



Flight-to-Quality in Northern Virginia

Strength and Opportunity in
Today's Office Market

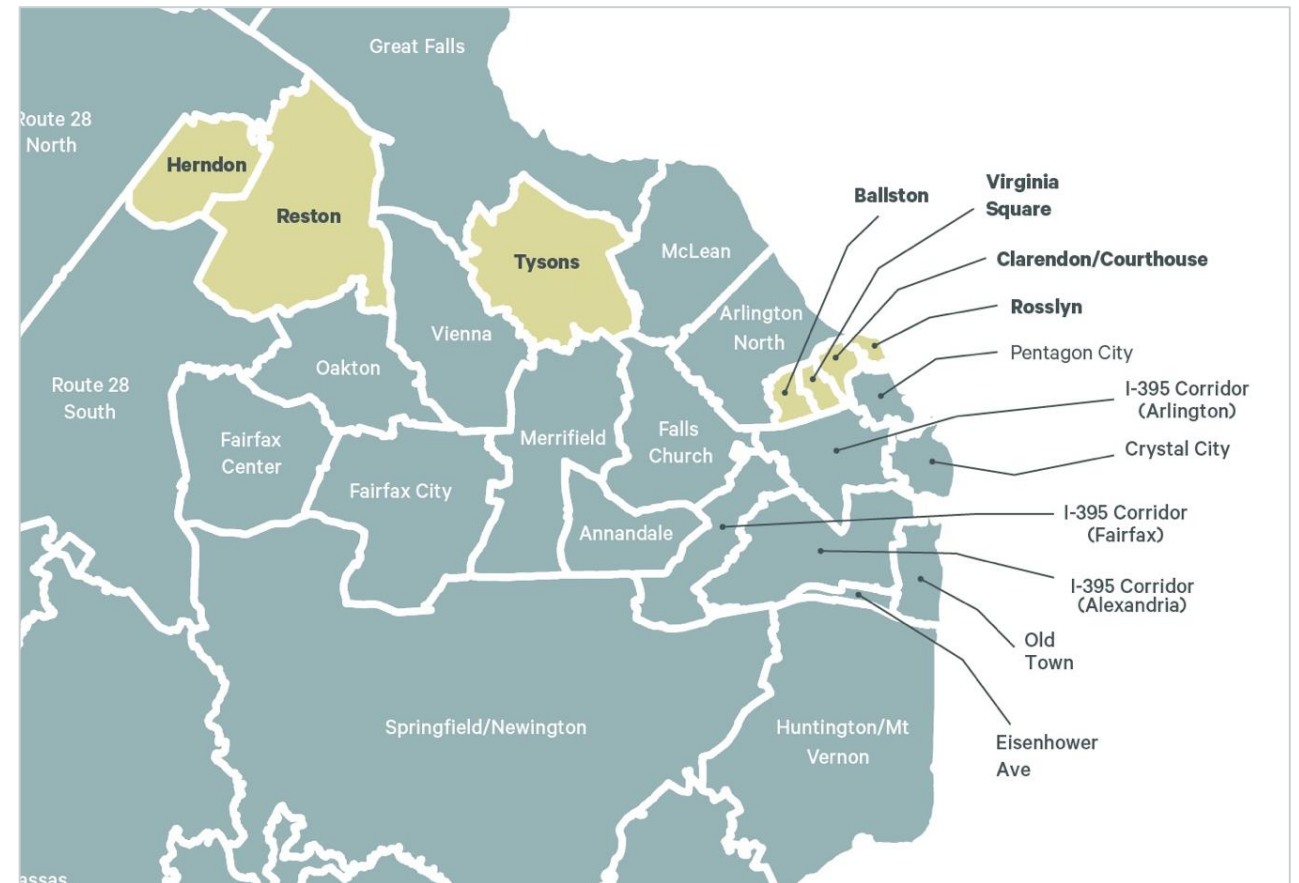
The New Segments of the Market

To better understand true vacancy and opportunity, CBRE Mid-Atlantic Research identified and analyzed two segments of the office market:

- **Trophy** buildings are the highest quality buildings in Northern Virginia, consistently achieving rents in the top 10% of their submarket. They are predominantly new construction, and have the highest quality and quantity of building amenities.
- **Class A+** achieve rents in the top 15% of buildings in their submarket, and include a successful suite of building amenities. Buildings in this set are typically earlier generation buildings that underwent extensive recent renovations.

These segments outperform the rest of the market (Commodity Class A and Classes B and C) in demand and deal financials. While the concept of differentiation within the Class A set is not new, there is now enough clarity on the demand side to create these distinct categories. Combined, these asset classes account for 12% of the total office inventory (19.1 million sq. ft.).

CORE SUBMARKETS



Flight to Quality

In a soft market with overall rising vacancy and muted demand, two segments buck the trend: Trophy and Class A+ buildings, the assets in the top echelon of Northern Virginia's core submarkets. Those tenants that can engage the market are trading up to these properties for their amenities, floor plate efficiency, and locational advantages. As tenants turn to real estate to drive successful return-to-office initiatives and recruit and retain top talent, location and amenities remain critical factors in informing real estate decisions.

As a result, **these properties perform very differently from the rest of the market, capturing a disproportionate share of demand, seeing a lower vacancy rate, and garnering higher rental rates than the rest of the market.**

With flight to quality trends expected to continue, high quality product will remain opportunistic for tenants and landlords alike.



Trophy

- Top 10% in taking rents
- Predominantly new construction
- Highest quality and quantity of building amenities

These Trophy buildings consistently command rents in the top 10% of all buildings in Northern Virginia. They are predominantly new construction, with an average age of just 6 years (or delivered 2017, on average). Beginning ten years preceding the pandemic, developers built a slate of buildings of unparalleled quality in Tysons, the RB Corridor, and Reston.

Trophy buildings have multiple high-quality amenities such as fitness centers, luxury tenant lounges, private outdoor spaces, and proximity to a wide array of walkable retail.

Characteristics

- Typically new construction, average age 6 years
- Architectural design
- Exceptional views
- Superior amenities, including
 - Rooftop terraces and tenant-only outdoor spaces
 - Luxury and high-end tenant lounges and fitness centers
 - High-end conference centers
- Structured parking
- Beautiful lobbies and atriums
- Proximate to retail and other neighborhood services

Class A+

- Top 15% in taking rents in core submarkets, excluding Trophy buildings
- Typically buildings with recent significant renovations that improved systems, physical upgrades, and building amenities

Class A+ buildings consistently command taking rents among the top 15% of office properties in the core submarkets. Similar to Trophy product, Class A+ buildings have multiple high-quality amenities, such as tenant lounges and fitness centers. The Class A+ set is typically older than Trophy product with an average age of 24 years (or delivered 1999, on average). Many underwent significant renovations since the onset of the pandemic.

In total, 46 office properties totaling 12.8 million sq. ft. across the core submarkets qualify as Class A+ buildings, accounting for 8% of the overall Northern Virginia office market.

Differentiating Characteristics

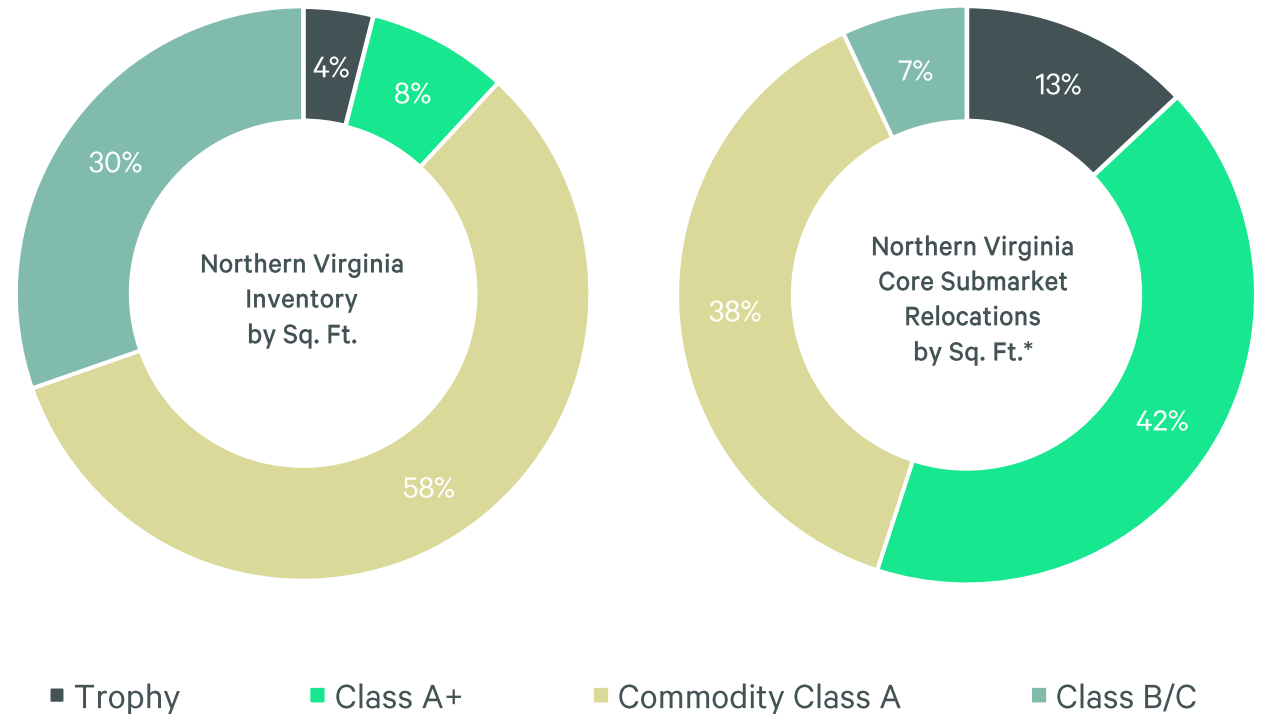
- Average age 24 years
- High-quality views
- Quality building amenities, including
 - Rooftop terraces and tenant-only outdoor spaces
 - Luxury and high-end tenant lounges and fitness centers
 - High-end conference centers
- Structured parking
- Refreshed and upgraded lobbies and atriums
- Proximate to retail and other neighborhood services

CLASS A+

Demand

As occupiers continue to seek top tier of office product, the two highest segments are overperforming other building classes. **While only representing 12% of total inventory, Trophy and Class A+ properties captured more than half (55%) of private sector relocation leasing activity** in core submarkets since the onset of the pandemic. The Trophy segment captured 13% of activity, which is more than three times its market share. Additionally, Class A+ buildings captured 42% of relocation activity, which is more than five times its share of inventory and more than triple the Trophy segment.

Among relocations into Class A+ and Trophy buildings, 58% moved out of lower tier building classes, leaving behind space that is harder to backfill.



*Includes 10,000+ SF relocation leases

Rent Analysis

Strong demand for quality space has driven up rents for the top tier of product. Trophy taking rents average \$52.33 per sq. ft. on a full-service basis, which is a 17% premium over commodity Class A space.

Class A+ taking rents average \$44.76 per sq. ft. on a full-service basis, which is a 14% discount from Trophy space, but still a 17% premium over commodity space.

Generous concession packages within Trophy and Class A+ space allow many tenants to relocate with significantly reduced out-of-pocket costs. These offerings are hovering around a historic high, but have likely peaked as lenders are pushing back in the economic and lending climate.

| | Trophy | Class A+ | Overall Market |
|---------------------------------------|-------------|-------------|----------------|
| Average Asking Rent | \$59.20 FSG | \$45.85 FSG | \$35.21 FSG |
| Average Base Taking Rent | \$52.33 FSG | \$44.76 FSG | \$38.33 FSG |
| Average Tenant Improvement Allowance* | \$111.32 | \$91.08 | \$81.78 |
| Average Abatement* | 15.7 Months | 11.4 Months | 11.3 Months |

*Concessions normalized for 10-year (120-month) term. All stats weighted by sq. ft.

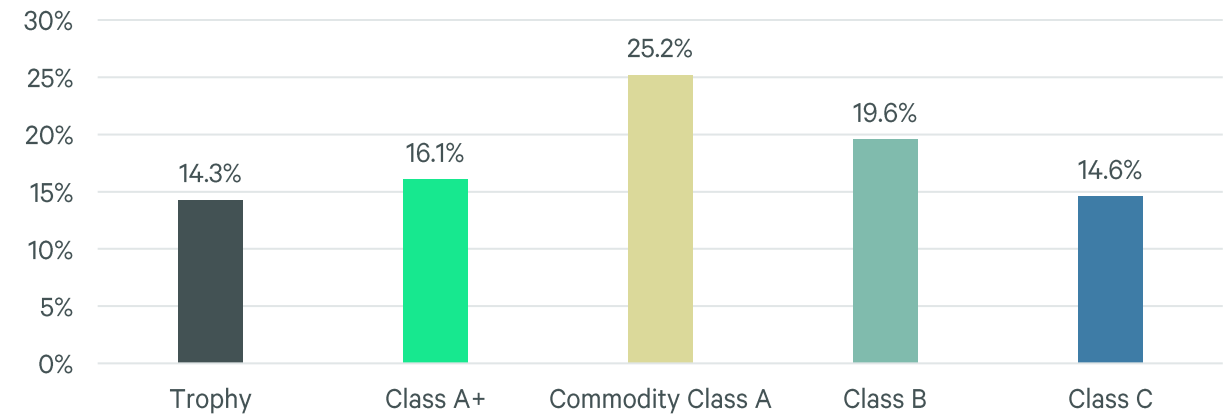
The Next Generation of Opportunity

Since 2020, there has been a clear shift toward the top tier of the market. While vacancy has increased 420 bps in commodity Class A space, it has decreased by 50 bps in Trophy space and 60 bps in Class A+ space.

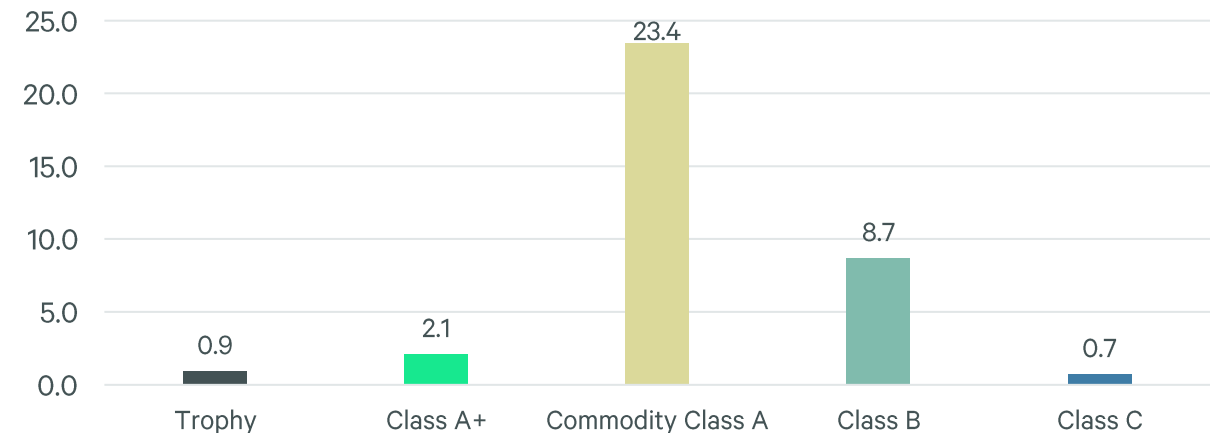
Today, vacancy lands at 14.4% for Trophy space and 16.1% for Class A+ space, significantly lower than the overall office market of 22.2%.

As leasing activity improves following a recession, flight-to-quality trends will continue, and absorption of Trophy and Class A+ space will continue. As a result, when lending conditions improve, upgrades and improvements to commodity Class A properties are expected to accelerate to meet post-pandemic occupier needs and wants.

Vacancy Rate by Class



Total Vacancy by Class (SF, Millions)



Key Findings

FOR INVESTORS

In a flight to quality, Trophy and Class A+ captured 55% of core submarket relocation activity, though they make up just 12% of inventory.

Class A+ showed particular strength, with 42% of core submarket relocation activity, though it makes up just 8% of inventory.

The Class A+ vacancy rate is 16.1%. The Trophy vacancy rate sits at 14.4%. Both outperform the overall market vacancy rate of 22.2%.

Class A+ asking rates offer a 14% discount to Trophy and represent a 17% premium to commodity space.

FOR OCCUPIERS

Trophy and Class A+ properties offer the characteristics decision-makers seek to magnetize the office and attract employees to return.

Themes of a soft market dominate the media, but with demand strong at the top end of the market, there may be more competition for available space.

Higher quality space is typically more efficient, offering occupiers the opportunity to shed space while also modernizing their workplace.

Concessions hovering around record highs aid in relocation and build-out costs.

Thank you



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