# WASHINGTON, DC METRO

## EXECUTIVE SUMMARY

- The region's employment base is diversifying – specifically toward the tech sector, fueled in part by Amazon's growing presence.
- While Washington has a smaller percentage of occupancy by co-working firms, any pull-back by operators, such as WeWork, could impact the market.
- The metro area could experience a temporary pause in leasing activity during the 2020 election year.
- Tight industrial market conditions are expected to continue.
- The highest-quality downtown office assets continue to trade at values over $1,100 psf, though not with the frequency they did in 2017-2018.
- The gap between downtown and suburban pricing for stabilized office assets is at its smallest since 2013.

**Economists expect Washington's overall economy to grow by an average of nearly 2% annually over the next five years, with some pockets outperforming others. While the area's economy has historically relied heavily on growth in federal spending, the industry base is diversifying. Economists anticipate that about a quarter of future expansion will come from the professional, scientific and technical services sector.**

Washington's 385-msf office market has recorded increasing positive absorption in recent years, thanks to tenants such as Amazon and the expansion of co-working providers. Still, supply continues to outpace demand, keeping vacancy elevated. Face rates are being held in most submarkets while concessions have been trending upward. Anecdotally, some tenants are already pulling back on long-term lease commitments due to uncertainties about the future, including the 2020 presidential election. Yet, the market is becoming more and more bifurcated. Sought-after new and amenity-rich product is outperforming the market as a whole, often at the expense of older buildings as tenants trade one address for another. Although new development has begun to taper regionally, and in spite of elevated vacancy, some large speculative projects, such as Foulger-Pratt's Tysons Central, continue to break ground. The Tysons submarket is becoming increasingly urbanized since the Metrorail expanded service there in 2013. The region's overall vacancy rate could tick up slightly in 2020 without an increase in net new demand.

While still in the early stages of buildout, which is likely to take five-plus years and ultimately house at least 25,000 employees, Amazon's HQ2 campus in National Landing is a prime example of placemaking. The planned developments and redevelopments are expected to reinvigorate the submarket's aged office and housing inventories. A number of infrastructure improvements are also intended to enhance walkability within the submarket and connectivity to its surroundings.

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### KEY MARKET METRICS – 2020 EXPECTATIONS

Annual growth rates, estimated for year-end 2020 vs year-end 2019.

| | OFFICE | INDUSTRIAL |
|---|---|---|
| Rental Growth | → | ↑ |
| Vacant Space | ↑ | → |
| Construction Levels | → | ↓ ↓ ↓ |
| Leasing Volume | → | ↑ |
| Investment Volume | → | ↑ |

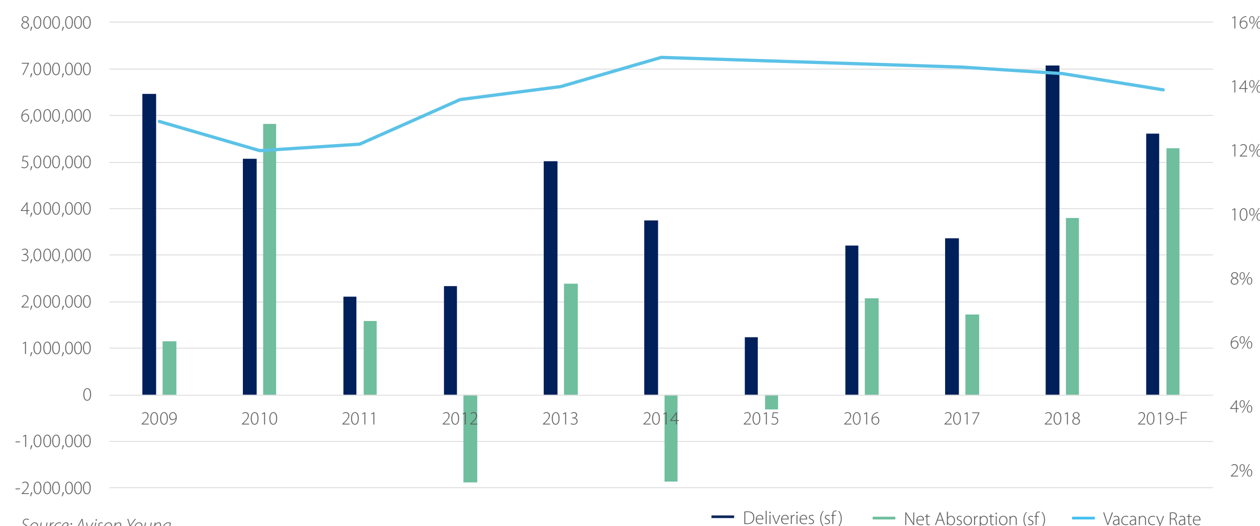
The region's 200-msf industrial market has recorded an overall vacancy rate in the single digits for the past several years. Demand in the area, specifically in the Dulles Technology Corridor of Northern Virginia, is driven by Big Data firms and the cloud computing needs of both the private and public sectors. Also, the I-95 Corridor spans the region, connecting Washington to Baltimore and its shipping port, and is a primary logistics route for the East Coast. Overall limited construction and current tight market conditions should keep indicators healthy. For warehouse development that does occur, look for a move toward multi-story, vertical buildings due to the scarcity of land. Further rent growth is anticipated for 2020 as a seemingly endless demand for data centers and distribution facilities, married with land constraints, will likely push rents higher.

On the retail front, activity is mostly centered on tenant amenities, either in mixed-use, such as Tysons' successful The Boro development, or the renovation of existing properties. Neighborhood centers fill the need for products and services that cannot be purchased online, such as fitness venues, hair and nail salons and dry cleaners.

Total investment volume in 2019 was approximately $20.4 billion, a touch below the 2018 figure, but aided by a flurry of downtown office sales that rushed to close before increases in Washington, DC's deed transfer and recordation taxes took effect on October 1. The office and multifamily property types each exceeded $8 billion and together accounted for 84% of the region's 2019 sales volume. The gap between downtown and suburban pricing for stabilized office assets is at its smallest since 2013. Office cap rates have continued to tick downward, and a low-interest-rate environment could allow them to trend even lower. As a result, investors faced with heavily-compressed cap rates for core office product are increasingly turning to deals with a value-add component. Overall sales volume in 2020 is expected to increase slightly over the total recorded in 2019.

**June 2019 marked 10 years since the end of the Great Recession, and it has been a decade of incredible office market expansion that saw nearly 39 msf deliver and vacancy that averaged 13.9% after climbing steadily into the double digits where it remains today.**

### HISTORICAL OVERALL OFFICE VACANCY-DELIVERIES-ABSORPTION

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