

SUBURBAN MARYLAND OFFICE MARKET

MARKET ACTIVITY MODEST IN SECOND QUARTER AMID CORONAVIRUS DISRUPTION

Suburban Maryland's office demand continued to soften during the second quarter of 2020 with negative 23,648 square feet of quarterly absorption, bringing year-to-date net absorption to negative 195,051 square feet. Likely a 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 14.4% at the end of the second quarter, unchanged from the previous quarter but down 80 basis points from a year ago. Asking rental rates ended the second quarter of 2020 at \$28.68/SF, an increase of 2.4% from \$28.00/SF in the second 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 second-quarter 2020, 2.3 million square feet of office space is under construction in Suburban Maryland in five projects, excluding renovations. The pipeline is approximately 73.0% preleased. While there were no office deliveries in the first or second quarter of 2020, two projects are slated for delivery in the second half 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; and 909 Rose Avenue in the North Bethesda submarket, which preleased approximately 16,000 square feet to workplace consultant OneDigital. Developer Federal Realty also plans to occupy approximately 40,000 square feet in the building, dubbed 909 Rose.

CLASS A FUNDAMENTALS

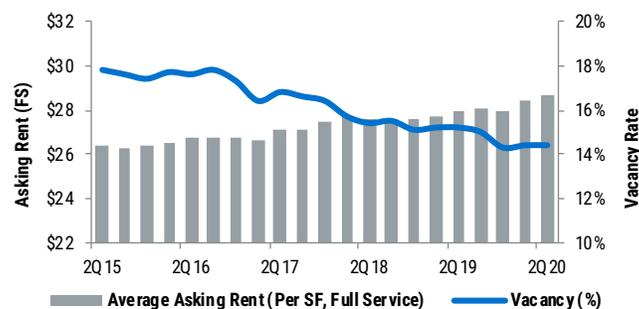
Demand in Suburban Maryland's Class A office market was modest during the second quarter of 2020, registering negative 9,508 square feet of net absorption. This was the second consecutive quarter of negative net demand in the Class A market; year-to-date absorption for Class A space registers negative 145,622 square feet. However, Class A vacancy, which registered 15.3% at the end of the second quarter, has declined 90 basis points over the past year. Class A asking rents averaged \$30.77/SF, up 1.5% from the \$30.33/SF measured one year ago. All 2.3 million square feet of office space under construction in the market will be Class A space when it is delivered.

CURRENT CONDITIONS

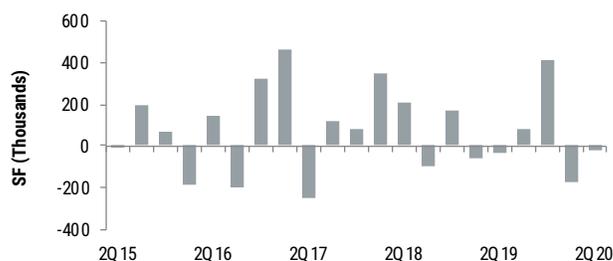
- Suburban Maryland registered negative 23,648 square feet of absorption during the second quarter of 2020.
- The vacancy rate is down 80 basis points from one year ago to 14.4%, and the average asking rent rose 2.4% over the past year. However, demand has slowed materially in 2020.
- 2.3 million square 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)	74.5 M	74.5 M	74.2 M	↑
Vacancy Rate	14.4%	14.4%	15.2%	↑
Quarterly Net Absorption (SF)	-23,648	-171,403	-29,628	↑
Average Asking Rent (Per SF, Full Service)	\$28.68	\$28.42	\$28.00	↔
Under Construction (SF)	2.3 M	2.3 M	2.2 M	↓
Deliveries (SF)	0	0	175,000	↔

INVESTMENT SALES VOLUME MODEST

Investment sales activity in the Suburban Maryland office market has been modest over the past several years, even prior to disruption brought on by the coronavirus pandemic. There were no sales transactions larger than \$20 million during the second quarter. The most recent significant sales transaction occurred in the first quarter with the sale of the Barlow Building at 5454 Wisconsin Avenue in the Bethesda submarket. A joint venture between Alony Hetz and Carr Properties sold the property to Starwood Capital for \$160 million, or \$592 per square foot. It was 92% leased at the time of sale.

VACCINE RESEARCH COULD BE A MAJOR DRIVER FOR LOCAL LIFE SCIENCES GROWTH

Life sciences and biotechnology have a significant 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.

Now with the worldwide race to develop a coronavirus vaccine, the area may further benefit from growth in the local biotechnology sector. Local companies, including Emergent BioSolutions, Novavax, Vigene and GeneDx, are all working on some stage of the vaccine development cycle and preparing for the massive scale-up that would be needed if a successful vaccine candidate were to be discovered. Because local companies have a focus on gene and cell therapies and experience with other vaccines, the area has a particular advantage over other biotechnology clusters in the U.S. The infrastructure available in the area can essentially support the entire vaccine product development cycle, from research and development all the way through manufacturing.

While 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 remains limited amidst uncertainty surrounding the duration and severity of the coronavirus pandemic. The recession caused by the global pandemic will likely slow job creation in numerous sectors, which could in turn slow office demand considerably.

The pipeline of office deliveries over the next two years is substantial, especially in transit-oriented submarkets, which will push overall vacancy higher in the intermediate term. However, the projects under construction are 73.0% preleased, which will help limit supply-side concerns.

The duration of the outbreak and the extent of the resulting economic decline 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 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 impact on the local economy and office market. Suburban Maryland's core sectors, such as life sciences, technology and the federal government, will help to insulate it against some of the worst impacts of a recession. 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 2020 LEASE TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
GSA – National Institute of Mental Health	6001 Executive Boulevard	North Bethesda	Lease Renewal	156,250
BAE Systems	520 Gaither Road	North Rockville	Lease Renewal	49,080
Children's National Health System	1 Inventa Place	Silver Spring	Lease Expansion	35,599
Aurinia Pharmaceuticals	77 Upper Rock Circle	North Rockville	New Lease	30,531

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)	2Q 2020 Absorption (SF)	YTD 2020 Absorption (SF)
Suburban Maryland	74,487,713	13.7%	14.4%	418,912	637,978	410,526	-23,648	-195,051
Beltsville	1,457,852	26.0%	26.9%	-21,783	77,319	-1,062	-13,100	3,025
Bethesda	10,919,394	11.0%	12.9%	-169,088	-152,116	184,922	-48,686	-134,590
Bowie	1,229,062	11.4%	13.4%	-203	45,968	4,239	0	-8,335
College Park	3,729,450	7.1%	7.2%	150,945	66,443	222,669	-5,667	-9,842
Gaithersburg	3,526,178	8.9%	9.0%	11,827	30,598	-226	22,263	-47,702
Germantown	2,308,113	19.3%	20.4%	22,381	-68,967	-42,624	-28,013	-42,054
Greenbelt	2,869,682	20.2%	20.3%	145,648	43,056	130,707	1,037	9,751
Landover/Lanham/Largo	4,597,337	13.5%	14.1%	145,750	166,268	5,221	26,950	24,049
Laurel	1,842,894	18.3%	18.3%	25,654	26,511	-95,067	6,125	4,206
North Rockville	11,693,189	17.6%	18.5%	-49,158	243,161	307,365	-2,655	-185,105
North Bethesda	9,792,014	14.7%	15.8%	-43,282	221,345	138,427	6,218	74,147
Rockville	8,430,831	10.7%	10.8%	206,338	-113,513	98,728	-25,177	-7,842
Silver Spring	9,756,065	12.7%	13.0%	-32,425	86,691	-618,759	43,560	147,660
Southern Prince George's	2,335,652	11.6%	11.7%	26,308	-34,786	75,986	-6,503	-22,419

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)
Suburban Maryland	74,487,713	13.7%	14.4%	418,912	637,978	410,526	-23,648	-195,051
Class A	40,875,424	14.2%	15.3%	539,240	491,325	365,346	-9,508	-145,622
Class B	23,166,110	13.6%	13.9%	9,503	171,921	128,079	-12,766	-6,522
Class C	10,446,179	12.0%	12.2%	-129,831	-25,268	-82,899	-1,374	-42,907

SUBMARKET STATISTICS – ALL CLASSES

	Total Inventory (SF)	Class A Asking Rent (\$/SF)	Class B Asking Rent (\$/SF)	Overall Asking Rent (\$/SF)	2Q 2020 Deliveries (SF)	YTD 2020 Deliveries (SF)	Under Construction (SF)
Suburban Maryland	74,487,713	\$30.77	\$27.31	\$28.68	0	0	2,253,431
Beltsville	1,457,852	\$23.15	N/A	\$22.80	0	0	0
Bethesda	10,919,394	\$45.13	\$39.85	\$40.71	0	0	1,466,664
Bowie	1,229,062	\$26.86	\$18.29	\$25.99	0	0	0
College Park	3,729,450	\$25.14	\$23.63	\$23.74	0	0	0
Gaithersburg	3,526,178	\$24.83	\$20.10	\$23.37	0	0	0
Germantown	2,308,113	\$26.22	\$22.43	\$23.93	0	0	0
Greenbelt	2,869,682	\$21.89	\$21.78	\$21.78	0	0	0
Landover/Lanham/Largo	4,597,337	\$22.34	\$20.99	\$21.29	0	0	0
Laurel	1,842,894	\$22.50	\$20.39	\$20.58	0	0	0
North Rockville	11,693,189	\$30.32	\$25.75	\$28.33	0	0	0
North Bethesda	9,792,014	\$31.05	\$28.43	\$29.30	0	0	212,000
Rockville	8,430,831	\$33.88	\$28.13	\$31.89	0	0	0
Silver Spring	9,756,065	\$31.09	\$25.74	\$27.74	0	0	0
Southern Prince George's	2,335,652	\$31.30	\$28.91	\$22.36	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)	2Q 2020 Deliveries (SF)	YTD 2020 Deliveries (SF)	Under Construction (SF)
Suburban Maryland	74,487,713	\$30.77	\$27.31	\$28.68	0	0	2,253,431
Class A	40,875,424	\$30.77	N/A	\$30.77	0	0	2,253,431
Class B	23,166,110	N/A	\$27.31	\$27.31	0	0	0
Class C	10,446,179	N/A	N/A	\$24.53	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.

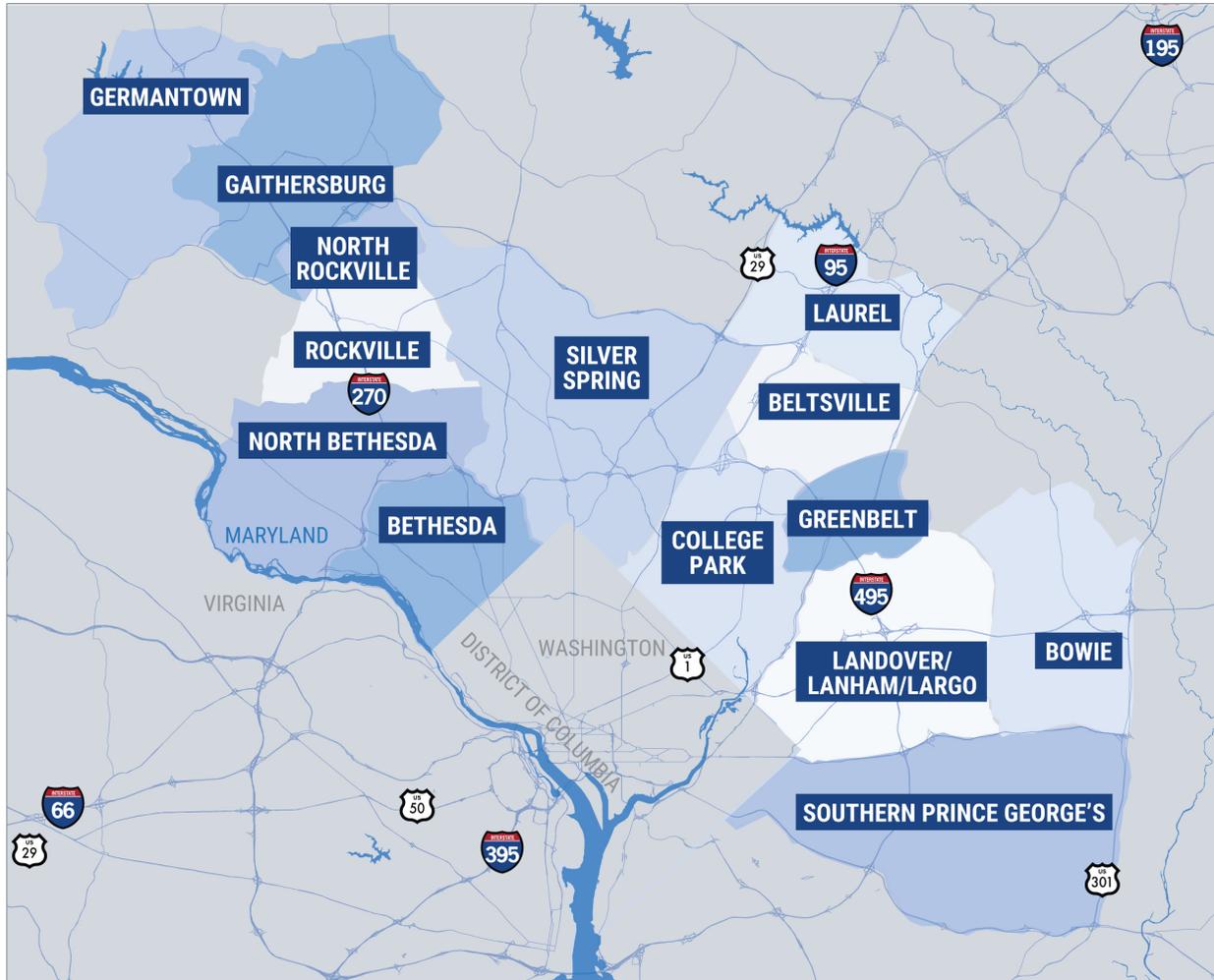
Sublease: Sublease space is offered and marketed as available by the current tenant, rather than directly from the owner.

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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