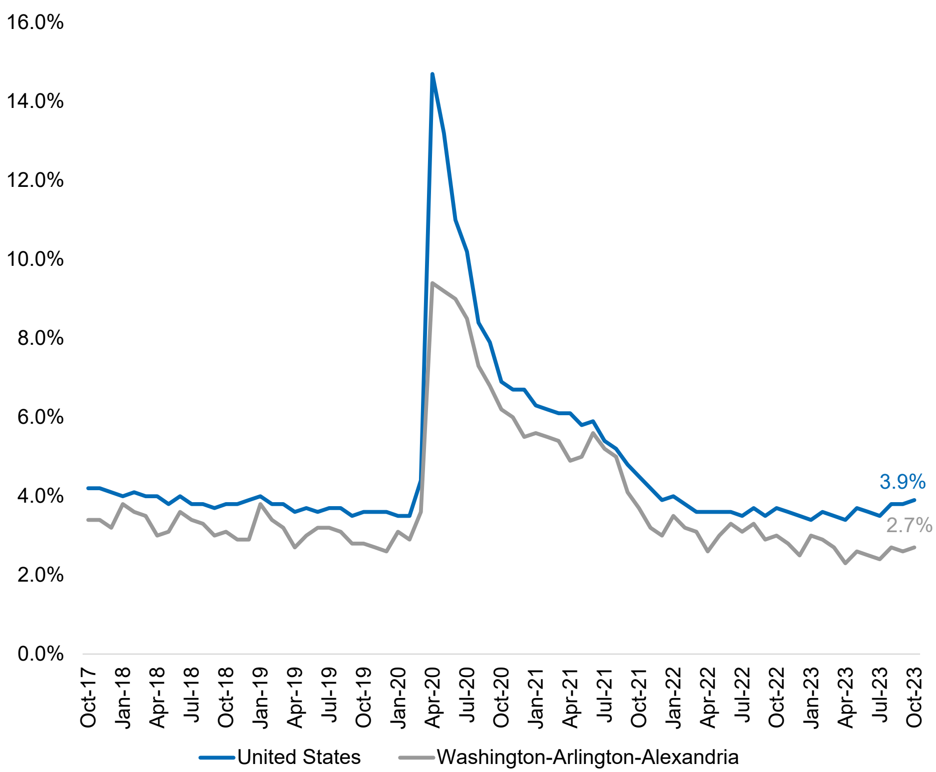
Washington Metro Area Commercial Real Estate Market Overview

February 16, 2024

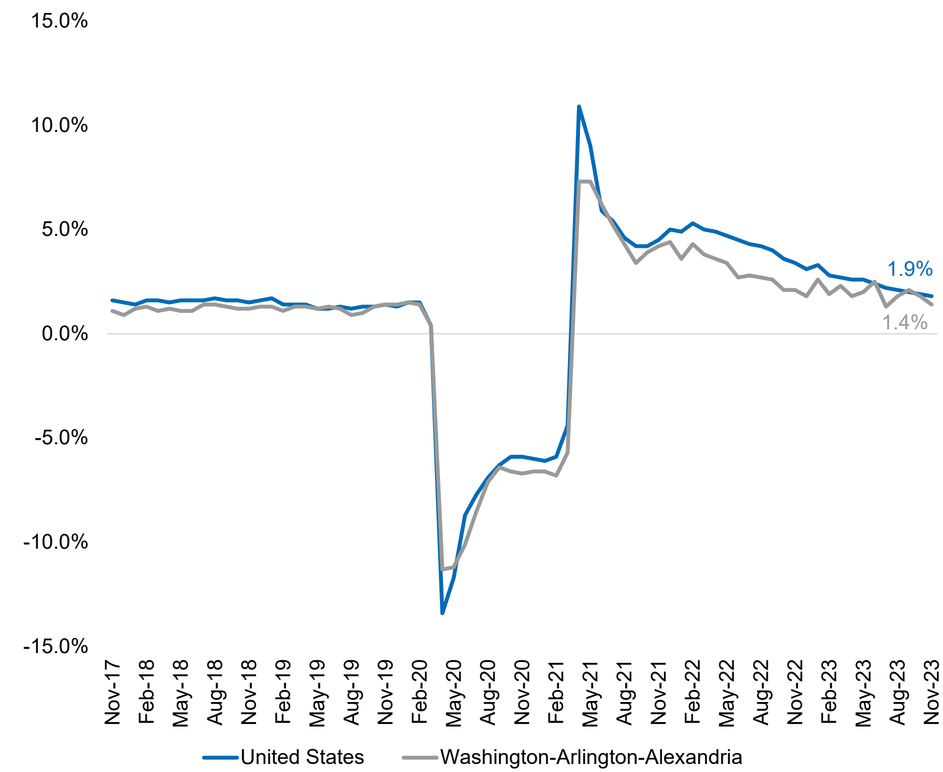
Metro Employment Trends Offer Mixed Signals

While the region's labor market remains on relatively solid footing with unemployment 120 basis points below the national average, job growth has begun to slow amid persistently high inflation and increasing interest rates.

Unemployment Rate, Seasonally Adjusted



Nonfarm Payroll Employment, Non-Seasonally Adjusted, 12-Month % Change

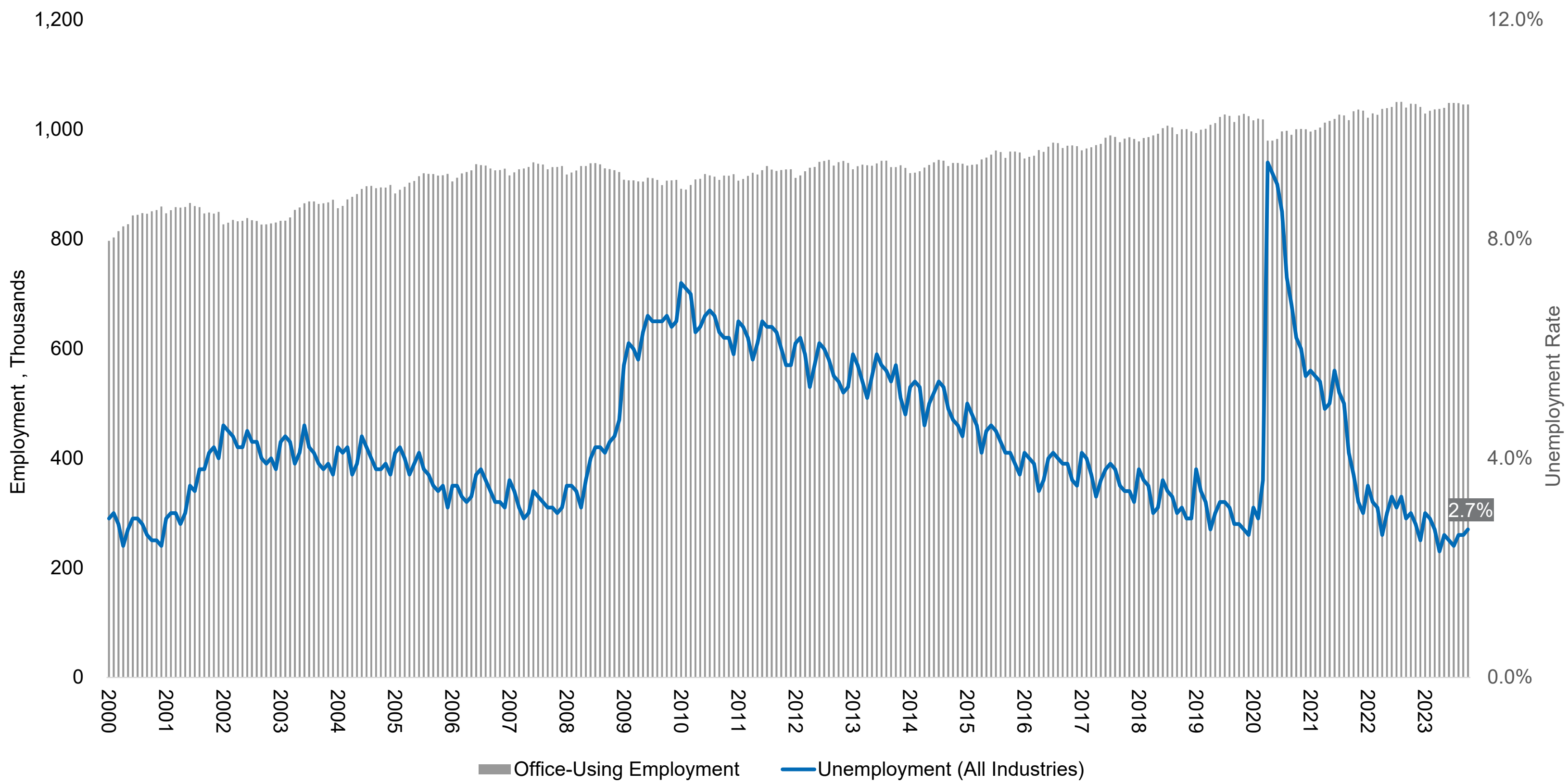


Source: U.S. Bureau of Labor Statistics, Washington-Arlington-Alexandria

Overall Office-Using Employment Has Rebounded

The number of office jobs has rebounded and exceeded pre-pandemic levels. Office-using jobs in the region are currently 1.3% higher than three years ago—just prior to the pandemic—and 6.3% higher than the pandemic-induced employment trough in April 2020.

Office-Using Employment* and Unemployment Across All Industries

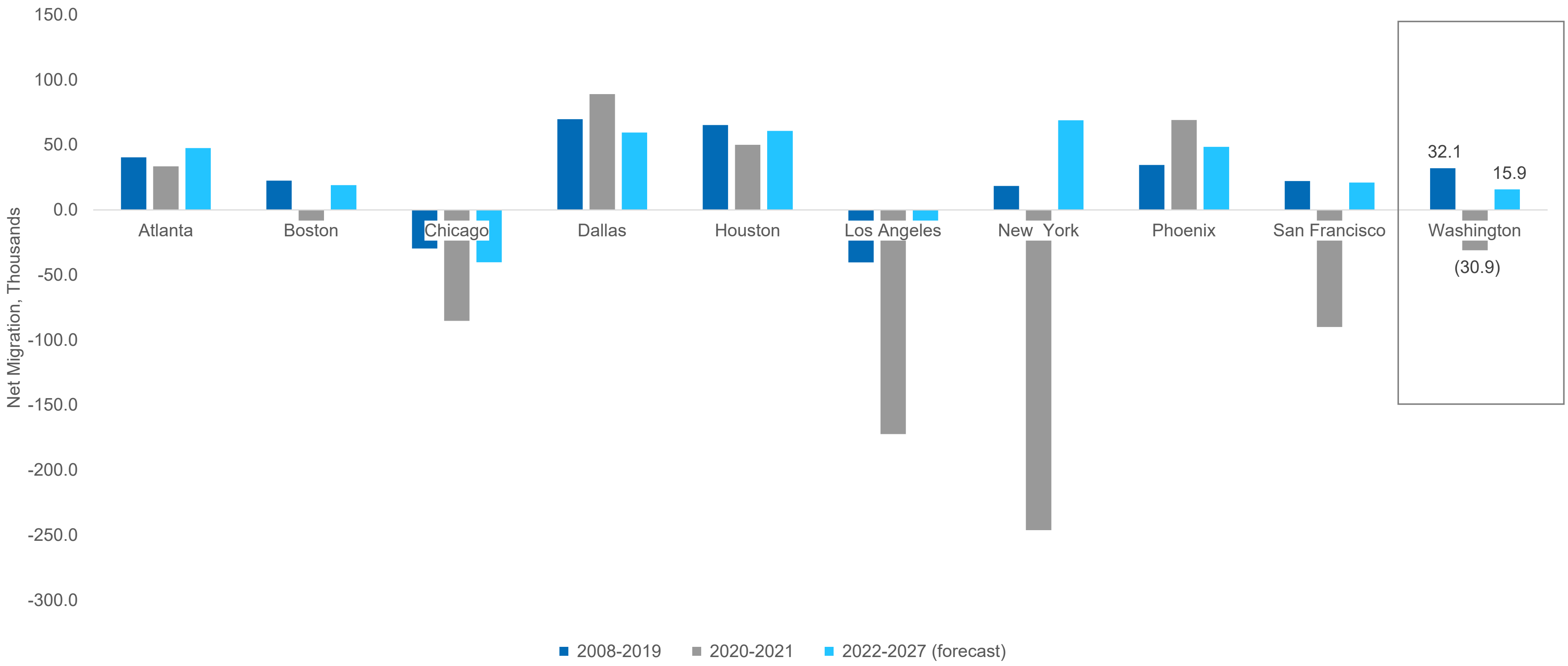


Source: U.S. Bureau of Labor Statistics, Washington-Alexandria-Arlington
Note: November 2023 data is preliminary.
*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

D.C. Metro Net Migration Expected to Attract 15,900 New Residents by 2027

During the 2008-2019 cycle, D.C.'s in-migration outpaced out-migration with 32,000 new residents in the years leading up to the Covid pandemic. While the District suffered from out-migration in 2020-2021, Oxford Economics predicts that 2022-2027 will bring 15.9 thousand net new residents—one of the biggest post-pandemic recoveries among large cities.

Historic And Forecasted Net Migration By Major Metro

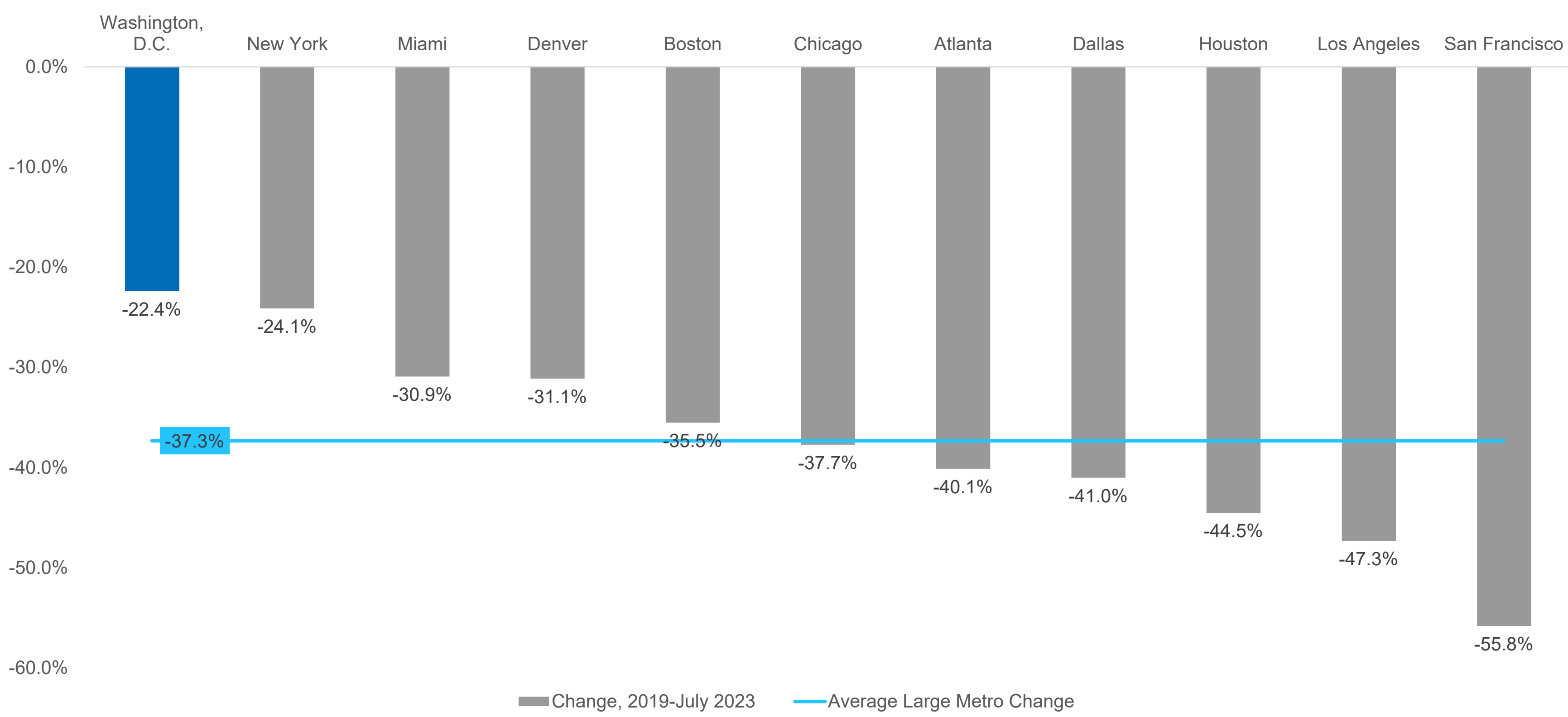


Source: Oxford Economics, Costar, Newmark Research

Office Traffic in D.C. Has Recovered Quicker Than Other Large U.S. Cities

Average monthly office visits in Washington, D.C. are down 22.4% since 2019, prior to the onset of the COVID-19 pandemic. However, office traffic in D.C. was less impacted than all other large U.S. cities surveyed. Cities like Dallas, Atlanta, Houston, and Los Angeles have lost more than 40% of average office visits. San Francisco is down 56% since 2019.

Change in Average Monthly Office Visits Per Working Day, May 2023 Compared to 2019

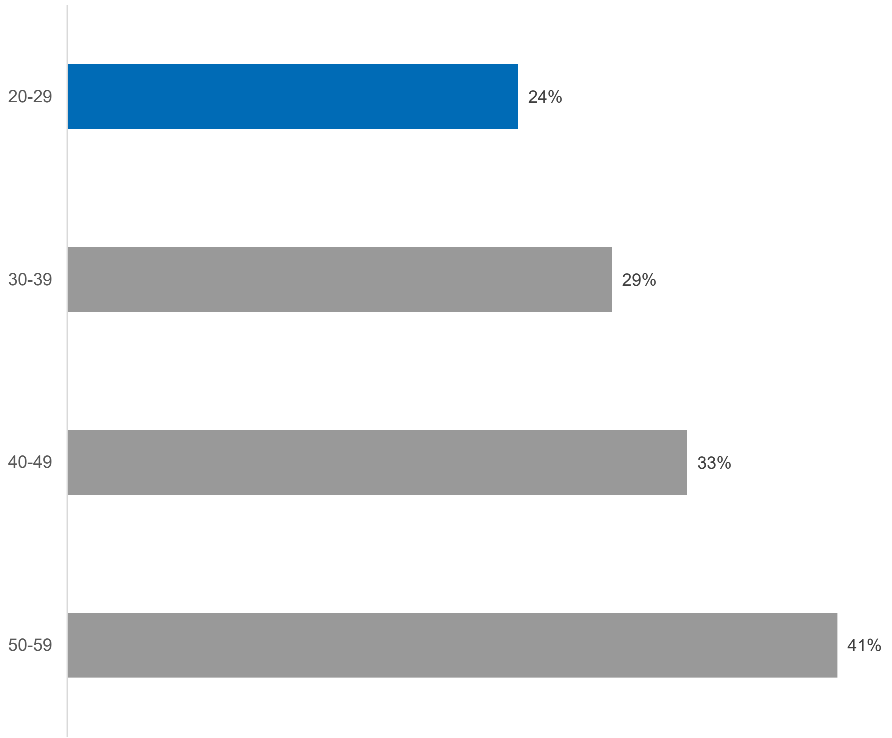


Source: Placer.ai, Newmark Research

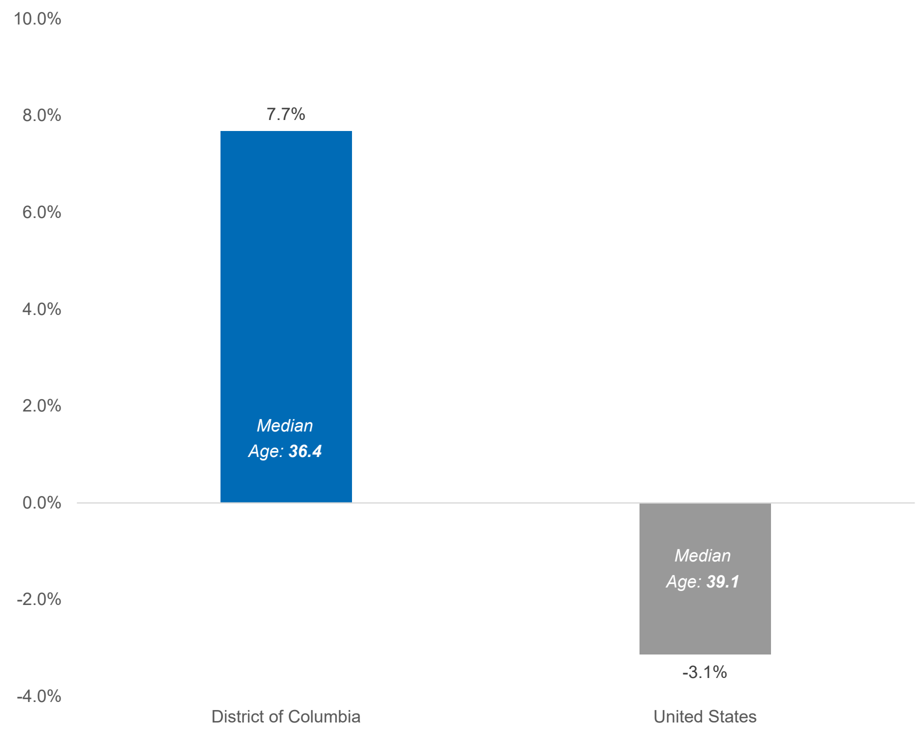
Younger Workers Prefer Office Time, And D.C.'s Workforce Is Getting Younger

Less than a quarter of workers in their 20s want to work from home full-time. In general, the older the employee, the more likely they are to prefer fully remote work. In the District of Columbia, the median age (36.4 years) is significantly lower than the U.S. average of 39.1 years. This bodes well for office demand, as it will be younger generations that desire designated office space.

Percent of Employees Who Prefer To Work From Home Full-Time



Five-Year Population Growth, 20-29 Year Olds (2023-2028)

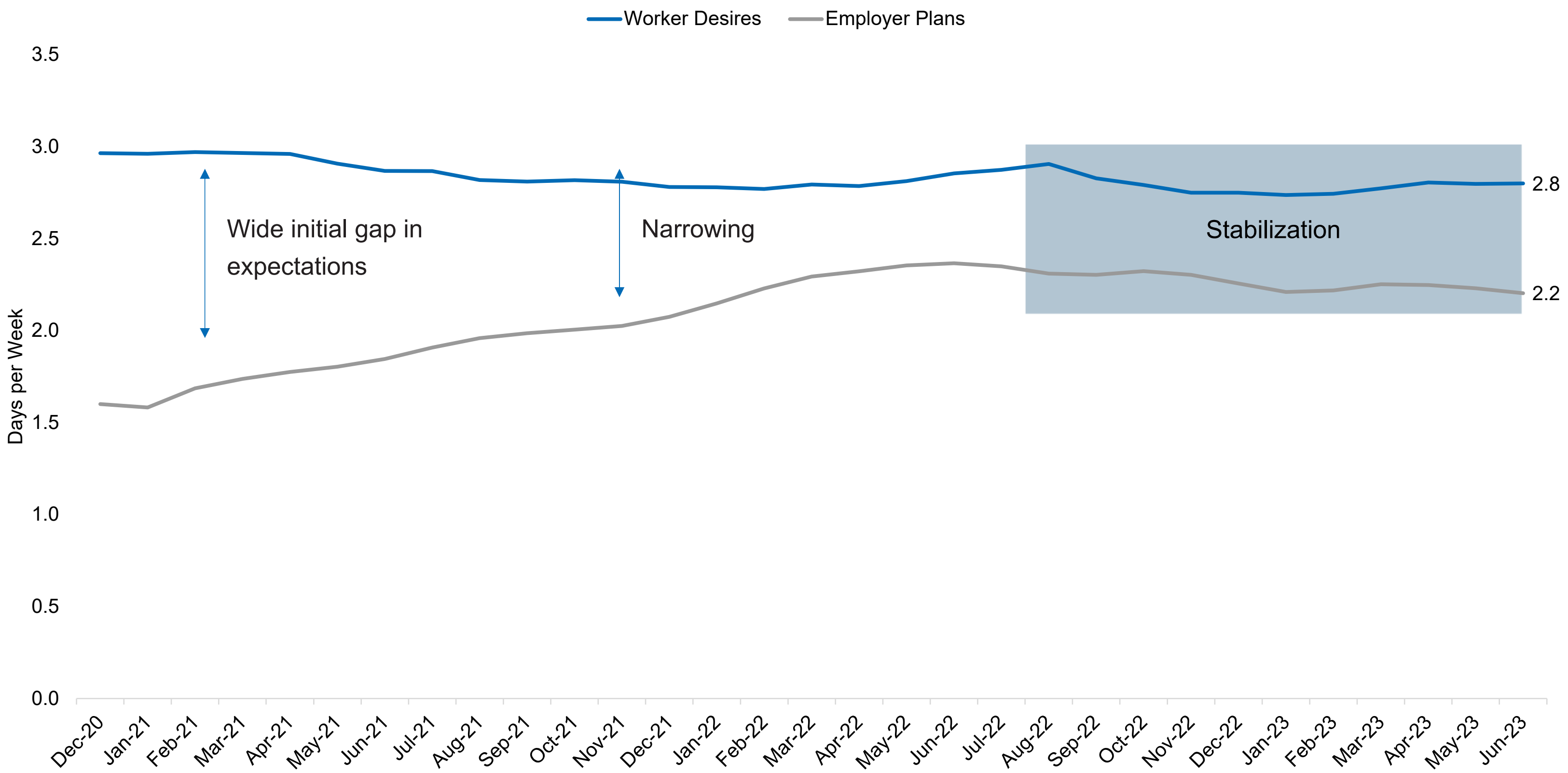


Source: Business Insider, ESRI

Gap between Worker and Employer WFH Expectations Has Stabilized

There is a persistent gap between the number of days workers would like to be able to work from home and employer policies. However, that gap has been mostly stable since the summer of 2022. Over the last year, there have been many headlines speculating that a recession would enable employers to have their way. It is logical that a weaker labor market would give employers more leverage, but 1) the economy is proving more resilient, 2) the gap in desires is narrow and 3) college-educated unemployment is 2.0%.

Average Days per Week Working From Home After the Pandemic Ends: Workers Able to Work From Home



Source: Barrero, Jose Maria, Nicholas Bloom, and Steven J. Davis, 2021. "Why working from home will stick," National Bureau of Economic Research Working Paper 28731.

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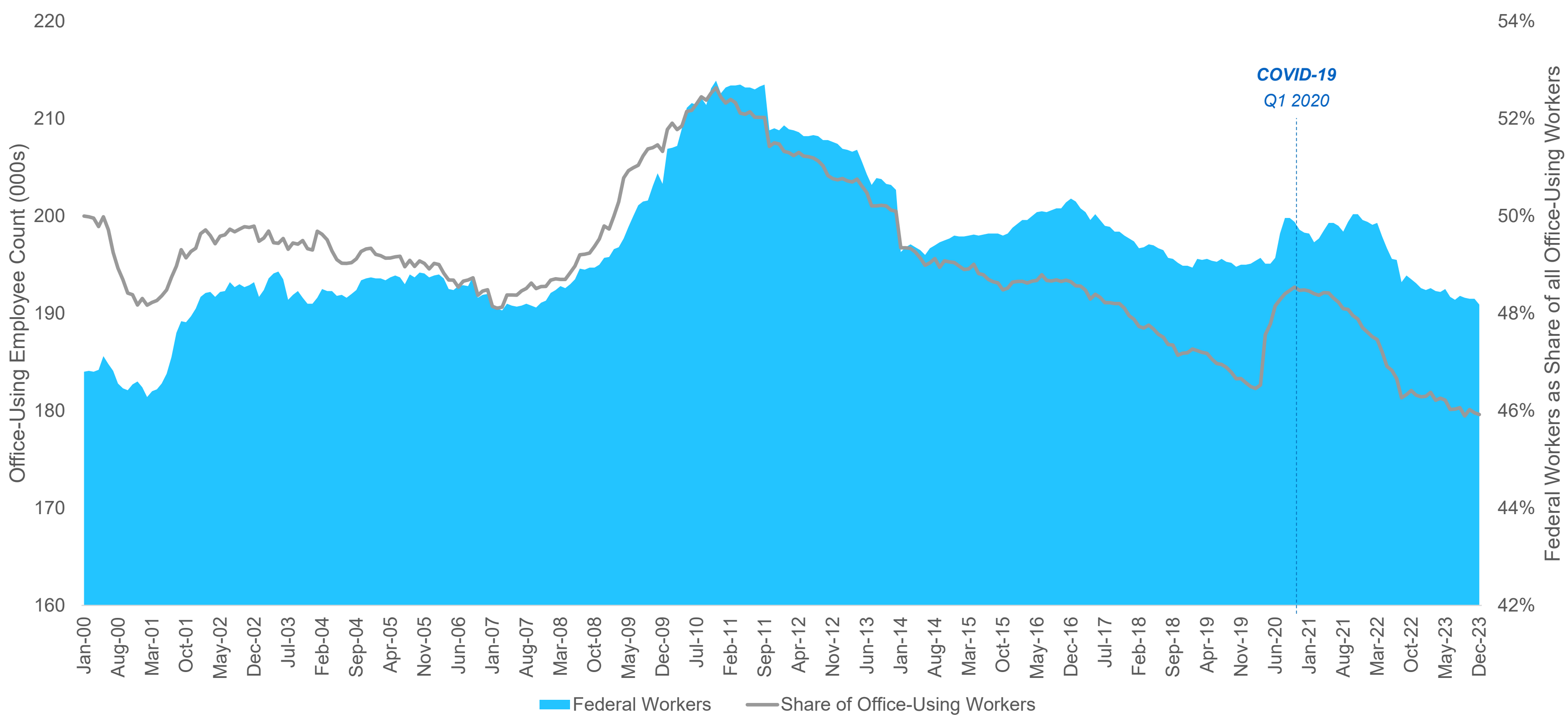
Federal Government Office Use

The D.C. Office Sector Is Diversifying, Less Dependent On Federal Workers

Exposure to federal government employment is decreasing in the District of Columbia. Federal government employment peaked at 214,000 workers in November 2010. The peak within the last cycle was 200,000 federal workers in November 2021, which has declined 4.6% since, ending 2023 at 191,000 federal workers.

Federal Government Employment as % of Total Office-Using Employment, District of Columbia



Source: BLS, FRED, Newmark Research
*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information, Government.

Government Return-to-Office Mandates Vary By Agency

On August 4, 2023 President Joe Biden instructed his cabinet to execute plans to return employees back to the office signaling change from the previous three years of remote work for the Federal Government.

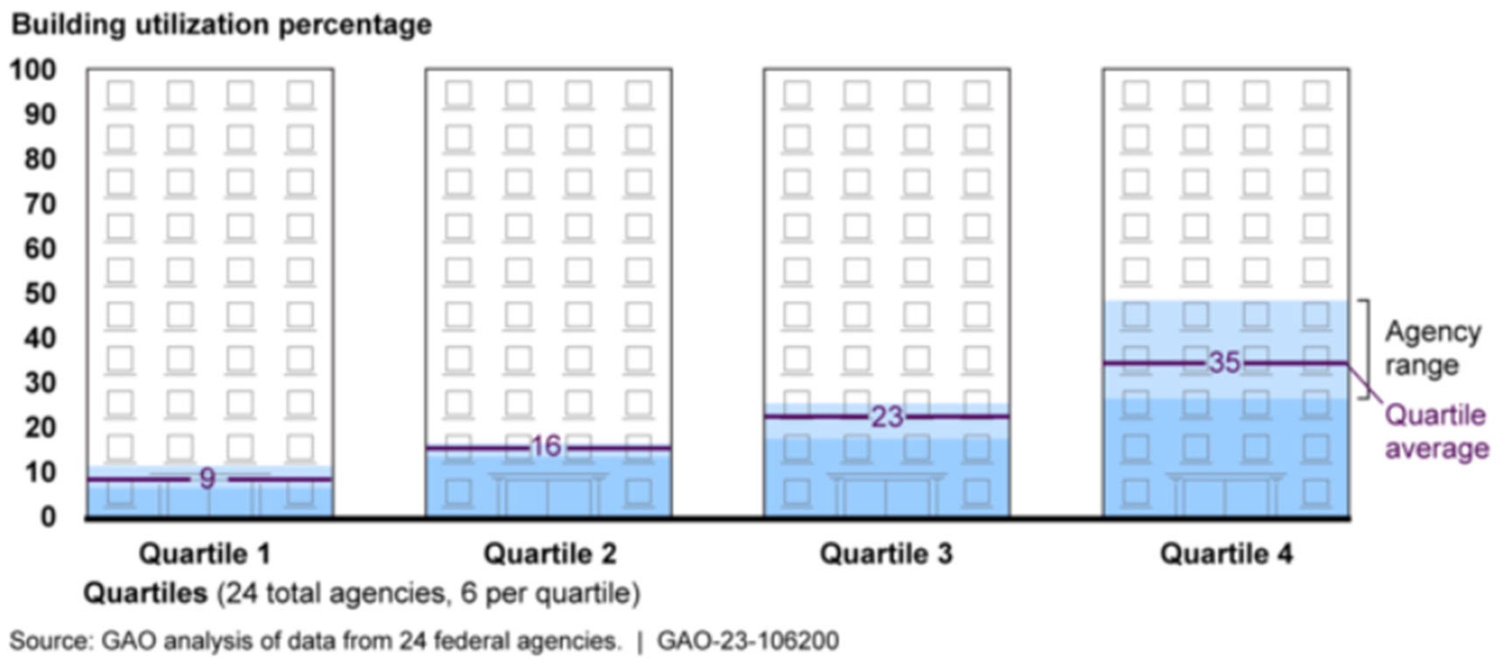
Government Days in Office per Pay Period (Typically Ten Business Days)

*Agencies that state days per week and not per pay period
**EPA leaves non managers days in office at discretion of Manager
*** Effective April 2024

17 of 24 Federal Agencies Use 25% Or Less Of Their HQ Building's Capacity

There is 21.5 million square feet of usable office space—conference rooms, team rooms, and offices—in the headquarters buildings of 24 agencies. Federal agencies spend about $2 billion a year to operate and maintain federal office buildings regardless of the buildings' utilization. In addition, agencies spend about $5 billion annually to lease office buildings.

Quartile Weekly Utilization Estimated Averages of Federal Headquarters Buildings across Three-Week Sample (One week in each of January, February, and March 2023)

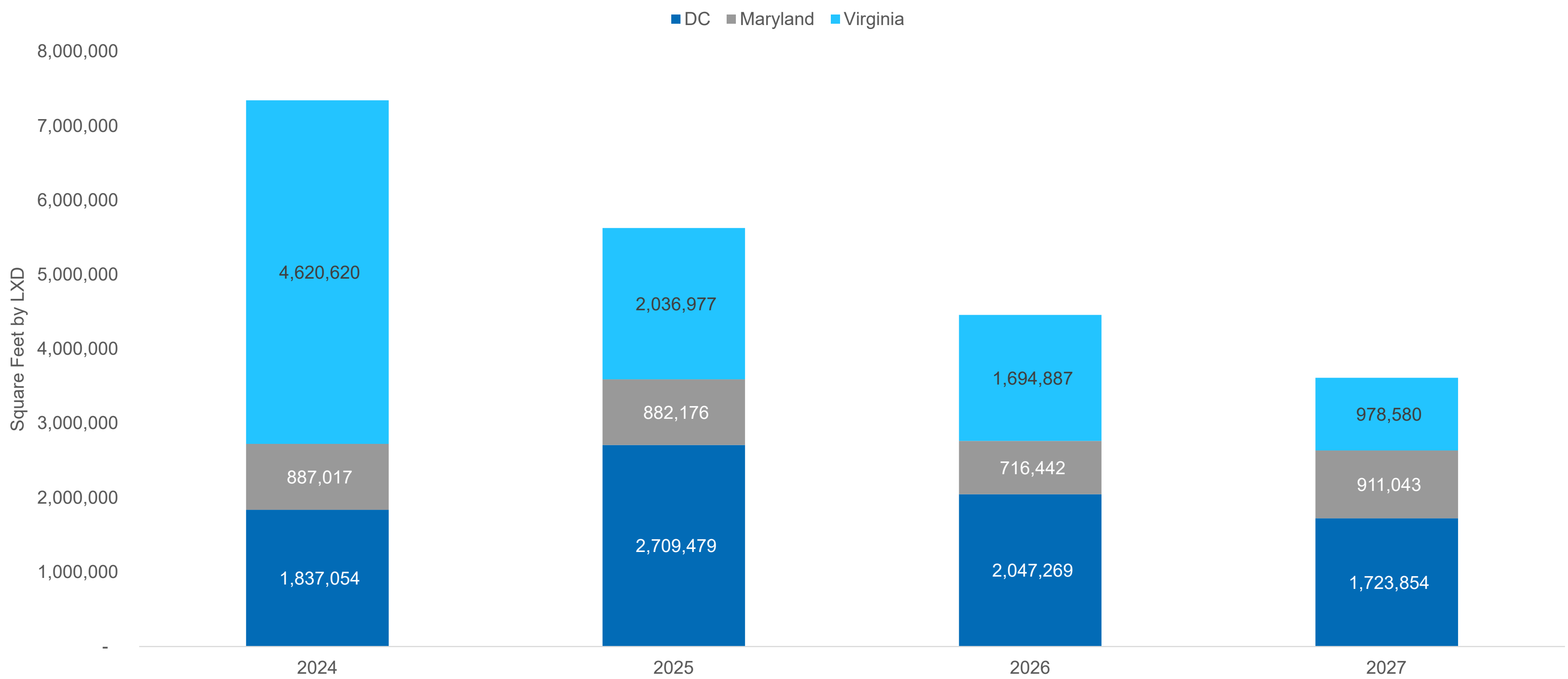


Source: U.S. Government Accountability Office (GAO), Newmark Research

Half of GSA's Leased Space in D.C. Expires By 2027

In D.C., 48% of GSA's total leased space will expire by 2027 (8.3M SF). In the DMV region, 40% of GSA-leased space will expire by 2027 (21.0M SF). Nationwide, 39% of leased space will expire by 2027 (68.5M SF), which represents almost half of all leases (3,405 leases out of 7,589 analyzed comps).

GSA Lease Expiration Dates by Year by State

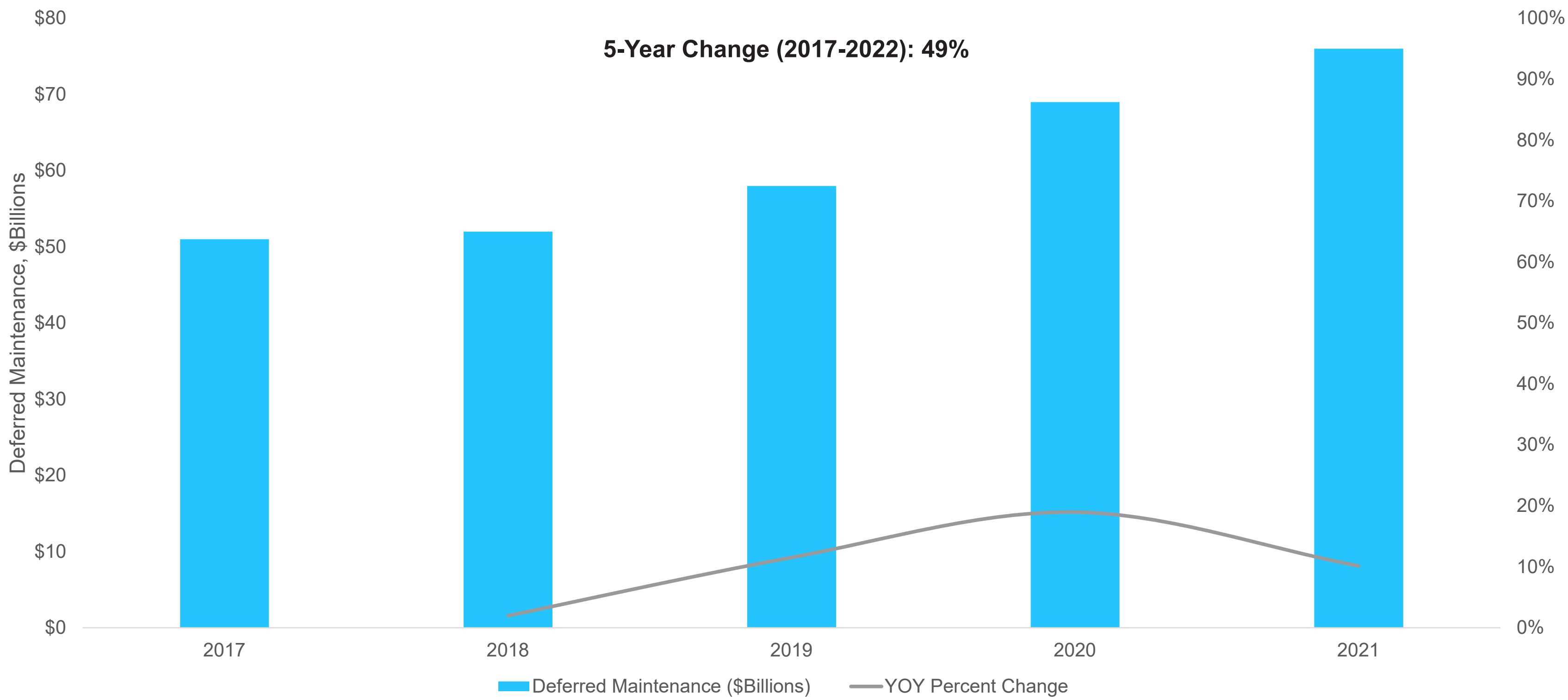


Source: GSA, U.S. Government Accountability Office (GAO), Newmark Research

Civilian Agencies Have Deferred $76 Billion Worth Of Repairs And Maintenance

Civilian agencies—i.e., non-military agencies—deferred $51 billion worth of repairs and maintenance in FY 2017. That amount grew to $76 billion in FY 2021. Officials at the Department of Energy (Energy); Department of Health and Human Services (HHS); Department of the Interior (Interior); and General Services Administration (GSA) attributed the increase to funding constraints and increases in maintenance and repair costs, among other factors.

Reported Deferred Maintenance



Source: U.S. Government Accountability Office (GAO), Newmark Research

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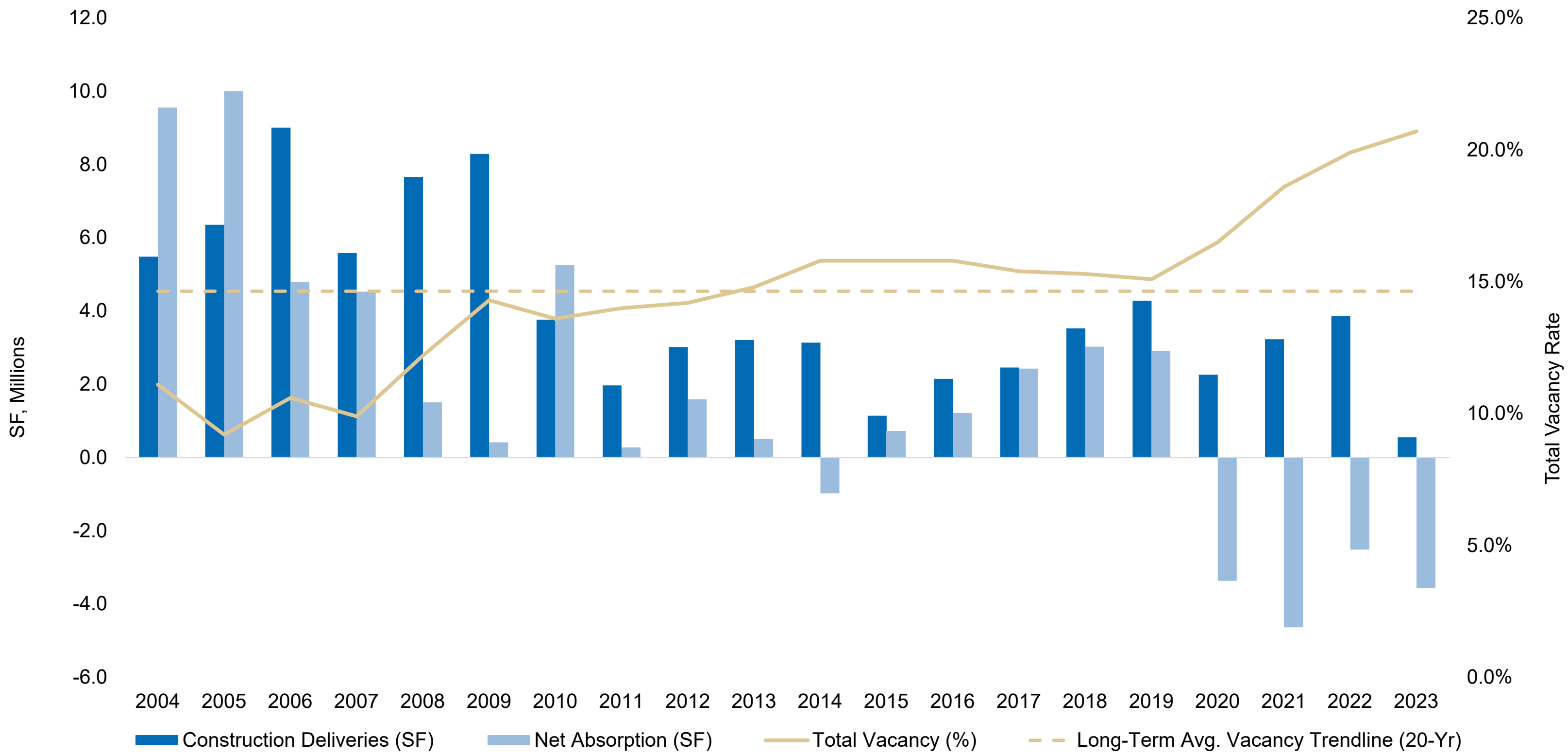
Office Leasing Market Fundamentals

Vacancy Rises but Construction Deliveries Slow Down

The metro area vacancy rate rose 40 basis points over the quarter to end 2023 at 20.7%. Only 551,520 square feet delivered in 2023, well below the 20-year average of 4.0 million square feet per year. A slowdown in office deliveries and the lack of new speculative office construction will be advantageous in helping to balance supply with waning demand.

Historical Construction Deliveries, Net Absorption, and Vacancy

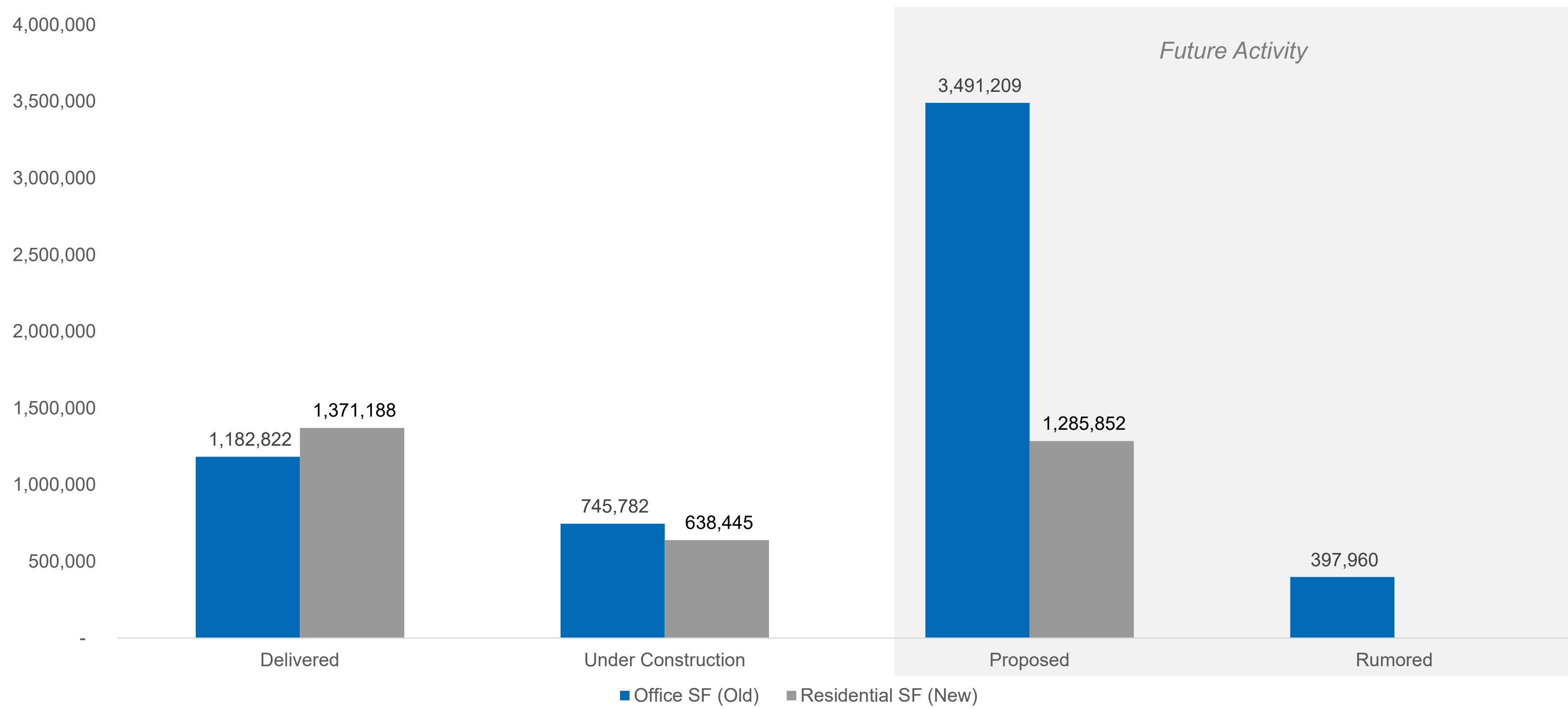


Source: Newmark Research

1.2 Million SF of D.C. Office Has Been Converted Since 2020 (1.0% of Inventory)

Since 2020, 1.2 million square feet of office space has been removed and 1.3 million square feet of multifamily property has been delivered in its place in the District of Columbia. Another 745,782 square feet of office space has been removed from the market's inventory and is currently under renovation to soon become residential in use. Another 3.5 million square feet of office space is proposed to become multifamily.

D.C. Office-To-Residential Conversion Projects, 2020-2023



Source: Newmark Research.

The District of Columbia Will Have Fewer Office Buildings by the Late 2020s

The looming wall of maturing office debt and the increasing share of underwater office assets necessitates that some buildings will be demolished for higher and better use as some borrowers return keys to lenders. This transitional increase in surface area may translate into new pocket parks, private office courtyards, beer gardens, and additional parking.

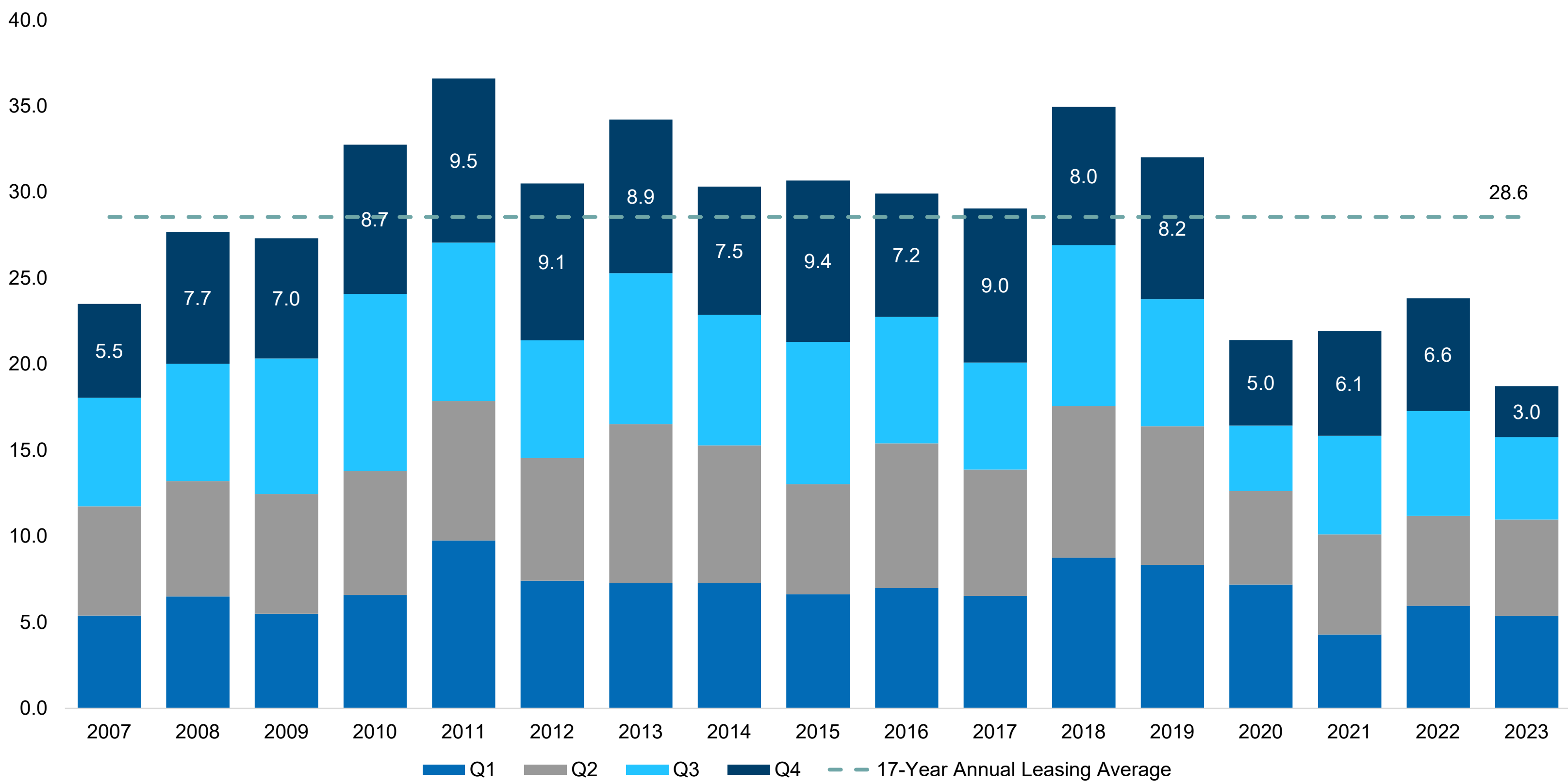
AI Imagines Future D.C. With Less Office Space

Source: Newmark Research, Midjourney

Leasing Activity Has Slowed

A cloudy economic outlook and the higher cost of capital has prompted many companies to pause, assess current conditions and enact cost-cutting measures where applicable. Annual leasing volume for 2023 is slightly lower than over the past three years, driven partly by a slower fourth quarter of leasing activity.

Total Leasing Activity (msf)

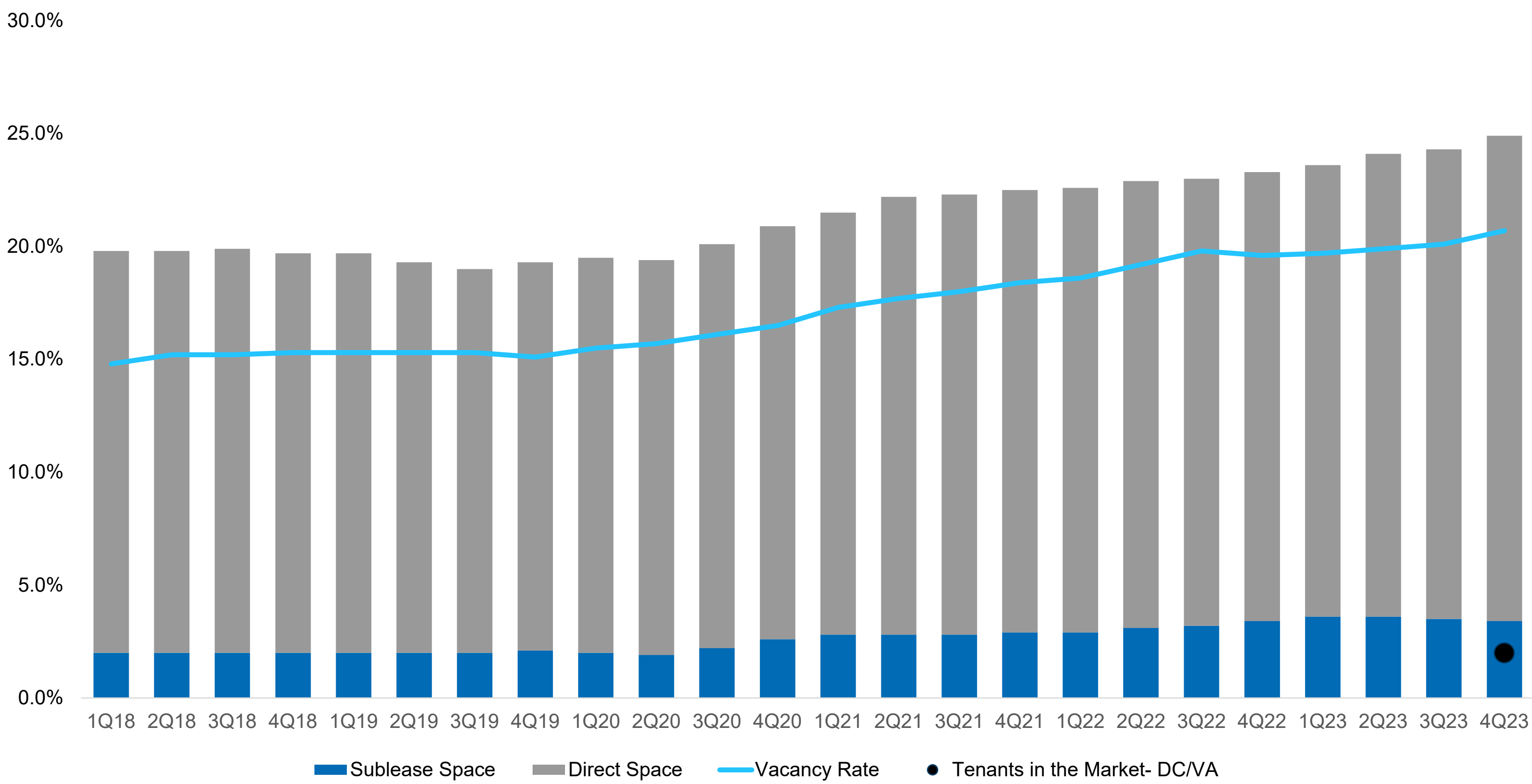


Source: Newmark Research, CoStar

Availability Continues to Increase While Tenant Demand Drops

Available office space sits at a historical high, both in terms of direct and sublease space. Over the past eight years, the direct availability rate has averaged 18.8% while the sublease availability rate has averaged 2.6%. The 4Q23 availability rates of 21.5% for direct space and 3.4% for sublease space are well above the long-term average. This expansion of available space is likely to continue as companies cautiously plan longer-term office strategies.

Available Space and Tenant Demand as Percent of Overall Market

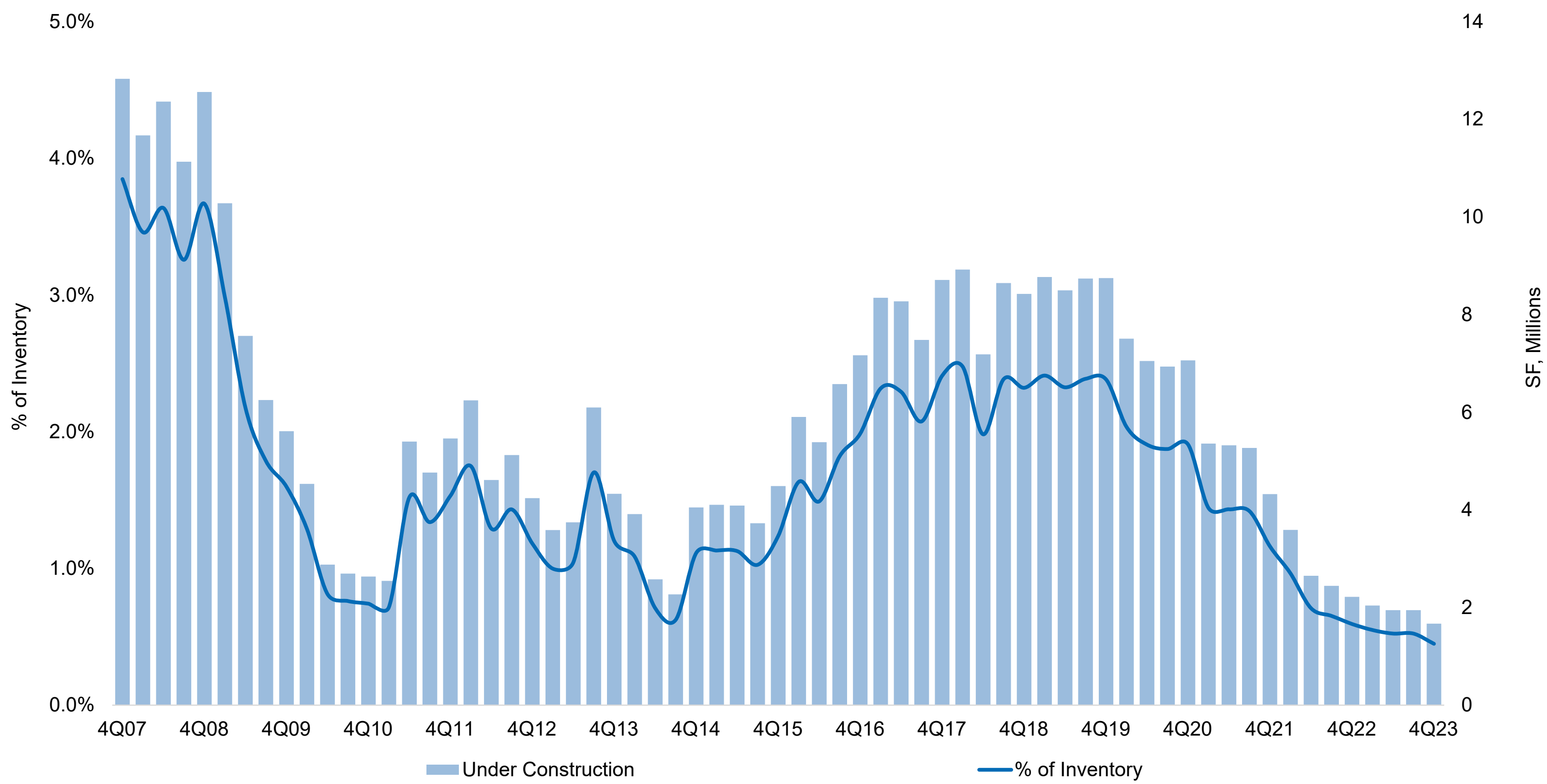


Source: Newmark Research

Deliveries Slow as Office Construction Pipeline Tapers

The Washington Metro area development pipeline remains historically low, with no new projects breaking ground and only two office deliveries this quarter. There are currently 10 office properties under construction in the region, well below the historical average of 29 properties under construction.

Office Under Construction and % of Inventory

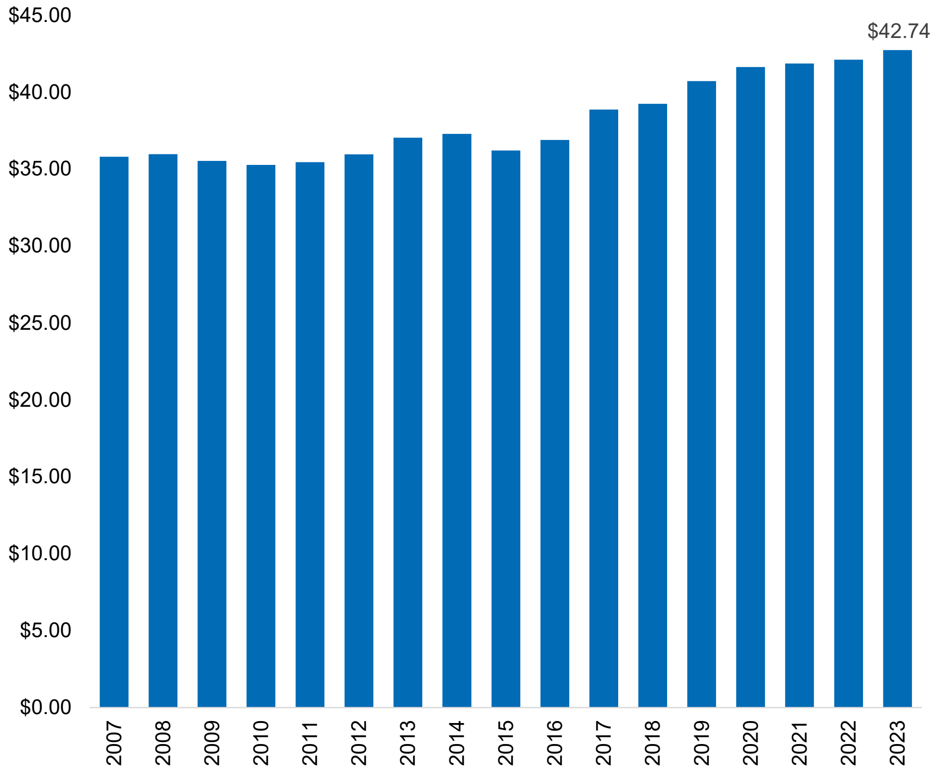


Source: Newmark Research, CoStar

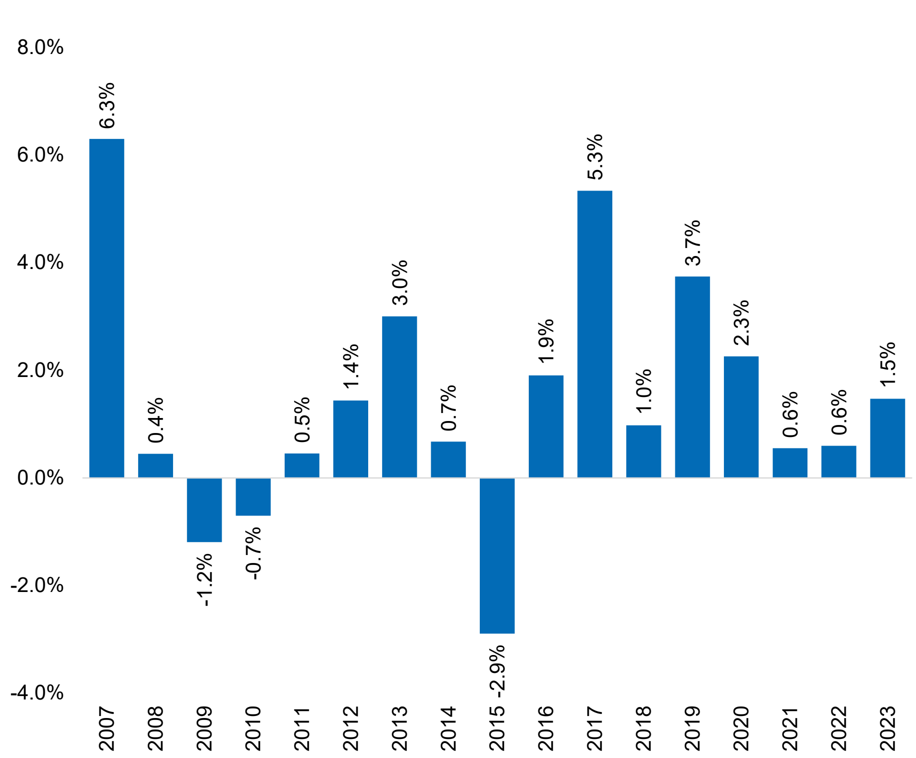
Market Maintains Rent Growth at a Decelerating Rate

In past cycles, asking rents have adjusted downward to account for depressed demand, but it often takes many quarters or even years for rates to fall, as asset owners seek to maintain face rates while increasing concessions to attract tenants. Year-over-year rental rate growth increased in 2023 to 1.5%, on par with the 1.4% year-over-year average since 2007.

Office Average Asking Rent, $/SF, FS



Year-over-Year Asking Rent Growth Rate

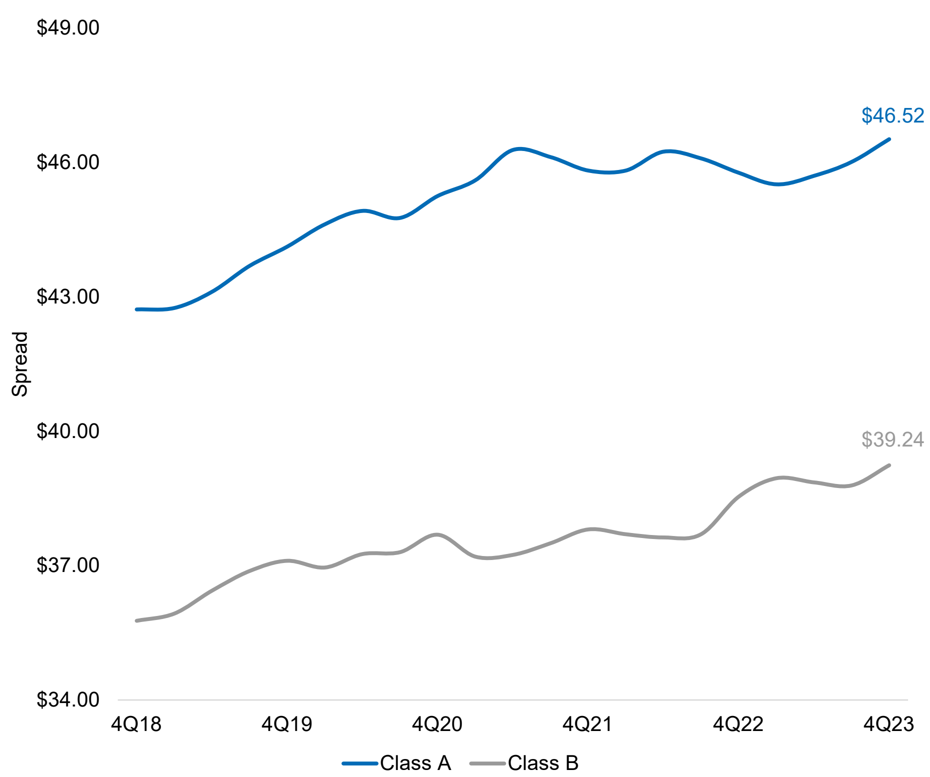


Source: Newmark Research, CoStar

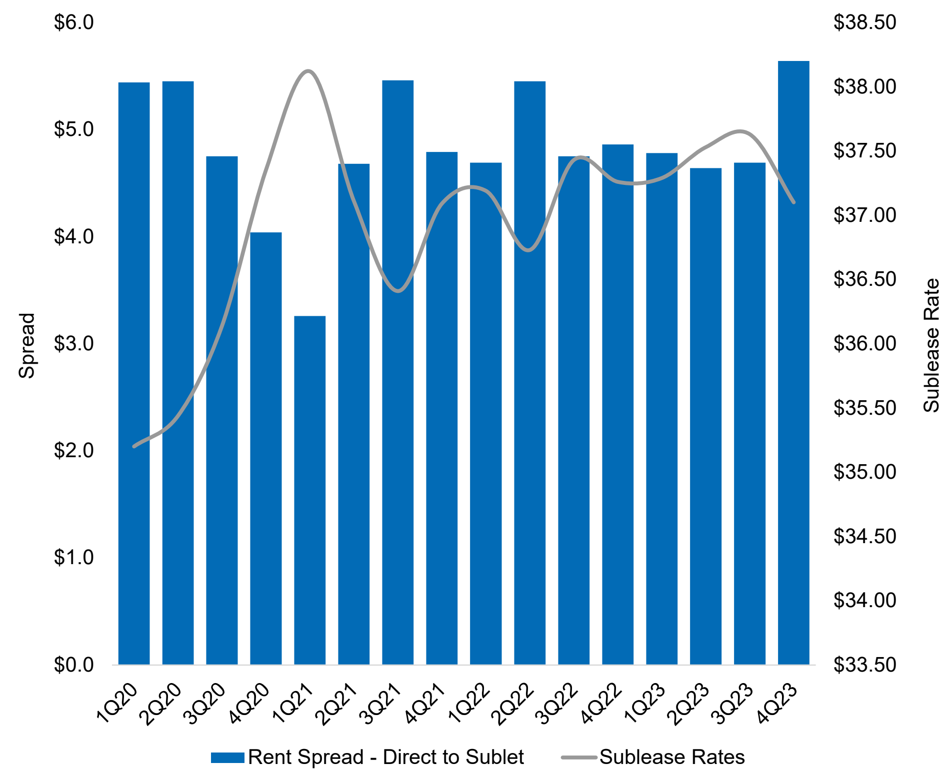
Asking Rents Continue to Rise

While both Class A and Class B asking rents dipped slightly over the past several quarters, they have since rebounded with both increasing into the fourth quarter of 2023. Despite a soft leasing market, asking rents have continued to increase as asset owners seek to maintain face rates. Trophy and Class A+ space continues to outperform the broader market.

Class A and Class B Asking Rents



Sublease Rates

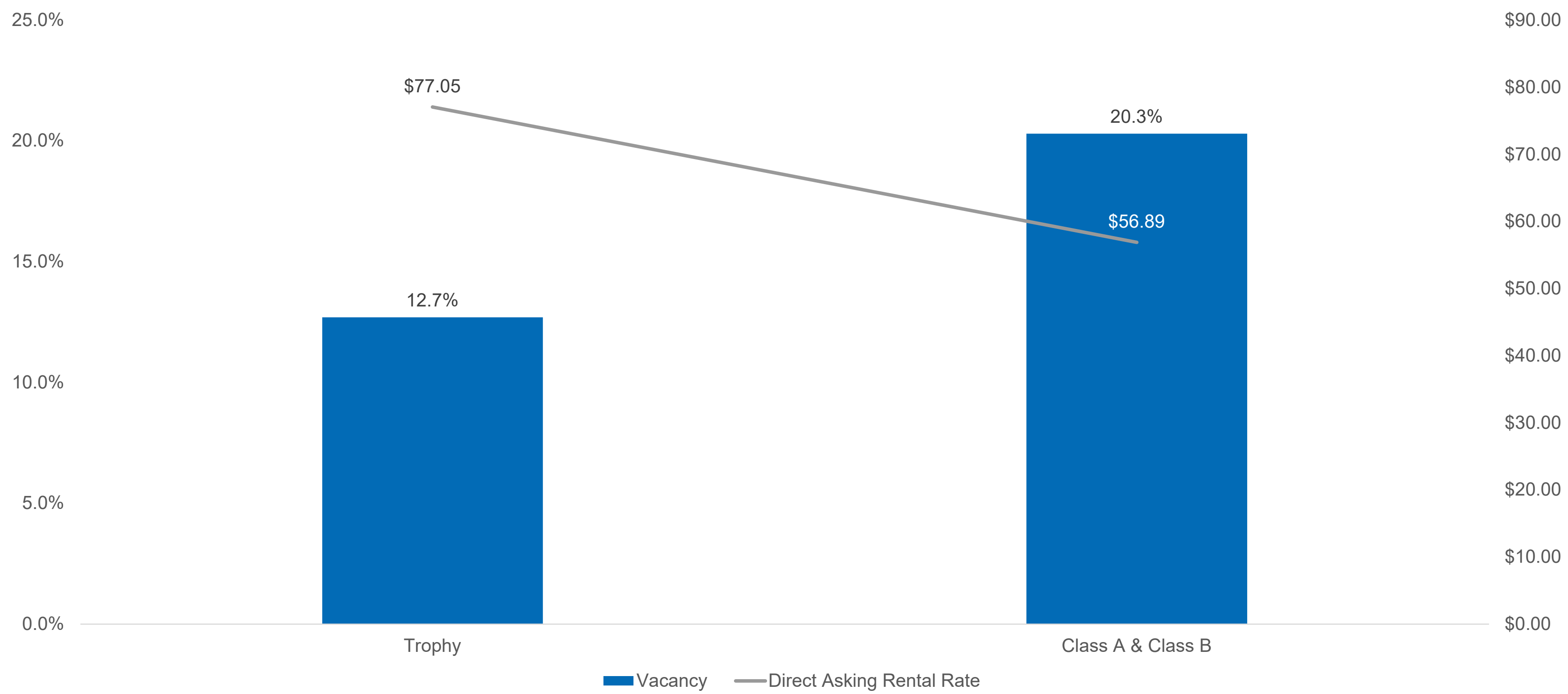


Source: Newmark Research, CoStar

District of Columbia Trophy Office Outperforms Class A & Class B

The District of Columbia, like many other office markets, is experiencing a bifurcation of performance across classes. “Flight to quality” is a pervasive trend and is especially observed among Trophy assets.

Vacancy and Rental Rates By Office Class, Q4 2023

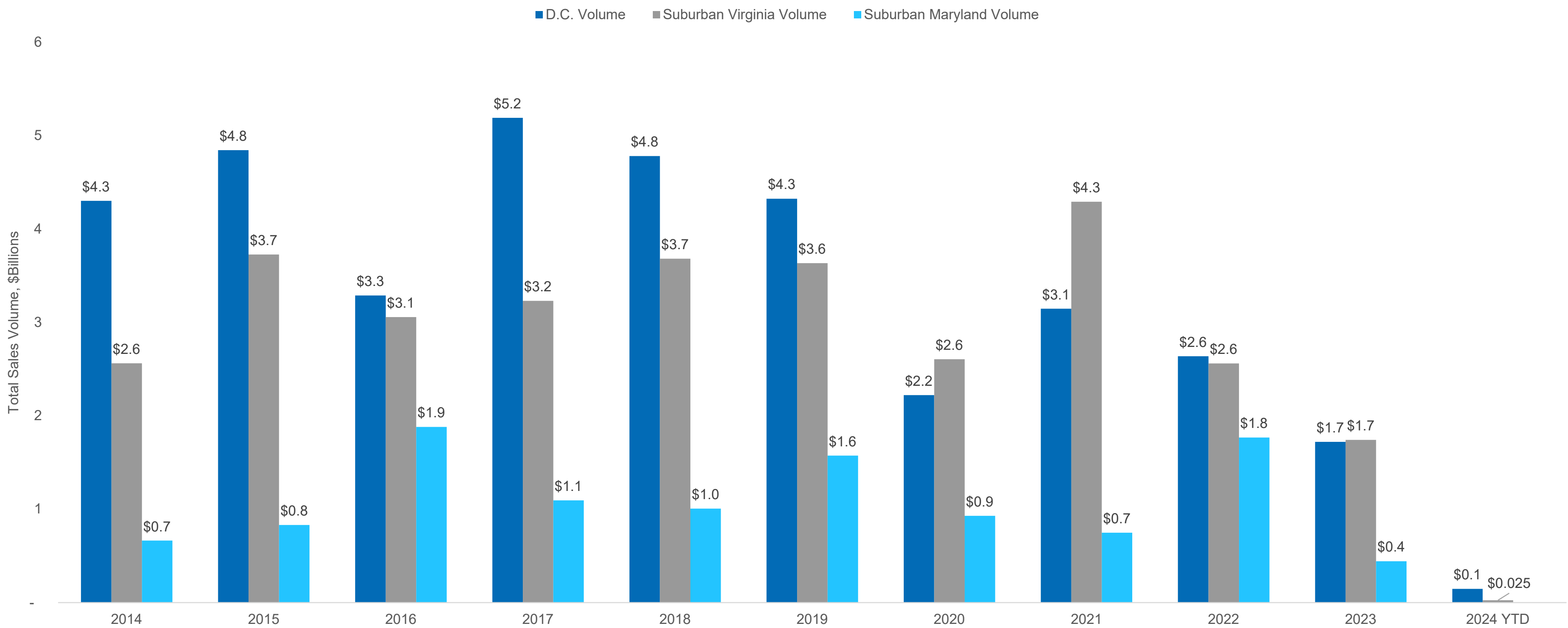


Source: Newmark Research.

Office Sales Volume in the DMV Region Began Slowing in 2018

The start of the Covid-19 pandemic in 2020 marked a ten-year low in annual office investment volumes, totaling $5.8 Billion for the D.C. metro, including its suburbs in Virginia and Maryland. Over the last decade (2013-2022), average annual office transaction volume was $8.1 Billion for the DMV region. While D.C.'s activity recovered to some extent in 2021 with $3.1B in trades, that same year set the high-water market for office sales in suburban Virginia, with $4.3B in trades.

Annual Office Sales Volume, District of Columbia Compared To Suburban Virginia and Suburban Maryland



Source: Newmark Research, RCA

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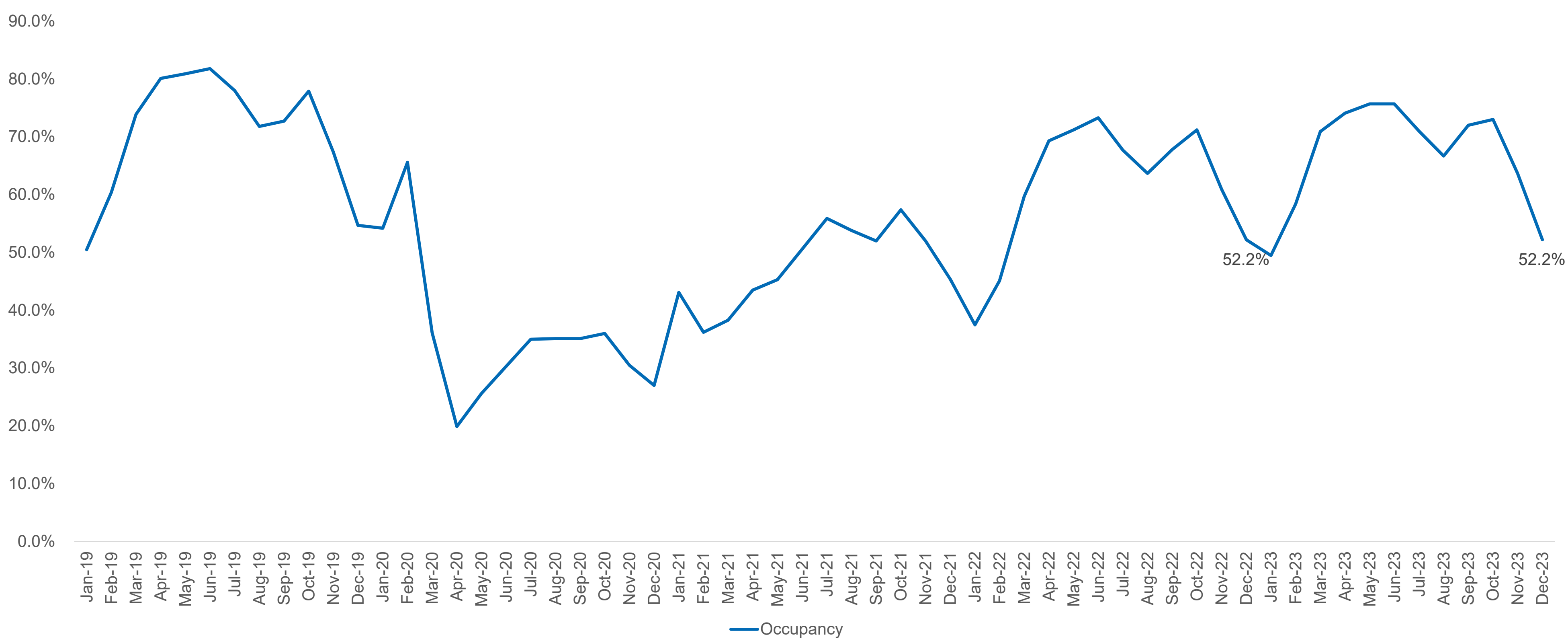
Retail, Tourism And Mobility

Metrowide Tourism Rebounds

As of December 2023, D.C. market hotel demand has remained neutral year-over-year. Hotel occupancy decreased to 52.2%--on par with seasonality decreases in November and December

Washington, D.C. Monthly Hotel Occupancy

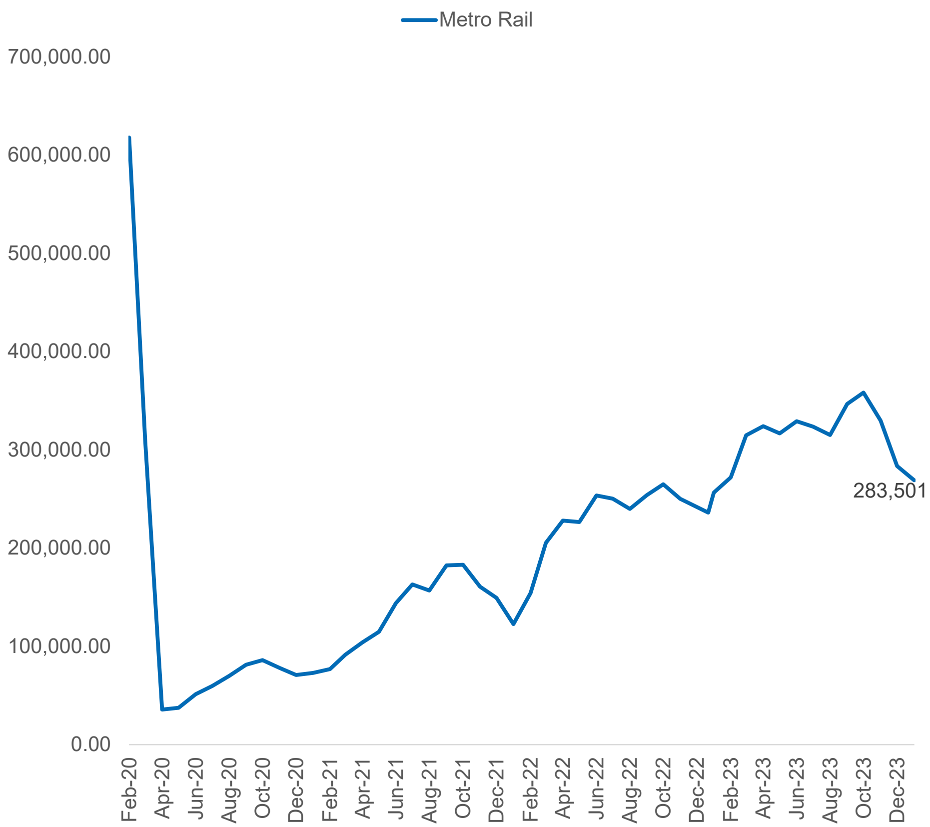


Source: STR, Newmark Research

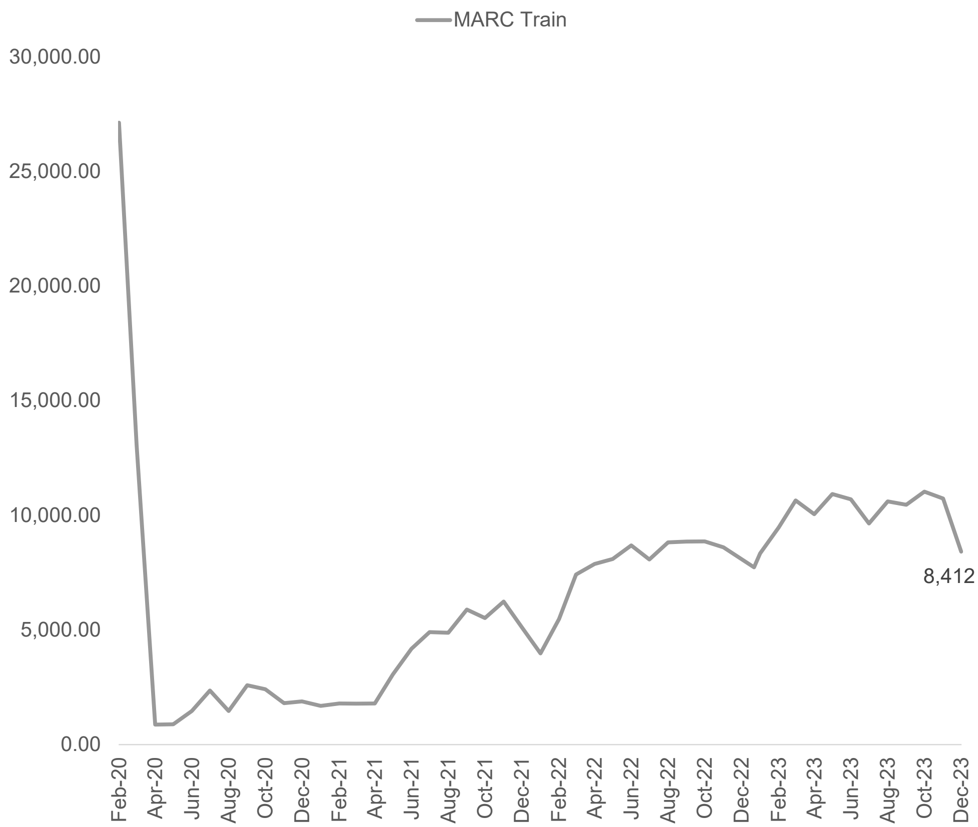
Metrowide Mobility Trends

The modes of transportation that have been most affected by the COVID-19 pandemic are the Washington Metro and the MARC Train, with significant declines in percentages during the initial months of the pandemic. Recovery has been modest for both the Metro Rail and Marc Train recovering 46% and 33% respectively when compared to January 2020.

Metro Rail Average Daily Ridership



MARC Train Average Daily Ridership

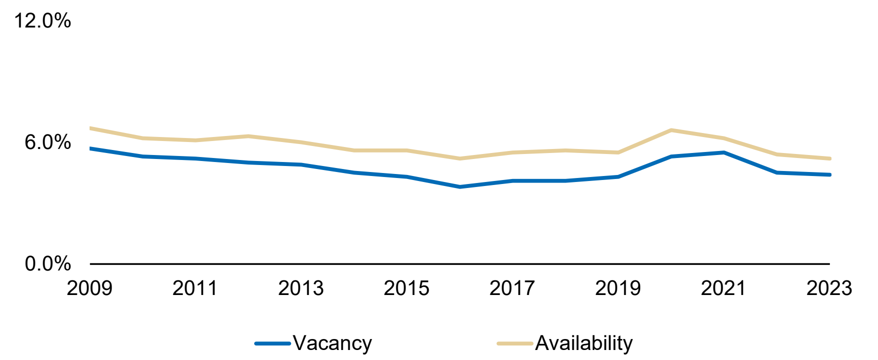


Source: Washington Metro Area Transit Authority, Maryland Transit Authority

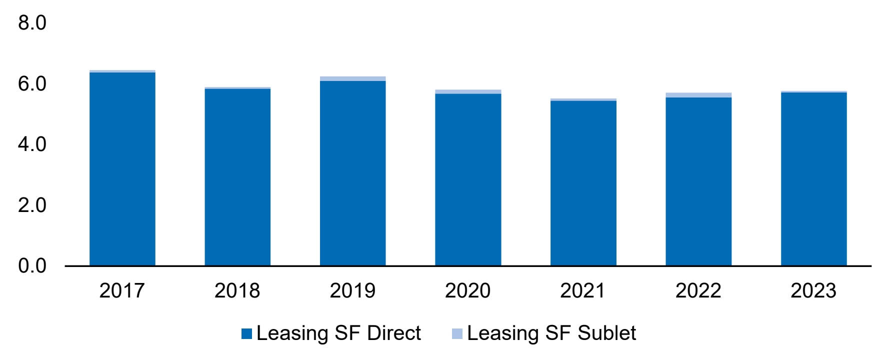
D.C.'s Metrowide Retail Vacancy is 4.4% And Rents Are Growing

The D.C. retail market has strong fundamentals. Vacancy and availability continue to decline, while asking rental rates are at an all-time high of $30.55 NNN per square foot.

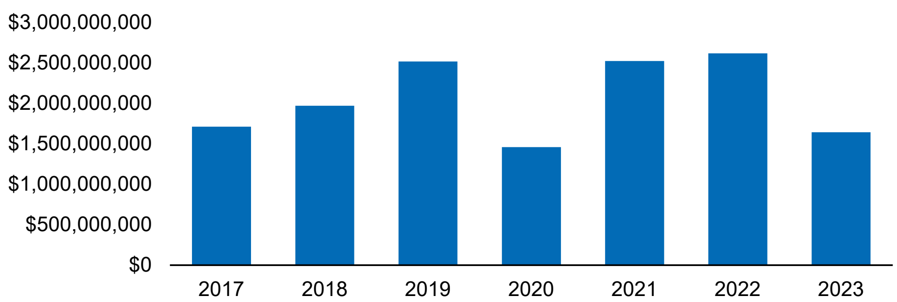
Vacancy and Availability Rates



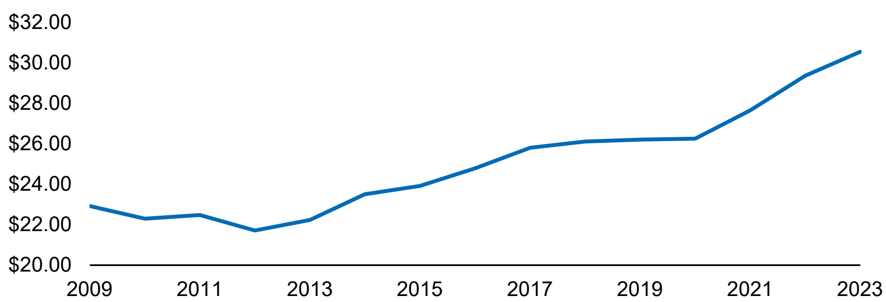
Overall Leasing Activity (SF in millions)



Total Sales Volume



Direct Average Asking Rents (NNN)



Source: Costar, Newmark Research

Post Pandemic Retail Environment Opportunities

Increased Suburbanization

As people leave the urban core for the suburbs this adds pressure for retailers to increase their suburban presence.

Since employers are still slow to mandate full-time on-site work schedules, most employed professionals are working from home at least part time. This change in work patterns results in more demand for neighborhood retail stores and services and a blurring of weekday and weekend shopping patterns. Consumers are visiting local grocery stores and shops more often during the work week since they are working from home and don't need to factor in the drive time. Retailers are choosing to locate closer to their end customer and the demand for almost all types of retail, particularly in grocery centered strip centers and "main street" retail, has rebounded to surpass pre-pandemic levels.

Brick and Mortar Presence

Online and Direct to Consumer retailers are finding the need for a brick-and-mortar presence.

While the pandemic accelerated online shopping habits for virtually every category, many traditional online retailers found that they needed a physical presence. Warby Parker, Allbirds and Bark are all examples on online companies that realized physical stores were necessary to grow their customer base and provide customers with product interaction. This trend has accelerated as online retailers find it increasingly expensive to grow their customer base due in part to changes in tracking online users.

Experiential Retail Grows

Demand for Experiential Retail Grows.

As economic uncertainty has caused many households to put a pause on big ticket item spending, opportunities for experiential retail shopping continues to grow. That includes Apple's genius bar to pop up immersive experiences all geared towards making the consumer feel engaged in the retail process. This trend is heightened by consumers "more flexible" work schedules and not having only the weekends dedicated to errands.

Post Pandemic Retail Environment

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The City of Falls Church falls into this definition of a suburb despite its Metro access and close proximity to the urban core. As employers are still slow to mandate full-time on-site work schedules, most employed professionals are working from home at least part time. This change in work patterns results in more demand for neighborhood retail stores and services and a blurring of weekday and weekend shopping patterns. Consumers are visiting local grocery stores and shops more often during the work week since they are working from home and don't need to factor in the drive time. Retailers are choosing to locate closer to their end customer and the demand for almost all types of retail, particularly in grocery centered strip centers and "main street" retail, has rebounded to surpass pre-pandemic levels.

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Post Pandemic Retail Environment

Environmentally Conscious Retail

Increased Demand for Environmentally Conscious Retail.

The emphasis on environmentally friendly sourcing impacts all types of retail products, but sustainability has also caused a boom in resale demand. From large retailers like Walmart, REI and Home Depot that have a secondhand presence to exclusively secondhand retailers like RealReal and ThredUp resale shopping is a trend that is here to stay.

Strip Shopping Centers

Resurgence of Strip Shopping Centers.

Changing shopping patterns resulting from Covid have led to an increased preference by shoppers for strip centers at the expense of regional malls. Strip centers have been able to attract longtime anchors of regional malls with their new smaller footprints, and the convenience of grocery stores, restaurants, and service-oriented retailers all in one location with easy parking have led this shift.

Limited Retail Availability

Record Low Retail Availability.

Despite inflationary pressures and high interest rates, the demand for retail space has remained strong. Severely constrained supply due to a sharp drop in retail construction since the financial crisis and improved online sales data and analytics used by retailers to pinpoint locations for successful stores has aided in this boom. Nationally, retail vacancy fell to 4.8%, the lowest level since this data was tracked in 18 years. This compares to nationwide office vacancy rates which are at a 30 year high of 18.2%. While landlords lowered rents for retail tenants at the beginning of the pandemic, the average asking rent for retail space is up 6.3% since mid-2020.

Post Pandemic Retail Environment - Challenges

Inflation

Inflation Hampering Discretionary Spending.

While near zero interest rates and government subsidies provided a cushion during the pandemic, the current inflationary environment remains a threat to discretionary spending. That has resulted in many retailers and restaurants rethinking their offerings, price points and competitive position.

In-Person Shopping Experience

Discontent with the In-Person Shopping Experience

Consumers are increasingly frustrated with in person shopping, even as they crave a hands -on experience. Retail staffing levels continue to shrink – down on average 24% from pre pandemic levels - as retail wages have grown exponentially. Retail workers often need to split their time between waiting on customers and filling on-line orders, creating frustration for in person shoppers. Increased theft (or “shrink”) has resulted in retailers locking up or moving more items off the sales floors all together resulting in shoppers sending more time finding an employee to unlock a cabinet. This applies to everything from electronics to deodorant, and estimates are that locking up items reduces sales by 15%-25% each year.

Alternative Retail Uses

In the DC Metro region, retailers are succeeding in a post Covid environment

and landlords are benefitting from lower vacancies and higher rents. High end regional malls, grocery anchored strip centers and main street retail are all performing well. Nationally, the expectation is for retail's strength to continue as almost half of the retailers surveyed in a 2023 Global Data report indicated that they plan to expand their footprint in the next five years.

The Global Data survey found grocery retailers as the most bullish on expansion, directly related to this sector's minimal reliance on online sales and desire for increased geographical reach.

Grocers that have announced expansion plans this year include Aldi, Costco, Sprouts, H Mart, and Wegmans. One notable trend for grocers is demonstrating flexibility in store design, layout, and merchandising. Grocers are having success in formatting and merchandising stores specifically for the local market, and focusing more on perishables than dry goods which can more easily be ordered online. An interactive shopping experience, with cooking demonstrations, product sampling and responsiveness to shoppers' requests are more common. Fresh Market and Sprouts are good examples of this strategy's success.

Other retail expansion is driven by the data that opening a physical store can significantly increase online sales

Retailers found that having a brick-and-mortar presence increased online sales by 37% in that particular market. By combining the convenience of online shopping with the personal touch of the in-store experience, customers engage in a more comprehensive shopping experience.

Retail innovation is also being seen in digital only stores.

Panera has been testing a digital first concept called Panera To Go. 1000 square foot stores with no dine in seating and all digital ordering. Similarly, merchandise lite stores are another way retailers are capitalizing on digital sales but maintaining a modest physical presence. Walgreens is testing small stores with minimal merchandise with most things ordered online or through in store kiosks for pickup at the counter. In addition to catering to digital shoppers, the lack of merchandise on the shelves is in direct response to the growing problem of store theft.

In store shopping for many types of retail is driven by consumers looking for inspiration and entertainment. Retailers who adapt their space to make the in-store shopping experience one where consumers can engage in new discovery and drive a sense community will succeed. This is particularly true for Gen Z shoppers who highly value the touch point of in person shopping at local and small businesses and are likely to accommodate higher pricing and smaller staffing to participate in this way. The Global Data survey revealed huge shifts in consumer views and habits related to shopping. In the last five years, consumers are 13% more likely to research products online before visiting stores. They are 11% more likely to buy online and collect in the store and 11% say they find store shopping more difficult.

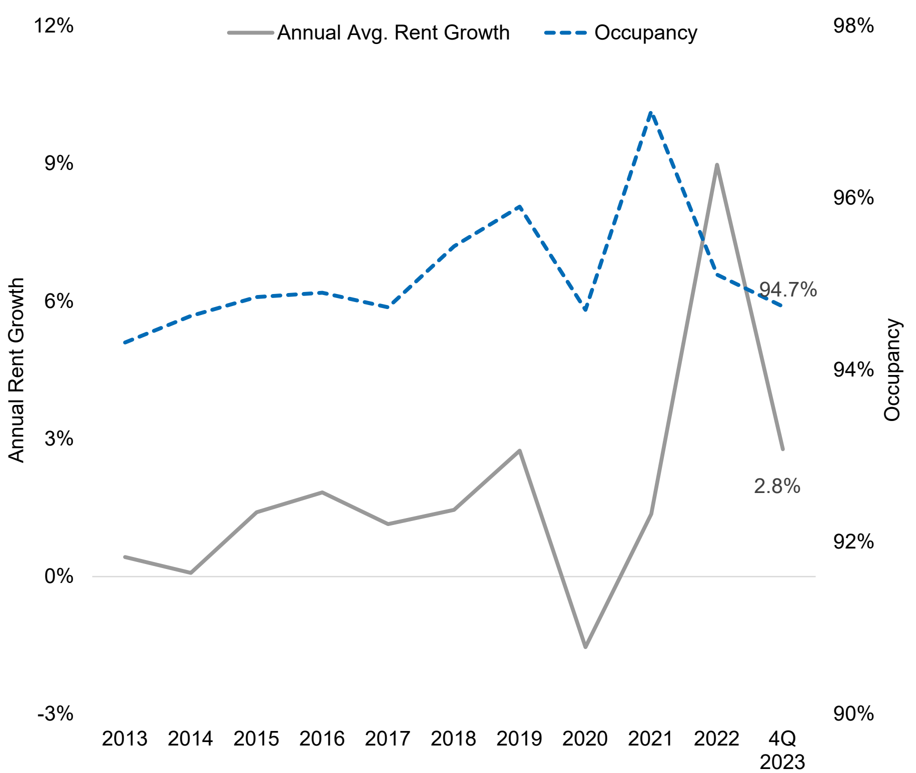
4Q23

Multifamily

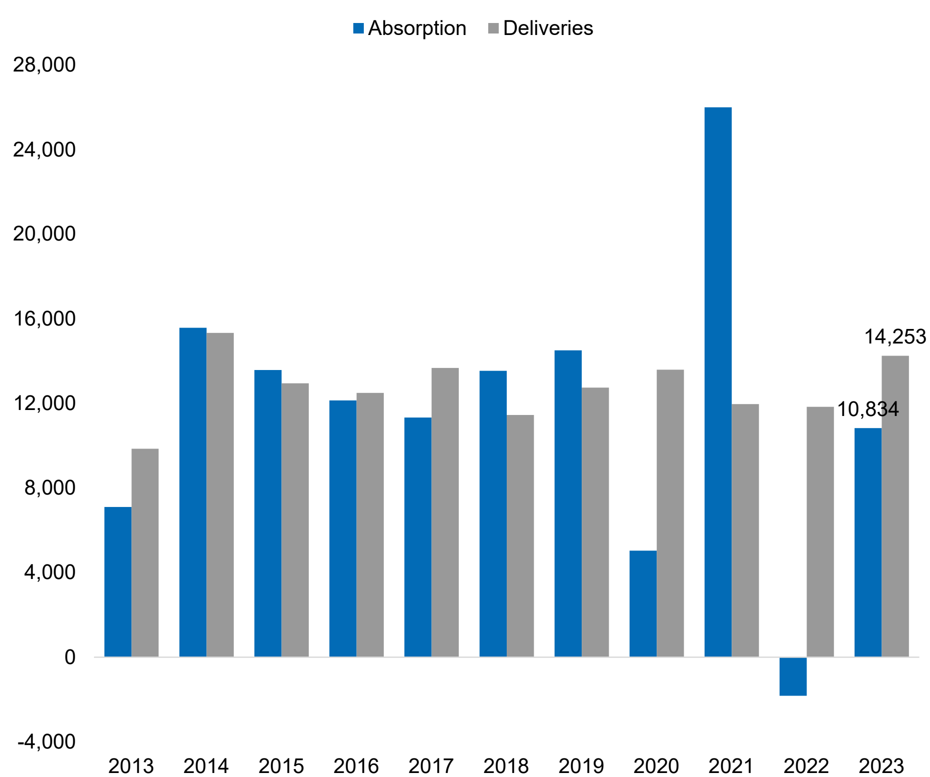
Washington Metro Area Multifamily Market Fundamentals

Washington Metro multifamily fundamentals remain strong in the fourth quarter of 2023. The 12-month growth rate of 2.8%, is well above the 10-year average of 1.9%. New construction deliveries have surpassed the 10-year annual average of 12,594 units for the first time since the start of the pandemic.

Effective Rents and Occupancy



Deliveries and Absorption (units)



Source: Newmark Research, Axiometrics

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Washington Metro Area Submarket Statistics – 4Q 2023

Occupancy in the region remains strong at 94.7% despite a significant delivery pipeline over the past several years. Rent growth remains healthy across most submarkets, with 26 of the region's 36 submarkets achieving rent growth of 2.5% or higher over the past year.

Multifamily Statistics by Submarket- As of 4Q 2023

Multifamily Submarket	Effective Rent	Avg. Annual Effective Rent Change	Inventory (Units)	Occupancy	Under Construction (Units)
Bethesda/Chevy Chase	$2,800	1.9%	15,571	94.9%	2,646
Central Alexandria	$1,821	2.9%	12,880	95.7%	901
Central DC	$2,622	3.0%	51,735	95.6%	2,233
College Park/Greenbelt	$1,873	2.7%	11,158	92.4%	451
Columbia Pike	$2,098	2.8%	15,282	96.5%	-
Crystal City/Pentagon City	$2,519	4.9%	15,098	94.8%	1,886
Downtown Silver Spring	$2,044	3.1%	14,533	95.1%	553
East Alexandria	$2,286	4.0%	21,147	95.2%	1,556
East Silver Spring/Takoma Park/Adelphi	$1,658	4.9%	17,563	96.4%	-
Frederick	$1,852	2.6%	12,072	95.8%	350
Fredericksburg/Stafford	$1,784	1.0%	15,398	94.6%	471
Gaithersburg	$2,006	3.8%	16,620	96.3%	244
Germantown	$2,015	3.1%	8,661	95.3%	-
Hyattsville/Riverdale	$1,632	2.8%	17,345	94.3%	1,282
Landover/Bowie	$1,873	1.1%	19,330	92.7%	1,092
Laurel/Beltsville	$1,731	0.3%	14,876	95.0%	-
Loudoun County	$2,151	4.5%	17,984	95.1%	200
Manassas/Far Southwest Suburbs	$1,903	4.2%	16,059	95.7%	-
Washington Metro	**$2,110**	**2.8%**	**684,856**	**94.7%**	**30,557**

Multifamily Submarket	Effective Rent	Avg. Annual Effective Rent Change	Inventory (Units)	Occupancy	Under Construction (Units)
Navy Yard/Capitol South	$2,725	0.6%	23,405	93.1%	3,638
North Arlington	$2,726	3.5%	33,048	96.1%	1,288
North Central DC	$1,912	3.5%	18,960	93.8%	1,264
Northeast DC	$2,341	-0.3%	29,050	93.4%	2,120
Northeast Montgomery County	$1,816	3.3%	9,312	95.1%	387
Northwest DC	$2,384	4.6%	22,764	96.1%	2,058
Reston/Herndon	$2,222	2.3%	22,235	94.9%	1,255
Rockville/North Bethesda	$2,302	2.4%	21,691	94.8%	1,024
Seven Corners/Baileys Crossroads/Annandale	$1,962	2.4%	11,922	95.5%	604
South Fairfax County	$2,002	1.1%	23,390	95.7%	366
South Prince George's County/St. Charles	$1,642	-2.3%	22,688	92.2%	-
Southeast DC	$1,416	2.8%	29,017	93.7%	987
Suitland/District Heights/Capitol Heights	$1,570	-6.1%	17,687	89.8%	327
Tysons Corner/Falls Church/Merrifield	$2,264	2.7%	29,066	95.4%	1,019
West Alexandria	$1,859	-2.7%	11,412	94.1%	-
West Fairfax County	$2,182	2.6%	17,581	96.0%	-
Wheaton/Aspen Hill	$1,982	2.1%	13,389	95.3%	-
Woodbridge/Dale City	$1,829	-1.4%	14,927	94.7%	355
Washington Metro	**$2,110**	**2.8%**	**684,856**	**94.7%**	**30,557**

Source: Newmark Research, Axiometrics

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BC0 Raymond has q4 updates

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Q&A

Current Capital Market Trends

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