The New Office Landscape

presentation to the
Montgomery County Planning Board
June 25, 2015
The New Office Landscape

OVERVIEW
Lisa Madigan Tate, Research + Special Projects Division staff

- Purpose of study
- Office market indicators
- Regional economic forces

ANALYSIS + RECOMMENDATIONS
Anita Morrison, Partners for Economic Solutions (PES)

- Office market restructuring
- Outlook for Montgomery County
- Recommendations
Purpose of Study
Purpose of study

Land use implications

- Rezoning / Conversion Requests
- Pipeline of Approved Development
- Master Planning
- Transportation Planning

Great Seneca Science Corridor - Approved Conversions to Date

<table>
<thead>
<tr>
<th>Plan No.</th>
<th>Plan Name</th>
<th>Commercial Square Feet to be Converted</th>
<th>Residential Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>11986186A</td>
<td>Hanover Shady Grove</td>
<td>120,063</td>
<td>366</td>
</tr>
<tr>
<td>120120180</td>
<td>Mallory Square</td>
<td>112,358</td>
<td>371</td>
</tr>
<tr>
<td>11996112A</td>
<td>Camden Shady Grove</td>
<td>155,330</td>
<td>475</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>387,751</strong></td>
<td><strong>1212</strong></td>
</tr>
</tbody>
</table>

Source: U.S. Bureau of Labor Statistics, Quarterly Census of Earnings & Wages
Office jobs are critical to our economy

4 major industries based in offices

= 41% of all jobs + 55% of total wages in Montgomery County

Average Weekly Wage by Industry in Montgomery County

- Federal Government: $1,935
- Information: $1,823
- Financial Activities: $1,743
- ALL OFFICE JOBS: $1,667
- Professional and Business Services: $1,497
- ALL JOBS: $1,245
- Education and Health Services: $945
- Other Services: $835
- Trade/Transportation/Utilities: $833
- Other: $812
- ALL NON-OFFICE JOBS: $790
- Leisure and hospitality: $415

Source: U.S. Bureau of Labor Statistics, Quarterly Census of Earnings & Wages
Office property values are an important component of the County’s tax base.
Goals of study

• Analyze trends in depth
• Not purely anecdotal: quantify impacts, outlook
• Identify best practices
• Recommend tangible land use and related strategies

Source: U.S. Bureau of Labor Statistics, Quarterly Census of Earnings & Wages
Office Market Indicators
The job market is recovering

Unemployment Rate

Source: U.S. Bureau of Labor Statistics
Local Area Unemployment Statistics
The region’s office market was starting to recover

- San Francisco
- New York/Silicon Valley
- Austin/Houston
- Washington, DC/Boston
- Baltimore/Dallas/Denver
- Detroit
- Cincinnati/Cleveland/New Jersey/Orlando/Phoenix
- Charlotte/Fairfield Co/Los Angeles/Miami/San Diego/St. Louis/Tampa
- Chicago/Orange Co/Raleigh-Durham
- Atlanta/Minneapolis/Richmond/Seattle/Philadelphia/United States
Four consecutive years of positive job growth in the region and county

Percent Change in Employment

Source: U.S. Bureau of Labor Statistics
Quarterly Census of Earnings & Wages
Post-recession job growth did not revive office demand

Office Vacancy Rate vs. Job Growth

Source: U.S. Bureau of Labor Statistics, Quarterly Census of Earnings & Wages; CoStar
This is a region-wide phenomenon

Vacancy Rate - Montgomery County
Vacancy Rate - Washington Metro

Source: CoStar
The regional office market is stagnating.

Office market indicators

Source: CoStar

Net Absorption

In millions of square feet

Source: CoStar
New space was added despite slowdown.

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Additions</th>
<th>Net Absorption</th>
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</thead>
<tbody>
<tr>
<td>2000</td>
<td>12.6</td>
<td>1.0</td>
</tr>
<tr>
<td>2001</td>
<td>10.6</td>
<td>2.8</td>
</tr>
<tr>
<td>2002</td>
<td>15.4</td>
<td>6.2</td>
</tr>
<tr>
<td>2003</td>
<td>6.2</td>
<td>7.6</td>
</tr>
<tr>
<td>2004</td>
<td>7.3</td>
<td>7.3</td>
</tr>
<tr>
<td>2005</td>
<td>6.7</td>
<td>10.4</td>
</tr>
<tr>
<td>2006</td>
<td>13.2</td>
<td>11.6</td>
</tr>
<tr>
<td>2007</td>
<td>9.1</td>
<td>2.8</td>
</tr>
<tr>
<td>2008</td>
<td>10.4</td>
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<td>7.1</td>
<td>4.5</td>
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<td>2010</td>
<td>4.9</td>
<td>4.9</td>
</tr>
<tr>
<td>2011</td>
<td>2.3</td>
<td>0.7</td>
</tr>
<tr>
<td>2012</td>
<td>1.6</td>
<td>0.7</td>
</tr>
<tr>
<td>2013</td>
<td>3.4</td>
<td>0.4</td>
</tr>
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</table>

In millions of square feet

Source: CoStar
Office market indicators

Result = rising vacancies

Source: CoStar
The region has +72 million square feet of vacant office space
The County has nearly 11 million square feet of vacant office space.

Office market indicators

- TOTAL OFFICE SPACE: 73.2 million sf
- VACANT SPACE: 10.9 million sf
- OCCUPIED SPACE: 62.5 million sf

Source: CoStar
Rents are flattening

Average Asking Office Rent, 1995 to 2015

Source: CoStar
The Washington region now trails most office markets in the U.S.

Office market indicators

- San Francisco Peninsula
- Houston/San Francisco/Silicon Valley
- Dallas
- Minneapolis
- Seattle
- Austin/Pittsburgh
- Portland/New York
- Boston/Denver/U.S.
- Austin/Houston/Los Angeles
- Charlotte/Fairfield Co
- Miami/Tampa/San Diego/St. Louis/Tampa
- Chicago/Orange County/Raleigh-Durham
- Charlotte/Milwaukee/Philadelphia
- Cincinnati/Detroit/Hampton Roads/Long Island/San Antonio/St. Louis
- Sacramento/West Palm Beach

2014 OFFICE PROPERTY CLOCK

Jones Lang LaSalle

2014
What happened to the office market recovery?

- **Regional Economic Shocks**
  - Federal budget cuts
  - Sequestration
  - Federal consolidation

- **Structural Changes in the Office Industry**
  - Shrinking office spaces
  - Changing location preferences
Regional Economic Forces
Federal spending cuts, sequestration strained area businesses and non-profits

<table>
<thead>
<tr>
<th>Year</th>
<th>Grants</th>
<th>Contracts</th>
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</thead>
<tbody>
<tr>
<td>2009</td>
<td>$0.74</td>
<td>$9.83</td>
</tr>
<tr>
<td>2010</td>
<td>$1.00</td>
<td>$9.12</td>
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<tr>
<td>2011</td>
<td>$1.53</td>
<td>$8.55</td>
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<tr>
<td>2012</td>
<td>$0.92</td>
<td>$8.24</td>
</tr>
<tr>
<td>2013</td>
<td>$0.75</td>
<td>$7.75</td>
</tr>
<tr>
<td>2014</td>
<td>$0.82</td>
<td>$8.58</td>
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</table>

Source: Federal Procurement Data System
Office jobs in the County were hard hit by federal budget turmoil

Regional economic forces

Health Care/Social Services 4,495
Education 3,798
Accommodation/Food Services 2,234
Retail 908
Management 512
Information 183
Construction 176
Utilities 96
Real estate (151)
Arts, Entertainment, and Recreation (216)
Agriculture and Mining (512)
Transportation/Warehousing (681)
Finance/Insurance (691)
Wholesale trade (931)
Manufacturing (1,234)
Professional and Technical Services (1,818)
Business Services (1,986)

Source: Bureau of Labor Statistics, Quarterly Census of Earnings & Wages
Bipartisan agreement: cut leasing costs
GSA: Freeze the footprint

- Reduce leased space
- Use space more efficiently
- Consolidate into government-owned buildings
Office Market Restructuring
Changing Use of Space

- Technology cuts the cords that bound workers to their offices
- New economy businesses seek flexible spaces that encourage collaboration
- Innovative office designs increase employee density
- Less file storage and library space

Courtesy of Smith Group/JJR
Office market restructuring

GSA adopted downsizing trends to cut space utilization
Federal downsizing will continue

Consolidation into GSA-owned space: National Institute of Allergy and Infectious Diseases

Consolidation of federal leased space: National Institutes of Health in Rock Spring
Office market restructuring

2.3 million square feet of Federal office leases expire in 2015

Source: U.S. General Services Administration, Inventory of Federal Leased Space
Companies dependent on knowledge workers are voting with their feet

- Transit access, primarily Metro
- Mixed-use environments
- Sustainable buildings
- Pedestrian-oriented areas
Office market restructuring

Office tenants are seeking out more accessible mixed use environments

RESTON TOWN CENTER
PIKE AND ROSE
NAVY YARD
MOSAIC DISTRICT
TYSONS CORNER CENTER
NOMA
Single-use, auto-oriented office parks are losing their appeal

2014 VACANCY RATE BY AREA

- Montrose Pky: 32.7%
- I-270 Montrose: 31.6%
- Shady Grove LSC: 20.1%
- Rock Spring: 18.7%
- E I-270 at Gude: 17.5%
- Germantown: 16.4%
- Silver Spring CBD: 11.5%
- Bethesda CBD: 10.4%
- WesTech: 10.4%
- Rockville CBD: 6.6%

1995 VACANCY RATE BY AREA

- Silver Spring CBD: 24.0%
- E I-270 at Gude: 17.0%
- Germantown: 14.8%
- Montrose Pky: 12.3%
- Bethesda CBD: 12.2%
- Rockville CBD: 10.9%
- Rock Spring: 10.8%
- Shady Grove LSC: 6.4%
- I-270 Montrose to...: 4.2%
- WesTech: 1.7%

Source: Partners for Economic Solutions
Single-use, auto-oriented office parks are losing their appeal

Source: Partners for Economic Solutions
Montgomery County, Maryland

Outlook for Montgomery County
Future Montgomery County Office Vacancies

Even with no new construction, acceptable vacancy levels are unlikely until 2022

2019
- Vacancy rate: 10.4% to 15.2%
- Vacant space: 7.6 to 11.1 million sq. ft.

2022
- Vacancy rate: 7.1% to 14.8%
- Vacant space: 5.2 to 10.8 million sq. ft.
Analysis projects a soft regional office market for the next 5 to 10 years

- Office construction slowdown
- Uptick in conversions, demolitions, re-zoning, plan revisions
- Shopping for office space/ flight to quality
- Location, location, location
Some locations will recover; some will be unable to compete

**Best prospects**
- Quality properties
- Walkable, mixed-use environments
- Easy transit/highway access

**Worst prospects**
- Obsolete buildings
- Auto-centric, single-use environments
- Poor accessibility
- Isolated from worker housing, amenities and business centers
Implications for the Future

- New construction focused in prime locations, mixed-use with transit and quality public spaces
- Transit connectivity is increasingly important
- Limited demand for single-use office parks and campuses
- Pipeline of 22.7 million office square feet
  - Mostly in less competitive locations and configurations
Implications for the Future

- Declining property values and taxes
- Conversions to other uses
- Demolitions
Strategies & Best Practices
Best Practices

Rockville Town Center

Signature Theater in Shirlington

Reston Town Center

Capitol Riverfront
Transforming Office Parks

- Rezone for mixed uses
- Subdivide laboratory building
- Repurpose for hospitals
- Add retail, hotels and apartments by moving parking into garages
- Create pedestrian infrastructure

3rd Avenue in Northwest Park, Burlington, MA
Enhance Office Environments

- Continue to invest in transit
- Enhance walkability and connectivity
- Events and programming to enliven districts
- Partner with developers to diversify existing office parks
  - Remove any zoning impediments to redevelopment
  - Provide incentives for building improvements
Reduce Non-Competitive Space

- Encourage conversion to other uses: housing, hotels, public schools
- Encourage demolition and redevelopment by facilitating assembly of small office sites
- Discourage new development that can’t compete
Montgomery County has planned ahead of major market trends

- Compact Development
- Creating New Urban Centers
- Transit Oriented Development
- Mixed Use Zoning
- Retrofitting Suburban Office Parks
- Urban Design / Placemaking
Increase Office Demand

- Support economic development
- Fund economic incentives for large tenants
- Provide landlord incentives for small tenants
- Invest in the local workforce
- Protect and enhance the local quality of life
Prioritize

• Support existing mixed-use districts rather than creating new districts

• Not every Metro or light rail station can attract significant office development

• Target office park redevelopment incentives
  ▪ Opportunity for dense, walkable environment
  ▪ Good accessibility and visibility
  ▪ Available sites or vacant buildings
  ▪ Residents + businesses to support retail + restaurants
  ▪ Willing owners
Staff contact:
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Access the full report at
http://www.montgomeryplanning.org/research