

BALTIMORE OFFICE MARKET

BALTIMORE OFFICE MARKET SOFTENS IN SECOND QUARTER AS PANDEMIC'S IMPACT ARRIVES

The Baltimore metro area's office market exhibited softening office leasing metrics in the second quarter of 2020, with an uptick in vacancy due to a new delivery and limited leasing activity. These conditions were not unexpected amid the coronavirus pandemic. Net absorption during the second quarter was modestly positive. Baltimore registered 39,014 square feet of net absorption during second-quarter 2020, down from 60,091 square feet during first-quarter 2020, but up from 2,176 square feet in second-quarter 2019. The pace of net absorption has decelerated over the past year, averaging 33,931 square feet per quarter, compared with 139,845 square feet per quarter from second-quarter 2015 to second-quarter 2019.

The overall vacancy rate for Baltimore's office market was 13.5% at the end of the second quarter, up 40 basis points from one year ago. Leasing activity will likely continue to slow in the near term, driving vacancy higher as tenants remain cautious amid economic turmoil related to the COVID-19 outbreak.

Asking rents averaged \$24.04/SF during second-quarter 2020, up from \$23.77/SF during the previous quarter; however, rent adjustments can lag overall market conditions during periods of transition. Rents had edged downward during first-quarter 2020. The Baltimore office market registered positive rent change in all but two quarters during the period between second-quarter 2015 and third-quarter 2019. Despite rents softening in fourth-quarter 2019 and first-quarter 2020, there has still been a flight to quality in the market among those tenants seeking space, with tenants opting for more efficient space in well-located, highly-amenitized assets. Asking rents will likely tick up in the longer-term as the economy stabilizes and new product delivers.

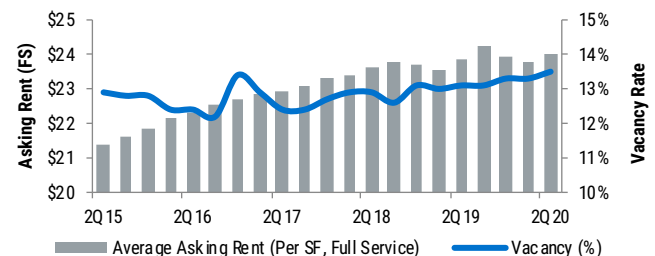
Growth in Baltimore's office market over the past two years has been driven by the region's cybersecurity and defense contracting presence, particularly in suburban submarkets including BWI and Columbia. Consolidations and the flight to suburban assets have caused vacancies to increase Downtown, with the Central Business District registering negative net absorption during the first half of 2020, following occupancy losses in both 2018 and 2019. Due to the pandemic, it is likely this trend will continue in the near future, as companies will possibly seek office space in less dense areas in an attempt to reduce exposure to disease.

CURRENT CONDITIONS

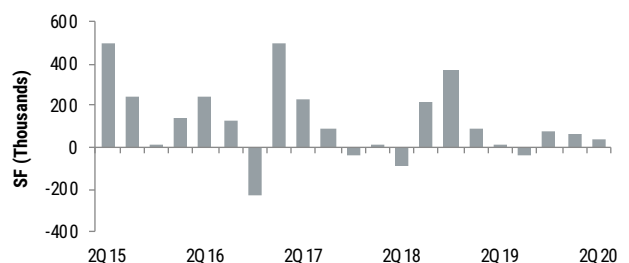
- The Baltimore office market registered 39,014 square feet of net absorption during the second quarter of the year, down slightly from 60,091 square feet during the prior quarter.
- The overall vacancy rate for Baltimore's office market was 13.5% at the end of the second quarter, up 40 basis points from one year ago.
- 285,000 square feet of office space is under construction in the Baltimore metro area, just 0.3% of standing inventory.

MARKET ANALYSIS

Asking Rent and Vacancy Rate



Net Absorption



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	82.6 M	82.3 M	81.9 M	↑
Overall Vacancy Rate	13.5%	13.3%	13.1%	↑
Quarterly Net Absorption (SF)	39,014	60,091	2,176	↔
Average Asking Rent (Per SF, Full Service)	\$24.04	\$23.77	\$23.88	↔
Under Construction (SF)	285,000	517,773	938,737	↑
Deliveries (SF)	232,773	0	0	↓

CORONAVIRUS CONTINUES TO CHALLENGE BALTIMORE'S OFFICE MARKET

Through most of the second quarter, the Baltimore area was under COVID-19 restrictions that closed non-essential businesses and schools. These restrictions began in Maryland on March 23, and the state began re-opening on May 15.

Although the full impact of the coronavirus on the region's office market remains uncertain, the office market saw a deceleration in demand during the second quarter, which is likely to persist as many employees continue to work remotely and the economy slowly recovers. Office development projects continued as construction was deemed an essential business. One significant project delivered during the second quarter: 1201 Wills Street, Beatty Development Group's new, 12-story, 330,000-square-foot mixed-use building in the Harbor Point development. The building includes 232,773 square feet of office space and was preleased to tenants including Ernst & Young, Jellyfish and WeWork. The development has faced some uncertainty recently as it is rumored that WeWork may back out of its lease in the midst of turmoil surrounding the company that began with its failed IPO and worsened with the pandemic. This would have been WeWork's first location in Baltimore.

Two office buildings totaling 285,000 square feet are currently under construction in the Baltimore metro area. While the pipeline is currently modest, Baltimore City recently approved a bond issuance to assist in the financing of the new \$5.5 billion, 235-acre Port Covington project. The project has been delayed due to COVID-19 and protests from the community over public funding but is expected to begin work later this year. Three cybersecurity firms have committed to moving to Port Covington in its first phase of development.

The project's first phase is expected to include approximately 3 million square feet of mixed-use space, including 1.3 million square feet of office space, 338,000 square feet of retail space, 976,000 square feet of residential space and 285,000 square feet of hotel space. While there is still significant economic uncertainty right now, the approved funding was a win for the commercial real estate industry in Baltimore and for a development that has already overcome significant challenges and delays in securing final funding.

INVESTMENT SALES VOLUME IS MODEST DURING SECOND QUARTER

The Baltimore market saw one significant office sales transaction during second-quarter 2020 for \$23.0 million, down from the \$108.9 million in volume recorded during first-quarter 2020. The only notable sale of the quarter was Merritt Properties' acquisition of the Lyndwood Executive Center in the Columbia submarket. NewTower Trust Company sold the 164,414-square-foot office complex for \$23.0 million, or \$140/SF.

Despite the moderating pace of volume over the past year, Baltimore's investment sales market has proven sturdy over the past five years. Baltimore remains an attractive target, as investors are drawn to the region's burgeoning education/health and cybersecurity sectors and their potential to support demand for office space. Johns Hopkins University has emerged as one of the leaders in COVID-19 research, which should help bolster demand for space in the future. Hospitals have seen their revenues suffer recently due to postponed elective surgeries, but the region's strength in medicine and healthcare sets it up well at a time when those fields are in the spotlight. The transformation or revitalization of select neighborhoods, including Port Covington and Columbia, also appeals to long-term investors.

NOTABLE 2Q LEASE TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
Zenimax	200 International Circle	I-83	Expansion	104,028
Verizon	309 International Circle	I-83	Lease Renewal	22,373
Heritage Financial	307 International Circle	I-83	Lease Renewal	11,001
Intelligensis	6950 Columbia Gateway Drive	Columbia	Direct Lease	10,831

NOTABLE RECENT SALES TRANSACTIONS

Building	Submarket	Sale Price	Price/SF	Square Feet
40 Wight Avenue	I-83	\$39,100,000	\$296	132,207
Lyndwood Executive Center	Columbia	\$23,000,000	\$140	164,414

BALTIMORE OFFICE MARKET OUTLOOK

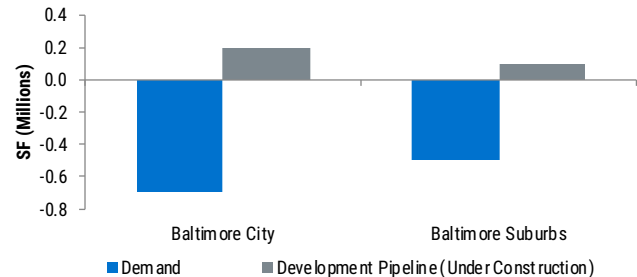
The Baltimore metro area is expected to see soft office leasing metrics over the next 24 months. Baltimore suffered significant job losses in March and April as a result of the pandemic, although May showed the beginnings of recovery with 33,200 jobs added across the metro area.

NKF forecasts a loss of 59,700 jobs during calendar year 2020 before an average increase of 11,750 jobs per annum from 2021 through 2024 once the economy stabilizes. As seen in the adjacent chart, negative net absorption is projected over the next 24 months, as the pace of leasing has slowed and some tenants look to consolidate regional footprints. Overall, metro Baltimore's vacancy rate is expected to increase 180 basis points to 15.3% by June 2022; the lack of new construction in progress will help to keep vacancy in check.

The average asking rent may be little changed in the short term as office owners watch to see what the effects of COVID-19 will be in the longer run before making any decisions on rent reductions. They likely will first address leasing challenges by increasing concessions, placing downward pressure on effective rents in the near term.

SUPPLY / DEMAND FORECAST

Baltimore Metro Area | 24 Months Ending June 2022



Source: NKF Research; June 2020

MARKET STATISTICS BY CLASS

	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2017 Absorption (SF)	2018 Absorption (SF)	2019 Absorption (SF)	2Q 2020 Absorption (SF)	YTD 2020 Absorption (SF)
Baltimore Metro Area	82,551,664	12.9%	13.5%	814,102	508,284	127,335	39,014	99,105
Class A	49,036,203	13.7%	14.6%	579,095	152,877	78,869	20,122	52,934
Class B	27,609,561	11.8%	12.0%	196,304	309,642	68,305	19,001	21,064
Class C	5,905,900	11.3%	11.3%	38,703	45,765	-19,839	-109	25,107

MARKET STATISTICS BY CLASS

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	2Q 2020 Deliveries (SF)	YTD 2020 Deliveries (SF)	Under Construction (SF)
Baltimore Metro Area	82,551,664	\$26.06	\$20.78	\$24.04	232,773	232,773	285,000
Class A	49,036,203	\$26.06	NA	\$26.06	232,773	232,773	285,000
Class B	27,609,561	NA	\$20.78	\$20.78	0	0	0
Class C	5,905,900	NA	NA	\$20.34	0	0	0

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

SUBMARKET STATISTICS – ALL CLASSES

	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2017 Absorption (SF)	2018 Absorption (SF)	2019 Absorption (SF)	2Q 2020 Absorption (SF)	YTD 2020 Absorption (SF)
Baltimore Metro Area	82,551,664	12.9%	13.5%	814,102	508,284	127,335	39,014	99,105
Annapolis	3,228,553	12.5%	12.9%	22,743	10,663	30,066	20,299	20,164
Baltimore County East	1,891,681	13.0%	13.0%	-34,679	109,034	11,816	17,757	5,511
Baltimore Midtown	2,345,974	5.5%	5.5%	-17,554	29,573	-6,386	-1,819	52,000
Baltimore Northeast	1,179,016	0.5%	0.5%	10,919	5,736	23,344	0	14,646
Baltimore Northwest	1,229,881	9.5%	9.7%	2,671	194	-5,735	715	-2,225
Baltimore Southeast	6,869,047	13.5%	14.6%	7,534	-168,823	23,332	-1,300	-57,277
Baltimore Southwest	2,319,701	23.7%	23.7%	-5,566	28,539	9,386	-35,262	-55,878
BWI	9,670,197	8.1%	8.5%	183,910	382,861	67,081	15,723	111,479
Carroll County	369,095	6.3%	6.3%	4,655	3,846	-12,332	333	352
CBD Baltimore	15,272,878	17.0%	17.8%	256,360	-42,343	-30,178	12,077	-50,750
Columbia	11,894,492	13.5%	14.0%	355,218	-183,209	160,285	-23,292	-10,765
Ellicott City	879,329	7.3%	7.8%	-12,549	-6,371	6,128	-6,471	-1,591
Harford County	1,910,894	17.5%	18.3%	28,649	5,295	32,920	-1,936	18,471
I-83	7,863,296	9.4%	9.7%	-8,390	292,229	-15,978	-5,912	-32,855
I-97 Crain Highway Corridor	726,522	19.8%	20.2%	38,623	24,669	-24,650	6,700	-3,590
Reisterstown Road Corridor	4,865,322	12.9%	14.3%	12,050	6,691	70,680	19,415	39,767
Route 1 Corridor	1,215,332	17.7%	19.1%	-5,843	-39,100	-17,997	16,344	36,231
Route 2 Corridor	931,886	8.2%	8.2%	4,468	-16,548	-19,876	-936	-16,157
Towson	4,684,858	16.0%	16.0%	12,866	43,952	-125,344	-10,095	-3,106
Woodlawn	3,203,710	10.9%	10.9%	-41,983	21,396	-49,227	16,674	34,678

SUBMARKET STATISTICS – ALL CLASSES

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	2Q 2020 Deliveries (SF)	YTD 2020 Deliveries (SF)	Under Construction (SF)
Baltimore Metro Area	82,551,664	\$26.06	\$20.78	\$24.04	232,773	232,773	285,000
Annapolis	3,228,553	\$33.04	\$24.55	\$31.73	0	0	100,000
Baltimore County East	1,891,681	\$25.91	\$23.02	\$23.89	0	0	0
Baltimore Midtown	2,345,974	NA	\$23.11	\$22.48	0	0	0
Baltimore Northeast	1,179,016	NA	\$18.50	\$18.50	0	0	0
Baltimore Northwest	1,229,881	NA	\$26.35	\$26.35	0	0	0
Baltimore Southeast	6,869,047	\$28.25	\$25.40	\$25.78	232,773	232,773	185,000
Baltimore Southwest	2,319,701	\$24.52	\$17.01	\$17.20	0	0	0
BWI	9,670,197	\$29.21	\$21.69	\$26.50	0	0	0
Carroll County	369,095	\$24.50	\$14.57	\$16.24	0	0	0
CBD Baltimore	15,272,878	\$27.15	\$19.69	\$24.58	0	0	0
Columbia	11,894,492	\$26.88	\$22.45	\$25.78	0	0	0
Ellicott City	879,329	\$21.01	\$20.79	\$20.26	0	0	0
Harford County	1,910,894	\$27.21	\$23.79	\$25.37	0	0	0
I-83	7,863,296	\$26.53	\$16.51	\$24.99	0	0	0
I-97 Crain Highway Corridor	726,522	\$24.14	\$19.29	\$22.08	0	0	0
Reisterstown Road Corridor	4,865,322	\$23.65	\$20.94	\$22.09	0	0	0
Route 1 Corridor	1,215,332	\$23.45	\$21.13	\$21.57	0	0	0
Route 2 Corridor	931,886	\$21.00	\$19.08	\$19.68	0	0	0
Towson	4,684,858	\$22.44	\$20.04	\$20.74	0	0	0
Woodlawn	3,203,710	\$22.43	\$19.37	\$20.65	0	0	0

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

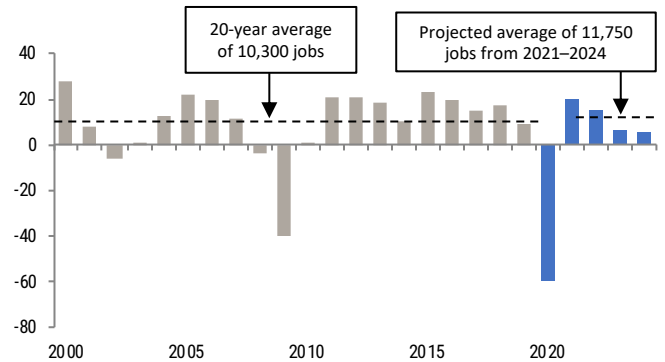
ECONOMIC CONDITIONS

The Baltimore region's unemployment rate registered 10.4% in April 2020, 430 basis points lower than the national rate of 14.7%. Both the Baltimore and U.S. unemployment rates have risen sharply since February due to the pandemic's impact. As evidenced by lower unemployment than the national rate, Baltimore may be somewhat insulated from the worst impacts of a recession as its core job sectors, such as Professional and Business Services and Education/Health, may be better equipped to handle this specific downturn. Employment is likely to rebound during the second half of 2020, although a full recovery is unlikely to occur until 2021 at the earliest.

For the 12-month period ending in May 2020, every Baltimore job sector experienced losses with the exception of Mining, Logging and Construction. The office-using sectors all saw job losses with most coming in the Other Services and Information sectors. Although almost all sectors experienced job losses over the past 12 months, Baltimore has recovered some of those jobs, gaining 33,200 jobs in May. Overall, non-farm payroll employment decreased by 170,600 jobs, or 11.9%, during the 12 months ending in May 2020.

EMPLOYMENT FORECAST

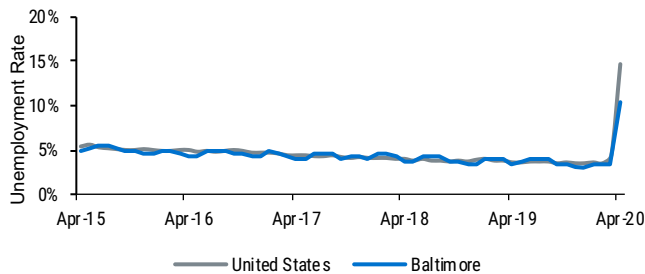
Baltimore Metro Area, Payroll Job Change, 2000–2019 and Forecast 2020–2024



Source: U.S. Bureau of Labor Statistics, Moody's Analytics, NKF Research; June 2020
*Previous projections have been revised due to COVID-19 and are subject to further revision as conditions change.

UNEMPLOYMENT RATE

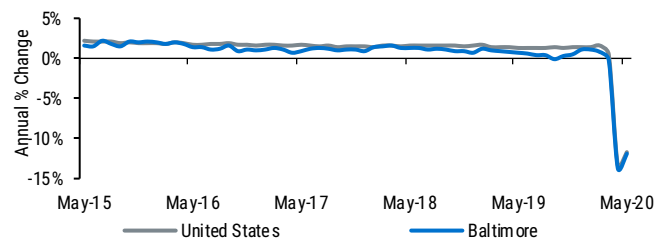
U.S. – Seasonally Adjusted, Baltimore – Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics, NKF Research; June 2020

PAYROLL EMPLOYMENT

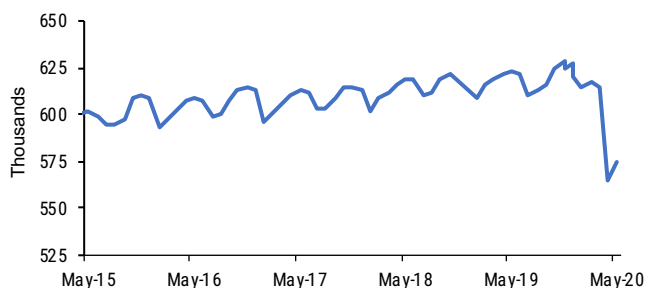
Total Nonfarm, U.S. – Seasonally Adjusted, Baltimore – Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics, NKF Research; June 2020

OFFICE-USING EMPLOYMENT*

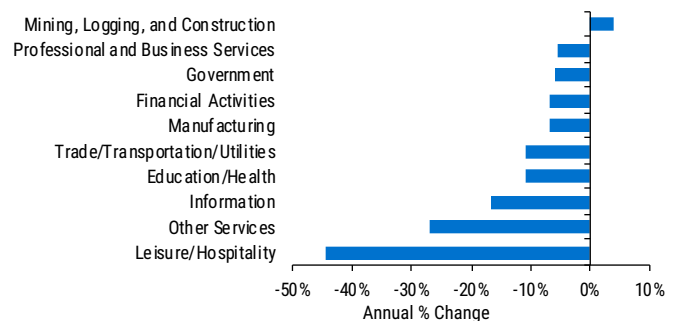
Baltimore, Office-Using Employment (000's), Not Seasonally Adjusted



*Identified as Financial Activities, Government, Information, Other Services, and Professional and Business Services
Source: U.S. Bureau of Labor Statistics, NKF Research; June 2020

EMPLOYMENT GROWTH BY INDUSTRY

Baltimore, % Change, 12 Months Ending May 2020, Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics, NKF Research; June 2020

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 Baltimore Metro Area office market. Properties that are more than 75% owner-occupied 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.

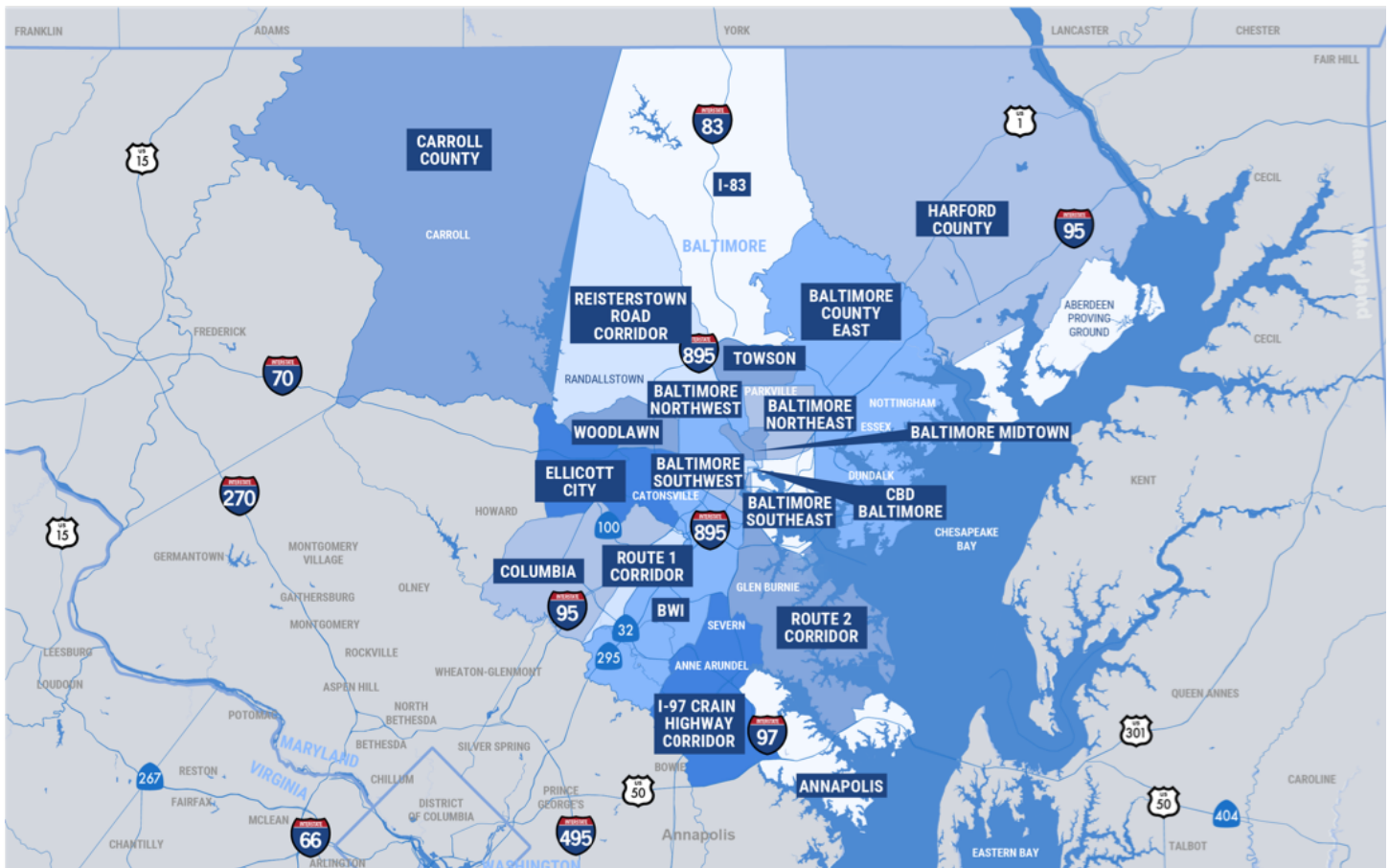
Sublease: Sublease space is offered and marketed as available by the current tenant, rather than directly from the owner.

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.

BALTIMORE OFFICE SUBMARKETS



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