



DISTRICT OF COLUMBIA 4Q16 OFFICE MARKET

DISTRICT SEES GROWTH IN 2016, BUT VACANCY FLAT AS DELIVERIES CANCEL OUT UPTICK IN DEMAND

The District of Columbia's office market conditions tightened steadily during 2016. Absorption was positive, but vacancy remained flat, as new deliveries countered the modest uptick in demand. Net absorption registered 236,554 square feet during the fourth quarter, bringing the year-to-date total to 1.1 million square feet. Despite positive net demand, the vacancy rate rose 20 basis points during the fourth quarter to 11.5%, a result of three new properties delivering. However, vacancy is still down 10 basis points from one year ago. Asking rental rates rose 2.7% over the past year, to \$52.79/SF. Although demand has remained modest, the significant pace of redevelopment, renovations and new construction in the District has pushed asking rents higher.

New Administration's Impact on the District's Office Market Is Likely to be Modest

November's election results remain foremost on the minds of Washington residents and investors, given the city's status as the nation's capital. Various market observers have weighed in, and the consensus appears to be that the Trump Administration will potentially have a materially positive impact on Washington's commercial real estate market. However, there is reason to believe that the impact will be more moderate. Mr. Trump ran on a platform of increased infrastructure spending, which could boost local construction employment and possibly benefit Metrorail, but he is likely to face opposition from fiscal conservatives in the House of Representatives. He also ran on a platform of increased defense spending, which is more likely to benefit Northern Virginia than the District. Likewise, his proposed tax and healthcare reforms may result in lobbying industry growth, while his background as a developer could yield tax and regulatory legislation favorable to the commercial real estate industry. However, these real estate industry benefits would more likely boost profitability than increase demand for office space.

Mr. Trump's platform also called for the shrinking of domestic programs and their related agencies, which are concentrated in the District. If these initiatives are passed by Congress, they could offset potential local gains from infrastructure and defense spending. Therefore, the upcoming change in administration is not likely to have a material impact on demand for commercial space in Washington. One notable exception would be if foreign investors were to no longer see Washington as a safe haven for capital and reduce their investment in this market. Nevertheless, the relative strength of the U.S. economy compared with others around the globe will likely keep foreign investment dollars flowing into Washington.

Current Conditions

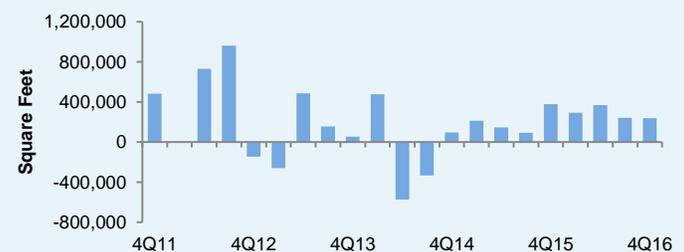
- The District of Columbia ended 2016 with 1.1 million square feet of annual net absorption and an overall vacancy rate of 11.5%, down 10 basis points over the past year.
- The Class A market posted strong quarterly absorption of 621,428 square feet, but its vacancy rate of 12.3% is still elevated compared with the Class B rate of 10.5%.
- Investment sales activity picked up in the second half of 2016, registering \$3.4 billion in sales volume through November.

Market Analysis

Asking Rent and Vacancy Rate



Net Absorption



Market Summary

	Current Quarter	Prior Quarter	Year Ago Period	24-Month Forecast
Total Inventory (SF)	124.4 M	124.2 M	124.2 M	↑
Vacancy Rate	11.5%	11.3%	11.6%	↑
Quarterly Net Absorption (SF)	236,554	240,691	378,278	↑
Average Asking Rent	\$52.79	\$52.62	\$51.42	↑
Under Construction (SF)	4.2 M	3.6 M	2.2 M	↔
Deliveries (SF)	739,827	0	478,882	↔



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Class A Market Fundamentals See Strong Finish to 2016

The Class A and trophy market experienced a strong fourth quarter of 2016, absorbing 621,428 square feet during the quarter as opposed to the negative quarterly absorption registered in Class B and Class C properties. The Class A vacancy rate ticked down 20 basis points over the quarter to 12.3% and is down 40 basis points from a year ago. Still, vacancy in Class A properties remains elevated in comparison with Class B properties, which ended the fourth quarter at a 10.5% vacancy rate. There is a marked bifurcation within Class A properties, with trophy and “Class A plus” properties significantly outperforming the commodity and “Class A minus” space. Asking rents for Class A space in the District of Columbia have remained fairly flat over the past 12 months, increasing only 0.6% to \$56.90/SF as of the fourth quarter.

Much of the fourth-quarter absorption is a result of the Department of Justice beginning its multi-phased move to its new headquarters at Constitution Square in NoMa. The agency moved in to approximately 354,000 square feet at 175 N Street NE and will occupy approximately 475,000 square feet of additional space at 150 M Street NE when it delivers in 2018. The agency is vacating four properties in the East End, which will likely lead to further negative absorption in that submarket unless the current era of soft demand changes course over the next two years.

Densification and Consolidation Continue to Limit Demand

There has been considerable discussion of office consolidation and densification—a reduction in the square footage occupied per employee—and the impact it has had on the commercial real estate market in Washington. This trend has been especially pronounced for law firms and the federal government, two sectors that occupy a

significant amount of office space in the District of Columbia. Lower levels of hiring in the legal services industry have further reduced the need for space, and consolidation in legal services, such as the merger between Kaye Scholer LLP and Arnold & Porter LLP, may compound the effects of densification. In the District of Columbia, these factors, in conjunction with a significant amount of office space expected to come online within the next three years, have resulted in a tenant-friendly market.

NoMa and East End Lead in Fourth-Quarter Deliveries

Fourth-quarter office deliveries were concentrated in the NoMa and East End submarkets. Uline Arena, a 244,000-square-foot NoMa office and retail redevelopment, delivered in December 2016 and includes the city's flagship REI location. In the East End, 600 Massachusetts Avenue NW and 1000 F Street NW also delivered during December. With an April 2017 move-in date, Venable LLP is 600 Massachusetts Avenue NW's major tenant, with a pre-lease for 245,000 square feet of the building's 401,172 total square feet. 1000 F Street NW, encompassing 94,655 square feet, includes 10 stories of office atop ground-floor retail. In total, approximately 1.7 million square feet of new and renovated office space delivered in 2016.

As of the fourth quarter, the District's office development pipeline totals approximately 5.5 million square feet, comprising 4.2 million square feet of new construction and 1.3 million square feet of redevelopment or renovation. Redevelopment is primarily focused in the Central Business District, accounting for 1.2 million square feet of space. The majority of new construction activity is focused in the core submarkets of the East End and Central Business District, with five projects totaling 2.3 million square feet under construction.

Recent Lease Transactions

Tenant	Building	Submarket	Type	Square Feet
MacFadden	555 12 th Street NW	East End	Direct Lease	120,000
Federal Election Commission	1050 1 st Street NE	NoMa	Direct Lease	98,681
FTI Consulting	555 12 th Street NW	East End	Direct Lease	93,507
Aspen Institute	2300 N Street NW	West End	Direct Lease	92,602
Amtrak	1 Massachusetts Avenue NW	NoMa	Direct Lease	85,000

Recent Sales Transactions

Building	Submarket	Sale Price	Price/SF	Square Feet
655 15 th Street NW	East End	\$356,500,000	\$607	587,050
815 Connecticut Avenue NW	CBD	\$240,319,000	\$1,018	236,000
500 North Capitol Street NW	Capitol Hill	\$231,419,000	\$995	232,521
1030 15 th Street NW	CBD	\$228,000,000	\$695	328,218
1025 Thomas Jefferson Street NW	Georgetown	\$141,800,000	\$439	322,780



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Growing Venture Capital

During the first three quarters of 2016, venture capital investment in the District of Columbia grew by 23.1% over the same period in 2015, to \$188.8 million. This growth is in contrast to the trend experienced throughout the broader United States, which saw investment decline by 18.7% for the first three quarters of 2016 versus the same period in 2015. During 2016, the District topped a list of the best U.S. cities for social entrepreneurship—startups oriented toward solving social problems—and sources suggest its proximity to policy-makers and a population of regulatory experts also make it a popular location for young businesses. Growth in tech-oriented industries is expected to increase demand for non-traditional office space, with features such as open, collaborative floorplans and flexible meeting areas. It also may encourage absorption of sublet space, as this often is available at a discount and offers greater flexibility in timing and capital.

Investment Sales Volume Escalates in Second Half of 2016

Through the end of November 2016, 24 major office investment properties traded hands in the District of Columbia for a total of \$3.4 billion in sales volume. After a slow first half of the year—with less than \$1 billion in sales volume registered through June—volume picked up in the second half of the year, thanks in part to continued interest from foreign buyers. Most notably, Japanese firm Unizo purchased five District of Columbia office properties in 2016. Through November, the largest

sale of the fourth quarter and also the year was 655 15th Street NW. Blackstone purchased the Class A property from a joint venture between Boston Properties and the New York State Common Retirement Fund for \$356.5 million, or \$607/SF. The property traded at a 4.5% cap rate. Through November, District of Columbia sales volume was even with 2015's annual volume of \$3.4 billion. Volume in 2016 will top the previous year's total once the December transactions are tallied.

District of Columbia Outlook

Despite consistent asset sales and sturdy absorption, the District of Columbia will remain a tenant's market in the near term, especially for commodity Class A space. During the 24 months ending in December 2018, office space deliveries are expected to exceed demand, with 3.7 million square feet of delivered space compared with 2.3 million square feet of demand. This supply-demand imbalance is exacerbated by the many District of Columbia tenants that have already locked in long-term leases to relocate after their current leases expire. These forward-looking leases capitalize on the current tenant's market, prompting landlords to increase concessions or reduce rents to fill space.

For additional information on the Washington metropolitan area economy and office market outlook, please visit the [Washington, DC Market Reports](#) page at ngkf.com.

Market Statistics By Class

	Total Inventory (SF)	Direct Vacancy Rate	Total Vacancy Rate	2013 Absorption (SF)	2014 Absorption (SF)	2015 Absorption (SF)	4Q16 Absorption (SF)	2016 Absorption (SF)
Class A	77,790,474	11.6%	12.3%	298,636	498,653	283,047	621,428	1,398,599
Class B	40,452,128	9.6%	10.5%	147,507	-737,573	547,630	-344,641	-236,078
Class C	6,163,644	8.1%	8.4%	-10,916	-102,025	-1,100	-40,233	-25,313
District of Columbia	124,406,246	10.8%	11.5%	435,227	-340,945	829,577	236,554	1,137,208

Market Statistics By Class

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	4Q16 Deliveries (SF)	2016 Deliveries (SF)	Under Construction (SF)
Class A	77,790,474	\$56.90	N/A	\$56.90	739,827	1,067,652	4,164,299
Class B	40,452,128	N/A	\$44.48	\$44.48	0	135,798	0
Class C	6,163,644	N/A	N/A	\$40.77	0	0	0
District of Columbia	124,406,246	\$56.90	\$44.48	\$52.79	739,827	1,203,450	4,164,299


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Submarket Statistics – All Classes

	Total Inventory (SF)	Direct Vacancy Rate	Total Vacancy Rate	2013 Absorption (SF)	2014 Absorption (SF)	2015 Absorption (SF)	4Q 2016 Absorption (SF)	2016 Absorption (SF)
Capitol Hill	4,520,744	6.5%	6.9%	235,127	-226,956	149,518	20,742	110,415
Capitol Riverfront	3,685,480	9.6%	10.2%	-16,657	45,862	241,453	19,028	27,229
Central Business District	38,174,367	7.5%	8.4%	144,828	65,715	545,344	13,925	790,187
East End	41,304,315	13.8%	14.8%	-350,310	467,574	-63,081	-336,839	-357,104
Georgetown	2,851,274	4.3%	6.3%	109,854	59,086	58,942	4,983	-50,766
NoMa	11,099,645	9.0%	9.3%	594,630	11,446	145,735	517,854	545,234
Southwest	11,885,278	12.8%	13.1%	-247,873	-207,415	58,756	84,170	133,113
Uptown	7,360,638	15.0%	16.4%	-64,634	-445,744	-140,736	-95,325	-121,726
West End	3,524,505	11.5%	11.8%	30,262	-110,513	-166,354	8,016	60,626
DC - District of Columbia	124,406,246	10.8%	11.5%	435,227	-340,945	829,577	236,554	1,137,208

Submarket Statistics – All Classes

	Total Inventory (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Overall Asking Rent (Price/SF)	4Q 2016 Deliveries (SF)	2016 Deliveries (SF)	Under Construction (SF)
Capitol Hill	4,520,744	\$61.85	\$48.80	\$57.32	0	0	694,920
Capitol Riverfront	3,685,480	\$45.97	NA	\$45.97	0	0	235,000
Central Business District	38,174,367	\$59.20	\$47.03	\$54.56	0	263,623	1,125,000
East End	41,304,315	\$60.86	\$44.75	\$56.23	495,827	495,827	1,142,850
Georgetown	2,851,274	\$58.74	\$40.39	\$47.24	0	0	0
NoMa	11,099,645	\$52.32	\$42.86	\$51.39	244,000	444,000	475,000
Southwest	11,885,278	\$48.76	\$39.71	\$44.00	0	0	491,529
Uptown	7,360,638	\$43.35	\$38.55	\$41.71	0	0	0
West End	3,524,505	\$56.11	\$47.06	\$53.72	0	0	0
DC - District of Columbia	124,406,246	\$56.90	\$44.48	\$52.79	739,827	1,203,450	4,164,299



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District of Columbia Office Submarkets



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