Occupancy Loss Continues Despite Strong Private Sector Activity in Q3

▲ 22.7%	▼ (331,681)	▶ 398,134	▶ $59.03
Vacancy Rate	SF Net Absorption	SF Under Construction	Average Gross Asking Rate

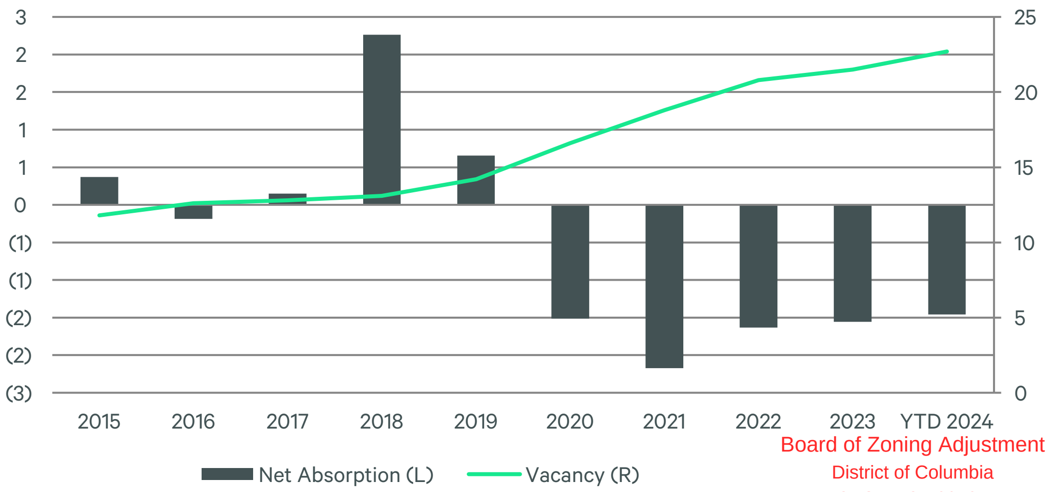
Note: Arrows indicate change from previous quarter.

Office vacancy continues to rise in Washington, DC, increasing 30 basis points to 22.7% in the third quarter. Occupancy loss in Washington, D.C. reached 332,000 sq. ft. for the quarter, driven by a small number of large contractions. The most notable lease of the quarter was Fannie Mae's 341,000 sq. ft. renewal at Midtown Center, in which the company, while right-sizing, recommitted to keep its headquarters in the District for the longer term. Four occupiers, Fannie Mae, CoStar, the Department of Treasury, and the Commodity Futures Trading Commission (CFTC), account for more than two-thirds of the city's 2024 occupancy loss.

Lease volume continues to increase from the pandemic era average. During the third quarter, volume reached 1.6 million sq. ft. and was largely driven by private sector tenants, which accounted for 78% of all activity.

With Trophy options limited and just one remaining office building under construction in the city, private sector tenant demand is increasingly shifting to the Class A+ market. The Class A+ vacancy rate, comprising an inventory of 14.7 million sq. ft, dropped 120 basis points in Q3 and is down 180 basis points year-over-year. With Class A+ taking rents tracking 20% lower than Trophy space and tracking 11% higher than Commodity Class A rents, the asset class represents an attractive opportunity for tenants looking to upgrade to higher-quality space at a relative discount to Trophy.

FIGURE 1: Historical Supply & Demand Dynamics



Source: CBRE

Board of Zoning Adjustment
District of Columbia
CASE NO.18878F
EXHIBIT NO.9

Sector Snapshot

Legal

Law firm leasing remained relatively quiet in Q3, with just 110,000 sq. ft. of leases signed. Year-to-date the legal sector has accounted for 16% of leasing activity, tracking slightly lower than 2023 levels, but still the third-highest share among all sectors. Notable Q3 leases include Fragomen's extension at 1101 15th Street NW, which will keep the firm in its space until 2037, and McKool Smith's relocation to 1717 K Street NW, where the firm leased 12,650 sq. ft.

Business and Financial Services

Business and financial services firms led leasing activity during the third quarter, with leases totaling 566,500 sq. ft. The most notable lease was Fannie Mae's 341,000 sq. ft. renewal and contraction at Midtown Center, which also drove nearly all the sector's total occupancy loss. Remaining activity was driven by mid-sized tenants, with 15 total leases greater than 10,000 sq. ft signed during the third quarter.

Government

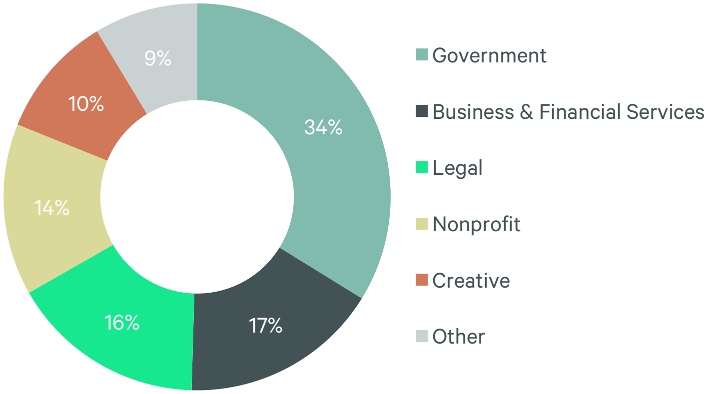
Government leasing slowed during Q3, with just two federal agencies leasing a combined 295,000 sq. ft. However, government leasing has accounted for the highest share of the market's leasing activity year-to-date, at 34% of all activity. Most notably in Q3, GSA signed a 198,000 sq. ft. lease on behalf of Court Services and Offender Supervision Agency (CSOSA) at 501 3rd St NW in Capitol Hill. CSOSA will consolidate personnel from offices in the East End and NoMa. Broadly, the government continues to be a significant driver of high vacancy in Washington, D.C., with the sector adding 202,000 sq. ft of additional occupancy loss during the third quarter.

FIGURE 2: Select Notable Q3 2024 Lease Transactions

Tenant	Industry	Address	Submarket	SF	Lease Type	Market Effect
Fannie Mae	Business and Financial Services	1100 15th St NW	CBD	341,000	Renewal	Contraction
GSA- CSOSA	Government	501 3rd St NW	Capitol Hill	198,000	New Lease	Contraction
Mathematica	Technology	1100 1st St NE	NoMa	62,890	Renewal	Contraction
Anduril Industries	Technology	999 E St NW	East End	55,000	New Lease	Growth
American Association for Justice	Nonprofit	777 6th St NW	East End	36,796	Renewal	Contraction
Chicago School of Psychology	Education	1101 K St NW	East End	28,897	New Lease	Growth
Fragomen, Del Rey, Bernsen & Loewy	Legal	1101 15th St NW	East End	26,141	Renewal	Flat
Citigroup	Business and Financial Services	1101 Pennsylvania Ave NW	East End	23,539	Renewal	Flat
Amentum	Business and Financial Services	300 M St SE	Capitol Riverfront	20,861	Renewal	Flat
Rokk Solutions	Business and Financial Services	2020 K St NW	CBD	19,517	Renewal/Expansion	Growth

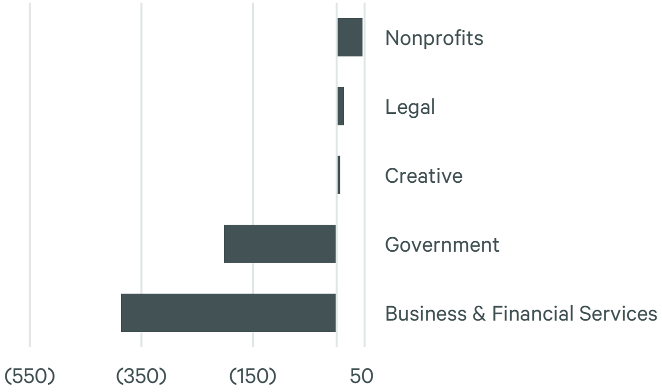
Source: CBRE

FIGURE 3: YTD 2024 Gross Leasing by Sector (Share by SF)



Source: CBRE

FIGURE 4: Q3 2024 Net Absorption by Sector (SF, 000's)



Source: CBRE

Development Activity

Stonebridge and Rockefeller Group's 600 5th Street NW is the only building underway in Washington, DC. The redevelopment is 52% preleased to Crowell & Moring and is expected to deliver in early 2026.

Of note, favorable dynamics at the top of the market are pushing some owners to renovate their buildings to capture more tenancy at higher rates. Several multi-million-dollar renovations in the East End and CBD are either currently underway or forthcoming in Q4 2024.

FIGURE 5: Development Pipeline – Under Construction

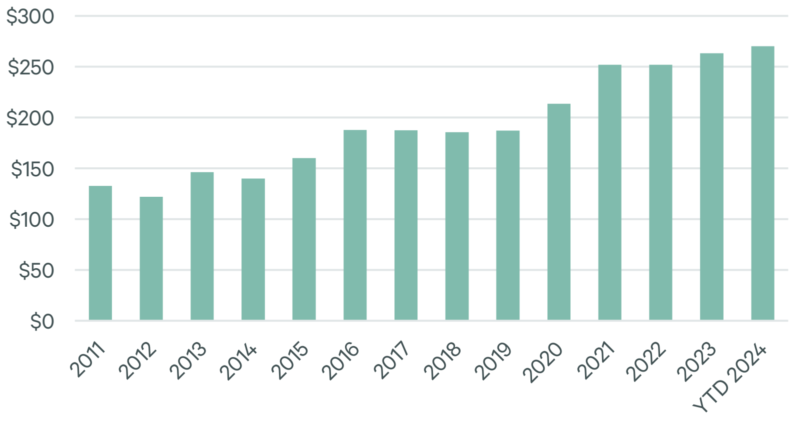
Expected Delivery	Address	Submarket	SF	Preleased (%)	Developer(s)
2026	600 5th St NW	East End	398,134	52%	Stonebridge + Rockefeller Group

Source: CBRE

Pricing

Overall asking rents remain flat at $59.02 per sq. ft. per annum on a full-service basis. Rent abatement also remained flat at 22 months for a 12-year term, though tenant improvement allowances moved upward to $141 per sq. ft. on a 12-year lease term, across all asset classes, reflecting a small number of above-market packages.

FIGURE 6: Total Concession Packages



*Analysis includes non-GSA leases sized 10,000 SF+ in the CBD, East End and Capitol Hill. Concessions weighted by SF and normalized for 12-year term.

Source: CBRE

FIGURE 7: Asking Rent Changes by Asset Class

Asset Class	Gross Rent Per SF	Quarter-over-Quarter Change
Trophy	$91.34	+1.2%
Class A	$60.10	-0.2%
Class B	$48.63	+0.1%
Overall	$59.03	-0.5%

Source: CBRE

Distress

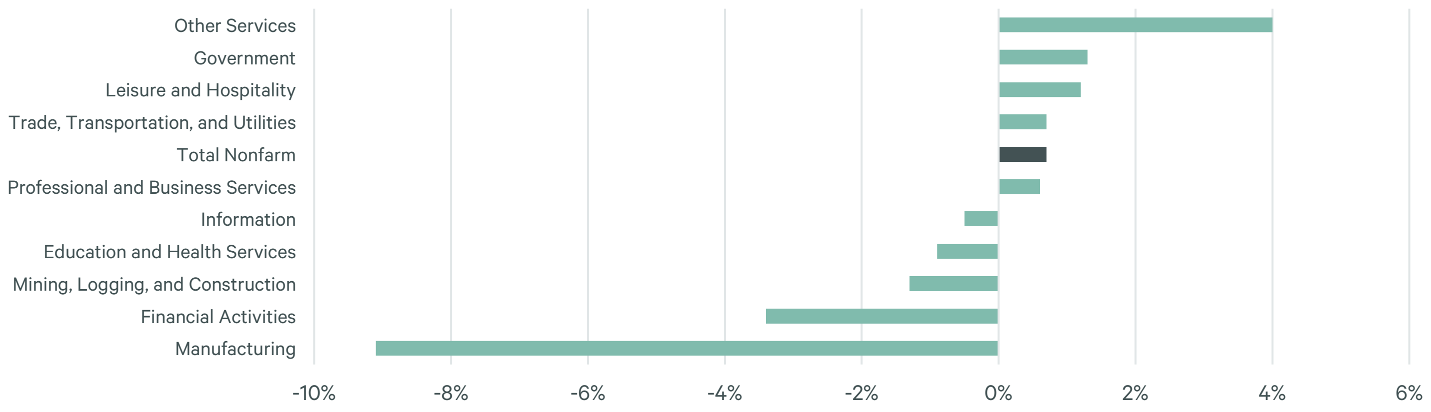
In a high vacancy environment, an increasing number of owners of commercial office stock are facing distress, particularly when their debt matures. In 2024, 18 buildings have gone into foreclosure, already more than double the total number recorded in 2023. Most foreclosed buildings were Commodity Class A and Class B. On average, these buildings were 47 years old with a vacancy rate of 51.6% at the time of foreclosure.

Economic Outlook

Soft landings are rare, but recent data suggest that this outcome for the economy is increasingly likely. Business investment is holding its own and consumer distress is confined to a few vulnerable segments. Discretionary spending, such as travel, is generally on a par with last year although many signs indicate the post-pandemic spending boom is over. The key threat to consumption is a rollover in the labor market although the recent bump in unemployment appears benign, mainly driven by an increase in participation. A reason for concern is the decline in the share of private industries that are creating jobs. On the other hand companies are not shedding workers at a particularly high rate. The labor market has slowed, but it is not slumping.

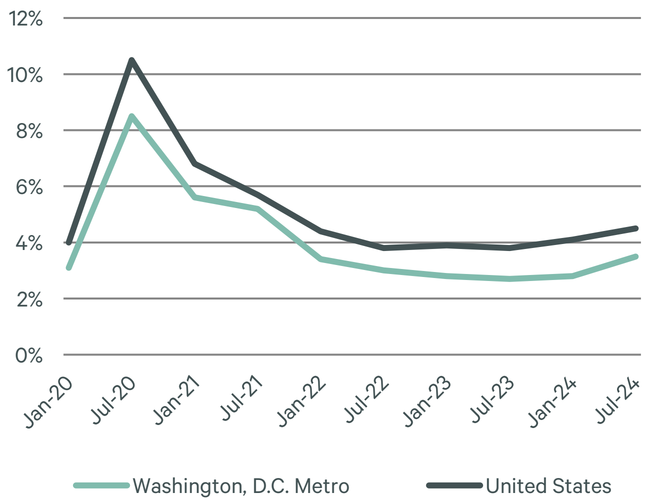
While many are focused on November's election the most consequential policy lever has already been pulled via the FOMC's 50 bps September cut and signaling another 50 by year-end. This easing of financial conditions combined with continued economic growth should support modest hiring and consumption that precedes tighter commercial space market fundamentals. This backdrop will breathe fresh wind into real estate transactions markets and coincides with other signals that cap rates have peaked and may be starting to fall in some sectors.

FIGURE 8: Employment Growth by Industry, 12-Month Percent Change



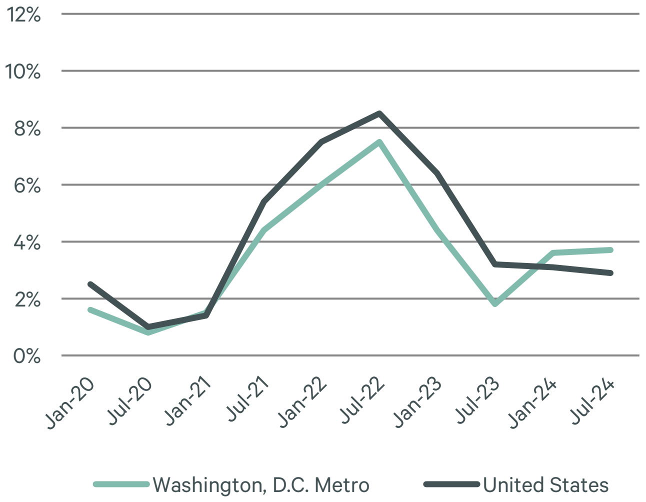
Source: BLS

FIGURE 9: Unemployment Rate



Source: BLS

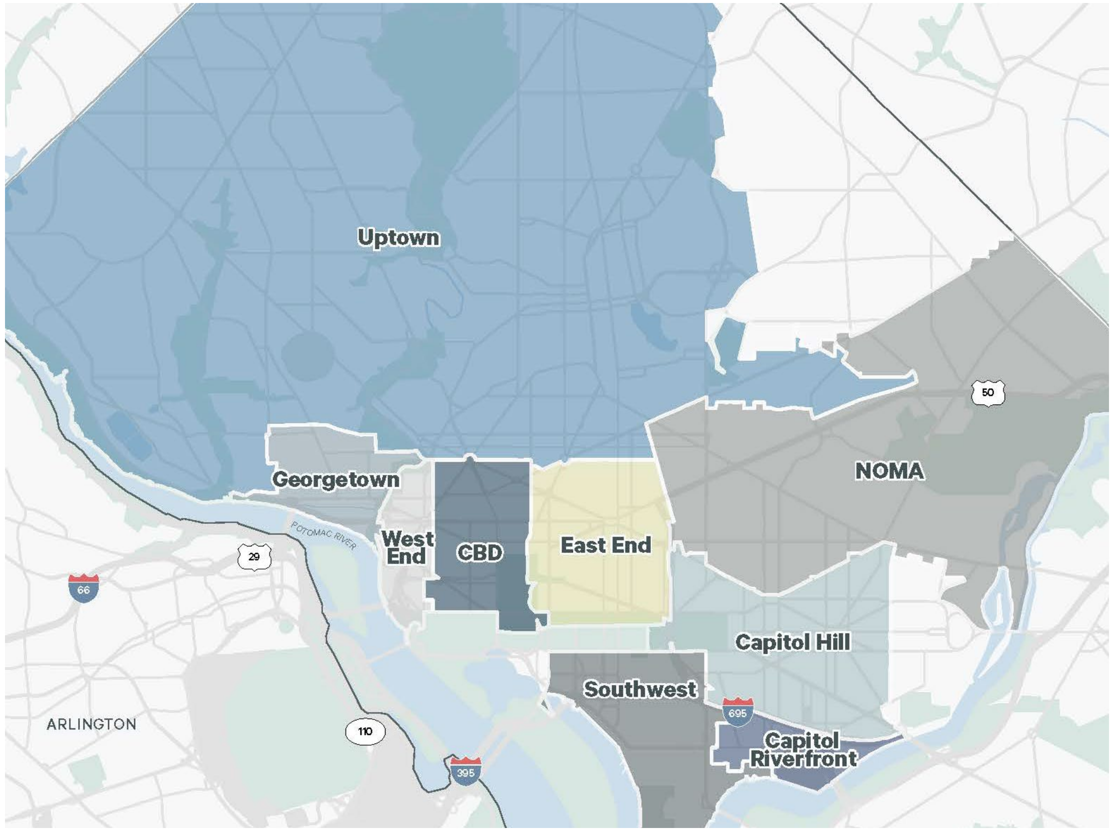
FIGURE 10: Consumer Price Index, 12-Month Percent Change



Source: BLS

FIGURE 11: Key Market Statistics

	Number of Buildings	Inventory (SF)	Overall Vacancy Rate (%)	Q3 2024 Net Absorption (SF)	2024 Net Absorption (SF)	Gross Asking Rent ($/SF)	Under Construction (SF)
Capitol Hill	30	4,981,275	25.4%	39,195	(95,824)	79.27	-
Capitol Riverfront	14	3,311,678	28.9%	(42,708)	(180,500)	57.24	-
CBD	218	40,076,563	24.7%	(250,414)	(863,654)	60.12	-
East End	194	43,004,635	24.1%	83,581	45,886	59.80	398,134
Georgetown	22	2,634,779	33.4%	615	20,869	53.59	-
NoMA	45	12,321,592	16.3%	(144,460)	(260,527)	51.57	-
Southwest	36	11,913,311	13.4%	293	(50,794)	51.72	-
Uptown	63	4,499,743	19.3%	2,374	(8,695)	45.48	-
West End	16	2,687,653	22.0%	(20,157)	(55,825)	53.93	-
Trophy	47	13,941,160	15.4%	(369,478)	(290,165)	91.34	398,134
Class A	301	78,672,661	22.5%	216,780	(573,312)	60.10	-
Class A+*	47	14,713,549	22.1%	165,777	294,164	72.81	-
Class B	244	29,804,278	25.9%	(185,125)	(608,399)	48.63	-
Class C	46	3,013,130	27.1%	6,142	22,812	47.23	-
Overall	638	125,431,229	22.7%	(331,681)	(1,449,064)	59.03	398,134



Source: CBRE

*Buildings achieving top 25% of taking rents, many recently renovated

CBRE Mid-Atlantic Research began using a proprietary database for office properties in mid-2024. Beginning Q3 2024, statistics and trends reported in previous reports likely changed due to our revised data methodologies. The information contained in this report references office properties 20,000 square feet or larger (excluding owner-occupied) located in submarkets shown on the above map.

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CBRE

MARKETBEAT
WASHINGTON, DC
OFFICE Q3 2024

CUSHMAN & WAKEFIELD

MARKET FUNDAMENTALS

	YOY Chg	12-Month Forecast
21.9% Vacancy Rate	▲	▲
-907M YTD Net Absorption, SF	—	▼
$54.62 Asking Rent, PSF	▼	—

(Overall, All Property Classes)

ECONOMIC INDICATORS

	YOY Chg	12-Month Forecast
3.4M Washington, DC Metro Employment	▲	▲
2.9% Washington, DC Metro Unemployment Rate	▲	▲
4.2% Country Unemployment Rate	▲	▼

Source:BLS

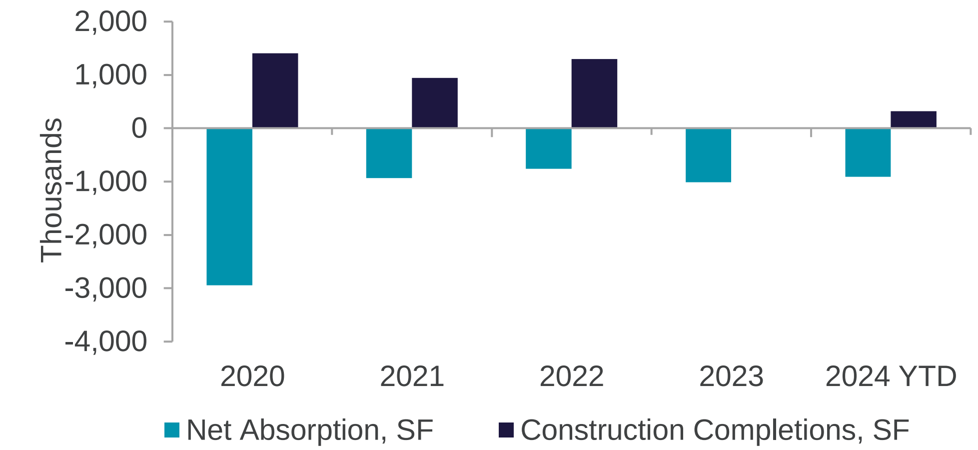
MARKET SEGMENTS

In the third quarter, Washington, DC recorded 1.8 million square feet (msf) in gross leasing, bringing year-to-date (YTD) leasing to 6.1 msf. New leasing yielded 1.2 msf, bringing YTD new deals to 2.7 msf while renewal deals registered 550,000 sf in Q3, bringing YTD activity to 3.3 msf. New leasing outpaced renewal activity for the first time in five consecutive quarters. New leases signed in Q3 accounted for 60% of all leases signed in the District and 89% of new leases occurred in the core submarkets of CBD and East End.

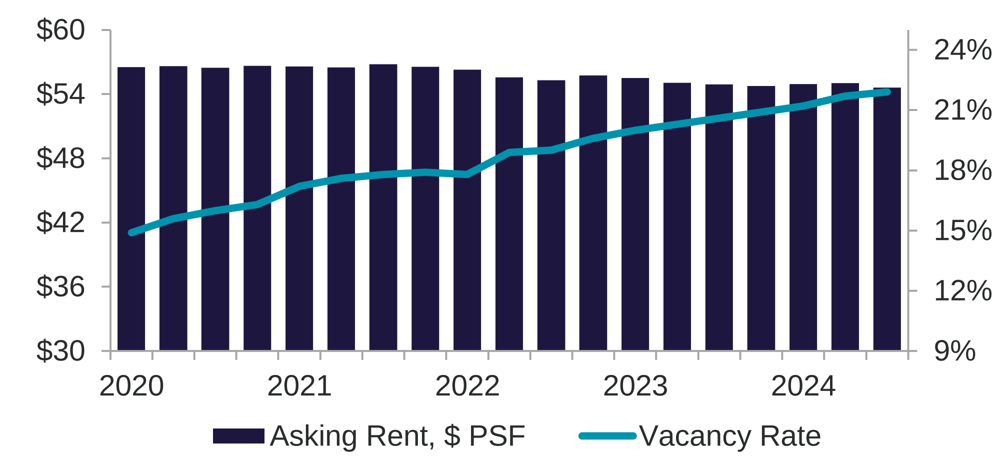
In Q3, there were three 100,000 sf+ deals signed by the federal government or quasi-government organizations. The U.S. Agency for Global Media signed a new deal for 350,000 sf at 1875 Pennsylvania Ave NW. The federal agency that oversees Voice of America will move from their longtime 698,000 sf headquarters in Southwest to a 350,000-sf new HQ in the CBD. The legal sector recorded 10 deals in Q3 totaling 105,000 sf. Brown Rudnick signed for 27,513 sf at 1900 N St NW and will vacate 35,000 sf in the East End in early 2025. Also in the CBD, Torridon Law sublet 21,931 sf at 801 17th St NW which is the first office presence the newly formed law firm will have in DC. Florida-based telecom company Skye Telecom will open a new office in Capitol Hill after signing a 14,000-sf deal at 300 New Jersey Ave NW.

Despite a few new users to the city, Q3 leasing activity had several notable contractions. Eight out of the top ten deals in Q3 were contractions with the average tenant downsizing by 81,672 sf or 36% of the original space. Contractions were driven by the Federal Government as government-related tenants contracted by a combined 894,000 sf from their previous DC footprints. Court Services & Offender Supervision Agency (CSOSA) consolidated several offices into a 198,561-sf office at 501 3rd St NW. The largest contraction on a percentage basis by the federal government was the Department of Treasury which reduced its footprint by 65% when it consolidated two locations into 68,700 sf at 1575 Eye St NW.

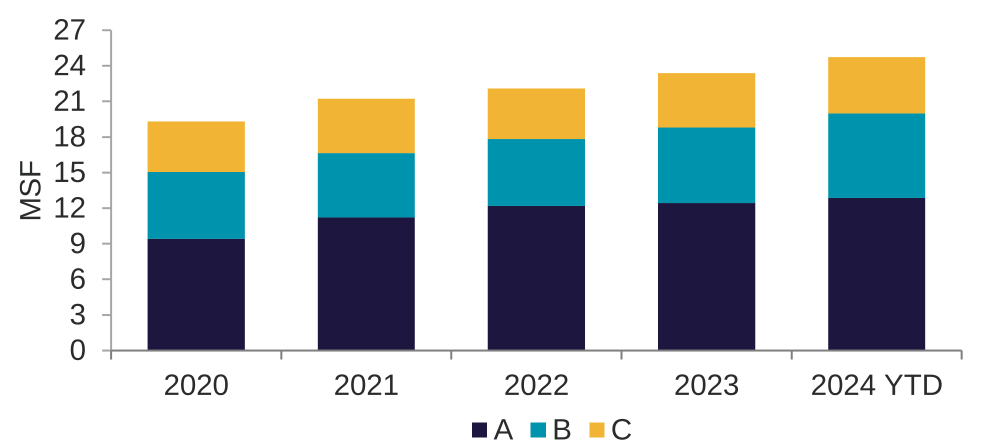
SPACE DEMAND / DELIVERIES



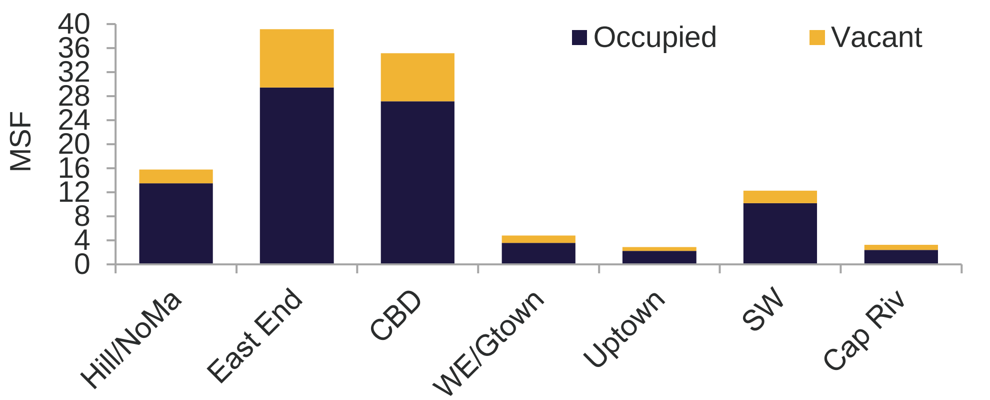
OVERALL VACANCY & ASKING RENT



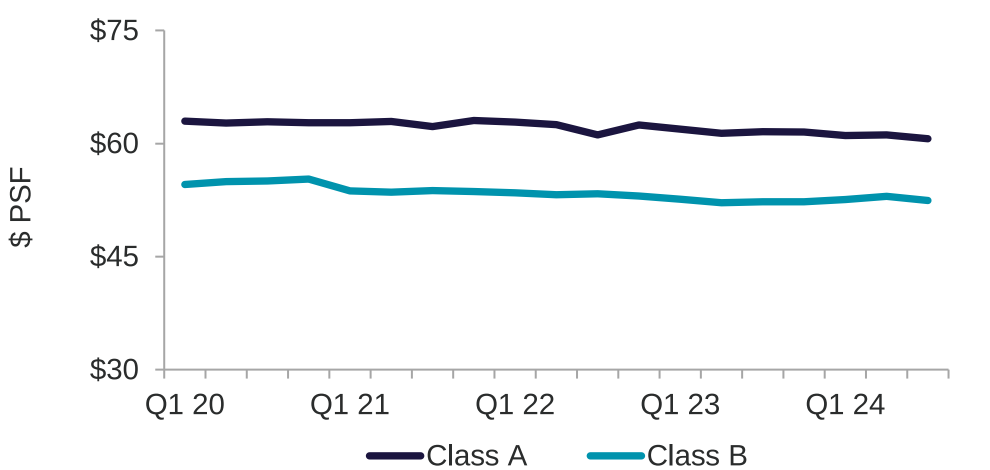
VACANT SPACE BY CLASS



SUBMARKET COMPARISON



ASKING RENT COMPARISON



The American Association for Justice is giving back 14,000 sf in its 36,796-sf renewal at 777 6th St NW and The Chicago School will downsize by 6% after consolidating into 28,997 sf at 1101 K St NW.

SUPPLY & DEMAND

Washington, DC recorded just over 136,000 sf of negative absorption in Q3, bringing YTD absorption to negative 907,000 sf. Class B and C product comprised 90% of YTD absorption with negative 562,000 sf and 255,000 sf, respectively, while Class A buildings recorded negative 90,000 sf YTD. For the past four quarters, East End has been the primary driver of negative absorption in DC. Thus far in 2024, East End has recorded negative 786,000 sf while CBD yielded 127,000 sf of absorption. East End recorded negative 76,000 sf in Q3 after Merrill Lynch left 73,500 sf at 1152 15th St NW to consolidate at 1800 K St NW. The Institute of International Finance also shrank in the East End, shedding 33,000 sf after giving back two floors and restacking on two other floors. The largest move of the quarter occurred within the CBD when Gibson Dunn left 230,000 sf at 1050 Connecticut Ave NW for 164,000 sf at 1700 M St NW. Net positive absorption in the CBD also came from the Whitehouse Historical Association opening a 32,000-sf immersive experience space at 1700 Pennsylvania Ave NW.

Vacancy rates increased 20 basis points (bps) from the previous quarter to 21.9% in Q3. Class A vacancy was flat from Q2 2024 at 18.6% and Class B rose 30 bps to 26.8%. Compared to the 20.6% vacancy in Q3 2023, vacancy rose 130 bps with Class A increasing 60 bps and Class B rising 240 bps. Within Class A space, the trophy component continues to outperform, ending the third quarter at 12.8%.

PRICING

Since the pandemic, rents in Washington, D.C. have been relatively flat going from $55.59 per square foot (psf) at the end of 2019 to $54.62 psf in Q3 2024 as robust free rent and tenant improvement concession have bolstered rental rates. Rents have decreased $0.39 from last quarter and decreased $0.33 from $54.95 in Q3 2023. Rents fell the most in Capitol Riverfront falling $3.51 while the CBD was the only submarket where rents rose, increasing $0.02 over the last 12 months. Tenant improvements (TIs) grew from an average of $100 psf in 2019 to $155 psf in Q3 2024 while abatement packages increased from 1.2 months to 1.6 months per year of term for deals in core submarkets over 10,000 sf with five years or more of lease term.

OUTLOOK

- Expect future vacancy rates to remain elevated as companies continue to reevaluate their space needs especially across Class B and C buildings while trophy vacancy rates dwindle as flight to quality continues to drive leases to best-in-class assets while new supply remains limited.
- Overall average concessions are expected to soften as landlords are more willing to trade lower concessions for lower rents as funding for many cash-strapped owners remains elusive, however large leases that solve occupancy issues will still likely meet or exceed $300 per square foot in incentives.
- Capital markets have been more active in 2024 as compared to 2023. There have been 21 office buildings sold for over $881 million combined. This is up 74.5% compared to the 14 buildings sold for $505 million over the same period in 2023.

MARKET STATISTICS

SUBMARKET	INVENTORY (SF)	SUBLET VACANT (SF)	DIRECT VACANT (SF)	OVERALL VACANCY RATE	CURRENT QTR OVERALL NET ABSORPTION (SF)	YTD OVERALL NET ABSORPTION (SF)	YTD LEASING ACTIVITY (SF)	UNDER CNSTR (SF)	OVERALL AVG ASKING RENT (ALL CLASSES)*	OVERALL AVG ASKING RENT (CLASS A)*
Capitol Hill / NoMa	15,430,807	38,673	2,237,990	14.8%	15,693	55,096	130,863	0	$52.23	$54.30
East End	39,127,107	320,628	9,343,428	24.7%	-75,508	-785,522	1,009,138	385,000	$56.52	$64.96
CBD	35,214,857	156,786	7,828,193	22.7%	-58,074	126,821	1,251,997	0	$55.41	$64.81
West End / Georgetown	4,806,248	152,562	1,104,199	26.1%	-2,195	-186,923	68,139	0	$50.01	$56.48
Uptown	2,896,111	74,690	563,357	22.0%	-8,875	-4,534	16,223	0	$45.19	$47.31
Southwest	12,284,502	20,183	2,066,819	17.0%	29,246	-36,669	215,749	0	$49.20	$51.72
Capitol Riverfront	3,225,932	117,435	715,606	25.8%	-36,675	-75,535	57,762	0	$57.64	$57.64
DOWNTOWN TOTALS	**112,985,564**	**880,957**	**23,859,592**	**21.9%**	**-136,388**	**-907,266**	**2,749,871**	**385,000**	**$54.62**	**$60.92**

**Rental rates reflect full service asking*

KEY LEASE TRANSACTIONS Q3 2024

PROPERTY	SUBMARKET	TENANT	SF	TYPE
1875 Pennsylvania Avenue NW	CBD	Voice of America (US Agency for Global Media)	350,000	New Lease
1100 15th Street, NW	CBD	Fannie Mae	340,000	Renewal*
501 3rd Street, NW	East End	CSOSA	198,561	New Lease
1575 Eye Street, NW	CBD	GSA- Department of Treasury	68,700	New Lease
601 13th Street, NW	East End	BGR Group	42,000	Renewal*, Expansion
777 6th Street, NW	East End	American Association for Justice	36,796	Renewal*
1101 K Street, NW	East End	The Chicago School	28,897	New Lease
1900 N Street, NW	CBD	Brown Rudnick	27,513	New Lease
1101 15th Street, NW	East End	Fragomen, Del Rey, Bernsen & Loewy	26,141	Renewal*
801 17th Street, NW	CBD	Torridon Law	21,931	Sublease

**Renewals not included in leasing statistics*

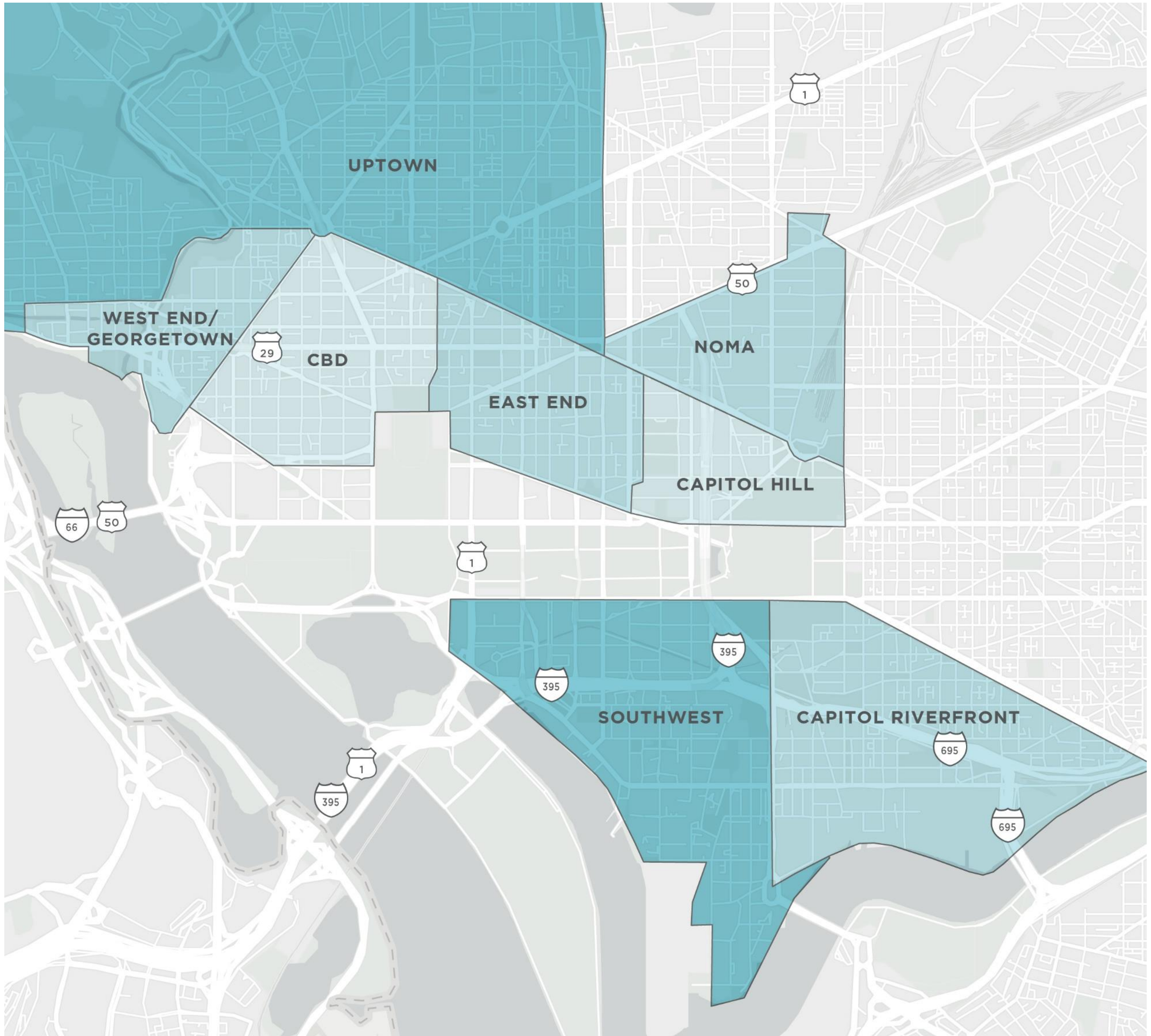
KEY SALES TRANSACTIONS Q3 2024

PROPERTY	SUBMARKET	SELLER/BUYER	SF	PRICE / $ PSF
2000 K Street, NW	CBD	Tishman Speyer / Spear Street Capital	233,292	$140,200,100 / $600.96
701 8th Street, NW	East End	Voya Investment / Douglas Development	134,448	$34,250,000 / $254.75
1201 Connecticut Avenue, NW	CBD	BrightSpire Capital / Duball LLC	169,549	$21,500,000 / $126.81
1200 18th Street, NW	CBD	Paragon Real Estate / The Davis Companies	207,789	$18,500,000 / $89.03

KEY CONSTRUCTION COMPLETION YTD 2024

PROPERTY	SUBMARKET	MAJOR TENANT	SF	OWNER/DEVELOPER
1700 M Street NW	CBD	Gibson Dunn	320,782	Skanska

OFFICE SUBMARKETS



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JLL SEE A BRIGHTER WAY

Research

United States

Office | Q3 2024

Washington, DC

- Washington, DC experienced 181,000 s.f. of net occupancy loss in Q3 and total vacancy grew to 20%.
- Class A vacancy saw a 30 basis-point drop to 20.2%, the largest quarter-over-quarter decrease since 2020, after posting 102,000 s.f. of positive absorption for the quarter. Rental rates held steady across all asset classes.
- Sublease availability is at a three-year low, holding steady in Q3 after declining by 340,000 s.f. in Q2, with 3.2 million s.f. available at the quarter's close.

Fundamentals		Forecast
YTD net absorption	-825,939 s.f.	↓
Total vacancy	20.0%	↑
Class A direct asking rent	$75.79 p.s.f.	↓
Overall direct asking rent	$59.12 p.s.f.	→
Concessions	Stable	→
Under construction	400,000 s.f.	→
Preleased	50.0%	↑

Washington, DC's vacancy rate continues to rise, hitting 20% in Q3 2024, following 185,000 s.f. of net occupancy loss for the quarter. NPR vacated the top three floors of its office in NoMa, resulting in 107,000 s.f. of the occupancy loss. CBD saw the largest submarket absorption gains of the quarter with 89,000 s.f. of positive movement.

Trophy space continues to outperform the market, with direct rents rising to $90 p.s.f. full service for the first time ever, 58% above the market average. Class A+ average asking rates jumped 7% in Q3 to $80.04 full service as space at the top of the market continues to dwindle. Only one office building in DC remains under construction, Stonebridge's Trophy project at 600 5th Street NW.

Washington, DC saw a dip in leasing over the quarter. 33 leases over 10,000 s.f. closed in Q3, representing 1.2 million s.f. of space. Four tenants signed leases over 50,000 s.f., including Fannie Mae's 340,000-s.f. renewal at 1100 15th. Federal leasing activity also saw a jump with CSOSA's 501 3rd St NW consolidation from multiple offices.

Sublease availability held at 3.2 million s.f., which is a three-year low. A 21,000 s.f. law firm sublease helped contribute to keeping the availability steady.

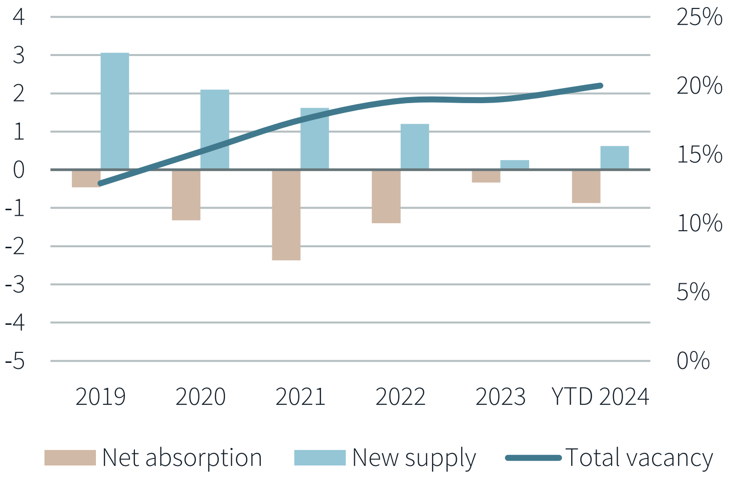
A total of 27 office buildings are proposed for conversion in DC. If these conversion projects are all completed, DC's office inventory will shrink by 5.8 million s.f. As importantly, conversions will improve the mix of uses and sense of place downtown.

Outlook

The District will continue to experience bifurcation across several segments. For example, Trophy represents 10% of inventory but 27% of leasing volume in 2024. As Trophy supply tightens, the next-best buildings, consisting of Class A+, will be the beneficiaries of unmet demand Meanwhile, 88.0% of direct vacancy sits in Class B/C or older Class A buildings. From a location perspective, vacancy is disproportionately concentrated in mid-block buildings, a trend expected to continue as corner buildings outperform.

Historical supply and demand trends

s.f. (millions)



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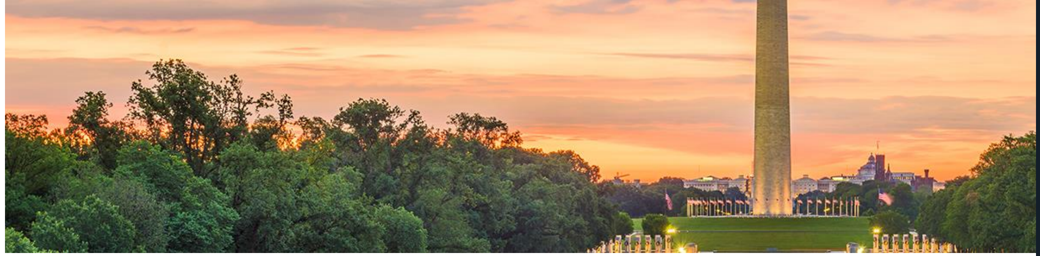

Research

United States

Office | Q3 2024

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GAO Highlights

Highlights of GAO-23-106200, a testimony before the Subcommittee on Economic Development, Public Buildings, and Emergency Management, Committee on Transportation and Infrastructure, House of Representatives

Why GAO Did This Study

The federal government owns over 500 million square feet of office space that costs billions annually. As the country emerges from the pandemic, the federal government has a unique opportunity to reconsider how much and what type of office space it needs.

This testimony discusses the preliminary results of an ongoing GAO review that (1) assesses the extent to which agencies utilized their headquarters buildings in selected weeks of early 2023; (2) describes the costs of underutilized federal office space; and (3) discusses challenges agency officials identified to increasing the utilization of their headquarters buildings.

GAO collected building size and attendance data from 24 federal agencies for one week in January, February, and March of 2023. GAO calculated the capacity of each headquarters building by dividing the size of the building by a per-person benchmark used by the General Services Administration. GAO then calculated utilization for each building by dividing the in-office attendance for the sample period by the capacity for each building. The percentages in this testimony are preliminary estimates based on ongoing work and are subject to change.

The General Services Administration and the Department of Veterans Affairs provided comments, which are reprinted in the appendixes.

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View GAO-23-106200. For more information, contact David Marroni at 202-512-2834 or MarroniD@gao.gov.

July 13, 2023

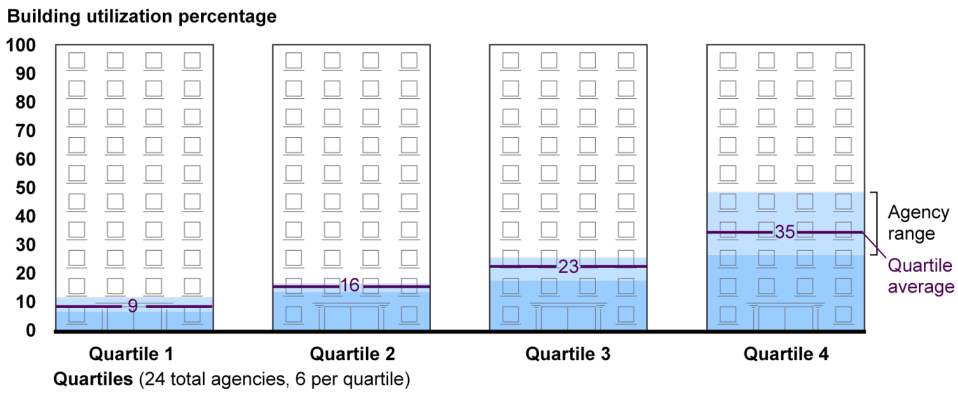
FEDERAL REAL PROPERTY

Preliminary Results Show Federal Buildings Remain Underutilized Due to Longstanding Challenges and Increased Telework

What GAO Found

Federal agencies have long struggled to determine how much office space they needed to fulfill their missions efficiently. Retaining excess and underutilized space is one of the main reasons that federal real property management has remained on GAO's High-Risk List since 2003. Seventeen of the 24 federal agencies in GAO's review used an estimated average 25 percent or less of their headquarters buildings' capacity in a three-week sample period across January, February, and March of 2023. On the higher range, agencies used an estimated 39 to 49 percent of the capacity of their headquarters on average.

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



Source: GAO analysis of data from 24 federal agencies. | GAO-23-106200

Underutilized office space has financial and environmental costs. Federal agencies spend about $2 billion a year to operate and maintain federal office buildings regardless of the buildings' utilization. In addition, agencies spend about $5 billion annually to lease office buildings. Any reduction in office space could reduce these costs. Office buildings also have environmental costs that could be lowered with better utilization. For example, GSA renovated and reduced its current agency real estate footprint, which helped reduce energy consumption and costs.

Agency real property officials identified challenges to increasing their headquarters building utilization.

- **Funding.** Additional budget resources are needed to reconfigure existing space to increase utilization and support a hybrid work environment.
- **Potential policy changes.** Concerns about the future of in-office attendance policies and habits have caused a reluctance to reduce headquarters space.
- **Standards.** There are no standards for how federal agencies should measure utilization to guide agency efforts.
- **Culture.** Agency leaders can be reluctant to share headquarters space among inner-agency components or other agencies.

https://www.wsj.com/real-estate/washington-dc-office-market-trouble-058d4fdf

REAL ESTATE

The D.C. Office Market Is in Trouble—No Matter Who Wins the Election

Biden administration struggles to get members of federal workforce back to the office on a more regular basis

By Peter Grant Follow

July 23, 2024 5:30 am ET

An office building in Washington, D.C., was being converted to apartments earlier this year. PHOTO: ANDREW CABALLERO-REYNOLDS/AFP/GETTY IMAGES

The Washington, D.C., office market is struggling with rising foreclosures, plunging values and its highest vacancy rate ever. The outlook looks grim whether Donald Trump or President Biden's Democratic Party successor is in the White House next year.

The Biden administration has struggled to get more of the tens of thousands of members of the federal workforce in the District of Columbia back to the office on a more regular basis. That struggle is likely to continue if a Democrat wins the White House in November, especially Vice President Kamala Harris, whom Biden endorsed Sunday when he announced he was exiting the race.

If Trump returns to the White House, the district's office market could be hit even harder. He has already pledged to abolish the Education Department, which has more than 2,500 employees in the district.

Some of Trump's powerful allies hope he will go further. In its initiative known as Project 2025, the conservative Heritage Foundation calls for firing federal workers and closing "wasteful and corrupt" bureaus.

"The surest way to put the federal government back to work for the American people is to reduce its size and scope back to something resembling the original constitutional intent," the report says, though recently Trump has publicly distanced himself from Project 2025.

The district's office market is poised to get worse regardless of the outcome of the election. The federal government is likely to shed more space in the years to come partly because of the growing number of employees working remotely.

Six agencies, including the Justice and Treasury departments, have lease expirations between 2024 and 2027 in which they are expected to give up close to 600,000 square feet, according to Cushman & Wakefield.

Office markets throughout the U.S. are experiencing historic levels of distress. The rise of remote work has undermined workplace demand. High interest rates have reduced property values by tens of billions of dollars in a business that depends heavily on leverage.

While some pockets, such as New York City, have shown recent signs of bouncing off a bottom, the slow return of federal workers to the office continues to sour the mood of the district's office owners.

A Government Accountability Office review of 24 federal agencies last year estimated that 17 of them used on average one-quarter or less of the capacity of their headquarters buildings during a three-week sample period.

The district's office vacancy rate rose to a new high of 22.4% in the second quarter from less than 14% in the fourth quarter of 2019, according to CBRE Group.

In the first quarter, about 39% of Washington office loans that were securitized were either in default or at risk of default, according to the credit-research firm KBRA Analytics, the seventh highest rate in the country.

Creditors foreclosed on 12 district office buildings in the first half of this year, already exceeding the total for 2023.

The amount of occupied space declined by more than 500,000 square feet in the second quarter, "with the federal government accounting for nearly half of the occupancy loss," CBRE said in a recent report.

Bars, restaurants and other small businesses that depend on federal workers have struggled. Last year the district projected a budget gap of close to $500 million in its fiscal plan partly because of a drop in real-estate tax collection.

Despite some positive signs, "the District of Columbia's economy has consistently underperformed the national economy across nearly all indicators," Glen Lee, the city's chief financial officer, said in a letter to elected officials earlier this year.

The Biden administration told Congress in April that it is working toward a goal in which those eligible for telework are in the office at least 50% of the time. Government employee unions, which are among the Democratic Party's biggest supporters, have opposed these efforts, a stance likely to continue if Democrats stay in power.

If Trump is elected, he is widely expected to try to force workers back at a higher rate. But he also would likely resume efforts to eliminate the Education Department and move agencies out of the city, which could more than offset any positive impact from bringing more workers back to the workplace.

Trump would meet political resistance no matter what he tries to do, as he did when he was in the White House. Indeed, the full-time federal civilian workforce increased 0.9% a year on average during the Trump administration, according to a report by the Partnership for Public Service, a nonprofit group trying to improve the federal government.

Congress would have to approve the elimination of the Education Department or any other agency. A second Trump administration also would likely meet significant resistance if it starts where the former president left off during his term in the White House in trying to change rules to make it easier to fire civil servants.

Some problems with federal office space in recent years have been obvious to Democrats and Republicans. For example, presidents going back to George W. Bush have determined that the deteriorating J. Edgar Hoover Building, the Federal Bureau of Investigation's headquarters, is obsolete and inefficient. Yet none of them have been able to make much progress with plans to relocate the agency or overhaul the property.

Under the Biden administration's latest plan, which calls for a new headquarters in Greenbelt, Md., construction wouldn't begin until 2029.

"Anything any president would have to do related to an agency occupying their space has to go through the bureaucracy," said Matt Pestronk, president and co-founder of Post Brothers, a developer that has purchased two office buildings at steep discounts to convert them into apartments.

"That's the real thing that's caused big parts of Washington to stagnate," he said.

Write to Peter Grant at peter.grant@wsj.com

Appeared in the July 24, 2024, print edition as 'D.C. Office Market's Struggles to Persist'.

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The Increasing Levels of Vacant Office Space: The Achilles' Heel of DC's Office Market

Daniel Muhammad
Monday, July 15, 2024 - 4:00pm

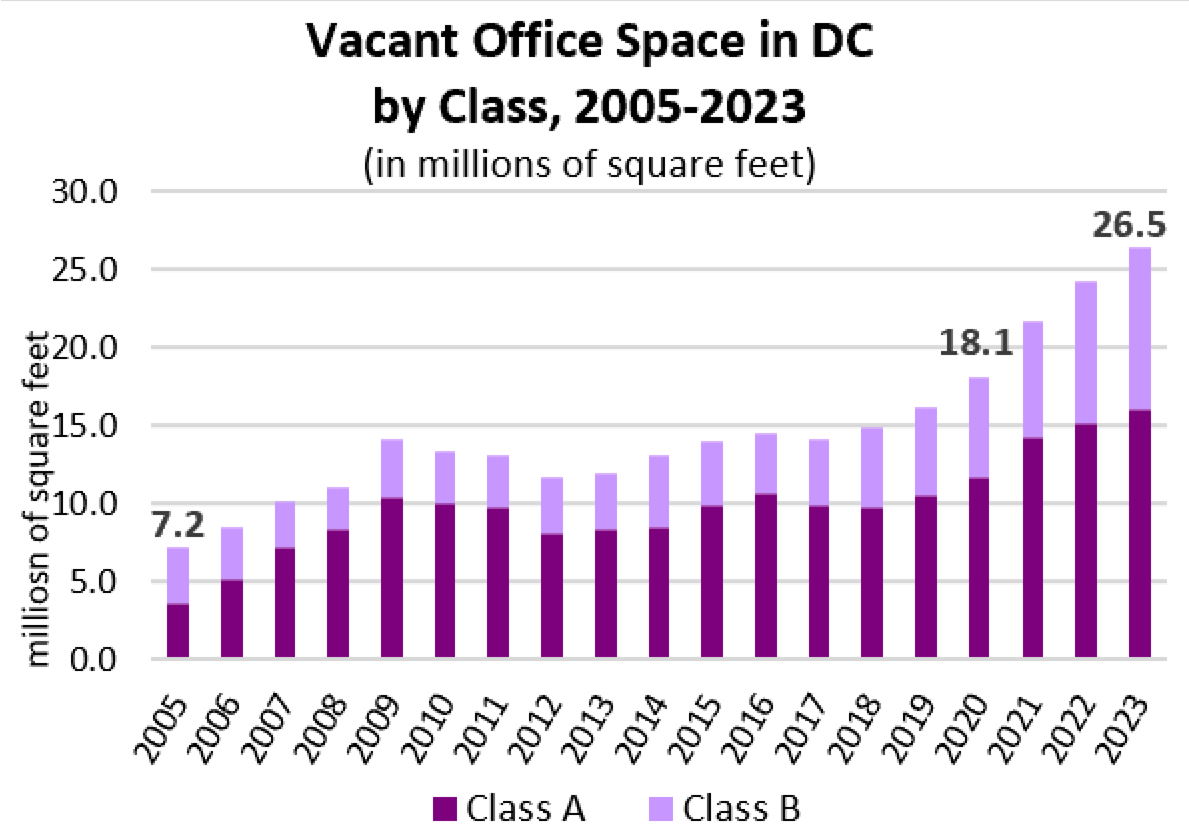
When a city's commercial office buildings are experiencing a trend of increasing net vacant space over the long term, it signifies a growing lack of demand for office space in the market. This surplus of available office space can prompt a decline in property assessment values as the buildings produce less net income and are considered less sought-after assets. In this context, fewer investors/potential buyers may be less inclined to purchase these buildings, reducing sale prices for the few transactions that do occur. These buildings' overall market value diminishes with lower sale prices and decreased demand.

The following analysis illustrates how the recent trend of rapidly increasing levels of vacant office space in DC is impacting the value of several hundred large office buildings. The analysis identifies

Shrinking Office Demand Drives Vacancy Rates Higher

One of the major problems plaguing the District of Columbia office market is the growing amount of vacant office space. Between 2020 and 2023, vacant office space increased by 8.4 million square feet (msf) or 46.2 percent. (Figure 1)

Figure 1



Source: CoStar

Initially, Class B office space experienced a faster increase in vacancy rates than Class A office space. However, due to the surge of remote work starting in 2020, new office leases across both sectors required, on average, 13 percent less space. Consequently, the total space demanded by all office tenants decreased by 5.2 million square feet (3.8 percent) between 2020 and 2023, the most significant decline in total space in the past two and a half decades (Figure 2).

Figure 2

OFFICE OF REVENUE ANALYSIS
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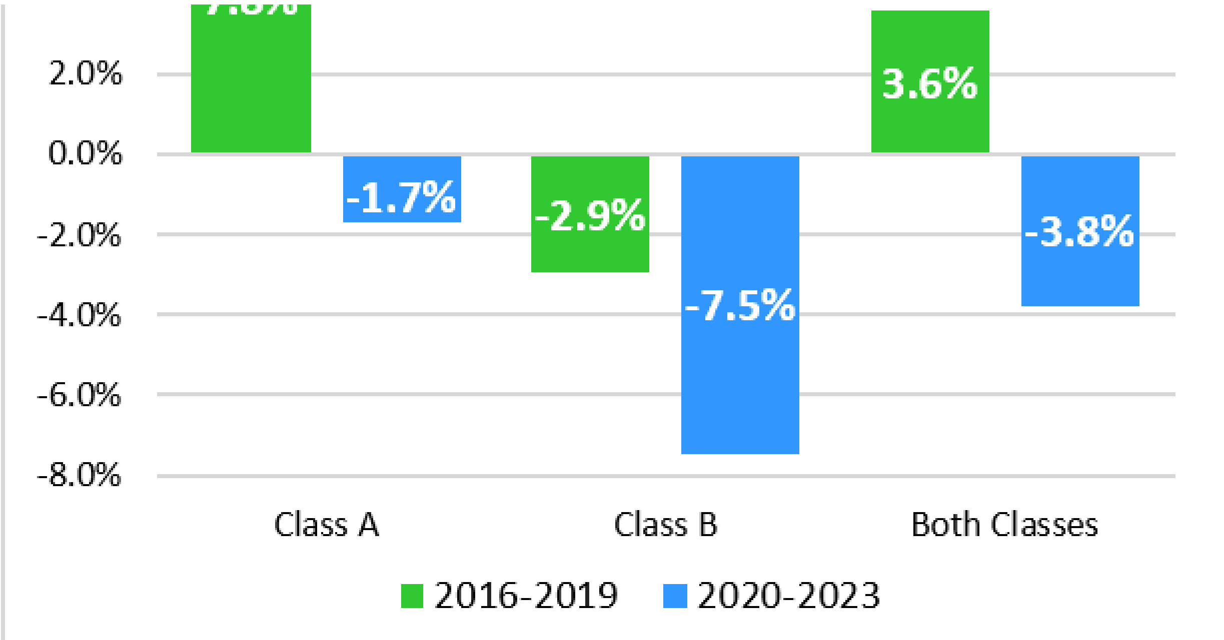

Source: CoStar

While the decreasing demand for space is a primary cause of the growing amount of excess office space in recent years, this issue has been further exacerbated by the continuous, albeit modest, expansion in the net supply of office space (Figure 3). This increase in supply from 2020 to 2023 has been exclusively in Class A properties, with Class B space decreasing over the same period. Consequently, the city's direct vacancy rate rose from 11.7 percent in 2020 to 15.6 percent in 2023.

Figure 3

OFFICE OF REVENUE ANALYSIS
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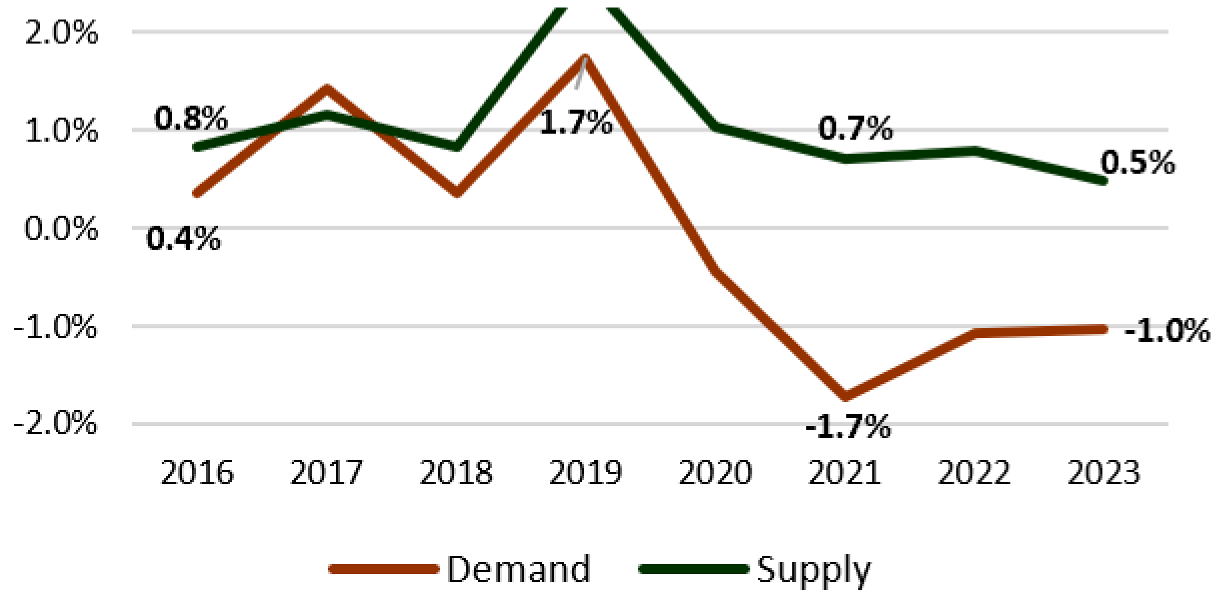

Source: CoStar

The supply of office space is the total square footage of city office space in privately owned, existing, and fully constructed class A and B commercial office buildings that are leased, for lease, or for sale. The demand for office space is the total square footage of space for the same set of buildings that is under a lease obligation and physically occupied by a tenant.

The Primary Source for Declining Values

As vacancy rates in the District of Columbia office market have increased, another consequential trend has emerged: declining property values. This decrease is the result of various factors, including the notable increase in vacant office space.

Table 1 shows the economic situation of all fully taxable office buildings with an assessment value of more than $10 million in 2020. Of the 572 office buildings, the top 20 percent highest valued buildings (114 buildings) accounted for half of the $66.1 billion in assessed value and $1.219 billion in total real property taxes paid by all that year.

Quintile 3	114	$ 9,512,768.5	14.4%	$ 83,445.3	$ 108,984.3	$ 178,150.4	14.5%	$ 1,562.7	$ 2,059.8
Quintile 4	115	$ 16,665,810.9	25.2%	$ 144,920.1	$ 174,900.0	$ 311,150.8	25.7%	$ 2,705.7	$ 3,305.6
Quintile 5	114	$ 33,426,801.8	50.6%	$ 293,217.6	$ 770,711.7	$ 607,666.4	49.8%	$ 5,330.4	$ 14,566.5
Total	**572**	**$ 66,122,447.2**	**100.0%**	**$ 115,598.7**	**$ 770,711.7**	**$ 1,218,662.8**	**100.0%**	**$ 2,130.5**	**$ 14,566.5**

Data Source: ORA analysis of OTR's annual real property tax data for TY 2020

However, by 2023, 85.3 percent of these buildings experienced a decrease in value, causing them to lose a total of $6.9 billion (11.9 percent) in value and pay $143.2 million less in real property taxes in 2023 (Table 2).

Table 2

Large Commercial Office Buildings with Reduced Assessment Values from 2020 to 2023
($ in thousands)

		Assessment Value			Real Property Tax		
	# of Properties	Reduction in Assessment Value	% Reduction	Avg Reduction in Assessment Value	Reduction in Real Property Taxes	% Reduction	Avg. Reduction in Real Property Taxes
Quintile 1	87	-$217,100.1	-14.9%	-$2,495.4	-$4,538.7	-16.6%	-$52.2
Quintile 2	99	-$599,154.8	-15.4%	-$6,052.1	-$12,491.4	-17.2%	-$126.2
Quintile 3	99	-$1,020,706.9	-12.6%	-$10,310.2	-$21,387.4	-13.9%	-$216.0
Quintile 4	99	-$1,446,608.0	-10.1%	-$14,612.2	-$27,849.0	-10.3%	-$281.3
Quintile 5	104	-$3,625,373.2	-12.0%	-$34,859.4	-$76,891.1	-13.9%	-$739.3
Total	**488**	**-$6,908,943.0**	**-11.9%**	**-$14,157.7**	**-$143,157.6**	**-13.3%**	**-$293.4**

Data Source: ORA analysis of OTR's annual real property tax data for TY 2020 and TY 2023

In Figure 4, you can see the real property taxes paid by large commercial office buildings with an assessment value of more than $10 million in 2020 (LCOBs) as a proportion of real property taxes paid by all properties in the District from 2005 to 2023. The percentage of taxes paid by LCOBs reached its peak in 2015 at 47.9 percent and has been steadily declining since then. In 2023, LCOBs only accounted for 37.8 percent of all property taxes paid to the District, as the assessed value of LCOBs grew by just 4.1 percent from 2015 to 2023, while residential property grew by 58 percent.

Figure 4

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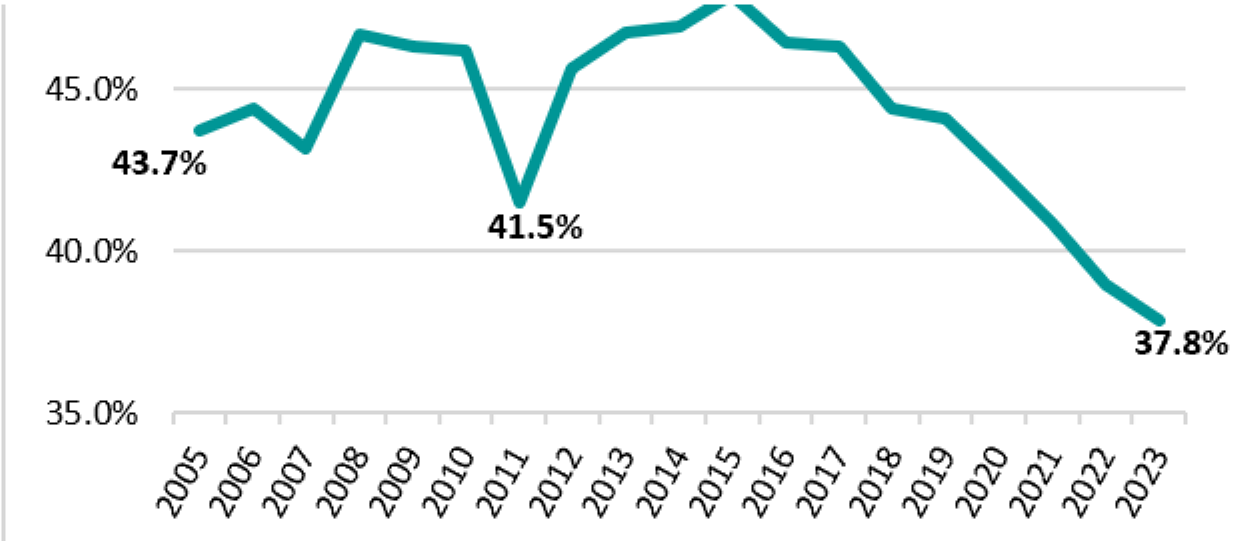


Source: ORA analysis of OTR's annual real property tax data for TYs 2005-2023

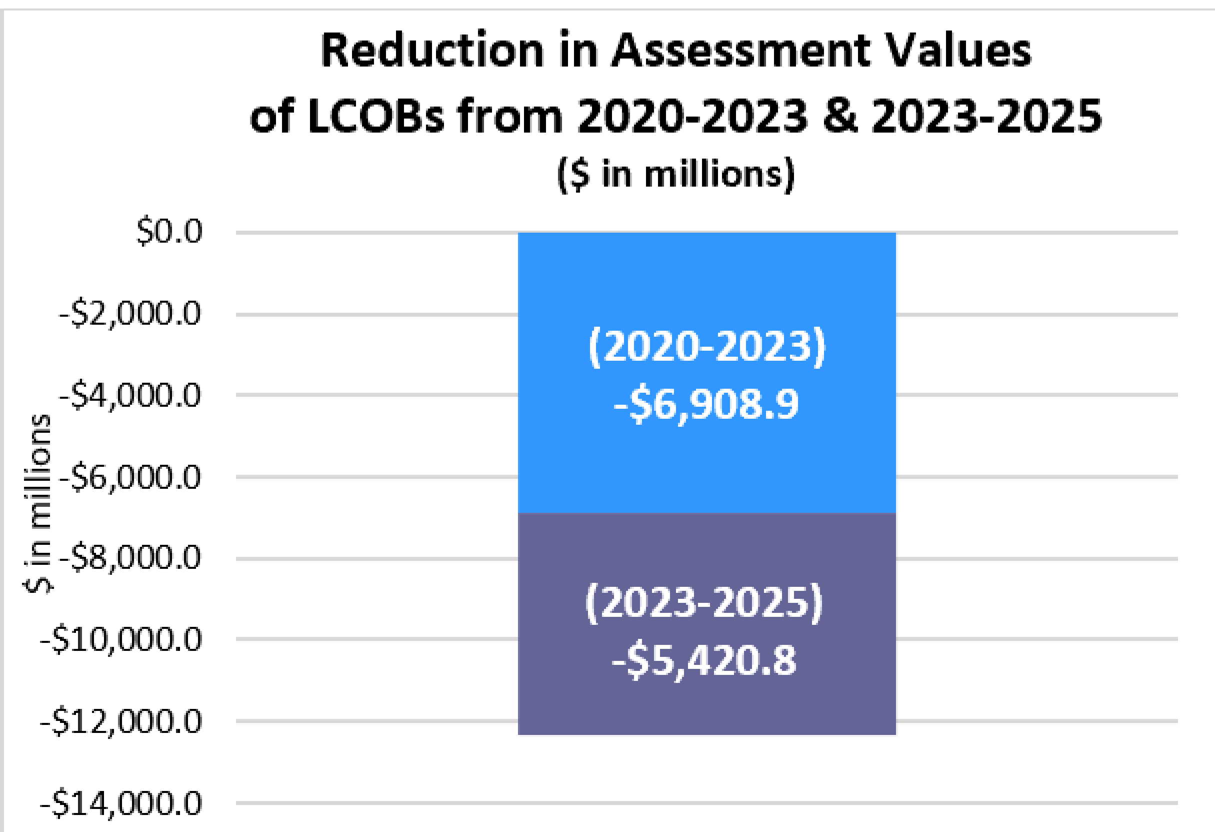
Additionally, the steady decline illustrated in Figure 4 is expected to persist, with 492 (86.0 percent) of the city's most valuable LCOBs projected to experience an additional 10.8 percent decrease in value between 2023 and 2025(Table 3). The FY 2025 assessment values are currently proposed assessments and have not yet been through the appeals process, meaning the final decrease between FY23 and FY25 could be higher than shown in Table 3. These assessment values come from our Real Property Tax Administration.

	# of Properties	Reduction in Assessment Value	% Reduction	Avg Reduction in Assessment Value
Quintile 1	96	-$229,760.0	-16.0%	-$2,393.3
Quintile 2	102	-$697,900.8	-19.4%	-$6,842.2
Quintile 3	102	-$1,008,911.9	-13.2%	-$9,891.3
Quintile 4	99	-$1,577,521.9	-11.8%	-$15,934.6
Quintile 5	93	-$1,906,684.6	-7.9%	-$20,502.0
Total	**492**	**-$5,420,779.1**	**-10.8%**	**-$11,017.8**

Source: ORA analysis of OTR's annual real property tax data for TYs 2023 and 2025

If we combine this projected loss in value with already realized losses, 86 percent or more of the city's highest-value LCOBs (large commercial office buildings) could lose a total value of $12.3 billion at some point between 2020 and 2025 due to a decrease in demand for leased space (as shown in Figure 5).

Figure 5



value. The 2025 assessment values are subject to appeal and could drop further.

Decreased Interest in Buying DC Office Buildings and the Impact on the Deed Tax

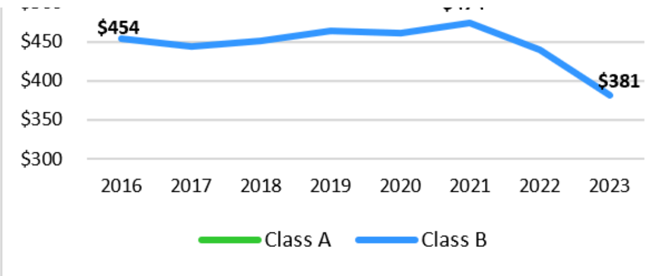
The difficult market conditions appear to be contributing to a decline in investor confidence, prompting property investors and potential buyers to hesitate or even abandon their pursuit of owning city office buildings. Consequently, the diminishing interest in purchasing office properties more ostensibly reflects the challenges confronting the city's commercial real estate sector.

Table 4 shows that from 2020 to 2023, there have been fewer market sales and more foreclosures than in the previous four years. (Six of the market sales in 2020 to 2023, entailed converting office buildings to primarily residential use.)

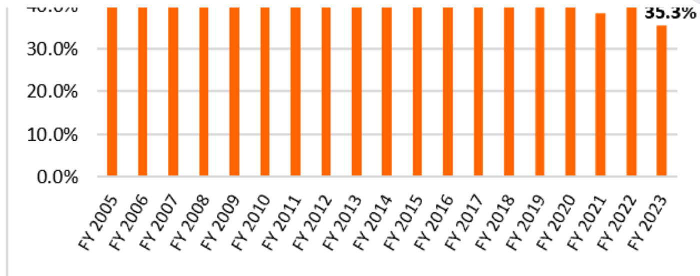
Year	Market Sales	Foreclosures	Other Sale/Transfer Types	All Property Sales & Transfers
2016	15	0	15	30
2017	16	0	10	26
2018	16	1	6	23
2019	18	0	19	37
Total 2016-2019	**65**	**1**	**50**	**116**
2020	6	0	8	14
2021	15	1	6	22
2022	8	1	6	15
2023	9	3	6	18
Total 2020-2023	**38**	**5**	**26**	**69**

Source: ORA analysis of OTR's annual real property tax data for TYs 2016 to 2023

Between 2021 and 2023, the average sales price per square foot for commercial buildings declined by 17.3 percent for Class A office buildings and 19.6 percent for Class B buildings (Figure 6). The decline in the number of sales and prices of commercial buildings explains the halving in commercial deed tax collections (as a share) between 2005 and 2023 (Figure 7).



Data Source: CoStar



Data Source: ORA analysis of OTR's Deed Tax data for FYs 2005 & 2023

Impact on Building Values in the Medium-Term

Between 2012 and 2023, unoccupied office space in the District of Columbia more than doubled from 11.7 to 26.5 million square feet. As a result, the direct vacancy rate increased from 9.3 to 15.6 percent. Since 2020, the demand for office space has decreased due to the rise of remote work, and this trend is expected to continue over the next three years. According to CoStar, the amount of empty office space in the city is projected to increase by an additional 11.8 million square feet (equivalent to 44.5 percent) by 2027. But while falling average office rents per square foot and rising market cap rates are also adversely affecting office property assessments, the predominant factor is the increase in vacancy rates. These trends are expected to result in continued lower annual assessment values for hundreds of office buildings until at least 2027.

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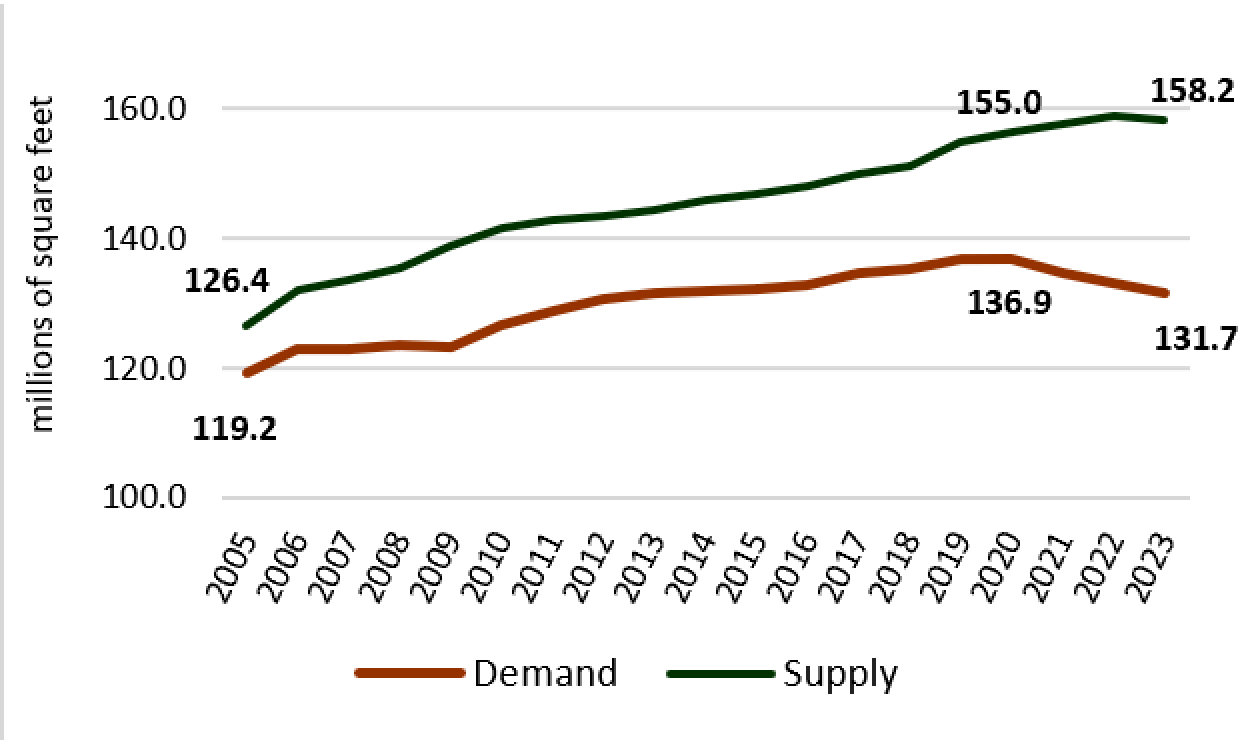

Data Source: CoStar

What is this data?

This study used administrative real property tax data from the Office of Tax and Revenue as well as commercial real estate market data from CoStar between the years of 2005 and 2023. CoStar Group, Inc. is a company that provides information, analytics, and marketing services to the commercial property industry both in the United States and abroad.

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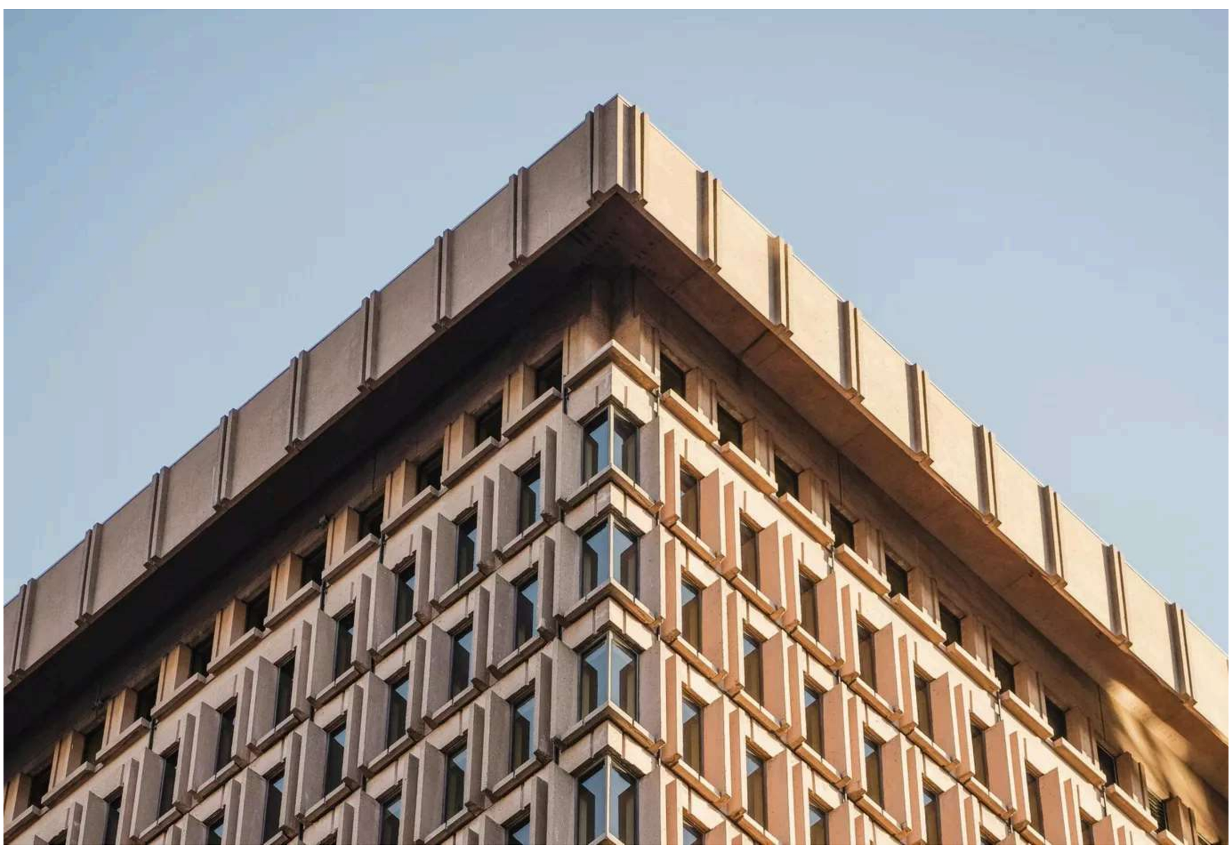
Office Loan Delinquencies Surge To 6.5% To End 2023, Hotels Not Far Behind

January 17, 2024 | Dees Stribling, Bisnow National (https://www.bisnow.com/author/dees-stribling-4660) (mailto:dees.stribling@bisnow.com)



Office-backed commercial loans finished 2023 with a delinquency rate of 6.5%, up from 5.1% in the third quarter, according to the Mortgage Bankers Association (https://www.mba.org/news-and-