

# WASHINGTON METROPOLITAN AREA

## 4Q17 ECONOMY AND OFFICE MARKET OUTLOOK

### EXECUTIVE SUMMARY

## REGIONAL ECONOMIC GROWTH MODERATING; OFFICE MARKET OUTPERFORMS 2016

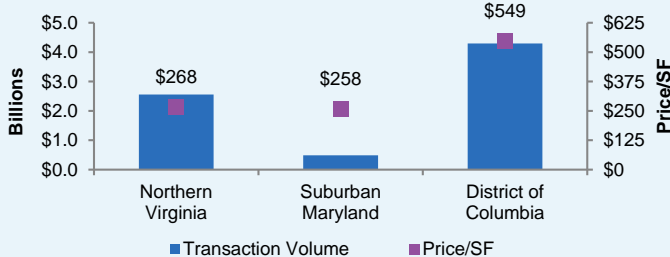
The Washington metro area's economic growth moderated from 2016, whereas office market metrics outperformed 2016. For the 12 months ending in October, the region added 46,400 jobs, down slightly from 2016. This compares favorably to the metro's 20-year average growth of 44,200 jobs per annum. The Washington Leading and Coincident Indices have also started to moderate. This suggests that the current pace of growth will carry into the beginning of 2018, which would lend credence to the consensus of economists who predict that the next downturn will occur in late 2018 or 2019.

The region's unemployment rate was 3.6% in October 2017, down 30 basis points from 12 months prior. The region's largest employment sector, at 23.0% of the region's total employment, was Professional and Business Services (PBS). This sector added 13,300 jobs in the 12 months ending October 2017, or 28.7% of the total jobs added. Jobs in this sector tend to be high-paying and use office space, which bodes well for the continued improvement of regional office market metrics.

The Washington area's office market experienced robust **demand** during the fourth quarter and finished 2017 with a total of 2.2 million square feet of net absorption. Strong absorption across all three substate areas contributed to the region's strongest performance since 2010 and only its third positive annual absorption total in the past seven years. The fourth quarter alone saw the region absorb 1.1 million square feet, accounting for half of the annual demand and exceeding all of 2016's yearly figure. Even with the delivery of 2.4 million square feet of new product, the region's overall **vacancy rate** declined to 16.1%, down 50 basis points from one year ago and down 10 basis points from the prior quarter.

### Capital Markets

#### 2017 Office Investment Sales\*



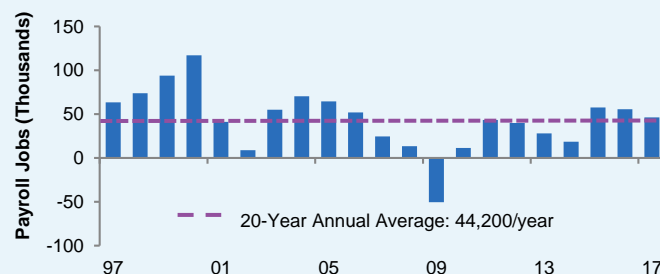
\*Data through November  
Source: Real Capital Analytics, NKF Research; as of December 13, 2017

### Economy

- **Historical Job Change:** 46,400 jobs added in the 12 months ending October 2017, versus 44,200 per annum for the past 20 years.
- **Projected Job Growth:** NKF forecasts an average increase of 41,900 jobs per annum from 2017 through 2021.
- **Unemployment Rate:** 3.6% in October 2017, down 30 basis points from October 2016.

Source: Dr. Stephen Fuller, Bureau of Labor Statistics, NKF Research; December 2017

#### Washington Metro Payroll Job Change

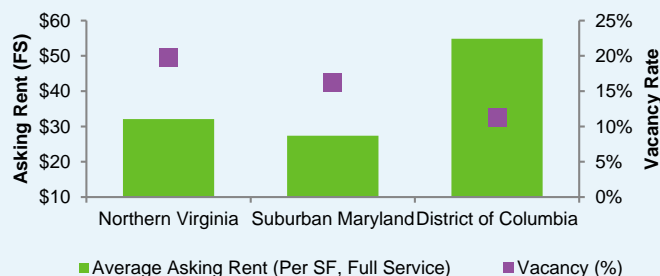


Note: Totals reflect annual average net change, except 2017, which reflects change for the 12 months ending October 2017

Source: Bureau of Labor Statistics, NKF Research; December 2017

### Office Market

#### Asking Rent and Vacancy Rate



### 4Q17 Office Market Summary

	Northern Virginia	Suburban Maryland	District of Columbia	Metro Region
Total Inventory (SF)	165.3 M	74.5 M	124.3 M	364.1 M
Vacancy Rate	19.8%	16.2%	11.2%	16.1%
YTD Net Absorption (SF)	909,175	506,659	800,623	2.2 M
Average Asking Rent (Per SF, Full Service)	\$32.09	\$27.40	\$54.83	\$38.12
Under Construction (SF)	1.5 M	890,000	6.1 M	8.5 M
YTD Deliveries (SF)	1.9 M	0	458,889	2.4 M

## WASHINGTON METROPOLITAN AREA 4Q17 ECONOMY AND OFFICE MARKET OUTLOOK

Weighted average **asking rents** increased 5.2% over the past 12 months to \$38.12/SF. This was largely a result of the outsized impact of new, core product and renovated assets being delivered to the market. The market remains tenant-favored, as significant concession packages continue to exert downward pressure on effective rents.

The Washington area registered \$1.4 billion in office sales transaction volume during the fourth quarter of 2017. Transaction volume in 2017 totaled \$7.3 billion, a 14.1% increase from 2016, bolstered by a strong first-quarter performance.

### Private Sector Growth on the Rise

Over the past 40 years, the Washington region has transitioned from deep-rooted dependence on the federal government to a more balanced regional economy. This process has accelerated in the midst of government austerity since 2010, and the private sector has adapted and found new ways to generate economic activity. On average, the government sector added 9,600 jobs every year from 2007 to 2011. From 2012 to 2016, this average declined to just 300 jobs a year. Meanwhile, private sector employment declined an average of 1,100 jobs per year from 2007 to 2011 but grew 39,700 jobs per year from 2012 to 2016. Put another way, whereas the government sector generated all of the region's job growth from 2007 to 2011, this ratio has flipped in the past five years, and now the private sector is the region's job generator. This growth appears to be continuing, with the private sector adding 13,300, or 28.7%, of the total jobs added in the 12 months ending October 2017.

## THE PRIVATE SECTOR IS NOW THE REGION'S JOB GENERATOR

The largest generator of private sector jobs in the region has been the Professional and Business Services sector (PBS). The region has undergone a significant transition over the past 42 years: In 1975, the region's employment comprised roughly 23% federal workers and 11%

PBS, but as of October 2017, it is 11% federal workers and 23% PBS. Although the federal government will likely always be a significant part of the Washington metro area economy, the fact that the private sector can continue to create high-paying, office-using jobs with a reduced dependency on the federal government is a significant source of optimism about the region's economic future. As the regional economy grows more diverse and less dependent on federal spending, the government's effect on the region's office market remains important but less dominant. It is a steadying influence rather than a driving influence.

### Fed Hikes Interest Rate for Third Time in 2017

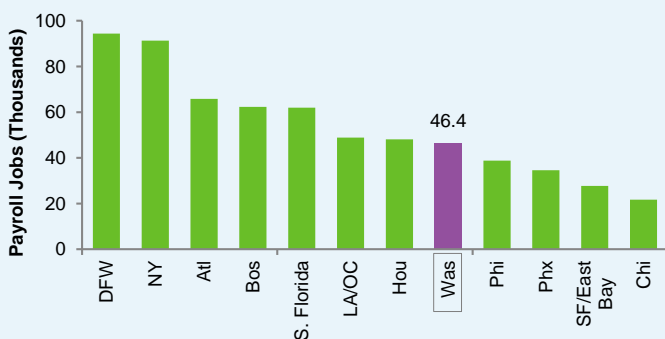
As was widely foreseen, the Federal Reserve raised the federal funds rate by another 25 basis points in December—the third time in 2017—with another three rate hikes anticipated for 2018. The Fed cited solid job growth and a near-target inflation rate as justification for its year-end hike. The December rate hike marked the sixth quarter-point increase since December 2015, with the rate now set at a range between 1.25% and 1.50% after remaining near zero for several years following the Great Recession and during the protracted recovery.

## THE FED CITED SOLID JOB GROWTH AND A NEAR-TARGET INFLATION RATE AS JUSTIFICATION FOR ITS YEAR-END HIKE

Rate increases are a potential concern for the commercial real estate industry, as higher rates could impact investment sales volume, cap rates, and borrowing and development velocity. During the second quarter of 2017, U.S. banks reported tightening lending standards on commercial real estate loans, which suggest that the continued introduction of interest rate hikes may further limit borrowing. Still, many analysts believe that the industry can digest a slow increase in rates with little disruption.

### Payroll Job Change – Largest Metro Areas

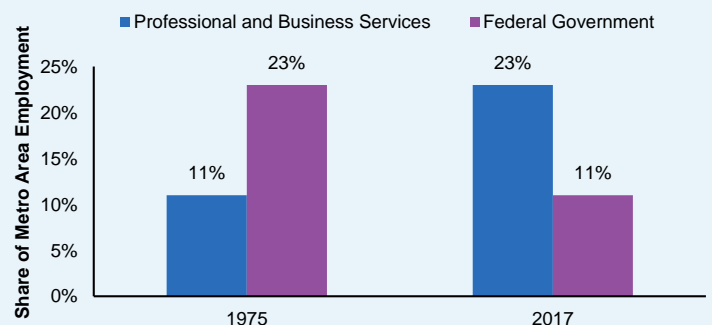
12 Months Ending October 2017



Source: U.S. Bureau of Labor Statistics, NKF Research; December 2017

### Prof./Bus. Services Now Larger Than Federal Government

Washington Region's Largest Job Sectors: 1975 vs. 2017



Source: U.S. Bureau of Labor Statistics, NKF Research; December 2017

## WASHINGTON METROPOLITAN AREA 4Q17 ECONOMY AND OFFICE MARKET OUTLOOK

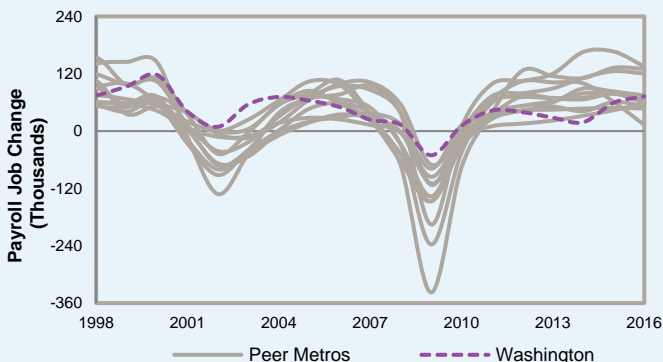
### Metro CMBS Delinquency: How Challenging is It?

A recent Bisnow article lamented the region's CMBS delinquency rate of more than 12.0%, citing limited rental growth and high vacancies. What the article does not consider is Northern Virginia's sizeable defense contractor community, which, following federal austerity measures and the Base Realignment and Closure Act (BRAC), caused significant devastation in the I-395 Corridor and Crystal City. Approximately 60.0% of the properties with CMBS loan defaults are located in these two submarkets, which experienced negative demand as the Department of Defense and many of its related contractors sharply reduced their leased office space. The BRAC-impacted submarkets contributed to 40.0% of the total outstanding principal balance of the CMBS loans, which total \$2.2 billion. For more information on BRAC and federal austerity, please see NKF's 2016 white paper [Political Control](#). When adjusted for BRAC-impacted submarkets, the metro area's CMBS delinquency rate falls to between 5.0% and 7.0%, on par with peer metros as measured by vacancy, such as Chicago and Philadelphia.

### Metro Washington: Future Home for Amazon's HQ2?

Early in September, Amazon announced plans to add a second North American headquarters. Since then, eight proposals—four in the District, one in Suburban Maryland and three in Northern Virginia—have been submitted to the tech giant. Amazon requires a minimum of 500,000 square feet of existing space in the near term for a move anticipated for 2019, with the potential to expand into 8.0 million square feet through 2027. The new headquarters would be a boost to Amazon's chosen jurisdiction, as a projected 50,000 jobs would be added, potentially spurring investment and driving activity to the chosen winner area. The Washington metro region—particularly Northern Virginia, with its land availability and growing tech sector—is considered to have many competitive advantages in Amazon's search for a second headquarters (dubbed HQ2), placing it among the top two or three metro regions that are competing. It does not hurt that The New York Times cited the Washington metro area as the likely runner-up in the competition (to Denver). It also does not hurt that Amazon's founder and chairman, Jeff Bezos, has a home in Washington.

### Washington's Recession Proof Nature



Source: U.S. Bureau of Labor Statistics, NKF Research; December 2017

### Development Pipeline Booming

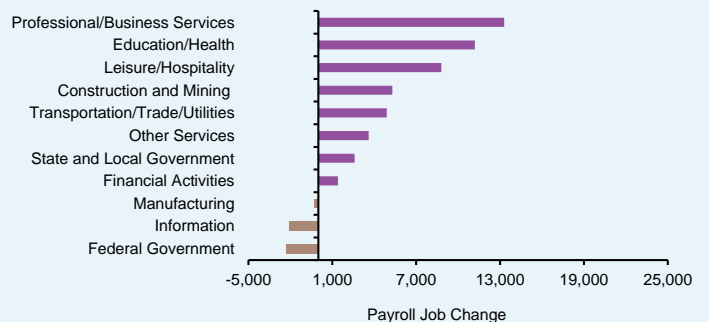
The Washington metro area has 11.5 million square feet of buildings in the development pipeline, with 8.5 million under construction and 3.0 million under renovation. Many tenants in the Washington metro area have shown a strong preference for new space and are willing to pay a premium to occupy new or newly renovated buildings, particularly those located near transit and with a strong amenity base. Demand for leased space in Class A assets quintupled 2016's figures, which saw 679,460 square feet of absorption. Drawn by the relatively strong performance of new Class A+ and trophy assets, many developers have begun or continued construction on a speculative basis despite elevated vacancy rates. Deliveries during the year were limited to the District and Northern Virginia, where eight projects totaling 2.4 million square feet were completed. In Suburban Maryland, the Bethesda submarket is poised for historic growth, with four projects totaling 1.9 million square feet in the pipeline, after several years of limited new supply. The District's current development pipeline is 56.5% pre-leased, Northern Virginia's is 57.8% pre-leased, and Suburban Maryland's is 91.6% pre-leased. Although there has been a notable uptick in demand in the region, the significant pace of new construction means supply will very likely outpace demand over the next several years.

### Still No Trump Bump?

Since President Donald Trump took office in January 2017, the world has focused its attention on Washington. Many commercial real estate investors who were uncertain about the state of economic affairs under the new presidential administration are heading into 2018 feeling bullish about the economy. In keeping with a presidential campaign promise, *The Tax Cuts and Jobs Act* passed on December 20, 2017 and will streamline the tax code and also positively impact the development community by leaving current provisions unchanged as they relate to carried interest and tax deferrals. One of the major changes to the tax code is the treatment of "pass-through" entities or "S-Corporations," which constitute the majority of real estate partnerships. These entities will be able to deduct 20% of income generated.

### Job Change by Industry

#### Washington Metro Area | 12 Months Ending October 2017



Source: U.S. Bureau of Labor Statistics, NKF Research; December 2017

## WASHINGTON METROPOLITAN AREA 4Q17 ECONOMY AND OFFICE MARKET OUTLOOK

### DEMAND POSITIVE ACROSS ALL THREE SUBSTATE AREAS FOR THE FOURTH QUARTER AND ALL OF 2017

The Washington area's office market experienced sturdy demand in 2017, as annual net absorption for the region totaled 2.2 million square feet. Strong absorption across all three substate areas contributed to the region's stout performance. In the fourth quarter alone, the region recorded 1.1 million square feet of absorption, accounting for half of annual demand and exceeding 2016's total yearly figure.

Last year, the District of Columbia led the Washington area in demand, with 1.2 million square feet of absorption. By comparison, annual absorption in 2017 was spread out across all three substate areas. Northern Virginia led the region with 909,175 square feet of absorption (after experiencing negative absorption during the last five years), followed by the District with 800,623 square feet, and Suburban Maryland with 506,659 square feet.

Even with the delivery of 2.4 million square feet of new product, the region's overall vacancy rate declined 50 basis points from one year ago to 16.1%, and edged down 10 basis points from the prior quarter. Weighted average asking rents increased 5.2% over the past 12 months to \$38.12/SF. This is largely a result of the outsized impact of new, core product and renovated assets being delivered to the market. Effective rents, on the other hand, continue to be under downward pressure, as incentives—especially tenant improvement allowances—are generous.

#### Class A Market Outperforms

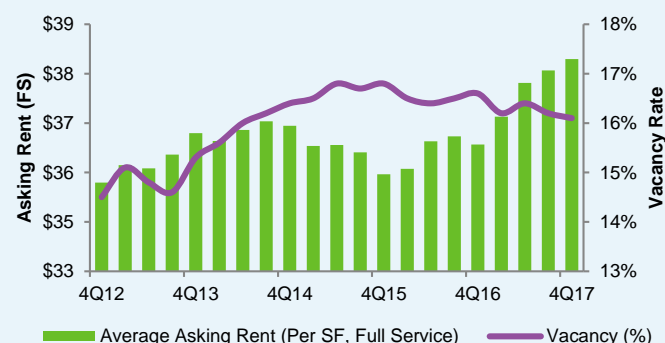
The Class A market experienced a significant uptick in demand, with 3.4 million square feet of absorption in 2017 versus 679,460 square feet in 2016. Tenant preference for new, quality space is evident. As a result of strong demand, the region's Class A vacancy rate declined 100 basis points over the year and ended 2017 at 15.9%. With the uptick in demand and the delivery of 2.4 million square feet of new Class A space over the past year, Class A asking rents metro-wide rose 4.4% over the past 12 months to \$42.36/SF. While these numbers point to a strong Class A market across the region, there are pockets where Class A assets are performing significantly better. The District of Columbia, Northern Virginia, and Suburban Maryland absorbed 1.6 million square feet, 1.2 million square feet, and 567,389 square feet of Class A space, respectively. Across all substate areas, trophy and "Class A-plus" office space have continued to outperform commodity Class A space.

#### Current Conditions

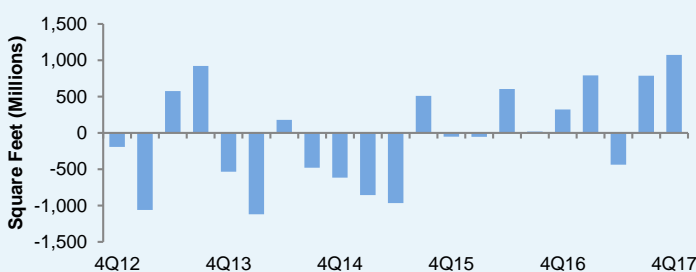
- The region absorbed 2.2 million square feet in 2017 and 1.1 million square feet in the fourth quarter alone, with positive absorption across all three substate areas.
- The Class A market saw a significant uptick in demand with 3.4 million square feet of absorption in 2017 versus 679,460 square feet in 2016.
- Asking rents have risen 5.2% over the past 12 months, reflecting the introduction of renovated and new 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)	364.1 M	363.0 M	363.2 M	↑
Vacancy Rate	16.1%	16.2%	16.6%	↑
Quarterly Net Absorption (SF)	1.1 M	788,727	324,116	↓
Average Asking Rent (Per SF, Full Service)	\$38.12	\$37.87	\$36.25	↑
Under Construction (SF)	8.5 M	7.4 M	7.1 M	↑
YTD Deliveries (SF)	2.4 M	1.4 M	2.2 M	↑



## WASHINGTON METROPOLITAN AREA 4Q17 ECONOMY AND OFFICE MARKET OUTLOOK

### Washington Area Economic Outlook

Washington area job growth and the Washington Leading and Coincident Indices peaked at mid-year, suggesting that the regional economy is moderating. The economy will likely continue to add jobs but at a slower pace because of interest rate hikes anticipated for the next two years; pending Congressional decisions on the budget for fiscal year 2018 that are likely to impact domestic spending; and the passage of *The Tax Cuts and Jobs Act*, whose changes regarding the treatment of S-Corporations will positively impact the commercial real estate community. It is the consensus of economists that the next national economic downturn will take place in late 2018 or 2019. With that in mind, and after consulting with Dr. Stephen Fuller of George Mason University, Newmark Knight Frank forecasts job growth of 41,900 positions per annum over the five-year period from 2017 to 2021, slightly below the 20-year average of 44,200 jobs per annum. The Professional and Business Services sector is expected to be the leading job growth sector over the next five years.

### Office Market Outlook

Over the next 12 months, the market faces several headwinds to demand and absorption:

- Developers continue to build new assets in Northern Virginia, Suburban Maryland and the District despite vacancy rates that remain stubbornly elevated, in part because of the under-demolished state of the region's obsolete office stock. While catering to the demand for highly amenitized, transit-oriented space, these new properties may need to offer higher concessions to attract tenants. This will place downward pressure on commodity Class A effective rents, as those properties struggle to compete in an environment of limited demand. Clean Class B space, at a relative bargain price, will remain in high demand.
- While the densification trend appears to have peaked, it is not yet over, and many new leases signed over the next several years will still translate into smaller footprints than were previously occupied.

- The Trump administration has been vocal about its desire to scale back the size of the federal government through attrition, with exceptions for military, public safety and public health organizations. This may reduce public sector demand for office space or shift demand to private sector contractors employed in maintaining the government's operations.
- While an increase in defense spending could benefit the region, particularly Northern Virginia, it may take a few years before that spending increase translates to greater net absorption, as most contractors do not lease space until a contract is awarded.
- Moderating regional job growth, issues of affordability and demographic shifts are seeing millennials less inclined to settle in the Washington metro area. The region is faced with persistent outmigration of this demographic cohort.

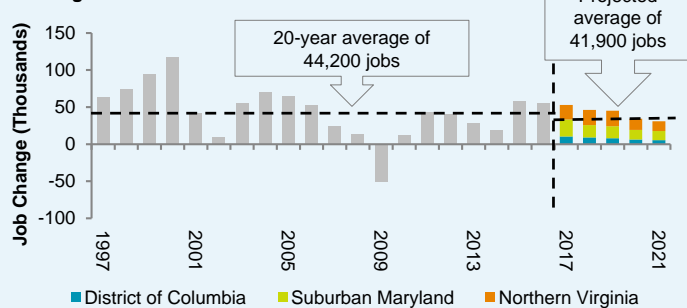
However, the market is experiencing or will experience some tailwinds:

- While densification remains a factor, it has begun to plateau, with major tenants such as 2U Inc., Nestle and Capital One either relocating to the area or expanding, particularly in Northern Virginia.
- Washington-area job growth in the Professional and Business Services sector has continued to represent an increasing share of job growth, accounting for 28.7% of the total jobs added in the 12 months ending October 2017. Since these are high-paying jobs that contribute to office demand, this bodes well for continued growth in the region's office market. In the 12 months ending October 2017, office-using sectors comprised a 35.6% share of the total jobs added in the region.

For additional information on the District of Columbia, Suburban Maryland and Northern Virginia office markets, please visit NKF's website: [Washington, DC Market Reports](#).

### Payroll Job Growth Forecast

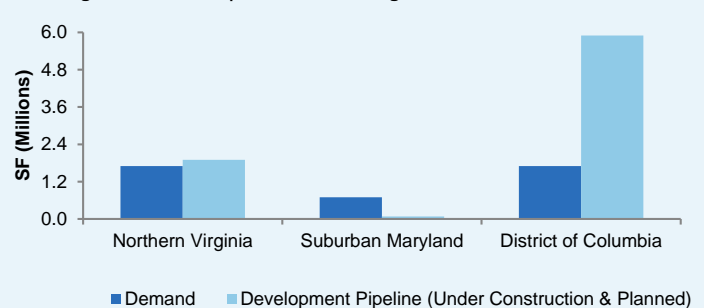
Washington Metro Area



Source: Dr. Stephen Fuller, U.S. Bureau of Labor Statistics, NKF Research; December 2017

### Supply/Demand Forecast

Washington Metro Area | 24 Months Ending December 2019



Source: NKF Research; December 2017

## DISTRICT OF COLUMBIA 4Q17 OFFICE MARKET

### DISTRICT DEMAND STRONG WITH BANNER FOURTH QUARTER PERFORMANCE

The District of Columbia ended 2017 on a positive note with 800,623 square feet of annual net absorption, its second-strongest performance of the last five years. Annual absorption was bolstered by strong fourth-quarter figures, as 463,590 square feet was absorbed. Absorption was concentrated in the NoMa, Southwest and West End submarkets and was partly attributable to tenants relocating their headquarters from the suburbs. The uptick in fourth quarter demand compared with the relatively tepid performance of the first three quarters of the year saw the vacancy rate decline 50 basis points to 11.2%, from 11.7% one year ago, while asking rental rates rose 3.9% from last year, to \$54.83/SF. Core submarkets such as the CBD and East End – as well as Capitol Hill – continue to command the highest rents in the District. Effective rents remain under downward pressure due to a substantial development pipeline yet continue to increase with the delivery of newer product.

#### District of Columbia Outlook

The District of Columbia is a tenant's market and will continue to favor tenants for the next 12 to 24 months, largely because of densification, a robust development pipeline (with 24 buildings expected to deliver in this timeframe) and GSA consolidations.

The District faces a supply-demand imbalance exacerbated by tenants that have locked in long-term leases to relocate as their current leases approach expiration. These forward-looking leases capitalize on the current tenant's market, prompting landlords to offer sizeable concession packages. Despite high asking rents, effective rents remain under downward pressure, as tenants are being offered free rent and high TI's to incentivize them to move. A flight to quality persists, as tenants are seeking well-located, highly amenitized space. Notwithstanding the competitive nature of the office leasing market in general, well-located trophy and renovated Class B properties have outperformed the market and will likely continue to do so. However, the amount of available and affordable Class B product is declining, as developers work to repurpose these buildings.

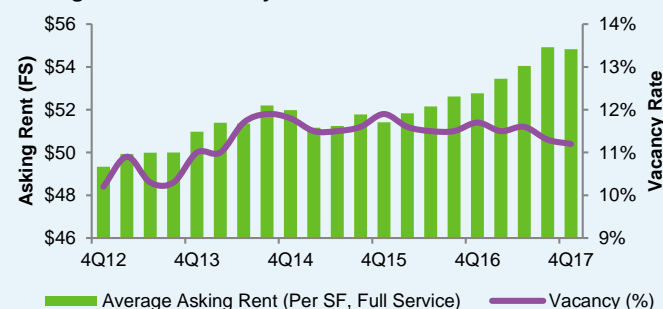
The District offers significant upside potential, with its LEED for Cities Platinum recognition highlighting the high quality of its existing inventory and tech's growing presence in the region, including Yelp's deal for 52,000 square feet at Terrell Place. Additionally, the Washington metro region is considered to have many competitive advantages in Amazon's search for an additional headquarters that place it among the top two or three metro regions competing for HQ2. Please see the Washington metro report for a more detailed discussion.

#### Metro Area Market Summary

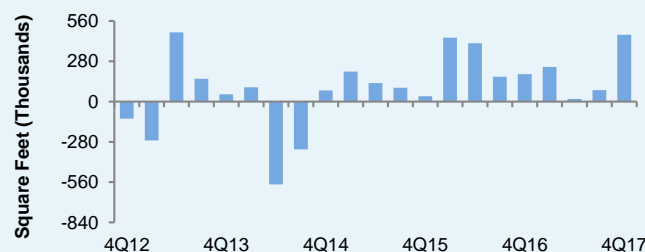
- The District of Columbia closed 2017 with 800,623 square feet of annual net absorption, bolstered by a strong-fourth quarter performance in which 463,590 square feet was absorbed—the strongest quarterly performance since the second quarter of 2013.
- The Class A market recorded 1.6 million square feet of absorption for the year, outpacing the 1.0 million square feet of Class A absorption in 2016.
- The vacancy rate edged down 50 basis points to 11.2%, from 11.7% 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)	124.3 M	124.1 M	124.3 M	↑
Vacancy Rate	11.2%	11.3%	11.7%	↑
Quarterly Net Absorption (SF)	463,590	79,178	190,573	↔
Average Asking Rent (Per SF, Full Service)	\$54.83	\$54.92	\$52.77	↑
Under Construction (SF)	6.1 M	5.3 M	4.2 M	↑
Deliveries (SF)	458,889	0	739,827	↑

## NORTHERN VIRGINIA 4Q17 OFFICE MARKET

### AFTER A SIX-YEAR DROUGHT, MARKET ACHIEVES POSITIVE ANNUAL ABSORPTION

Northern Virginia office market metrics showed remarkable strength in 2017, after six years of weakness:

- Net absorption exceeded 900,000 square feet—the first year of positive absorption since 2010.
- Even with nearly 2.0 million square feet delivered during the year, the overall vacancy rate edged down 20 basis points to 19.8%.
- After trading near \$32/SF for nearly five years, the average asking rent edged up 2.1% during 2017.

#### Northern Virginia Outlook

After six consecutive years of negative absorption, the Northern Virginia office market reached a turning point in 2017, as absorption measured 909,175 square feet. Remarkably, 2017 saw nearly 2.0 million square feet of office space deliver in Northern Virginia, demonstrating the market's appeal. However, with more than 1.5 million square feet of space currently under construction and a substantial future pipeline, the continued success of Northern Virginia's office market will depend on tenants seeking Class A and trophy space in transit-accessible submarkets. Northern Virginia's strong tenant base of defense contractors, cybersecurity players and government clients could stand to benefit from increased defense spending. Separately, Amazon made national headlines earlier in 2017, when the global e-commerce giant announced its search for a second U.S. headquarters. The Washington metro region is considered to have many competitive advantages in Amazon's search, placing it among the top two or three metro regions competing for Amazon's HQ2.

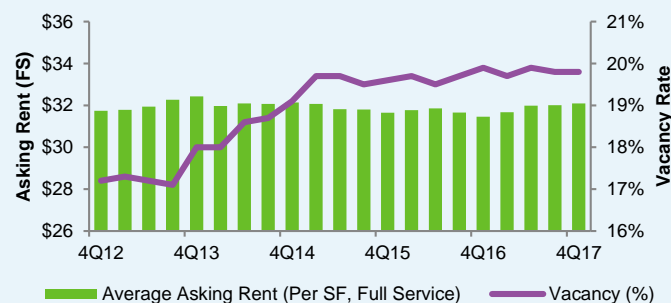
With nearly 1.0 million square feet of net annual absorption, the Northern Virginia office market outperformed expectations in 2017. Overall vacancy remained stable, and asking rents rose slightly through 2017, both signs that Northern Virginia's office market is gaining momentum as it moves into 2018. While Northern Virginia's office market remains tenant-favored, there has been a notable decline in the availability of large blocks of space throughout Northern Virginia. Trophy space located in transit-oriented submarkets like Tysons, the Rosslyn-Ballston Corridor and Reston will continue to command top-level rents through 2018. Conditions in these submarkets will continue to tighten, as the available product evolves with the introduction of more mixed-use development.

#### Metro Area Market Summary

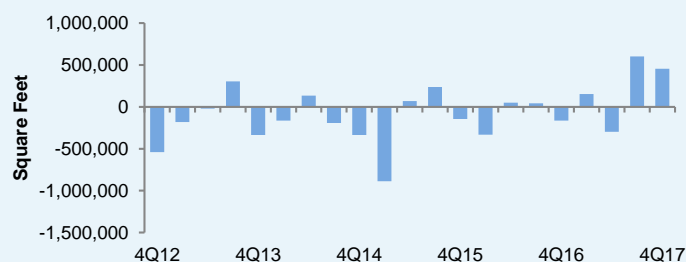
- Net absorption in Northern Virginia measured 455,959 square feet during the fourth quarter of 2017 and 909,175 square feet for the entire year.
- Central Place, a 552,781-square-foot office tower, delivered during the fourth quarter of 2017.
- Both vacancy and asking rents remained stable during fourth-quarter 2017 and have changed little over the past three years.

#### Market Analysis

##### Asking Rent and Vacancy Rate



##### Net Absorption



#### Market Summary

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	165.3 M	164.5 M	164.1 M	↑
Vacancy Rate	19.8%	19.8%	20.0%	↑
Quarterly Net Absorption (SF)	455,959	602,155	-163,379	↓
Average Asking Rent (Per SF, Full Service)	\$32.09	\$32.01	\$31.41	↔
Under Construction (SF)	1.5 M	2.1 M	3.0 M	↓
Deliveries (SF)	552,781	1.3 M	0	↑

## SUBURBAN MARYLAND 4Q17 OFFICE MARKET

### OFFICE MARKET METRICS SHOW STRENGTH IN 2017

The Suburban Maryland office market was strong in 2017, with 506,659 square feet of annual net absorption—the best showing in five years. The vacancy rate dropped 100 basis points from one year ago to 16.2%, while asking rental rates rose 2.3% from last year to \$27.40/SF. Class A fundamentals were also strong during 2017, recording 567,389 square feet of absorption, as the market continued to show a preference for quality.

#### Class A Office Market Outperforms in 2017

Suburban Maryland's Class A office market metrics indicated a continued flight to quality in 2017, with strong annual absorption—567,389 square feet compared with 117,640 square feet in 2016. The Class A market has rebounded from the major hit caused by GSA consolidation in 2016, as the vacancy rate ended 2017 at 17.3%, down 170 basis points year-over-year. Class A asking rates increased by 3.7% from last year to \$29.58/SF. Tenant flight to quality improves the chances that these trends will continue into 2018. Developers have responded by moving forward with plans for new Class A development. The Bethesda-Chevy Chase submarket alone has four mixed-use developments planned that will deliver nearly 1.9 million square feet of new Class A/trophy office space to the market.

#### Suburban Maryland Outlook

Office fundamentals in Suburban Maryland will remain consistent with recent performance as supported by a limited pipeline. However, construction will experience an uptick over the next several quarters, especially in transit-oriented submarkets like Landover/Lanham/Largo and Bethesda, as several projects are expected to break ground in the next 12 to 24 months. Tenant preference for high-quality Class A office space may be met with as much as 1.9 million square feet of Class A office space just in the Bethesda-Chevy Chase submarket, as plans move through the approval process. This level of new development will be transformational for the Suburban Maryland office market.

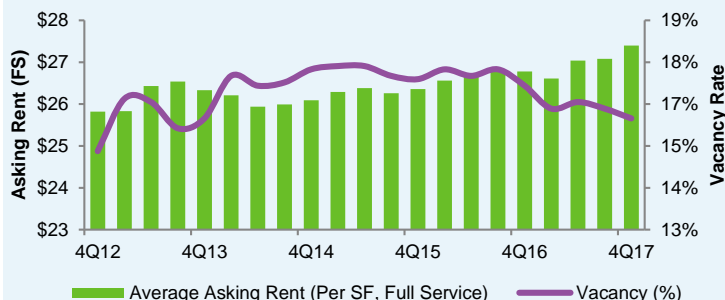
The passage of *The Tax Cuts and Jobs Act* on December 20, 2017, and the repeal of the Affordable Care Act (ACA) individual mandate could significantly affect healthcare-related agencies located in Suburban Maryland. Suburban Maryland's biotechnology corridor, which is home to more than 370 bioscience companies, may benefit from the new administration's emphasis on healthcare reform. Additionally, the tax bill rewrite provides major benefits to REITs, which may spur increased real estate investment.

#### Metro Area Market Summary

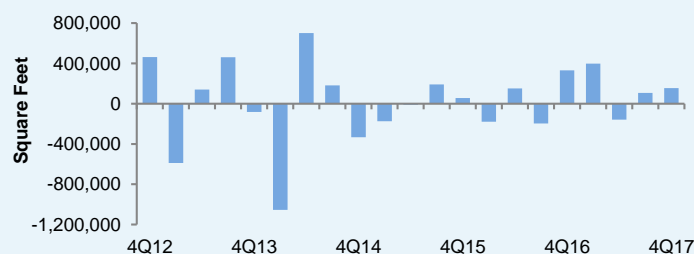
- Suburban Maryland closed 2017 with 506,659 square feet of annual net absorption, including a strong fourth-quarter 2017 that registered 155,031 square feet of absorption.
- The Class A market recorded 567,389 square feet of absorption in 2017, surpassing 2016's Class A figure, which saw 117,640 square feet of absorption.
- The vacancy rate declined 100 basis points over the year to 16.2%.

#### 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	74.4 M	74.8 M	↑
Vacancy Rate	16.2%	16.5%	17.2%	↔
Quarterly Net Absorption (SF)	155,031	107,394	331,672	↔
Average Asking Rent (Per SF, Full Service)	\$27.40	\$27.08	\$26.78	↑
Under Construction (SF)	890,000	75,000	0	↑
Deliveries (SF)	0	0	0	↑



# WASHINGTON METROPOLITAN AREA

## 4Q17 ECONOMY AND OFFICE MARKET OUTLOOK

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### Sub-state Statistics – Vacancy & Absorption

	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2014 Absorption (SF)	2015 Absorption (SF)	2016 Absorption (SF)	4Q 2017 Absorption (SF)	YTD 2017 Absorption (SF)
DC - District of Columbia	124,319,646	10.3%	11.2%	-731,779	468,789	1,221,885	463,590	800,623
MD - Maryland – Suburban	74,450,603	15.6%	16.2%	-506,293	62,309	217,859	155,031	506,659
VA - Virginia – Northern	165,286,533	19.1%	19.8%	-787,728	-1,891,331	-435,927	455,959	909,175
<b>Washington Metro Area</b>	<b>364,056,782</b>	<b>15.4%</b>	<b>16.1%</b>	<b>-2,025,800</b>	<b>-1,360,233</b>	<b>1,003,817</b>	<b>1,074,580</b>	<b>2,216,457</b>
	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2014 Absorption (SF)	2015 Absorption (SF)	2016 Absorption (SF)	4Q 2017 Absorption (SF)	YTD 2017 Absorption (SF)
Class A	215,774,500	15.1%	15.9%	229,875	-1,359,104	679,460	1,291,082	3,445,750
Class B	109,756,167	15.7%	16.4%	-2,036,847	66,653	735,769	-207,901	-498,443
Class C	38,526,115	16.3%	16.6%	-218,828	-67,782	-411,412	-8,601	-730,850
<b>Washington Metro Area</b>	<b>364,056,782</b>	<b>15.4%</b>	<b>16.1%</b>	<b>-2,025,800</b>	<b>-1,360,233</b>	<b>1,003,817</b>	<b>1,074,580</b>	<b>2,216,457</b>

### Sub-state Statistics – Rents & Development

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	4Q 2017 Deliveries (SF)	YTD 2017 Deliveries (SF)	Under Construction (SF)
DC - District of Columbia	124,319,646	\$57.93	\$48.79	\$54.83	458,889	458,889	6,113,668
MD - Maryland – Suburban	74,450,603	\$29.58	\$25.44	\$27.40	0	0	890,000
VA - Virginia – Northern	165,286,533	\$34.66	\$29.80	\$32.09	552,781	1,933,461	1,542,406
<b>Washington Metro Area</b>	<b>364,056,782</b>	<b>\$42.36</b>	<b>\$34.02</b>	<b>\$38.12</b>	<b>1,011,670</b>	<b>2,392,350</b>	<b>8,546,074</b>
	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	4Q 2017 Deliveries (SF)	YTD 2017 Deliveries (SF)	Under Construction (SF)
Class A	215,774,500	\$42.36	NA	\$42.36	1,011,670	2,392,350	8,493,074
Class B	109,756,167	NA	\$34.02	\$34.02	0	0	53,000
Class C	38,526,115	NA	NA	\$28.79	0	0	0
<b>Washington Metro Area</b>	<b>364,056,782</b>	<b>\$42.36</b>	<b>\$34.02</b>	<b>\$38.12</b>	<b>1,011,670</b>	<b>2,392,350</b>	<b>8,546,074</b>

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

## WASHINGTON METROPOLITAN AREA 4Q17 CAPITAL MARKETS

### 2017 SALES VOLUME OUTPERFORMS 2016, LED BY STRONG FIRST-QUARTER PERFORMANCE

The Washington region registered \$1.4 billion in office sales transaction volume during the fourth quarter of 2017 through November, bringing year-to-date transaction volume to \$7.3 billion. This represented a year-over-year increase of 14.1% from sales of \$6.4 billion in 2016. Pricing also increased by 16.6% from one year ago, to \$386/SF. The carryover of deals from fourth-quarter 2016 that did not close by year-end more than likely thrust first-quarter regional volume to the highest quarterly figure recorded during the last five-year period—a robust \$2.9 billion in sales.

Of the 66 sales transactions that occurred this year, 86.4% were for District of Columbia and Northern Virginia assets. The District led the region with the highest annual sales volume at \$4.3 billion, followed by Northern Virginia at \$2.6 billion and Suburban Maryland at \$488.6 million. There is a growing sense among investors that in terms of volume, the market peak was 2015. Yet core and trophy assets continue to set pricing records in the Washington market, and cap rates continue to surprise most observers, as they remain low in spite of recent interest rate hikes.

#### Office Investment Sales Outlook

The strong sales performance in the first quarter of the year pushed annual sales volume upwards, exceeding last year's total. Expect Washington-area investment sales to decrease slightly from their current pace of volume and pricing in 2018. However, Newmark Knight Frank expects investment sales in the Washington region will remain strong for three reasons:

1. Investors continue to seek the safety of a primary market like Washington during the mature phase of the cycle.
2. Commercial real estate represents a superior alternative to other forms of available investments, even if additional interest rate increases will likely give some buyers pause.
3. With a lack of other attractive investment options, investors, especially foreign investors, continue to target Washington.

#### Metro Area Market Summary

	Metro Region
4Q 2017 Transaction Volume*	\$1.4 B
2017 Transaction Volume*	\$7.3 B
2017 Average Price PSF*	\$386
2017 Average Cap Rate*	6.6%

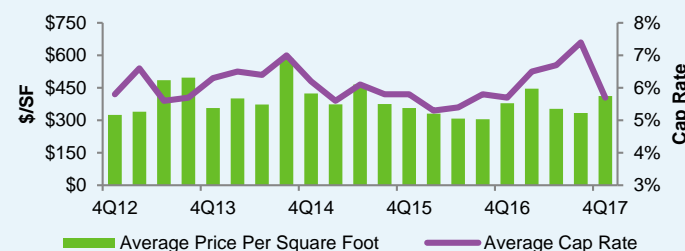
\*Data through November

Source: Real Capital Analytics, NKF Research; as of December 13, 2017

#### Market Analysis

##### Average Cap Rate and Price Per Square Foot

Office Sales

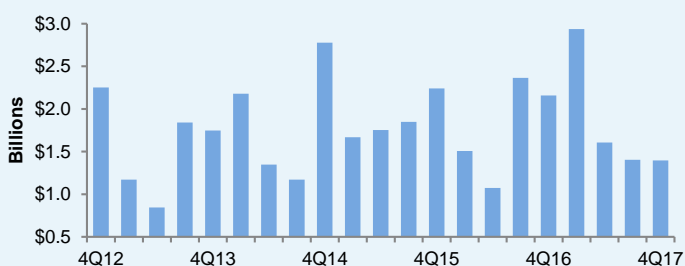


\*Data through November

Source: Real Capital Analytics, NKF Research; as of December 13, 2017

##### Quarterly Transaction Volume

Office Sales



\*data through November

Source: Real Capital Analytics, NKF Research; as of December 13, 2017

#### Major 4Q17 Sales Transactions

Address	Sale Price	Price/SF	Sub-state
1800 M Street NW	\$421.0 M	\$725	District of Columbia
7101 Wisconsin Avenue	\$105.7 M	\$458	Suburban Maryland
7900 Harkins Road	\$82.0 M	\$265	Suburban Maryland
4075 Wilson Boulevard	\$72.0 M	\$403	Northern Virginia

## 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, DC**

1899 Pennsylvania Avenue NW  
Suite 300  
Washington, DC 20006  
202.331.7000

**TYSONS**

1410 Spring Hill Road  
Suite 600  
McLean, VA 22102  
703.448.2000

**Gregory H. Leisch, CRE**

Senior Managing Director  
202.312.5745  
gleisch@ngkf.com

**Alexander (Sandy) Paul, CRE, LAI**

Senior Managing Director  
202.312.5783  
apaul@ngkf.com

**Bethany Schneider**

Research Manager  
202.664.5898  
bschneider@ngkf.com

**Natasha Flores**

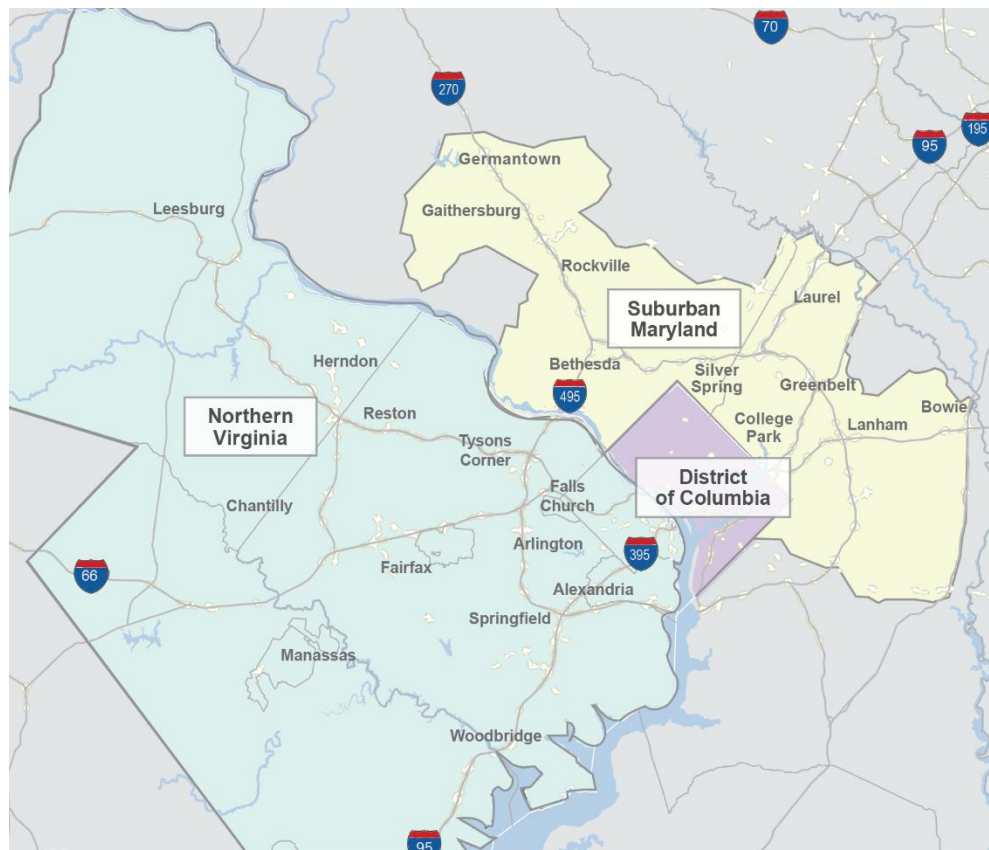
Senior Research Analyst  
202.664.5902  
natasha.flores@ngkf.com

**Nick Schlanger**

Senior Research Analyst  
202.312.5757  
nick.schlanger@ngkf.com

**Alex Shirokow-Louden**

Research Analyst  
202.312.5763  
alex.shirokow-louden@ngkf.com

**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.

**Newmark Knight Frank has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents.**

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