TRANSWESTERN

DISTRICT OF COLUMBIA OFFICE MARKET

Q2 2023

TRENDLINES

	Q2 2023	Q2 2022	ONE-YEAR TREND	FIVE-YEAR AVERAGE	12-MONTH FORECAST
UNEMPLOYMENT RATE	4.8	4.5	↑	6.0	↓
NET ABSORPTION (THOUSANDS SF)	(572.0)	77.0	↓	(83.8)	↔
DIRECT VACANCY RATE	14.1%	13.5%	↑	11.5%	↔
DIRECT VACANT SF (MSF)	20.5	19.5	↑	16.5	↔
UNDER CONSTRUCTION (MSF)	1.1	1.8	↓	3.4	↓
ASKING RENT, FULL SERVICE (PSF)	$53.40	$53.66	↓	$53.85	↔
SALES VOLUME (MILLIONS)	$0.0	$306.5	↓	$402.6	↔

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

OFFICE CONDITIONS DECLINED DURING Q2

Office market conditions in the District of Columbia contracted during the second quarter of 2023, with negative 572,000 SF in net absorption. This was due primarily to large move-outs, a lack of large lease signings, and continued rightsizing. The direct vacancy rate increased 20 basis points at 14.1% at June 2023. Asking rents inched downward 20 basis points during the past three months, averaging $53.40 PSF at June 2023.

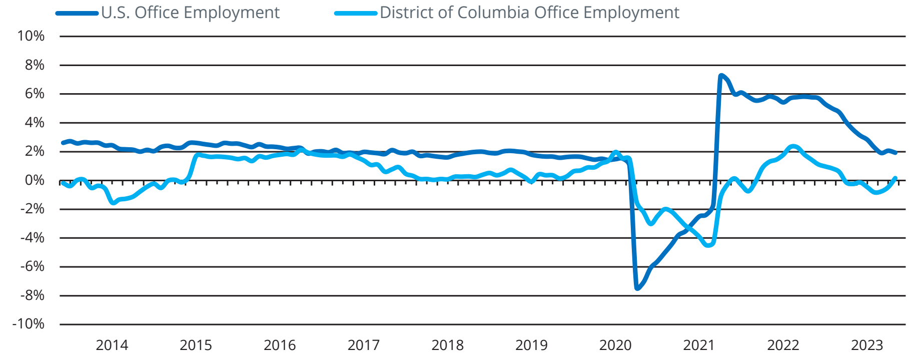
We expect office market conditions to remain soft in the District of Columbia during the second half of 2023, as future move-outs and rightsizing, coupled with limited leasing activity, will drag the overall market. Market improvement will likely not be seen until later in 2024. A reduced construction pipeline, which is down 38% year-over-year will help stabilize the market in due time. Although this will limit options to tenants looking to upgrade to new construction, these tenants could backfill 2nd generation Class A space as an alternative. Given record level availability, landlords will compete with generous concession packages, which will put pressure on the effective rent. Conversions of obsolete office buildings could help stabilize the market, but it is unlikely all announced buildings will convert leaving some owners exploring alternative options.

ECONOMY

Office-Using Job Growth Softening

- 13,500 new jobs were added to the District of Columbia economy during the 12-months ending May 2023, which is well-ahead of the pre-pandemic 5-year average of 9,800. This was driven by restaurants and bars.
- 800 office-using jobs were added during the 12 months ending May 2023, which is below the pre-pandemic 5-year average of 4,800. Most of this small gain was due to finance/insurance companies and law firms.
- The unemployment rate for the District of Columbia is currently at 4.9% as of May 2023 and averaged 4.8% for the past three months. The rate is up from 4.3% 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.

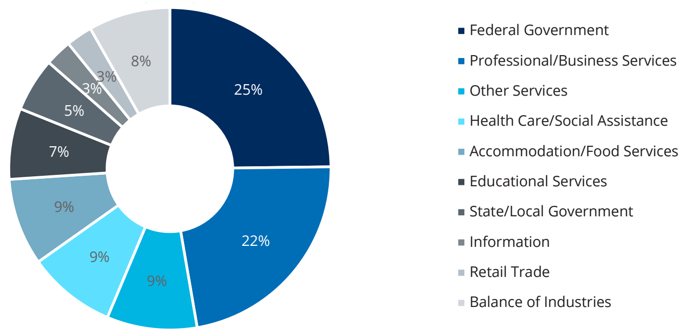
Y-O-Y CHANGE IN OFFICE JOBS



Source: Bureau of Labor Statistics, Transwestern

SHARE OF EMPLOYEES BY INDUSTRY

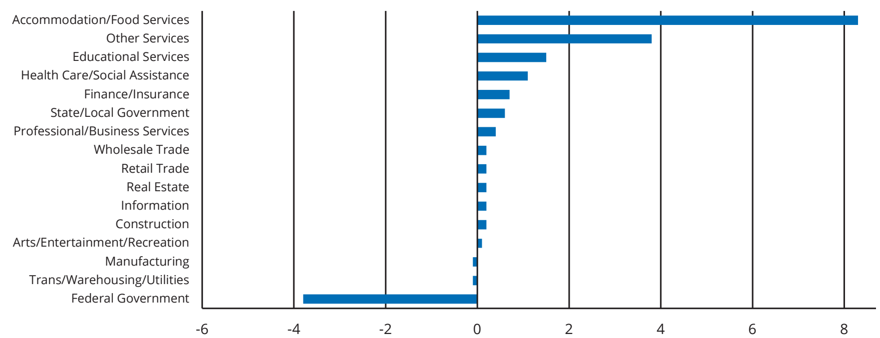
Dsictrict of Columbia | May 2023



Source: Bureau of Labor Statistics, Transwestern

Y-O-Y CHANGE IN JOBS BY INDUSTRY

Dsictrict of Columbia



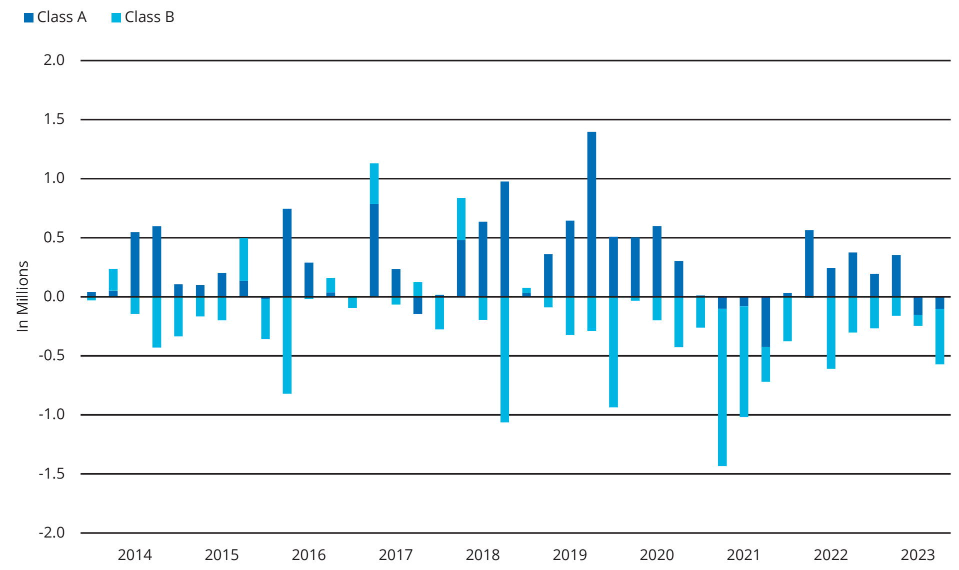
Source: Bureau of Labor Statistics, Transwestern

NET ABSORPTION

Coworking Spaces Struggle in Q2

- Net absorption totaled negative 572,000 SF during the second quarter of 2023, after finishing with negative 248,000 SF during the first quarter of 2023. This compares to the second quarter of 2022 when net absorption totaled positive 77,000 SF.
- Class A net absorption totaled negative 103,000 SF, driven by multiple mid-size move outs and downsizing. This is the first time since the second quarter of 2021 that Class A has totaled negative net absorption in back-to-back quarters. Class B contributed the majority with negative 470,000 SF.
- The most notable deal this quarter was Davis Polk leasing 81,632 SF at 1050 17th Street, NW in the CBD. The law firm will relocate from 901 15th Street, NW and plans to occupy the top five floors and penthouse of the recently purchased Hines office building. Another notable deal was the Environmental Defense Fund, represented by Transwestern, signing 34,584 SF at 555 12th Street, NW in the CBD. The nonprofit will relocate from 1875 Connecticut Avenue, NW.
- Offsetting leasing activity this quarter were multiple large to mid-sized move outs. WeWork vacated 209,520 SF at 655 15th Street, NW in the East End. In the Georgetown, Katten Muchin Roseman gave back 72,370 SF on the 2nd, 3rd and 4th floors at 2900 K Street, NW and relocated to 1919 Pennsylvania Avenue, NW in the CBD. Regus vacated 34,929 SF at 600 Massachusetts Avenue, NW in the East End as well.
- We anticipate office demand will face ongoing challenges during the second half of 2023, as economic headwinds cause select tenants to pause lease decisions. We predict tenants will continue to process current working trends to determine the correct amount of space they need.

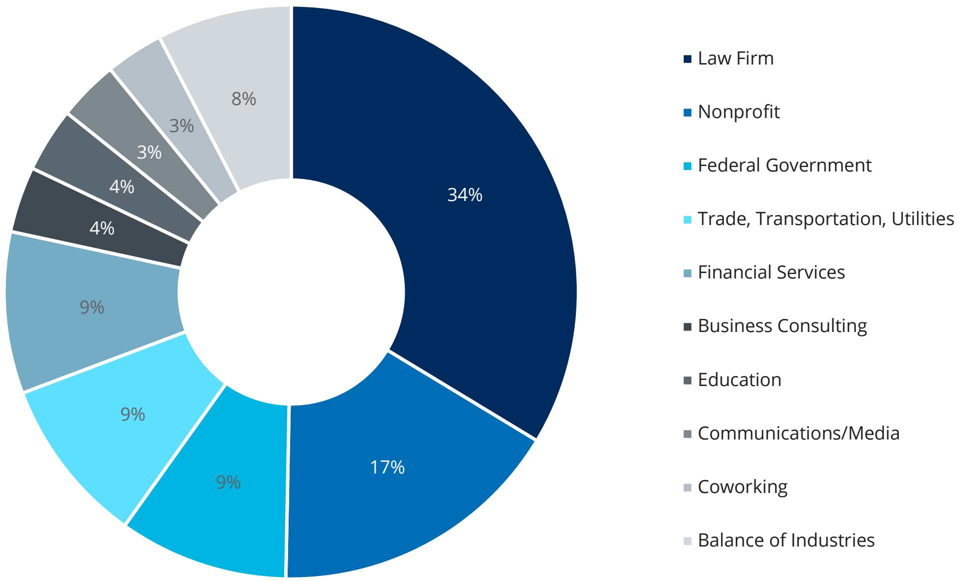
NET ABSORPTION BY CLASS



Source: CoStar, Transwestern

SHARE OF LEASING ACTIVITY BY INDUSTRY

YTD 2023



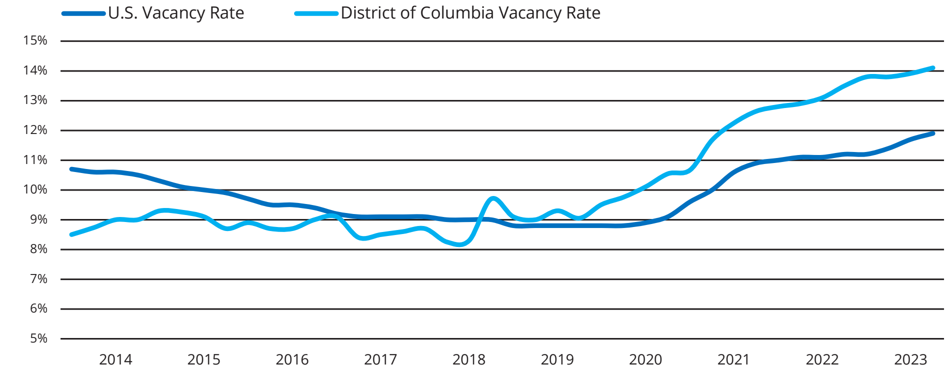
Source: CoStar, Transwestern

VACANCY

Vacancy Rate Inches Upward in Q2

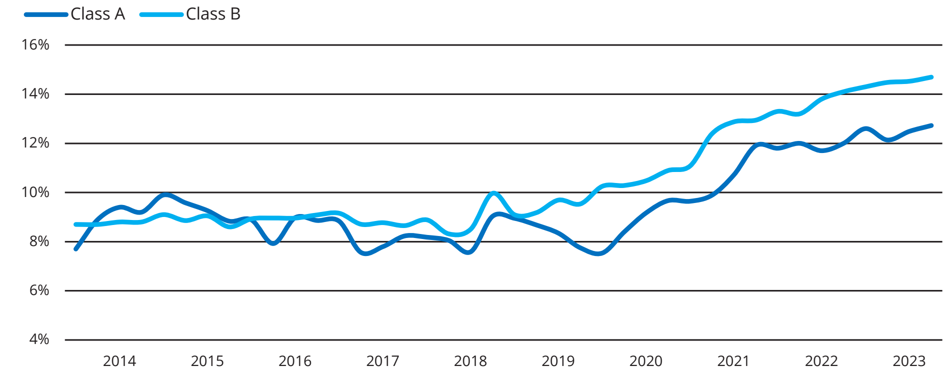
- The direct vacancy rate continued to rise during the quarter to 14.1% and remains elevated from 13.5% one year ago.
- The Class A direct vacancy rate increased 20-basis points to 12.7% over the past three months and is elevated compared to 12.0% one year ago.
- The Class B/C vacancy rate increased 20 basis points to 14.7% at June 2023 and is up from 14.1% one year ago. The rise this quarter was due mostly to tenants vacating older product in the East End, Georgetown, and NoMa submarkets.
- The vacancy rate will remain challenged during the balance of 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 stabilize, while older product could continue to struggle.

DIRECT VACANCY RATE



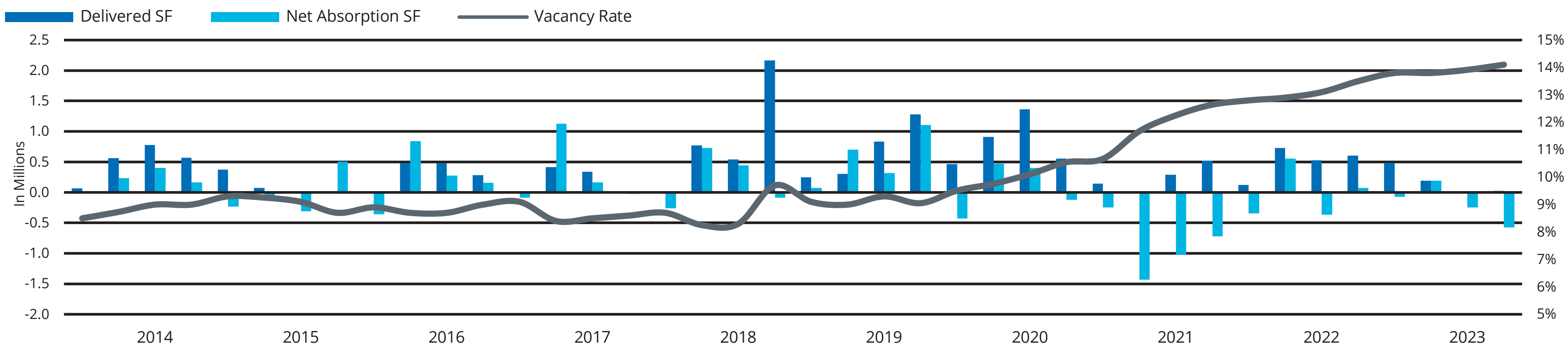
Source: CoStar, Transwestern

DIRECT VACANCY RATE BY CLASS



Source: CoStar, Transwestern

DELIVERY IMPACT ON KEY INDICATORS



Source: CoStar, Transwestern

UNDER CONSTRUCTION

Limited Deliveries Allows for Market Recovery

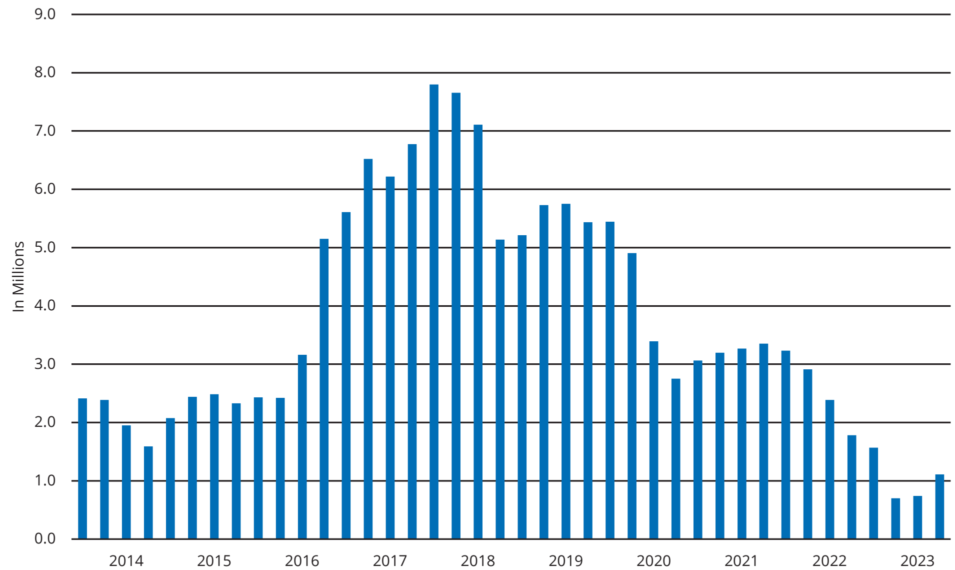
- One renovation project delivered during the second quarter of 2023 for a total of 28,752 SF. This compares to zero projects delivering during the first quarter of 2023 and three projects delivering one year ago during second quarter of 2022 for 604,000 SF.

- There is 1.1 million SF under construction in the District of Columbia, with majority of the construction concentrated in the CBD, East End, and Capitol Hill. Projects in the pipeline are currently 44% pre-leased. This is down notably from 1.8 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 delivers by late 2023. Another recent project is 600 5th Street, NW developed by Stonebridge and Rockefeller Group. The project will bring 400,000 SF of Class A inventory to the East End submarket. This building is already halfway pre-leased with the law firm Crowell & Moring signing a 199,000 SF lease this quarter.

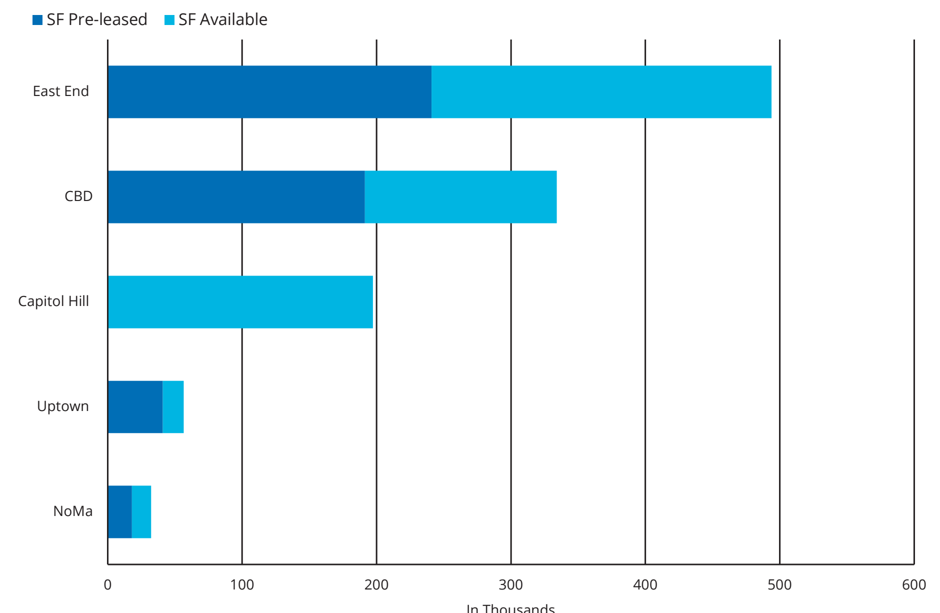
- The construction pipeline will continue to decelerate as developers analyze the current economic climate. Select owners will remain patient and look for conversion or renovation opportunities for flight to quality. Overall, this will ultimately help balance supply/ demand fundamentals in due time.

UNDER CONSTRUCTION



Source: CoStar, Transwestern

UNDER CONSTRUCTION BY SUBMARKET



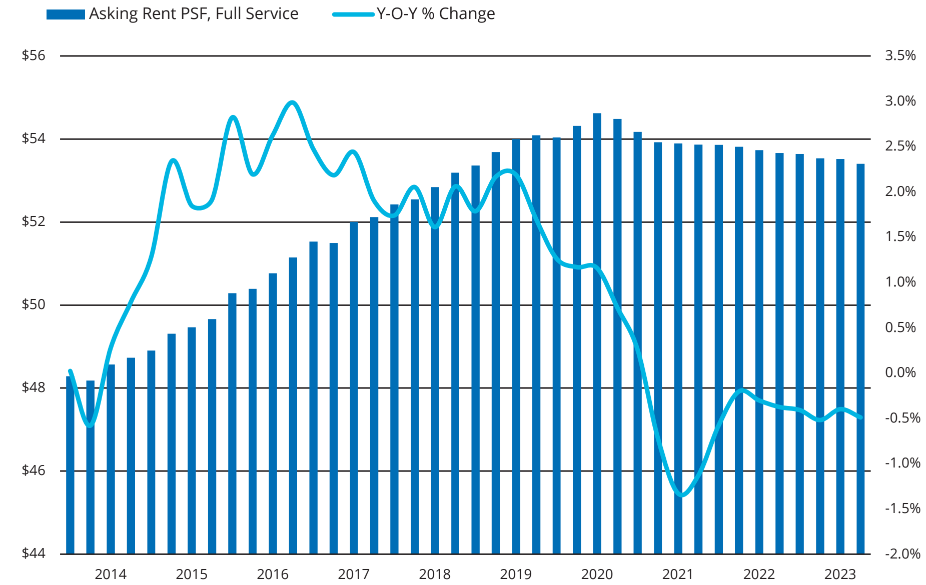
Source: CoStar, Transwestern

RENTAL RATES

Asking Rents Inched Downward During the Quarter

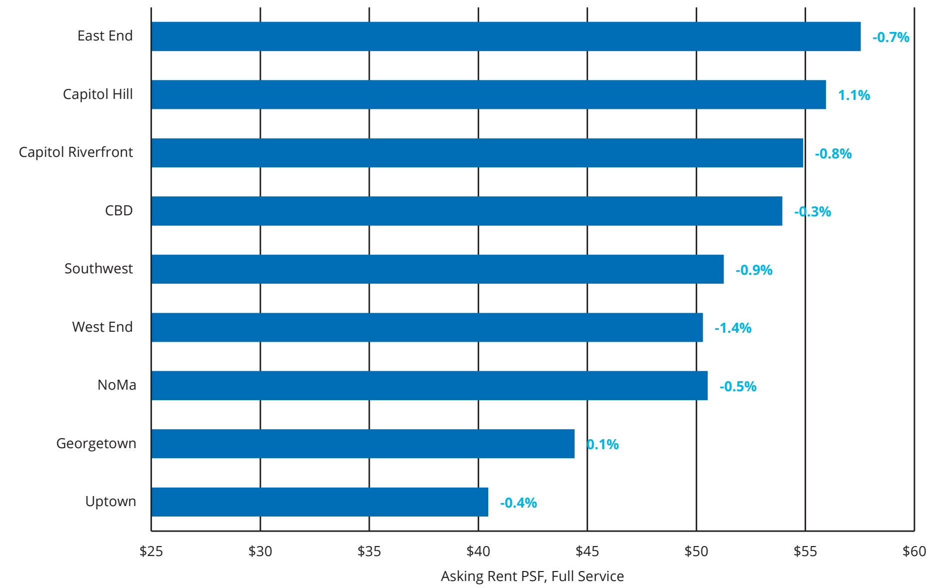
- Asking rents declined slightly during the quarter, decreasing 20 basis points finishing the quarter at $53.40 PSF in June 2023. Year-over-year, rents are down 50 basis points.
- Class A asking rents dropped since last quarter, landing at $57.04 PSF, while Class B/C decreased slightly finishing at $44.97 PSF.
- Rent growth is the strongest in the Capitol Hill submarket year-over-year, rising 1.1%. Offsetting this gain was West End, which reduced 1.4%.
- 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 $121 PSF, and free rent averaged 20.5 months for a typical 10-year or longer term on a new lease during the first half of 2023. This compares to $127 PSF and 18.9 months during 2022.
- We anticipate limited asking rent growth in 2023. Newer space should garner greater rent gains due to continued demand and quality product coming on-line. However, older properties will likely be challenged as tenants vacate in favor of flight to quality.

ASKING RENT



Source: CoStar, Transwestern

ASKING RENTS BY SUBMARKET AND Y-O-Y GROWTH



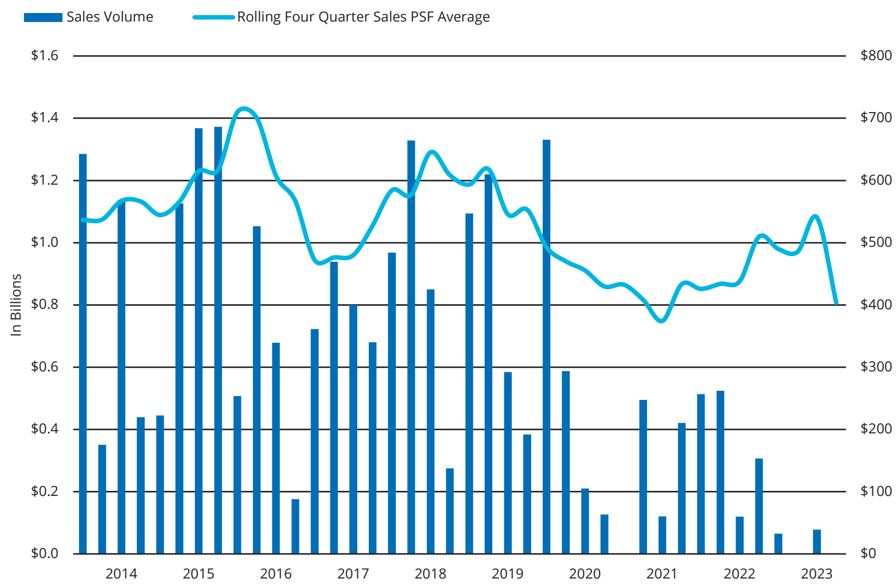
Source: CoStar, Transwestern

SALES

Investment Sales Ebbs in Q2 2023

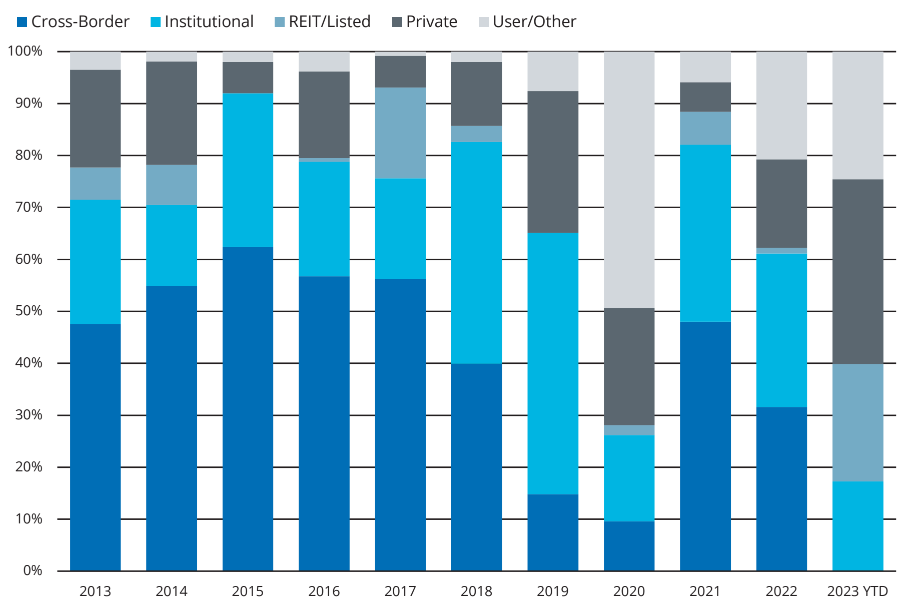
- There were no investment sale transactions in the second quarter of 2023. This compares to two transactions totaling $138.1 million, or $437 PSF, during the first quarter of 2023. During the second quarter of 2022, the sales volume totaled $306.5 million or $324 PSF on two transactions.
- Office investment sales have all but halted as investors await clarity on return to work and tenant demand for office space, as well as a stabilization in interest rates amidst aggressive rate hikes by the Federal Reserve. Although the Fed paused increasing the rate at the June meeting, they could reverse course later this year.
- The office market largely remains in a period of price discovery for cash-flowing product, with residential conversions making up the majority of trades that have occurred, perhaps setting a bottom to the market.

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
CROWELL & MORING	600 5th St NW	East End	Pre-Lease	198,877
COURT SERVICES & OFFENDERS SUPERVISORY AGENCY & THE DC PRETRIAL SERVICES AGENCY	633 Indiana Ave	East End	Extension	151,300
FRIED, FRANK, HARRIS, SHEIVER & JACOBSON	801 17th St NW	CBD	Renewal	103,000
DAVIS POLK	1050 17th St NW	CBD	New Lease	81,632
HOLLINGSWORTH G P	1350 I St NW	East End	Renewal	49,145
SAVE THE CHILDREN	899 N Capitol St NE	NoMa	Lease Restructure & Early Renewal	35,819

= Transwestern deal
Source: CoStar, CompStak, Transwestern.

NOTABLE SALES

ADDRESS	SUBMARKET	SALE DATE	SALES PRICE	BUILDING SF	PRICE PSF	BUYER	SELLER
1050 17TH ST NW	CBD	Mar-23	$59,812,500	154,000	$388	Hines	The Lenkin Company
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

= Transwestern deal
Source: CoStar, Real Capital Analytics, Transwestern.

MARKET INDICATORS

All Classes of Space | Q2 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	6,513,526	15.2%	15.5%	334,000	26,000	133,000	$53.95
EAST END	48,752,797	7,108,158	14.6%	15.6%	493,774	(446,000)	(564,000)	$57.53
CAPITOL HILL	6,204,902	1,042,424	16.8%	18.2%	192,156	72,000	180,000	$55.95
NOMA	11,915,358	691,544	5.8%	6.0%	32,251	(108,000)	(90,000)	$50.52
CAPITOL RIVERFRONT	5,762,589	599,309	10.4%	14.0%	0	29,000	(81,000)	$54.89
SOUTHWEST	13,153,644	1,631,052	12.4%	12.5%	0	(43,000)	(5,000)	$51.26
GEORGETOWN	2,964,995	839,094	28.3%	29.6%	0	(101,000)	(213,000)	$44.42
WEST END	3,892,187	541,014	13.9%	18.1%	0	(4,000)	(74,000)	$50.30
UPTOWN	9,573,793	1,491,597	15.6%	16.6%	56,476	3,000	17,000	$40.46
TOTAL	**145,072,413**	**20,457,718**	**14.1%**	**15.0%**	**1,108,657**	**(572,000)**	**(697,000)**	**$53.40**

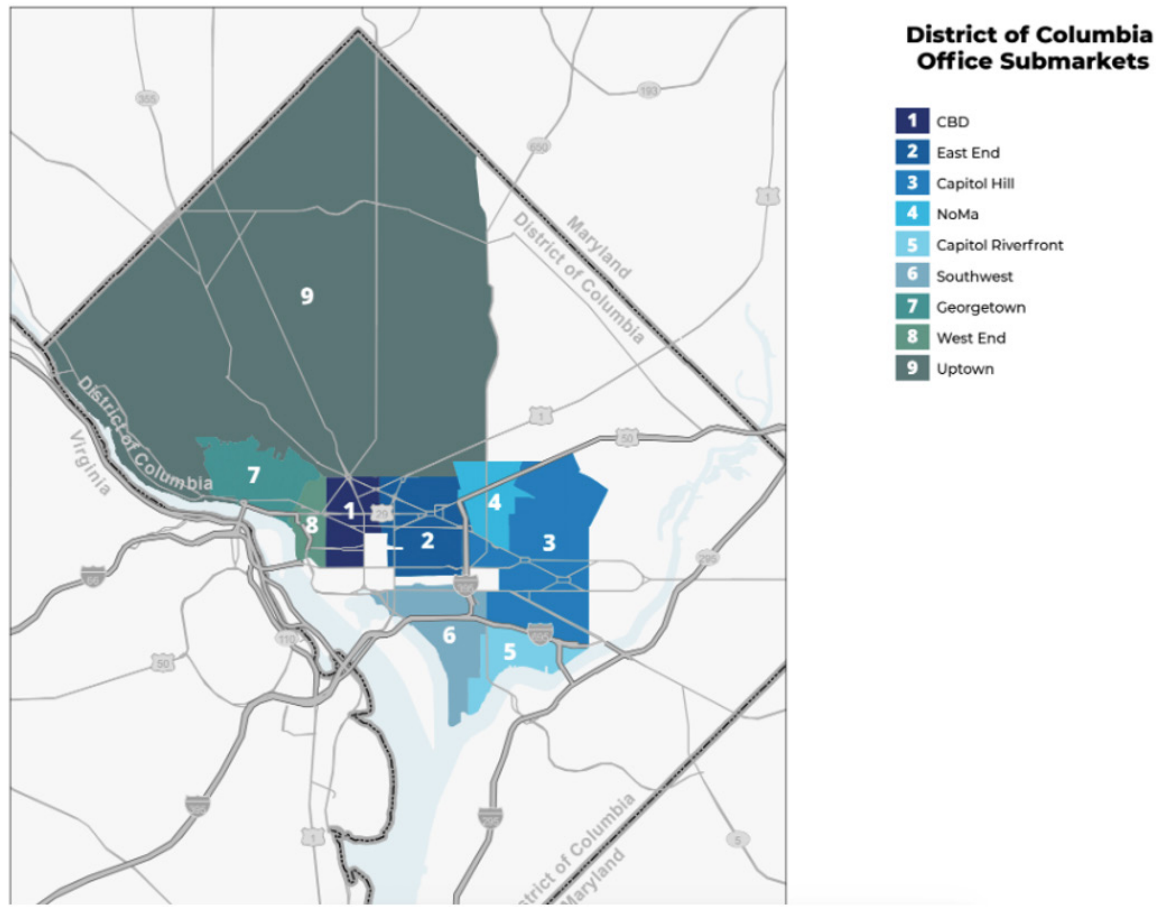
Source: CoStar, Transwestern

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.

ABOUT TRANSWESTERN

The privately held Transwestern companies have been delivering a higher level of personalized service and innovative real estate solutions since 1978. Through an integrated, customized approach that begins with good ideas, the firm drives value for clients across commercial real estate services, development, investment management, and opportunistic endeavors for high-net-worth investors. Operating from 33 U.S. offices, Transwestern extends its platform capabilities globally through strategic alliance partners whose unique geographic, cultural, and business expertise fuels creative solutions. Learn more at transwestern.com and @Transwestern.



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