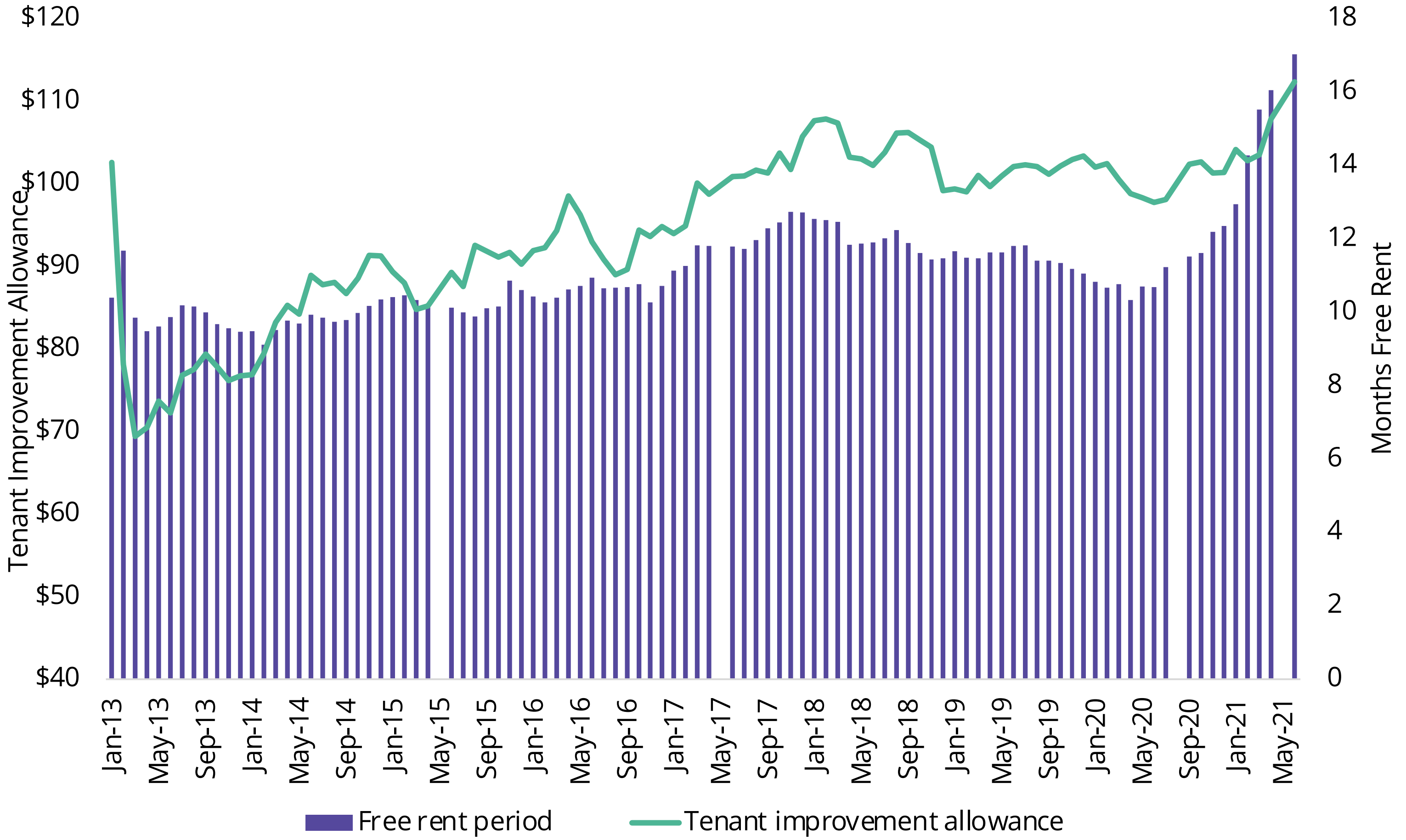
Note: Class A office properties. Trailing 12-month unweighted averages. Excludes subleases, renewals and expansions. Source: AVANT by Avison Young

Concessions

58.1%

Rise in average free rent period since March 2020

Concessions have increased astronomically since March 2020, with average TI allowance up by 11.8% and average free rent period up by 58.1% as landlords seek to attract tenants in an environment with extremely limited activity.



Note: Class A office properties.
Trailing 12-month unweighted averages. Excludes subleases, renewals and expansions.
Normalized to 10-year lease terms. Source: AVANT by Avison Young

Class B and C economics after the pandemic

Period	Average base rent	Average free rent period	Average tenant improvement allowance	Average net effective rent
2018 to 03/2020	$52 psf	10 months	$69 psf	$46 psf
04/2020 to today	$55 psf	14 months	$82 psf	$49 psf

Note: Class B and C direct relocations only, normalized for 10-year lease terms.
Source: AVANT by Avison Young

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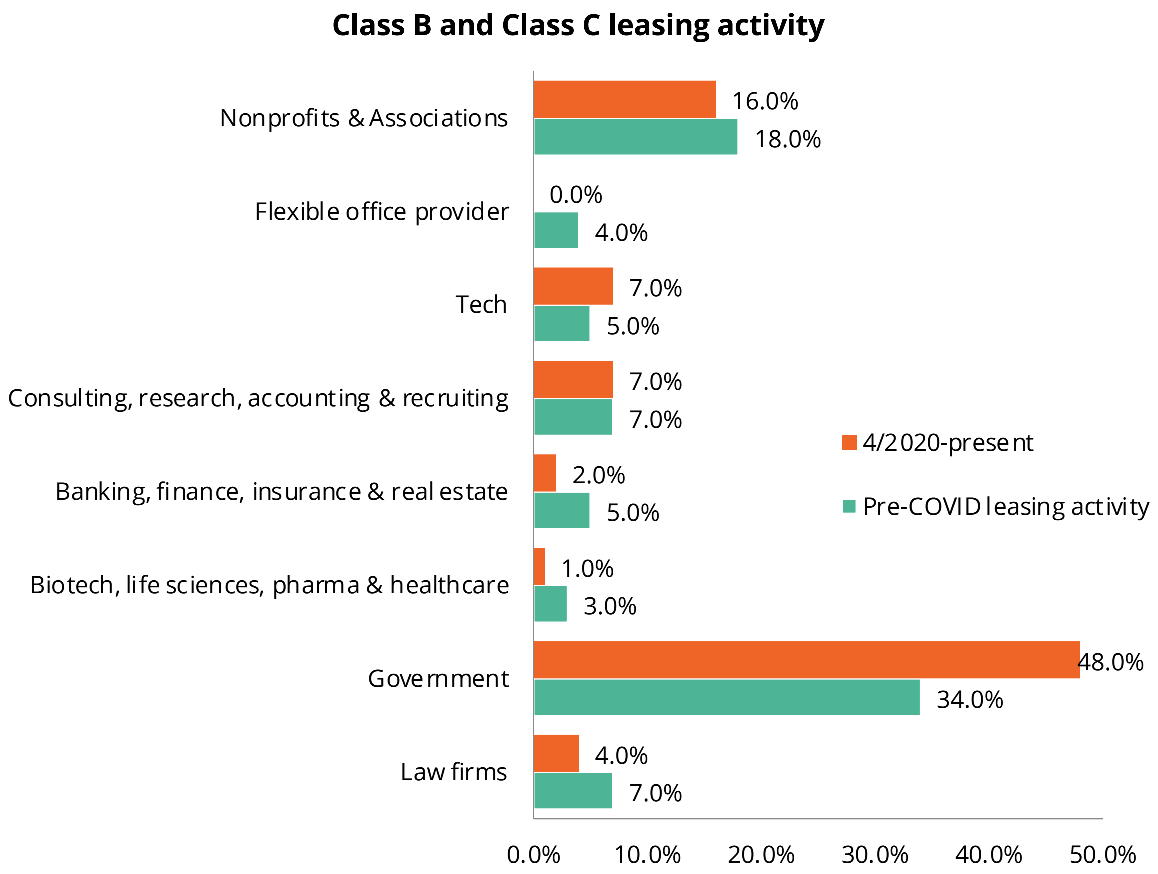
GSA Leasing activity

34%

2018-3/2020 Class B and Class C activity by GSA Tenants

GSA tenants that anchored demand for commodity properties represented almost half of total leasing amongst the Class B and Class C market segments.



Source: AVANT by Avison Young

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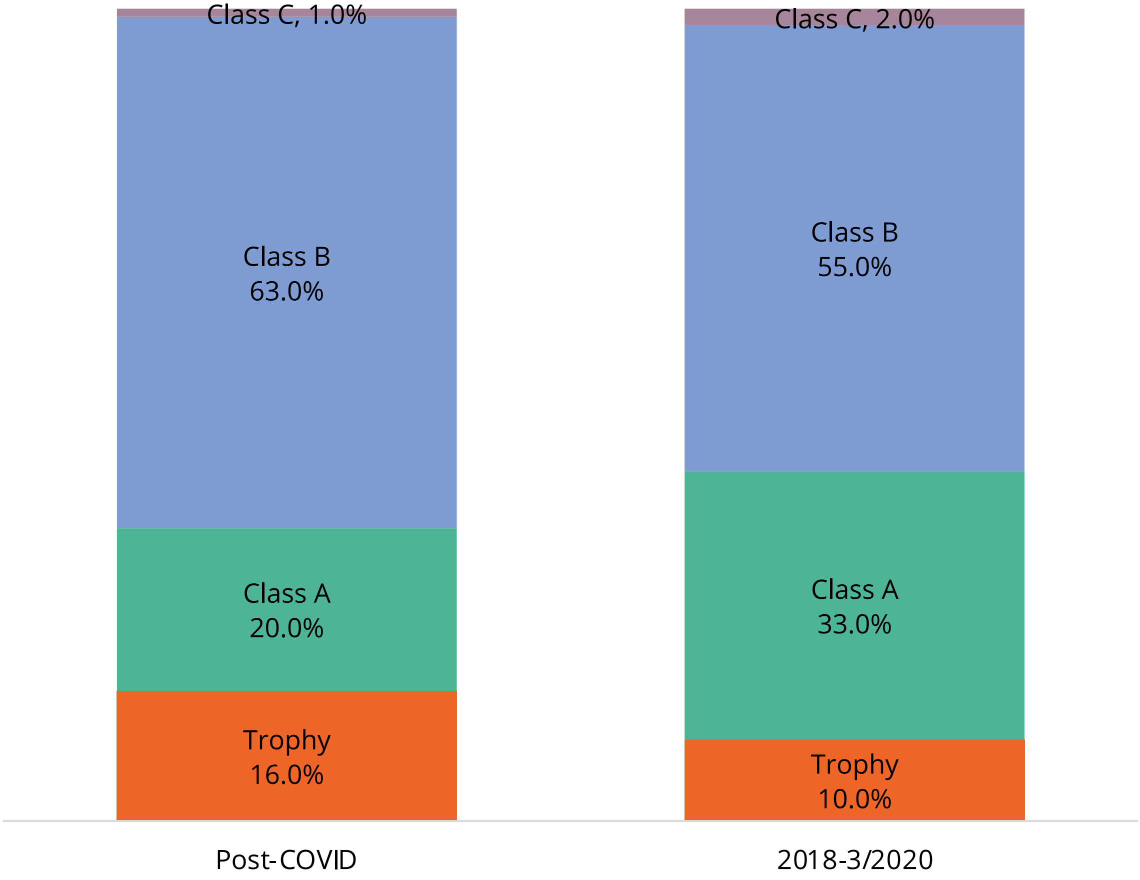
Class B leasing

63%

Class B office leasing activity post-COVID

Large federal government deals continued to get signed in the pandemic when most private-sector tenants were inactive, which drove up the share of leasing activity in the Class B segment.



Source: AVANT by Avison Young

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DC's Development Pipeline

18 properties

Under construction

2.8 msf

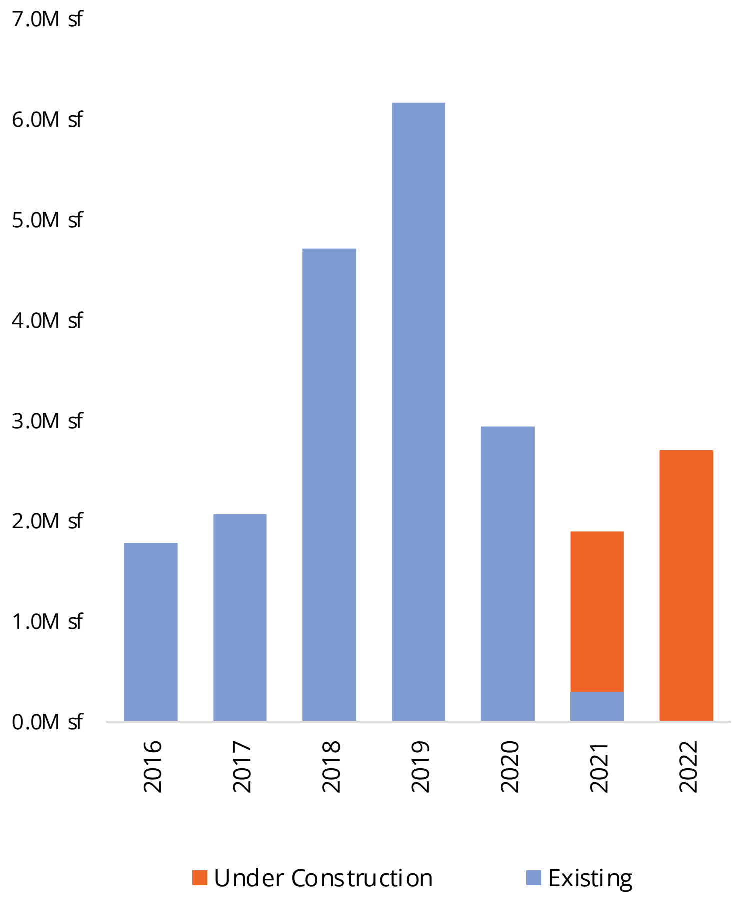
Under construction

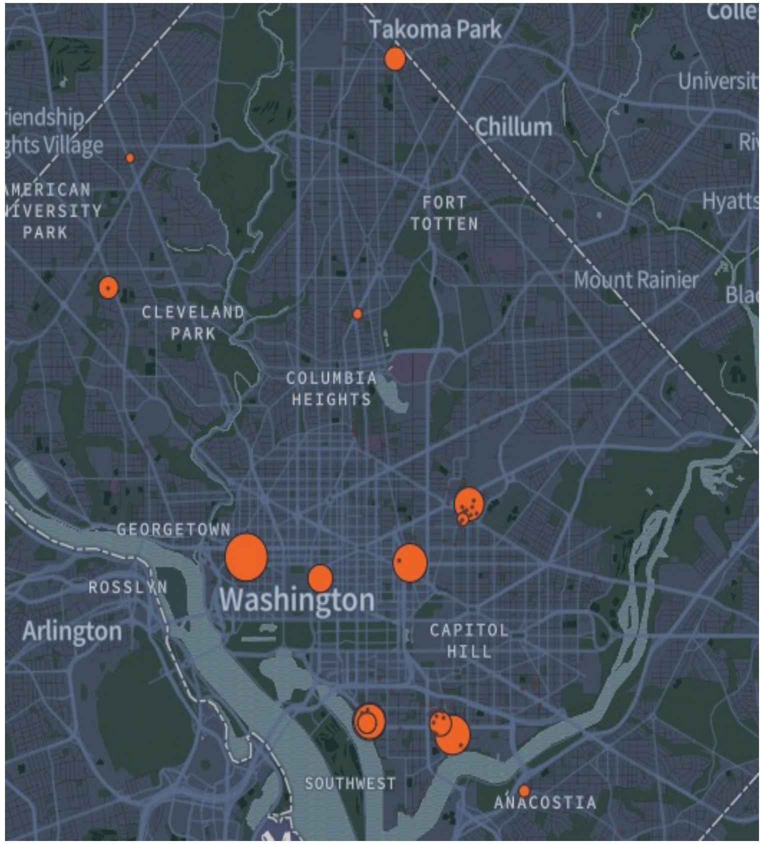
1.5%

share of office inventory

1969

average delivery date of existing DC offices





Source: AVANT by Avison Young

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03.

Capital market conditions

Investment sales are making a resurgence in 2021, led by long-term-stabilized core assets.

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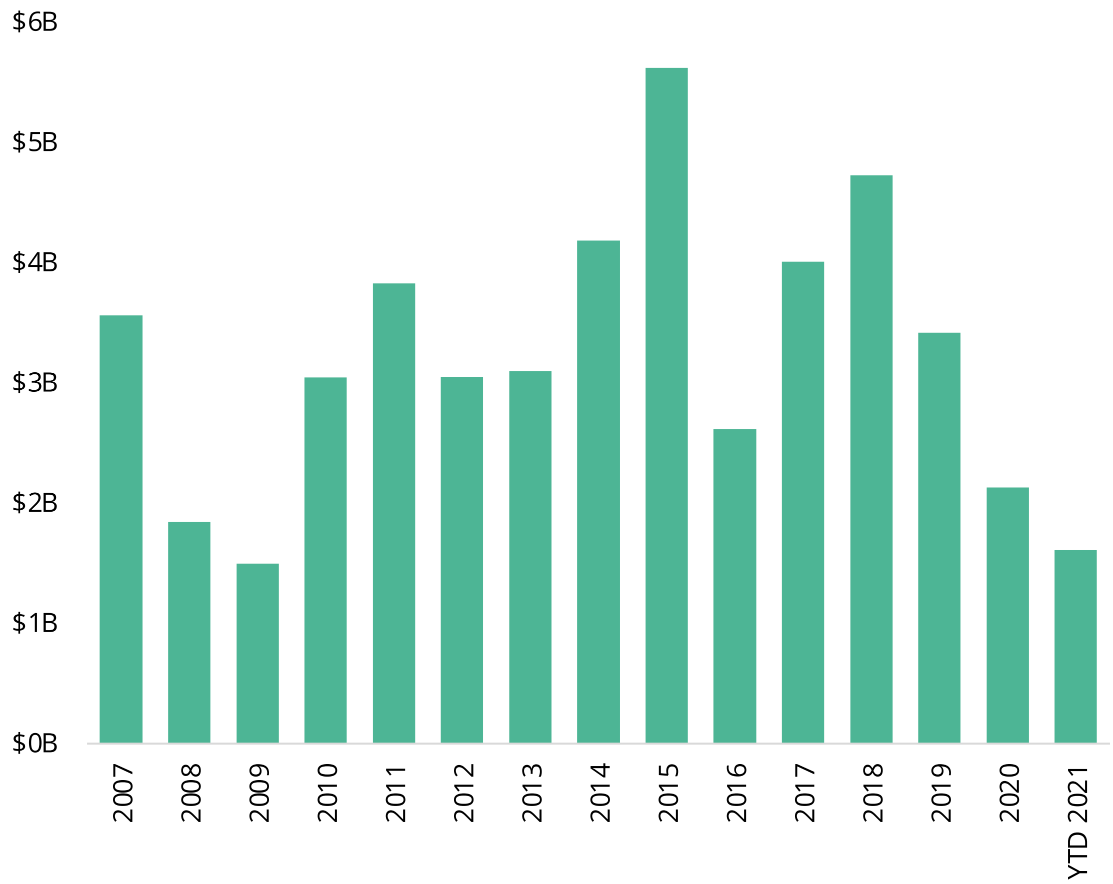
Office investment dollar volume

$3.7B

office investment dollar volume 2020 to present

Although 2020 saw a drop in investment activity similar to that of 2008, 2021 YTD volume is on pace to match a typical year from the past cycle.



Source: AVANT by Avison Young, RCA

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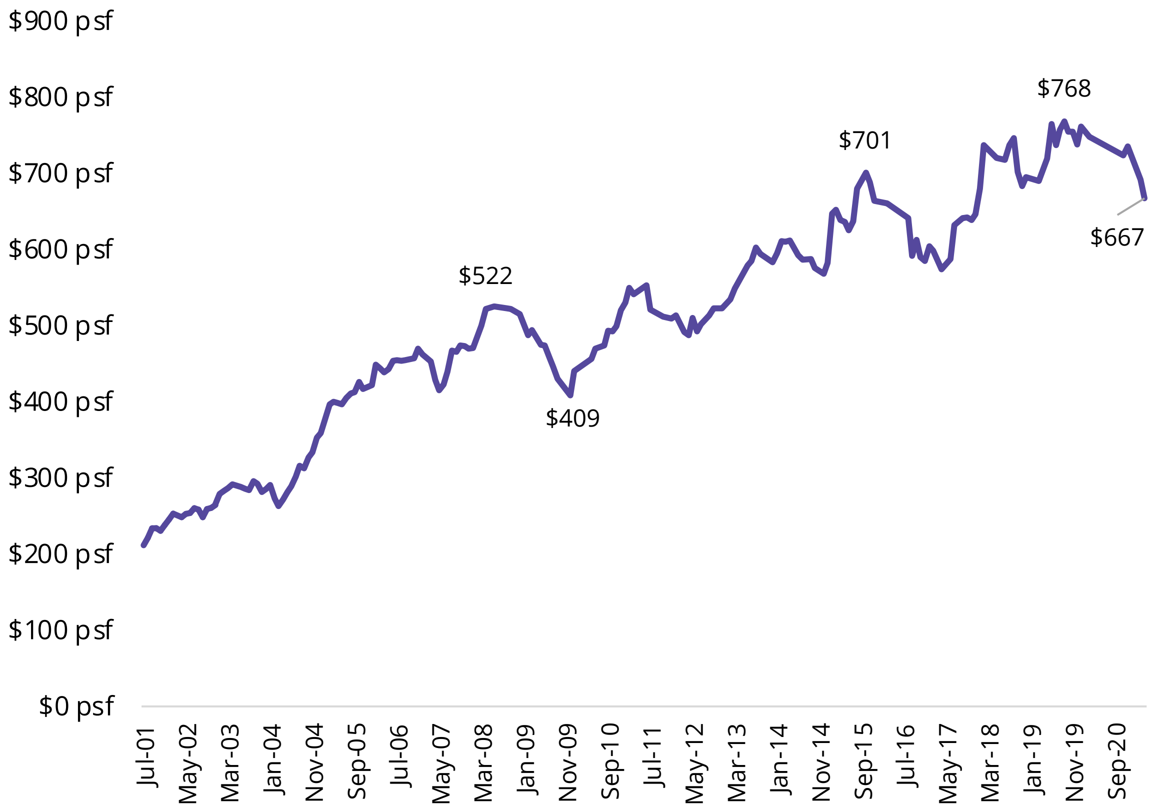
Office asset pricing

-10.7%

DC stabilized office pricing from March 2020 to present

Pricing for stabilized assets has fallen during the pandemic, but the drop has not been substantially larger than other fluctuations seen throughout the past cycle.



Source: AVANT by Avison Young, RCA
Includes Core and Core-Plus sales

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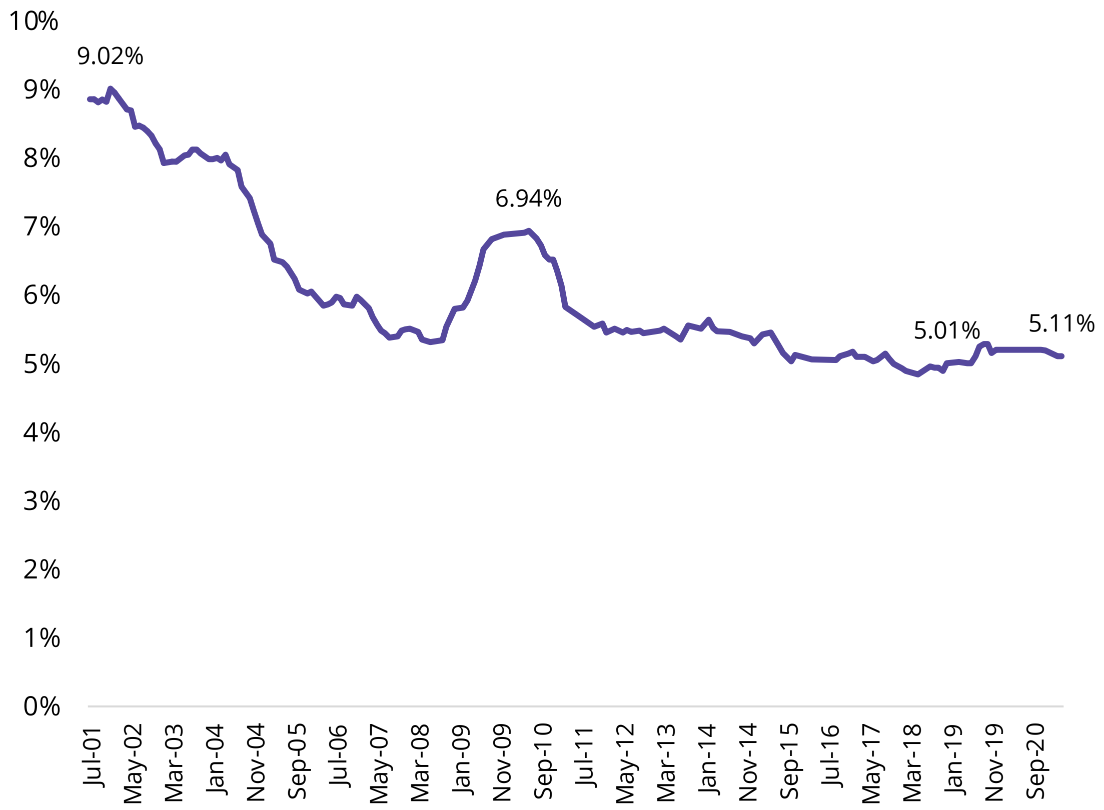
Office asset cap rates

10 bp

Rise in Washington, DC stabilized core office cap rates

In stark contrast to the Global Financial Crisis, cap rates on stabilized assets in core submarkets have risen only nominally, though relatively few such sales have been observed since the onset of the pandemic given depressed sale volume.



Source: AVANT by Avison Young, RCA
Includes Core and Core-plus profile sales in the CBD and East End.

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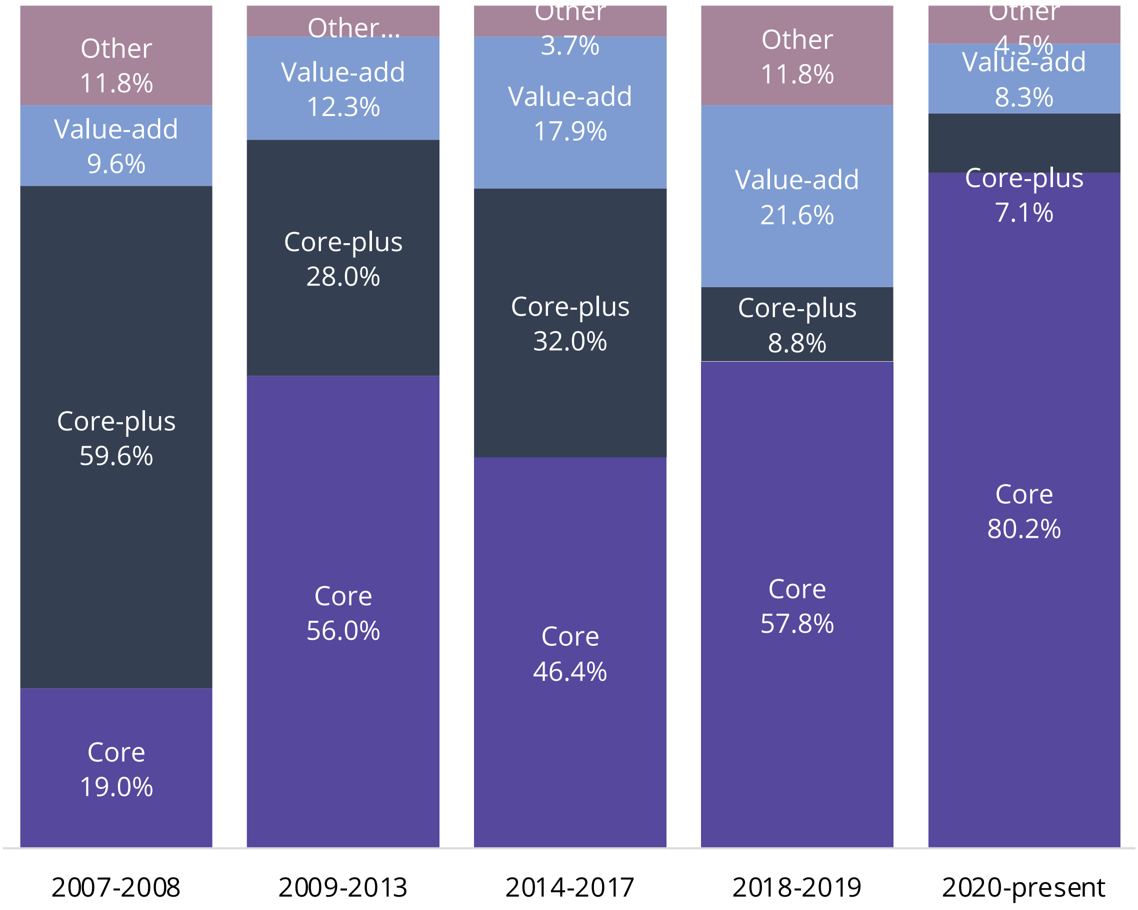
Office investment asset profiles

80.2%

DC core investments since 2020

Pre-COVID, investors had been shifting toward value-add plays due to highly compressed yields on core deals, but have shied away from such buys in favor of safer, stabilized assets in 2020-2021.



Source: AVANT by Avison Young, RCA

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Looking forward

Here's what we can expect

- **Widespread vaccination** efforts are underway, meaning that employers will be able to formulate more cohesive return to office strategies even if those strategies do not involve full-time office use.
- Demand **for amenities** has increased drastically, particularly regarding **large, versatile conference facilities**. In-person meetings are returning, and with that, employers require the necessary infrastructure.
- **Interest in spec suites has been on the rise**, as small tenants who have delayed their leasing decisions now need quick occupancy and flexible terms.
- **Tour activity** has surged in recent weeks, but this positive trend has yet to translate to a recovery in actual leasing activity.
- **Long-term stabilized assets** will continue to see strong investor demand, but such offerings will likely become scarcer given elevated market vacancy and sparser tenant activity in a post-COVID environment.

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Let's talk

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