

Office space monitor: april-june 2014

The federal sector continues to be a drag on suburban office markets in the region, but demand accelerates in Washington, D.C.

office market overview

Through the long recession and early phases of the recovery, the federal government helped stabilize employment and office demand in the Washington, D.C. region. Successive rounds of federal spending cuts, space reductions and government shutdowns have reversed this regional economic advantage, especially in suburban office markets dependent on federal contract dollars, jobs, and leases. Slowing construction will only partly offset the growth in surplus office space over the next year, as weak leasing activity and scheduled new federal spending cuts further inhibit absorption. In sharp contrast to its sluggish suburban neighboring markets, Washington, D.C. is enjoying surging office rents and occupancies, powered by private sector job growth and tenant demand for transit-accessible prime urban space.

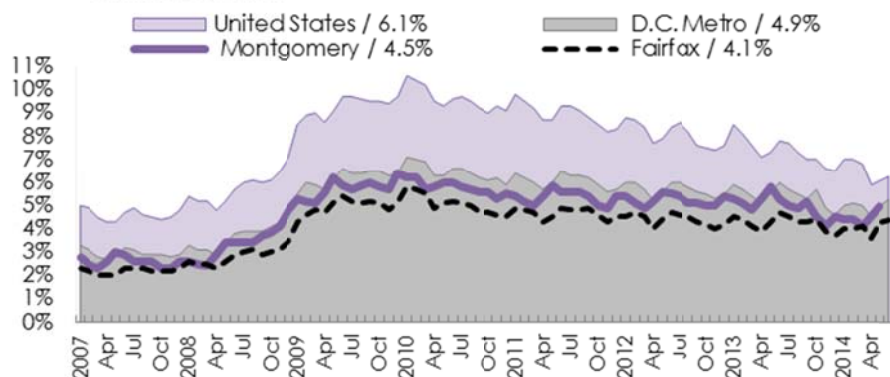
office demand

Employment trends have a sizeable impact on the office leasing environment. The region's average 2nd quarter unemployment rate fell to 4.9 percent, compared to 5.5 percent one year ago. Montgomery County's average quarterly unemployment rate fell from 5.3 percent to 4.5 percent over the year. This is not necessarily a positive sign. Over the same period, the number of employed County residents fell by nearly 3,400 and more than 11,000 residents left the labor force, indicating that a shrinking labor pool—not resurgent hiring—is driving down the County's jobless rate. In this case, a declining unemployment rate is unlikely to reinvigorate office demand.

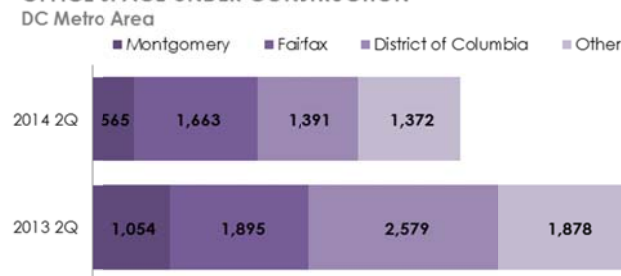
MONTGOMERY COUNTY, MARYLAND

Economic Indicators	2013 2Q	2014 2Q	net change
RESIDENT LABOR FORCE	541,900	530,762	(11,138)
EMPLOYED COUNTY RESIDENTS	509,415	506,790	(2,625)
UNEMPLOYMENT RATE	5.3%	4.5%	-0.8%
Office Market Snapshot	2013 2Q	2014 2Q	net change
AVERAGE RENT	\$28.09	\$27.84	-\$0.25
VACANCY RATE	13.7%	14.8%	1.1%
AVAILABILITY RATE	17.9%	18.9%	1.0%
NET ABSORPTION	38,123	335,971	297,848
DELIVERIES			
Buildings	1	2	1
Square Feet	197,720	600,998	403,278
UNDER CONSTRUCTION			
Buildings	5	6	1
Square Feet	1,053,566	565,048	(488,518)
INVENTORY			
Buildings	1,516	1,514	(2)
Square Feet	72,482,471	72,967,420	484,949
Vacant Square Feet	9,931,144	10,805,315	874,171

UNEMPLOYMENT RATE



OFFICE SPACE UNDER CONSTRUCTION



Sources: Labor market data: U.S. Bureau of Labor Statistics, *Local Area Unemployment Statistics*, *Current Employment Survey*, and *Quarterly Census of Earnings and Wages* data as of August, 2014. Office market data: CoStar, 7/22/2014.

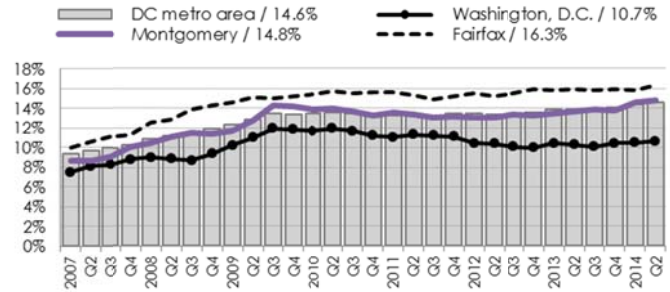
second quarter office market highlights

Between the second quarters of 2013 and 2014, office rents continued on a slight downward slide in Montgomery County and other suburban office markets, while rising steadily in the District of Columbia. Average asking rents fell over the year by 25 cents to \$28.09 in Montgomery County, and by 76 cents to \$28.36 in Fairfax County. In Washington, D.C., office rents per square foot reached \$49.64, up by \$1.13 from the prior year.

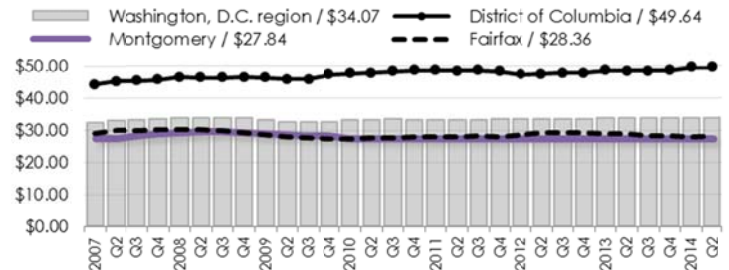
Montgomery County's office vacancy rate increased from 13.7 percent in the 2nd quarter of 2013 to 14.8 percent in the 2nd quarter of 2014. Vacancies in Fairfax County also increased, but at a slower pace, from 15.9 percent to 16.3 percent year over year. Washington, D.C. experienced a slight increase in office vacancies, from 10.3 percent to 10.7 percent over the year, but its vacancy rate remains the lowest in the region.

Adding to concerns over the local office market is that an unknown amount of leased space is not actually being used nor is it being offered for sublease by tenants. This "shadow vacancy" is a barometer of future office market conditions, but is not tracked by commercial real estate data sources. One proxy for this indicator is the spread between the reported vacancy rate and the "availability rate," which includes currently leased space that is coming back on the market. The spread between vacant and available space in Montgomery County increased from 2.1 percent in 2007 to 4.1 percent in 2014. The 2nd quarter 2014 office availability rate in the County was 18.9 percent, compared to a reported 14.8 percent vacancy rate.

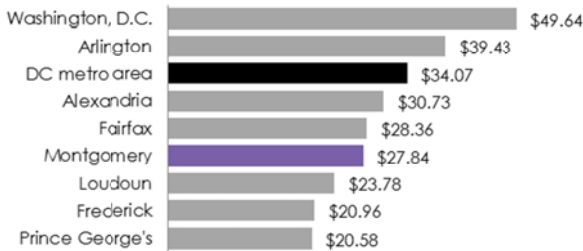
OFFICE VACANCY RATE



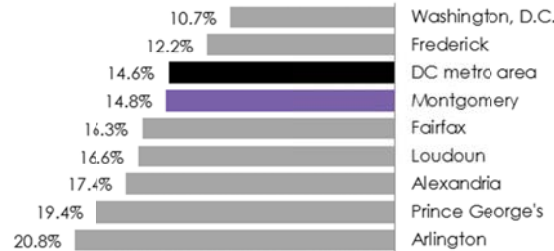
AVERAGE OFFICE RENT PER SQUARE FOOT



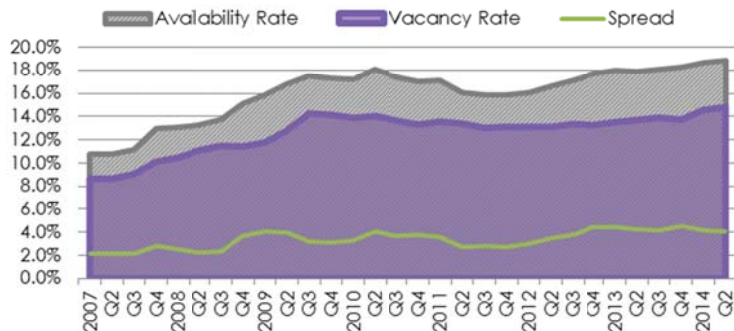
AVERAGE OFFICE RENT PER SQUARE FOOT



OFFICE VACANCY RATE



VACANT VS. AVAILABLE OFFICE SPACE



OFFICE SQUARE FOOTAGE UNDER CONSTRUCTION IN MONTGOMERY COUNTY

By submarket

