

WASHINGTON METRO AREA ECONOMY AND OFFICE MARKET

REGIONAL OFFICE MARKET AND ECONOMY REMAIN ON STEADY GROWTH PATH

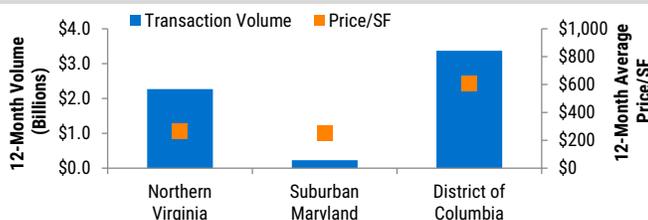
The Washington metro area economy continued to grow during the fourth quarter of 2018. For the 12 months ending in October 2018, the region added 60,700 jobs, well above the metro area's 20-year average growth of 43,300 jobs per annum. The October figure continues a slight moderation in job growth since the summer that is likely to continue into the new year. However, signs point to a sturdy regional economy, and steady growth is expected to continue into 2019.

Office demand in the Washington metro area also held steady through fourth-quarter 2018, although absorption across the sub-state areas was uneven. The region registered 481,797 square feet of positive net absorption during the quarter. Positive net absorption of 348,582 square feet in Northern Virginia and 168,759 square feet in Suburban Maryland was slightly tempered by negative net absorption of 35,544 square feet in the District of Columbia. Large spaces in Northern Virginia and Suburban Maryland were occupied by tenants such as General Dynamics and the state of Maryland, which contributed to positive demand in those jurisdictions. For the year, net absorption for the region was positive 2.6 million square feet. At 16.1%, the region's overall vacancy rate declined 10 basis points over the quarter and is 30 basis points lower than the vacancy recorded one year ago.

The Washington region registered \$5.9 billion in office sales transaction volume in 2018. Transaction volume is down from 2017, when volume measured \$8.0 billion. Inventory remains low, resulting in near-record per square foot prices, as transactions across the metro area averaged \$419/SF in 2018. Meanwhile, region-wide cap rates averaged 6.3% in 2018.

CAPITAL MARKETS

Office Investment Sales Volume and Price/SF 2018



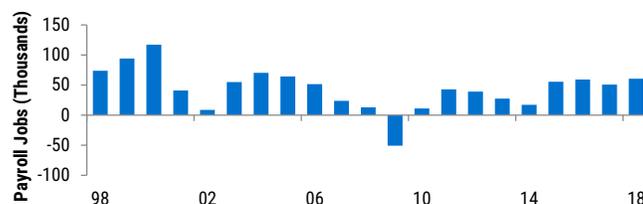
Source: Real Capital Analytics, NKF Research; December 2018

ECONOMY

- **Historical Job Change:** 60,700 jobs were added in the 12 months ending October 2018, versus 43,700 per annum for the past 20 years.
- **Projected Job Growth:** NKF forecasts an average increase of 41,100 jobs per annum from 2018 through 2022.
- **Unemployment Rate:** 3.2% in October 2018, down 30 basis points from October 2017.

Source: Dr. Stephen Fuller, U.S. Bureau of Labor Statistics, NKF Research; December 2018

Washington Metro Payroll Job Change

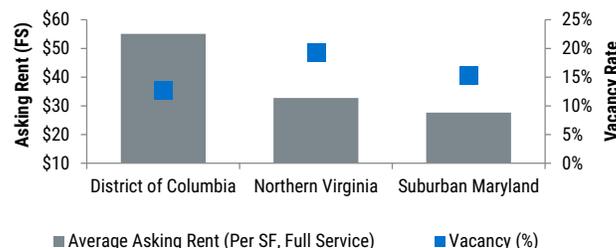


Note: Totals reflect annual average net change, except 2018, which reflects change for the 12 months ending October 2018

Source: U.S. Bureau of Labor Statistics, NKF Research; December 2018

MARKET ANALYSIS

Asking Rent and Vacancy Rate



MARKET SUMMARY

	District of Columbia	Northern Virginia	Suburban Maryland	Metro Region
Total Inventory (SF)	126.9 M	164.7 M	74.1 M	365.7 M
Vacancy Rate	12.7%	19.2%	15.3%	16.1%
Quarterly Net Absorption (SF)	-35,544	348,582	168,759	481,797
Average Asking Rent (Per SF, Full Service)	\$55.08	\$32.72	\$27.63	\$38.46
Under Construction (SF)	3.5 M	2.1 M	2.3 M	8.0 M
YTD Deliveries (SF)	2.6 M	801,802	75,000	3.5 M

Note: Totals may not sum due to rounding

AMAZON HQ TO BE BOON FOR REGION

Amazon's arrival in Northern Virginia will provide a boost to the office market in National Landing, a newly-dubbed area that includes Crystal City, Pentagon City and North Potomac Yard in Alexandria. Amazon expects to fill 400 jobs in 2019, followed by 1,180 in 2020. By 2030, that number should be a minimum of 25,000 in total, with the potential to expand to 37,850 by 2034.

Amazon's presence is likely to attract other like-minded companies and to further reduce the dependence of the area's economy on the federal government while activating the multihousing and retail sectors. It also may accelerate the redevelopment of obsolete office assets.

One reason Amazon decided to locate a portion of HQ2 in Northern Virginia was the area's formal commitment to expanding its higher education programs. Virginia Tech's \$1.0 billion investment in a new Innovation Campus proximate to HQ2 – supported in part by additional funds from the Commonwealth of Virginia – will benefit not only Amazon but also the region's workforce and other employers in the long term. Additionally, George Mason University is committing \$250.0 million to a new digital innovation program that will assist in the creation of a talent pipeline for the next generation.

The national and public nature of Amazon's search and the status that the region, particularly Crystal City, enjoyed as a frontrunner for the massive project has earned the region an enormous amount of free publicity. The press has highlighted Crystal City and National Landing for their proximity to the nation's capital, accessibility via road and transit, and supply of office space. This positive press benefits the entire Washington region and has a chance to resonate beyond Amazon's decision. If Amazon is able to find a suitable workforce and culture in the Washington region—undoubtedly hiring some of its workers from the District of Columbia and Maryland as well as Virginia—then so can other tech firms and large companies in other talent-starved industries.

REGIONAL ECONOMY CONTINUES TO DIVERSIFY

Washington has long been known as a government town: As recently as 2010, the federal government accounted for nearly 40.0% of the regional economy. By 2017, however, this figure was down to approximately 31.0%. Many large companies are finding they need to establish a presence on the East Coast. This is particularly true of tech companies, which are finding it increasingly necessary to establish bases near Capitol Hill for lobbying purposes.

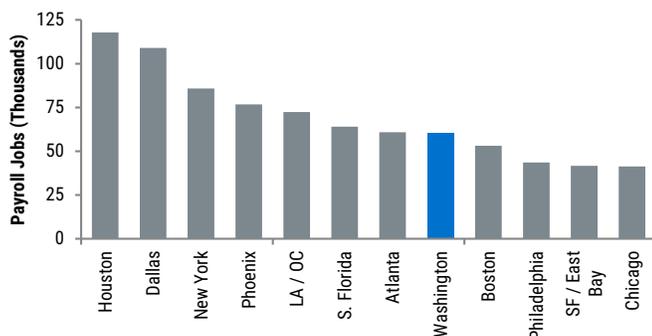
With the economy diversifying at a rapid rate, momentum in the region has been accelerating in recent years with large companies such as Nestle, Hilton, Northrop Grumman and Volkswagen all moving major operations to the area in a search for access to a highly educated workforce. Additional relocations to the region from the private sector could provide a safeguard against some of the challenges that the regional economy has had to endure, most notably federal budget austerity measures—a major issue for an area so reliant on the federal government for so long.

COWORKING MORE THAN A TREND

The coworking and flexible office trend has grown rapidly over the past several years and has become a major focus of the commercial real estate industry in cities nationwide. Whether pure coworking, executive office suites or flexible office, tenants have responded to this office space model in a way that will not be undone. Many tenants are finding coworking and flexible office space to be viable options for their businesses, as those tenants collaborate with their brokers to identify a tipping point between the rent premium charged for coworking or flexible office space and the additional flexibility those formats provide via shorter lease terms. The model for office use has been changed, largely to the benefit of the U.S. office market thus far, as operators have taken a large amount of vacant space off the market during this cycle. For more on this topic, and an assessment of five potential paths for the coworking segment of the U.S. office market, please see our new white paper, which is available on the Thought Leadership section of our website at ngkf.com.

PAYROLL JOB CHANGE – LARGEST METRO AREAS

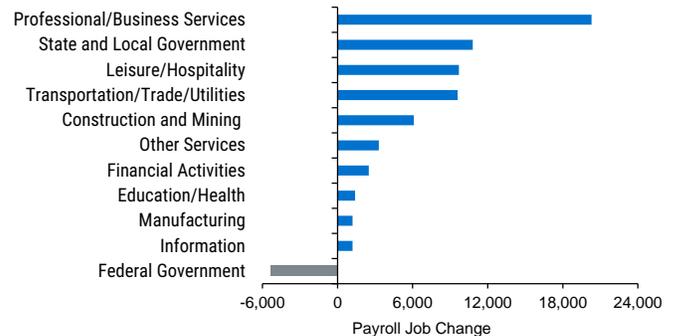
12 Months Ending October 2018



Source: U.S. Bureau of Labor Statistics, NKF Research; December 2018

JOB CHANGE BY INDUSTRY

Washington Metro Area | 12 Months Ending October 2018



Source: U.S. Bureau of Labor Statistics, NKF Research; December 2018

REGIONAL DEMAND REMAINS STEADY

Demand in the Washington area office market moderated during the fourth quarter of 2018, with absorption in the suburbs outpacing demand in the District. The region registered 481,797 square feet of net absorption during the quarter. Positive net absorption of 348,582 square feet in Northern Virginia and 168,759 square feet in Suburban Maryland was slightly tempered by negative net absorption of 35,544 square feet in the District of Columbia. In Northern Virginia, large moves by General Dynamics and American Institutes for Research contributed to positive demand. For 2018, net absorption for the region registered 2.6 million square feet—the highest annual total since 2010.

Region-wide, five projects delivered in the Washington metro area during the fourth quarter. The largest completed project during the quarter was One Freedom Plaza, a 286,850-square-foot property in the East End submarket, which was 73% leased at completion. The second largest project to deliver was 500 L'Enfant Plaza SW, a 215,000-square-foot building in the Southwest submarket. The property delivered 70% preleased. The Washington area has a significant development pipeline with 8.0 million square feet of new product under construction. The Wharf, in the Southwest submarket, and The Yards, in the Capitol Riverfront submarket—two of the region's largest developments—are set to break ground on second phases in 2019. Each has secured an anchor tenant to kick-start office construction as part of the larger mixed-use projects.

At 16.1%, the region's overall vacancy rate declined 10 basis points compared to the third quarter and 30 basis points compared to one year ago. Weighted average asking rents increased 0.8% over the past 12 months to \$38.46 per square foot. This is largely the result of the outsized impact of new core product and renovated assets being delivered to the market. Effective rents, on the other hand, remain under downward pressure, as incentives—especially tenant improvement allowances—remain near cyclical highs.

CLASS A MARKET DOMINATES ABSORPTION IN 2018 AS FLIGHT TO QUALITY PERSISTS

During the fourth quarter, the region's Class A market registered positive 178,920 square feet of net absorption, as demand of negative 233,760 square feet in the District was outpaced by positive 259,899 square feet in Northern Virginia and positive 152,781 square feet in Suburban Maryland. Tenant preference for new, quality space is evident, as much of the Class A space that was returned to market this quarter was in the commodity Class A category. The Class A vacancy rate mirrors the broader market at 16.1%, which is even with one year ago. Class A rents averaged \$42.19/SF metro-wide during the fourth quarter.

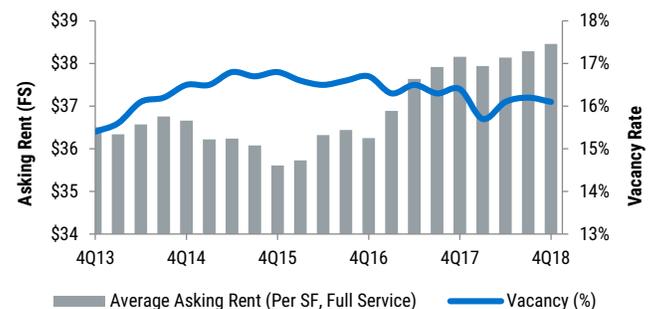
While the Class A market across the region remains sturdy, there are pockets where Class A assets are significantly outperforming. Across all sub-state areas, trophy and Class A+ properties have continued to outperform commodity Class A space. In fact, on a net basis for all of 2018, the Class A market captured more than 100% of all net new demand; Class B and C assets experienced slightly negative net absorption.

CURRENT CONDITIONS

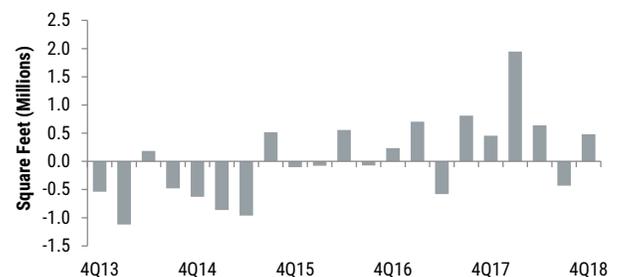
- The region registered 481,797 square feet of net absorption during the fourth quarter, with positive demand in the suburbs outweighing negative demand in the District.
- The Class A market mirrored the overall market during the quarter, registering net absorption of positive 178,920 square feet.
- Asking rents have risen 0.8% 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)	365.7 M	365.2 M	363.6 M	↑
Vacancy Rate	16.1%	16.2%	16.4%	↑
Quarterly Net Absorption (SF)	481,797	-429,980	453,818	↑
Average Asking Rent (Per SF, Full Service)	\$38.46	\$38.29	\$38.16	↑
Under Construction (SF)	8.0 M	8.3 M	8.6 M	↓
YTD Deliveries (SF)	3.5 M	2.8 M	2.5 M	↓

WASHINGTON AREA ECONOMIC OUTLOOK

For the 12 months ending in October 2018, the region added 60,700 jobs, well above the metro area's 20-year average job growth of 43,300 jobs per annum. The October figure continues a slight moderation since the summer that is likely to continue into the new year. However, signs point to a sturdy regional economy and steady growth is expected to continue into 2019.

The Washington Leading Index maintained its positive trajectory through the first half of 2018, suggesting that the regional economy still has room to run, but it has been decelerating recently. As the economic cycle enters its mature phase, Washington will likely continue to add jobs, although at a decelerating rate of growth. In consultation with Dr. Stephen Fuller of George Mason University, Newmark Knight Frank forecasts job growth of 41,100 positions per annum over the five-year period from 2018 to 2022, slightly below the region's 20-year average of 43,700 jobs per annum.

OFFICE MARKET OUTLOOK

Over the next 12 months, the market faces several headwinds to demand and absorption, limiting rent growth for investors:

- Tenants maintain leverage in an already competitive office market, with some asset owners offering sizeable concession packages to help backfill space. This puts downward pressure on commodity Class A effective rents, as those properties struggle to compete in an environment of limited demand. High-quality Class B space at a relatively bargain price will remain in demand.
- Densification within the Washington area office market appears to be at or near its peak for most industries. As employers continue to place ever greater emphasis on attracting and retaining top talent, the benefit of cutting costs by reducing the square footage occupied per worker is often outweighed by the loss of productivity within the workplace. However, while densification in most industries begins to plateau, consolidations and downsizing in the legal sector persist, and their effect on the District's office market is significant.

- Issues of affordability and demographic shifts are seeing millennials less inclined to settle in the Washington metro area. The region faces persistent outmigration of this demographic cohort, although older millennials continue to move into the region on a net basis.
- The construction pipeline remains robust. Our two year forecast projects new supply will outpace demand in the District of Columbia and Suburban Maryland. However, the reverse will be true in Northern Virginia. For the Washington Metro Area as a whole, this supply/demand mismatch will lead to a 30-basis-point uptick in vacancy over the next 24 months to 16.4%.

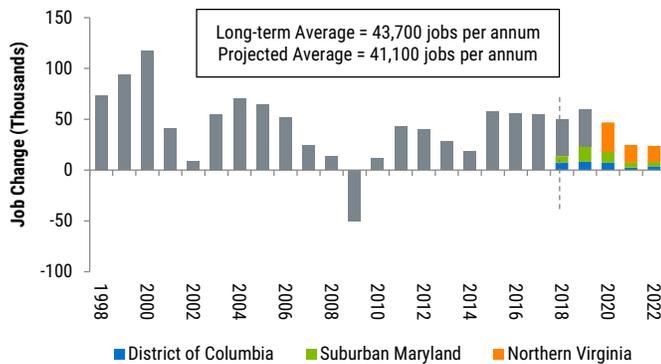
However, the market is experiencing or will experience some significant tailwinds:

- The federal budget passed in March 2018 includes a significant uptick in defense spending. Greater activity among government contractors is likely to increase absorption and reduce vacancy in submarkets that have a high concentration of defense contractors, notably Tysons, Reston and parts of Arlington. Asset owners have begun to plan for this demand by building larger spec suites in these submarkets.
- Amazon's decision to locate half of it's HQ2 in Northern Virginia will add more than 25,000 jobs to the region by 2030, with the possibility of further expansion. Notably, ancillary jobs added to the region on Amazon's coattails will result from a steady economic multiplier effect in the retail and hospitality sectors.
- With 20,300 jobs added in the 12 months ending October 2018, the Professional and Business Services sector has continued to represent an increasing share of job growth and will be the leading contributor to office demand in the region. The State and Local Government as well as Leisure and Hospitality sectors also accounted for a substantial share of job growth. Jobs within the federal government have been a declining share of the regional employment market.

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

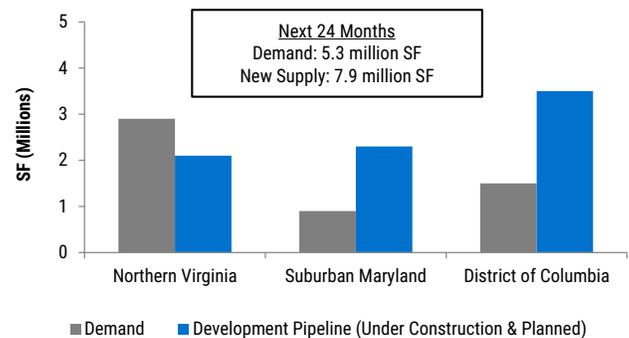
Washington Metro Area



Source: U.S. Bureau of Labor Statistics, Stephen S. Fuller Institute, NKf Research; December 2018

SUPPLY/DEMAND FORECAST

Washington Metro Area | 24 Months Ending December 2020



Source: Stephen S. Fuller Institute, NKf Research; December 2018

DISTRICT OF COLUMBIA MAINTAINS STEADY PERFORMANCE IN 2018

The District of Columbia experienced 632,819 square feet of net absorption in 2018, the second-highest total in the past five years. The vacancy rate rose 130 basis points year-over-year to 12.7%. This increase is largely attributed to significant developments that delivered at the end of 2018, with large tenants scheduled for first-quarter 2019 occupancy.

Two projects totaling 494,150 square feet of office space delivered in fourth-quarter 2018:

- One Freedom Plaza at 1301 Pennsylvania Avenue NW delivered in December, adding 279,150 square feet to the East End submarket. The space is anchored by Kirkland & Ellis, and was 73.3% preleased at completion.
- 500 L'Enfant Plaza SW also delivered in December, bringing 215,000 square feet to the Southwest submarket. It will be anchored by The Urban Institute and was 70.4% pre-leased at completion.

Williams & Connolly signed the largest lease of the quarter, taking 292,000 square feet at 690 Maine Avenue SW. The prominent law firm will serve as the anchor tenant for phase II of The Wharf and will relocate from 725 12th Street NW in 2022.

DISTRICT OF COLUMBIA OUTLOOK

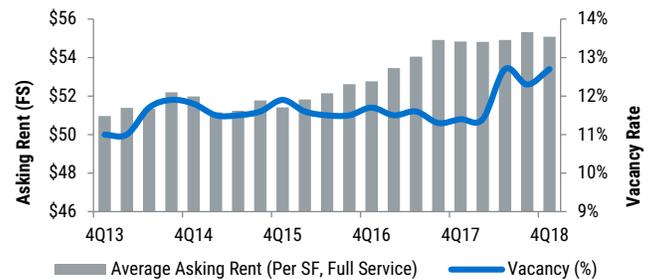
The District of Columbia's office market conditions likely will favor tenants over the next 24 months, largely because of a robust development pipeline—14 buildings, not including renovations, are expected to deliver in this timeframe—and GSA and law firm consolidations. The District faces a supply-demand 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 rising asking rents, effective rents remain under downward pressure, as tenants are being offered significant concession packages to incentivize a move or renewal. The 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 quality Class B properties have outperformed the market in general and will likely continue to do so. However, the amount of available and affordable Class B product is declining at premier locations. Commodity Class A space—mostly buildings that delivered 10 to 15 years ago—is oversupplied; this segment of the market is stressed.

CURRENT CONDITIONS

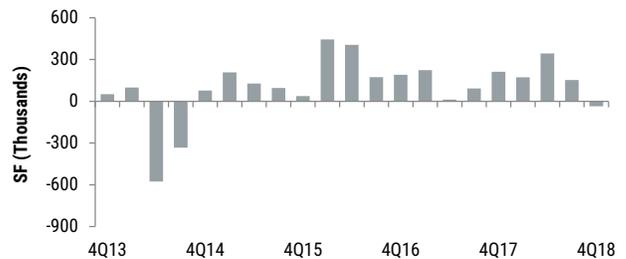
- The District of Columbia closed 2018 with 632,819 square feet of annual net absorption, despite a tepid fourth quarter with negative 35,544 square feet of absorption.
- The Class A market recorded 1.1 million square feet of absorption for the year, compared with 1.5 million square feet of Class A absorption in 2017.
- The vacancy rate rose 130 basis points to 12.7%, from 11.4% 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)	126.9 M	126.5 M	124.3 M	↑
Vacancy Rate	12.7%	12.3%	11.4%	↓
Quarterly Net Absorption (SF)	-35,544	152,556	212,595	↑
Average Asking Rent (Per SF, Full Service)	\$55.08	\$55.32	\$54.83	↑
Under Construction (SF)	3.5 M	4.0 M	6.2 M	↓
Deliveries (SF)	494,150	0	458,899	↑

A POSITIVE FOURTH QUARTER TO END A STURDY YEAR

After posting strong net absorption through the first half of 2018, demand turned negative during the third quarter. However, this was just a blip, as absorption was positive in the fourth quarter. Notable market developments included:

- Net absorption measured 348,582 square feet during the fourth quarter; annual absorption for 2018 measured 1.4 million square feet, a high for this cycle.
- Overall vacancy declined 20 basis points to 19.2% in the fourth-quarter.
- Penrose II, a 125,000-square-foot spec building set to deliver in the second quarter of 2020, began construction during the fourth quarter, with no space preleased.
- Average overall asking rents increased 1.9% from one year ago to \$32.72/SF.

As of fourth-quarter 2018, 2.1 million square feet of office space is under construction in Northern Virginia, excluding renovations. In December, Zumot Real Estate Management broke ground on Penrose II, a 125,000-square-foot building located in the Route 28 South submarket. The spec building will deliver in the second quarter of 2020. JBG Smith began renovations this quarter on 1770 Crystal Drive, which will have 258,000 square feet of office space occupied by Amazon when it delivers in 2020.

Two new office properties delivered in Northern Virginia during the fourth quarter of 2018. 3000 Potomac Avenue, a 100,000-square-foot building in the Crystal City/Pentagon City submarket, was completed in November 2018. The project will be 60% occupied by the owner, National Industries for the Blind, and 40% occupied by Kaiser Permanente. Also delivered in the fourth quarter was 44921 George Washington Boulevard, a 46,002-square-foot speculative building, and the newest addition to the University Commerce Center in Ashburn, with no preleasing at the time of delivery.

NORTHERN VIRGINIA OUTLOOK

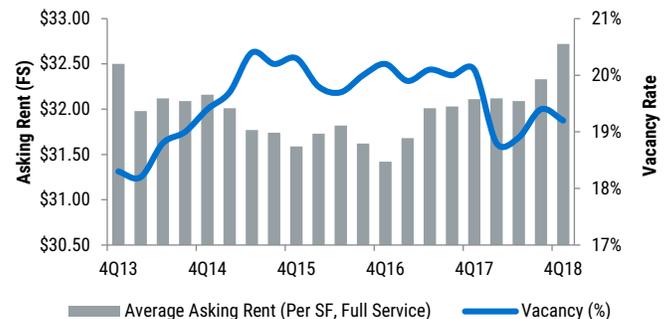
Office deliveries in Northern Virginia will increase in 2019 and 2020, but accelerating demand will bolster rents. Trophy space located in transit-oriented submarkets such as Tysons, the Rosslyn-Ballston Corridor and Reston will continue to command top-level rents over the next several quarters, even with new supply coming to market. Conditions in these submarkets will continue to tighten, as the available product evolves with the introduction of more mixed-use development.

CURRENT CONDITIONS

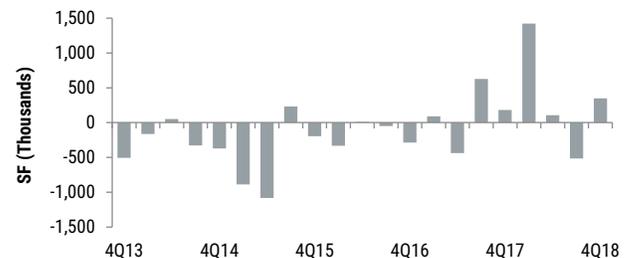
- Northern Virginia's construction pipeline remained greater than 2.0 million square feet at fourth-quarter 2018.
- Amazon signed the largest leases of the quarter, combining for 537,000 square feet across three buildings in Crystal City.
- 3000 Potomac Avenue, a 100,000-square-foot building located within the Crystal City/Pentagon City submarket, delivered during the fourth quarter of 2018. It is fully occupied by Kaiser Permanente and National Industries for the Blind.

MARKET ANALYSIS

Asking Rent and Vacancy Rate



Net Absorption



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	164.7 MSF	164.5 MSF	164.9 MSF	↑
Vacancy Rate	19.2%	19.4%	20.1%	↓
Quarterly Net Absorption (SF)	348,582	-516,149	182,360	↑
Average Asking Rent (Per SF, Full Service)	\$32.72	\$32.33	\$32.11	↑
Under Construction (SF)	2.1 MSF	2.1 MSF	1.3 MSF	↑
Deliveries (SF)	146,002	480,000	702,781	↑

SUBURBAN MARYLAND OFFICE MARKET TIGHTENS

Suburban Maryland's office market tightened in the fourth quarter of 2018 after occupancy declined during the third quarter. Notably:

- Net absorption measured 168,759 square feet in the fourth quarter, bringing the 2018 total absorption to 644,734 square feet.
- The vacancy rate declined 40 basis points to 15.3% during the fourth quarter.
- 909 Rose, a 212,000-square-foot speculative office building, began construction in the fourth quarter and is expected to deliver in the Spring of 2020. It will be part of the Pike & Rose development in North Bethesda.
- Asking rental rates ticked up slightly over the past year from \$27.40/SF to \$27.63/SF.

As of fourth-quarter 2018, 2.3 million square feet of office space is under construction in Suburban Maryland, excluding renovations. In December, Federal Realty Investment Trust broke ground on 909 Rose, a 212,000-square-foot building located in the North Bethesda submarket. Two significant projects are set to deliver in 2019: 4000 Garden City Drive, a 175,000-square-foot building at the New Carrollton Metro Station and 4747 Bethesda Avenue, a 300,000-square-foot building in Bethesda.

One new office property delivered in Suburban Maryland during the fourth quarter of 2018: 5801 University Research Court, a 75,000-square-foot building in the College Park submarket. The state of Maryland will occupy 85% of the project, and Cybrary will occupy the remaining 15%. This building was also the only delivery of 2018. There is currently 2.3 million square feet of office space under construction in the market and the pipeline is approximately 80% preleased.

SUBURBAN MARYLAND OUTLOOK

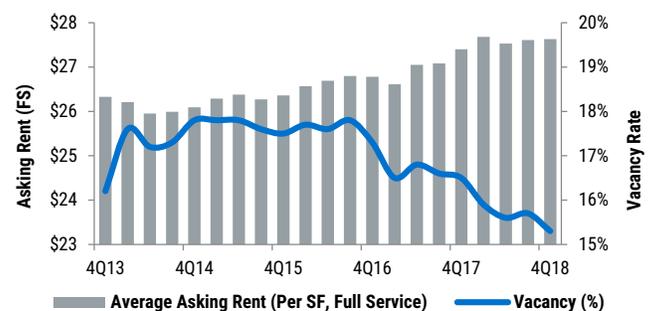
Office fundamentals in Suburban Maryland are likely to tighten in the coming quarters as a large amount of new but preleased office space comes on line. Construction likely will continue at robust levels over the next couple of years, especially around the future Purple Line stations and in other transit-oriented submarkets such as Landover/Lanham/Largo and Bethesda. Tenants' preference for high-quality Class A office space can be met with the 2.3 million square feet of new construction delivering in Suburban Maryland over the next three years. As developers continue to show confidence in the region, Maryland is working to improve its infrastructure and address congestion by adding new transit options, improving existing public transportation and adding express toll lanes on major routes.

CURRENT CONDITIONS

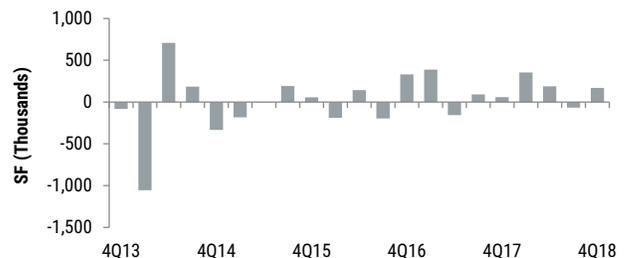
- Suburban Maryland registered 168,759 square feet of absorption during the fourth quarter of 2018.
- The vacancy rate declined 120 basis points from one year ago to 15.3%, the lowest figure since the fourth quarter of 2012.
- Class A market conditions tightened, with 152,781 square feet of absorption and a vacancy rate of 16.3%.

MARKET ANALYSIS

Asking Rent and Vacancy Rate



Net Absorption



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory	74.1 MSF	74.2 MSF	74.3 MSF	↑
Vacancy Rate	15.3%	15.7%	16.5%	↑
Quarterly Net Absorption (SF)	168,759	-66,387	58,863	↑
Average Asking Rent (Per SF, Full Service)	\$27.63	\$27.61	\$27.40	↑
Under Construction (SF)	2.3 MSF	2.2 MSF	1.1 MSF	↑
Deliveries (SF)	75,000	0	0	↑

SUBMARKET STATISTICS – VACANCY AND ABSORPTION

	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2015 Absorption (SF)	2016 Absorption (SF)	2017 Absorption (SF)	4Q 2018 Absorption (SF)	YTD 2018 Absorption (SF)
Washington Metro Area	365,700,416	15.3%	16.1%	-1,410,988	749,629	1,471,311	481,797	2,638,323
District of Columbia	126,859,469	12.0%	12.7%	468,789	1,221,885	541,328	-35,544	632,819
Suburban Maryland	74,100,454	14.7%	15.3%	56,309	198,902	381,758	168,759	644,734
Northern Virginia	164,740,493	18.1%	19.2%	-1,936,086	-671,158	548,225	348,582	1,360,770

	Total Inventory (SF)	Direct Vacancy Rate	Overall Vacancy Rate	2015 Absorption (SF)	2016 Absorption (SF)	2017 Absorption (SF)	4Q 2018 Absorption (SF)	YTD 2018 Absorption (SF)
Washington Metro Area	365,700,416	15.3%	16.1%	-1,410,988	749,629	1,471,311	481,797	2,638,323
Class A	219,414,881	15.1%	16.1%	-1,359,104	543,020	3,058,883	178,920	2,905,654
Class B	108,964,610	16.1%	17.0%	28,090	615,806	-815,856	238,629	-189,572
Class C	37,320,925	14.0%	14.1%	-79,974	-409,197	-771,716	64,248	-77,759

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)	4Q 2018 Deliveries (SF)	YTD 2018 Deliveries (SF)	Under Construction (SF)
Washington Metro Area	365,700,416	\$42.19	\$35.16	\$38.46	715,152	3,522,932	7,966,315
District of Columbia	126,859,469	\$59.02	\$48.76	\$55.08	494,150	2,646,130	3,543,672
Suburban Maryland	74,100,454	\$29.78	\$25.80	\$27.63	75,000	75,000	2,345,767
Northern Virginia	164,740,493	\$34.99	\$30.51	\$32.72	146,002	801,802	2,076,876

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	4Q 2018 Deliveries (SF)	YTD 2018 Deliveries (SF)	Under Construction (SF)
Washington Metro Area	365,700,416	\$42.19	\$35.16	\$38.46	715,152	3,522,932	7,966,315
Class A	219,414,881	\$42.19	NA	\$42.19	669,150	3,476,930	7,886,315
Class B	108,964,610	NA	\$35.16	\$35.16	46,002	46,002	80,000
Class C	37,320,925	NA	NA	\$29.22	0	0	0

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

METRO AREA INVESTMENT SALES VOLUME EDGES DOWN BUT PRICING TICKS HIGHER

The Washington region registered \$5.9 billion in office sales transaction volume in 2018. Transaction volume is down from 2017, when volume measured \$8.0 billion. However, inventory remains low, resulting in near-record per square foot prices; transactions across the metro area averaged \$419/SF in 2018. Meanwhile, region-wide cap rates averaged 6.3% in 2018. The sale of the Presidential Building, located at 1111 Pennsylvania Avenue NW, for \$338.0 million, represented the largest transaction during the quarter. The property, which is located in the East End submarket, sold for \$1,020/SF and was 100% occupied at time of sale. The second largest transaction for the quarter involved The Westbridge Building, located at 2550 M Street NW in the West End submarket, which sold for \$167.0 million, or \$806/SF. The property was 100% occupied at the time of sale.

WASHINGTON MARKET REMAINS APPEALING TO FOREIGN INVESTORS SEEKING STABLE RETURNS

Washington remains an attractive gateway market for foreign capital. Investors remain bullish on the Washington area and continue to place capital here because of the market’s long-term safety and the stability of returns. As was the trend throughout 2017, foreign investors remain especially interested in Washington area office assets. For 2018, total foreign office volume for the Washington metropolitan area measured \$2.0 billion, and foreign buyers accounted for 38% of office assets sold in the District of Columbia—the region’s core.

OFFICE INVESTMENT SALES OUTLOOK

Office transaction volume in 2018 lagged behind that of 2017 but remained robust. Total volume decreased in each of the past five quarters, but sales prices, which had been relatively stagnant for a brief period, rose 5.8% over the past 12 months, showing that demand remains strong. NKF expects Washington area investment sales volume in 2019 to continue at the slightly decelerating pace seen in 2018, although pricing will remain robust for three reasons:

- Investors—especially foreign investors—continue to seek the safety of a primary market like Washington during the mature phase of the cycle.
- Gradually accelerating demand for office space is meeting a low inventory of available assets for sale, especially in the market’s core.
- 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. The volatile nature of the stock market during the fourth quarter of 2018 highlighted the value of commercial real estate.

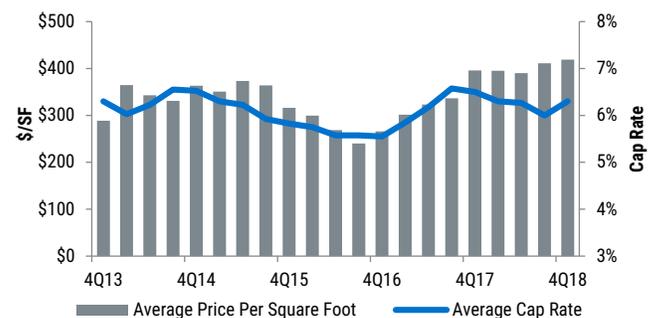
METRO AREA MARKET SUMMARY

	Metro Region
2018 Transaction Volume	\$5.9 B
2017 Transaction Volume	\$8.0 B
2018 Average Price Per Square Foot	\$419
2018 Average Cap Rate	6.3%

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

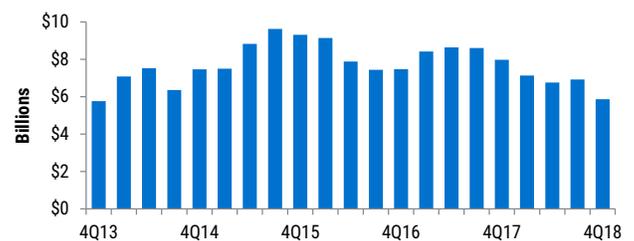
MARKET ANALYSIS

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

MAJOR 2018 OFFICE SALES TRANSACTIONS

Address	Sale Price	Price/SF	Sub-state
3000-3050 K St NW	\$415 M	\$740	DC
1111 Pennsylvania Ave NW	\$338 M	\$1,020	DC
1300 N 17 th St	\$250 M	\$629	VA
1440 New York Ave NW	\$250 M	\$1,168	DC
1765-1785 Greensboro Station Pl	\$244 M	\$380	VA
13200 Woodland Park Rd	\$226 M	\$560	VA

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.

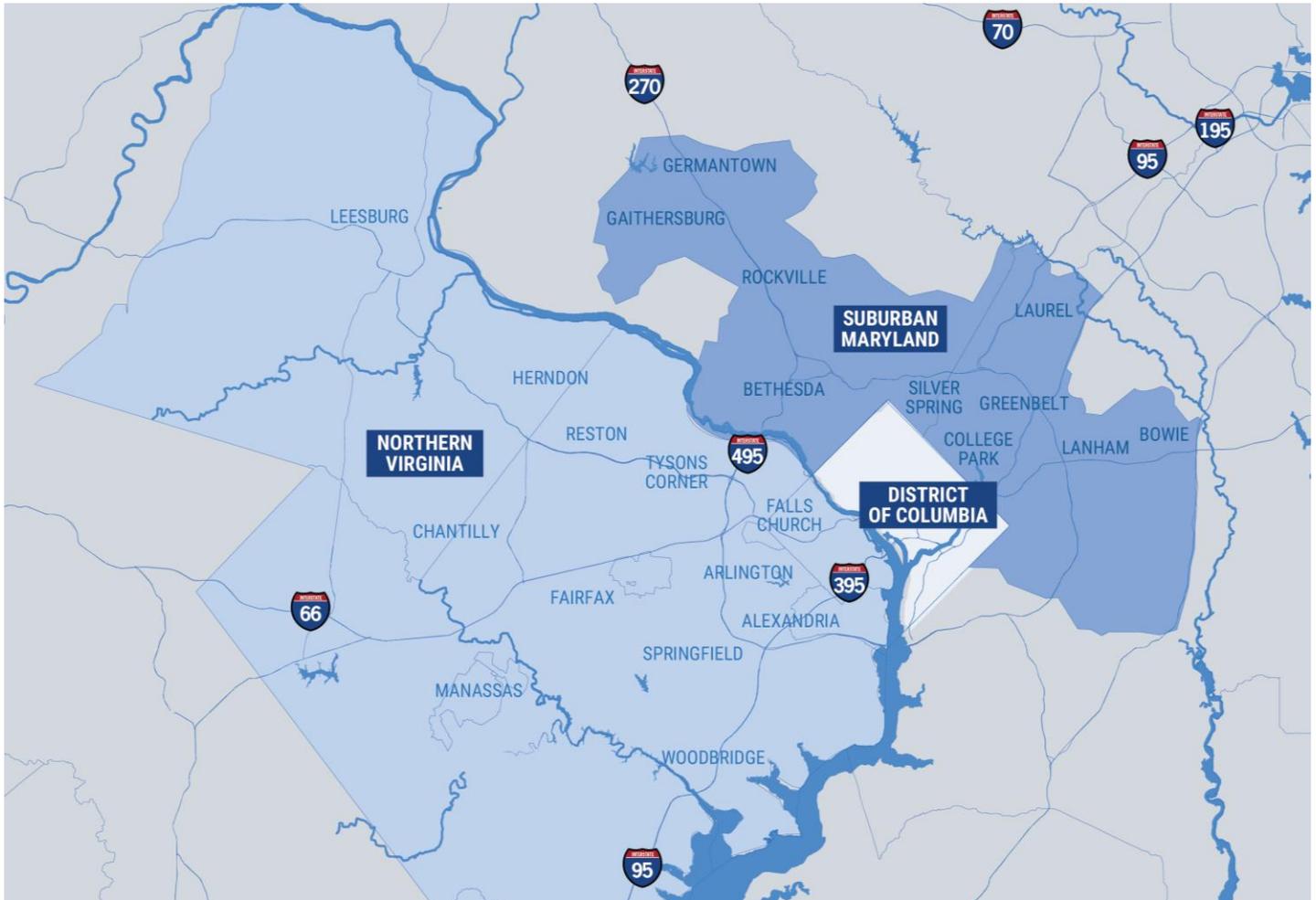
Transaction Volume: Total volume of office transactions \$20 million and greater during a specific reporting period.

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.

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

NICK SCHLANGER

Senior Research Analyst
202.312.5757
nick.schlanger@ngkf.com

ALEXANDER (SANDY) PAUL, CRE, LAI

Senior Managing Director
202.312.5783
apaul@ngkf.com

JORDAN SCHOTT

Senior Research Analyst
202.664.5902
jordan.schott@ngkf.com

BETHANY SCHNEIDER

Associate Director
202.664.5898
bschneider@ngkf.com

KEVIN SWEENEY

Senior Research Analyst
202.312.5763
kevin.sweeney@ngkf.com

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. Newmark Knight Frank Research Reports are available at www.ngkf.com/research

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