

# SUBURBAN MARYLAND OFFICE MARKET

## MARKET ACTIVITY UNEVEN IN THIRD QUARTER AS COVID-19 DISRUPTION CONTINUES

Suburban Maryland's office demand continued to soften during the third quarter of 2020 with negative 219,117 square feet of quarterly absorption, bringing year-to-date net absorption to negative 540,798 square feet. As a continued result of disruption related to COVID-19, market activity was modest, with limited leasing activity and few notable tenant moves. The overall vacancy rate registered 15.0% at the end of the third quarter, an increase of 40 basis points from the previous quarter but level with a year ago. Asking rental rates ended the third quarter of 2020 at \$28.78/SF, an increase of 2.5% from \$28.09/SF in the third quarter of 2019. While it may seem counterintuitive that asking rents increased despite negative demand for space, market forces often take a while to adjust, and it is likely effective rents will be flat to declining over the next year as owners increase concessions to lure tenants in an environment of tepid demand.

As of third-quarter 2020, 2.2 million square feet of office space is under construction in Suburban Maryland in five projects, excluding renovations. The pipeline is approximately 76.9% pre-leased. While there were no office deliveries in the first or second quarter of 2020, 909 Rose Avenue in the North Bethesda submarket delivered during the third quarter. The property delivered approximately 31% pre-leased and counted workplace consultant OneDigital and the asset's developer, Federal Realty, as tenants at opening. Two projects are slated for delivery during the fourth quarter of the year. The Wilson at 7272 Wisconsin Avenue in the Bethesda submarket is 78.7% pre-leased to tenants including Enviva, WeWork, Fox 5 and ProShares. Additionally, 4600 River Road in the College Park submarket, a 139,095-square-foot property, will deliver during the fourth quarter of the year and is currently 39.9% pre-leased.

### CLASS A FUNDAMENTALS

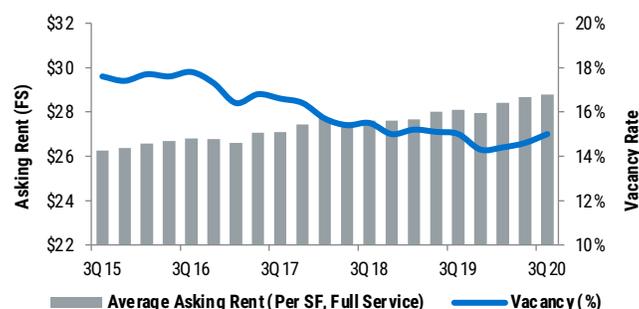
Demand in Suburban Maryland's Class A office market was modest during the third quarter of 2020, registering 21,221 square feet of net absorption, though this is an uptick following two consecutive quarters of negative net demand in the Class A market; year-to-date absorption for Class A space registers negative 210,165 square feet. However, Class A vacancy, which registered 15.9% at the end of the third quarter, has declined 20 basis points over the past year. Class A asking rents averaged \$30.74/SF, up 1.2% from the \$30.39/SF measured one year ago. All 2.2 million square feet of office space under construction in the market will be Class A space when it is delivered.

### CURRENT CONDITIONS

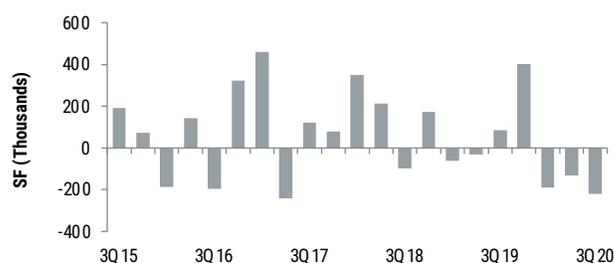
- Suburban Maryland registered negative 219,117 square feet of absorption during the third quarter of 2020. Year-to-date, absorption is negative 540,798 square feet.
- The vacancy rate is up 40 basis points from last quarter but level with one year ago at 15.0%. Demand has slowed materially in 2020.
- 2.2 million square feet is under construction, but groundbreakings are likely to slow given the nation's current economic challenges.

### MARKET ANALYSIS

#### Asking Rent and Vacancy Rate



#### Net Absorption



### MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	74.6 M	74.5 M	74.2 M	↑
Vacancy Rate	15.0%	14.6%	15.0%	↑
Quarterly Net Absorption (SF)	-219,117	-132,886	84,724	↑
Average Asking Rent (Per SF, Full Service)	\$28.78	\$28.67	\$28.09	↔
Under Construction (SF)	2.2 M	2.3 M	2.6 M	↓
Deliveries (SF)	212,000	0	0	↑

## MONTGOMERY COUNTY LOOKS TO LIFE SCIENCES TO BE A MAJOR DRIVER FOR LOCAL GROWTH

Montgomery County has been facing some headwinds recently. Economic development and job creation have been slow, while fewer companies have been moving into the county than its more competitive neighbors, including the District of Columbia, Arlington and Fairfax Counties in Northern Virginia, as well as Prince George’s County. Though overall county vacancy has decreased by 100 basis points over the past five years, to 15.0%, absorption has been negative in 11 of the past 20 quarters. Overall asking rents in the County have risen by 6.6% during the past five years, though much of this growth has been in the down-county submarkets, like Bethesda. Similarly, while there is a robust pipeline of office space under construction, all of it will deliver in the Bethesda submarket.

A potential silver lining for the county during the coronavirus pandemic is the large life sciences and biotechnology presence in Suburban Maryland, particularly in Montgomery County, largely due to the prevalence of large federal government operations in the area. These include: the National Institutes of Health in Bethesda and its subsidiaries throughout the county; the Food and Drug Administration in Silver Spring and Rockville; and the National Institute of Standards and Technology in Gaithersburg. These agencies have been a magnet for private firms looking to gain access to research and available talent. The I-270 Technology Corridor, which includes the submarkets of Bethesda, North Bethesda, Rockville, North Rockville, Gaithersburg and Germantown, has benefitted from high-paying jobs that have helped drive economic activity in the area and have allowed real estate values to appreciate.

The race to develop a coronavirus vaccine could benefit the entire region due to growth in the local biotechnology sector, particularly Montgomery County. Many local companies have received federal contracts, are working on some stage of the vaccine development cycle, and are preparing for the massive scale-up that would be needed if a successful vaccine candidate were to be discovered. The infrastructure available in the area due to an existing focus on gene, cell and vaccine therapies provides the area with tremendous advantages, which can essentially support the entire vaccine product development cycle.

Though most of the vaccine work requires lab and manufacturing space, the growth of these companies could also lead to office space demand as they scale up operations. In addition to direct demand for commercial real estate, local companies being involved in a successful vaccine likely would be an economic boon for the entire Washington region, attracting additional economic investment to the area.

## SUBURBAN MARYLAND OUTLOOK

Office fundamentals in Suburban Maryland are likely to remain soft in the months ahead as leasing activity continues to be limited amidst uncertainty surrounding COVID-19. The recession caused by the global pandemic has led to job losses throughout the Washington region, although office-using jobs have seen fewer layoffs and furloughs than leisure/hospitality and retail positions, somewhat insulating the office market. The pipeline of office deliveries in Suburban Maryland over the next two years is substantial, although it is concentrated in Bethesda; overall vacancy will edge higher in the intermediate term. However, Suburban Maryland’s office projects under construction are 68.9% preleased, which will help limit supply-side concerns.

The potential for a second wave of the virus and the extent of the resulting economic whiplash is unknown at this point, but it is likely that job losses in some private sector industries will have an impact on Suburban Maryland office space demand. However, it is also likely the Suburban Maryland market will see necessary public investment and federal government growth in response to the pandemic over the next few months. This federal government growth, which is likely to occur across the Washington metro area, will lessen the negative impact on the local economy and office market. Suburban Maryland’s core sectors, including life sciences, technology and the federal government, will hasten the market’s recovery. Once a treatment or vaccine for the virus emerges, the region could be poised for steady growth—perhaps even more than previously forecast, given the strengths of the area in science and medical research.

For additional information on the Washington metropolitan area economy and office market outlook, please visit the [Mid-Atlantic Market Reports](#) page at ngkf.com.

## NOTABLE 3Q 2020 LEASE TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
GSA – Health and Human Services	7501 Wisconsin Avenue	Bethesda	Lease Renewal	47,000
GSA – National Institutes of Health	6100 Executive Boulevard	North Bethesda	Lease Extension	43,629
United States Pharmacopeial Convention	12725 Twinbrook Parkway	Rockville	Lease Extension	38,980
EagleBank	11900 Bournefield Way	Silver Spring	New Lease	27,552

## NOTABLE RECENT SALES TRANSACTIONS

Building	Submarket	Sale Price	Price/SF	Square Feet
77 Upper Rock Circle	North Rockville	\$48.1 M	\$211	228,080
5454 Wisconsin Avenue	Bethesda	\$160.0 M	\$592	270,480

## SUBMARKET STATISTICS – ALL CLASSES

	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2017 Absorption (SF)	2018 Absorption (SF)	2019 Absorption (SF)	3Q 2020 Absorption (SF)	YTD 2020 Absorption (SF)
<b>Suburban Maryland</b>	<b>74,631,169</b>	<b>14.3%</b>	<b>15.0%</b>	<b>418,912</b>	<b>637,978</b>	<b>394,044</b>	<b>-219,117</b>	<b>-540,798</b>
Beltsville	1,457,852	28.5%	29.6%	-21,783	77,319	-1,062	-29,970	-35,949
Bethesda	10,919,394	13.5%	15.1%	-169,088	-152,116	187,647	-201,112	-370,372
Bowie	1,229,062	13.3%	15.3%	-203	45,968	4,239	-23,177	-31,512
College Park	3,729,450	6.1%	6.2%	150,945	66,443	222,669	38,487	28,645
Gaithersburg	3,526,178	8.9%	9.0%	11,827	30,598	-226	-22,355	-59,486
Germantown	2,308,113	19.7%	20.7%	22,381	-68,967	-42,624	-8,588	-50,642
Greenbelt	2,869,682	22.1%	22.7%	145,648	43,056	130,707	-20,238	-58,325
Landover/Lanham/Largo	4,597,337	12.5%	12.9%	145,750	166,268	5,221	26,692	78,916
Laurel	1,842,894	19.3%	19.6%	25,654	26,511	-95,067	-23,992	-19,786
North Rockville	11,624,645	16.9%	17.8%	-49,158	243,161	307,365	67,005	-95,988
North Bethesda	10,004,014	16.4%	17.4%	-43,282	221,345	128,491	45,938	63,758
Rockville	8,430,831	11.0%	11.2%	206,338	-113,513	94,590	-15,969	-50,438
Silver Spring	9,756,065	12.8%	13.5%	-32,425	86,691	-623,892	-73,783	57,487
Southern Prince George's	2,335,652	10.6%	10.6%	26,308	-34,786	75,986	21,945	2,894

## MARKET STATISTICS BY CLASS

	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2017 Absorption (SF)	2018 Absorption (SF)	2019 Absorption (SF)	3Q 2020 Absorption (SF)	YTD 2020 Absorption (SF)
<b>Suburban Maryland</b>	<b>74,631,169</b>	<b>14.3%</b>	<b>15.0%</b>	<b>418,912</b>	<b>637,978</b>	<b>394,044</b>	<b>-219,117</b>	<b>-540,798</b>
Class A	41,087,424	14.8%	15.9%	539,240	491,325	365,775	21,221	-210,165
Class B	23,166,110	13.8%	14.3%	9,503	171,921	115,306	-175,012	-195,773
Class C	10,377,635	12.9%	13.1%	-129,831	-25,268	-87,037	-65,326	-134,860

## SUBMARKET STATISTICS – ALL CLASSES

	Total Inventory (SF)	Class A Asking Rent (\$/SF)	Class B Asking Rent (\$/SF)	Overall Asking Rent (\$/SF)	3Q 2020 Deliveries (SF)	YTD 2020 Deliveries (SF)	Under Construction (SF)
<b>Suburban Maryland</b>	<b>74,631,169</b>	<b>\$30.74</b>	<b>\$27.63</b>	<b>\$28.78</b>	<b>212,000</b>	<b>212,000</b>	<b>2,180,526</b>
Beltsville	1,457,852	\$22.97	N/A	\$22.68	0	0	0
Bethesda	10,919,394	\$45.92	\$39.70	\$41.32	0	0	1,466,664
Bowie	1,229,062	\$26.48	\$18.29	\$25.58	0	0	0
College Park	3,729,450	\$25.27	\$24.09	\$23.57	0	0	139,095
Gaithersburg	3,526,178	\$24.80	\$20.66	\$23.75	0	0	0
Germantown	2,308,113	\$26.27	\$22.48	\$23.96	0	0	0
Greenbelt	2,869,682	\$22.53	\$21.53	\$22.09	0	0	0
Landover/Lanham/Largo	4,597,337	\$22.34	\$21.14	\$21.38	0	0	0
Laurel	1,842,894	\$22.50	\$20.47	\$20.81	0	0	0
North Rockville	11,624,645	\$29.76	\$25.72	\$27.96	0	0	0
North Bethesda	10,004,014	\$29.51	\$28.71	\$28.44	212,000	212,000	0
Rockville	8,430,831	\$33.69	\$28.33	\$31.62	0	0	0
Silver Spring	9,756,065	\$31.36	\$26.36	\$28.05	0	0	0
Southern Prince George's	2,335,652	N/A	\$27.90	\$21.78	0	0	574,767

## MARKET STATISTICS BY CLASS

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	3Q 2020 Deliveries (SF)	YTD 2020 Deliveries (SF)	Under Construction (SF)
<b>Suburban Maryland</b>	<b>74,631,169</b>	<b>\$30.74</b>	<b>\$27.63</b>	<b>\$28.78</b>	<b>212,000</b>	<b>212,000</b>	<b>2,180,526</b>
Class A	41,087,424	\$30.74	N/A	\$30.74	212,000	212,000	2,180,526
Class B	23,166,110	N/A	\$27.63	\$27.63	0	0	0
Class C	10,377,635	N/A	N/A	\$24.42	0	0	0

Note: Asking rents are quoted on a full service basis.

## 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.

**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.

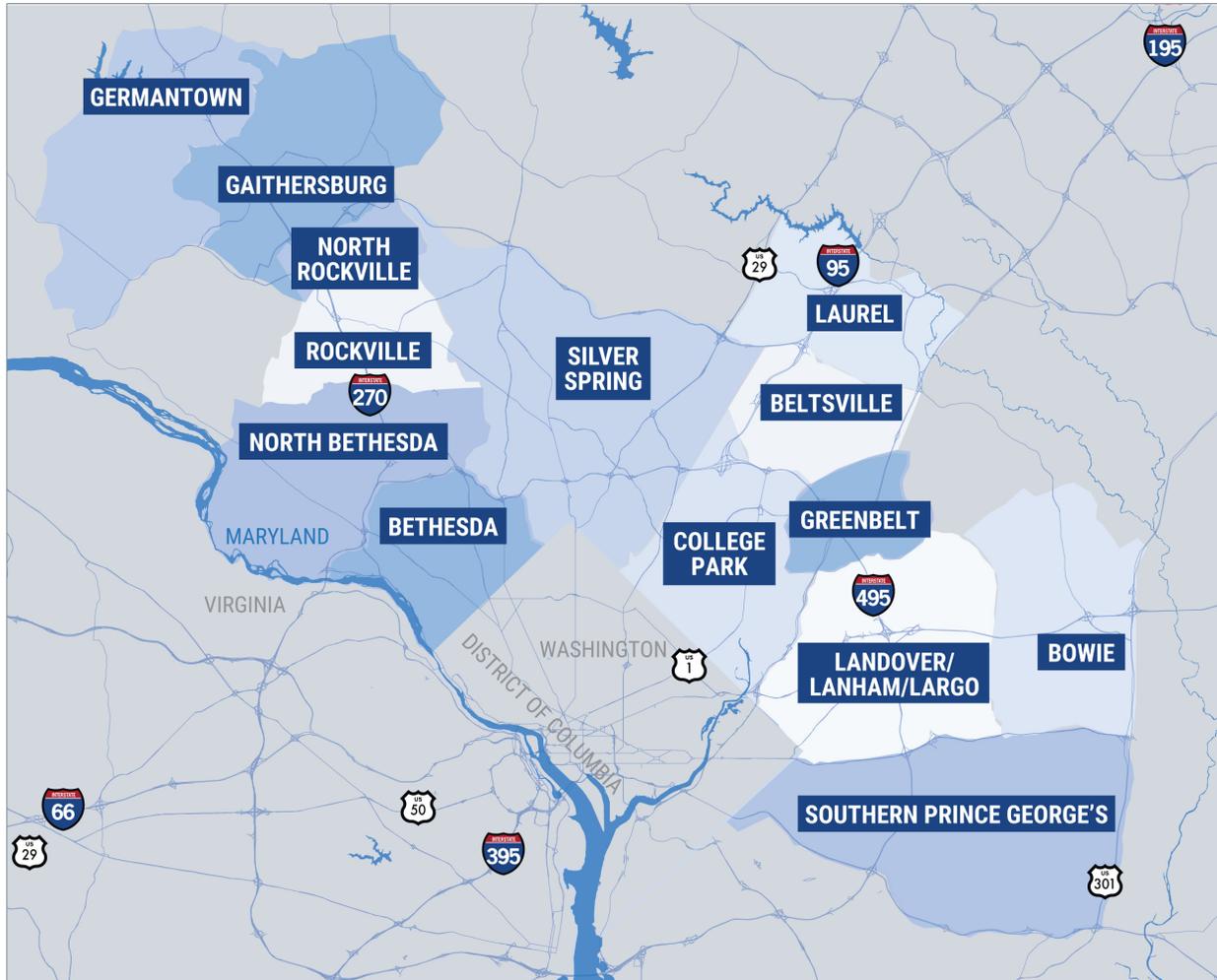
**Sublease:** Sublease space is offered and marketed as available by the current tenant, rather than directly from the owner.

**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.

## SUBURBAN MARYLAND OFFICE SUBMARKETS



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