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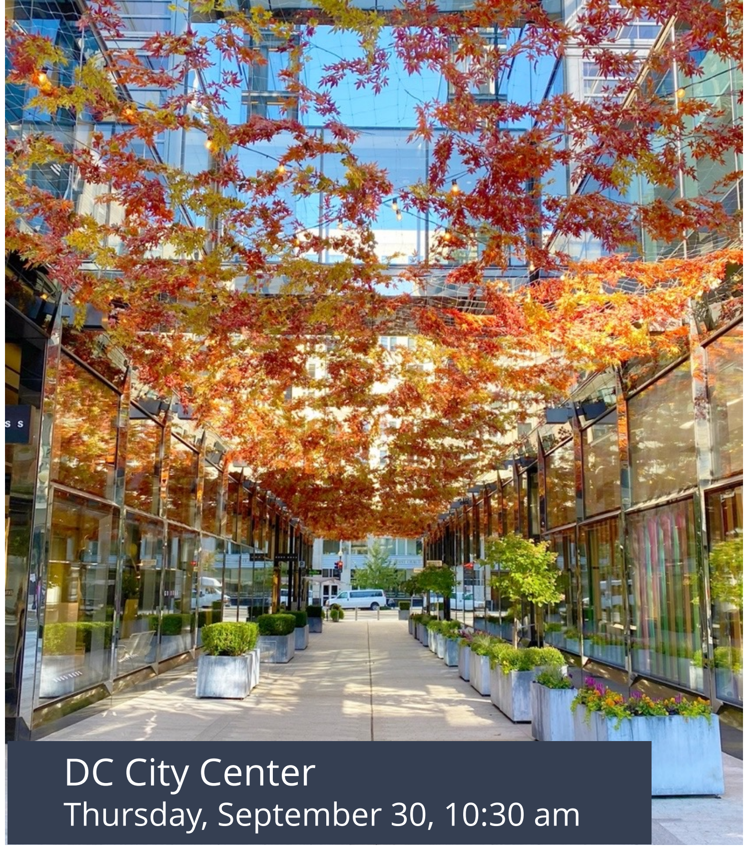
District of Columbia Office Insight Report

Q3 2021

AVANT
by AVISON YOUNG

Nationals Park, Red Sox vs Nats
Saturday, October 2, 6:00 pm


DC City Center
Thursday, September 30, 10:30 am


Gallery Place Metro Station
Thursday, September 30, 11:00 am


11th & F Street, NW
Thursday, September 30, 11:00 am

Capital One Arena
Thursday, September 30, 11:00 am


Chinatown Retail
Thursday, September 30, 10:45 am

Key takeaways

Economic conditions

- Office-using jobs totals have declined **1.6 percent** compared with 5.4 percent for other industries' job losses. Return-to-office activity remains depressed, suggesting office-using sectors have been well-equipped to work remotely.
- Larger job losses in non-office-using sectors underscore the disproportionate impact the pandemic had on the discretionary segments of the local economy, backed by retail closures in the District.
- In the Golden Triangle Business Improvement District, there were **56** storefront vacancies pre-COVID and **125** vacancies today.

Recovery rate

- The overall post-COVID rate of recovery based on extrapolated mobility data is **64.8 percent** suggesting that many consumers are ready to return to their pre-Covid routines, yet offices are seeing only **36.0 percent** of pre-Covid mobility.
- Office activity is lagging the region's overall recovery suggests that employer mandates may be needed for office utilization to return to pre-pandemic levels.
- Reopening efforts and increased vaccination rates have allowed the Washington, DC unemployment rate to rebound from a high of 10.6 percent to **6.3 percent**.

Office demand

- Leasing activity has paused, decreasing by **44.6 percent** compared with long-term historical averages.
- The federal government accounted for **48 percent** of commodity leasing post-covid, though continued shrinkage in the federally leased footprint could exacerbate an already anemic leasing market.
- The quarter ended with two very large government leases by the SEC and DoJ. Federal government leases post-pandemic **averaged 97,000 sf, compared to just 14,000 sf in the private sector.**

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Key takeaways

Office supply

- Direct and sublease vacancy have achieved all-time highs, totaling **14.0 percent**. Avison Young projects continued increases in that rate for the foreseeable future.
- The sublease market continues to drag aggregate fundamentals, accounting for a record **1.79 msf** of vacant space. However, some prospective sublandlords have pulled their space from the market after unsuccessfully capturing demand by subtenants.
- 21 Projects are either under construction or renovation, totaling **4.4 msf.** As of the end of the quarter, that space was ~28% preleased, which will contribute to total vacancy upon delivery.

Pricing trends

- Landlords have increased concessions by **12.49 percent** year-over-year since 2020, becoming increasingly aggressive to attract long-term tenants. Concessions in DC remain highest on record, without increasing base rents.
- Tenants that postponed their long-term occupancy are requesting smaller footprints, facilitating a flight to quality, as they can afford more per sqft without increasing their annual rent obligations.
- Flight to quality includes amenity-rich options such as large conference and outdoor space to incentivize employees to return to work.

Capital markets

- The market continues to price in higher risks with just **$3.7B** of DC offices having been sold since 2020, an annualized decrease of **37 percent** compared with the past five-year average.
- There have been no deals within the Trophy asset class in 2021 highlighting the lack of high-end offerings in the market.
- There continues to be volatility within the office segment with asset pricing softening by **10.7 percent** from March 2020 to present. Investors are being more strategic around core investment rather than value-add scenarios.

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Economic and demographic trends

While DC shows strong signs of resiliency across several recovery metrics, it has not translated to reductions in vacancy rates or increased deal-flow in office leasing.

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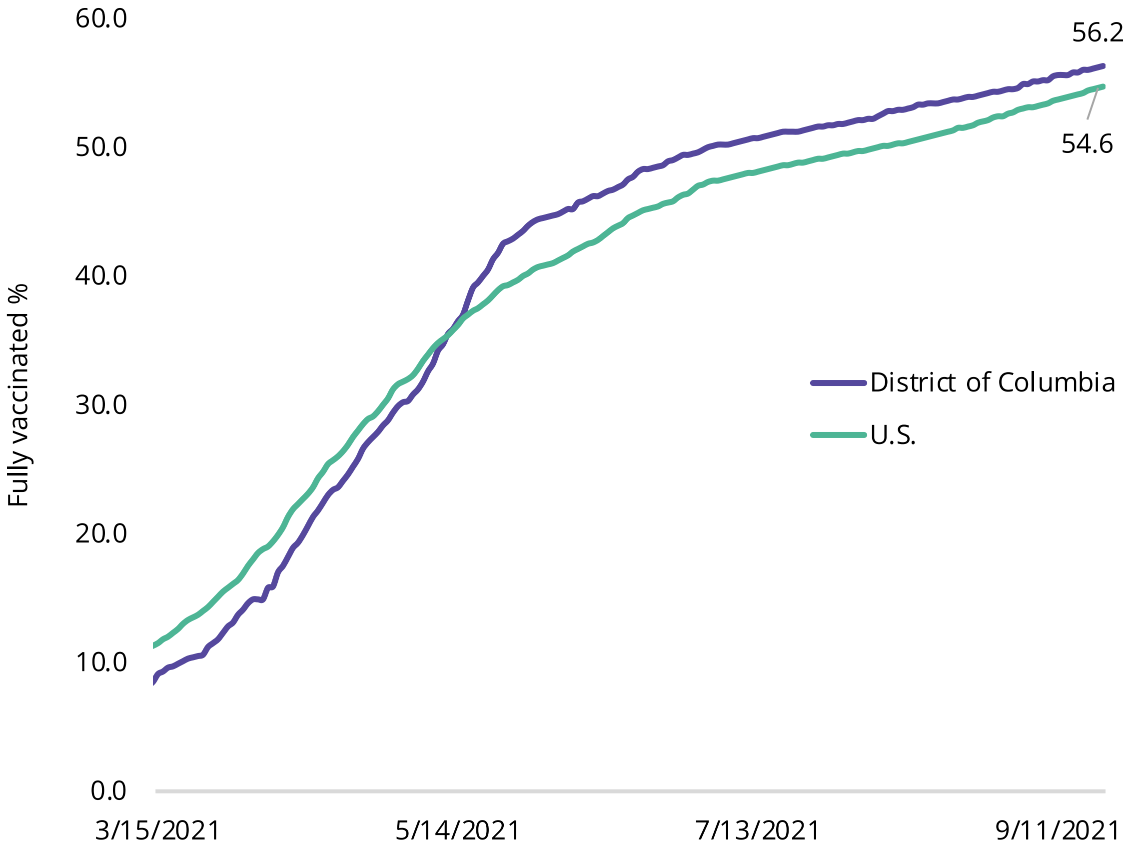
Vaccination rates

56.2%

Share of total District of Columbia population that is vaccinated

The District of Columbia proportionate vaccination rates have surpassed U.S. averages, an important metric that has led to loosening of restrictions. Despite the increase in vaccinations, the reinstitution of the mask-mandate Downtown has hampered the city's overall recovery and plans to return to normal.



Source: CDC

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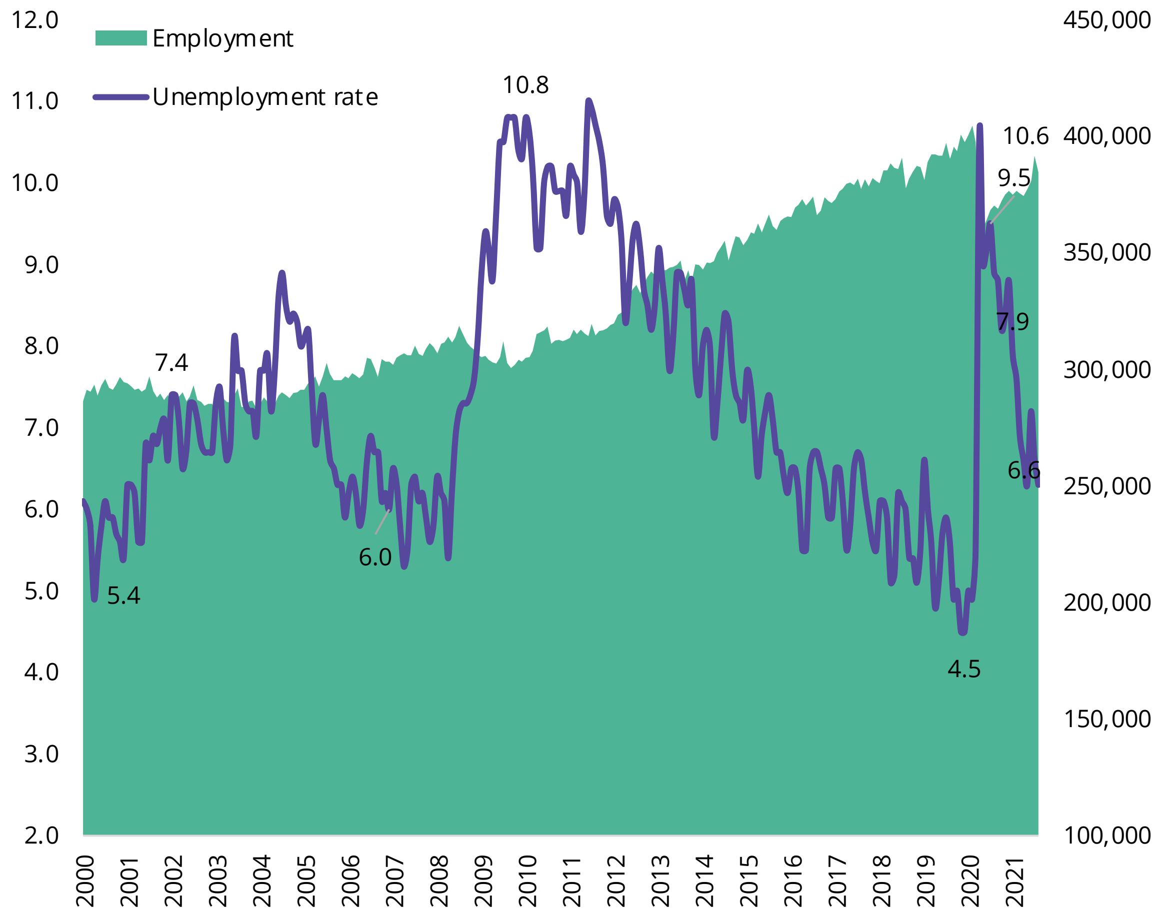
Employment and unemployment rate

6.3%

District of Columbia unemployment rate as of August 2021, trending above the height of the financial crisis

Historically tightened labor market conditions were halted by the pandemic with nearly 44,000 job losses between February and May 2020. However, reopening efforts enabled the economy to add 23,700 jobs since May 2020.



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

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Office-using job gains and losses

-5.4%

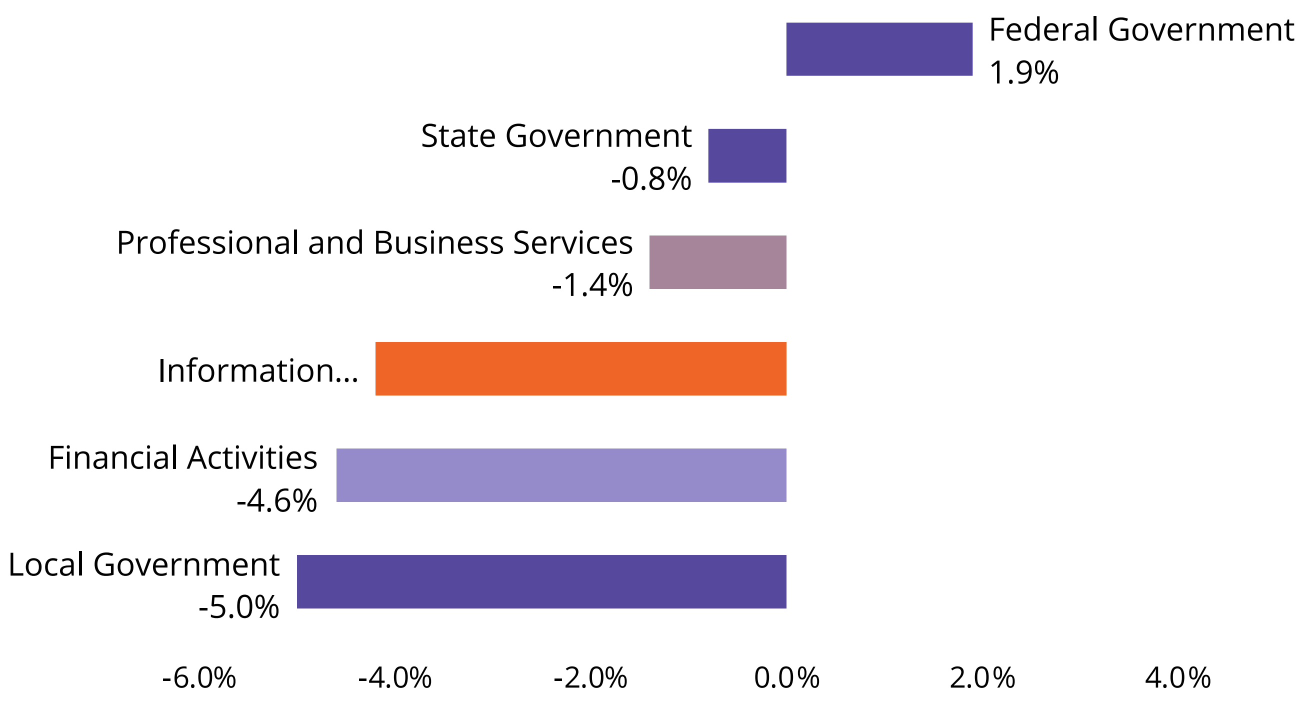
Change in office-using employment during the pandemic

Employment across Metro DC declined by 5.4% since the start of the pandemic, though office-using jobs contracted by 1.6%. This recession's impact on the office-using labor market has been less severe than the global financial crisis, when Financial Activities job losses totaled 7.5%.

VIEW DASHBOARD

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

February 2020 to April 2021



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

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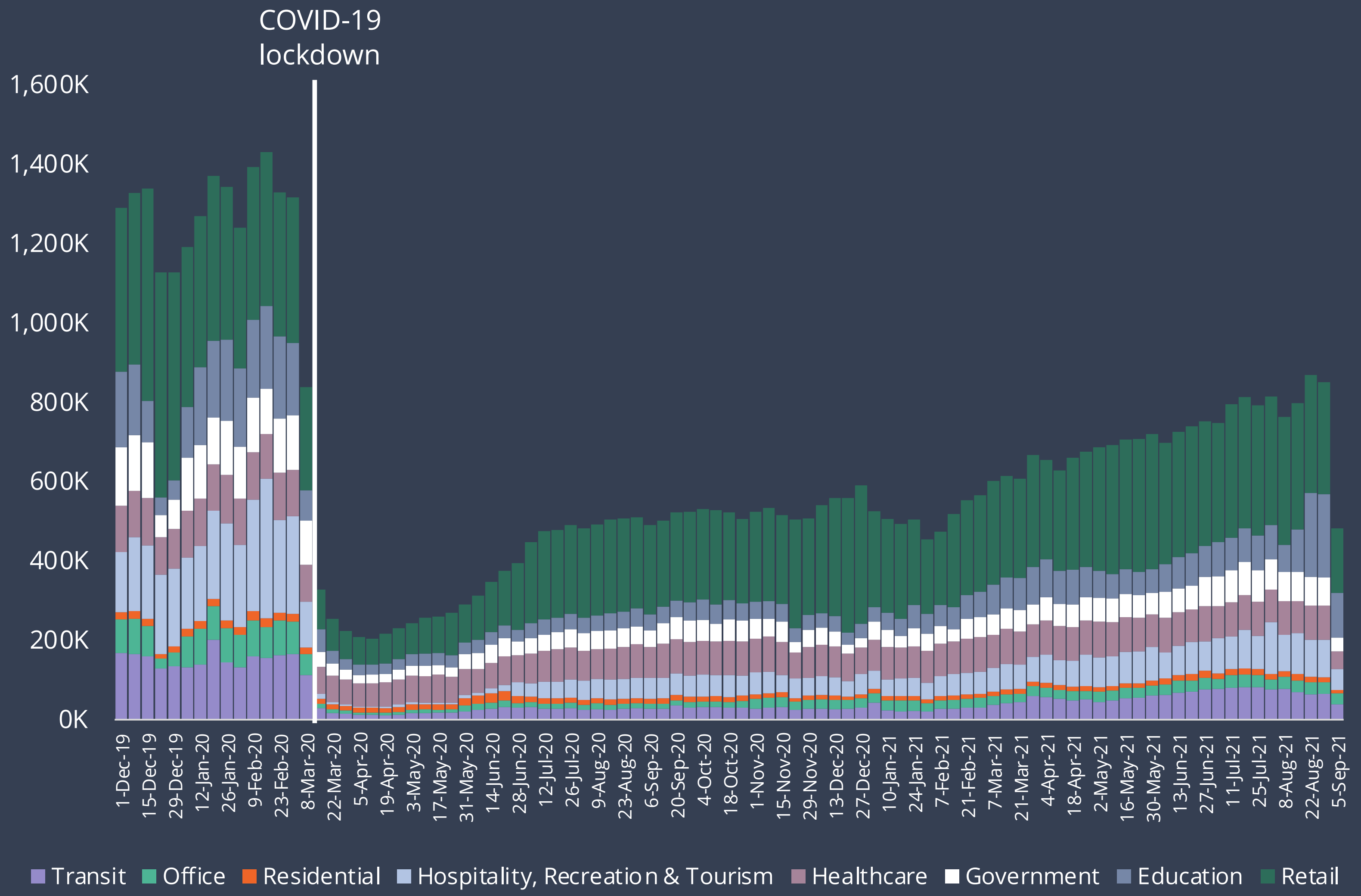
Recovery index

64.8%

Trailing six-week average COVID rate of recovery for representative locations

Across various sectors such as retail, transit, office, and recreation, weekly visitor traffic has recovered to nearly two thirds of pre-pandemic levels.



Note: Representative areas of interest. Weekdays only. Pre-COVID period measured as 12/1/2019 to 3/8/2020. Source: Orbital Insights, AVANT by Avison Young

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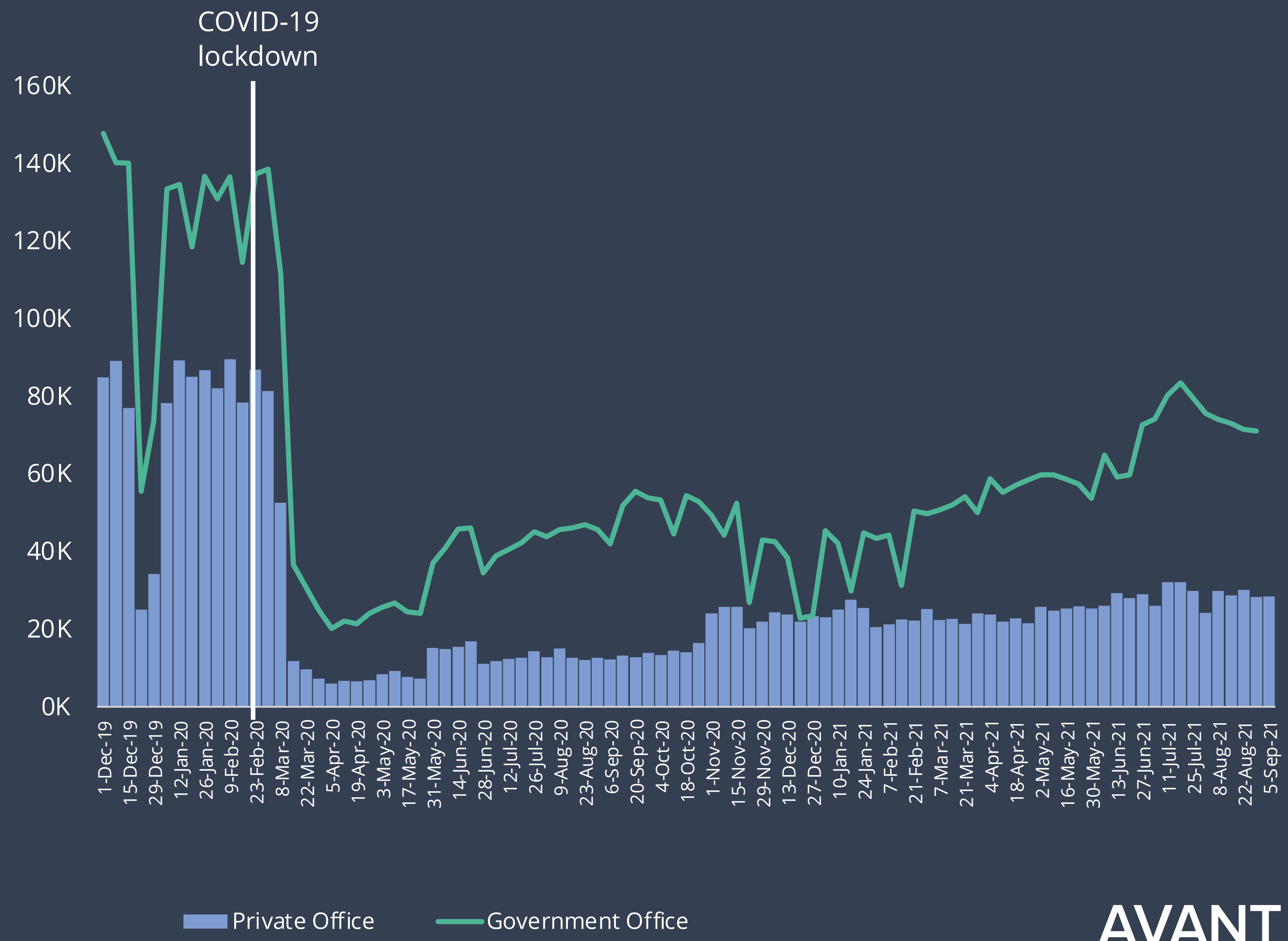
Recovery index

36.0%

Trailing six-week average COVID rate of recovery for representative office locations

Office recovery has lagged the region's overall recovery, suggesting that employees are not fearful of COVID-19 but rather simply prefer to work remotely given the option.



Note: Representative areas of interest. Weekdays only.
Pre-COVID period measured as 12/1/2019 to 3/8/2020.
Source: Orbital Insights, AVANT by Avison Young

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U.S. return-to-work rates since start of COVID

-72.3%

Average office visitor volumes across U.S. gateway cities, March 2, 2020 vs. September 20, 2021

Return-to-work efforts across cities have been influenced by governmental regulations (informed by infection and vaccination rates), office-using industry composition and employees' reliance on mass transit.

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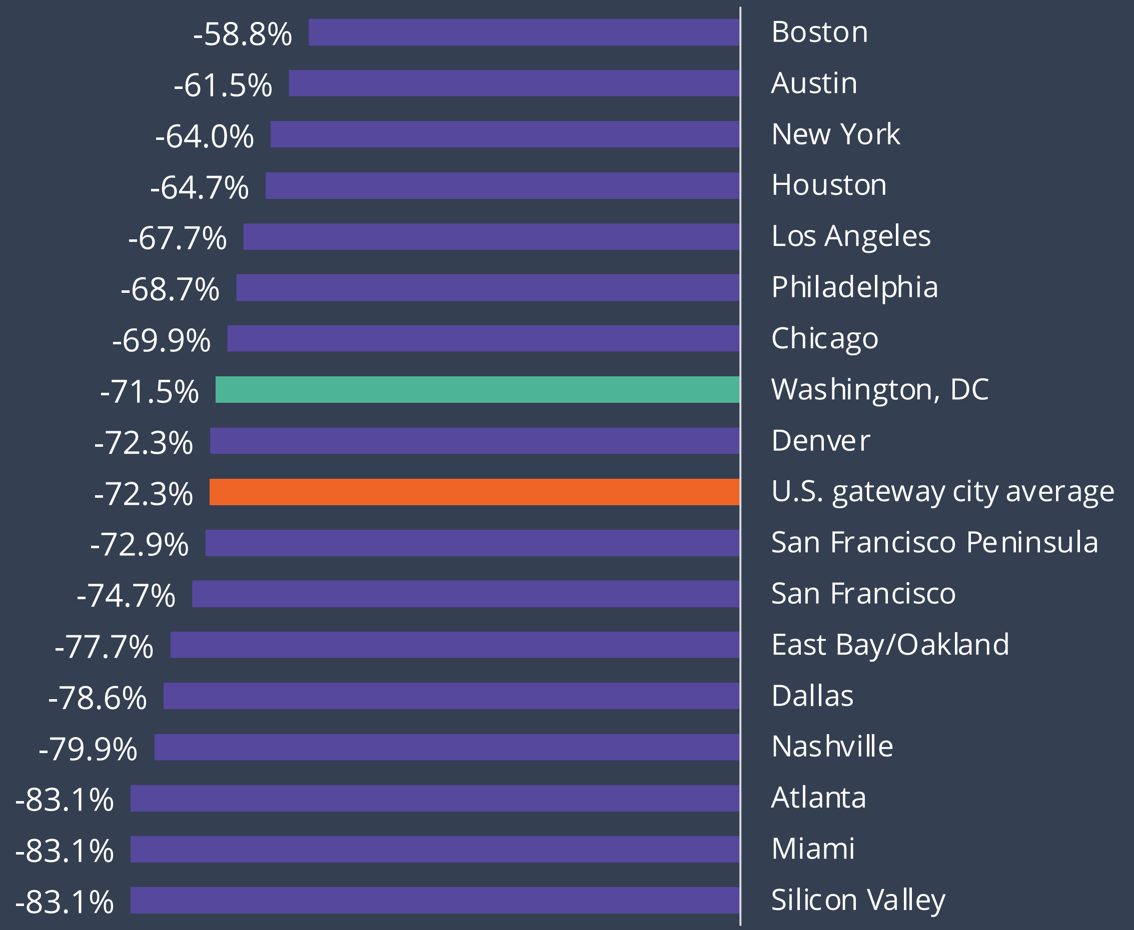

Note: Representative full-building office occupiers only.
Weekdays only. Data as of September 20, 2021.
Source: Orbital Insight, AVANT by Avison Young

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U.S. return-to-work rates since start of COVID

-68.4%

Average law firm visitor volumes across U.S. gateway cities, March 2, 2020 vs. September 20, 2021

Law firms have balanced remote and in-person policies that results in higher return-to-work than many sectors, while life sciences and real estate companies have embraced flexible in-office and remote working arrangements.

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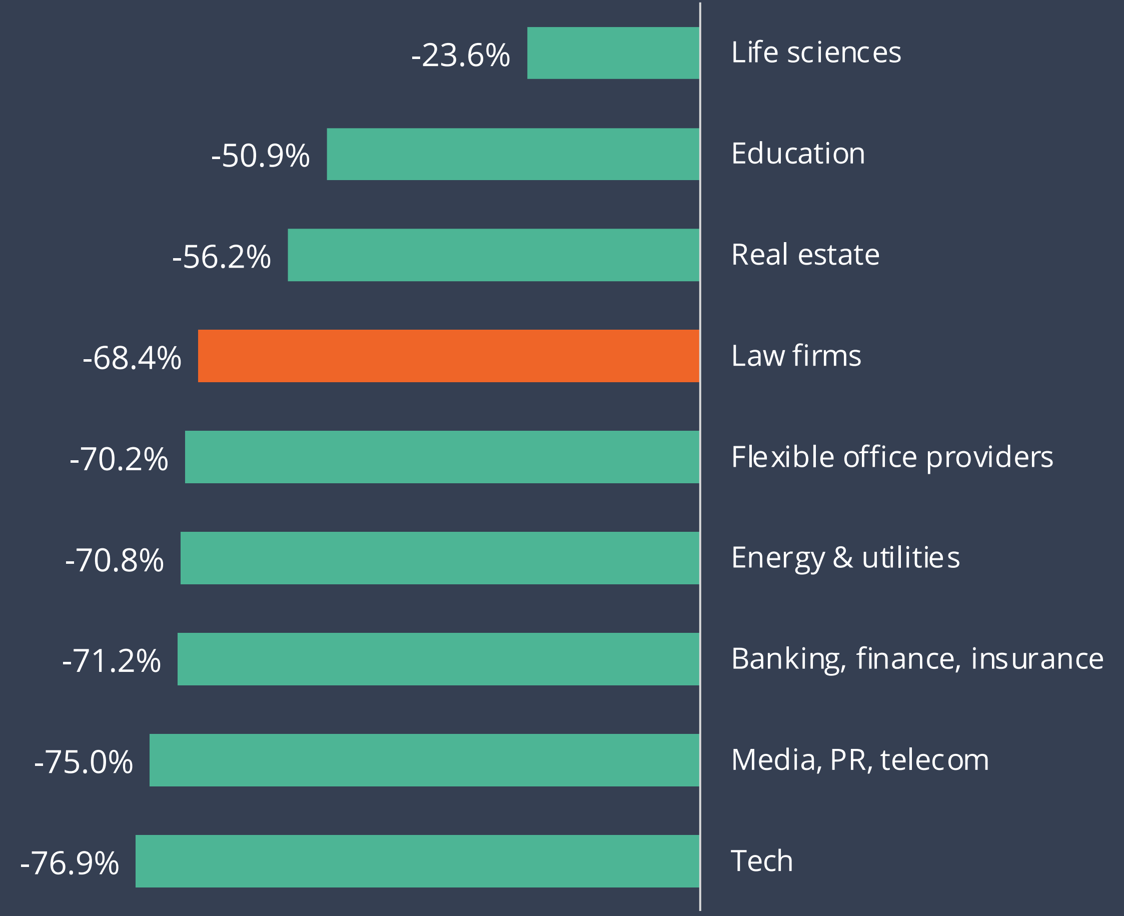

Note: Representative full-building office occupiers only.
Weekdays only. Data as of September 20, 2021.
Source: Orbital Insight, AVANT by Avison Young

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Change in local activity levels, 2019 vs. 2021

-80.0% Office	**-34.5%** Retail	**-67.2%** Transit	**-23.3%** Healthcare
+0.6% Education	**-40.4%** Government	**-47.6%** Residential	**-42.0%** Hospitality & Tourism

Note: Select, representative areas of interest only. Weekdays only.
Week of September 16, 2019 vs. week of September 20, 2021.
Source: Orbital Insight, AVANT by Avison Young

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Evolution of local return-to-work efforts

+20.0%

DC Metro office visitor volume since the Fourth of July 2021

While office activity remains dramatically below the levels of traffic seen before the pandemic, it has recovered substantially from the low point of the COVID-19 lockdowns.

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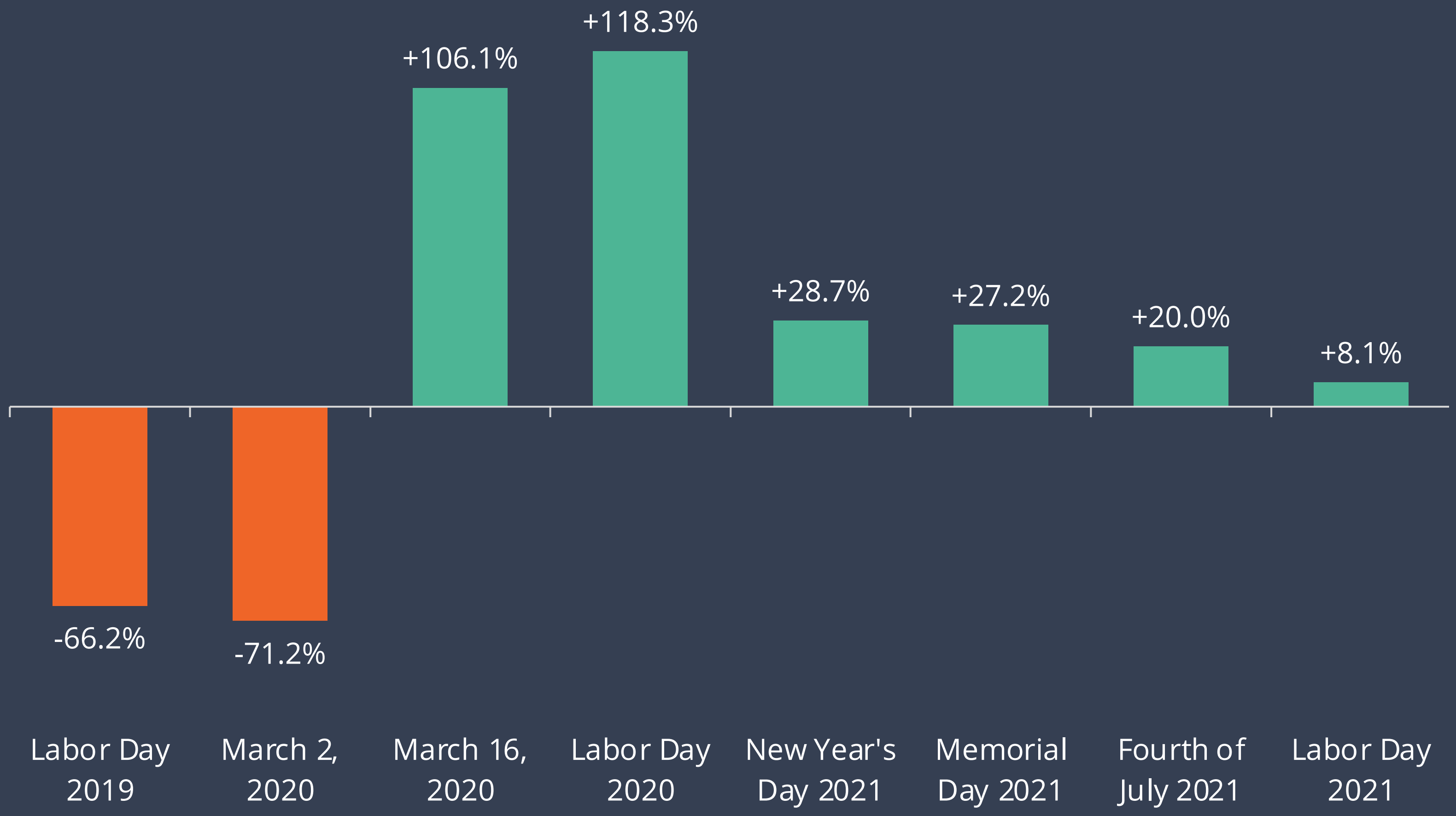

Note: Select, representative occupiers only. Weekdays only.
Data as of September 20, 2021.
Source: Orbital Insight, AVANT by Avison Young

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Local return to work efforts by industry

-50.5%

Law Firm office visitor volume since Labor Day 2019

District of Columbia law firms have reinforced hybrid remote/in-person work schedules, though creative companies have adopted remote work strategies.

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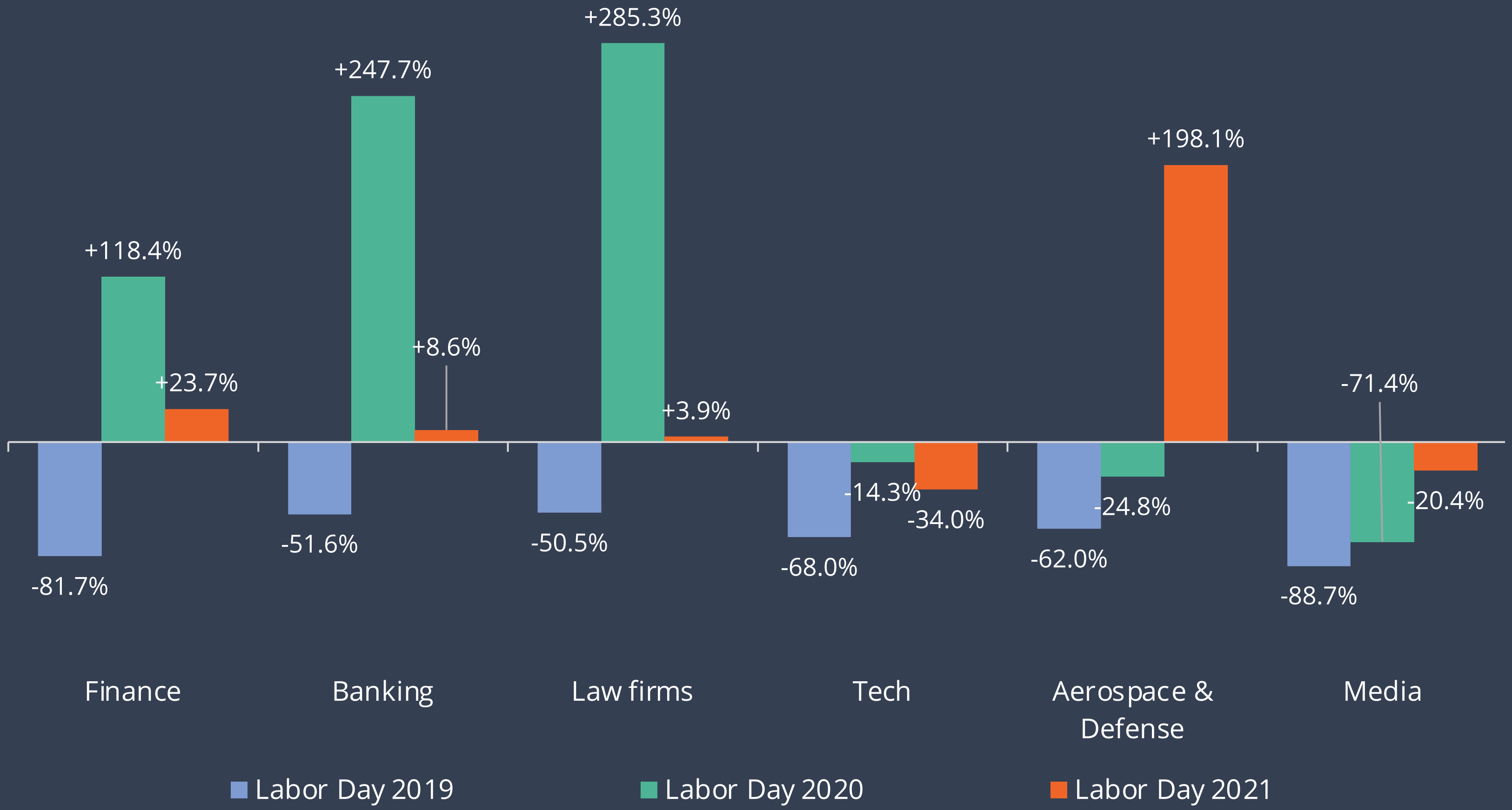

Note: Representative full-building office occupiers only.
Weekdays only. Data as of September 20, 2021.
Source: Orbital Insight, AVANT by Avison Young

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Office occupier conditions

DC remains a tenant's market as landlords try to attract new occupiers with record concessions while maintaining or reducing base rents.

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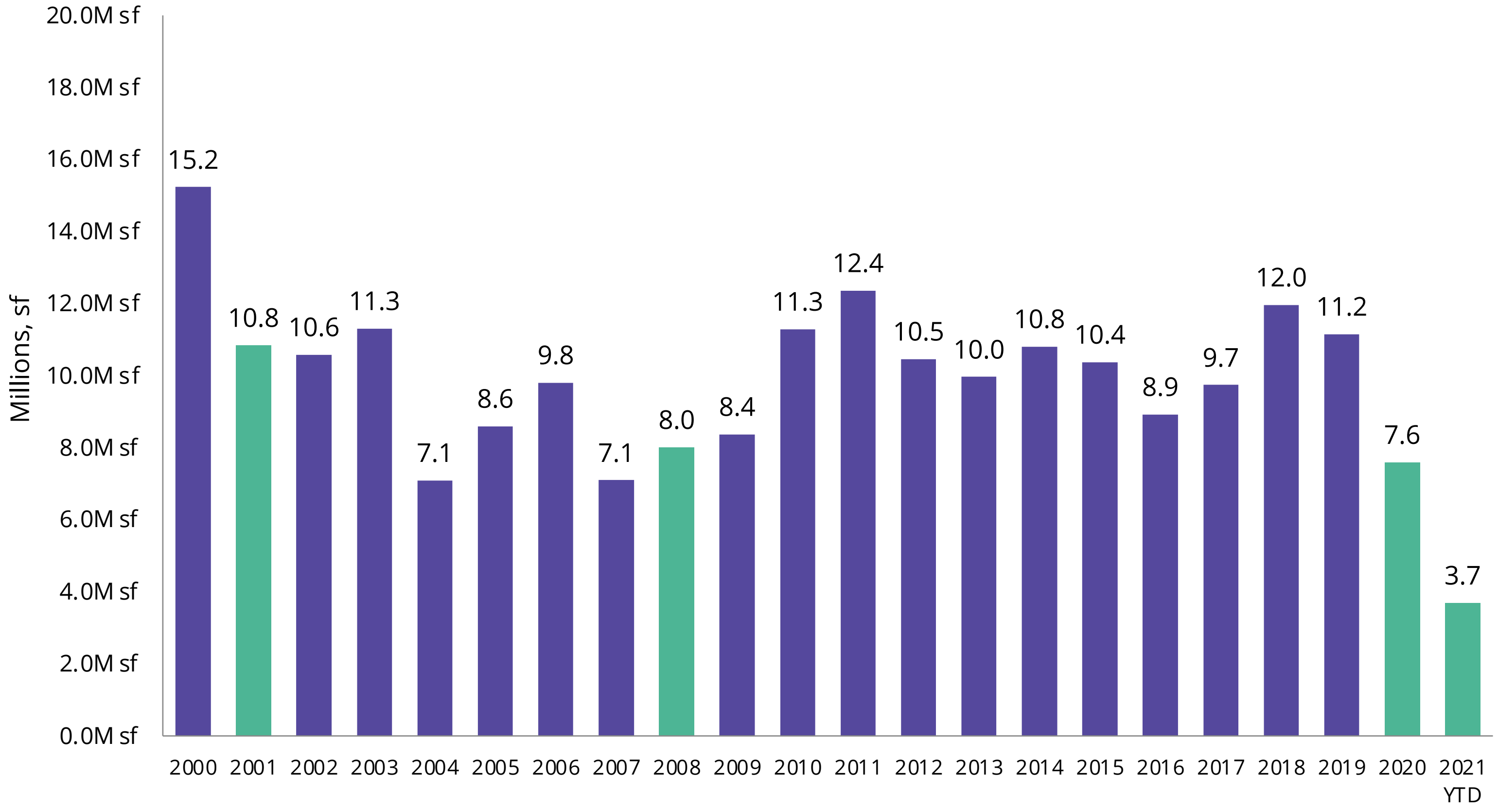
Office leasing activity

-32.4%

YTD leasing versus first three quarters of 2020

Although tour activity has picked up, it has yet to result in an increase in leasing activity, which is on pace to finish the year below 2020 despite loosened restrictions and a rising vaccination rate.



Source: AVANT by Avison Young

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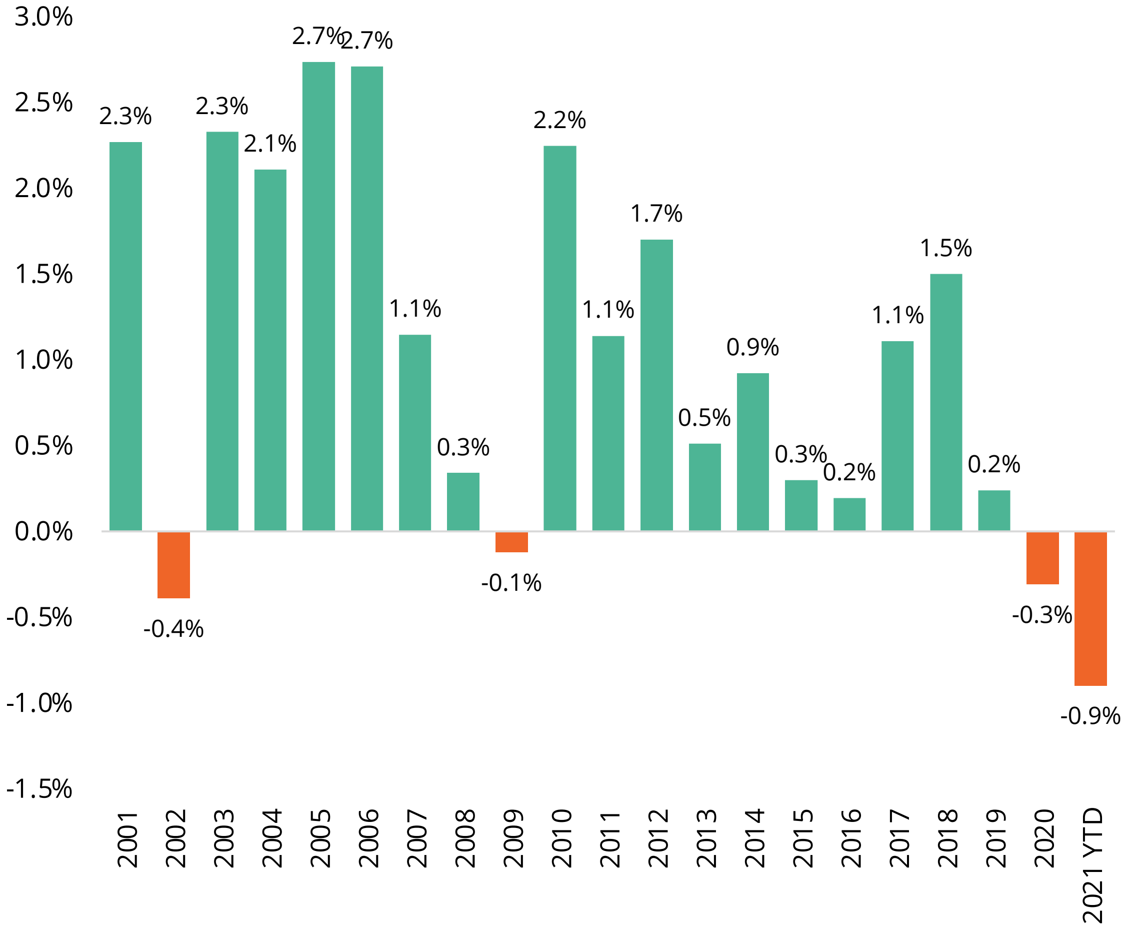
Absorption

-1.2%

Net absorption as a percentage of inventory, 2020 through Q3 2021

Negative absorption from 2020 to Q1 2021 has totaled 1.75 million sf, totaling -1.2% of the existing stock. This negative absorption significantly surpasses the lows of the early 2000's recession (-0.4%) and global financial crisis (-0.1%). The presence of the federal government has helped DC's office market stay comparatively resilient through economic hardship.



Source: AVANT by Avison Young

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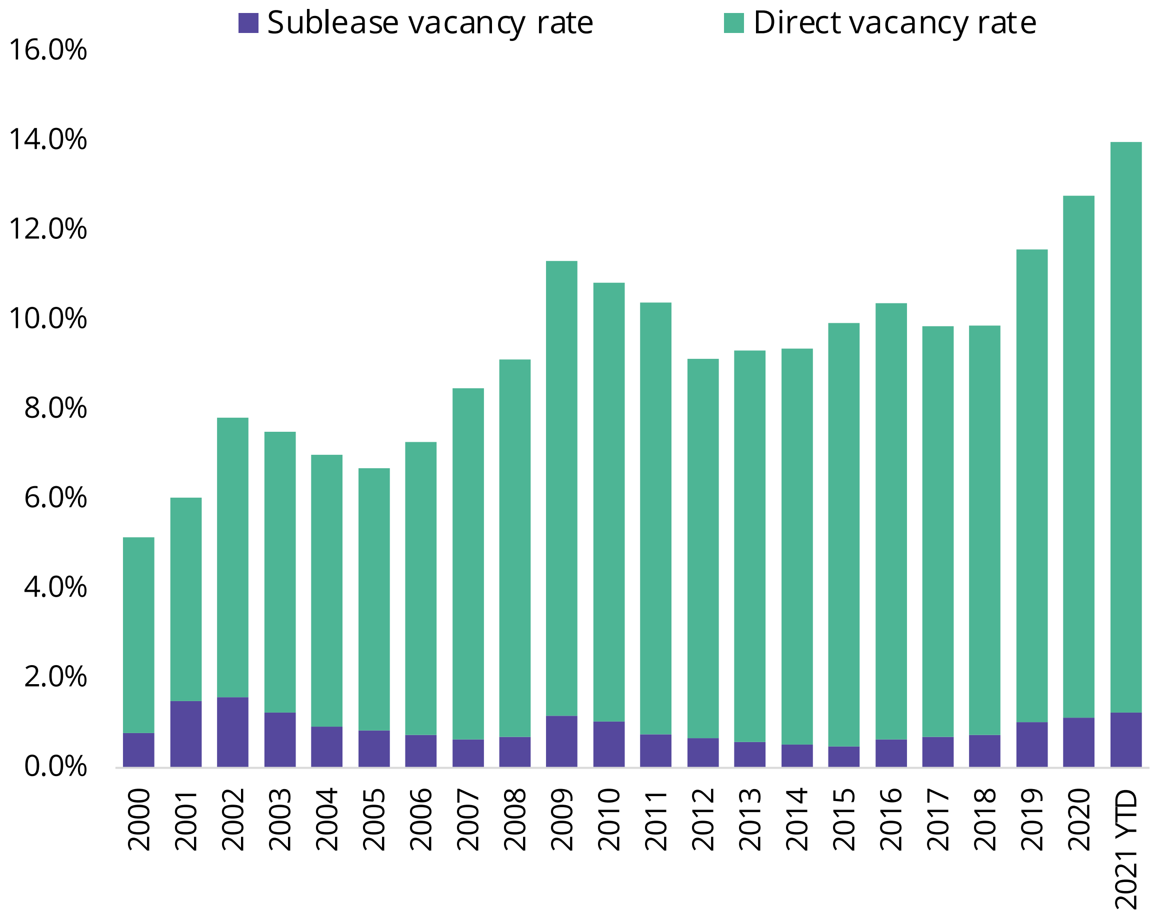
Vacancy rate

14.0%

Record high District of Columbia vacancy as of Q3 2021

Direct and sublease vacancy have both reached record highs in 2021 and show no signs, yet, of topping out.



Source: AVANT by Avison Young

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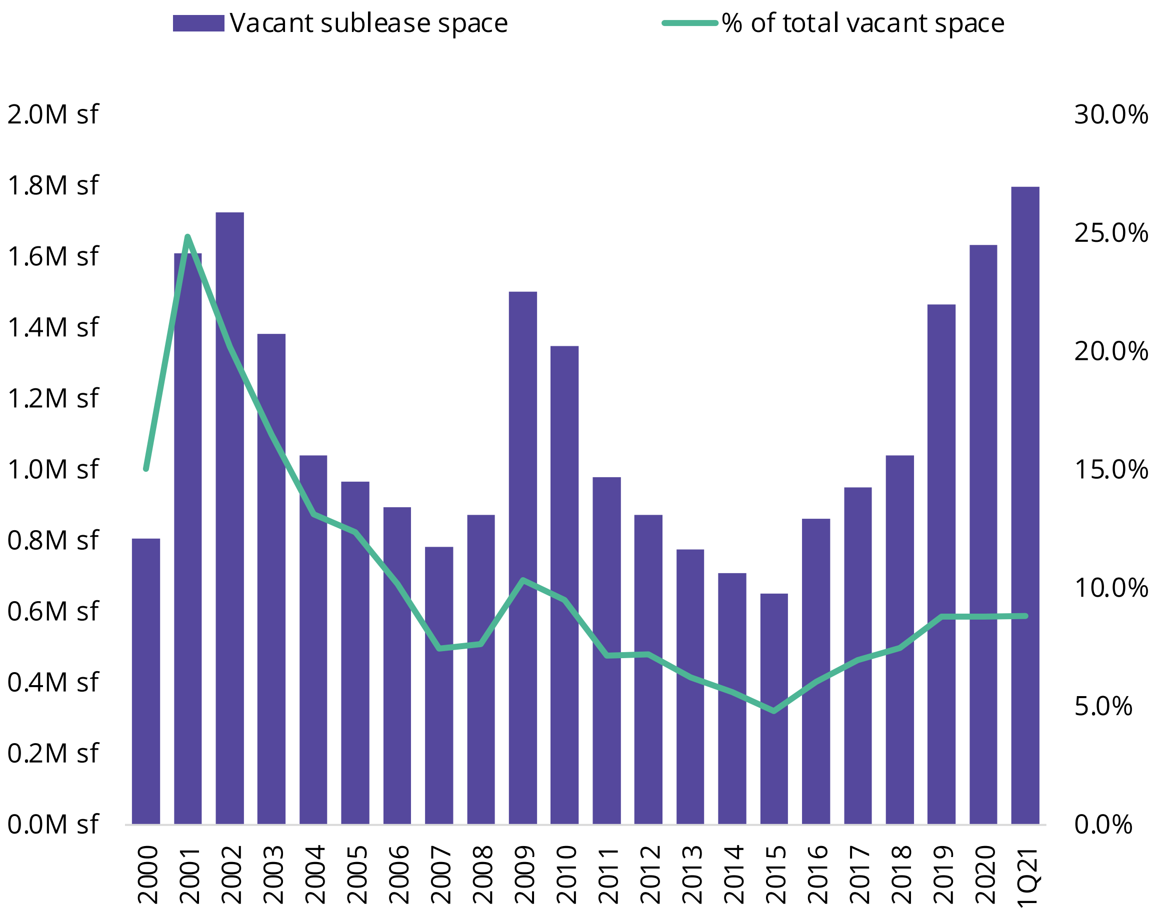
Vacant sublease space

1.8 msf

Record levels of sublease vacant space

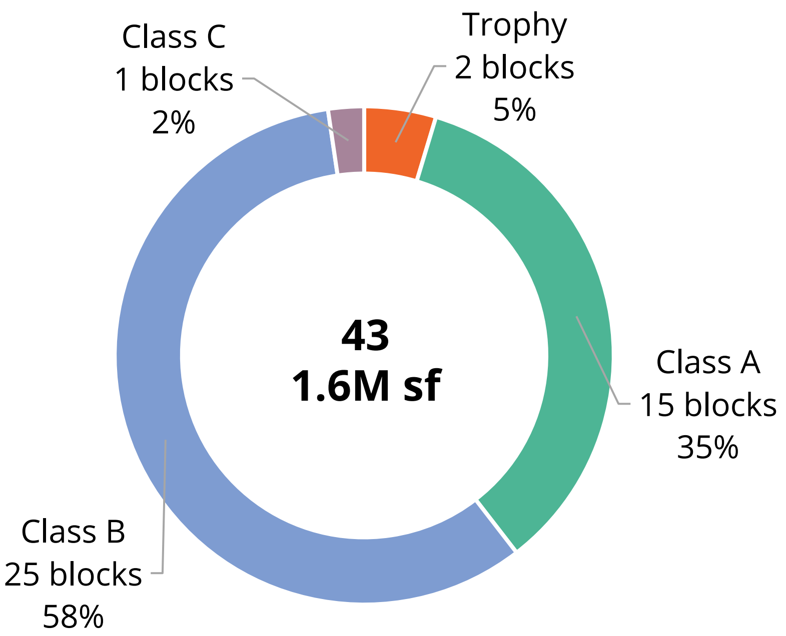
The volume of vacant sublease space on the market has reached a 20-year high, though it still accounts for only 8.8% of total vacant space. There is an increased demand for spec/move-in-ready sublet options throughout DC-metro region.



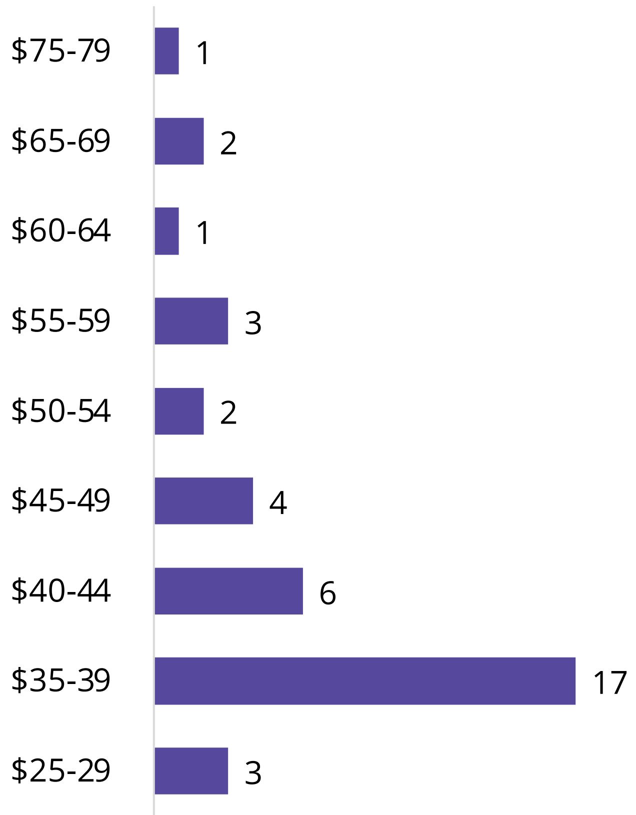
Source: AVANT by Avison Young

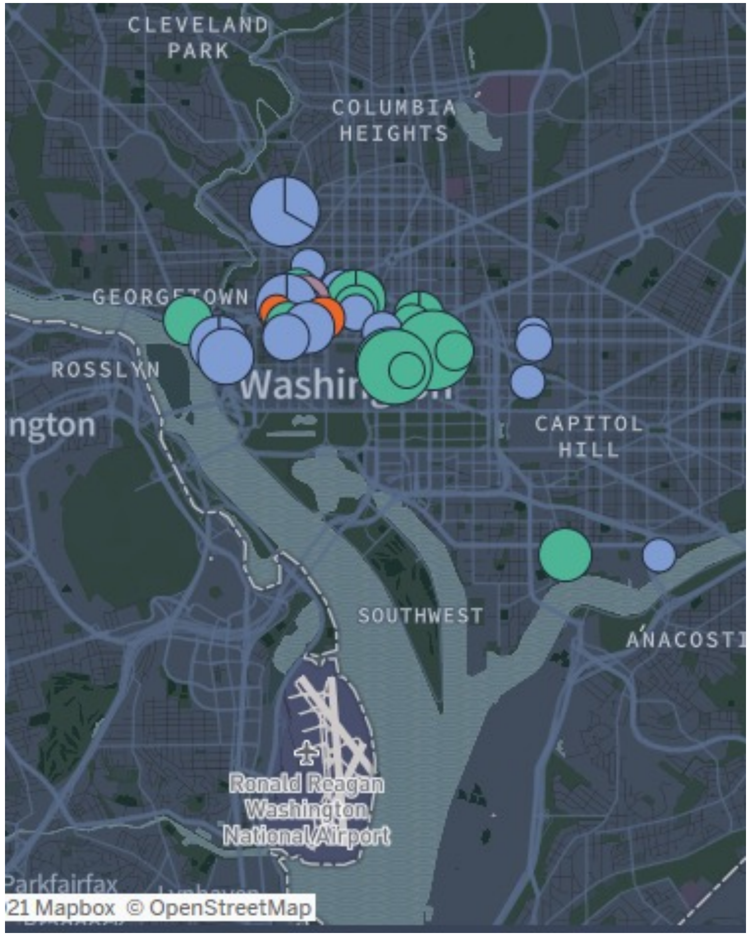
Sublease supply pipeline

Building classification



Asking rent per square foot





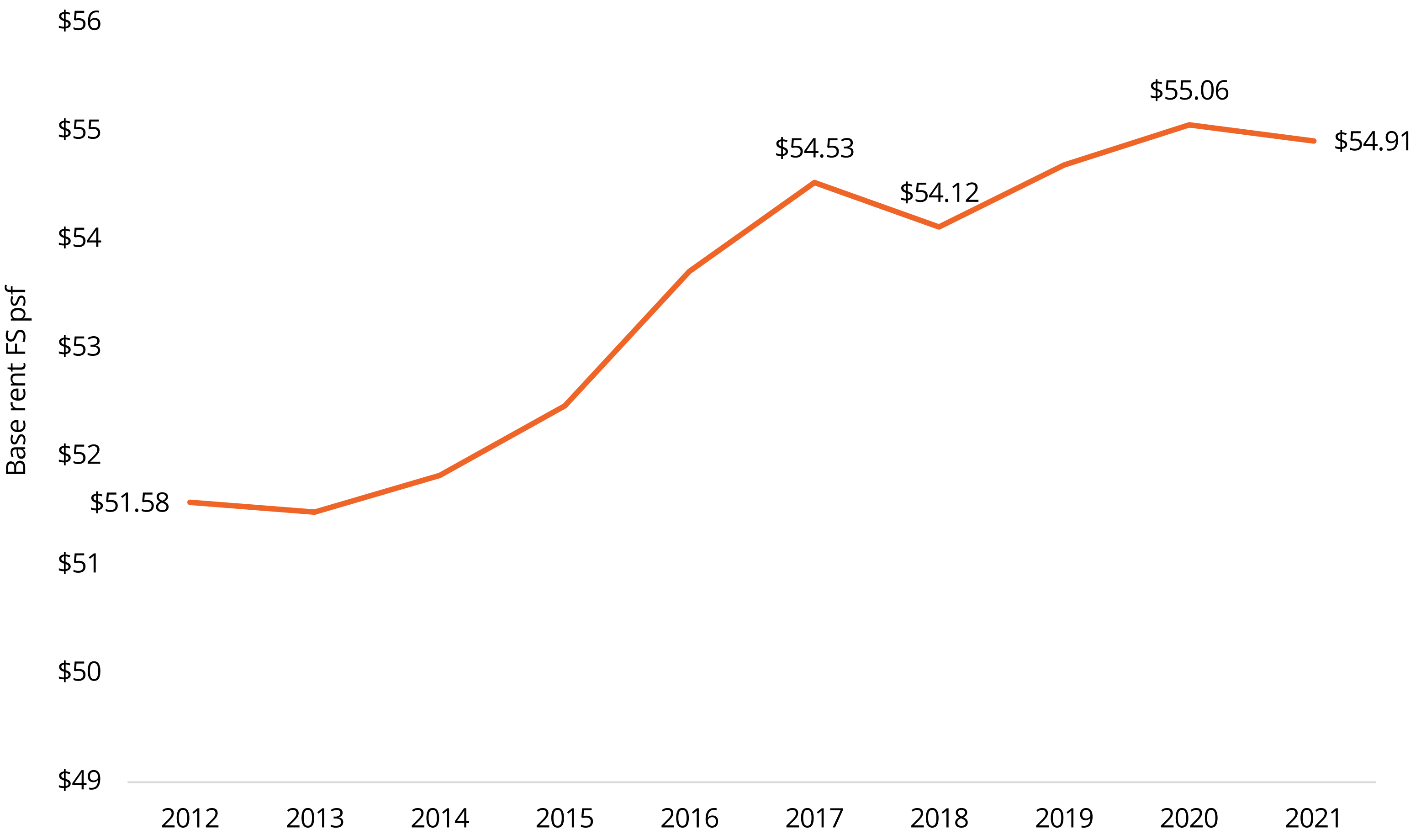
Source: AVANT by Avison Young
Note, these figures are comprised of Large Blocks only (20k +)

Rents

-0.3%

Change in base rents, year-to-date 2021

After continuing to rise in the face of the pandemic in 2020, average rents have now begun to erode slightly in 2021.



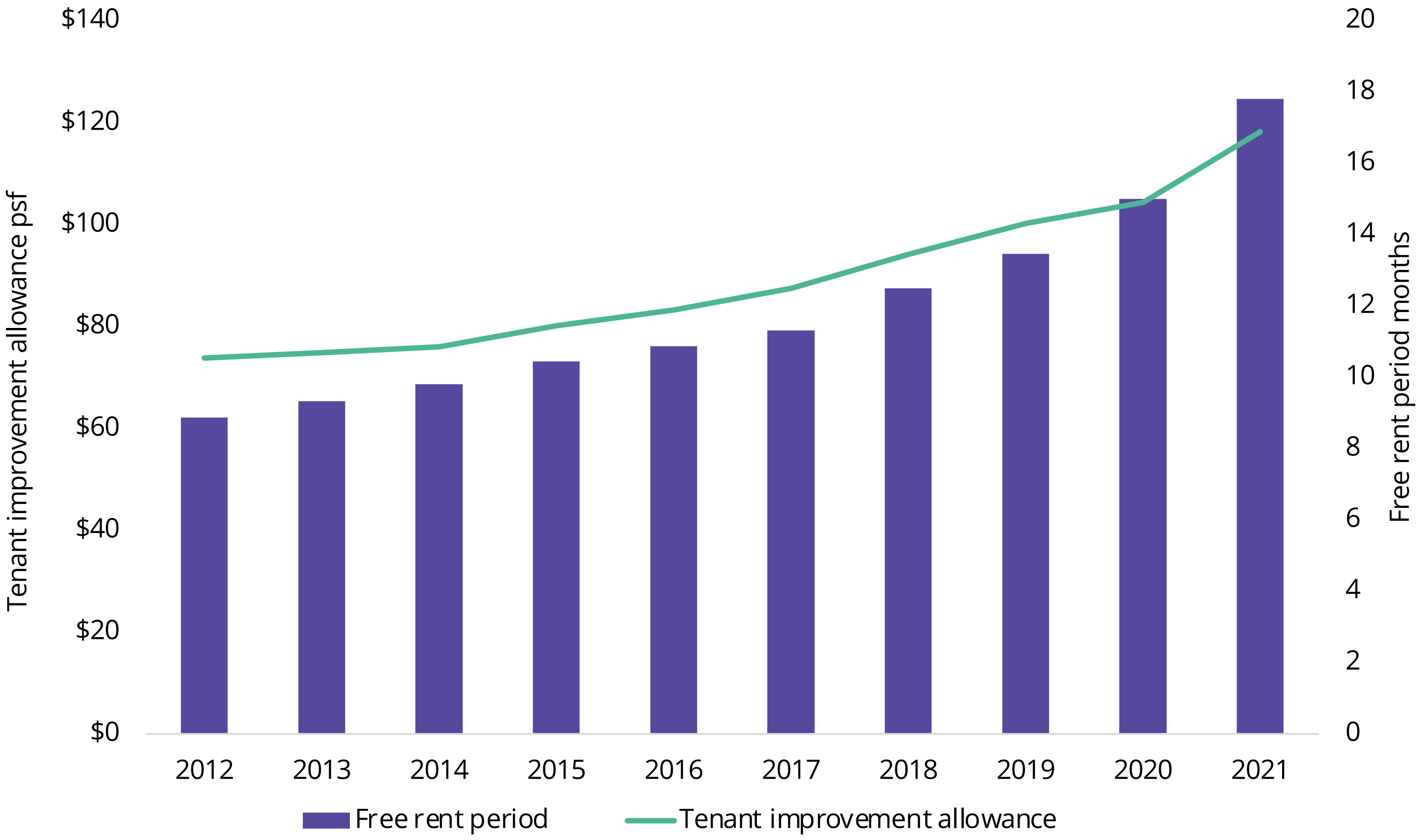
Note: Excludes subleases, expansions and renewals.
Source: AVANT by Avison Young

Concessions

13.3%

Change in tenant improvement allowance amounts, year-to-date 2021

Tenant improvement allowances and free rent periods have consistently increased year over year, a sign that the office market truly is a tenant's market. DC remains the country's softest office market when measuring concessions.



Note: Excludes subleases, expansions and renewals. 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	$51 psf	10 months	$79 psf	$43 psf
04/2020 to today	$56 psf	15 months	$84 psf	$46 psf

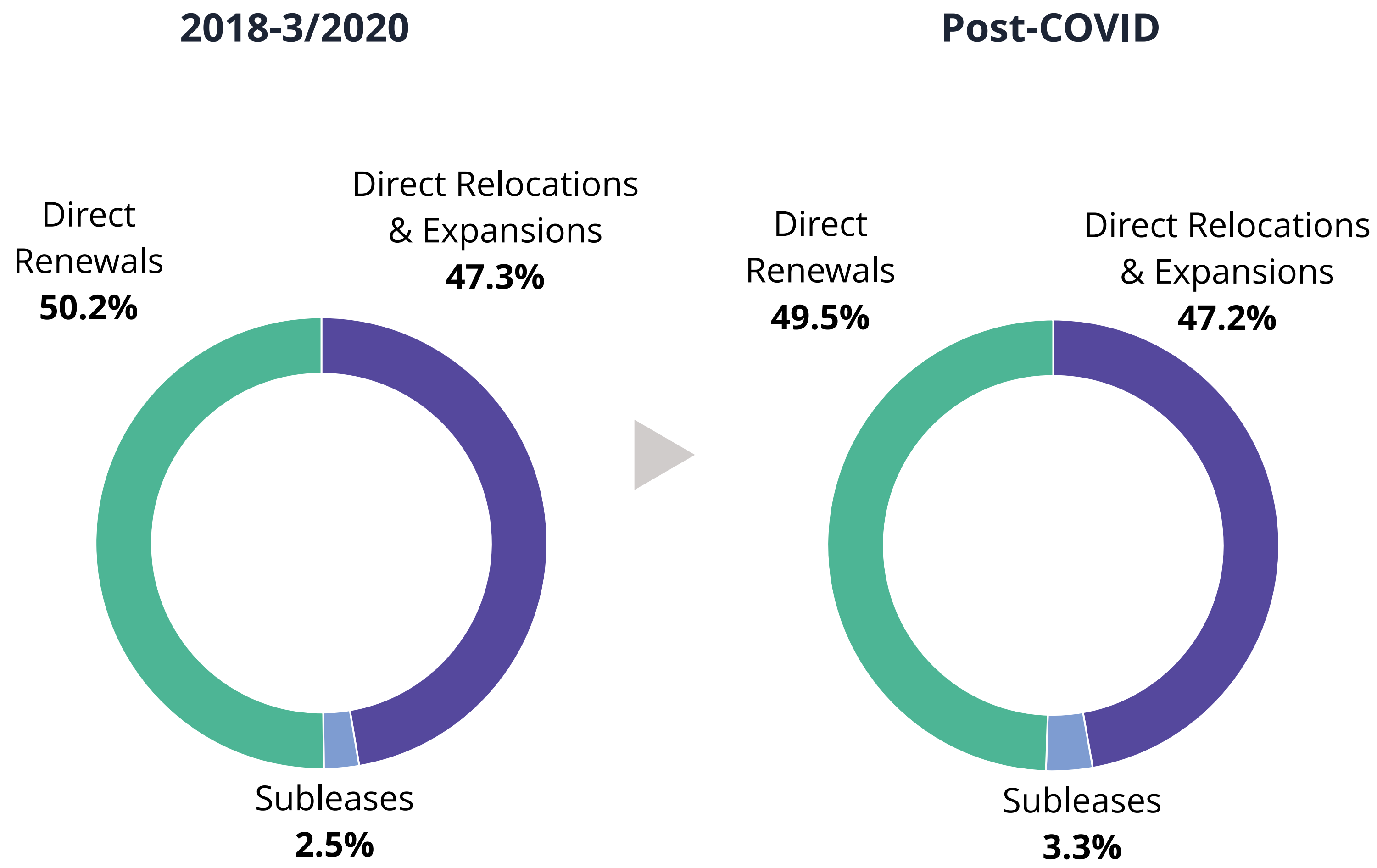
Note: Class B and C direct relocations only normalized for 10-year lease terms. 03/2020 describes timing of onset of COVID-19 pandemic.
Source: AVANT by Avison Young

Transaction activity by lease type

49.5%

Renewals share of total DC office leasing activity post-COVID

Renewals have remained relatively stagnant, with a slight uptick in sublease activity, seen by many employers as a cheaper alternative, requiring less of a commitment.



Source: AVANT by Avison Young

Office development pipeline

21 properties

Under Construction or Renovation

4.4 msf

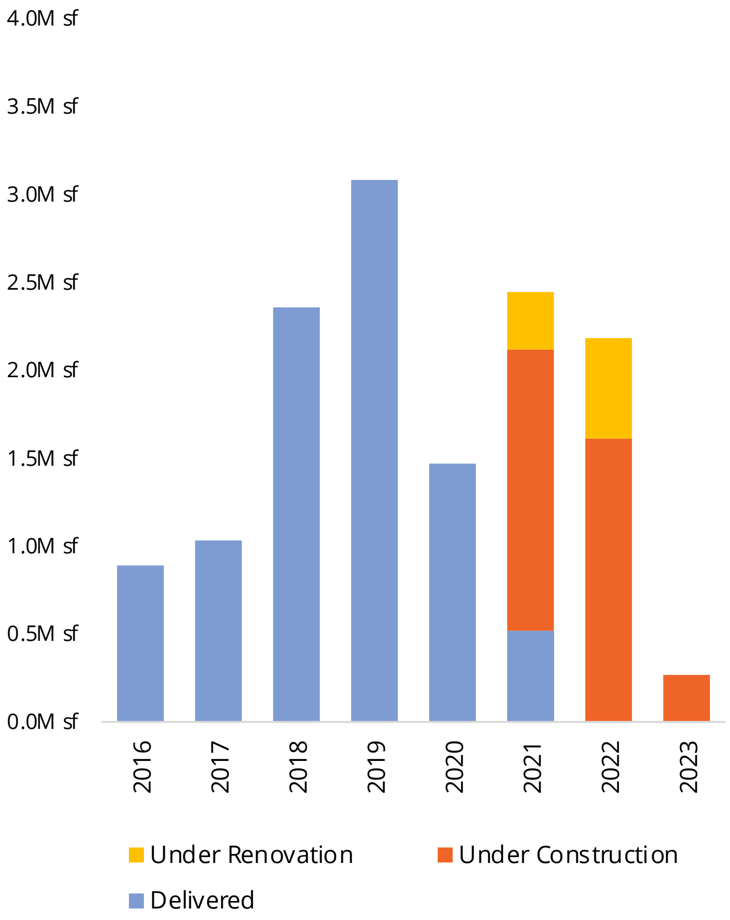
Under Construction or Renovation

2.4%

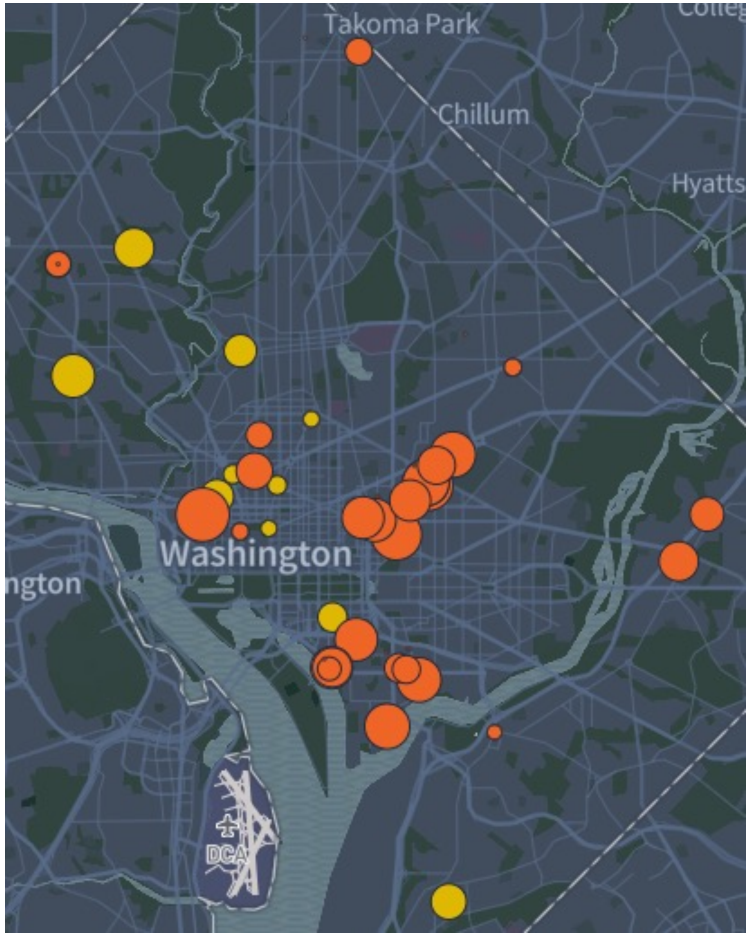
share of office inventory

1968

average delivery date of existing District of Columbia offices



Source: AVANT by Avison Young

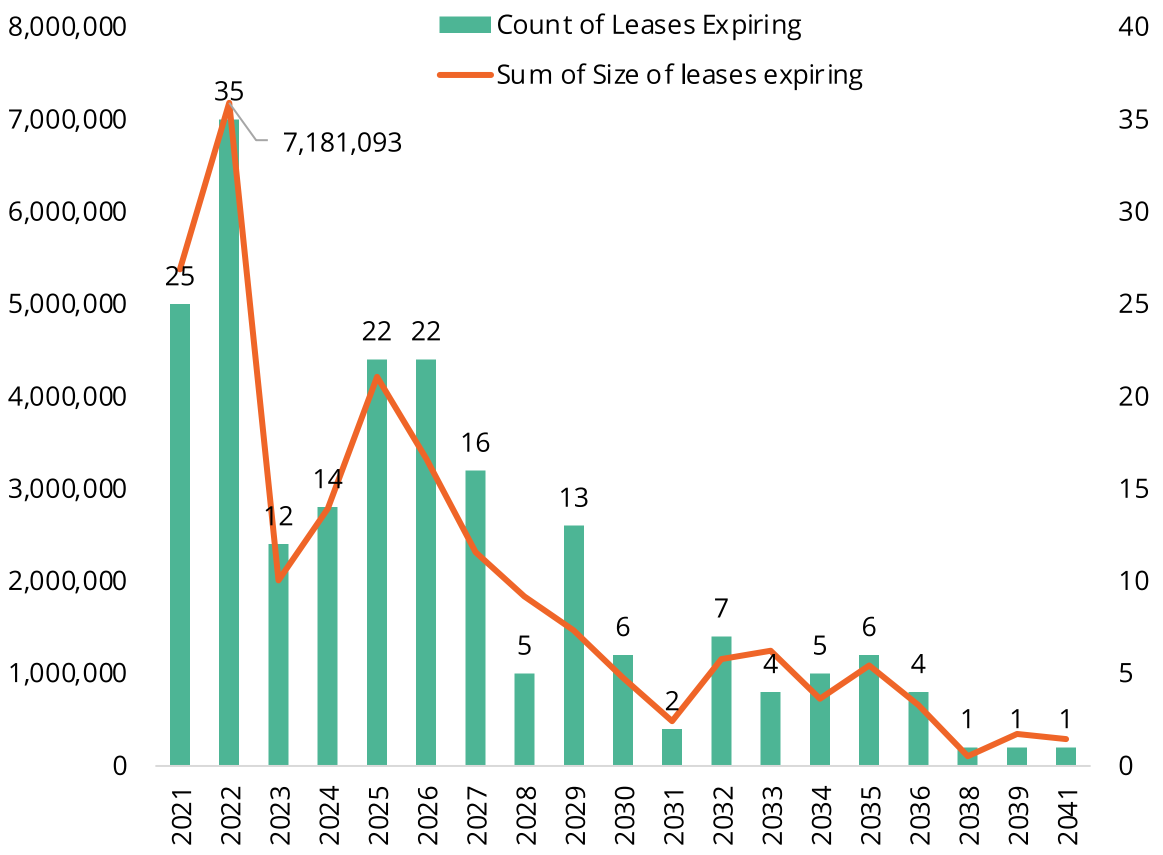


GSA Lease Expirations

21.6 Million

Square footage of GSA leases expiring in DC by 2025

The GSA has always been the largest consumer of office space in DC and with hybrid or remote-work models becoming more prevalent chances are they will shed excess office space in some capacity, whether it be moving into unused owned space or adopting a teleworking approach.



Source: GSA Lease Inventory

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Capital market conditions

Investors are continuing to favor stabilized, and less risky, assets in the DC market to mitigate potential losses due to the uncertainty's surrounding return to office.

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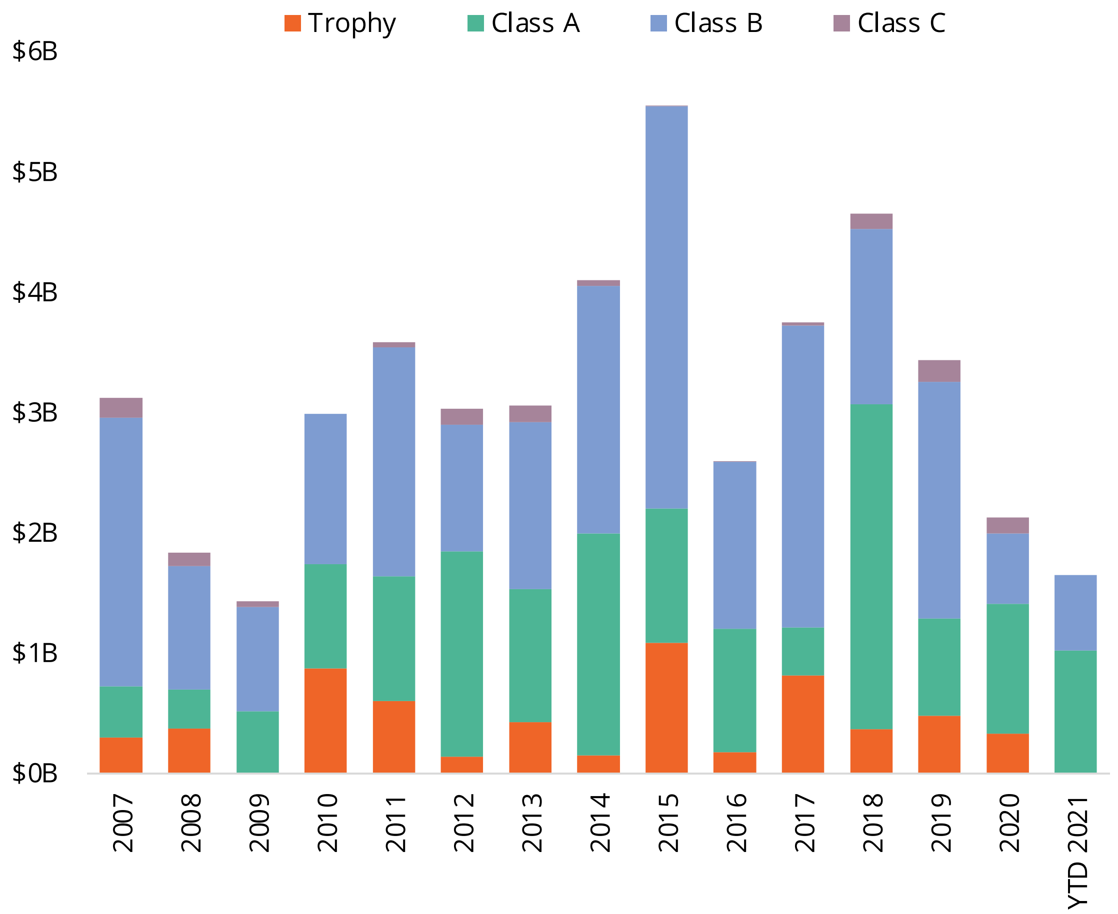
Office investment dollar volume

$3.7B

District of Columbia office dollar volume 2020 to present

Office sales activity has temporarily paused during the risk-pricing crisis, decreasing by an annualized rate of 37% compared with the prior five-year average dollar volume.



Source: AVANT by Avison Young,

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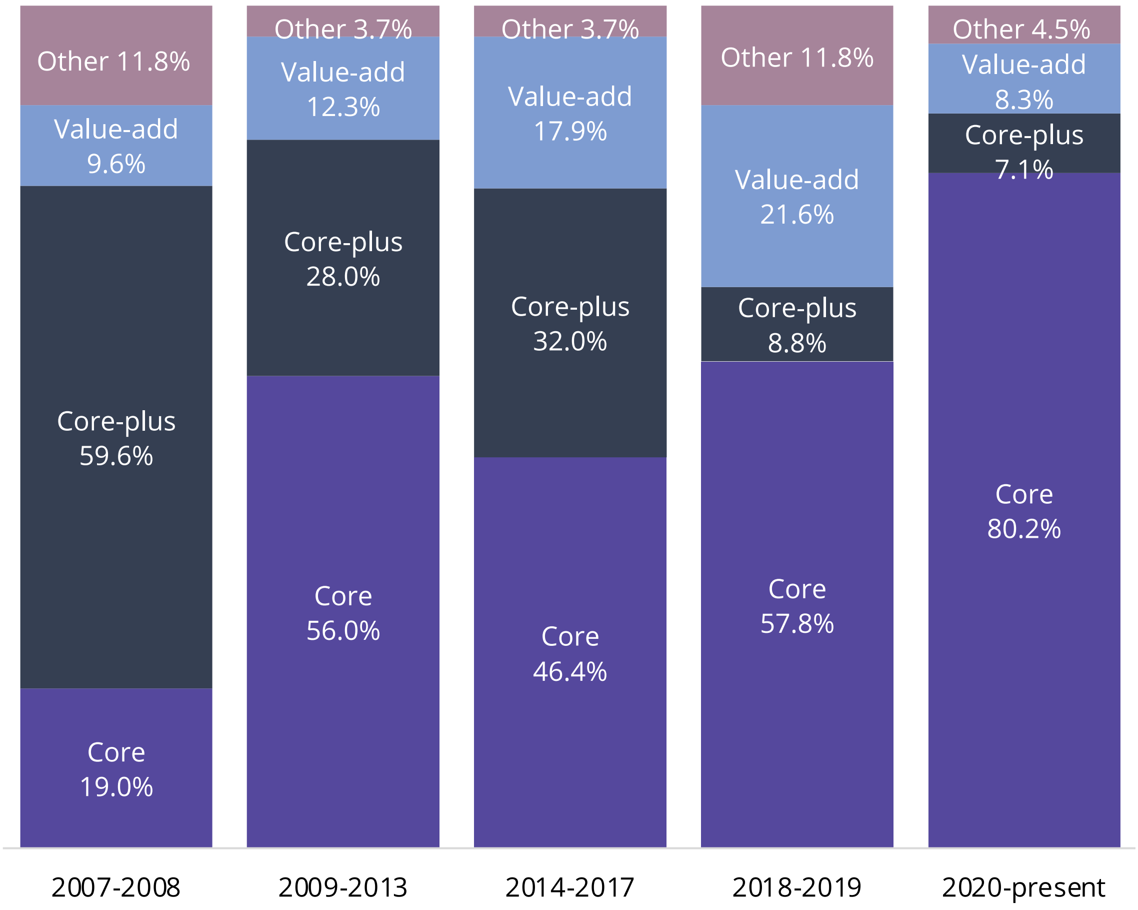
Office investment asset profiles

80.2%

DC core investments since 2020

Core investments have become more prevalent as investors prioritize “safe-haven” investments over riskier, value-add investments.



Source: AVANT by Avison Young

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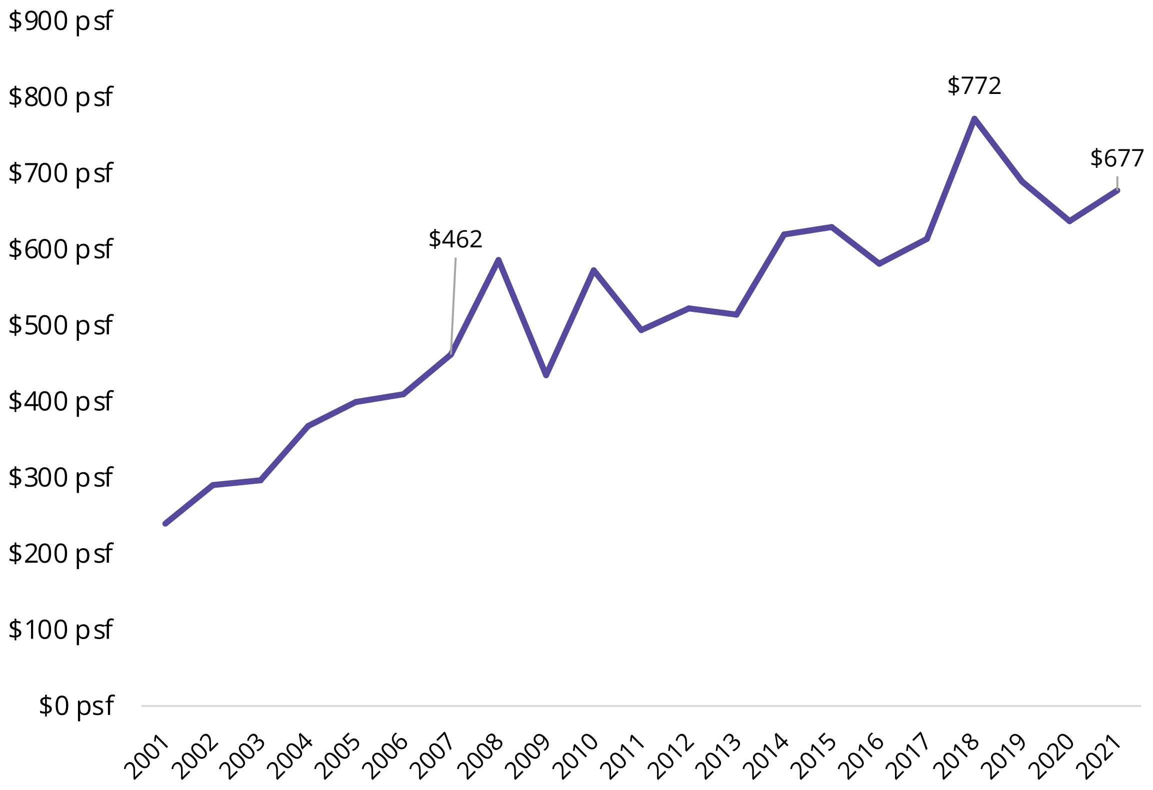
Office asset pricing

+6.3%

District of Columbia stabilized office pricing since end of 2020

Pricing for stabilized assets has fallen during the pandemic and have bounced back slightly in 2021 as investors proceed with slightly more confidence than previous years.



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

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Looking forward

Here's what we can expect

- Primary end-users continue to question their need for traditional office-space valued pre-pandemic, and with the flexibility of remote work, vacancy could climb another **20-25% in the next 48 months** leading to declines in face rents and increased concessions.
- **Interest in spec suites and move-in-ready options will continue to rise** as tenants are tending to favor more flexible lease terms given continued uncertainty about the future of their workforce.
- **Flight to quality** will continue to persist, with tenants favoring buildings that offer **robust amenities** such as conferencing facilities and roof terraces.
- **Return-to-work** remains something to watch, as some companies will be returning to the office in the coming months, with others opting to push their date until 2022. Regardless, weekend activity in retail-heavy corridors is experiencing a more expeditious return to pre-COVID levels.
- **Core investments** will continue to be the preferred avenue for investors, opting for less risk instead of value-add investments which had been more common in the past. However, if interest rates continue to stay low this trend could potentially resume.

Get in touch

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Let's talk

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