THE BRIGHT SIDE

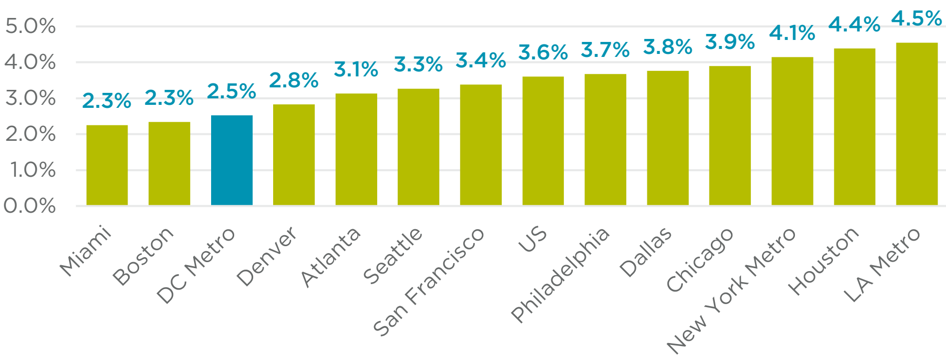
FINDING OPPORTUNITY IN THE DC OFFICE MARKET

GENERAL ECONOMY

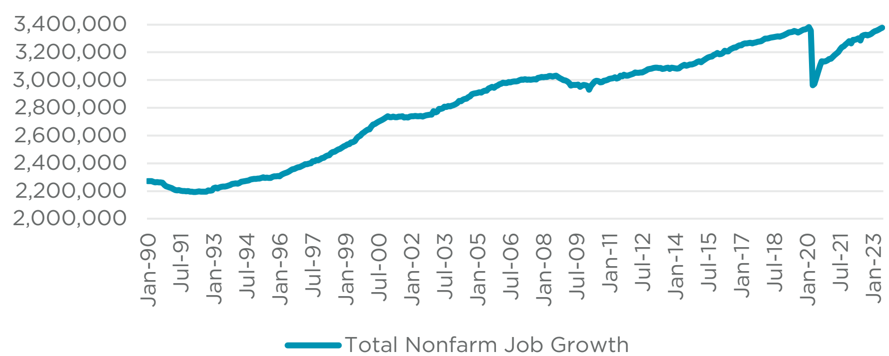
The DC Metro Region regained all the job losses experienced during the COVID-19 pandemic and now boasts 3.4 million jobs, more than at any other point in history. Job growth is particularly strong in office-using sectors like professional and business services, with 22,500 more jobs than pre-pandemic levels. Other job sectors experiencing high growth include construction, information, education and healthcare services (3,900, 3,700, and 11,000 jobs greater than pre-pandemic levels, respectively). The regional unemployment rate ended June 2023 at 2.5% - the lowest recorded rate since December of 1999. Among major metropolitan markets, 2.5% is the third lowest, behind Boston and Miami (both at 2.3%) and significantly lower than the overall U.S. rate of 3.6%.

UNEMPLOYMENT AMONG MAJOR U.S. METROS

June 2023



TOTAL NONFARM JOB GROWTH IN THE DC METRO REGION



Source: Bureau of Labor Statistics (BLS)

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THE TROPHY MARKET

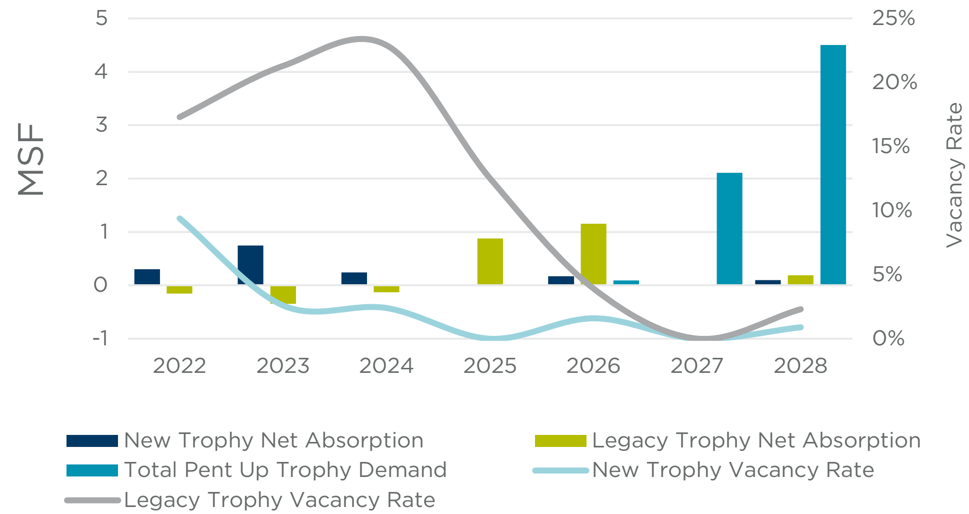
The DC office market is rife with news about distress in the sector but many of these reports overlook the continuing strength of top tier trophy office product. While Class B and C vacancies are hovering north of 22% and 25%, respectively; and Class A vacancies stand at 18.6%, overall trophy product finished the second quarter of 2023 at 12.6% with quality, large blocks of high-end space increasingly hard to come by.

DC VACANCY BY CLASS

The trophy market has averaged over 600,000 square feet (SF) of absorption in recent years and with only 2.5 MSF of current vacancy combined with falling new supply, availability in trophy buildings will be increasingly hard to secure in the next 48 months. Furthermore, availabilities in trophy assets that were delivered in 2010 or later are currently in the single digits.

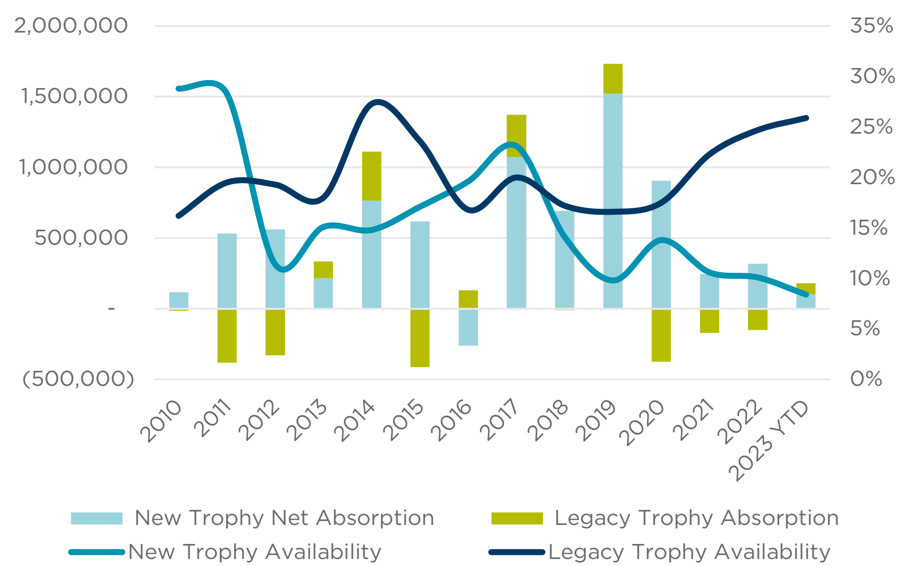
As new trophy vacancy approaches zero by 2025, an average of 475,000 SF of trophy demand gets passed onto legacy trophy assets. Legacy trophy quickly tightens as new options are scarce and are leased quickly. Trophy space of any kind will be at near full occupancy by 2027, ultimately producing 4.5 MSF of pent-up trophy demand by 2028 with no product available to house it.

TROPHY FORECAST



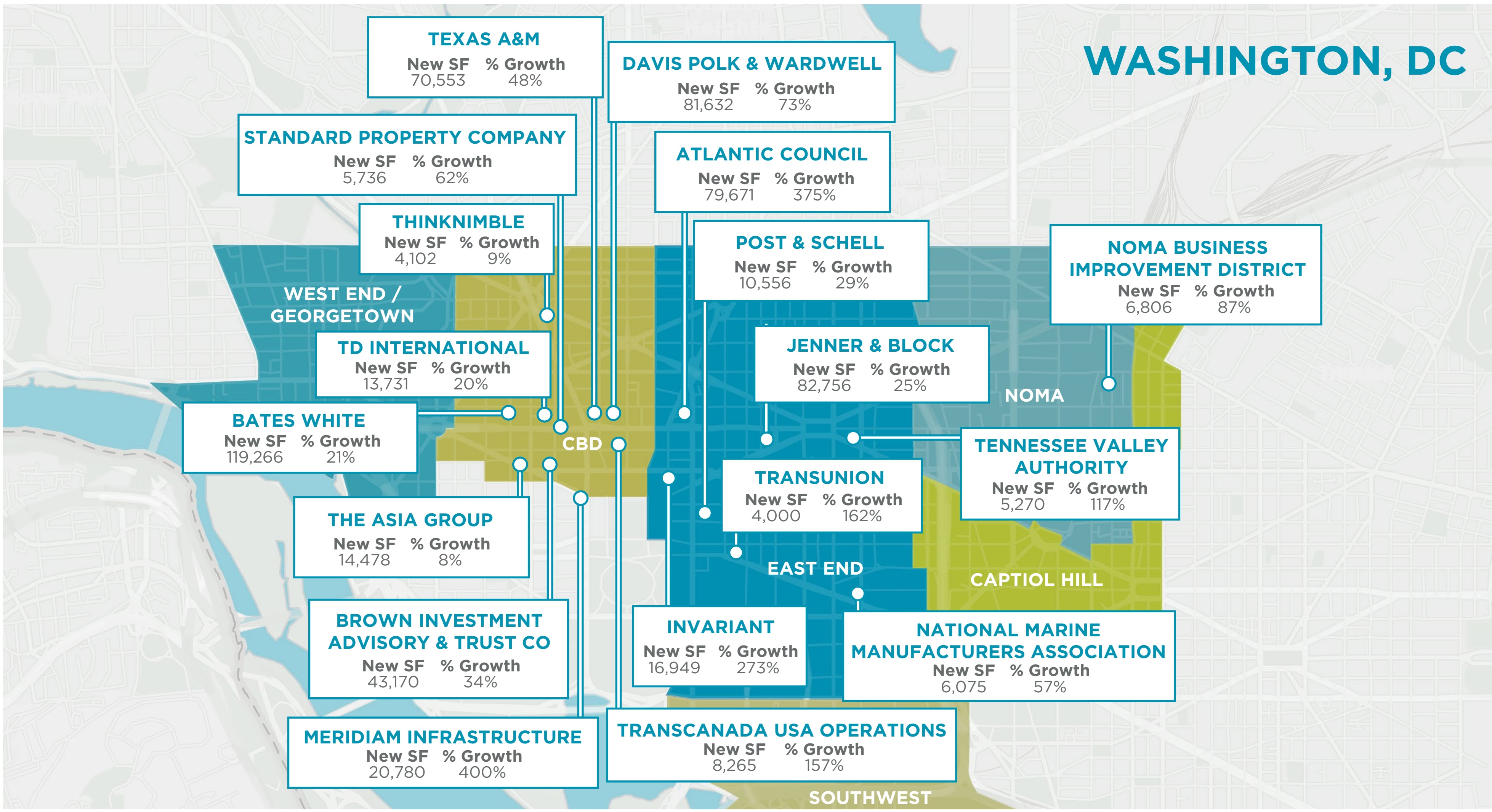
LEGACY VS. NEW TROPHY

Trophy Built After 2010 is Outperforming



TENANT EXPANSIONS

While large tenants are downsizing an average of 32% in relocations, growth among smaller users is notable. Cushman & Wakefield has tracked 24 occupiers between 1,600 and 100,000 SF that have increased their office leases in 2023 with an average increase of 9,200 SF, or 106%. Two-thirds of the expanding users came from the Legal, Financial, or Not-for-Profit sectors. Notable transactions are shown in the map below.



OFFICE CONVERSIONS

The increased conversion of office space to other uses and the removal of obsolete office product has the potential to speed up recovery in the office sector. Multifamily conversions underway include 1111 20th St, NW, 1313 L Street, NW, and several buildings in and around the old Fannie Mae campus on Wisconsin Avenue, NW. Currently, there are 20 office buildings totaling 4 MSF under conversion or are planned to be converted into nearly 3,700 apartments with another 16 buildings totaling 3.4 MSF that could meet the same fate.

Office conversion to educational use continues following the sale of the old Newseum to Johns Hopkins University and 111 Massachusetts Avenue, NW to Georgetown Law. Most recently, the previous headquarters of the National Association of Broadcasters at 1771 N Street, NW was sold to the University of Southern California for $49.4 million, or $813 per square foot.

COMPLETED / UNDER CONSTRUCTION	PLANNED	PROPOSED / ON MARKET	RUMORED	TOTAL
11 PROJECTS	18 PROJECTS	16 PROJECTS	10 PROJECTS	45 PROJECTS
2,953,943 SQUARE FEET	3,614,636 SQUARE FEET	1,460,549 SQUARE FEET	1,895,271 SQUARE FEET	9,924,399 SQUARE FEET

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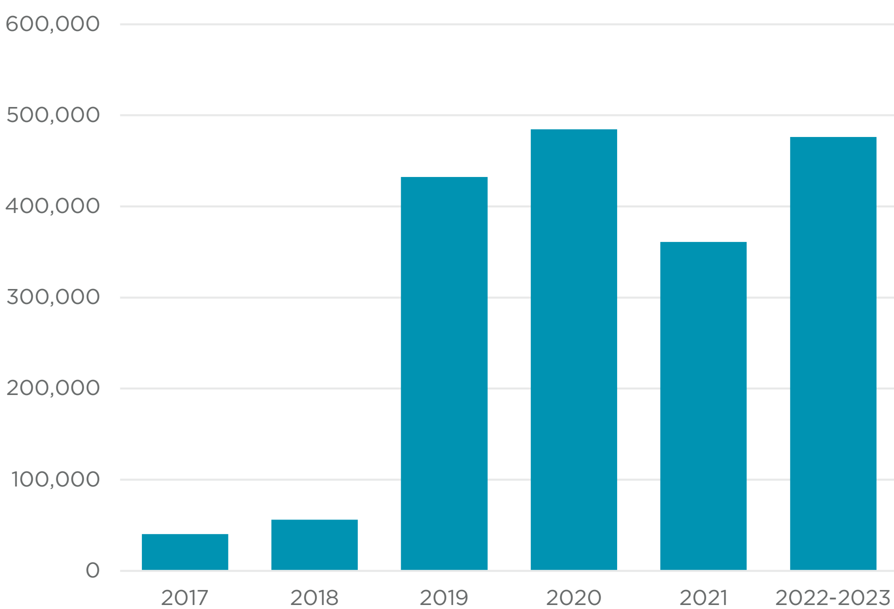
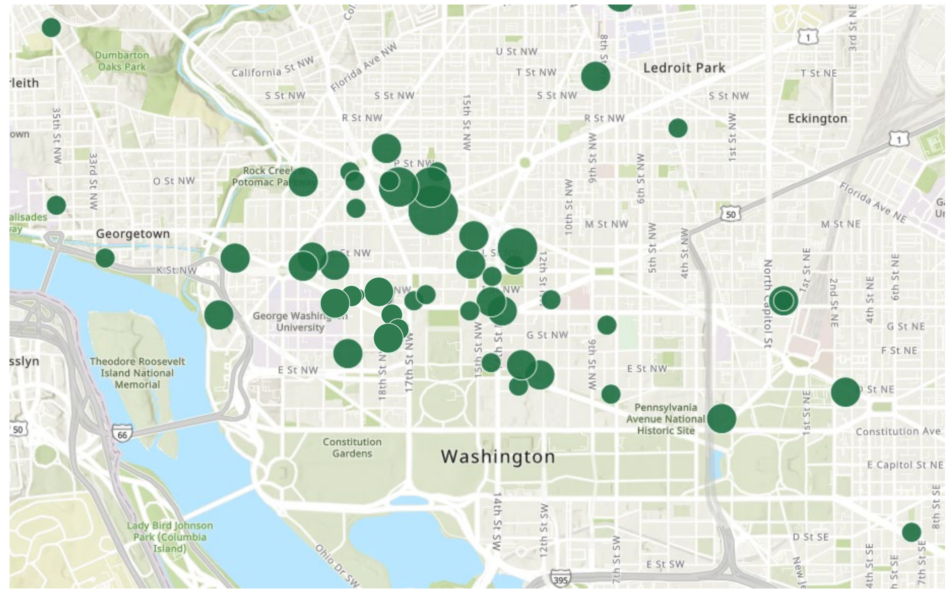
EDUCATION: DC IS THE EPICENTER OF COLLEGE SATELLITE CAMPUSES

Growing, large footprint users are hard to come by. In recent years, coworking and technology tenants had comprised the major growth engines for the office market. We can now add Higher Education to the list. Colleges and Universities are opening new classroom spaces and lobbying centers throughout Washington, DC and this has accelerated in recent years. This growth has encompassed both the leasing and sales side of the office market. Since 2019, higher education institutions have leased or purchased an average of 440,000 SF annually, up from 48,000 SF in 2017-2018.

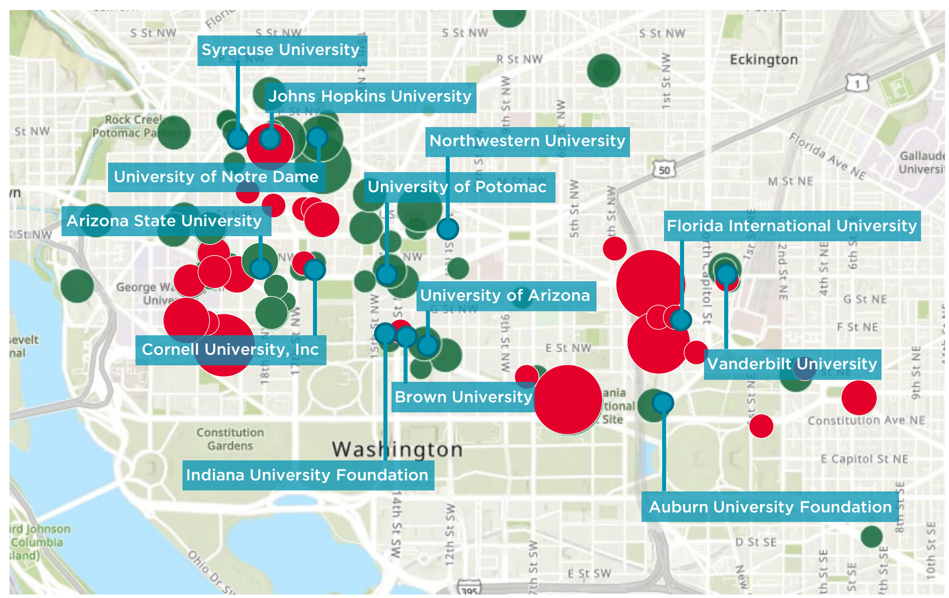
GROWTH IN EDUCATION
Sf Sold / Leased To Higher Ed



Pre - 2018



Today



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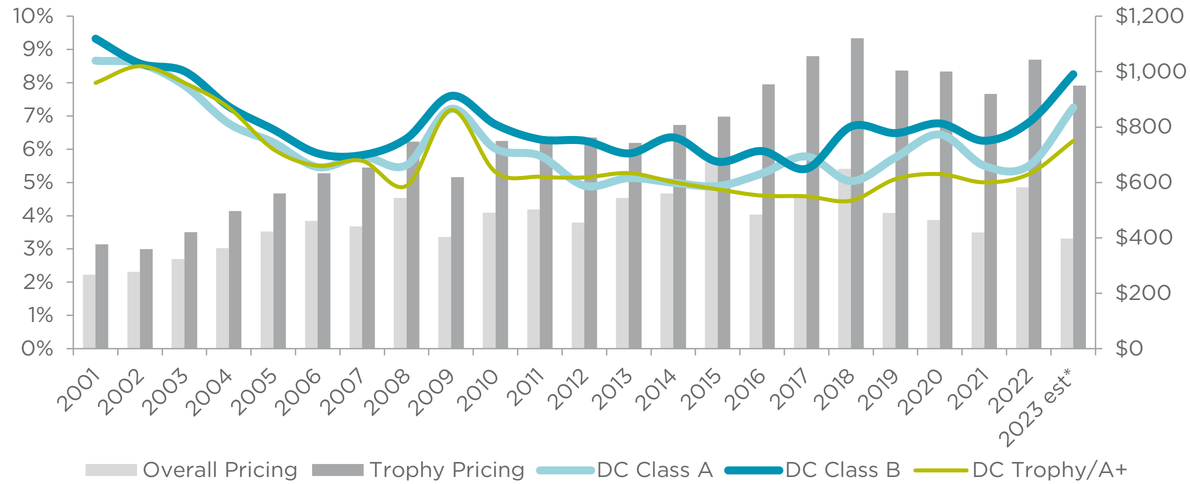
OFFICE SALES PRICING

Lower occupancy expectations, increased interest rates and the lack of available debt have combined to impair office liquidity limiting data points. This has made data points difficult to come by. Recent transactions are beginning to provide some clarity and paint a more complete picture. Although not located in DC proper, one core trade that we can point to is the recapitalization of the trophy building at 4747 Bethesda Avenue in the Bethesda/Chevy Chase submarket. The asset is a 2019 delivery with 12 years of weighted average lease term and traded for $815 per square foot at an 8% cap rate equivalent – a strong data point in the current market. Pricing is coming in on two additional Pennsylvania Avenue assets with rumored pricing pointing to continued strength for top tier office product.

OFFICE CAP RATES VS. PRICING



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