Real estate industry report prompts hope of turnaround

Washington Business Journal Suzanne White July 7, 2003

Relief is on the horizon for the commercial real estate industry, according to a recent analysis compiled by members of the Greater Washington Commercial Association of Realtors.

GWCAR finds that the first quarter pace of construction, stable vacancy rates and decline of sublet space are factors indicating a turnaround.

According to the report -- which comes from information from various brokerage firms -- overall vacancy in the area hit 15 percent in the first quarter, which was just a slight increase from the prior quarter.

In the first quarter, sublease space returned to 2001 levels and investment sales continued to be among the strongest in the nation. Major transactions in the first quarter in D.C. included the Wilmer Cutler & Pickering lease at 1801, 1875 and 1899 Pennsylvania Ave. for 476,000 square feet; and the sale of 1399 New York Ave. NW for \$511 per square foot, the highest per-square-foot deal of the quarter.

New construction slowed in Northern Virginia and Maryland during the quarter; however, D.C. activity continued to gain momentum.

According to the report, there were 5.8 million square feet of buildings under construction or renovation in the District in early 2003, of which 43 percent was preleased. There is 3 million square feet of Class A office space set to deliver in 2003. Vacancy rates in D.C. were 7.6 percent, with 49,104 square feet of absorption.

The ray of light in Northern Virginia is that things aren't getting dramatically worse, according to the report.

"Market fundamentals continue to deteriorate, although at a much slower pace than a year ago," states the report, written for GWCAR (www.gwcar.org) by Scott Franklin, a research associate at Cushman & Wakefield. "There is reason to believe that the Northern Virginia office market has seen its worst days."

In the first quarter, vacancy rates increased slightly -- from 19 to 20.5 percent -- while direct vacancy rates, which don't include sublet space, increased from 14 to 15.3 percent. Areas of Fairfax County have not yet rebounded from the glut of office space returned to the market by technology and telecom companies. However, sublease space has been slowly absorbed and is down over 10 percent from a year ago.

Like Northern Virginia, suburban Maryland ended the first quarter with a slight increase in vacancy rates with overall vacancy, including sublet space reaching 15 percent and direct vacancy at 12 percent. Maryland had 418,429 square feet of space absorbed in the market, largely due to Discovery Communications' relocation to its new 600,000-square-foot headquarters in Silver Spring, the only building to deliver during the quarter.

Donohoe Construction recently began building The Lofts at Crystal Towers, at 15th and Fern streets in Pentagon City.

The four-story, wood-frame apartment building will include 212 units with a mix of studios, one- and two-bedroom apartments. There are about 20, two-level loft apartments with bedrooms overlooking the living area.

Other units will include up to 10-foot ceilings and loft style open floor plans with a variety of finishes, such as stained concrete floors and cork floors.

Amenities will include a fitness center, swimming pool and underground parking.

The project is scheduled for completion in 2005. It is owned and developed by Charles E. Smith Residential (www.smithapartments.com).

Donohoe Construction (<u>www.donohoe.com</u>) is a division of The Donohoe Cos., headquartered in D.C.

Two firms made their acquisition debut in the D.C. market with the purchase of 1411 K St. NW.

Meritage Properties, a New York firm started by a former Tishman Speyer executive, and Buchanan Partners, which has developed 2 million square feet in Maryland and Virginia, partnered to buy the Class B building.

The 14-story, 65,000-square-foot office, located in the central business district, was built in 1959 and renovated in 1990s. The office is 97 percent leased, to tenants such as the Washington Better Business Bureau, Weight Watchers, Digital Legal Services and Windbourne & Costas consulting firm.

The building was sold by an affiliate of RAB Management for \$10 million, or about \$155 per square foot.

Dek Potts and Jim Meisel of the Washington office of Advantis/GVA represented the purchaser and were the sole brokers involved in the sale of the building.

Buchanan Partners (<u>www.buchananpartners.com</u>) and Meritage plan to reposition the building, which is a block from MacPherson Square Metro station. The new owners, however, do not plan to increase the size of the building or upgrade it from Class B to

Class A, as has been the trend this year.

Dunn & Associates of Alexandria has been hired to design the building's renovations.

"I expect this to be the first of several Washington-area acquisitions we will be making together," says Andrew Nathan, who started Meritage Properties in February.

Georgetown University leased 30,000 square feet at 11333 Woodglen Drive in Rockville, allowing the landlord to start building the office. The JBG Cos. (www.jbg.com) will start demolition of the current office and replace it with a 66,000-square-foot Class A office and lab in Woodglen Park.

Georgetown University was represented by Transwestern Commercial Services. Scheer Partners represented JBG.

Woodglen Park includes four, four-story buildings totaling 181,429 square feet on 3.9 acres. It is being redeveloped by JBG to include office, retail and residential space.