RESEARCH **2Q 2020**

Newmark Knight Frank

WASHINGTON METRO AREA ECONOMY AND OFFICE MARKET

PANDEMIC-INDUCED JOB LOSSES STALL OFFICE MARKET AS REGION FACES RECESSION

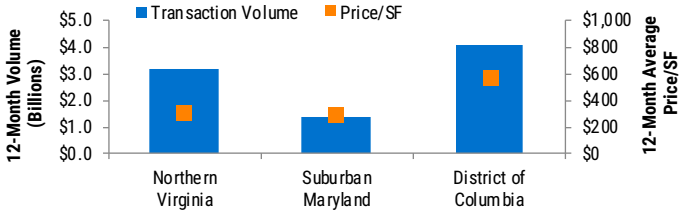
The Washington metro area's employment base contracted significantly during the second quarter of 2020. For the 12 months ending in April 2020, the region lost 317,000 jobs; this compares with the metro area's 20-year average growth of 38,800 jobs per annum, and is the first time job change has been negative in the region since the first quarter of 2010. The unemployment rate was up to 9.9% in April, 300 basis points higher than the rate's peak during the Great Recession. The area's gross regional product change likely will be negative during 2020 due to fallout from the coronavirus pandemic. According to the Stephen S. Fuller Institute, the Washington region's economy is projected to contract by 5.3%–6.0% in 2020. The Fuller Institute's Leading Index, a predictor of the economy's performance over the next six to eight months, decreased 11.7% for the 12 months ending in April, as the effects of the pandemic have come into focus. The recession caused by the shutdown is expected to be deep but relatively short-lived, with the recovery likely beginning during the second half of 2020.

Office space demand in the Washington metro area was slightly positive overall during the second quarter and up from the previous quarter; it was bolstered by the occupancy of pre-leased space. However, market activity was slow due to limited movement during the ongoing period of pandemic-related quarantine, which forced remote work and limited economic and transaction activity. The second quarter saw 255,223 square feet of net absorption in the region, with only Northern Virginia registering a positive total, at 306,804 square feet. Net absorption registered negative 27,933 square feet in the District of Columbia and negative 23,648 square feet in Suburban Maryland. At 16.5%, the region's overall vacancy rate was up 20 basis points from the previous quarter and up 40 basis points from the rate recorded one year ago.

The Washington region registered $8.6 billion in office sales volume for the 12 months ending in the second quarter of 2020. This marks an increase from the 12-month period ending in the second quarter of 2019, when volume was $7.4 billion, although sales volume in the second quarter of 2020 was only $343.5 million due to a pandemic-induced slowdown of activity in global and domestic markets. Transactions across the metro averaged $383/SF over the past 12 months, and regional cap rates averaged 6.4% over the same period.

CAPITAL MARKETS

Office Investment Sales Volume and Price/SF 12 Months Ending 2Q 2020



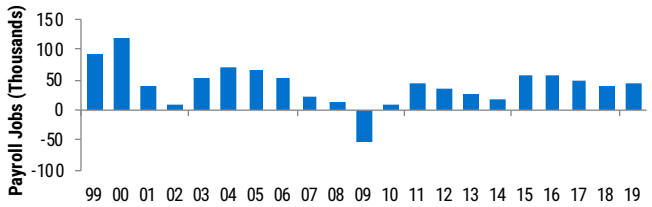
Source: Real Capital Analytics, NKF Research; June 2020

ECONOMY

- **Historical Job Change:** 317,000 jobs lost in the 12 months ending in May 2020 due to coronavirus shutdowns. The region has added an average of 38,800 jobs per annum over the past 20 years.
- **Projected Job Growth:** NKF forecasts the net loss of 114,000 jobs during 2020 before an average increase of 44,250 per annum from 2021 through 2024 once the economy stabilizes.
- **Unemployment Rate:** 9.9% in April 2020, an increase of 710 basis points over the rate of 2.8% at April 2019.

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

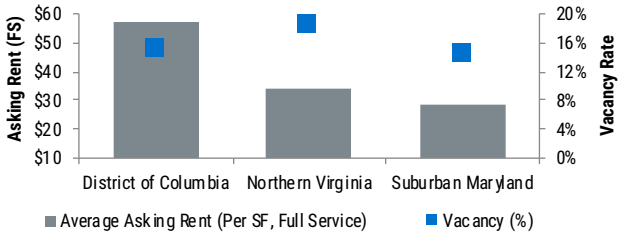
Washington Metro Payroll Job Change



Note: Totals reflect annual average net change
Source: U.S. Bureau of Labor Statistics, NKF Research; June 2020

MARKET ANALYSIS

Asking Rent and Vacancy Rate



MARKET SUMMARY

	District of Columbia	Northern Virginia	Suburban Maryland	Metro Area
Total Inventory (SF)	130.2 M	164.9 M	74.5 M	369.6 M
Vacancy Rate	15.0%	18.6%	14.4%	16.5%
Quarterly Net Absorption (SF)	-27,933	306,804	-23,648	255,223
Average Asking Rent (Per SF, Full Service)	$57.05	$33.63	$28.68	$40.66
Under Construction (SF)	2.4 M	2.2 M	2.3 M	6.9 M
YTD Deliveries (SF)	1.2 M	0.8 M	0	2.1 M

Note: Totals may not sum properly due to rounding

RESILIENCE OF REGIONAL ECONOMY TO PROPEL MARKET IN MONTHS AHEAD

During previous downturns, the Washington market outperformed its peer cities, thanks in large part to the presence of the federal government and its spending that is captured by local contractors. Importantly, the current crisis has its own unique attributes, and years of economic diversification in the region may have modestly softened its recession-resistant nature. However, the expansion of sectors that are likely to continue to grow during and after the COVID-19 pandemic, including tech and life sciences, creates a formidable resilience that puts the Washington market in a good position for the next growth cycle.

Importantly, the composition of the Washington metro area's job market provides a foundation for the local economy. Although less of the region's output is directly linked to the federal government than it has been previously, the industries that have replaced much of that output have suffered fewer losses and will help propel the local economy out of the downturn by supporting other sectors and property types. The national economy has lost 11.7% of total non-farm jobs over the past 12 months, hastened by the sudden shifts caused by the pandemic. The Washington metro area has seen a smaller share of job losses, at 9.5%, and the region's most prevalent job sectors have performed substantially better. As of May 2020, 24.8% of the Washington metro area's jobs are in the Professional and Business Services sector, which has seen only 2.9% of its jobs lost. Further, office-using jobs account for 61.9% of total jobs in the market but have also seen losses of only 2.9%. With significant job losses in non-office-using sectors such as Leisure and Hospitality, the share of office-using jobs relative to overall employment is 4.2 percentage points higher than it was in May 2019. Jobs in these sectors have been able to better withstand the shutdown due to their increased ability to work remotely. These jobs are typically higher-wage positions, which impacts renters' ability to maintain rent payments, and should allow the retail market to recover more quickly than in other markets where the job composition and wages are disparate.

Although leasing velocity was slow during the second quarter, activity in the Washington metro area has been greater than in other peer markets, suggesting that the market is poised for a swift recovery when conditions begin to normalize. While every facet of the regional economy is feeling some pain from the economic decline, the Washington metro area likely will be one of the markets to lead the nation into recovery.

GOVERNMENT CONTRACTING A BOON FOR REGION

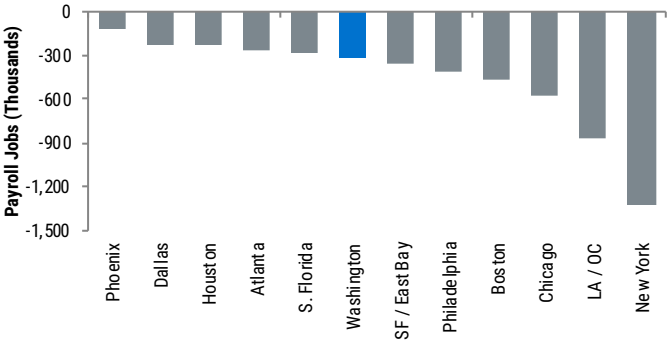
Because the Washington metro area boasts a strong technology workforce and is home to the nation's capital and the Pentagon, it captures an outsized share of government contracts in a traditional year. However, that advantage has been magnified by the necessary speed and size of the federal government's response to the COVID-19 outbreak, a response that also will bolster the region's demand for office and retail space as well as multifamily units. In fact, before the pandemic, federal procurement spending in the Washington metro area reached an all-time high in 2019, with $83.6 billion dispersed, surpassing the previous record set during 2010 in the wake of the Great Recession. Federal government agencies are rapidly expanding their response, infusing the private sector with more federal dollars. Through mid-June, the federal government had awarded COVID-19 contracts totaling nearly $3.5 billion in the District of Columbia, Northern Virginia and Suburban Maryland. Led by Virginia, all three of the region's jurisdictions rank in the top five nationally in terms of obligations that have been awarded thus far, joining New York, which has seen the highest number of COVID-19 cases, and Georgia, which has seen the largest amount of contract obligations awarded, as it is home to the Centers for Disease Control in Atlanta.

SUBLEASE AVAILABILITY REMAINS MODEST

The sublease market in the Washington metro area has been stable since the onset of the COVID-19 pandemic, even as social distancing measures have forced companies to work remotely and reimagine their office space needs. The region's sublease availability rate—a measure of available sublease space as a proportion of total inventory—measured 1.5% at the beginning of the pandemic and has since risen only 30 basis points, to 1.8%. The District of Columbia has the region's highest sublease availability rate at 2.2%, while Suburban Maryland registers 1.8% and Northern Virginia—the region's largest market by inventory—registers 1.6%. The region's sublease availability rate remains below the regional peak of 2.4%, which occurred at the peak of the Great Recession in the third quarter of 2009. Importantly, the Washington metro area has the second lowest sublease availability rate among peer metro areas, behind only South Florida. Other major markets, such as San Francisco, Boston, Dallas, New York, Los Angeles and Chicago all face higher sublease availability rates, and rates that are rising at a faster pace. While the sublease availability rate in the Washington metro area is likely to rise further, a large amount of sublease space being placed on the market is not the most likely outcome because of the employment mix noted earlier.

PAYROLL JOB CHANGE – LARGEST METRO AREAS

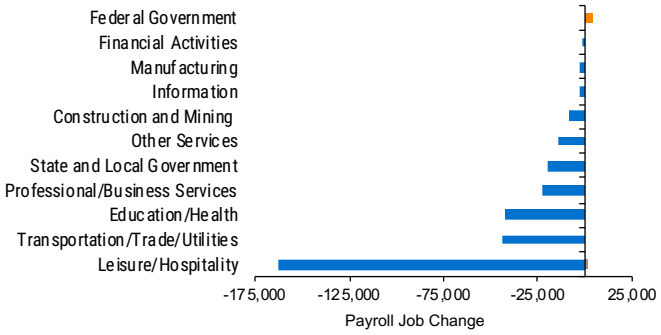
12 Months Ending May 2020



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

JOB CHANGE BY INDUSTRY

Washington Metro Area I 12 Months Ending May 2020



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

REGION SEES POSITIVE NET DEMAND

Office space demand in the Washington metro area was slightly positive overall during the second quarter and up from the previous quarter; it was bolstered by the occupancy of pre-leased space. However, market activity was slow due to limited movement during the ongoing period of pandemic-related quarantine, which forced remote work and limited economic and transaction activity. The second quarter saw 255,223 square feet of net absorption in the region, with only Northern Virginia registering a positive total, at 306,804 square feet. Net absorption registered negative 27,933 square feet in the District of Columbia and negative 23,648 square feet in Suburban Maryland. At 16.5%, the region's overall vacancy rate was up 20 basis points from the previous quarter and up 40 basis points from the rate recorded one year ago.

Four notable projects delivered in the Washington metro area during the second quarter, two in the District of Columbia and two in Northern Virginia. In the District, 1050 17th Street NW, a 154,413-square-foot project in the CBD submarket, delivered vacant, while 2100 L Street NW, a 180,650-square-foot office property in the CBD submarket, delivered 53% pre-leased. Morrison & Foerster is expected to move into 81,000 square feet at the property during the second half of the year. In Northern Virginia, 1750 Presidents Street, a 287,000-square-foot building, delivered fully preleased to Leidos and will serve as the firm's new headquarters. 1906 Reston Metro Plaza, a 186,457-square-foot office building, also delivered in the second quarter and was 53.6% preleased to Neustar. Despite the region's elevated vacancy rate, weighted average asking rents increased 3.7% over the past 12 months to $40.66/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 essentially flat over the past 12 months. Effective rents are likely to decline in the months ahead in response to a COVID-related reduction in leasing activity.

DEMAND FOR CLASS A SPACE UNEVEN ACROSS SUBSTATE AREAS DURING THE SECOND QUARTER

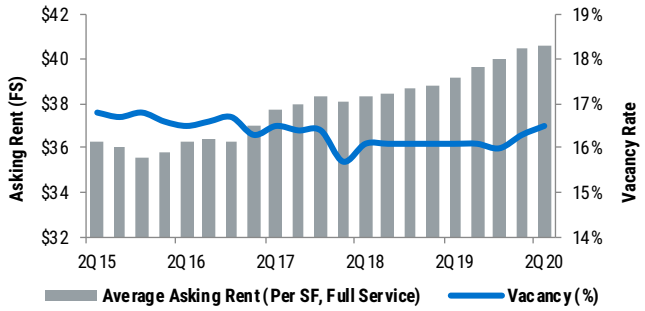
The region's Class A market registered 594,600 square feet of net absorption during the second quarter, with positive net demand of 215,129 square feet in the District of Columbia and 388,979 square feet in Northern Virginia. Suburban Maryland registered negative demand for Class A space, with net absorption registering negative 9,508 square feet. The Class A vacancy rate registered 16.3% as of the second quarter, an increase of 40 basis points over one year ago, as new, top-quality product has continued to deliver to the market. Class A rents averaged $44.51/SF metro-wide as of the end of the second quarter, although demand for premier space has lessened during the shutdown. Across all substate areas, trophy and Class A+ properties have continued to outperform commodity Class A space. The commodity Class A segment of the market—which includes properties that are generally 10 to 20 years old and have not been renovated—remains under downward rent pressure. The commodity Class A market will continue to be challenged, though renewals and short-term extensions by tenants looking to wait out the pandemic could help to buoy the segment, especially as tenants determine the feasibility of increased rental rates as the uncertainty caused by the economic downturn persists.

CURRENT CONDITIONS

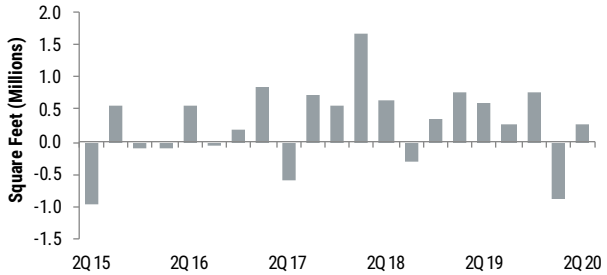
- The region registered 255,223 square feet of net absorption during the second quarter, with positive net demand in Northern Virginia and negative net demand in the District of Columbia and Suburban Maryland.
- Class A space tallied positive net absorption of 594,600 square feet during the second quarter. Class B and Class C space registered negative net demand during the quarter.
- Despite elevated vacancy, the average asking rent has risen 3.7% over the past 12 months, reflecting the introduction of new and renovated product to the 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)	369.6 M	368.4 M	366.2 M	↑
Vacancy Rate	16.5%	16.3%	16.1%	↑
Quarterly Net Absorption (SF)	255,223	-890,357	593,814	↑
Average Asking Rent (Per SF, Full Service)	$40.66	$40.54	$39.21	↑
Under Construction (SF)	6.9 M	7.7 M	8.6 M	↓
Deliveries	0.8 MSF	1.2 MSF	1.5 MSF	↑

WASHINGTON AREA ECONOMIC OUTLOOK

The Washington metro area's employment base contracted significantly during the second quarter of 2020. For the 12 months ending in April 2020, the region lost 317,000 jobs; this compares with the metro area's 20-year average growth of 38,800 jobs per annum, and is the first time job change has been negative in the region since the first quarter of 2010. The unemployment rate was up to 9.9% in April, 300 basis points higher than the rate's peak during the Great Recession. The area's gross regional product change likely will be negative during 2020 due to fallout from the coronavirus pandemic. According to the Stephen S. Fuller Institute, the Washington region's economy is projected to contract by 5.3%-6.0% in 2020. The Fuller Institute's Leading Index, a predictor of the economy's performance over the next six to eight months, decreased 11.7% for the 12 months ending in April, as the effects of the pandemic have come into focus. The recession caused by the shutdown is expected to be deep but relatively short-lived, with the recovery likely beginning during the second half of 2020.

As the economic cycle continues in this new phase, Washington has likely already suffered the majority of its job losses in the short term, as the coronavirus pandemic has impacted every aspect of the economy. Newmark Knight Frank forecasts region-wide job losses of 114,000 positions during calendar year 2020, followed by a modest but steady recovery averaging 44,250 jobs per annum over the four-year period from 2021 to 2024. This job forecast is a preliminary projection that is subject to change as conditions evolve. Losses will begin to reverse over the remainder of the year. A majority of the job losses have occurred in the Retail; Education and Health; and Leisure and Hospitality sectors, while the region has experienced fewer job losses in office-using sectors, helping to insulate the region's office market to a degree.

OFFICE MARKET OUTLOOK

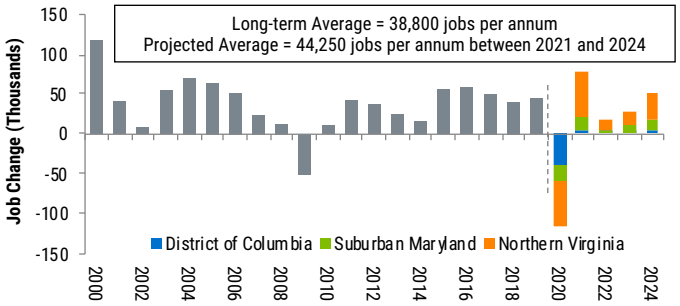
Over the next 12 to 24 months, the market faces a number of challenges that will impact absorption and rent growth, but opportunities also persist:

- 9.0 million square feet of new office space has delivered in the past two years. This increase in inventory has led to a continued rise in concession packages for both new and existing product. Both landlords and tenants are showing a cautious attitude that may slow the market and soften rents.
- The Class A market faces supply headwinds from projects that are currently under construction in the region. Approximately 6.0 million square feet of Class A space will be delivered over the next 24 months, placing downward pressure on fundamentals as competition increases.
- Although rumors exist about coworking companies such as WeWork seeking to restructure or terminate lease deals, nothing material has come to pass to this point. Coworking has helped to buoy the region's absorption over the past couple of years, so major changes in the industry will be a disruptive force on market fundamentals.
- Densification within the region's office market appears to be plateauing, as employers place greater emphasis on workplace strategy to attract and retain top talent, though consolidations and downsizing in the legal sector persist. However, there is a range of possible outcomes as it relates to densification. The longevity and breadth of remote work is uncertain. If employers find that remote work capabilities are sufficient for their business model, smaller office footprints could become the norm. Still, remote work has been possible for years, and some companies that chose to try it have since brought those employees back to the office due to declining efficiency and productivity, plus a loss of corporate culture. Further complicating matters, uncertainties remain about office layouts and worker preferences regarding social distancing within the office. Partial remote work, or shifts in office attendance, will also affect the demand for office space in the period ahead.
- Job losses caused by the pandemic will likely impact construction starts in the intermediate-to-long term. Office projects currently underway have not faced significant delays, as the local and federal government have determined construction to be essential. Still, the speed with which a recovery occurs will likely lead to changes for some proposed or planned projects that have not yet broken ground. A smaller office supply pipeline may rein in increasing vacancy levels as demand in the market may begin catching up to supply.
- Jobs with the federal government have represented a declining share of the regional employment market over the past several years, but that trend has reversed as the government addresses the dual public health and economic crises. The federal government is the only sector in the region that had positive 12-month net job growth after the onset of the pandemic. Demand for office space from the federal government could potentially see an uptick across the region in the coming year.

For additional information on the District of Columbia, Northern Virginia, and Suburban Maryland office markets, please visit NKF's website: Mid-Atlantic Market Reports.

PAYROLL JOB GROWTH FORECAST

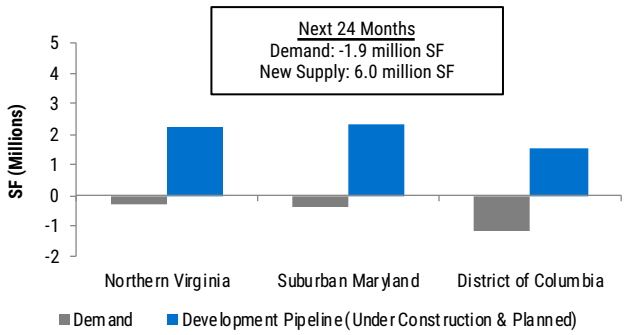
Washington Metro Area | 2020–2024



Source: U.S. Bureau of Labor Statistics; forecast developed by NKF Research with reference to data from the Stephen S. Fuller Institute and Moody's Analytics; June 2020
Note: Previous projections have been revised due to the coronavirus pandemic and are subject to further revision as conditions change.

SUPPLY/DEMAND FORECAST

Washington Metro Area | 24 Months Ending June 2022



Source: Stephen S. Fuller Institute, NKF Research; June 2020

CORONAVIRUS IMPACTS DISTRICT OFFICE MARKET

The District of Columbia experienced uneven office leasing metrics during the second quarter of 2020, with modestly negative net absorption and slightly lower asking rents. The COVID-19 pandemic had a significant impact on the economy and office market during the quarter, as many employees were forced to work from home, slowing market activity considerably. Vacancy ticked up as well, a result of slow leasing velocity, delayed move-ins and 335,063 square feet of new office space that delivered during the quarter. Two notable new construction projects that delivered were: 1050 17th Street NW, a 154,413-square-foot office building in the Central Business District submarket. The property delivered entirely vacant. Additionally, 2100 L Street NW, a 180,650-square-foot office property in the Central Business District submarket. The building was 53% pre-leased at time of completion, with Morrison & Foerster expected to move into 81,000 square feet during the second half of the year.

The District of Columbia registered negative 27,933 square feet of net absorption during the second quarter of 2020. The downturn created by the COVID-19 pandemic impacted the District of Columbia office market in many ways, perhaps most visibly in terms of the lack of absorption by coworking companies, as the model itself came under pressure due to heightened worries over physical proximity and open and shared office space.

Vacancy continues to tick up, registering 15.0% at the end of second-quarter 2020. This is largely due to a robust construction pipeline; 3.4 million square feet has delivered in the District of Columbia since the start of second-quarter 2019. Leasing activity likely will remain slow in the near term. As tenants wait to reoccupy their offices, many are also examining their space needs, as remote work has become more realistic for many companies. However, social and physical distance guidelines may result in a reversal of the recent densification trend, with each employee present in the office occupying more space. This will partially offset a loss of occupancy due to more remote work.

Average asking rents ticked down during the second quarter to $57.05/SF, although this was an increase of 2.0% from one year ago. Although current office leasing conditions are expected to remain slow in the short term, asking rents are likely to remain at current levels or potentially tick up with new construction set to deliver.

The District's construction pipeline remains active at 2.4 million square feet, excluding renovations, as developers sought to capitalize on strong trophy market fundamentals in recent years. The COVID-19 outbreak has not led to any significant delays to current office construction projects thus far, including nearly 600,000 square feet long projected to deliver in the District over the next 12 months. However, the economic outlook may alter construction plans over the next few years, as developers seek to determine the best timing or whether a different property type might result in a better return.

DISTRICT OF COLUMBIA OUTLOOK

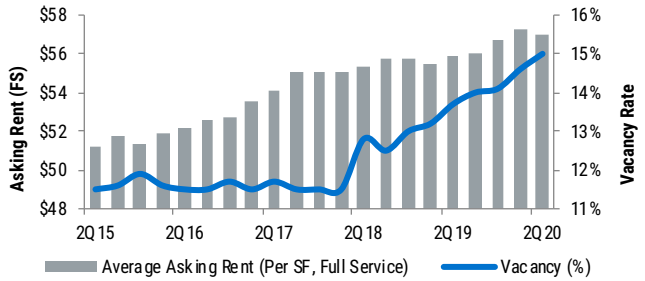
The District of Columbia's office market faces significant headwinds, with conditions likely to favor tenants over the next 12 months. The market entered an economic downturn with elevated vacancy rates and a supply/demand imbalance rooted in the demand for new trophy office space, which encouraged developers to bring a significant amount of new product to the market despite abnormally high overall vacancy rates. Although the full impact of the coronavirus on the region's office market remains unclear, the current deceleration in demand is likely to linger, as short-term economic growth has slowed dramatically in the midst of sustained reduced consumer spending and continued unemployment, which reached 11.1% in the District in April 2020.

CURRENT CONDITIONS

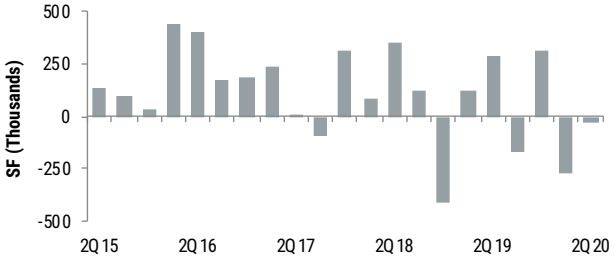
- The District of Columbia registered negative 27,933 square feet of net absorption during the second quarter of 2020.
- The vacancy rate has risen 130 basis points from a year ago to 15.0%, as a large amount of new space without significant pre-leasing has delivered in the past 12 months.
- Asking rents were down during the second quarter to $57.05/SF, although this is still an increase of 2.0% from one year ago.

MARKET ANALYSIS

Asking Rent and Vacancy Rate



Net Absorption



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	130.2 M	129.5 M	127.8 M	↑
Vacancy Rate	15.0%	14.6%	13.7%	↑
Quarterly Net Absorption (SF)	-27,933	-271,352	281,363	↓
Average Asking Rent (Per SF, Full Service)	$57.05	$57.29	$55.92	←→
Under Construction (SF)	2.4 M	2.7 M	3.6 M	↓
Deliveries (SF)	335,063	913,083	1.3 M	↓

NORTHERN VIRGINIA MARKET STURDY IN SECOND QUARTER DESPITE COVID-19 PANDEMIC

Despite the COVID-19 pandemic, demand for office space in Northern Virginia was steady in the second quarter of 2020, as 306,804 square feet were absorbed. Leidos took possession of its new 287,000-square-foot headquarters at 1750 Presidents Street in the second quarter which helped buoy absorption. Gross leasing during this period was strong despite the accelerating coronavirus pandemic. The most significant deal of the quarter was by Microsoft, which announced it will be occupying 396,740 square feet at 11955 Freedom Drive in Reston. Overall vacancy ended the first quarter at 18.6%, an increase of 10 basis points from the prior quarter and from one year ago. Average overall asking rents increased 1.6% from one year ago to $33.63/SF.

Office space under construction in Northern Virginia, excluding renovations and owner-occupied buildings, totaled 2.2 million square feet at the end of the second quarter. The overall pre-lease rate of the buildings under construction was 71.9%. Tenants that have preleased large blocks of space include ICF International (207,000 square feet), Fannie Mae (850,000 square feet), and the Transportation Security Administration (625,000 square feet). Reston continued to lead the way in new development, with 1.3 million square feet of office space under construction.

Two major projects delivered in the second quarter of 2020. 1750 Presidents Street, a 287,000-square-foot building, delivered 100.0% preleased to Leidos and will serve as the firm's new headquarters. 1906 Reston Metro Plaza, a 186,457-square-foot building , also delivered in the second quarter. The building is 53.6% preleased to Neustar. A combination of fewer deliveries and increased demand caused vacancy rates to decline throughout 2019. Vacancy ticked up slightly in the first half of 2020, and the impacts of the COVID-19 pandemic on office demand through the remainder of 2020 are uncertain. Construction continued almost unabated during the second quarter in Northern Virginia, with slight delays due to increased safety precautions and social distancing guidelines.

NORTHERN VIRGINIA OUTLOOK

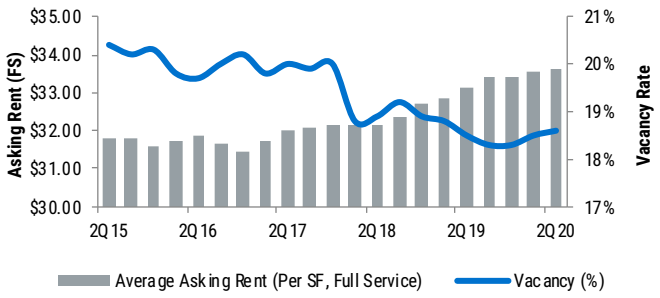
Most of Northern Virginia's office market fundamentals remained sturdy in the second quarter of 2020. Rental rates continued to climb, gross leasing remained strong even in the face of a global pandemic, and absorption was positive. There was a slight uptick in vacancy due to deliveries and it was a slow quarter for investment sales. The duration of the outbreak and the degree of the resulting economic impact are still unknown at this point. It is certain that job losses in the private sector, especially in the service and retail industry, will continue to have an impact on Northern Virginia; however, the Northern Virginia market has seen growth in response to the pandemic because of its tech-orientation. The Commonwealth of Virginia has received over $1.5 billion in federal contracts related to COVID-19 as of June 17, second only to Georgia, the home of the CDC. This federal contracting growth will lessen the impact on the local economy and office market. Northern Virginia's core sectors—government contracting and technology—will help insulate it against some of the worst impacts of a recession. Once conditions begin to return to normal, these sectors are likely to resume the growth they had pursued in Northern Virginia prior to the outbreak.

CURRENT CONDITIONS

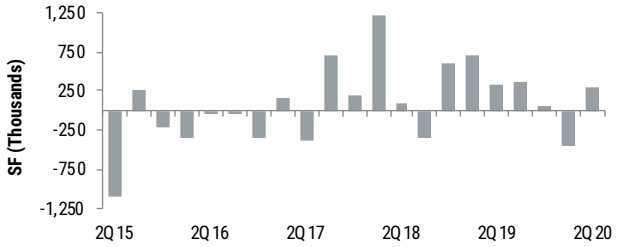
- Northern Virginia's construction pipeline remains robust at 2.2 million square feet.
- The largest lease of the quarter was signed by Microsoft: a new lease for 396,740 square feet at 11955 Freedom Drive in Reston.
- Two Reston buildings completed construction in the second quarter of 2020, totaling 473,457 square feet. Groundbreakings without substantial preleasing are likely to ease in the year ahead given overall economic conditions.

MARKET ANALYSIS

Asking Rent and Vacancy Rate



Net Absorption



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	164.9 M	164.4 M	164.2 M	↑
Vacancy Rate	18.6%	18.5%	18.5%	↓
Quarterly Net Absorption (SF)	306,804	-447,422	342,079	↑
Average Asking Rent (Per SF, Full Service)	$33.63	$33.53	$33.10	↑
Under Construction (SF)	2.2 M	2.7 M	2.8 M	↓
Deliveries (SF)	473,457	329,788	0	↑

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.

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.

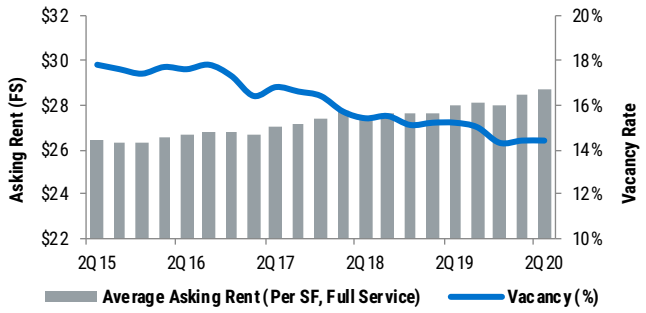
The duration of the outbreak and the extent of the resulting economic decline is unknown at this point, but it is likely that job losses in some private sector industries will have an impact on Suburban Maryland office demand. However, it is also likely the Suburban Maryland market will see necessary 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.

CURRENT CONDITIONS

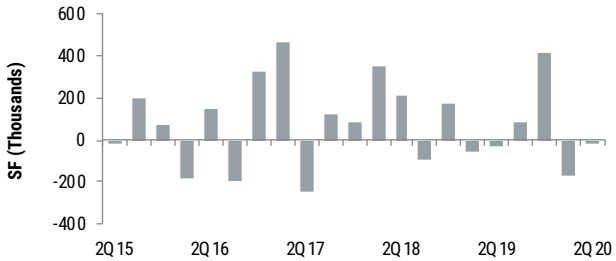
- Suburban Maryland registered negative 23,648 square feet of absorption during the second quarter of 2020.
- The vacancy rate is down 80 basis points from one year ago to 14.4%, and the average asking rent rose 2.4% over the past year. However, demand has slowed materially in 2020.
- 2.3 million square 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	↔

SUBMARKET STATISTICS — VACANCY AND ABSORPTION

	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)
Washington Metro Area	**369,630,688**	**15.6%**	**16.5%**	**1,531,170**	**2,351,335**	**2,437,161**	**255,223**	**-635,134**
District of Columbia	130,235,407	13.9%	15.0%	463,758	136,619	555,500	-27,933	-299,465
Suburban Maryland	74,487,713	13.7%	14.4%	418,912	637,978	410,526	-23,648	-195,051
Northern Virginia	164,907,568	17.8%	18.6%	648,500	1,576,738	1,471,135	306,804	-140,618

	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)
Washington Metro Area	**369,630,688**	**15.6%**	**16.5%**	**1,531,170**	**2,351,335**	**2,437,161**	**255,223**	**-635,134**
Class A	223,986,701	15.2%	16.3%	2,945,116	3,116,783	2,444,325	594,600	197,140
Class B	108,763,657	16.5%	17.3%	-633,939	-719,470	220,999	-182,920	-397,056
Class C	36,880,330	15.1%	15.3%	-780,007	-45,978	-228,163	-156,457	-435,218

SUBMARKET STATISTICS — RENTS AND DEVELOPMENT

	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)
Washington Metro Area	**369,630,688**	**$44.51**	**$37.44**	**$40.66**	**808,520**	**2,051,391**	**6,891,402**
District of Columbia	130,235,407	$61.42	$50.59	$57.05	335,063	1,248,146	2,401,948
Suburban Maryland	74,487,713	$30.77	$27.31	$28.68	0	0	2,253,431
Northern Virginia	164,907,568	$36.12	$31.05	$33.63	473,457	803,245	2,236,023

	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)
Washington Metro Area	**369,630,688**	**$44.51**	**$37.44**	**$40.66**	**808,520**	**2,051,391**	**6,891,402**
Class A	223,986,701	$44.51	NA	$44.51	808,520	2,051,391	6,891,402
Class B	108,763,657	NA	$37.44	$37.44	0	0	0
Class C	36,880,330	NA	NA	$29.54	0	0	0

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

SALES VOLUME HEALTHY OVER PAST 12 MONTHS, BUT MARKET FACES CONTINUED UNCERTAINTY

The Washington region registered $8.6 billion in office sales volume for the 12 months ending in the second quarter of 2020. This marks an increase from the 12-month period ending in the second quarter of 2019, when volume was $7.4 billion. Transaction volume was down during the second quarter of 2020 due to the COVID-19 global pandemic, as capital, both domestic and foreign, was scarce. Transactions across the metro area averaged $383/SF over the past 12 months. Regional cap rates averaged 6.4% over the past 12 months, although premier downtown product continued to achieve sub-5% rates before the COVID-19 pandemic arrived.

The largest transaction of the second quarter included 2001 Wisconsin Avenue NW and 3300 Whitehaven Street NW in the Uptown submarket, a portfolio known as the Harris and Green Buildings, which totals 240,475 square feet. The properties sold for $85 million, or $353/SF. Grosvenor Americas purchased the properties, which are 100% occupied and count the British International School of Washington and the Georgetown University Center for Child and Human Development as tenants.

SECOND QUARTER SALES VOLUME IS MODEST; REGION'S STRENGTHS AND PENDING ELECTION MAY SPUR VOLUME DURING SECOND HALF OF 2020

Following steady annual transaction volume over the past few years, second-quarter investment sales volume was $343.5 million, down significantly from the second quarter of 2019, when volume measured $1.3 billion. The first half of 2019 was unusually slow in terms of quantity and volume but accelerated significantly in the second half of the year. Prospects for a similar turnaround in 2020 are less likely due to the ongoing global health crisis, although an increase in sales volume is expected over the second half of the year as the economy begins to normalize and as investors consider the potential impact of the November election. Nonetheless, the pandemic is likely to reduce investment volume in the near term. There may be opportunities in the coming months for shrewd investors to buy low, or for institutional investors to purchase with long-term holding strategies, as distressed and core assets are likely to lead the way out of the lull.

OFFICE INVESTMENT SALES OUTLOOK

Although office transaction volume has been remarkably steady since reaching its cyclical high in 2015, transaction volume will likely be reduced in 2020. The impact of the coronavirus on the investment sales market has been significant so far, as the global economy faces sustained headwinds and job losses continue to mount, potentially impacting the investment-worthiness of some assets. That said, Washington's educated workforce and mix of industries gives the region a boost relative to many of its peer markets.

Importantly, ongoing volatility in the American and global economies will continue to underscore the value of hard assets such as commercial real estate. Investors—domestic and foreign—will likely seek the safety of a primary market such as Washington. However, a second wave of the coronavirus in the fall could create disruption—which may further emphasize the relative value of Washington's history of stable returns.

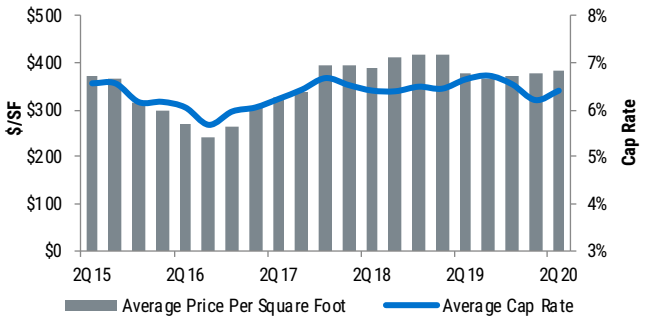
METRO AREA MARKET SUMMARY

	Metro Region
12-Month Transaction Volume at 2Q 2020	$8.6 B
12-Month Transaction Volume at 2Q 2019	$7.4 B
12-Month Trailing Average Price PSF at 2Q 2020	$383
12-Month Trailing Average Cap Rate at 2Q 2020	6.4%

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

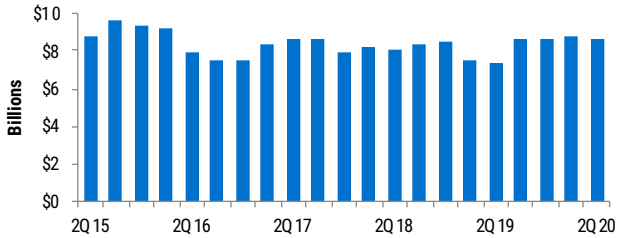
MARKET ANALYSIS

Average Office Cap Rate and Price Per Square Foot



Note: Values are trailing 12-month averages
Source: Real Capital Analytics, NKF Research

Trailing 12-Month Office Transaction Volume



Source: Real Capital Analytics, NKF Research

TOP 2Q 2020 OFFICE SALES TRANSACTIONS

Address	Sale Price	Price/SF	Substate Area
2001 Wisconsin Avenue NW*	$85 M	$353	DC
1530 Wilson Boulevard	$71 M	$417	VA
8283 Greensboro Drive	$57 M	$255	VA
1307 New York Avenue NW	$42 M	$391	DC
1509 16th Street NW	$27 M	$830	DC

* Portfolio with 3300 Whitehaven Street NW
Source: Real Capital Analytics, NKF Research

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.

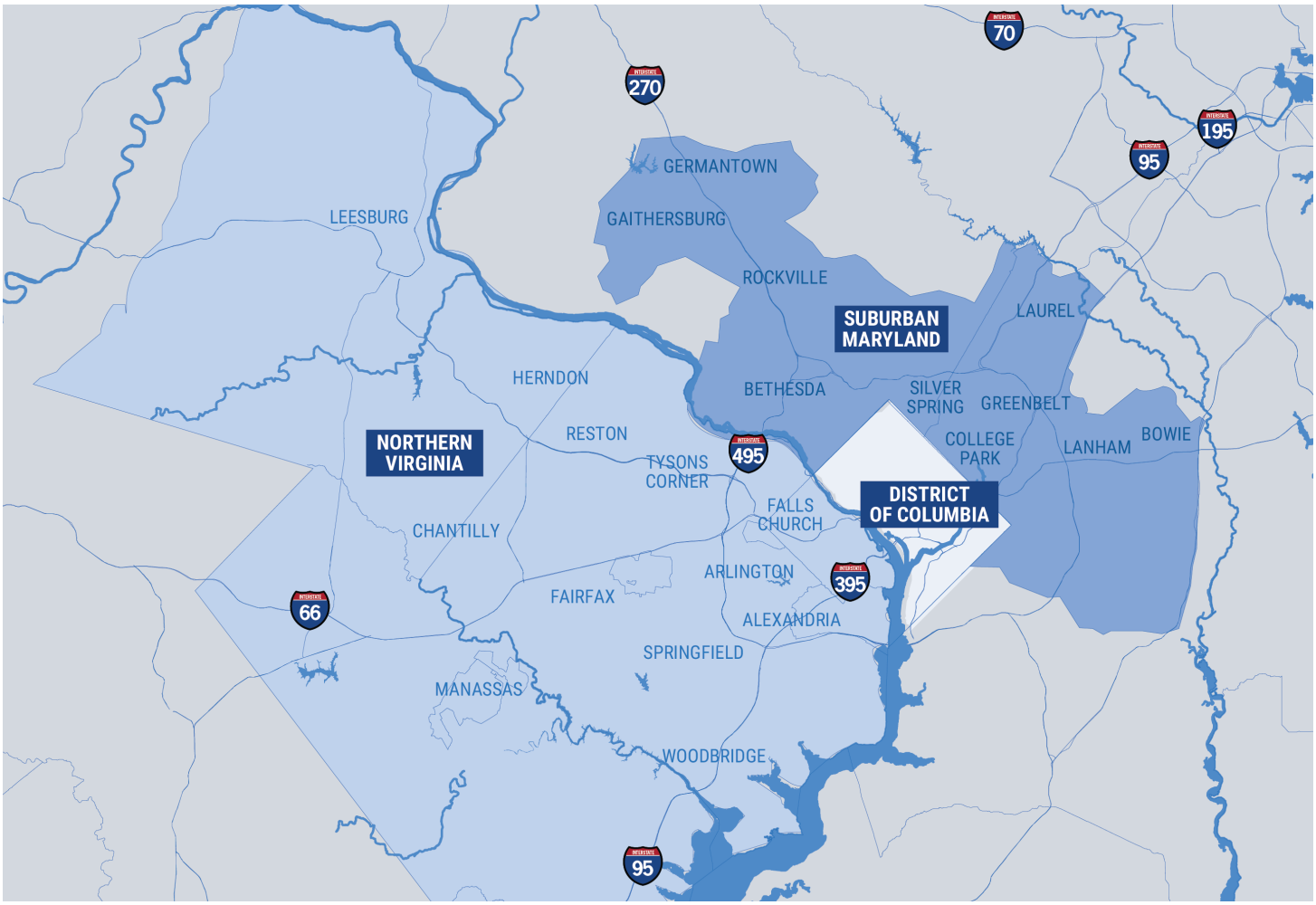
Transaction Volume: Total volume of office transactions $20 million and greater during a specific reporting period.

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.

WASHINGTON METRO AREA



Note: Major jurisdictions are labeled to provide orientation. This is not an exhaustive list of all covered submarkets. For detailed submarket maps for Northern Virginia, Suburban Maryland and the District of Columbia, please see each area's office market report.

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