

DISTRICT OF COLUMBIA OFFICE MARKET

Q1 2023

TRENDLINES

	Q1 2023	Q1 2022	ONE-YEAR TREND	FIVE-YEAR AVERAGE	12-MONTH FORECAST
UNEMPLOYMENT RATE	4.4	5.9	↓	6.1	↓
NET ABSORPTION (THOUSANDS SF)	(248.0)	(365.0)	↑	(59.4)	↔
DIRECT VACANCY RATE	13.9%	13.1%	↑	11.4%	↔
DIRECT VACANT SF (MSF)	20.2	19.0	↑	16.3	↔
UNDER CONSTRUCTION (MSF)	0.7	2.4	↓	3.5	↓
ASKING RENT, FULL SERVICE (PSF)	\$53.52	\$53.73	↓	\$53.87	↔
SALES VOLUME (MILLIONS)	\$78.3	\$120.2	↓	\$422.8	↔

Source: Bureau of Labor Statistics, CoStar, Real Capital Analytics, Transwestern

OFFICE CONDITIONS CONTRACTED DURING Q1

Office market conditions in the District of Columbia diminished during the first quarter of 2023, with negative 248,000 SF in net absorption. This was due primarily to mid-sized tenant moveouts and downsizing. The direct vacancy rate inched upward 10 basis points at 13.9% at March 2023. Asking rents remained relatively flat during the past three months, averaging \$53.52 PSF at March 2023.

The District has yet to fully realize the full impact of tenant rightsizing to accommodate expanded hybrid work schedules. The majority of companies believe a physical office is needed but are shedding real estate on average of 20%. This will impact the office market over the next several quarters. Flight to quality will keep top tier office space healthy with lower grade space struggling to keep and attract tenants. Given record level availability, landlords will compete with generous concession packages. Conversions of obsolete office buildings could help stabilize the market, but it is unlikely all announced buildings will convert leaving some owners exploring options.

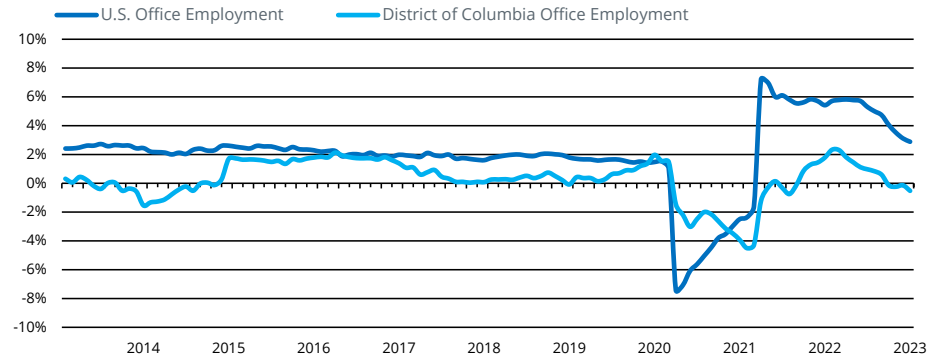


ECONOMY

Office-Using Job Growth Softening

- 15,200 new jobs were added to the District of Columbia economy during the 12-months ending January 2023, which is well-ahead of the pre-pandemic 5-year average of 9,800. This was driven by restaurants and bars.
- 2,600 office-using jobs were cut during the 12 months ending January 2023, which is below the pre-pandemic 5-year average of 4,800. Most of this loss occurred within the federal government.
- The unemployment rate for the District of Columbia is currently at 4.9% as of January 2023 and averaged 4.4% for the past three months. The rate down from 6.3% one year ago and is down notably since the peak of 10.4% in April 2020.
- We expect office-using job growth in the District of Columbia to ramp up over the next five years, adding just over 5,000 new jobs per year on average. However, this will be softer in 2023 due to economic uncertainty, with stronger growth in later years. We expect most of the growth to occur within civic/social organizations, consulting, and tech sectors.

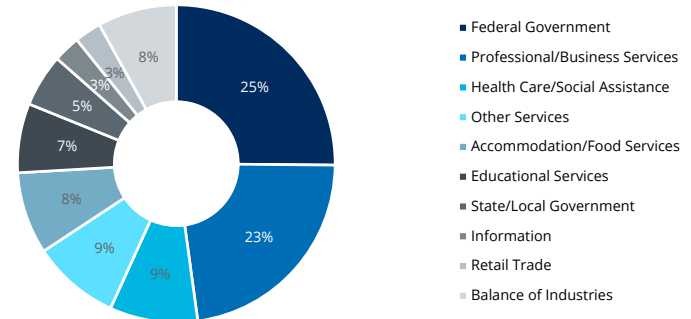
Y-O-Y CHANGE IN OFFICE JOBS



Source: Bureau of Labor Statistics, Transwestern

SHARE OF EMPLOYEES BY INDUSTRY

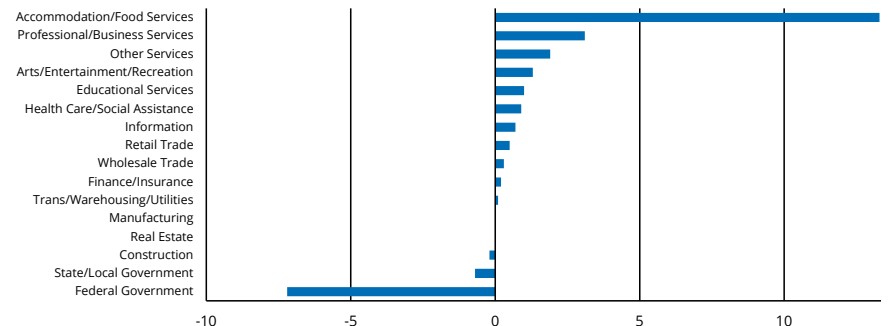
District of Columbia | January 2023



Source: Bureau of Labor Statistics, Transwestern

Y-O-Y CHANGE IN JOBS BY INDUSTRY

District of Columbia



Source: Bureau of Labor Statistics, Transwestern

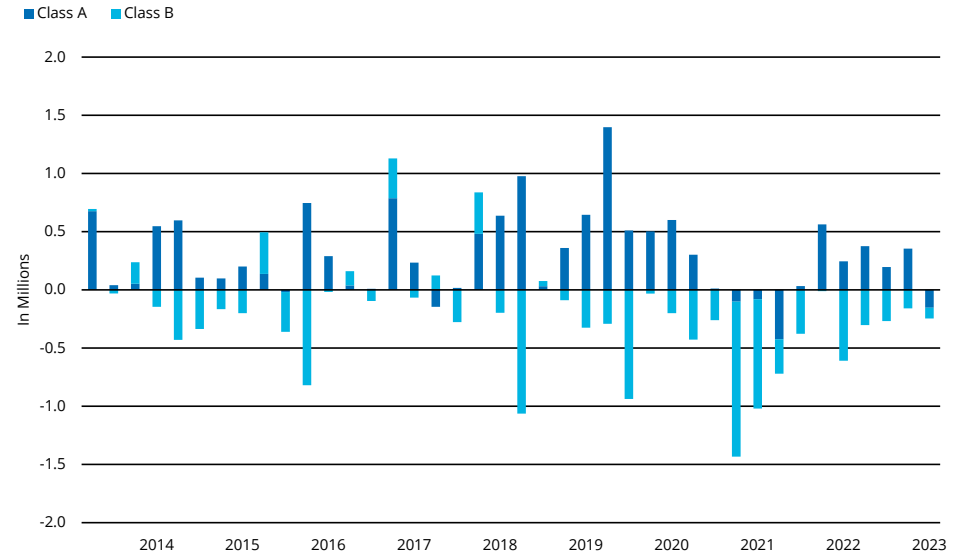


NET ABSORPTION

Negative Net Absorption Led by Multiple Mid-Sized Moveouts in Q1

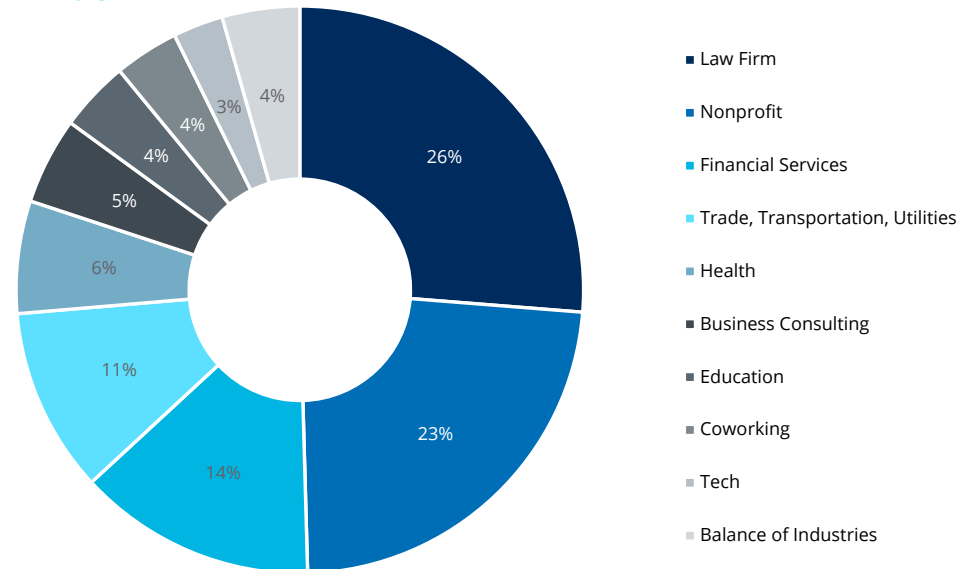
- Net absorption totaled negative 248,000 SF during the first quarter of 2023, after finishing 2022 with positive 195,000 SF during the fourth quarter of 2022. This compares to a year ago during the first quarter of 2022 where net absorption totaled negative 365,000 SF.
- Class A net absorption totaled negative 153,000 SF, driven by multiple midsize moveouts and downsizing. This is the first quarter since the second quarter of 2021 that Class A has totaled negative net absorption. Class B contributed as well with negative 93,000 SF.
- The most notable deal this quarter was Atlantic Council leasing 79,663 SF of space at 1400 L Street, NW in the East End. The non-profit will relocate from 1030 15th Street, NW. Another notable deal was Caplin & Drysdale signing a lease at 1200 New Hampshire Avenue, NW for 36,826 SF in the CBD. The law firm decided to downsize and consolidate to one floor to accommodate for their hybrid work policy. They will be moving from One Thomas Circle in the East End.
- Offsetting leasing activity this quarter were multiple mid-sized moveouts across the District. WeWork vacated 50,568 SF at 1875 K Street, NW in the CBD. In the Uptown submarket, National Women’s Law Center gave back the 7th and 8th floor at 11 Dupont Circle, NW for a total of 31,773 SF. Salvation Army vacated 33,924 SF at 2626 Pennsylvania Avenue, NW in the West End. This asset is slated to covert to multifamily.
- We expect office demand to remain challenged during 2023, as economic headwinds cause select tenants to pause lease decisions. We predict tenants will be in a period of rightsizing trying to find the correct amount of space needed as they navigate their work environment policies moving forward.

NET ABSORPTION BY CLASS



Source: CoStar, Transwestern

SHARE OF LEASING ACTIVITY BY INDUSTRY YTD 2023



Source: CoStar, Transwestern

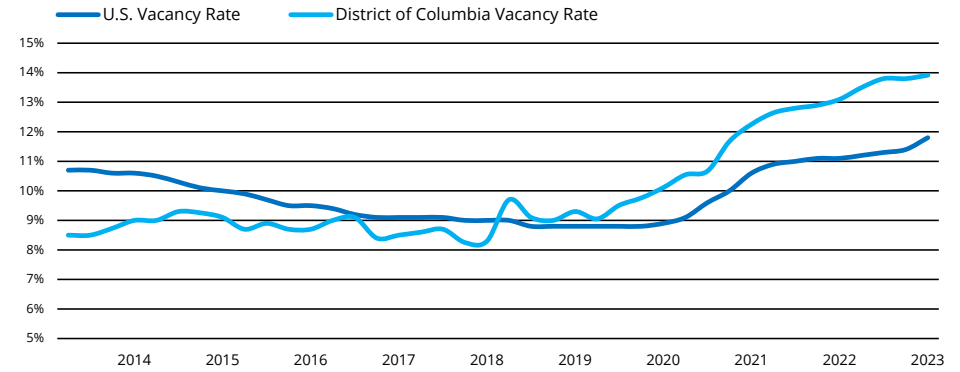


VACANCY

Vacancy Rate Inches Up in Q1

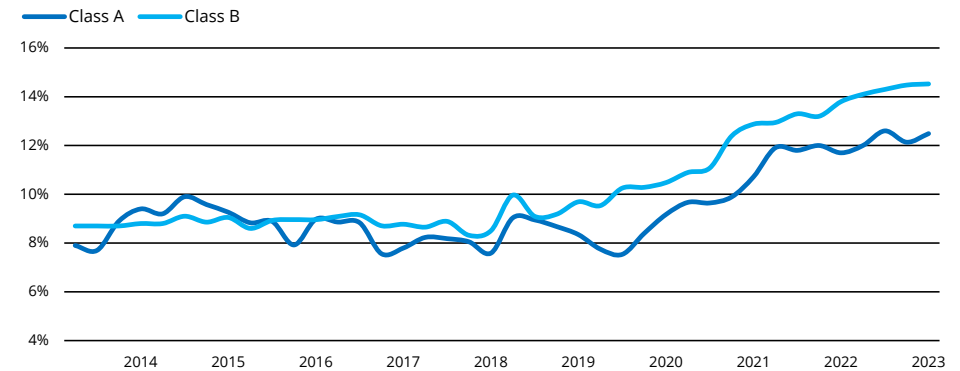
- The direct vacancy rate was inched upward during the quarter to 13.9% and remains elevated from 13.1% one year ago.
- The Class A direct vacancy rate increased 40-basis points to 12.5% over the past three months and is elevated compared to 11.7% one year ago.
- The Class B/C vacancy rate increased slightly by 10 basis points to 14.5% at March 2023 and is up from 13.8% one year ago. The rise this quarter was due mostly to tenants vacating older product in the Georgetown and West End submarket.
- The vacancy rate will remain under pressure through 2023 as tenants continue to right size real estate. The rate could somewhat be protected if the slated obsolete office products get demolished in preparation for conversion to another product, The rate for newer product will likely edge down, while older product will continue to see a rise.

DIRECT VACANCY RATE



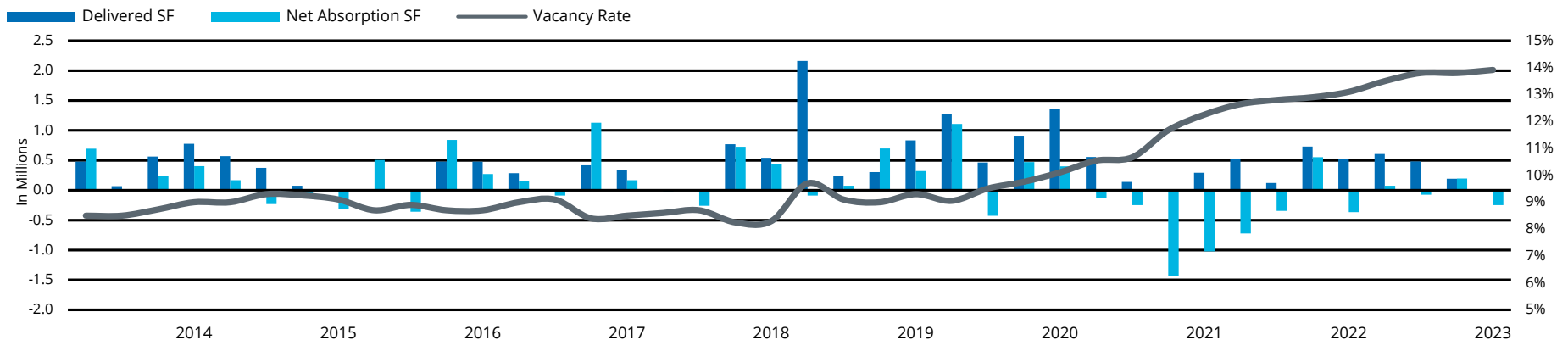
Source: CoStar, Transwestern

DIRECT VACANCY RATE BY CLASS



Source: CoStar, Transwestern

DELIVERY IMPACT ON KEY INDICATORS



Source: CoStar, Transwestern

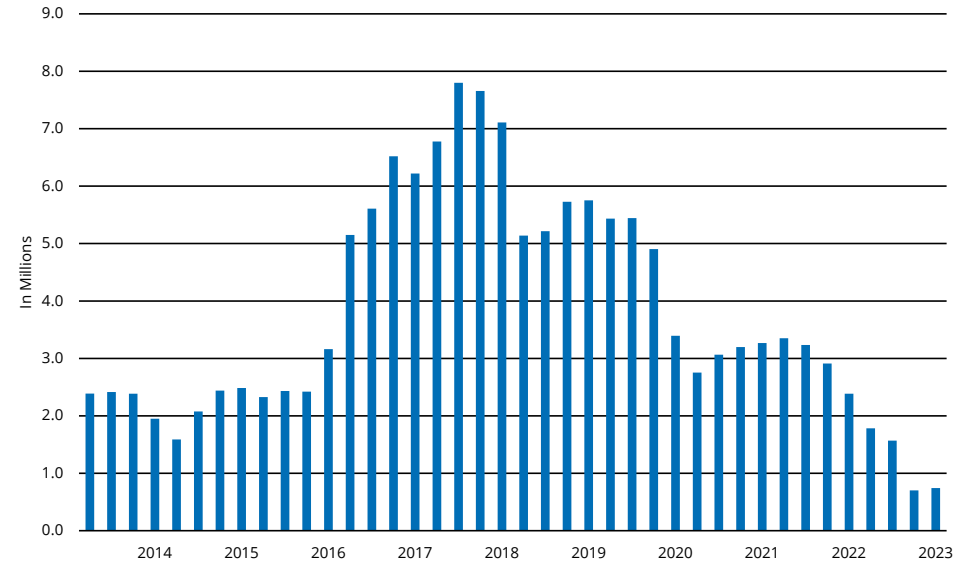


UNDER CONSTRUCTION

No New Deliveries Allows for Market Recovery

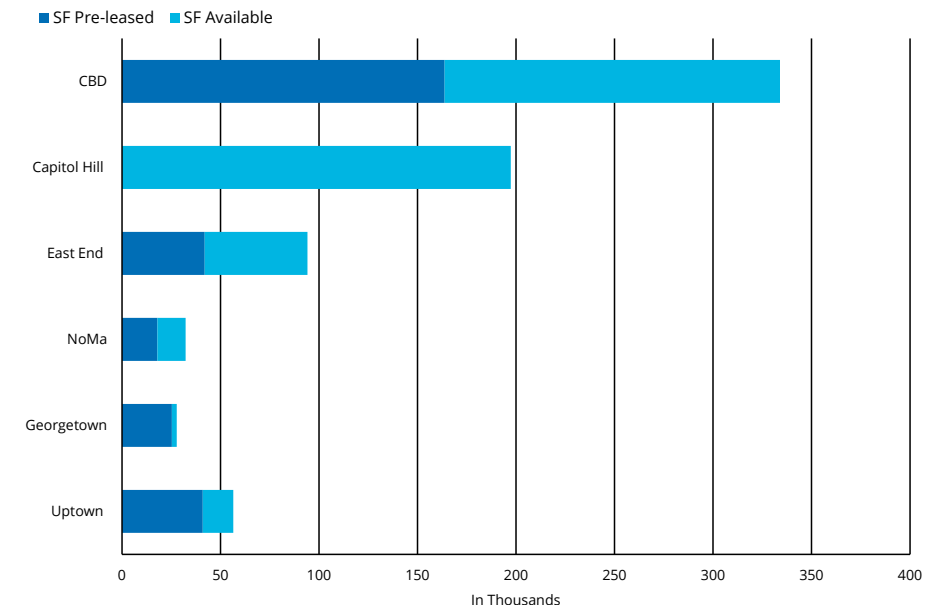
- Zero projects delivered during the first quarter of 2023. This compares to two projects delivering during the fourth quarter of 2022 for a total of 194,000 SF and three projects delivering one year ago during first quarter of 2022 for 524,000 SF.
- There is 742,000 SF under construction in the District of Columbia, with majority of the construction concentrated in the CBD and Capitol Hill. Projects in the pipeline are currently 39% pre-leased. This is down notably from 2.4 million SF one year ago.
- One notable building set to deliver is the mixed-use development at 20 Massachusetts Avenue, NW in the Capitol Hill submarket. This project will bring 197,000 SF of space to the market when it is slated to deliver by late 2023. Another project is 1700 M Street, NW developed by Skanska that is slated to bring 334,000 SF of Class A inventory to the CBD submarket.
- The construction pipeline will continue to decelerate as developers pause breaking ground under the current economic climate. Select owners will remain patient and look for conversion or renovation opportunities for flight to quality. Overall, this will ultimately help balance supply/demand fundamentals.

UNDER CONSTRUCTION



Source: CoStar, Transwestern

UNDER CONSTRUCTION BY SUBMARKET



Source: CoStar, Transwestern

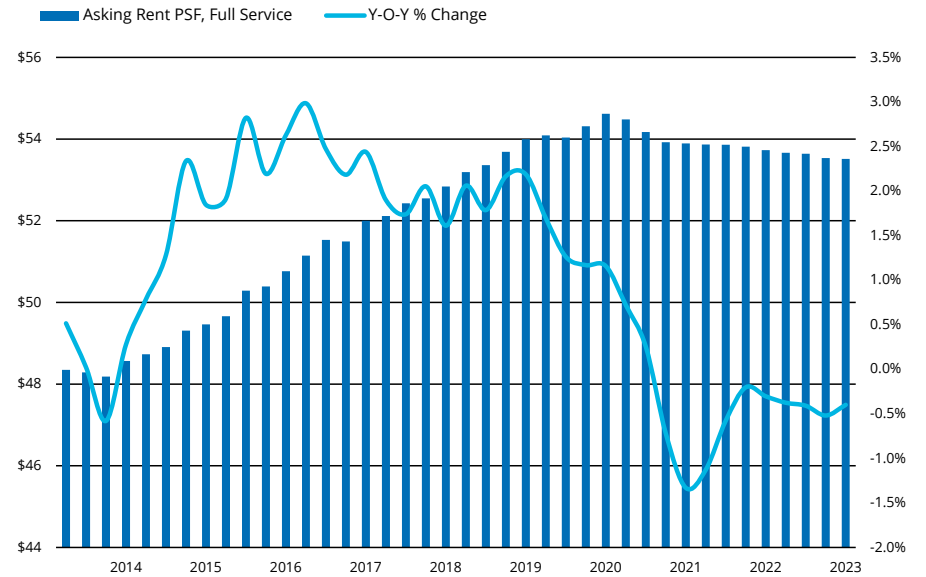


RENTAL RATES

Asking Rents Under Pressure but Stable

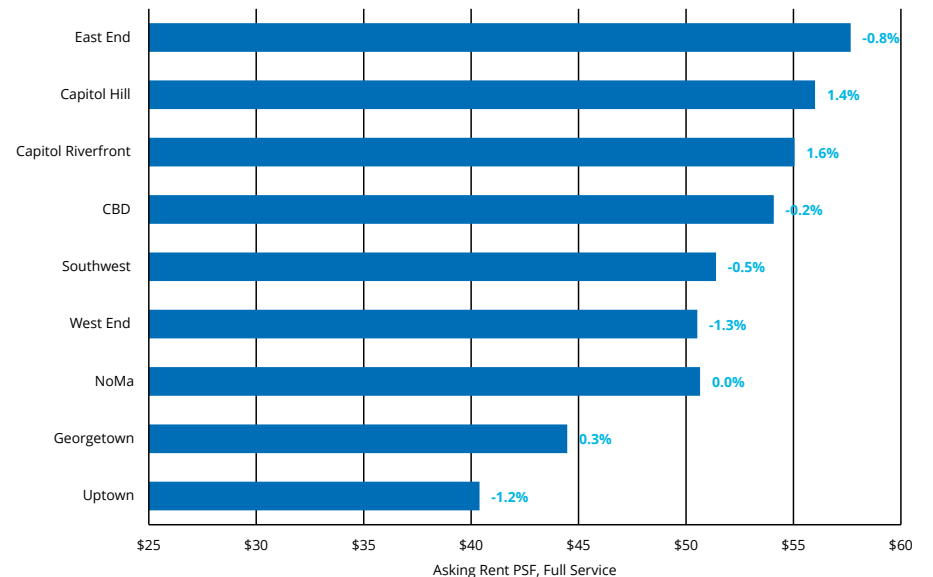
- Asking rents remained constant during the quarter, landing at one cent below last quarter at \$53.52 PSF in March 2023. Year-over-year, rents are down 40 basis points, driven by reduction in Class B/C buildings.
- Class A asking rents remained similar to last quarter, landing at \$57.18 PSF, while Class B/C finished at \$45.02 PSF.
- Rent growth is the strongest in the Uptown year-over-year, rising 2.6%. Offsetting this gain was West End, which reduced 1.3%.
- Concession packages are elevated in the District of Columbia and will likely remain so through 2023, which will put downward pressure on effective rates. Tenant improvement allowances averaged \$133 PSF, and free rent averaged 19.9 months for a typical 10-year or longer term on a new lease during 2022. This compares to \$127 PSF and 18.9 months during 2022.
- We anticipate limited asking rent growth in 2023. Newer space should achieve greater rent gains due to continued demand and quality product coming on-line. However, older properties will likely experience downward pressure as tenants vacate in favor of flight to quality.

ASKING RENT



Source: CoStar, Transwestern

ASKING RENTS BY SUBMARKET AND Y-O-Y GROWTH



Source: CoStar, Transwestern

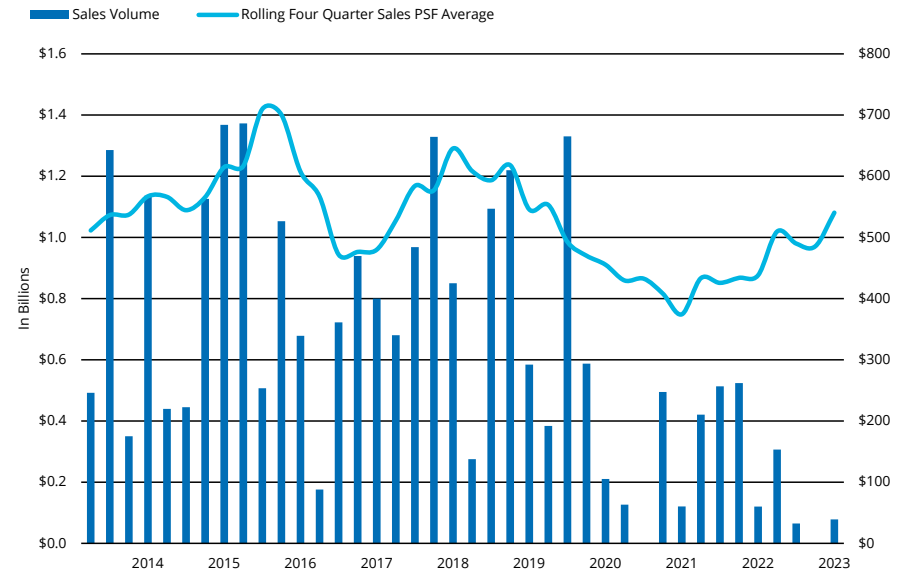


SALES

Limited Investment Sales in Q1 2023

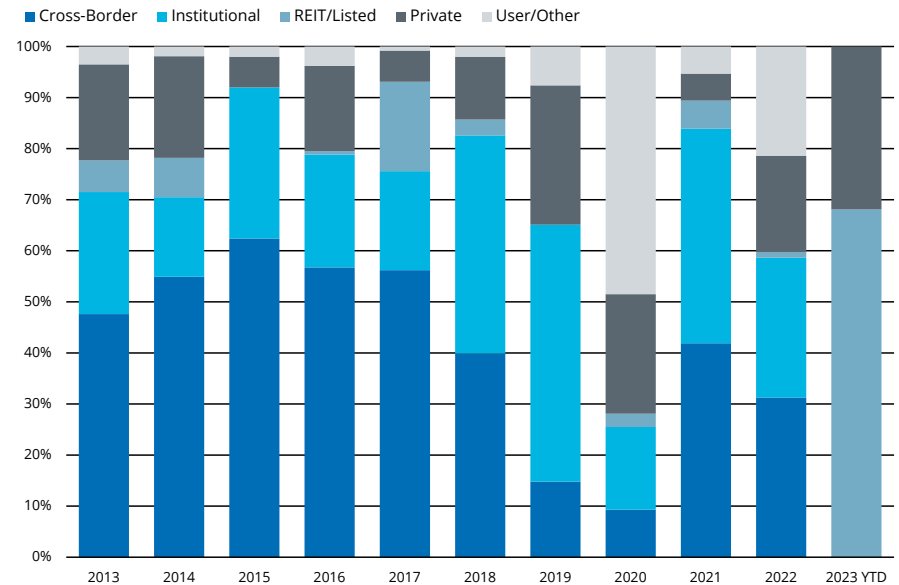
- Investment sales volume totaled \$78.3 million at \$483 PSF during the first quarter on one transaction. Welltower purchased 2021 K Street, NW from TF Cornerstone. The building was 83% leased at the time of sale and sold at a 6.5% cap rate. This compares zero transactions during the fourth quarter of 2022. During the first quarter of 2022, investment sales volume totaled \$120.2 million or \$318 PSF on three total transactions.
- Activity was limited to start 2023, as investors were sidelined due to the current economic climate and continuous Federal Reserve interest rate increases. In addition, acquisition groups are more focused on the current trend of office buildings converting to multifamily rather than operating as office.
- Transaction volume will likely remain limited during the balance of 2023 due to limited liquidity, ongoing price discovery, as well as limited occupancy levels in office product.

SALES VOLUME



Source: CoStar, Real Capital Analytics, Transwestern

BUYER CAPITAL COMPOSITION



Source: CoStar, Real Capital Analytics, Transwestern



NOTABLE LEASES

TENANT	ADDRESS	SUBMARKET	TYPE	SF LEASED
PILLSBURY WINTHROP SHAW PITTMAN	1200 17th St NW	CBD	Extension & Downsizing	89,000
ATLANTIC COUNCIL	1400 L St NW	East End	New Lease	79,663
UNIVERSAL SERVICE ADMINISTRATION	700 12th St NW	East End	Renewal	70,205
NATIONAL FISH AND WILDLIFE	1625 Eye St NW	CBD	New Lease	64,806
CADWALADER WICKERSHAM & TAFT	1919 Pennsylvania Ave NW	CBD	New Lease	42,572
WORLD BANK	1899 Pennsylvania Ave NW	CBD	Renewal	37,810

Source: CoStar, CompStak, Transwestern.

NOTABLE SALES

ADDRESS	SUBMARKET	SALE DATE	SALES PRICE	BUILDING SF	PRICE PSF	BUYER	SELLER
2021 K ST NW	CBD	Jan-23	\$78,250,000	162,000	\$483	Welltower Inc.	TF Cornerstone, Inc.
1801 L ST NW	CBD	Jul-22	\$64,750,000	199,846	\$324	Empire Leasing, Inc.	The Kaplan Family
1900 N ST NW	CBD	Jun-22	\$265,000,000	271,433	\$976	Commerz Real AG	JBG SMITH Properties
1901 PENNSYLVANIA AVE NW	CBD	Apr-22	\$41,500,000	104,944	\$395	Josef Pultuskier	Brookfield Property Group
2115 WISCONSIN AVE NW	Uptown	Mar-22	\$91,500,000	184,822	\$495	Ritz Banc Group	The JBG Companies
1000 U ST NW	Uptown	Mar-22	\$1,000,000	83,104	\$12	David R Jefferson	Prince Hall Charitable Fndtn

Source: CoStar, Real Capital Analytics, Transwestern.



MARKET INDICATORS

All Classes of Space | Q1 2023

SUBMARKET	INVENTORY SF	DIRECT VACANT SF	DIRECT VACANCY RATE	OVERALL VACANCY RATE	UNDER CONSTRUCTION SF	NET ABSORPTION SF	Y-O-Y NET ABSORPTION SF	ASKING RENT PSF, FULL SERVICE
CBD	42,852,148	6,539,238	15.3%	17.3%	334,000	(9,000)	61,000	\$54.08
EAST END	49,022,797	6,931,823	14.1%	15.6%	94,157	0	(279,000)	\$57.66
CAPITOL HILL	6,204,902	1,114,400	18.0%	19.4%	197,324	(29,000)	34,000	\$56.01
NOMA	11,915,358	583,853	4.9%	5.3%	32,251	19,000	(12,000)	\$50.65
CAPITOL RIVERFRONT	5,762,589	628,122	10.9%	14.9%	0	(58,000)	(144,000)	\$55.05
SOUTHWEST	13,233,029	1,667,362	12.6%	12.8%	0	(20,000)	445,000	\$51.40
GEORGETOWN	2,964,995	738,284	24.9%	26.3%	27,752	(91,000)	(110,000)	\$44.47
WEST END	3,892,187	537,122	13.8%	17.2%	0	(19,000)	(79,000)	\$50.52
UPTOWN	9,573,793	1,494,469	15.6%	16.4%	56,476	(41,000)	37,000	\$40.39
TOTAL	145,421,798	20,234,673	13.9%	15.5%	741,960	(248,000)	(47,000)	\$53.52

Source: CoStar, Transwestern



RESEARCH METHODOLOGY

The information in this report is the result of a compilation of information on office properties located in the District of Columbia. This report includes single tenant, multi-tenant and owner-user properties 15,000 SF and larger, excluding those properties owned by a government agency.

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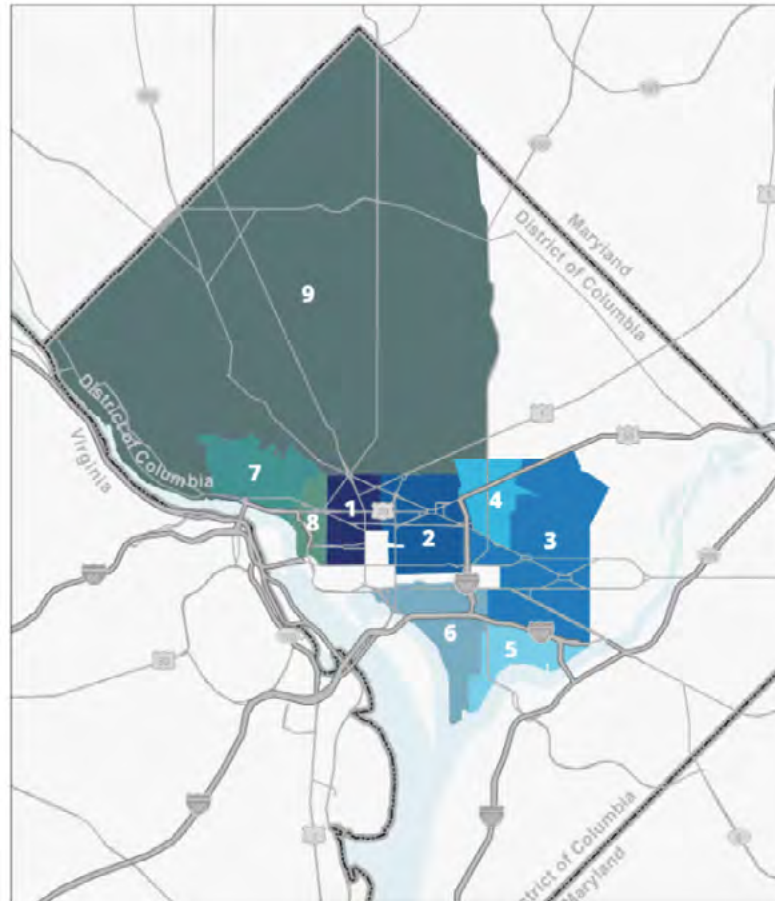
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District of Columbia Office Submarkets

- 1 CBD
- 2 East End
- 3 Capitol Hill
- 4 NoMa
- 5 Capitol Riverfront
- 6 Southwest
- 7 Georgetown
- 8 West End
- 9 Uptown