JOB CREATION CONTINUES, DRIVING GRADUAL OFFICE MARKET EXPANSION

The Washington metro area’s employment base continued to grow during the second quarter of 2019. For the 12 months ending in April 2019, the region added 29,800 jobs, which is below the metro area’s 20-year average growth of 41,000 jobs per annum and slightly lower than the average over the past 12 months. However, the very low unemployment rate of 2.9% points to a sturdy regional economy, and the area’s gross regional product is likely to increase through the rest of 2019, though perhaps at a more moderate pace. The Fuller Institute’s Leading Index edged up in June, but the recent trend has suggested the regional economy is decelerating.

Office demand in the Washington metro area was positive during the second quarter, but down from the previous quarter. The second quarter saw 592,216 square feet of positive absorption in the region, topping 200,000 square feet in two of the three substate areas and with positive totals in all three. Net absorption registered 316,937 square feet in the District of Columbia, 207,177 square feet in Northern Virginia, and 68,102 square feet in Suburban Maryland. Large spaces in Northern Virginia that were occupied by the Air Line Pilots Association in the Tysons submarket and WeWork in the Rosslyn submarket contributed to positive absorption. In the District of Columbia, several large tenants expanded their footprints, which contributed to positive net demand. At 16.2%, the region’s overall vacancy rate remained even with that of first-quarter 2019 but was 10 basis points higher than the vacancy rate recorded one year ago.

The Washington region registered $6.4 billion in office sales transaction volume for the 12 months ending in the second quarter of 2019. Transaction volume is down from the 12-month period ending in the second quarter of 2018, when volume measured $8.0 billion. However, inventory remains low, and interest in assets high, resulting in elevated per-square-foot prices, as transactions across the metro area averaged $379/SF over the past 12 months. Meanwhile, region-wide cap rates have been edging higher and averaged 6.3% over the past 12 months.

ECONOMY

- Historical Job Change: 29,800 jobs were added in the 12 months ending April 2019, versus 41,000 per annum for the past 20 years.
- Projected Job Growth: NKF forecasts an average increase of 34,600 jobs per annum from 2019 through 2022.
- Unemployment Rate: 2.9% in April 2019, 20 basis points lower than the rate of 3.1% at April 2018.


WASHINGTON METRO AREA ECONOMY AND OFFICE MARKET
OFFICE DEMAND SHIFTING EASTWARD

Traditionally, the District’s core office submarkets, such as West End, CBD, East End and Capitol Hill have seen the lion’s share of growth. Over the past few years, however, growth has been trending toward emerging areas like NoMa, Capitol Riverfront and Southwest, as these have become more established office submarkets. Developments such as Constitution Square, The Yards and the Wharf have been attracting tenants that traditionally would have looked farther west or near the Capitol. Over the past five years, the West End, CBD, East End and Capitol Hill submarkets have seen a 310-basis-point increase in vacancy, from 11.1% to 14.2%, while emerging submarkets to the east and south have seen a 250-basis-point decline in vacancy, from 13.5% to 11.0%. Absorption has skewered higher in the emerging submarkets as well, with 2.1 million square feet of net absorption in those submarkets during the past five years compared with 1.4 million square feet in West End, CBD, East End and Capitol Hill. Perhaps most telling is that asking rental rates are growing more quickly in the emerging submarkets than in what are generally considered to be the core submarkets. Rents in the emerging submarkets have increased 9.6% over the past five years, whereas the West End, CBD, East End and Capitol Hill submarkets have seen rent growth of only 5.0% over the same time period.

SOURCES OF INTERNATIONAL CAPITAL EVOLVE

Foreign investment in Washington metro area office assets has lagged during the first half of 2019, as detailed on page 9 of this report. However, this change is occurring as the set of foreign buyers is evolving. Unizo, a Japanese firm, has been exiting the market after making a big splash as a buyer in recent years. However, other international buyers are becoming more active Washington investors, including Chilean firm Stars, French firm AXA, and Kuwaiti firm Wafra. Other foreign firms that have recent purchased office assets locally include CPP Investment Board of Canada, Deka Immobilien of Germany, and Masaveu Corporation of Spain.

The Washington market is likely to remain a significant player for international capital due to its history of stable returns. How much foreign capital is attracted to this market in 2019-2020 will depend in part on how well new trophy assets lease, the level of job creation, and macro effects such as interest rates.

THE AMAZON EFFECT: SEVEN MONTHS LATER

In November 2018, Amazon announced that the company had selected Arlington, Virginia, as the location for its new headquarters (HQ2). Since the decision, there has been a lot of activity in the surrounding area, both directly involving Amazon and also from companies that want to co-locate near Amazon. Since the announcement, Amazon’s plans have firmed up. The company has leased office space in four buildings in Crystal City and as of June has moved into its first space, at 2345 Crystal Drive. The other three buildings Amazon will be occupying in late 2019 and in 2020 are 1750 Crystal Drive, 1800 South Bell Street, and 241 18th Street South. Amazon and its development partner, JBG Smith, also have submitted plans for the new buildings Amazon will own and occupy at Metropolitan Park, a pair of 22-story office buildings totaling 2.1 million square feet. The plans also include retail, parking and a public park. The current timeline has one tower delivering in 2022 and the other in 2023. This still leaves a second development site, Pen Place, where no formal plans have been submitted as of mid-2019, although a 2025 delivery is expected.

Outside of Amazon, National Landing (as Amazon’s new neighborhood is now called) is seeing robust development activity. JBG Smith has plans to build 5,000 new multifamily units to keep pace with Amazon’s housing demand. In addition, many other developers are taking advantage of the imminent need for more housing and retail close to Amazon’s workplace.

There also is a need for newer office space, as most of Crystal City’s current inventory consists of aging Class B and Class C product. Developers are jumping on this opportunity, as other technology companies likely will seek a presence in National Landing. This is what happened in Seattle, as other tech companies sought to recruit Amazon’s workforce. Tech companies in National Landing also can take advantage of the new educational pipeline that will be available in the area.

Amazon’s presence certainly will change the dynamics of the regional office market, as it may attract additional tech companies and will continue to diversify the economy. Rising rents in National Landing may push federal offices and government contractors into Prince George’s County and exurban submarkets in Northern Virginia. A dearth of existing office supply in National Landing could benefit the District and Suburban Maryland as tenants widen their search for space.

PAYROLL JOB CHANGE – LARGEST METRO AREAS

12 Months Ending April 2019

<table>
<thead>
<tr>
<th>Metro Area</th>
<th>Payroll Jobs (Thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>New York</td>
<td>100</td>
</tr>
<tr>
<td>Dallas</td>
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<td>Houston</td>
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<td>LA/OC</td>
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<td>Chicago</td>
<td>60</td>
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<td>Phoenix</td>
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<td>SF/East Bay</td>
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<td>Washington</td>
<td>10</td>
</tr>
<tr>
<td>Boston</td>
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</tbody>
</table>


JOB CHANGE BY INDUSTRY

Washington Metro Area I 12 Months Ending April 2019

- Professional/ Business Services
- Leisure/ Hospitality
- Education/ Health
- State and Local Government
- Other Services
- Construction and Mining
- Federal Government
- Information
- Manufacturing
- Financial Activities
- Transportation/Trade/Utilities

REGION SEES POSITIVE NET DEMAND

Office demand in the Washington metro area was positive during the second quarter, but down from the previous quarter. The second quarter saw 592,216 square feet of positive absorption in the region, topping 200,000 square feet in two of the three substate areas and with positive totals in all three. Net absorption registered 316,937 square feet in the District of Columbia, 207,177 square feet in Northern Virginia and 68,102 square feet in Suburban Maryland. Large spaces in Northern Virginia that were occupied by the Air Line Pilots Association in the Tysons submarket and WeWork in the Rosslyn submarket contributed to positive absorption. In the District of Columbia, several large tenants expanded their footprints, which contributed to positive net demand. At 16.2%, the region’s overall vacancy rate remained even with that of first-quarter 2019 but was 10 basis points higher than the vacancy rate recorded one year ago.

Three notable projects delivered in the Washington metro area during the second quarter. The largest project completed during the quarter was 655 New York Avenue NW, a 761,024-square-foot property located in the East End submarket. The office portion was 53% leased at completion. Additionally, Four Constitution Square, a 522,550-square-foot property located at 150 M Street NE in the NoMa submarket, completed construction. It was 100% preleased to the Department of Justice, which consolidated operations from the CBD and East End. The Washington area has a significant development pipeline, with 9.2 million square feet of new product under construction, excluding renovations. The largest projects set to deliver in the second half of 2019 include 1900 N Street NW, a 271,067-square-foot project located in the CBD submarket. It is 69% preleased and will deliver in the third quarter. In addition, 4747 Bethesda Avenue, a 300,000-square-foot project set to deliver in the Bethesda submarket in the third quarter, is currently 71% preleased.

Despite the region’s elevated vacancy rate, weighted average asking rents increased 2.2% over the past 12 months to $39.00/SF. This is largely the result of the outsized impact of new core product and renovated assets being delivered to the market. Although asking rents are rising, concessions remain high and the average effective rent has been flat.

CLASS A MARKET LEADS IN OFFICE DEMAND

The region’s Class A market registered 679,671 square feet of net absorption during the second quarter, with net demand for premier space positive in two of three substate areas. The District of Columbia led the way with 582,825 square feet of Class A demand, followed by 239,921 square feet in Northern Virginia. Suburban Maryland saw negative absorption of 143,075 square feet, largely attributable to Discovery officially vacating its 143,075 square feet in Northern Virginia. Suburban Maryland saw negative absorption of 143,075 square feet, largely attributable to Discovery officially vacating its 143,075 square feet in the Silver Spring submarket. Tenant preference for new, quality product. Class A rents average $42.35/SF metro wide as of the end of the second quarter. Although demand for premier space remains sturdy overall, there are niches where Class A assets are significantly outperforming. Across all substate areas, trophy and Class A+ properties have continued to outperform commodity Class A space.
WASHINGTON AREA ECONOMIC OUTLOOK
The Washington metro area’s employment base continued to grow during the second quarter of 2019. For the 12 months ending in April 2019, the region added 29,800 jobs, which is below the metro area’s 20-year average growth of 41,000 jobs per annum and slightly lower than the average over the past 12 months. However, the very low unemployment rate of 2.9% points to a sturdy regional economy, and the area’s gross regional product likely increased through the rest of 2019, though perhaps at a moderate pace. The Fuller Institute’s Leading Index edged up in June, but the recent trend has suggested the regional economy is decelerating.

As the economic cycle moves through its mature phase, Washington likely will continue to add jobs, although at a slower rate of growth than seen earlier in the cycle. In consultation with Dr. Stephen Fuller of George Mason University, Newmark Knight Frank forecasts job growth of 34,600 positions per annum over the four-year period from 2019 to 2022, a modest decrease from the region’s 20-year average of 41,000 jobs per annum.

OFFICE MARKET OUTLOOK
Over the next 12 to 24 months, the market faces both headwinds and tailwinds that will impact absorption and rent growth:

• Class A asking rents are up 0.5% over the past two years—a small increase. Additionally, 8.1 million square feet of new office space delivered during this period. This uptick in delivered space has led to a flattening of average effective rents per square foot. Although asking rents are rising slightly, concessions also have risen over time. There has been some plateauing in the average concession package over the past year region-wide, but this has not yet led to a material rise in effective rents.

• As Amazon begins its move into National Landing, it remains to be seen how much of an impact its presence will have on office market fundamentals for the region. Northern Virginia, specifically National Landing, will see rising absorption and lower vacancy rates as Amazon occupies office space there, but there may be an additional impact from other tech and private-sector tenants potentially co-locating and clustering in the area.

Rising construction costs continue to plague Washington metro area developers, driving margins thinner and making it more difficult to find adequate funding for new projects, which may contribute to a slowdown in groundbreakings. According to developer Skanska, construction costs have increased approximately 4.0% to 4.5% annually over the last several years, significantly outpacing Class A office asking rents which have averaged a 0.5% year-over-year increase. However, landlords may actually benefit from a moderation in office delivery pace as the office vacancy rate in the Washington metro area has remained elevated over the past several years, a result of mismatched supply and demand fundamentals as tenants have shifted the way they use office space. A pullback in deliveries, combined with continued positive net absorption, should eventually lead to rising rents and declining vacancy.

• Notwithstanding higher costs, the construction pipeline remains robust for now. Our two-year forecast projects new supply will outpace demand in the District of Columbia and Suburban Maryland. However, the reverse will be true in Northern Virginia. For the Washington metro area as a whole, this supply/demand mismatch will lead to a 50-basis-point uptick in vacancy rate over the next 24 months to 16.7%.

• With 14,900 jobs added in the 12 months ending April 2019, the Professional and Business Services sector has continued to represent an increasing share of job growth and will be the leading contributor to office demand in the region. The Leisure/Hospitality and Education/Health sectors also accounted for a substantial share of job growth. Federal government jobs have represented a declining share of the regional employment market, but a shift toward a large private sector, and less dependence on the federal establishment, is good for the long-term health of the region’s economy.

• Personalized medicine, a focus of Inova’s expansion at its Merrifield campus, may become a new catalyst for regional economic growth. This project is likely to draw pharmaceutical and medical device firms to the region over the next decade, gradually creating demand for office space. For additional information on the District of Columbia, Northern Virginia, and Suburban Maryland office markets, please visit NKF’s website: Washington DC Market Reports.

PAYROLL JOB GROWTH FORECAST

| Washington Metro Area |

<table>
<thead>
<tr>
<th>Year</th>
<th>Job Change (Thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>100</td>
</tr>
<tr>
<td>2020</td>
<td>90</td>
</tr>
<tr>
<td>2021</td>
<td>80</td>
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</tbody>
</table>

Long-term = 41,000 jobs per annum
Projected Average = 34,600 jobs per annum

Source: U.S. Bureau of Labor Statistics, Stephen S. Fuller Institute, NKF Research; June 2019

SUPPLY/Demand FORECAST

Washington Metro Area | 24 Months Ending June 2021

<table>
<thead>
<tr>
<th>SF (Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Demand</td>
</tr>
<tr>
<td>Development Pipeline (Under Construction &amp; Planned)</td>
</tr>
</tbody>
</table>

Next 24 Months
Demand: 5.3 million SF
New Supply: 8.4 million SF

Northern Virginia
Suburban Maryland
District of Columbia

Source: Stephen S. Fuller Institute, NKF Research; June 2019
ABSORPTION STEADY, BUT DELIVERIES ACCELERATING

Although the District saw absorption in the second quarter of 2019 in line with first-quarter performance, the vacancy rate rose 50 basis points over the quarter to 13.6%, largely due to the delivery of three projects totaling 1.3 million square feet:

- 655 New York Avenue NW, a 645,751-square-foot office property in the East End Submarket, delivered during the second quarter. The building was 73% pre-leased at time of completion and will be anchored by The Advisory Board Company, which will occupy 302,006 square feet in the building.
- Four Constitution Square, a 522,550-square-foot office building in the NoMa submarket, delivered in June. The building has been fully leased by the Department of Justice.
- One M Street SE delivered during the second quarter of 2019, adding 118,000 square feet of office space to the Capitol Riverfront submarket. The building was 59% pre-leased at the time of completion.

The District of Columbia registered 316,937 square feet of net absorption in the second quarter of 2019, comparable to the 370,677 square feet absorbed in the first quarter. NoMa topped the District submarkets with 492,576 square feet of absorption, supported by the Department of Justice’s consolidation into Four Constitution Square at 150 M Street NE.

Several notable expansions in the East End submarket contributed to 208,285 square feet of positive net absorption, including The Carlyle Group’s move into an additional 69,784 square feet at 1001 Pennsylvania Avenue NW.

Average asking rents ticked up modestly during the quarter to $56.18, an increase of 0.9% from the first quarter and 0.5% compared with a year ago. Core submarkets such as the CBD, East End, and Capitol Hill continue to draw the highest rents in the District, led by Capitol Hill with an average asking rent of $60.31 per square foot during the second quarter. However, the gap between core and emerging submarket asking rents has slowly compressed as the new product in highly amenitized, mixed-use, emerging neighborhoods continues to attract private sector demand.

Developers continue to bring new product to the market, encouraged by strong demand for new trophy office space. The construction pipeline remains active at 3.6 million square feet, excluding renovations. The substantial development pipeline continues to exert downward pressure on effective rents, yet asking rents likely will continue to increase with the delivery of newer product.

DISTRICT OF COLUMBIA OUTLOOK

The District of Columbia’s office market conditions likely will favor tenants over the next 24 months, largely because of a robust development pipeline—13 buildings, not including renovations, are expected to deliver in this timeframe—and continued government agency and law firm consolidations. The District faces a supply-demand imbalance as developers continue to bring new product to the market despite elevated overall vacancy rates, encouraged by strong demand for new trophy office space. However, groundbreakings may slow in the immediate future, as rising construction costs and commercial real estate tax hikes make penciling new development more difficult.

CURRENT CONDITIONS

- The District of Columbia office market absorbed 316,937 square feet in the second quarter of 2019, supported by several tenant expansions.
- The vacancy rate rose 50 basis points from the previous quarter to 13.6%, as 1.3 million square feet of new product delivered to the market.
- The average asking rent registered $55.18/SF during the second quarter of 2019, up 0.5% from one year ago.

MARKET ANALYSIS

Asking Rent and Vacancy Rate

Net Absorption

MARKET SUMMARY
VACANCY EDGES DOWN DURING SECOND QUARTER OF 2019

Sturdy demand for office space continued in the second quarter of 2019. Quarterly absorption totaled 207,177 square feet, a less robust number than the first quarter’s tally but still in line with Northern Virginia’s recent performance. Overall vacancy decreased 20 basis points over the quarter to 18.8% and is 10 basis points lower than a year ago. Average overall asking rents increased 3.1% from one year ago to $33.10/SF.

As of second-quarter 2019, 2.9 million square feet of office space is under construction in Northern Virginia, excluding renovations and owner-occupied buildings. The overall pre-lease rate of the buildings under construction is 65.9%. Fannie Mae (850,000 square feet), the Transportation Security Administration (625,000 square feet) and Leidos (287,000 square feet) led the way in the pre-leaseing of large amounts of space. Amazon will occupy two buildings that are undergoing full-scale renovations in Crystal City: 1800 South Bell Street and 1750 Crystal Drive. In June, Comstock Partners broke ground on Reston Station Phase III, a 260,000-square-foot building located in the Reston submarket. The building will deliver in 2021 and has no pre-leasing activity to date. As of the second quarter, more than 1.7 million square feet, or about 60% of the pipeline, is under construction in Reston alone. There is one significant project set to deliver later in 2019, the 143,606-square-foot Boro Loft building, which is adjacent to the Boro Tower that delivered in the first quarter of 2019. The Boro Loft is 82.1% pre-leased and set to deliver in the third quarter. This year will be a slower year for deliveries; paired with a continued increase in demand, the office market likely will continue to see declining vacancy rates. Deliveries will pick back up in 2020, when nine buildings currently under construction or renovation are set to deliver, totaling 2.0 million square feet.

NORTHERN VIRGINIA OUTLOOK

Northern Virginia’s office market demand generally has been accelerating since 2017, when annual absorption measured 616,565 square feet, ending a six-year streak of negative absorption due to several factors, including the Base Realignment and Closure Act and ExxonMobil exiting the market. The increased demand continued in 2018, when annual absorption measured 1.5 million square feet, and the first half of 2019 continued this trend with 785,682 square feet of net absorption. Strong absorption is likely to continue throughout the rest of 2019, as Appian, Amazon, Akima, and Capital Hospice all are expected to move into large blocks of space.

Northern Virginia’s overall vacancy rate declined during the second quarter to 18.8%, due in part to the lack of new deliveries this quarter and was helped by companies moving into large blocks of space. Vacancy likely will continue to tick down, as limited deliveries during the second half of 2019 and tenants are set to move into the buildings delivered last quarter. The market’s overall average asking rental rate increased, indicating that asset owners believe the market will continue to tighten.

Amazon’s decision will continue to shape the market—beyond its direct hiring and physical occupancy of space—and will help the area attract other headquarters operations and technology-related companies that can benefit from proximity to Amazon.
OFFICE DEMAND ACCELERATES MODESTLY IN SECOND QUARTER

Suburban Maryland’s office demand picked up slightly in the second quarter of 2019 after absorption was negative in the first quarter. Notably:

- Net absorption measured 68,102 square feet in the second quarter of 2019.
- The overall vacancy rate remained steady at 15.2% during the second quarter, as compared to the previous quarter.
- Suburban Maryland continues to see a spike in development activity around Metro stations and the future Purple Line stations, as the Avocet Tower in Bethesda broke ground in the second quarter.
- Asking rental rates have increased 1.7% over the past year, ticking up to $28.04/SF from $27.56/SF.

As of second-quarter 2019, 2.7 million square feet of office space is under construction in Suburban Maryland in six projects, excluding renovations. The pipeline is approximately 80% pre-leased. Avocet Tower, a 22-story, 382,664-square-foot speculative building, broke ground at 7373 Wisconsin Avenue in the Bethesda submarket. The project is being developed by Stonebridge Associates. Two significant projects are set to deliver later in 2019: 4000 Garden City Drive, a 175,000-square-foot building at the New Carrollton Metro station and 4747 Bethesda Avenue, a 300,000-square-foot building in Bethesda.

There were no office deliveries during the second quarter. The most recent delivery was 5801 University Research Court, a 75,000-square-foot building in the College Park submarket that delivered in the fourth quarter of 2018. The State of Maryland occupies 85% of the project, and Cybrary will occupy the remaining 15% until its permanent headquarters space is completed at nearby 4600 River Road.

SUBURBAN MARYLAND OUTLOOK

Office fundamentals in Suburban Maryland may tighten modestly in the months ahead. There is a significant amount of new but preleased office space coming online, which will contribute to the tightening of the market. However, construction likely will continue at robust levels over the next two years, especially around the future Purple Line stations and in transit-oriented submarkets, pushing overall vacancy higher. Bethesda is seeing a boom in construction and will continue to heat up, with many projects underway or set to break ground soon. Tenants’ preference for high-quality Class A office space can be met with the 2.3 million square feet of new construction delivering in Suburban Maryland over the next few years. As developers continue to show confidence in the region, there also has been a focus on repurposing obsolete assets into other property types such as senior housing, multifamily, and laboratory space, which will help lower the office vacancy rate in the area over time.

CURRENT CONDITIONS

- Suburban Maryland registered 68,102 square feet of absorption during the second quarter of 2019.
- The vacancy rate is down 30 basis points from one year ago to 15.2%.
- Class A market conditions softened, with negative 143,075 square feet of absorption and a vacancy rate of 16.6%, 20 basis points higher than one year ago.

MARKET ANALYSIS

Asking Rent and Vacancy Rate

Net Absorption

MARKET SUMMARY

<table>
<thead>
<tr>
<th></th>
<th>Current Quarter</th>
<th>Prior Quarter</th>
<th>Year Ago Period</th>
<th>24-Month Forecast</th>
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<td>73.9 MSF</td>
<td>74.3 MSF</td>
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<tr>
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## SUBMARKET STATISTICS – VACANCY AND ABSORPTION

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<thead>
<tr>
<th>Submarket</th>
<th>Total Inventory (SF)</th>
<th>Direct Vacancy Rate</th>
<th>Overall Vacancy Rate</th>
<th>2016 Absorption (SF)</th>
<th>2017 Absorption (SF)</th>
<th>2018 Absorption (SF)</th>
<th>2Q 2019 Absorption (SF)</th>
<th>YTD 2019 Absorption (SF)</th>
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<tbody>
<tr>
<td><strong>Washington Metro Area</strong></td>
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<td>16.2%</td>
<td>673,188</td>
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<td>13.6%</td>
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<td>74,538</td>
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## SUBMARKET STATISTICS – RENTS AND DEVELOPMENT

<table>
<thead>
<tr>
<th>Submarket</th>
<th>Total Inventory (SF)</th>
<th>Class A Asking Rent (Price/ SF)</th>
<th>Class B Asking Rent (Price/ SF)</th>
<th>Overall Asking Rent (Price/ SF)</th>
<th>2Q 2019 Deliveries (SF)</th>
<th>YTD 2019 Deliveries (SF)</th>
<th>Under Construction (SF)</th>
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Note: Asking rents are quoted on a full service basis.
SALES VOLUME DECELERATES; PRICING REMAINS ELEVATED

The Washington region registered $6.4 billion in office sales transaction volume for the 12 months ending in the second quarter of 2019. Transaction volume is down from the 12-month period ending in the second quarter of 2018, when volume measured $8.0 billion. However, inventory remains low and interest in assets high, resulting in elevated per-square-foot prices, as transactions across the metro area averaged $379/SF over the past 12 months. Meanwhile, region-wide cap rates have been edging higher and averaged 6.3% over the past 12 months.

The largest transaction of the quarter was 2511 Jefferson Davis Highway in Crystal City, which sold for $123.1 million, or $344/SF. It was 91% occupied at the time of the sale. Additionally, the sale of Centerpointe I&II, located at 4000-4050 Legato Road in the Fairfax Center submarket, is pending. It includes two buildings totaling 417,720 square feet. The properties are expected to sell for $125.0 million, or $299/SF, and are 96% occupied at this time.

FOREIGN CAPITAL HAS STARTED TO LAG

Washington remains an attractive gateway market for foreign capital. Global investors remain bullish on the Washington area and continue to place capital here because of the market’s long-term safety and the stability of returns. However, foreign investment in Washington area office assets lagged during the first half of 2019. For the 12 months ending in the second quarter of 2019, total foreign office volume for the Washington metropolitan area measured $1.5 billion, compared with $2.8 billion for the 12 months ending in the second quarter of 2018. Foreign buyers accounted for 35% of office transaction volume in the District of Columbia—the region’s core—over the past 12 months.

OFFICE INVESTMENT SALES OUTLOOK

Office transaction volume has been remarkably steady since reaching its cyclical high in 2015, although the first half of 2019 saw transaction volume lag behind that of a year ago because a smaller number of assets traded in the region’s core, where pricing is highest. NKF expects Washington area investment sales volume will continue to taper gradually over the course of 2019, although pricing will remain robust for two primary reasons:

• Commercial real estate represents a superior alternative to other forms of available investments, particularly now that additional interest rate increases seem to be on hold. Ongoing volatility in the global economy will continue to underscore the value of commercial real estate.

• Investors—domestic and foreign—will continue to seek the safety of a primary market like Washington during the mature phase of the cycle. Sovereign wealth funds have been pulling back, but weakening confidence in the global economy underscores the value of hard assets in a market like Washington’s, which has a long history of steady returns.

Metro Area Market Summary

<table>
<thead>
<tr>
<th>Metro Region</th>
<th>12 Month Transaction Volume at 2Q 2019</th>
<th>$6.4 B</th>
</tr>
</thead>
<tbody>
<tr>
<td>12 Month Transaction Volume at 2Q 2018</td>
<td>$8.0 B</td>
<td></td>
</tr>
<tr>
<td>12 Month Trailing Average Price PSF at 2Q 2019</td>
<td>$379</td>
<td></td>
</tr>
<tr>
<td>12 Month Trailing Average Cap Rate at 2Q 2019</td>
<td>6.3%</td>
<td></td>
</tr>
</tbody>
</table>

Note: Averages are for trailing 12 months
Source: Real Capital Analytics, NKF Research

Market Analysis

Average Office Cap Rate and Price Per Square Foot

Trailing 12-Month Office Transaction Volume

Selected 2019 Office Sales Transactions

<table>
<thead>
<tr>
<th>Address</th>
<th>Sale Price</th>
<th>Price/SF</th>
<th>Substate Area</th>
</tr>
</thead>
<tbody>
<tr>
<td>250 E Street SW</td>
<td>$170 M</td>
<td>$508</td>
<td>DC</td>
</tr>
<tr>
<td>55 M Street SE</td>
<td>$135 M</td>
<td>$508</td>
<td>DC</td>
</tr>
<tr>
<td>4000-4050 Legato Road*</td>
<td>$125 M</td>
<td>$299</td>
<td>VA</td>
</tr>
<tr>
<td>2511 Jefferson Davis Highway</td>
<td>$123 M</td>
<td>$344</td>
<td>VA</td>
</tr>
<tr>
<td>830 1st Street NE</td>
<td>$117 M</td>
<td>$520</td>
<td>DC</td>
</tr>
</tbody>
</table>

*Pending as of late June 2019
METHODOLOGY

Market statistics are calculated from a base building inventory of office properties 20,000 SF and larger that are deemed to be competitive in the Washington Metro Area office market. Properties that are more than 75% owner-occupied and federally owned buildings are generally excluded from inventory.

GLOSSARY

**Asking Rental Rate:** The dollar amount asked by landlords for direct available space (not sublease), expressed in dollars per square foot per year. Average asking rents are calculated on a weighted average basis, weighted by the amount of available space. Asking rents are quoted on a full service basis, meaning all costs of operation are paid by the landlord up to a base year or expense stop.

**Cap Rate:** The ratio of Net Operating Income (NOI) to property asset value.

**Class A:** The most prestigious buildings competing for premier office users with rents above average for the area. Class A buildings have high-quality standard finishes, state-of-the-art systems, exceptional accessibility and a definite market presence.

**Class B:** Buildings competing for a wide range of users with rents in the average range for the area. Class B building finishes are fair to good for the area and systems are adequate, but the building cannot compete with Class A at the same price.

**Class C:** Buildings competing for tenants requiring functional space at rents below the area average.

**Deliveries:** Projects that have completed construction and received a certificate of occupancy.

**Net Absorption:** The net change in physically occupied space from one quarter to the next. Year-to-Date (YTD) Net Absorption is the net change in physically occupied space from the start of the calendar year to the current quarter. Net absorption is counted upon physical occupancy, not upon execution of a lease.

**Price Per Square Foot:** Transaction value divided by total square footage of the property.

**Sublease:** Sublease space is offered and marketed as available by the current tenant, rather than directly from the owner.

**Transaction Volume:** Total volume of office transactions $20 million and greater during a specific reporting period.

**Under Construction:** Properties undergoing ground-up construction in which work has begun on the foundation. Properties that have only undergone grading or other site work are not included as under construction.

**Under Renovation:** Properties undergoing significant renovations that require all tenants to be out of the building. These properties are removed from inventory during the renovation period and delivered back to inventory upon completion of the renovations. These properties are not included in under construction totals.

**Vacancy Rate:** The amount of space that is physically vacant, expressed as a percentage of inventory. (Space that is being marketed as available for lease but is largely occupied is not included in the vacancy rate.) The **Overall Vacancy Rate** includes all physically vacant space, both direct and sublease, while the **Direct Vacancy Rate** includes only direct space.
Newmark Knight Frank has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents. Newmark Knight Frank Research Reports are available at www.ngkf.com/research.

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