WASHINGTON D.C. OFFICE MARKETFLASH:
D.C. LEADS NATION IN RISING LEASE CONCESSIONS, TENANT FAVORABLE CONDITIONS

LEE & ASSOCIATES
COMMERCIAL REAL ESTATE SERVICES

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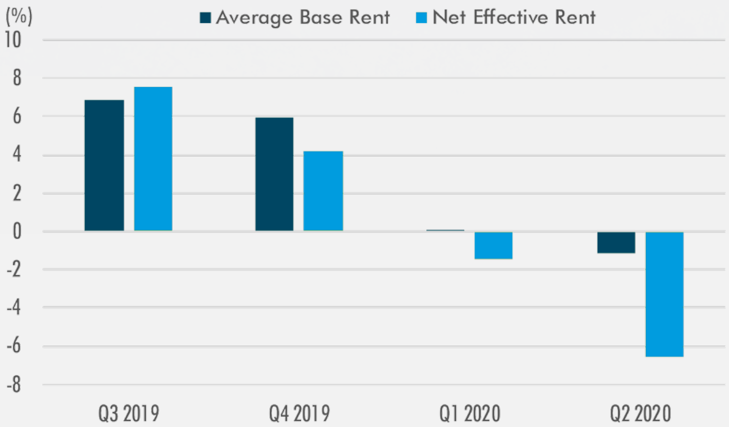
NATIONAL TRENDS

It would be hard to overstate the dramatic fallout from COVID-19 that defined the commercial real estate sector - and every major global market – in Q2 2020, as the world came to terms with the reality of a global pandemic. As employers across the country began to reevaluate their need for permanent, traditional office space, leasing markets in major US cities experienced record-setting drops in transaction volume, massive negative absorption, and climbing vacancy rates. On the ground, occupiers and owners saw firsthand the tangible effects of the pandemic as tenant concession packages – periods of free rent and tenant improvements allowances - rose to record high levels while the demand for office space fell by the largest amount since 2009.



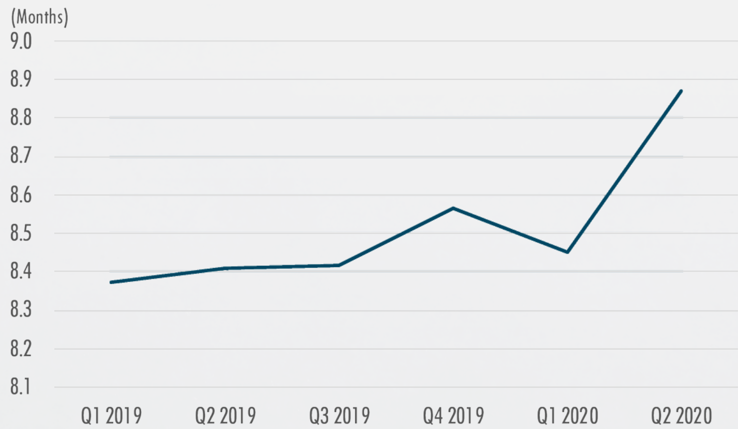
Despite a staggering drop in leasing volume, US base rents across the largest U.S. markets remained relatively stable from Q2 2019. Average net effective rents, however, which incorporate free rent and TI allowances into the calculation - fell expectedly given the massive packages offered to tenants this quarter. As illustrated in the graph (left), base rents fell only 1.1% in Q2 from a year ago, whereas net effective rents plummeted by 6.6%. These changes were far more pronounced in the largest U.S. markets, where the coronavirus has been more destructive.

Rent abatement was the primary driver of the dramatic dip in net effective rents, with free rent periods depicted below as a rolling average. Office leases in major markets averaged 10 months of free rent in Q2, up 13.7% from Q1. While less dramatic, tenant improvement allowances also rose significantly as a result of COVID-19, increasing 5.1% over Q1 to $75.57 per sq. ft.

WASHINGTON D.C.

Nowhere is the impact of Covid-19 more visible than in the nation's capitol. With Q2 leasing velocity down 73% from last year, the District's vacancy rate surpassed the suburbs and hit an all-time high of 15.4%. While a massive federal government presence traditionally insulates the District 's asking rents from wild fluctuations, the significantly increased value of concession packages – already the nation's highest since 2018 – continue to validate the conclusion that market conditions are the most tenant-favorable they've been in recent memory. For long-term, new, Class A leases, concessions for DC office tenants currently average $127.00 psf in tenant improvement allowance and 17 months of free rent, totaling $220.00 psf in combined value, the highest in the US.

Average Free Rent (per lease)



The growing supply-demand chasm favoring tenants in the office market - and the ensuing rise in concessions – will continue to increase in coming months, at least until the advent of a vaccine for COVID-19. While the national trend among major US markets will be largely similar, tenants in the DC market will continue to experience the most dramatic benefits of the current climate, given preexisting market conditions and a continued schedule of construction deliveries to an already-saturated office market. Tenants nearing the end of a lease cycle are well-advised to engage their brokers in conversations about strategies to maximize leverage and respectively strong bargaining positions.

TEAM

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