Suburban Maryland Office Insight Report

Q2 2021

Key takeaways

Economic conditions

- Reopening efforts and higher vaccination rates have allowed the Suburban Maryland unemployment rate to rebound from a high of 9.1 percent to **6.1 percent**.
- Office-using jobs losses in the Washington, DC MSA have declined **1.6 percent** compared with 9.4 percent for other industries' job losses, underscoring the disproportionate impact the pandemic has had on the discretionary segments of the local economy.

Recovery rate

- Based on extrapolated cell phone data, Metro DC overall activity over the past six weeks was **48.7 percent** of what it was in the six weeks before COVID-19 lockdown.
- Regional office activity over the past six weeks was **33.3 percent** of what it was in the six weeks before COVID-19 lockdown, lagging the rate of overall activity.

Office demand

- Leasing activity has paused, decreasing by **27.8 percent** compared with the first half of 2020. While tour activity is picking up, leases are not being signed quickly as some tenants are still determining their long-term space needs.
- Renewals have become more common, accounting for **48.6 percent** of post-COVID activity.
- Recent net absorption has totaled **-0.7 percent** of the existing stock, which is more negative than the figures recorded in past recessions.

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Key takeaways

Office supply

- Total and direct vacancy have reached all-time highs, totaling **15.8 percent** and **14.7 percent**, respectively.
- While the amount of vacant sublease space has increased to **1.1 msf**, the highest level since 2009, it has not surpassed the figures posted in past recessions.
- Increased activity in the biotech industry has been a silver lining for Suburban Maryland, particularly along the I-270 Corridor. There is a shortage of office lab space, however, especially for smaller tenants. Some landlords are looking to buy existing buildings and fit out the infrastructure to create multi-tenant incubators.

Pricing trends

- Class A office base rents decreased by **3.5 percent** in 2020, but have edged up again for a **0.5 percent** net increase between 2019 and 2021.
- Landlords have induced tenant commitments through record-setting concessions. Class A average abatement has risen by **21.4 percent**, and the average TI package has increased by **53.7 percent** since the end of 2019.

Capital markets

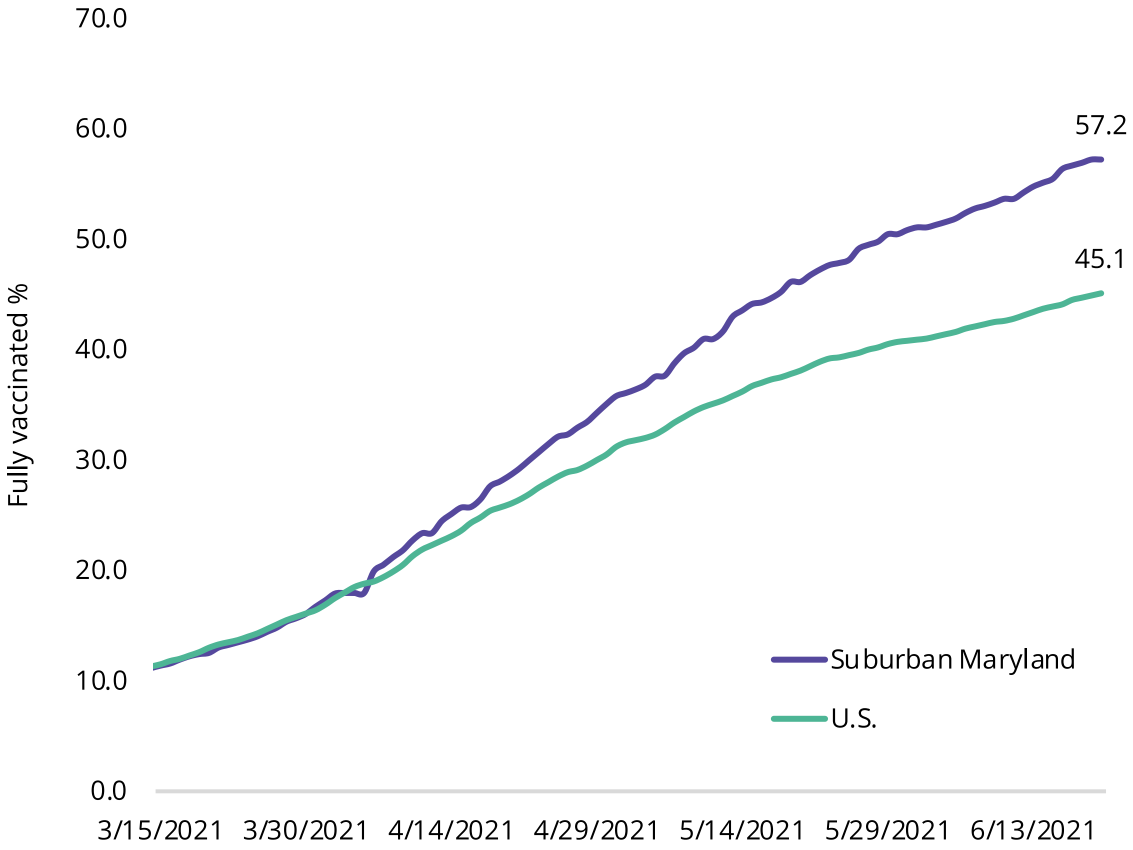
- Suburban Maryland core and core-plus office sales volume since 2020 stands at **$79.2M**, an annualized decrease of **91.7 percent** compared with the past five-year average.
- Asset pricing has softened by **3.8 percent** since 2019, as investors have adopted more conservative underwriting approaches.

Vaccination rates

57.2%

Share of total Suburban Maryland population that is fully vaccinated

Suburban Maryland proportionate vaccination rates have surpassed U.S. averages, an important metric that has allowed the area to loosen restrictions.



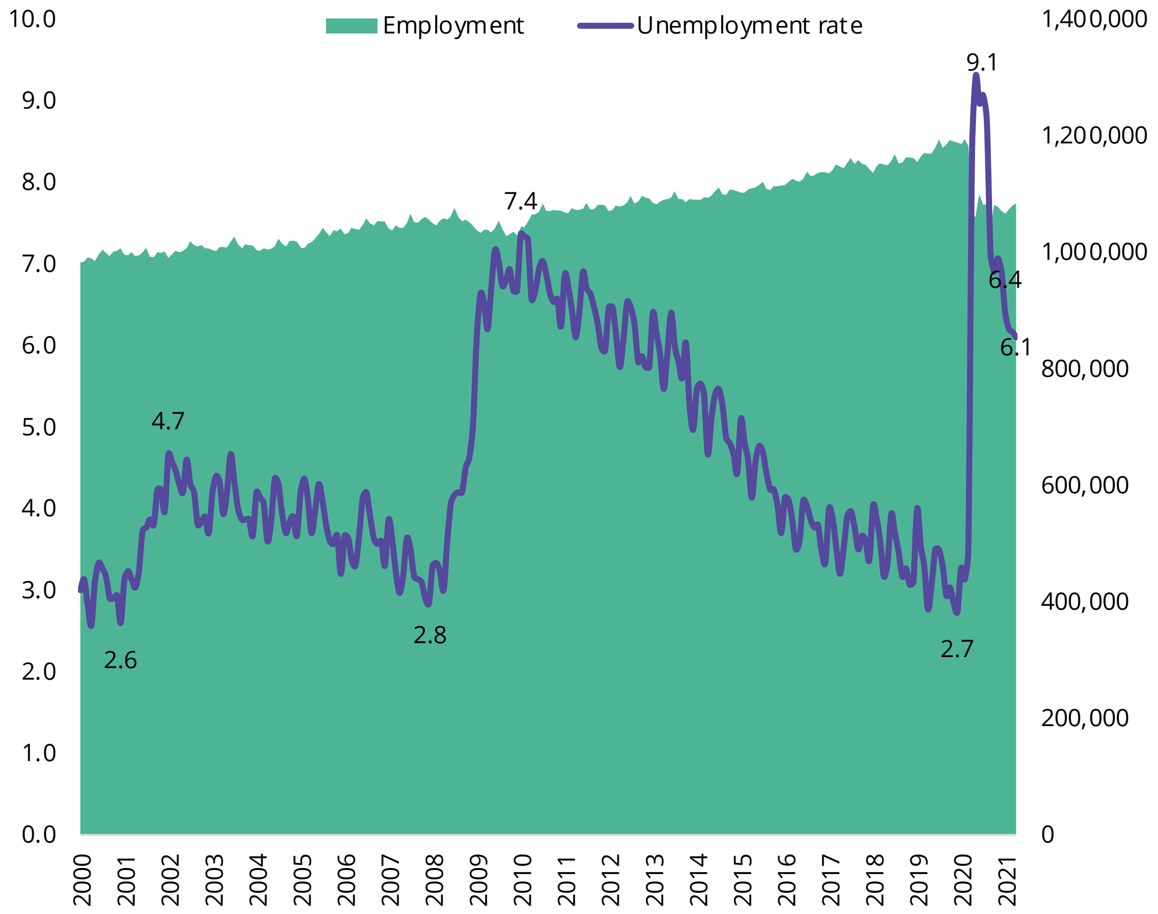
Source: CDC

Employment and unemployment rate

6.1%

Suburban Maryland unemployment rate as of April 2021, dipping below the height of the financial crisis

Historically tightened labor market conditions were halted by the pandemic with nearly 133,000 job losses between February and May 2020. However, reopening efforts enabled the economy to add 2.2% jobs since May 2020.



Note: Not seasonally adjusted data.
Source: Bureau of Labor Statistics

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Office-using job gains and losses

-1.6%

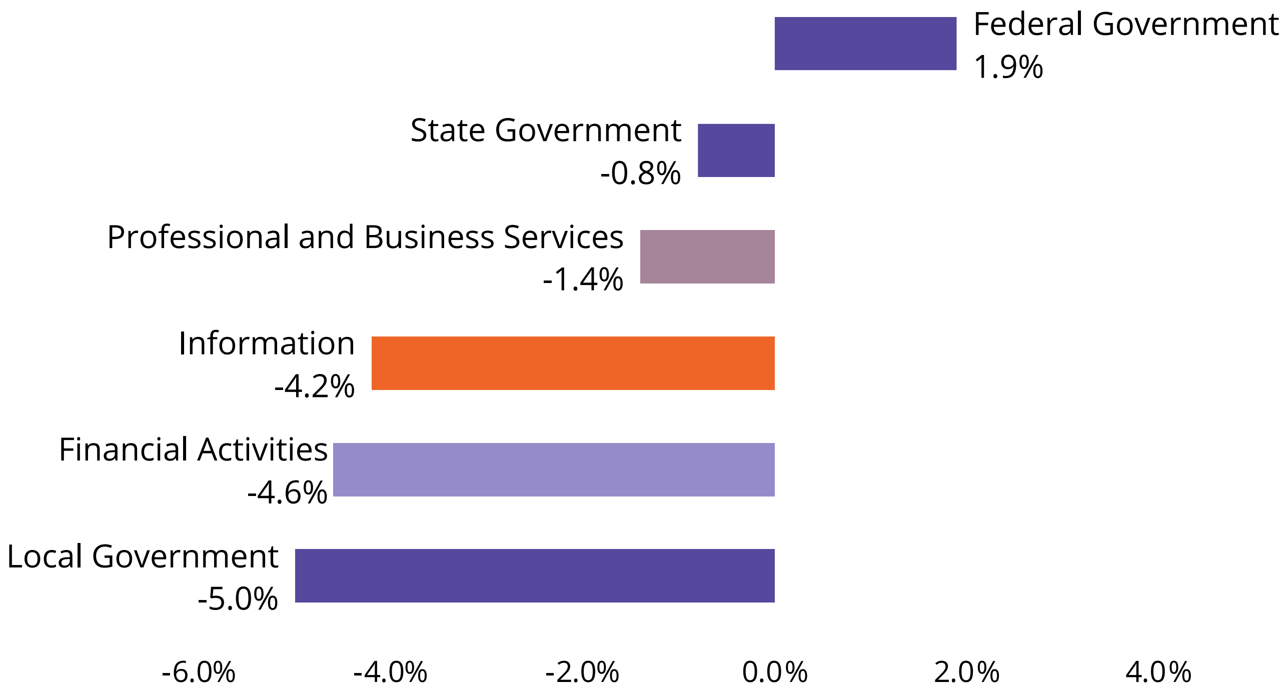
Change in office-using employment during the pandemic

Washington, DC MSA job losses have declined by 4.7% since the start of the pandemic, though office-using jobs contracted by just 1.6%. This recession's impact on the office-using labor market has been less severe than the global financial crisis, when Financial Activities job losses totaled 5%.

VIEW DASHBOARD

Total change in Washington, DC MSA job gains/(losses)

February 2020 to April 2021



Note: Not seasonally adjusted data. Metropolitan statistical area.
Source: Bureau of Labor Statistics

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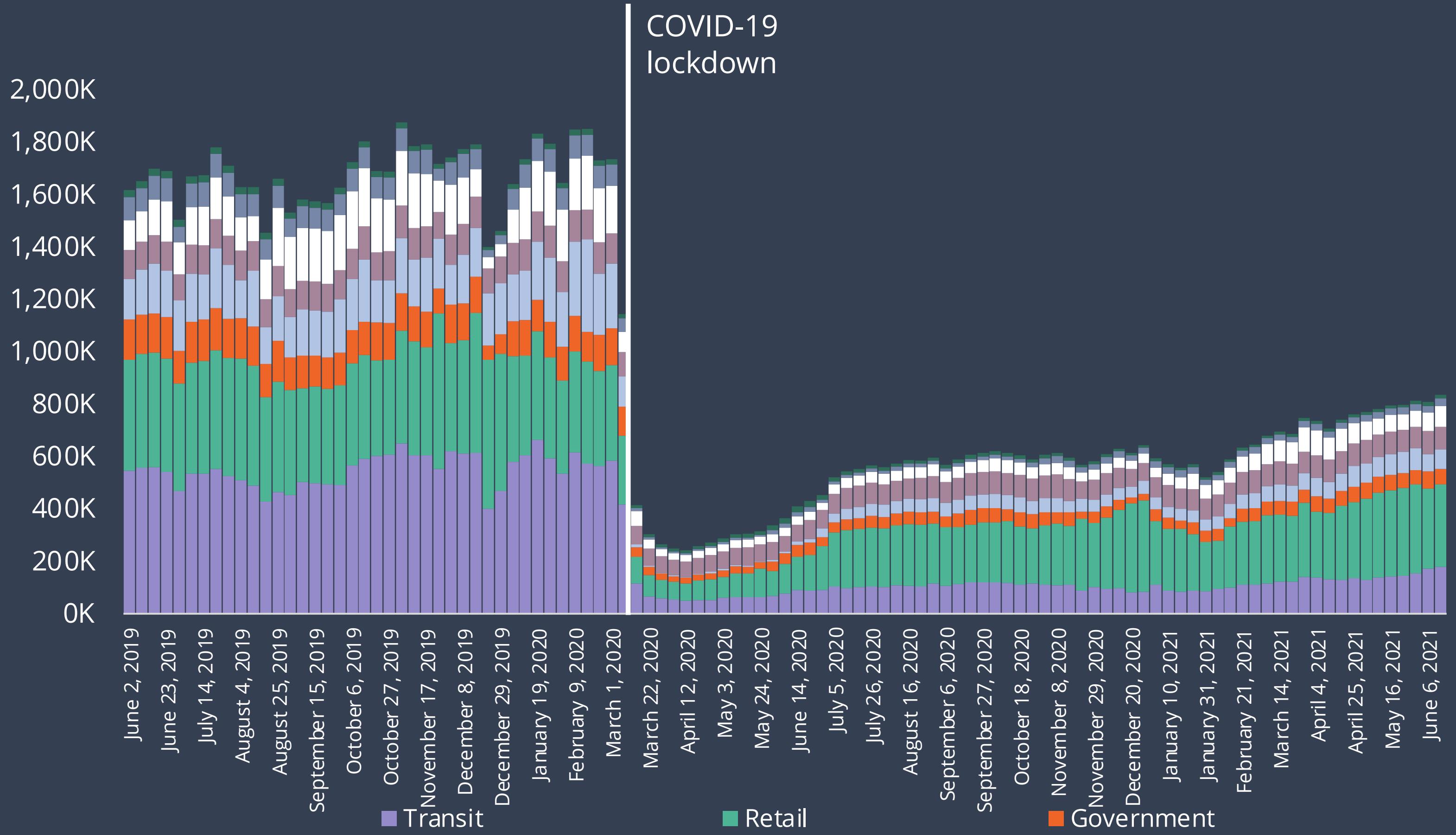
Recovery index

48.7%

Regional activity in past 6 weeks compared to the 6 weeks before lockdown

After remaining stagnant for all of 2020, visitor traffic to regional areas of interest has begun to increase slowly in 2021. Across all sectors, these locations have averaged nearly half of pre-COVID activity over the past 6 weeks.



Note: Representative areas of interest. Weekdays only.
Source: Orbital Insights, AVANT by Avison Young

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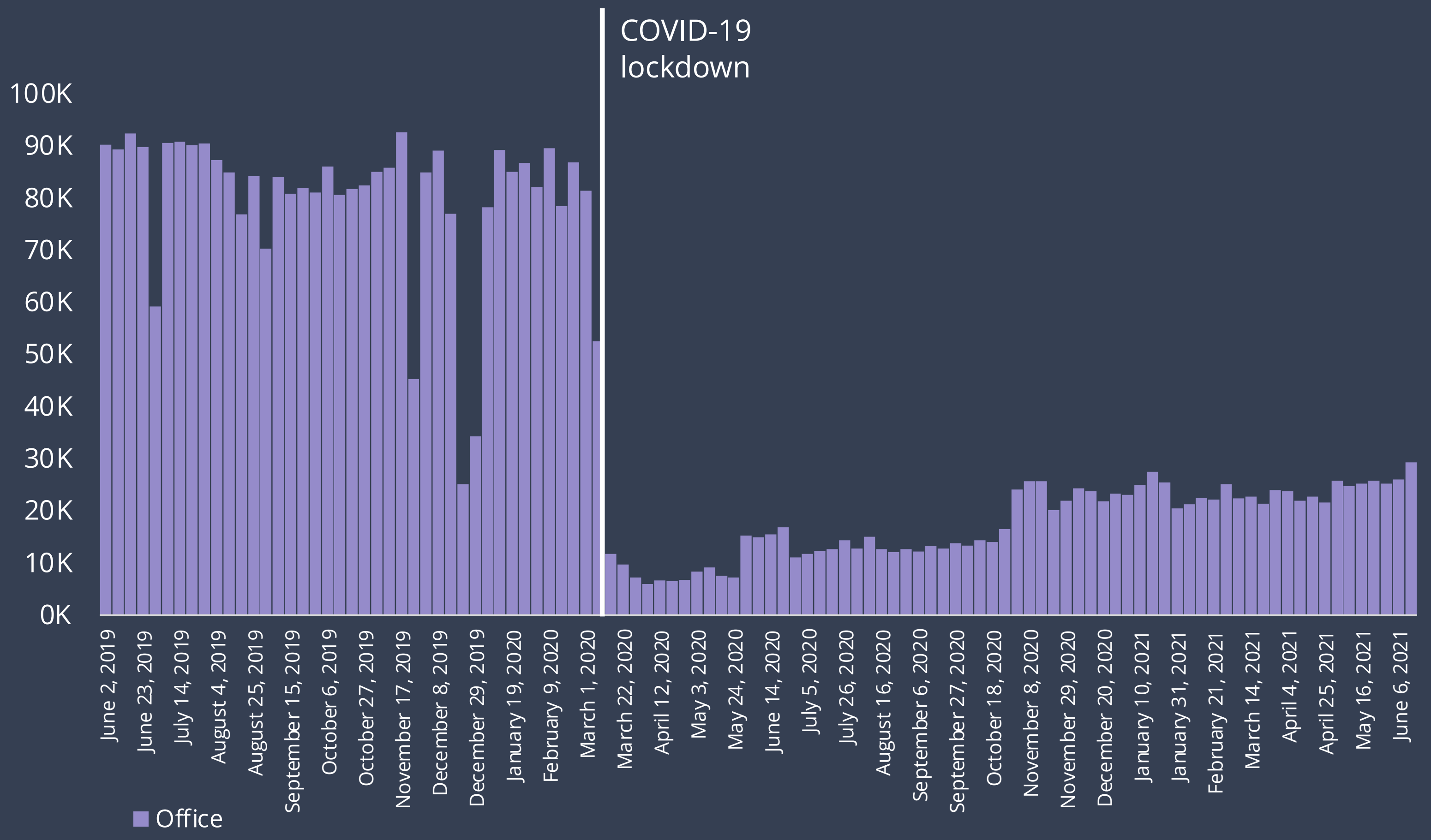
Recovery index

33.3%

Regional office activity in past 6 weeks compared to the 6 weeks before lockdown

Office buildings haven’t seen quite the resurgence in activity that the region overall has experienced, with just one third of pre-COVID weekly traffic returning.



Note: Representative areas of interest. Weekdays only.
Source: Orbital Insights, AVANT by Avison Young

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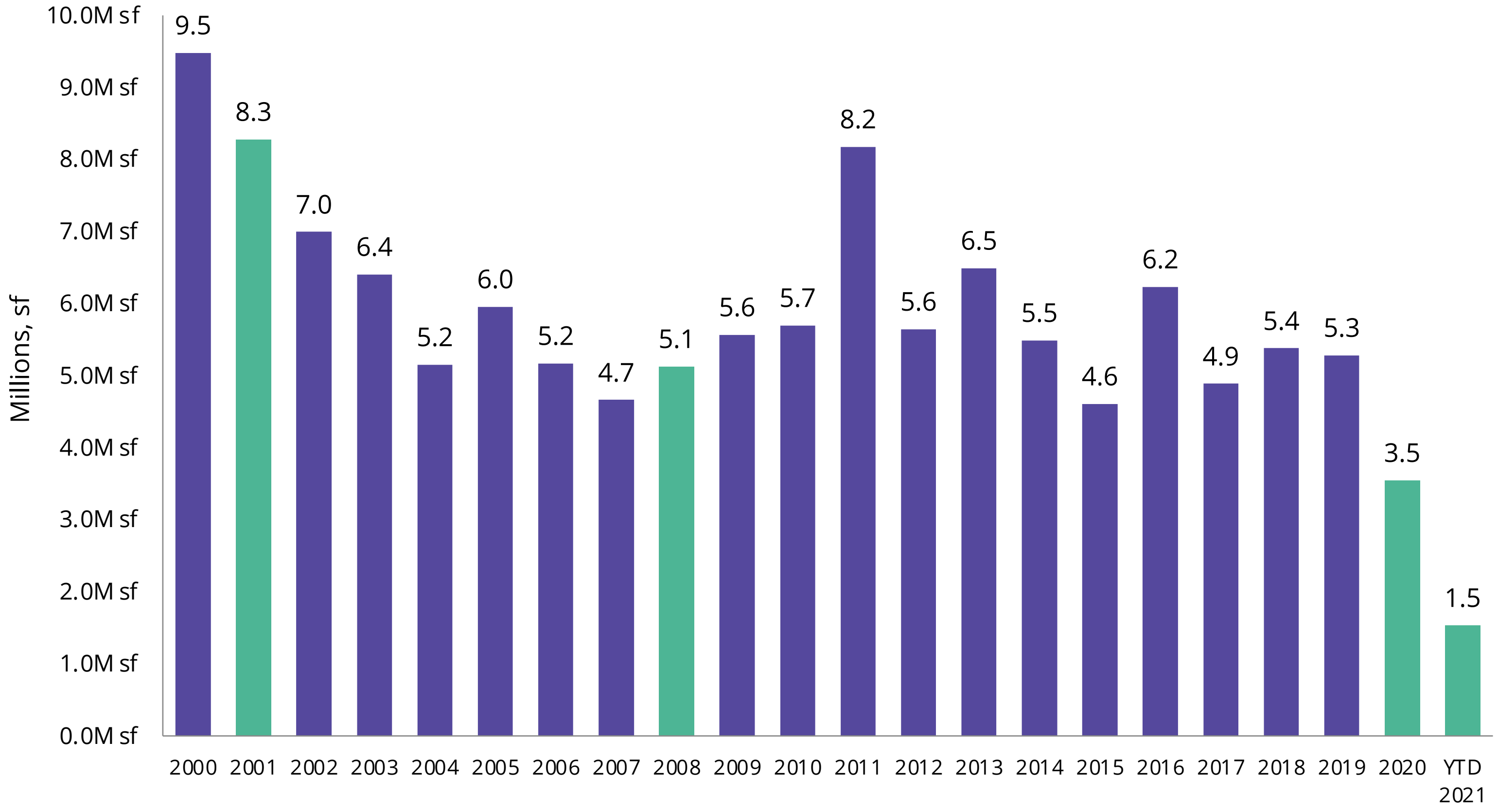
Office leasing activity

-27.8%

First-half 2021 leasing activity vs. first-half 2020 leasing activity

Unlike past recessions, in which Suburban Maryland's office market was unimpacted or even positively impacted, pandemic-related fears and restrictions have dramatically suppressed office leasing activity.



Source: AVANT by Avison Young, CoStar

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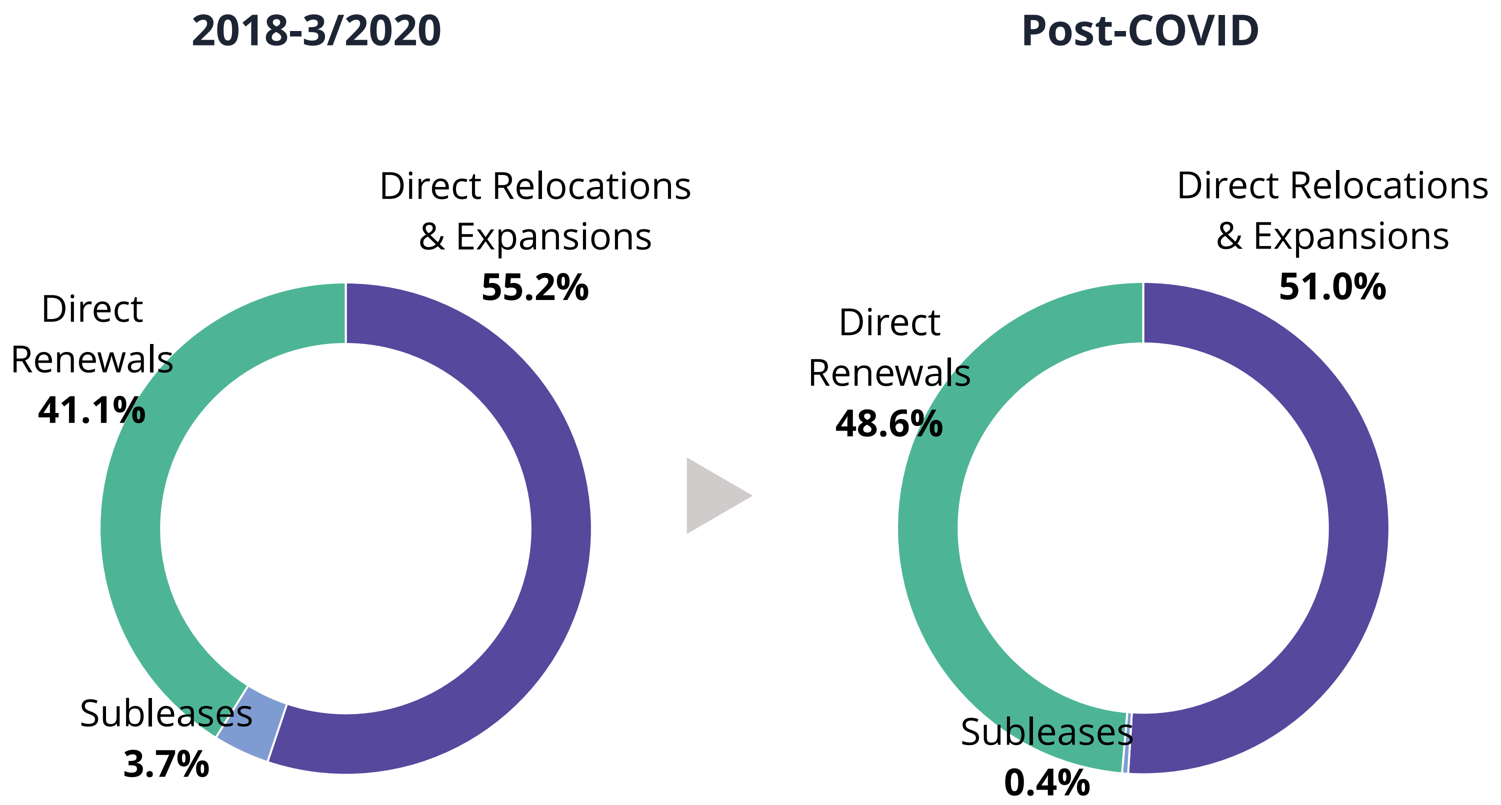
Transaction activity by lease type

48.6%

Renewals share of total Suburban Maryland office leasing activity post-COVID

Renewals (based on total sf) have become more common, providing tenants more time to navigate unprecedented environments.



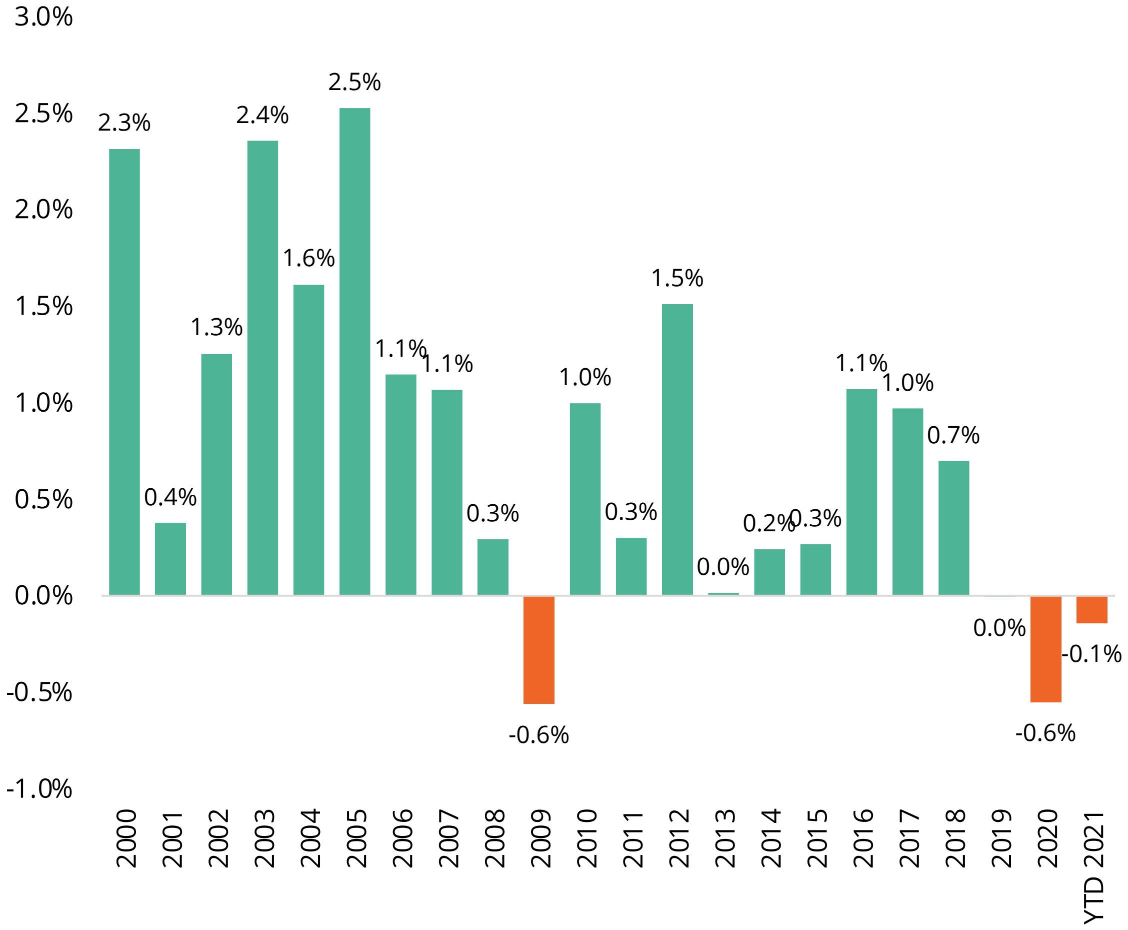
Source: AVANT by Avison Young

Absorption

-0.7%

Net absorption as a percentage of inventory, 2020 through Q2 2021

Negative absorption from 2020 to Q2 2021 has totaled 664,000 sf, or -0.7% of the existing stock. This negative absorption surpasses the lows of the early 2000s recession (0.4%) and global financial crisis (-0.6%).



Source: AVANT by Avison Young, CoStar

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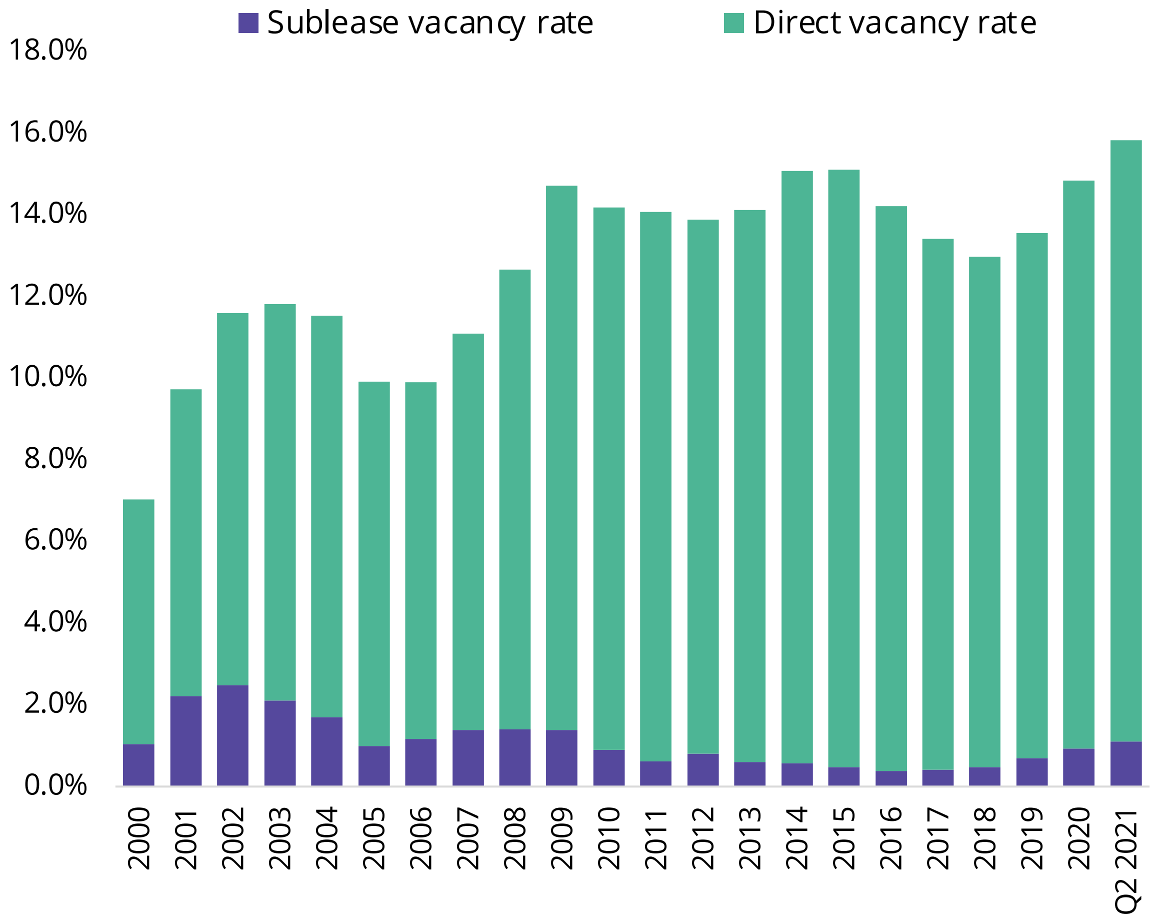
Vacancy rate

15.8%

Record high total vacancy as of Q2 2021

The total (15.8%) and direct (14.7%) vacancy rates for Q2 2021 are record highs, while sublease vacancy (1.1%) is at its highest level since 2009 (1.4%).



Source: AVANT by Avison Young, CoStar

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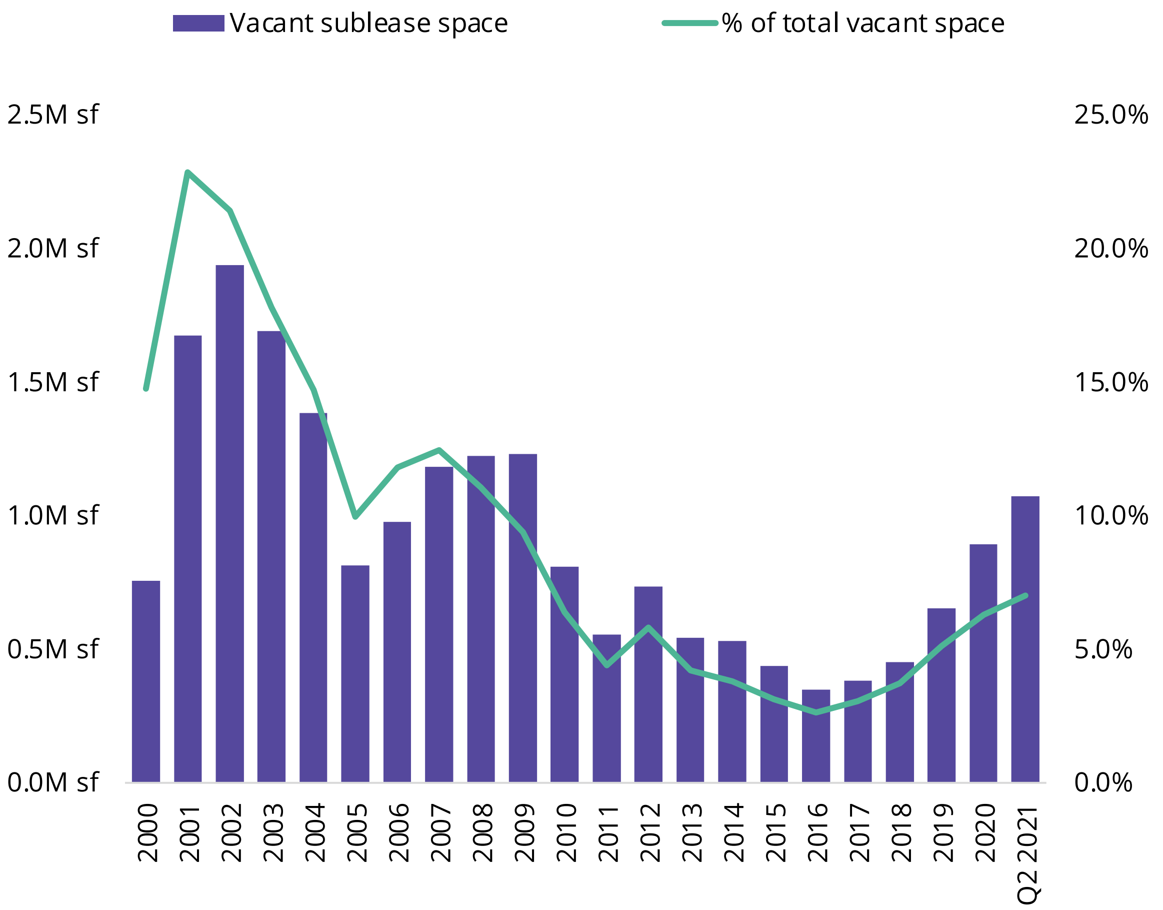
Vacant sublease space

1.1 msf

An increased but non-record level of sublease vacant space

While both the amount of vacant sublease space (1.1 msf) and the share of sublease-to-total vacant space (7%) are at the highest level since 2009, each metric remains well below the peak reached in 2002 and 2001, respectively.



Source: AVANT by Avison Young, CoStar

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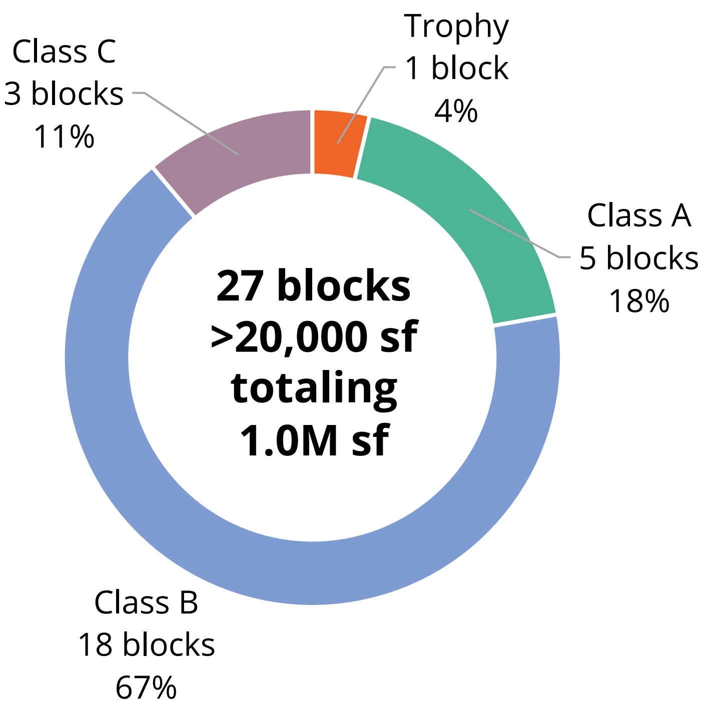
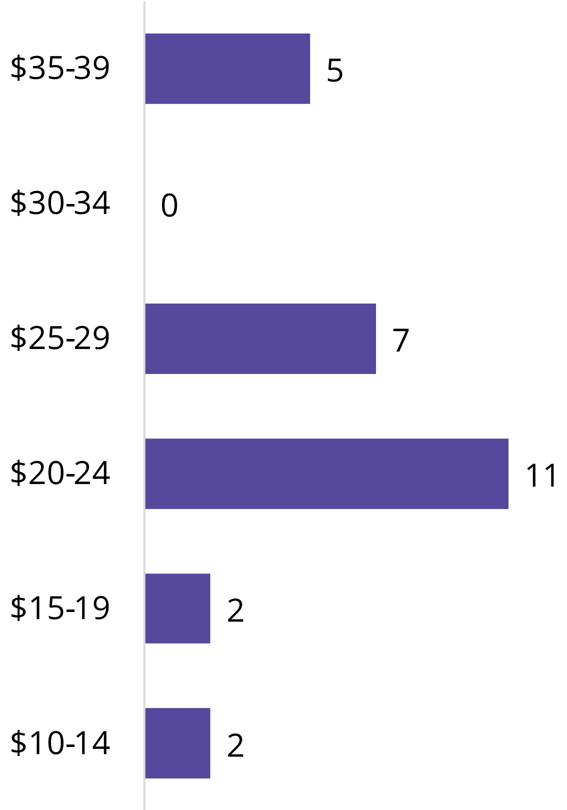
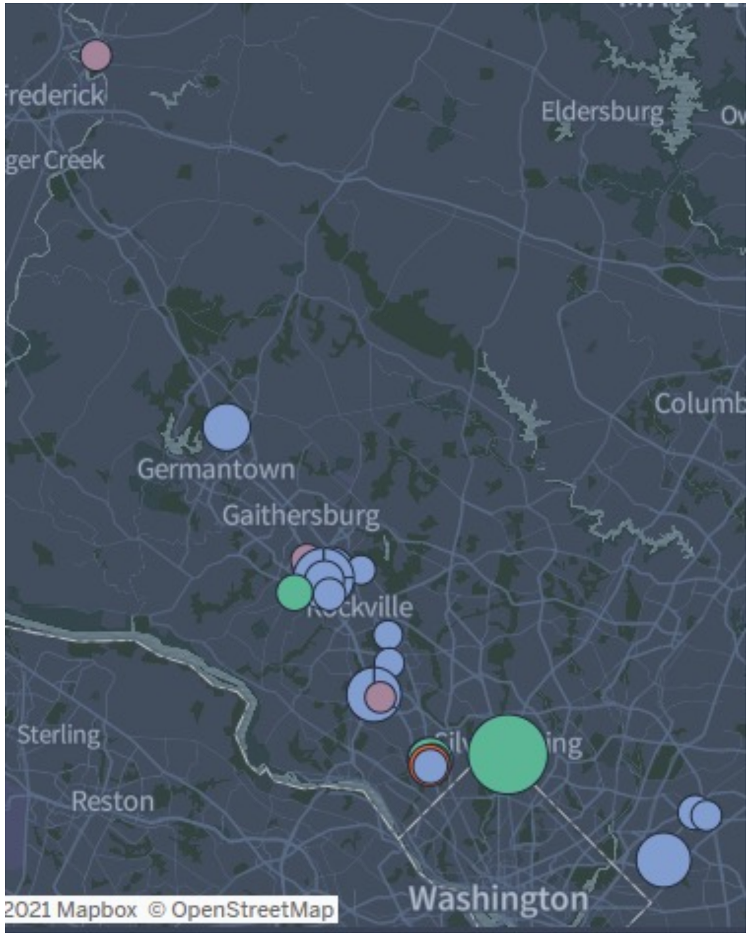
Sublease supply pipeline

Building classification



Asking rent per square foot





Note: Contiguous blocks of 20,000 sf or greater; vacant or available
Source: AVANT by Avison Young

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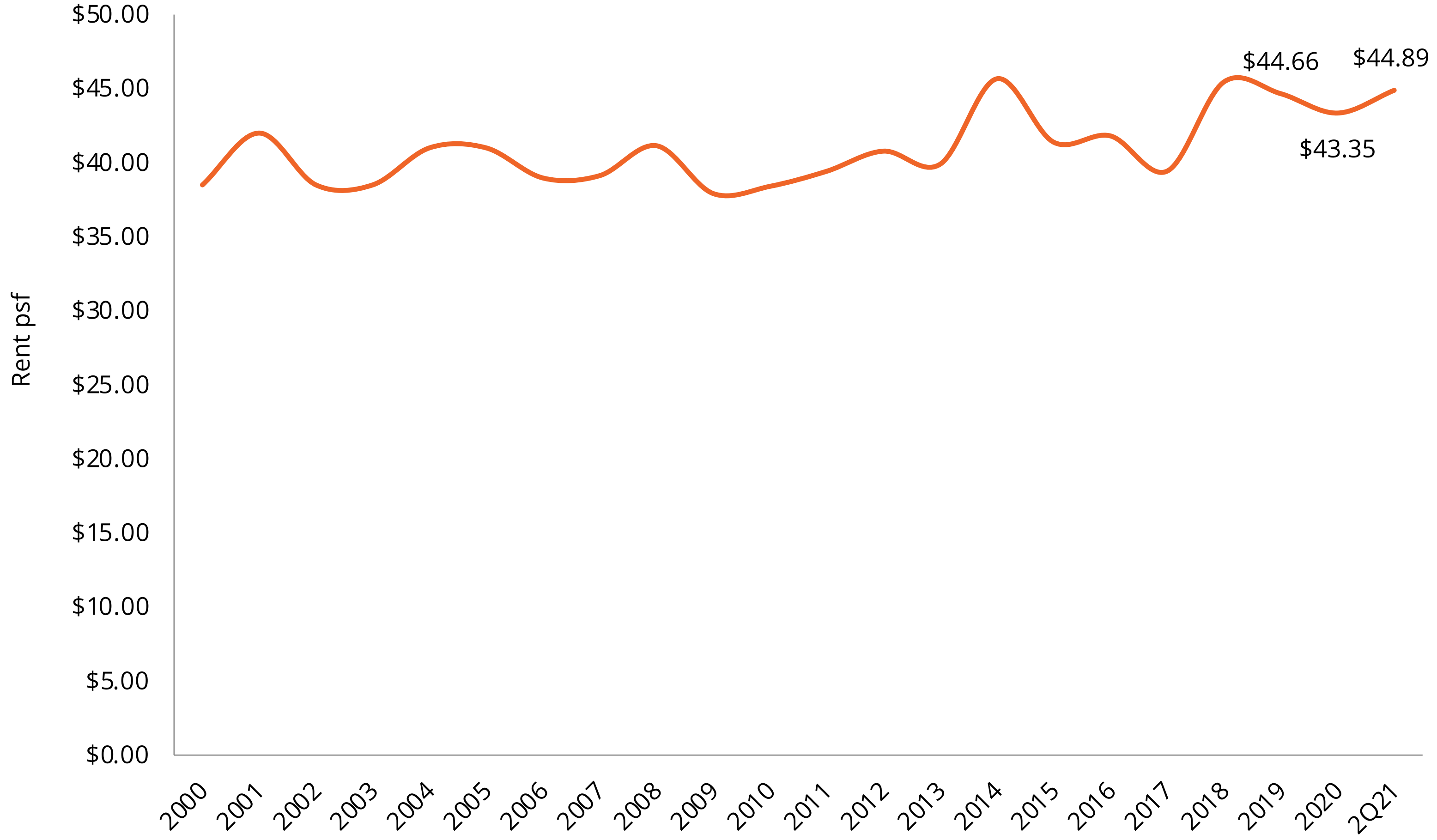
Base rents

+0.5%

Change in Class A average base rent since 2019

Class A base rents dipped 3.5% in 2020, but have climbed back to 2019 levels in 2021.



Source: AVANT by Avison Young

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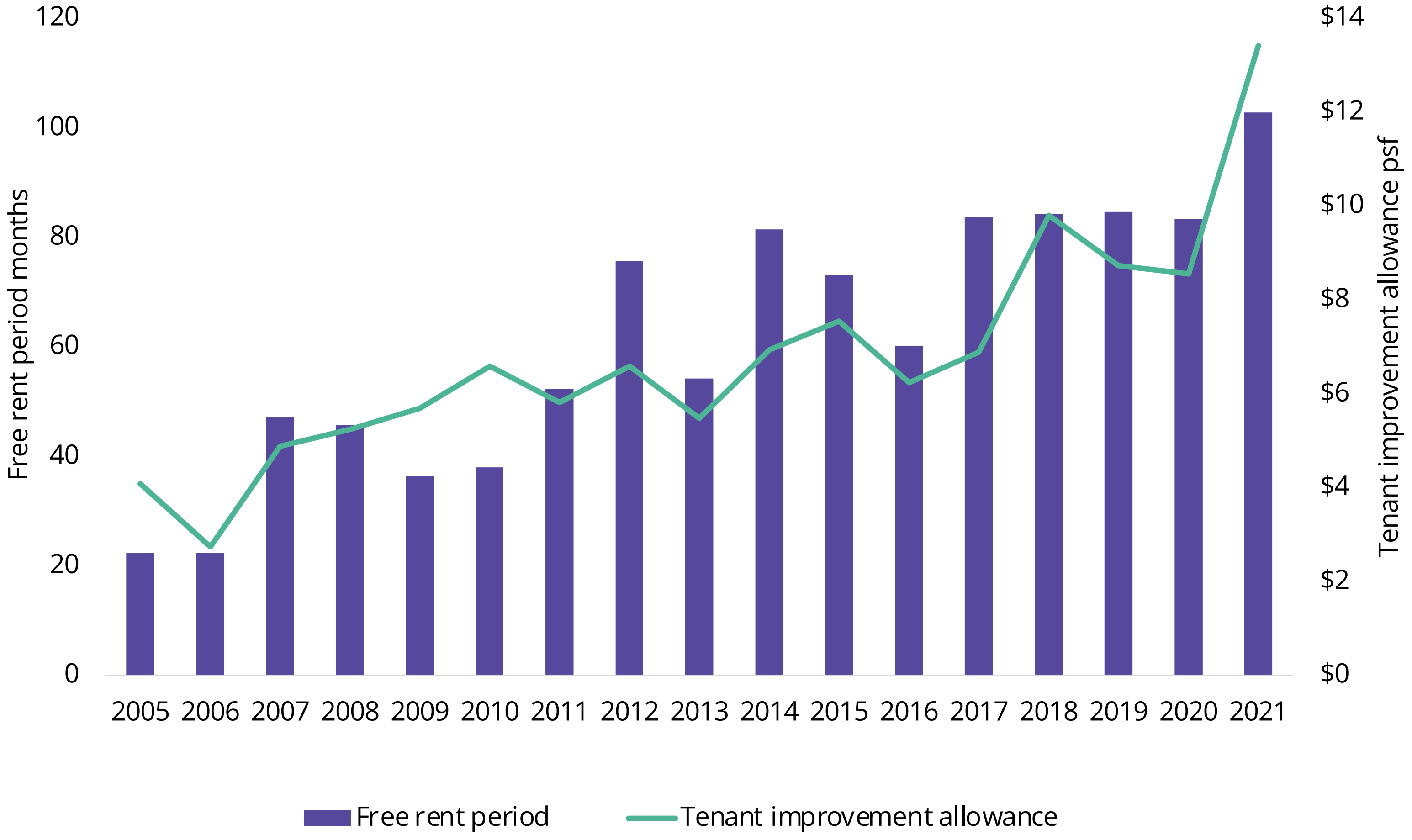
Concessions

21.4%

Rise in free rent since end of 2019

Concessions spiked in 2021, with the average free rent period rising 21.4% and average TI package increasing by 53.7%.



Note: Class A office properties.
Based on 10-year leases excluding subleases, renewals and expansions.
Source: AVANT by Avison Young

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Class B and C economics after the pandemic

Period	Average base rent	Average free rent period	Average tenant improvement allowance	Average net effective rent
2018 to 03/2020	$29.38 psf	10 months	$57.43 psf	$27.50 psf
04/2020 to today	$27.69 psf	10 months	$47.50 psf	$28.48 psf

Note: Class B and C direct relocations, 10+ year leases only.
Source: AVANT by Avison Young

Development pipeline

3 properties

Under construction

1.5 msf

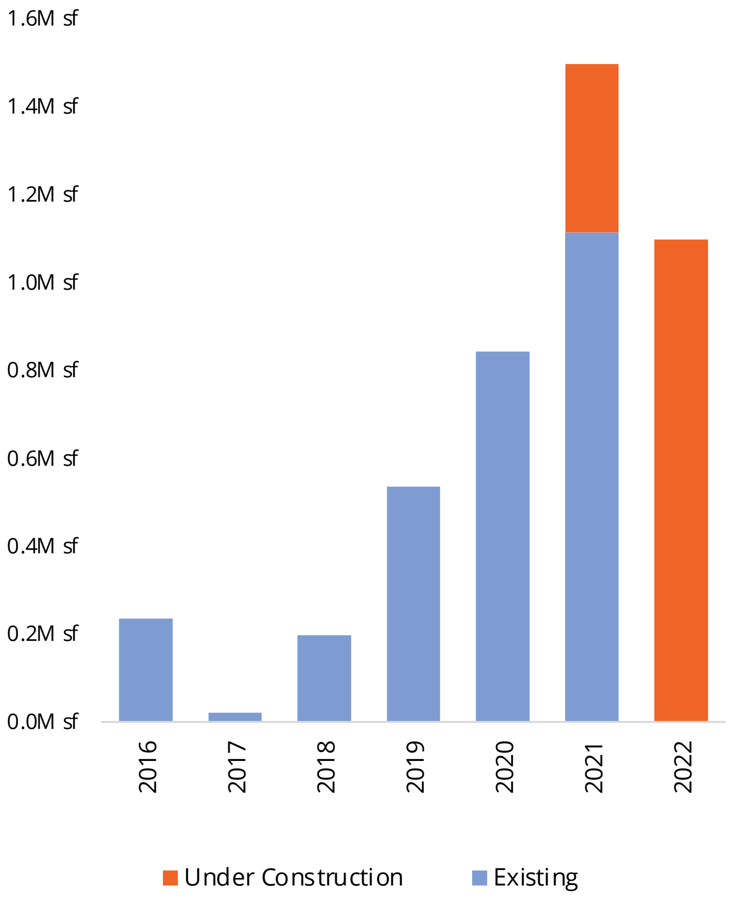
Under construction

1.7%

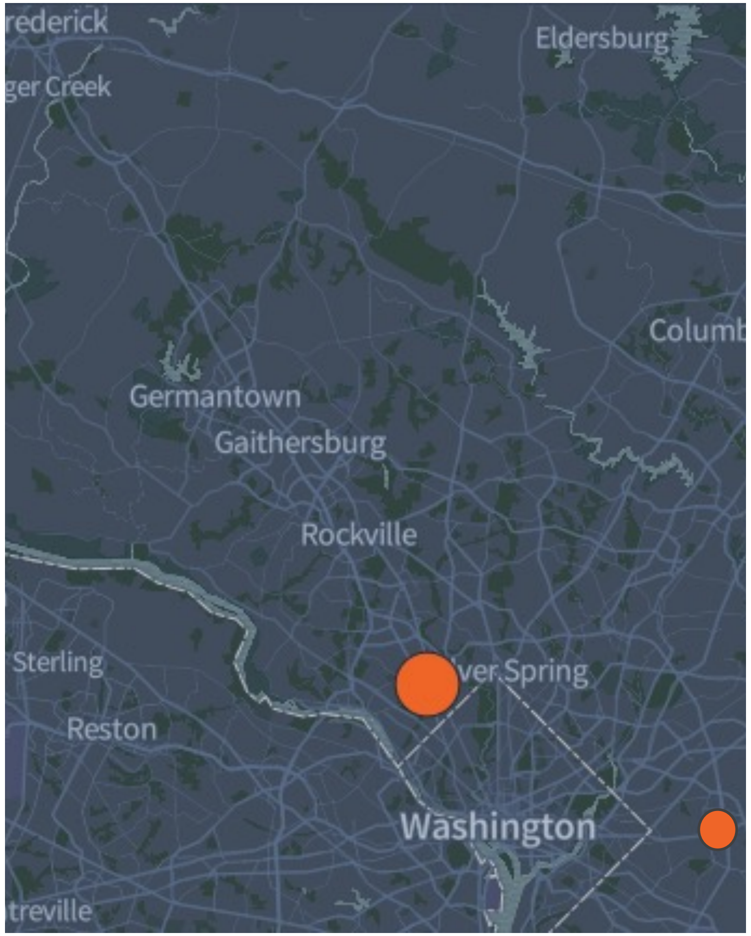
share of office inventory

1986

average delivery date of existing offices



Source: AVANT by Avison Young



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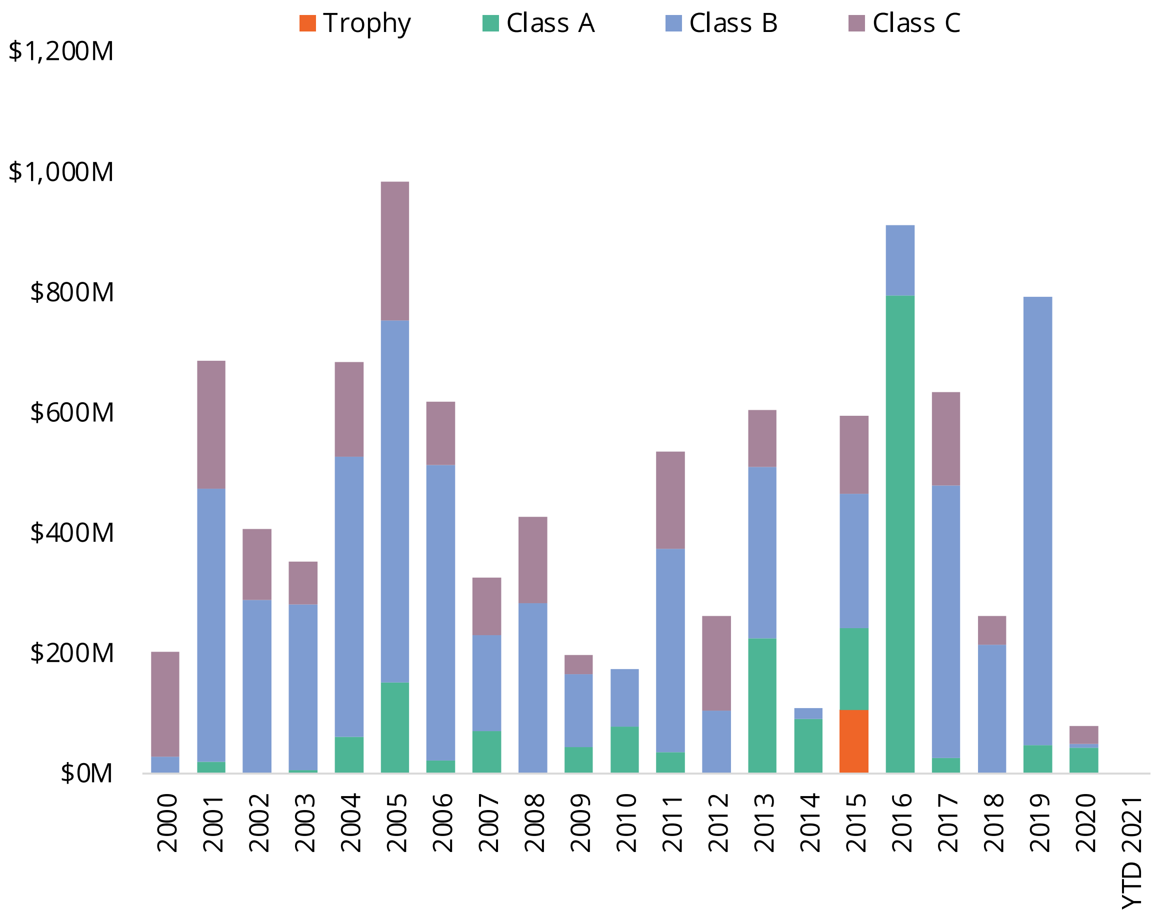
Office investment dollar volume

$79.2M

Suburban Maryland office dollar volume 2020 to present

Office sales activity has temporarily paused during the risk-pricing crisis, decreasing by an annualized rate of 91.7% compared with the prior five-year average dollar volume.



Note: Core and Core-plus only
Source: AVANT by Avison Young, RCA

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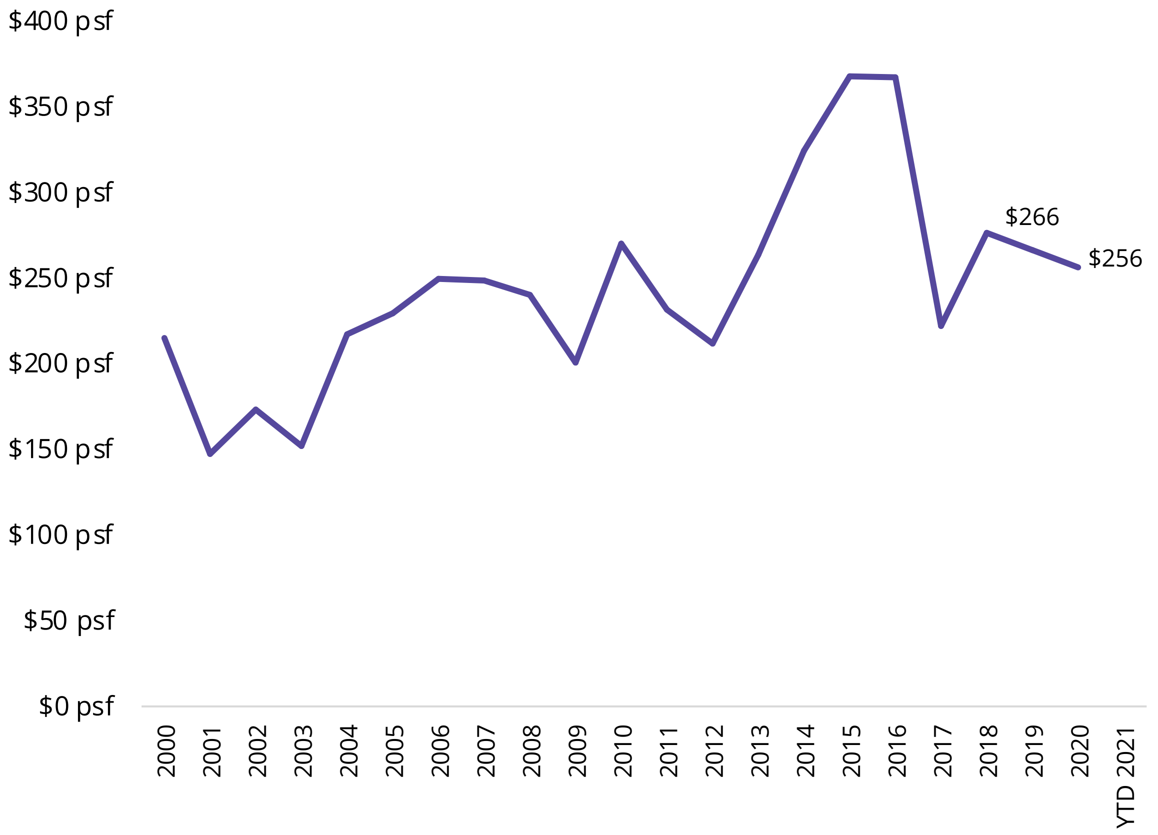
Office asset pricing

-3.8%

Suburban Maryland office pricing from 2019 to 2020

Pricing has softened during the pandemic as investors have adopted more conservative underwriting approaches and have allocated capital away from the perceived riskiness of office properties before occupier fundamentals stabilize.



Note: Core and Core-plus only
Source: AVANT by Avison Young, RCA

Looking forward

Here's what we can expect

- While Suburban Maryland's overall office market fundamentals may remain soft for an extended period, **leasing activity is anticipated to edge up in the second half of 2021** as more workers return to the office and tenants finalize decisions regarding long-term occupancy strategies.
- **Concession packages will likely remain elevated for some time**, not only to incentivize tenants to sign leases in a competitive environment, but also due to the rising costs of building materials. This will keep downward pressure on net effective rents.
- **Near-term vacancy resulting from construction deliveries should be relatively low**, as the office development pipeline has tapered to 1.5 msf (roughly 74% preleased) that is slated for completion by the end of 2022.
- **The uptick in biotech sector activity is expected to continue for the foreseeable future**. Because demand is outpacing supply, developers and landlords are exploring options for accommodating tenants, both large and small, as quickly as possible.

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Let's talk

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