WASHINGTON
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Angels & demos

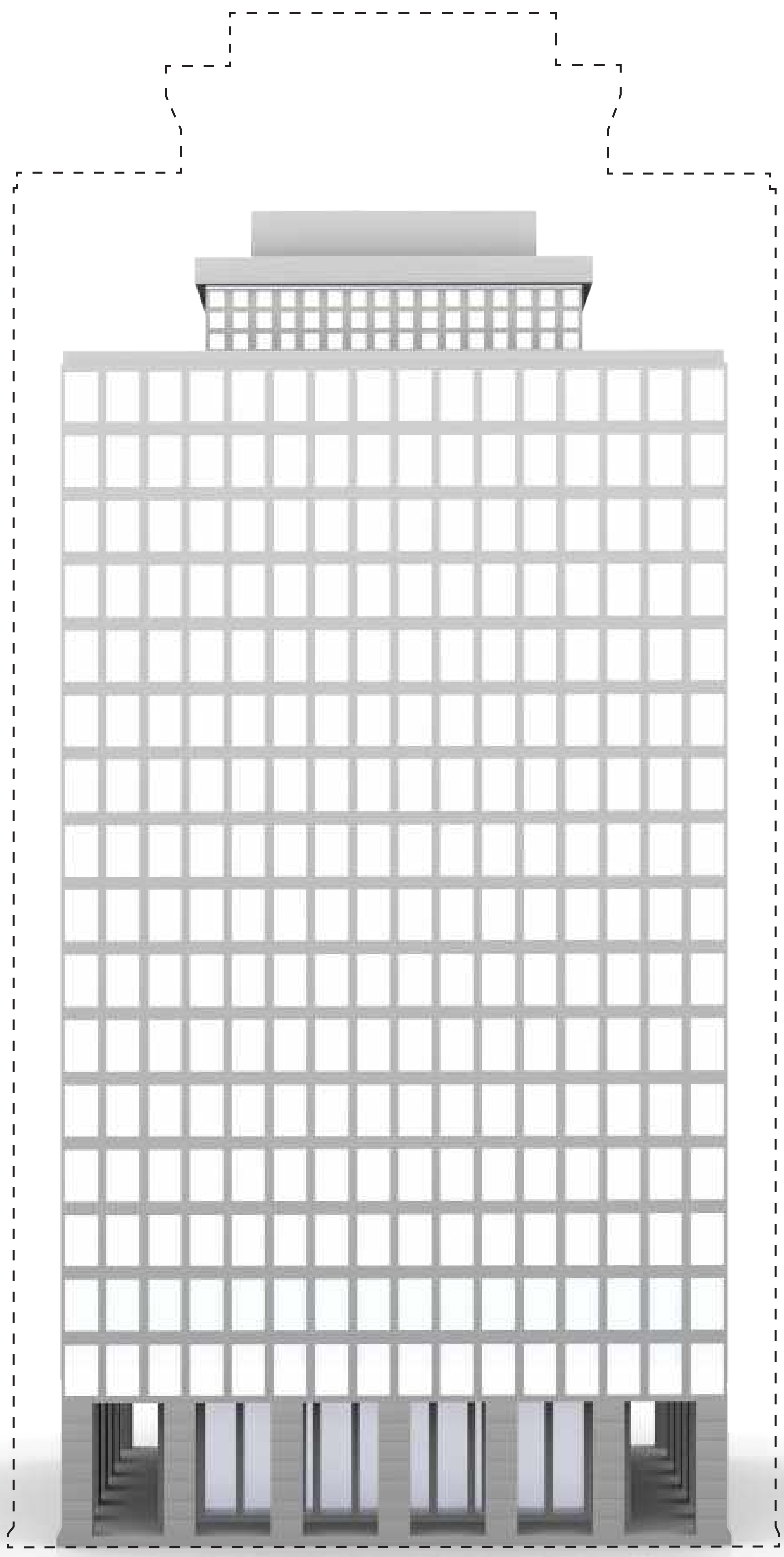
Her team will form an angel investor club for startups

INNOVATION & HEALTH, 12

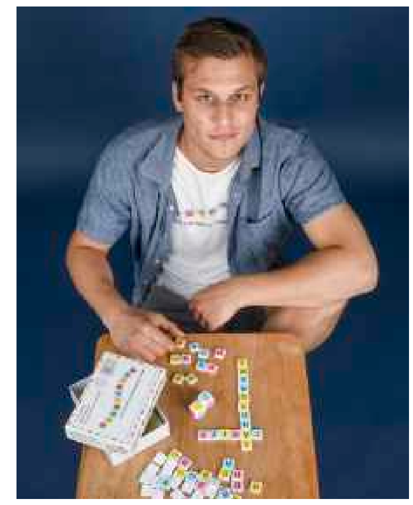
REAL ESTATE INC. EXTRA

THE REGION DOESN'T WANT THIS KIND OF FEDERAL CONTRACTING. BUT IT'S HAPPENING.

BY DANIEL J. SERNOVITZ | PAGE 28



15% decrease in GSA-leased square footage between 2014 and 2019



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REAL ESTATE INC. EXTRA

HONEY, WE SHRUNK THE FEDS

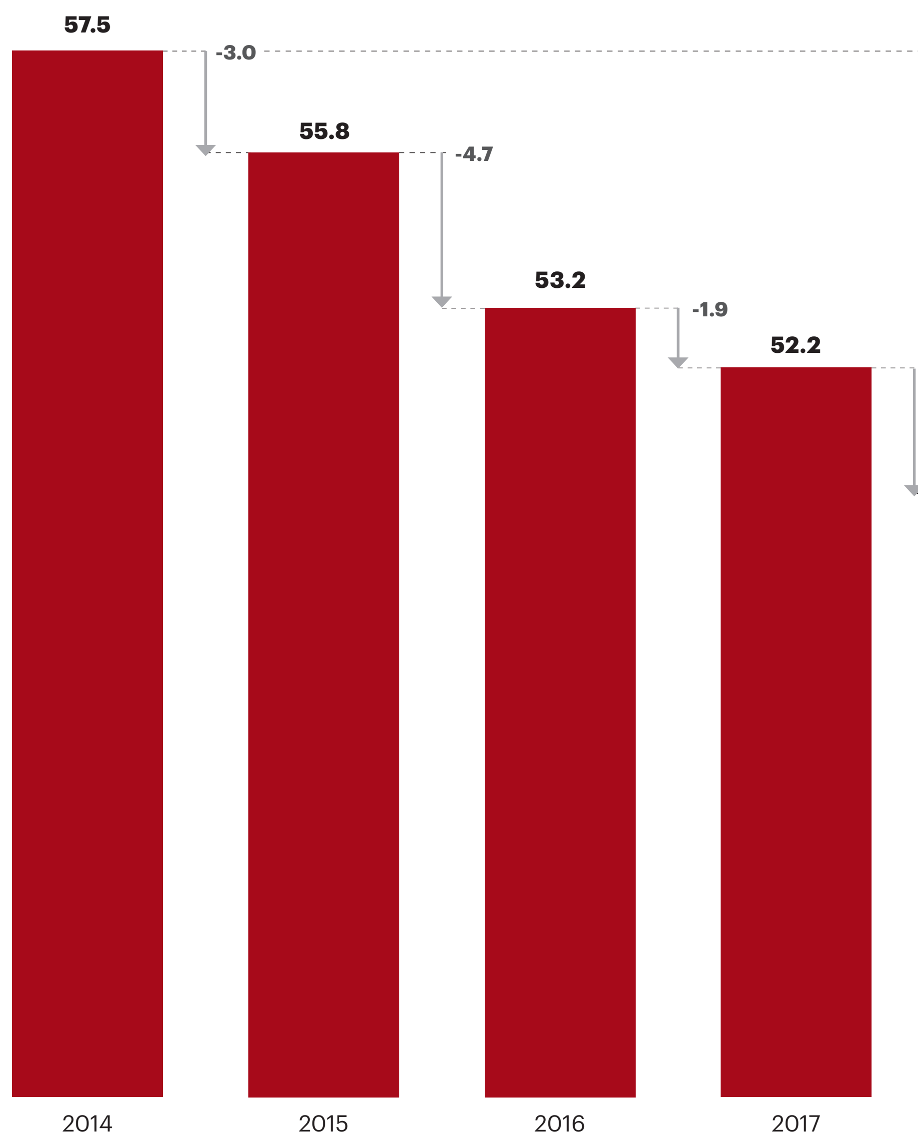
The federal real estate footprint is slimming. And it's leaving some landlords in a lot of pain.

BY DANIEL J. SERNOVITZ | dsernovitz@bizjournals.com

SHRINKING SPACES

The General Services Administration's leased portfolio peaked at 57.8 million square fe
Washington region. Its total number of leases had an even steeper fall in that time as b

AVERAGE TOTAL SQUARE FEET



When news emerged that two federal agencies would look to pack up and shift their offices – and hundreds of employees – to Kansas City and Colorado, the Washington region recoiled. Angst was high, suspicions flared over the Trump administration's motives and at least one legal protest was quickly filed. ¶ And yet, sadly, the planned departures of the Bureau of Land Management and parts of the Agriculture Department are just the tip of an ominous iceberg for the regional economy. ¶ Go below the surface, and experts see a slower, steadier decline in the federal footprint that is causing far more pain across the region's commercial real estate industry.

In the past five years, the feds have reduced their D.C.-area footprint by about 15%, from a peak of 57.8 million square feet to about 49.1 million, according to commercial real estate services firm CBRE. That's almost three times the rate of reduction in the federal government's national real estate portfolio, all in the name of efficiency and thrift. And that trend line isn't likely to stop as the feds continue to take a longer view on their leasing decisions.

In short, the D.C. region is bearing the brunt of federal shrinkage, to use a term coined by 1990s TV sitcom "Seinfeld." Local economists have warned that the region's longtime federal cushion has been fraying since the onset of sequestration – across-the-board cuts in the federal budget that began in 2013 – along with a smaller federal workforce and a yearslong mandate to consolidate and reduce federal real estate. But this data shows by just how much, and how fast.

This shift has created vacancies, small and large, in prominent buildings across the District, suburban Maryland and Northern Virginia, as the General Services Administration – the federal government's real estate and leasing arm – gets all the more discriminating about the space it seeks for federal agency tenants. And it's left developers and landowners at a fork in the road as they contend with refilling those spaces, particularly the smaller, older chunks of square footage that the feds were always relied upon to absorb.

"In '90s and early 2000s, GSA took down blocks of space 20,000 square feet here, 30,000 there, and they would fill up these buildings in lower-level spaces, back-alley spaces," said Marcy Owens Test, senior vice president with CBRE's federal lessor advisory group. "What's happening is a lot of these spaces that were filled by a federal agency on the second, third and fourth floor, the government's no longer a player."

A consolidating empire

Little more illustrates the federal real estate shrinkage in the region than these two stats, per CBRE's report on the federal footprint.

▶ **560:** The number of leases the GSA now holds in the region, down about 32% since its peak in 2012.

▶ **87,737 square feet:** The average federal lease size in Greater Washington, up about 27% since 2014.

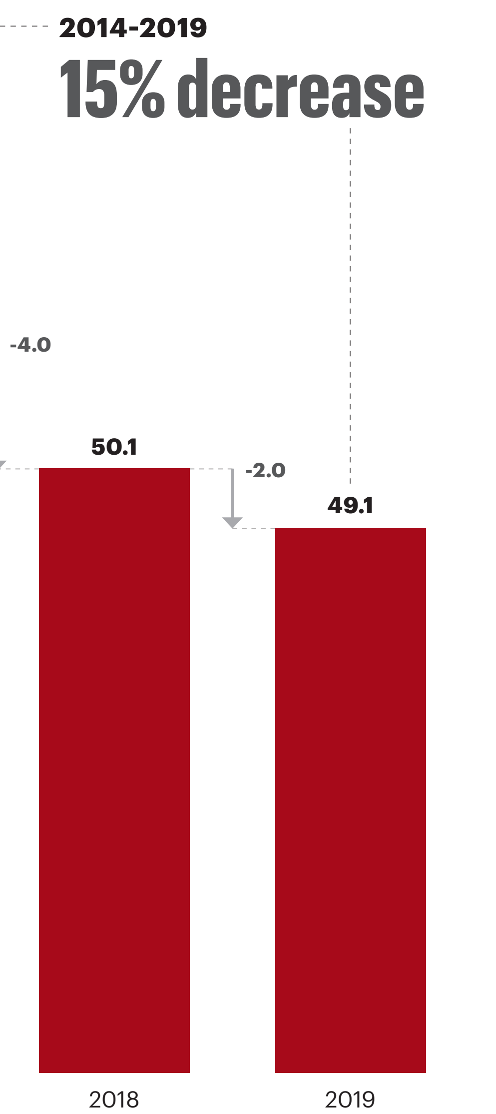
Essentially, the GSA is gobbling up larger blocks of leased space at a time, but doing so through fewer deals and within fewer buildings and in less space.

What's spurred this? While a smaller federal government workforce accounts for some of the reduction, the lion's share can be attributed to a wave of consolidation that has enabled the federal government to shed vast amounts of excess space and tens of millions of dollars for the sake of efficiency. That was, in part, due to an Obama administration mandate that's carried into the Trump administration and is unlikely to change with future leadership.

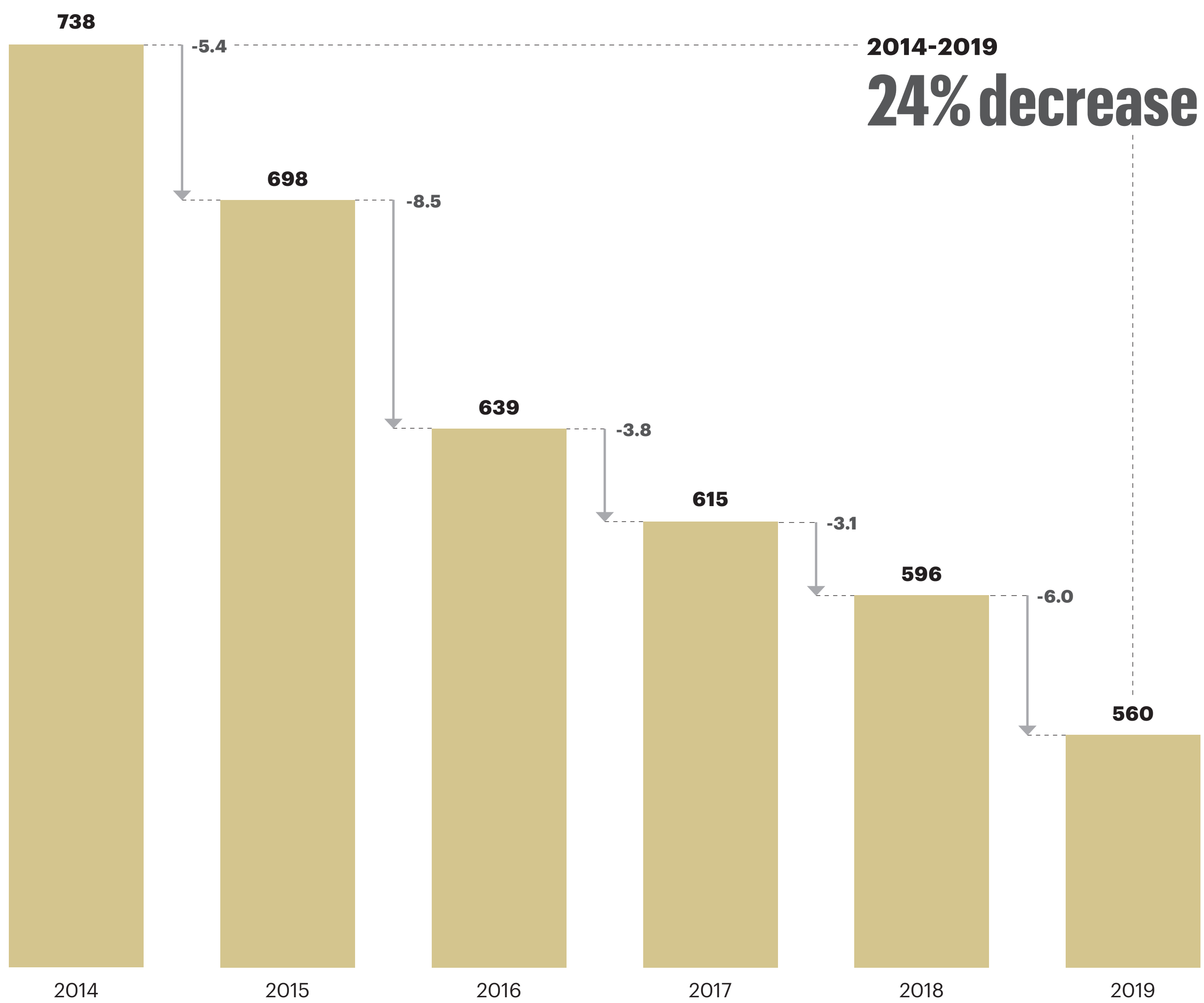
Under Dan Mathews, appointed commissioner of the GSA's Public Buildings Service in 2017, the agency has made a conscious push away from short-term leases and extensions in favor of longer-term leases, making those buildings more attractive to banks and outside investors. That positions the federal government's landlords to offer better deals and more concessions.

"At the end of the day, it's really the market that drives that, market vacancies, supply and demand. And right now there's a lot of sup-

eet in September 2013. Since then, it's been a rather speedy decline to an overall 15% decrease in average total square footage leased by the federal government across the
ooth sequestration — across-the-board federal budget cuts — set in in 2013 and the Obama administration began to push for more efficiency across its real estate footprint.



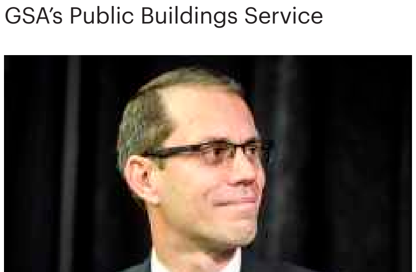
AVERAGE NUMBER OF LEASES



SOURCE: CBRE

"AT THE END OF THE DAY, IT'S REALLY THE MARKET THAT DRIVES THAT, MARKET VACANCIES, SUPPLY AND DEMAND. AND RIGHT NOW THERE'S A LOT OF SUPPLY OUT THERE IN THE NATIONAL CAPITAL REGION."

DAN MATHEWS, commissioner, GSA's Public Buildings Service



ply out there in the National Capital Region," Mathews said. "Not withstanding Amazon, there's still a lot of supply and we're getting fabulous deals right now, frankly. But again, we're getting that because we are putting long-term, firm-term leases out there."

Take the Department of Justice's relocation from multiple locations to Constitution Square in Northeast D.C. Or the Federal Communications Commission's planned move to Sentinel Square in NoMa. Or the Transportation Security Administration's planned move to Springfield. And to land the TSA, Boston Properties offered up 12 months of free rent and $25.8 million in tenant improvement allowances, underscoring the lengths landlords are willing to take to attract these agencies.

The federal exodus has served as the second blow of a one-two punch, starting with the ongoing densification among some of D.C.'s largest tenants, led by law firms, that have migrated to smaller spaces with more open and efficient layouts. Combined, those two changes have caused vacancy rates to climb to well above historical averages across Greater Washington. The region's vacancy rate has climbed from about 14.4% in mid-2013 to about 16.5%, according to CBRE.

This is hardly just a local phenomenon. The GSA has been slimming down nationally, but the D.C. region has borne much of the pain because it's home to most of its leases. In all, the feds have shed about 10.8 million square feet nationwide, a drop of about 5.45%. The D.C. region represents about 26% of that larger, 187.4 million-square-foot portfolio, but about 80.2% of the agency's space reductions since 2013.

Winners and losers

The Justice Department has experienced some of the most real estate loss. It dropped its footprint from about 1 million to around 839,000 square feet when it squeezed into one location, in Three and Four Constitution Square in NoMa.

That's been good for Stonebridge Associates. The D.C. developer finally landed a full-building tenant for all of Three Constitution Square, which had sat vacant since it delivered two years earlier, plus all of Four Constitution Square, a 475,000-square-foot building the agency moved into earlier this year.

But it's not so good for the landlords of the four buildings Justice vacated, now struggling to fill hundreds of thousands of square feet of newly empty office space. That's impacted local and national firms alike, D.C.-based S.C. Herman & Associates Inc. and New York's Tishman Speyer among them.

Republic Properties President Steve Grigg has been on both ends of that scenario. Republic lured the FCC to its Portals complex in Southwest D.C. in the 1990s as part of the agency's consolidation of six offices to one. Two decades later, the GSA made a deal in late 2016 to shift the FCC to a new building in NoMa, dropping about 186,000 square feet in the process. Republic, staring down nearly 660,000 square feet of empty space in Portals when the FCC moves out later this year, rebounded in late 2017 with another federal lease win for the Pension Benefit Guaranty Corp. But the financial agency isn't taking all of the FCC's space – just under 431,800 square feet of it.

Nevertheless, the game of agency musical chairs hasn't changed Republic Properties' approach to leasing, Grigg said. He reasons the Portals wasn't just designed for federal space from its start and there are still more options for companies to

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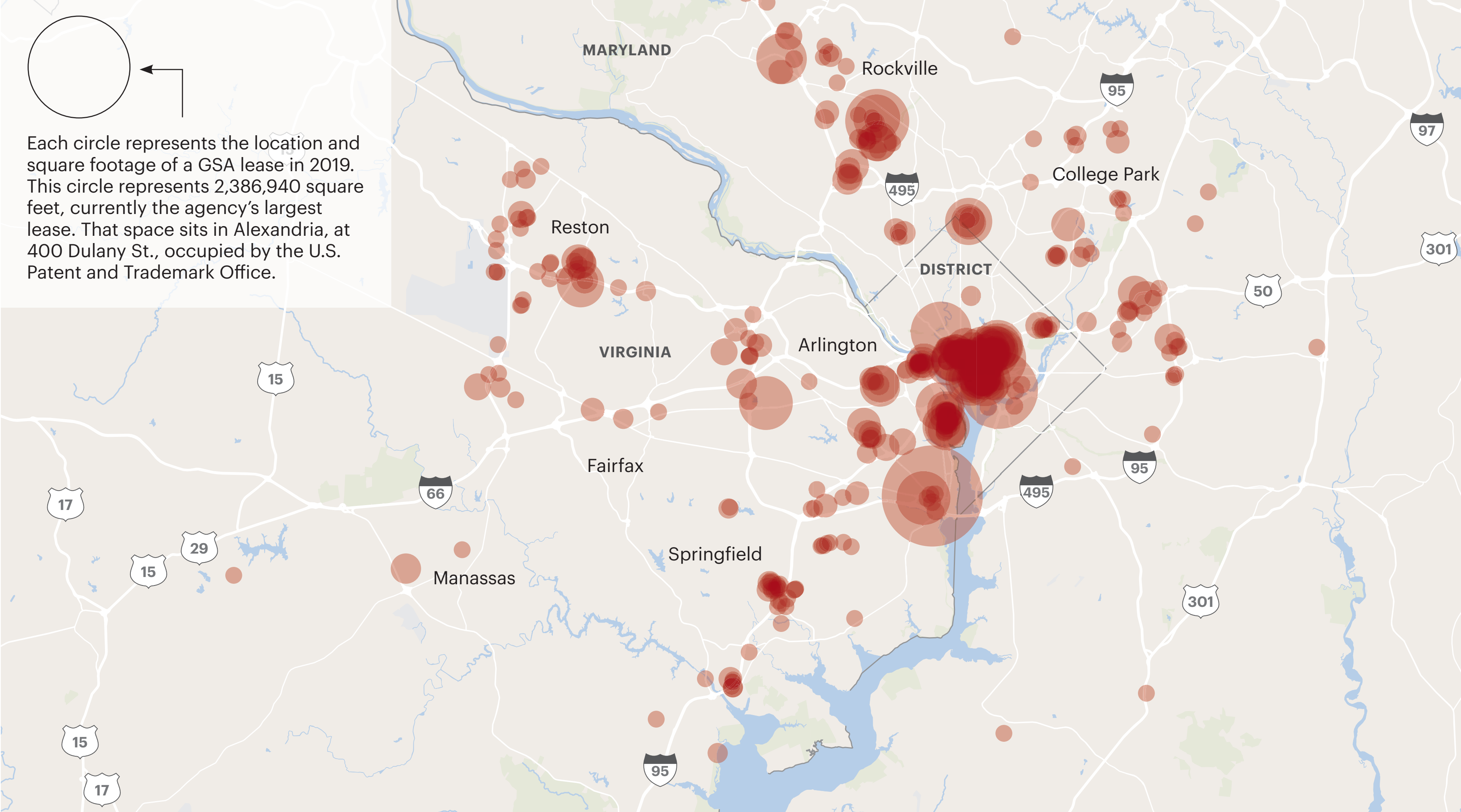
REAL ESTATE INC. EXTRA

WHERE THEY ARE

GSA leases, while still largely concentrated in the District and its immediate surroundings, are spreading further across the region.



SOURCE: CBRE

CONTINUED FROM PAGE 29

lease smaller chunks of its remaining space.

For other landowners, a larger question looms: Do you hold out hope for landing replacement government tenants, or invest millions of dollars to reposition the entire building to attract private sector tenants that could pay more in rent than the GSA's general lease cap of about $50 per square foot?

S.C. Herman is weighing those very options at 600 E St. NW, one of the Justice Department's former buildings. Tishman Speyer, which was also in the same boat at 601 D St. NW, has opted for a less intensive series of renovations after landing the D.C. Office of the Attorney General as a partial-building tenant.

Other properties, at least in their current shape, are less likely to be released to federal government tenants than others. Brookfield Properties, for example, has started to mull the future of 1200 K St. NW after the PBGC moves out. The agency was a good get when it moved in more than a decade ago, but the location has since become a stronger sell for law firms and other private tenants. And the latter is whom Toronto-based Brookfield is now targeting as it considers renovations to the property, including infusing it with more ground-floor retail, said Greg Meyer, executive vice president for Brookfield's D.C. region.

"We wouldn't pursue the government at all for it. It's just inappropriate – they wouldn't be able to pay the rent," Meyer said. "If there was something like a Cinderella slipper, would we chase after it? I wouldn't rule it out. I just think it's really unlikely."

In Crystal City, at 601 12th St. S., Brookfield has pretty much written off its chances of finding a replacement for the Transportation Security Administration once it moves out in mid-2020 for a new headquarters being built for it in Springfield. Facing a dated, inefficient layout at the Arlington building, Brookfield submitted plans this spring to demolish 601-701 12th St. S. and develop a larger mixed-use project that could benefit from its proximity to Amazon.com Inc.'s planned second headquarters nearby.

In that case, Brookfield lost the

SOME SIZABLE DROPS

The GSA has already completed or is underway with several agency space reductions, including these below.

DEPARTMENT OF JUSTICE

The agency shed about 206,000 square feet with its move from four buildings in the District to 839,000 square feet at Three and Four Constitution Square in NoMa.

FISH AND WILDLIFE SERVICE

The agency cast off about 72,000 square feet with its move from three buildings in Ballston to nearly 183,000 square feet at Seven Skyline Place in Falls Church.

NATIONAL LABOR RELATIONS BOARD

The NLRB dropped about 92,220 square feet with its move from Franklin Court at 1099 14th St. NW to about 143,116 square feet at 1015 Half St. SW.

NATIONAL SCIENCE FOUNDATION

The agency reduced its footprint by about 89,000 square feet with its move from two buildings in Ballston into a new 660,848-square-foot headquarters developed for it at 2415 Eisenhower Ave. in Alexandria.

CBRE's Marcy Owens Test said the feds are "no longer a player" for smaller chunks of spaces.

JOANNE S. LAWTON / STAFF

TSA to a development site near the Franconia-Springfield Metro where lower land costs enabled Boston Properties to nab the 622,812-square-foot lease. The GSA has been putting increased emphasis on price as a leading factor in its selection process, driving the federal government out of prime submarkets like the Rosslyn-Ballston corridor into outlying areas like Alexandria, Falls Church, Springfield and Camp Springs in suburban Maryland in the case of Citizenship and Immigration Services' planned headquarters.

That's equally true in the District, where the GSA has migrated to places like NoMa and Southwest D.C., where rent for new development has been cheaper than for existing office buildings downtown or on the East End. But that trend won't hold for long, said federal leasing expert Darian LeBlanc, executive vice chairman with Cushman & Wakefield who represented landlords like Stonebridge with its Justice lease in NoMa and Boston Properties with the TSA in Springfield.

Some of this will come at some cost to the government itself. All of the GSA's consolidation, he said, has been slowly depleting the supply of potential development sites in those

CONTINUED ON PAGE 32

THAT EMPTY FEELING

Different landlords, facing newly empty spaces, are responding to the slimmer GSA footprint in different ways.

ONE CONSTITUTION SQ.

At 1275 First St. NE, Stonebridge Associates scored a 173,000-square-foot lease with the Peace Corps in 2017 as part of its relocation from 1111 20th St. NW on D.C's West End. The space had been vacated by the GSA, which leased more than 300,000 square feet in the building for use as swing space while it renovated its own headquarters at 1800 F St. NW.

300 SEVENTH ST. SW

The Washington Metropolitan Area Transit Authority paid $51.3 million for 300 Seventh St. SW, with plans for a new D.C. headquarters. That came after the U.S. Department of Agriculture put the building's former owner, Joss Realty Partners, at risk of losing the property to foreclosure.

601 D ST. NW

Tishman Speyer retained Shimoda Design Group to draft renovation plans for 601 D St. in response to losing the DOJ to a new NoMa home. It initially considered repositioning the entire building to an all-glass facade and trophy class, but toned down the scope after the D.C. Office of the Attorney General opted to lease a large block of space in the building.

BALLSTON EXCHANGE

Formerly known as Stafford Place I & II, Jamestown overhauled the two-building complex at 4201 and 4121 Wilson Blvd. after National Science Foundation's 2017 move to Alexandria left 750,000 empty square feet. It has since inked new leases, including with coworking firm Industrious for nearly 25,000 square feet, but still has a substantial amount of vacant space.

REAL ESTATE INC. EXTRA

CONTINUED FROM PAGE 31

emerging markets. And as the cost of construction continues to rise, it could become even tougher for the federal government to anchor new construction at rental rates below its cap.

"The government has had its pick of great options in the District of Columbia for 15 years. And if they were not able to get cooperation from their incumbent owners, they would probably just pick up and move to a different location, and those options are just not there anymore," LeBlanc said. "They have soaked up a lot of the development potential in the low-cost areas, and so their ability to continue to consolidate is now not easy to do."

What then? The GSA could seek permission to raise its rent caps for new construction, eroding the savings it sought from its consolidation efforts. Or it could be forced to narrow its search to existing buildings or seek out multiple development sites in a concentrated area. It has a few years to figure it out, thanks to some existing buildings or planned development sites that still lie in places like 5001 Eisenhower Ave. NW in Alexandria, the Skyline complex in Falls Church and development sites at Poplar Point and St. Elizabeths east of the Anacostia River.

For now, Mathews said, the deals being offered by landlords are still competitive enough that the GSA isn't at risk of being priced out in the D.C. area. "I don't think we're there yet, the market is still very favorable for the government," he said. "That's the simple reality. I think we've all been a bit surprised just how long those favorable conditions have lasted for the government, but we're still in a buyer's market in most of the submarkets."

What's next

Here's a hard reality: The GSA is only partway through its consolidation process. The agency has an estimated 120 million square feet of leases set to expire in the next two years nationally, of which 32 million is in the D.C. region.

Of that local portfolio, about 22.1 million square feet are set to expire through 2023, with big deals pending, including for the Securities and Exchange Commission at nearly 1.7 million square feet, the National Protection and Programs Directorate at about 625,000 square feet, and the Food and Drug Administration at 400,000 square feet. The SEC isn't likely to see much of a space reduction, based on the congressionally approved prospectus authorizing the search (see above), but it's a safe bet some of those other deals will follow the pattern of shrinkage.

Why? Mathews said he has set a goal of saving the federal government nearly $5 billion through lease transactions during the current administration. It's already realized $1.9 billion, largely by negotiating longer-term deals with landlords with generous concession packages.

And what about those plans by BLM and USDA to shift hundreds of employees to locations outside of Greater Washington? Should other landlords leasing local space to federal tenants be worried about similar losses? Not necessarily, Test said. She said the writing was on the walls for the land management agency given the nature and geographic reach of its work. Other agencies have been considered for similar relocations, including the National Park Service and Fish and Wildlife Service.

Instead, she said, landlords

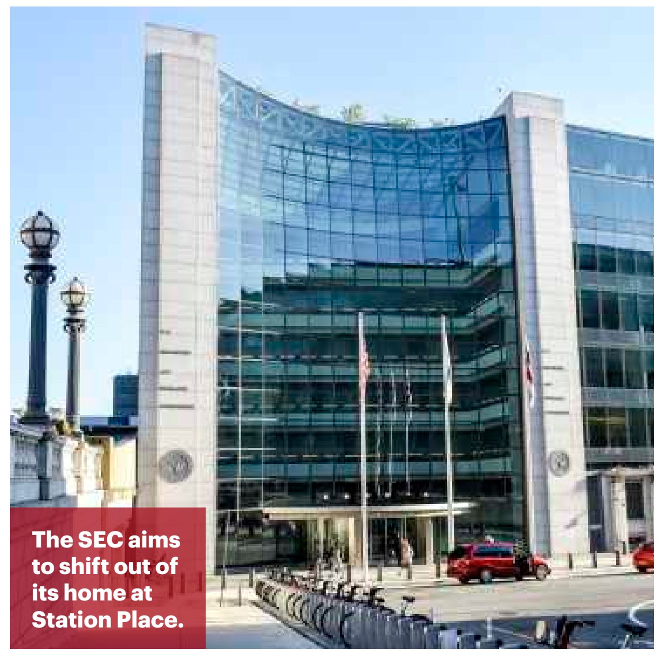
A CLOSER LOOK

SEC REMAINS AN ANOMALY IN ERA OF CONSOLIDATION

While many federal agencies reduced their footprints with moves to newer, more efficient spaces, there are always exceptions, and the Securities and Exchange Commission is one of the biggest, literally.

The regulatory agency leases nearly 1.3 million square feet at Station Place, a three-building complex near Union Station where it has been for more than 15 years. In one of her final actions as head of the General Services Administration under President Barack Obama, Denise Turner Roth sent a prospectus to the oversight committees in the House and Senate in December 2016 seeking permission for a new lease with substantially the same square footage.

Historically, that's all but a sure sign the federal tenant will stay put given all the disruption and expense involved with a move of that size. But it's unclear whether that will be the case here



The SEC aims to shift out of its home at Station Place.

FILE PHOTO

for a couple of reasons, and those variables could cause landlord Property Group Partners to lose its federal agency tenant — and the $58.8 million a year it was receiving in rent for the SEC.

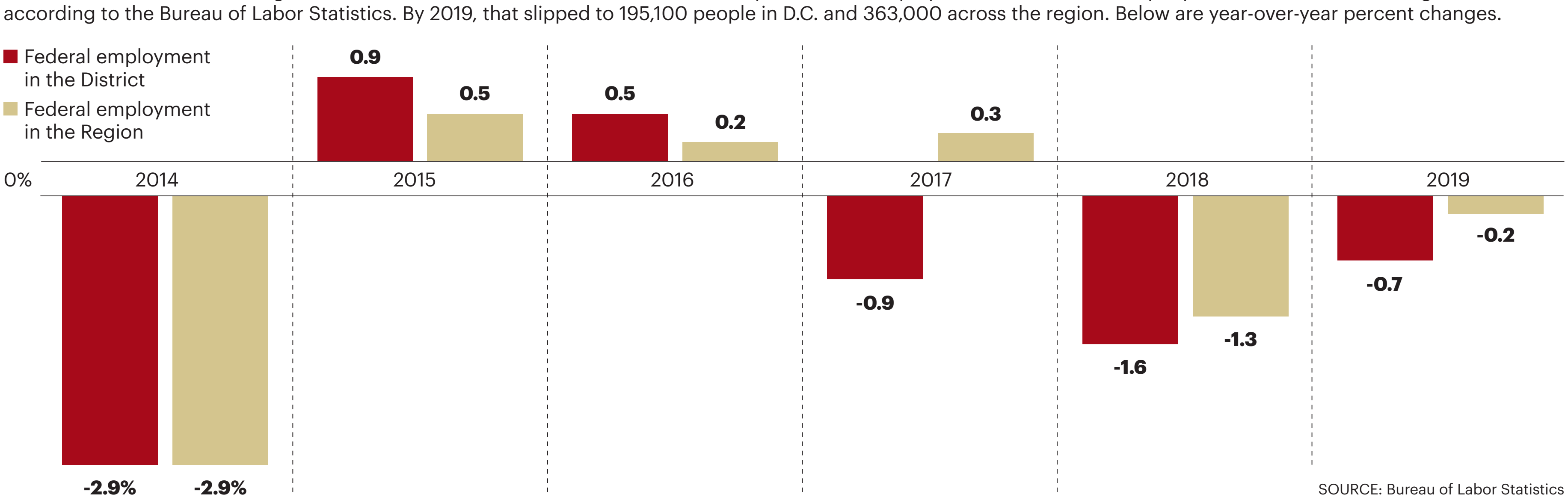
The first is whether other prospective landlords can offer a lower rental rate and greater concessions than PGP can to make it worth the federal government's while to relocate. The same can be said of any other big GSA search, but the District has offered incentives to at least one developer to help bring a federal agency across the Anacostia River to Poplar Point. Then again, with the rising cost of construction, that might not be enough.

In addition, there are two pending legal challenges to the GSA's search. PGP filed one that challenged a requirement that bidders include a purchase option allowing the federal government to buy the new space after a set period of time. A Court of Federal Claims judge rejected that protest in July, and it's unclear what PGP will do next. The second was filed by an affiliate of Redbrick LMD, which controls the Poplar Point site the District backed with tax breaks. The developer claims its bid was unfairly eliminated from competition. That protest was filed at the Government Accountability Office, which is slated to render a decision in October.

– Daniel J. Sernovitz

PERCENT CHANGES IN FEDERAL EMPLOYMENT

It's no coincidence that the region's federal workforce also shrank since 2014. That year, federal employment stood at 199,400 people in D.C. and 364,000 regionwide, according to the Bureau of Labor Statistics. By 2019, that slipped to 195,100 people in D.C. and 363,000 across the region. Below are year-over-year percent changes.



SOURCE: Bureau of Labor Statistics

Greg Meyer said Brookfield is targeting more private sector tenants in its redo of 1200 K St. NW.

JOANNE S. LAWTON / STAFF

should take a good look at which agencies are in their buildings and what their missions are to determine their own risk.

"What we'll find when things flush out is that there are some jobs that will move and others that won't move," Test said. "To me, it just continues to articulate the same message that we've been saying all along. You have to dig in to understand your tenant and what their demands are."

The National Capital Planning Commission, meanwhile, is suggesting we not panic just yet. Despite the decline, the D.C. region remains the seat of the federal government, and that's not likely to change, said Stephen Staudigl, an NCPC spokesman. Staudigl said the BLM and USDA moves represent just 0.19% of the total federal workforce. That's not to say that the balance of agencies based in the region won't fluctuate over time, given that some are already headquartered elsewhere, such as the Centers for Disease Control and Prevention in Atlanta. Still, he said, the D.C. area is relatively hallowed.

"The seat is symbolic and means Cabinet headquarters and the home of the president, Congress and judiciary," Staudigl said in an email. "This will not change, and the vast majority of agency leadership are still located in this region."

The NCPC recently released a draft of its Federal Workplace Element, an update to its comprehensive plan, which addresses the importance of the federal workforce in Washington. That document takes an optimistic view of their mutual need and support, right in its goal statement.

"With a vast amount of owned and leased federal real estate, federal employment and contractor procurement, the federal workplace significantly affects all sectors of the region's economy," it read. "Conversely, the federal government depends on a strong and economically vibrant region to maintain and enhance its operational efficiency and productivity. This relationship promotes many common economic interests between the federal government and the regional jurisdictions in Washington, D.C., Virginia and Maryland."

THE CHURN STILL TO COME

Several agencies are in the process of downsizing as you read this. These are some of the more notable cases.

FEDERAL COMMUNICATIONS COMMISSION
Will shed about 123,000 square feet with its planned move to a 473,000-square-foot headquarters being developed at 45 L St. NE in NoMa.

PENSION BENEFIT GUARANTY CORP.
Will shed about 35,400 square feet with its planned move to a nearly 431,800-square-foot lease at 445 12th St. SW, also known as the Portals II, part of the space the FCC is vacating for its new headquarters.

TRANSPORTATION SECURITY ADMINISTRATION
Will shed about 22,000 square feet with its planned move to a new, 625,000-square-foot headquarters being built for it in Springfield.

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House whisperer

Selling your home is brutal. She makes it easier.

EXECUTIVE PROFILE, 36

THE PROBLEM WITH D.C.'S OFFICE MARKET

COVER STORY BY DANIEL J. SERNOVITZ | PAGE 28

STAFF PHOTO ILLUSTRATION

TOPSHELF

Peebles sued

A partner on Peebles' SLS Hotel and condo project has sued the developer, just as it nears a crucial deadline. REBECCA COOPER, 6

INNOVATION & HEALTH

Inova's sixth investment

Babyscripts, an app that connects pregnant women to their doctors, just scored $500,000 from Inova's investment arm. SARA GILGORE, 12

REAL ESTATE INC.

What Bowser wants

We scoured Mayor Muriel Bowser's proposed budget for fiscal 2020 to see what capital projects are on tap. MICHAEL NEIBAUER, 22

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COVER STORY

A PERFECT STORM

HOW A GLUT OF SPACE IN TWO DOWNTOWN AREAS IS MAKING LIFE MISERABLE FOR LANDLORDS — AND GOOD FOR TENANTS

BY DANIEL J. SERNOVITZ | dsernovitz@bizjournals.com

Ray Ritchey still isn't sure they made the right call on the Robert S. Strauss Building, but what's done is done.

His company, Boston Properties Inc., a real estate investment trust, had come up with plans to convert the 12-story building near Dupont Circle into a trophy-class property after its anchor tenant, law firm Akin Gump Strauss Hauer & Feld LLP, moves out later this year for a newly renovated building a few blocks away.

But even if renovations were successful in attracting new tenants at higher rents – far from a sure thing in the face the District's soaring office vacancy rates – Boston Properties risked siphoning prospective tenants that could fill blocks of empty space at some of its other properties, such as Market Square North, Metropolitan Square and 901 New York Ave. NW. So the developer decided to sell the Strauss building, 1333 New Hampshire Ave. NW, late last year for $136.5 million to a joint venture that plans more modest renovations.

"One of the dilemmas we have is that this market has robbed the future to address the issues of today," Ritchey said. "So our viewpoint of redeveloping this into a trophy-level building didn't make economic sense."

Most big tenants with leases expiring in 2021 and 2022 have already inked deals for new space, Ritchey said, meaning Boston Properties likely wouldn't be able to secure an anchor tenant for another half decade.

It's that sort of calculus that has landlords in the District fretting these days. A slew of new trophy buildings, a near record high vacancy rate and diminishing demand – many companies and firms are still downsizing when they take new space – have created a set of circumstances landlords haven't faced on this scale in recent history, if ever.

For tenants, that's good news. For owners, it's a perfect storm.

IT'LL GET WORSE BEFORE IT GETS BETTER

Developers delivered more than 2 million square feet of new or substantially rebuilt office space into the District's office market last year, with more than 3 million square feet under construction Districtwide. That has pushed the vacancy rate for all investment grade property to 14.1 percent at the end of 2018, according to Cushman & Wakefield. Things are even worse for the commodity Class A market, made up largely of buildings developed 10 to 15 years ago that were once highly sought after and commanded the highest rental rates in the District. The vacancy rate for those properties closed out the year at around 14.2 percent.

All that new product, coupled with pre-leases not set to kick in for some time, has put D.C.'s office market on a trajectory to continue to see vacancy rates rise in the next few years. Older Class A properties in the city's core are feeling the most pain, potentially surpassing 20 percent vacancy by 2021, according to Cushman & Wakefield. The last time vacancy rates hit that level was in 2009 during the Great Recession.

Also adding to the pain: Many of the new buildings delivered over the past few years – mostly defined as trophy, meaning premium, top-of-the line buildings – are only partially leased, with companies mainly pre-leasing the top floors offering the choicest views. That creates a problem known as the muffin-top, forcing landlords to sweeten the deal with cheaper rental rates, months of additional free rent or tenant concessions to generate more activity on those lower floors.

The number of buildings in

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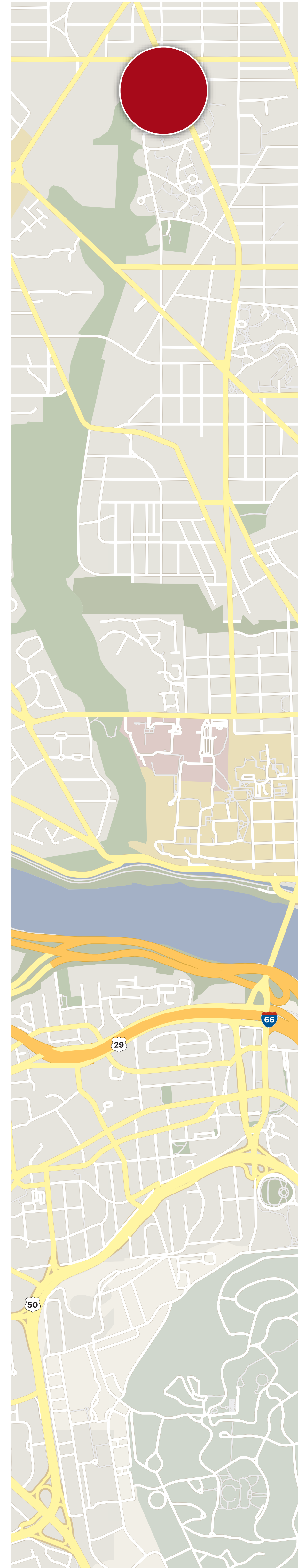


FOR LEASE

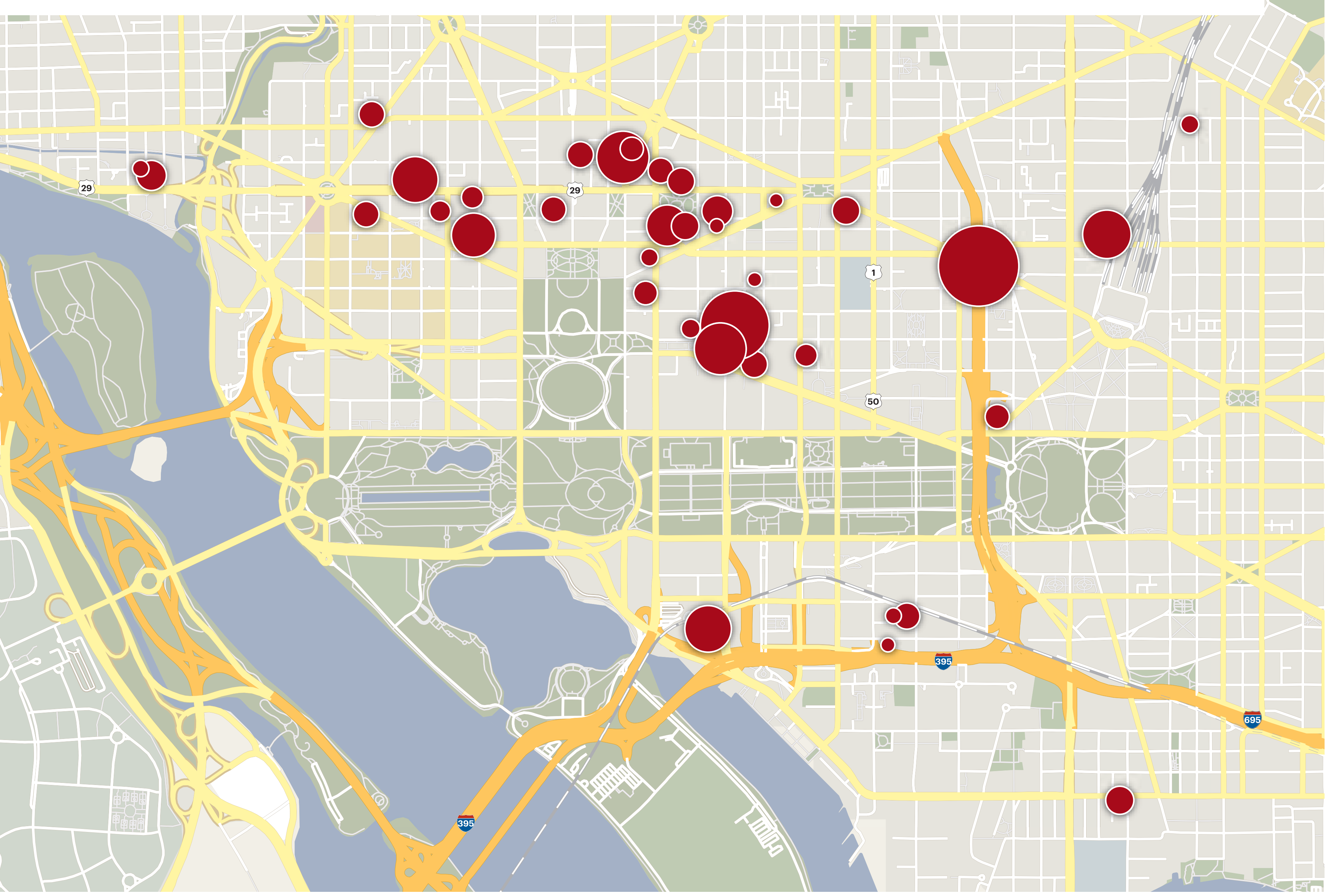
WHERE THE SPACES ARE

The map on this spread shows all the Class A and trophy buildings in D.C. with block of space larger than 50,000 square feet, with the size of the circle corresponding to the amount of space available. In some cases, the buildings have more than one block of space of that size. The chart below shows the 10 buildings with the most vacant space overall.

MOST VACANT AVAILABLE SPACE AMONG D.C. CLASS A BUILDINGS *By square footage*

SUBMARKET		
Uptown	4000 Wisconsin Ave. NW	371,947
Capitol Hill	200 Massachusetts Ave. NW	313,658
East End	555 12th St. NW	268,487
East End	1441 L St. NW	204,039
East End	1201 Pennsylvania Ave. NW	201,909
NoMa	810 1st St. NE	189,713
Southwest	1250-1280 Maryland Ave. SW	181,325
CBD	2001 K St. NW	179,485
CBD	1801 Pennsylvania Ave. NW	172,085
East End	1350 Eye St. NW	160,579

SOURCE: CoStar



COVER STORY

CONTINUED FROM PAGE 28

the District with blocks of 50,000 square feet or more of vacant space hit 52 as of February, according to CoStar, which tracks commercial real estate. Much of that space is concentrated in the Central Business District and East End, the area just east of Metro Center. Cushman & Wakefield reports there is more than 9 million square feet of empty space combined in those two submarkets, which span roughly from Washington Circle to Second Street NW and from the National Mall to P Street NW.

Many tenants are leaving downtown for emerging markets like The Wharf, where white-shoe law firm Williams & Connolly has signed on, or NoMa and the Capitol Riverfront business district.

A TENANT'S MARKET

All that means good news if you're a tenant looking for space, said Tom Fulcher, vice chairman and co-regional manager of tenant rep firm Savills Studley.

The glut of space caused rental rates across the board to hold mostly static, while the concessions landlords are offering tenants spiked by 15 percent since last year, according to JLL. From virtually nothing in 2005, landlords are now offering more than 14 months of free rent, while tenant improvements during that time nearly doubled from around $80 per square foot to around $120.

All things being equal, who wouldn't want to move to a brand new building that costs as much to rent as one that's more than three decades old?

That's created a sense of opportunism among some tenants, and Fulcher said he is working with some clients looking to get a bargain by leasing space on some of the lower floors of those newly delivered buildings. It's the kind of environment, he said, where you can really get creative and aggressive in advocating for space-seeking tenants. It's a dynamic that will only get better over the next few years as more space delivers and the demand for that pool of space remains unchanged.

"New product, it's better," he said. "You look at the old buildings, the old floor plates, the old air conditioning systems, the amenity levels, paired with the fact that companies are getting smaller, and you can move into a new building for the same as what you were paying in rent, or maybe less."

How much so? Wilmer Cutler Pickering Hale and Dorr LLP, which plans to move to a new building being developed by Boston Properties at 2100 Pennsylvania Ave. NW, is said to have been offered 12 months of free rent and $140 per square foot in tenant improvement costs. Cornerstone Research, which will be Akin Gump's new neighbor at Alexander Court, the combination by Rockrose Development Corp. and Spitzer Enterprises of two adjacent office buildings into a new trophy property, is said to be getting 15 months of free rent and $130 per square foot in TI. JBG Smith Properties is said to have offered equally generous concession packages to lure tenants, including real estate services firm CBRE Group Inc. and law firm Beveridge & Diamond PC, to a new, 271,000-square-foot trophy building at 1900 N St. NW near Dupont Circle.

JBG Smith has been on both the winning end and the losing end of the equation. Including CBRE, 1900 N St. NW is about 65 percent preleased, a year ahead of when the building is slated to deliver. But like Boston Properties, it has been working to limit its exposure to those older, Class A buildings downtown with big current or pending vacancies in favor of new, trophy construction. The developer has sold properties including the Warner Building, 1399 New York Ave. NW, and the Bowen Building at 875 15th St. NW ahead of law firm Paul Hastings LLP's departure.

"As we look at it, what we see is that the D.C. market remains uneven, and it varies widely on a submarket by submarket, and even asset basis," said Dave Ritchey, executive vice president at JBG Smith.

THE SOLUTION?

With all that new product, the challenge for landlords is to create space in older buildings that have a distinct and individual feel to them. Many owners willing to invest large sums of money on whole building conversions to attract new tenants are avoiding the pain of prolonged vacancies, while others making more modest improvements are being forced to sweat it out, drop their rental rates or increase their concessions to endure.

"Sometimes you have to reposition a building defensively, meaning you're not necessarily going to be able to raise rents, it's just something you've got to do to stay relevant," said Oliver Carr III, CEO of Carr Properties. "Then there are some of the more wholesale renovations, and those are based on the assumption of rent growth."

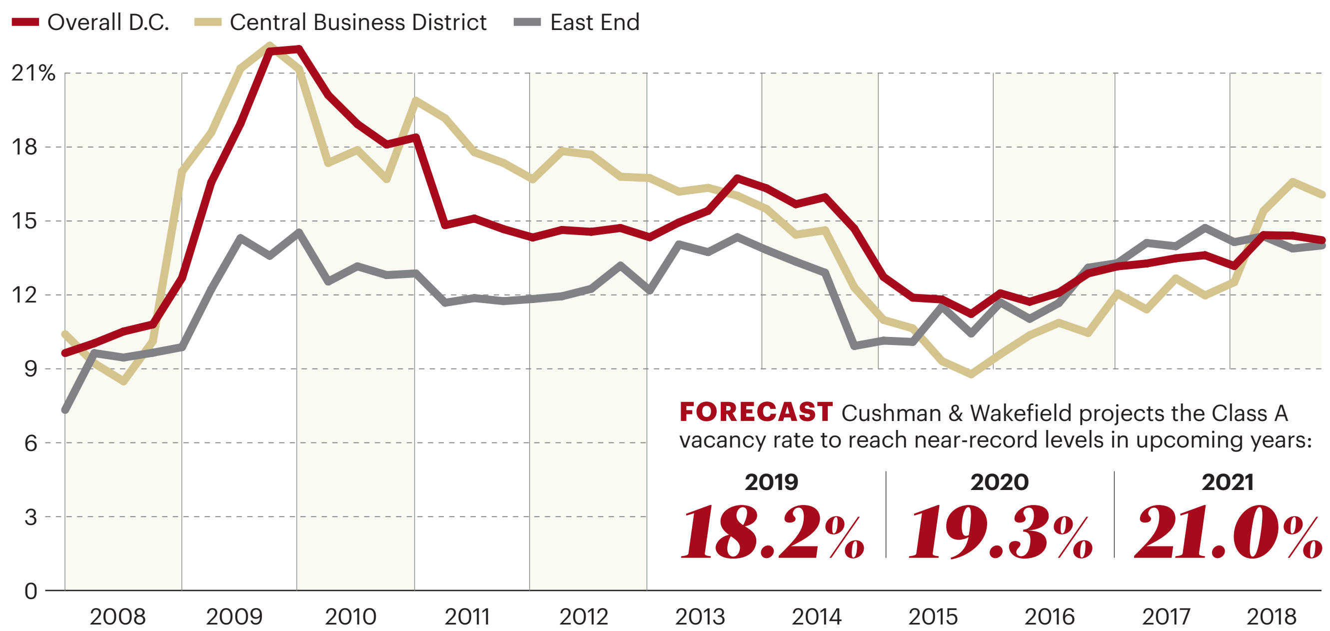
Carr recently delivered Midtown Center, its redevelopment of The Washington Post's former home at 15th and L streets NW, but it also owns a number of older buildings in the District, including the building where its headquarters is based at

THE NUMBERS

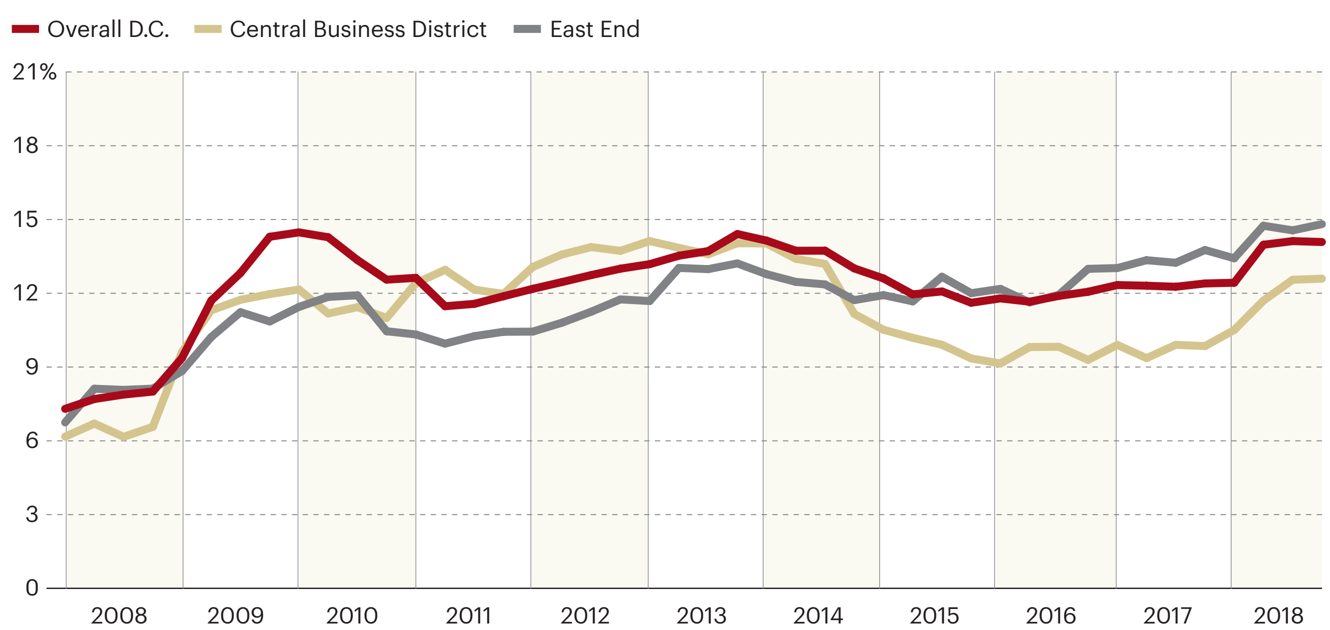
AN OMINOUS TREND

A glut of space in Class A office buildings in the Central Business District (essentially the area between Dupont Cirlce and K Street) and East End (the area between Metro Center and Judiciary Square) is driving vacancies to near-record highs.

CLASS A OFFICE VACANCY RATE



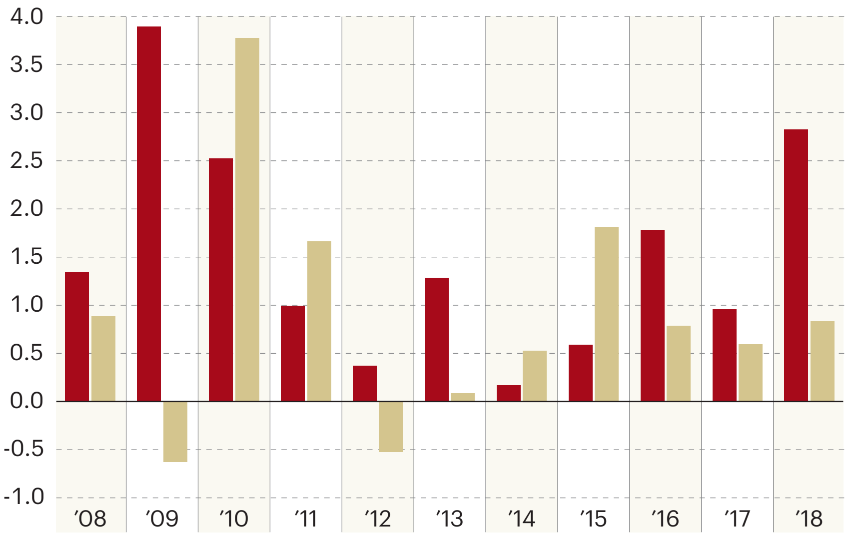
OVERALL D.C. OFFICE VACANCY RATE



SOURCE: Cuashman & Wakefield

OVERALL D.C. ABSORPTION *In millions of square feet*

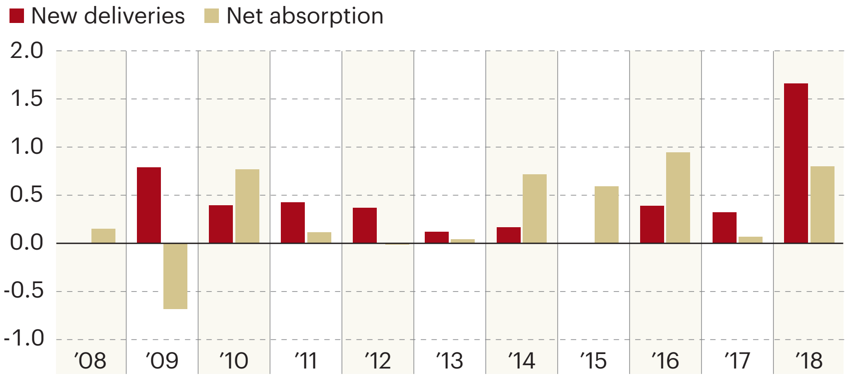
New deliveries ■ Net absorption



CENTRAL BUSINESS DISTRICT ABSORPTION

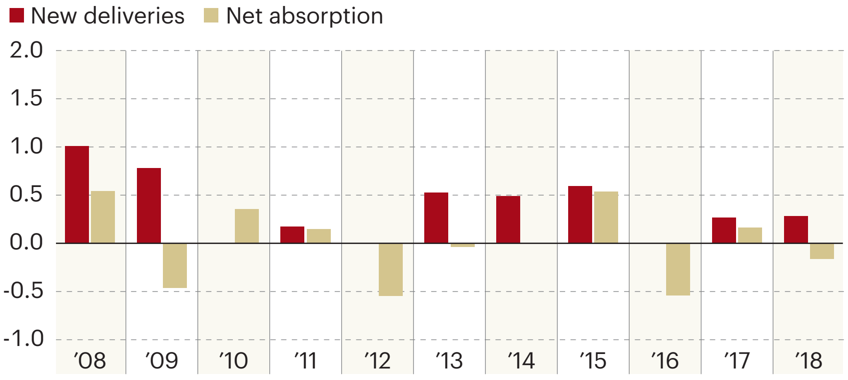
In millions of square feet

New deliveries ■ Net absorption



EAST END ABSORPTION *In millions of square feet*

New deliveries ■ Net absorption



1615 L St. NW. That 420,000-square-foot building will be the kick-off location for the Carr Experience, a blend of technology, hospitality and common-area spaces it hopes will engage more with tenants.

While developers can swap in floor-to-ceiling glass facades for punched windows and put things like coffee bars and plush seating in their lobbies, it's tougher to overcome constraints common to those older buildings, such as low ceiling heights and tight column spacing. That's why many of those repositioned buildings have been slower to lease up than new construction.

THE MERIDIAN EXPERIENCE

The Meridian Group overcame that with its conversion of part of Techworld Plaza into what it's now calling Anthem Row. Meridian basically emptied out the building to make way for major upgrades that helped boost occupancy to nearly 90 percent including expansion options.

A big get for Meridian came last February, when law firm Baker Botts leased the building's top floors as part of a relocation from the Warner Building at 1299 Pennsylvania Ave. NW. To land that big fish, Meridian needed to create what essentially feels like new space on the building's top two floors, removing the more restrictive column spacing, boosting the ceiling heights and creating private rooftop space for the law firm's use. Meridian hadn't been planning to do that initially, but allowing all the tenant leases in the property to expire before getting to work positioned it to work closely with Baker Botts to come up with the right mix of building improvements.

"It's not an open checkbook, but you need to be willing to increase your budget to accommodate specific requests," said Tom Boylan, senior vice president at Meridian. "At these rents, tenants demand exceptional space. You just have to be flexible and work collaboratively with the tenant design team to make this the best location possible."

"What I always advise is to be as opportunistic as possible, and don't get greedy in times like this when the vacancy rate is so high," Boylan said.

Location plays a factor too. Mount Vernon Square doesn't have waterfront views, but its proximity to Chinatown provides plenty of restaurants and entertainment venues. It's also close to the courts. Those things ensure downtown locations will be on the radar screen for large tenants, but it won't get them to sign a lease if the building's not the right fit.

Randy Harrell, vice chairman at CBRE and part of the team that repped Baker Botts, said Meridian's willingness to make additional building modifications on top of what it was already considering were critical in sealing the deal.

While the slew of new buildings has made it harder for the owners of older ones in downtown D.C., Harrell said there's another factor that could level the playing field. That's construction prices, which are rising at a rate faster than inflation, and he expects that will slow the pace of new construction, increase the asking rental rates those developers seek and give existing buildings in the CBD and East End time to fill up again.

"If you want to be positive about the core, you can be positive, because I do think the new construction pipeline is going to reduce," Harrell said.

Based on the number of big prelease deals that haven't yet delivered, vacancy rates aren't expected to crest for those Class A properties in D.C.'s core until at least 2021, said Nate Edwards, senior director of research for Cushman & Wakefield's D.C. region. They might peak sooner for those more desirable trophy properties, perhaps mid-2020. But what comes up will come down, said Edwards, who noted the last time Class A vacancy rates surpassed 20 percent, in the third quarter of 2009, they had started to notch down by the second quarter of 2010 and were under 17 percent to close the year.

That might come as little consolation to landlords struggling to fill empty pockets in their buildings, but Kevin Thorpe, global chief economist for Cushman & Wakefield, said there is a proverbial light at the end of the tunnel. The D.C. region led the nation for new construction in the period from 2008 to 2018, with about 33.6 million square feet, much of that in the District. Thorpe, speaking at Cushman & Wakefield's State of Real Estate Feb. 5, said it will take time for all of that new space to fill up, but he likened the situation to one of an adolescent that's gone through a growth spurt. It's feeling awkward now, but he anticipates the pace of new construction will slow down to catch up with demand.

"Tenants have loads of options, they have loads of options to choose from," he said. "This isn't really a sad story – I think it's an expansion story. It's a story of D.C. growing into its footprint, it's upgrading its office inventory."

THE LABELS

INSIDE THE DEFINITIONS

Defining what class an office building falls into can be subjective, and many real estate firms define the classes a bit differently. The Building Owners and Managers Association International offers this definition for a Class A property:

"Most prestigious buildings competing for premier office users with rents above average for the area. Buildings have high quality standard finishes, state of the art systems, exceptional accessibility and a definite market presence."

Some firms lump trophy and Class A properties into the same pool, while others draw a distinction between the two. Newmark Knight Frank, for example, offers this definition in its year-end market report to distinguish older properties in the District that were once regarded as prime from newer, trophies:

"Commodity Class A space — mostly buildings that delivered 10 to 15 years ago — is oversupplied; this segment of the market is stressed."

NAIOP, which represents office and industrial property owners, defines a trophy building as a landmark property that is located in a highly desirable submarket, designed by a recognized architect, and features high-end finishes or modern or efficient systems. These buildings command among the highest rental rates in the market, are more than 80 percent occupied by the market''s premier tenants, are highly sought after by institutional investors, and are more desirable than Class A properties.

There's no singular answer for every building, and adding a rooftop deck or swapping out an older facade for a new glass curtainwall isn't going to cut it in many cases. Debra Lehman Smith, a founding partner at Georgetown-based architecture firm Lehman Smith McLeish, said it's important for owners to think more holistically about their buildings and the potential users who will want to lease space in them.

"We have to think differently as a landlord than we ever did before," she said. "So, is that amenity rich? Is that carving up your building? I always think it's unfortunate when you look at some of these building owners when they just try to put a new skin on it or put a new lobby in it and they don't rethink what can I really do with my building."

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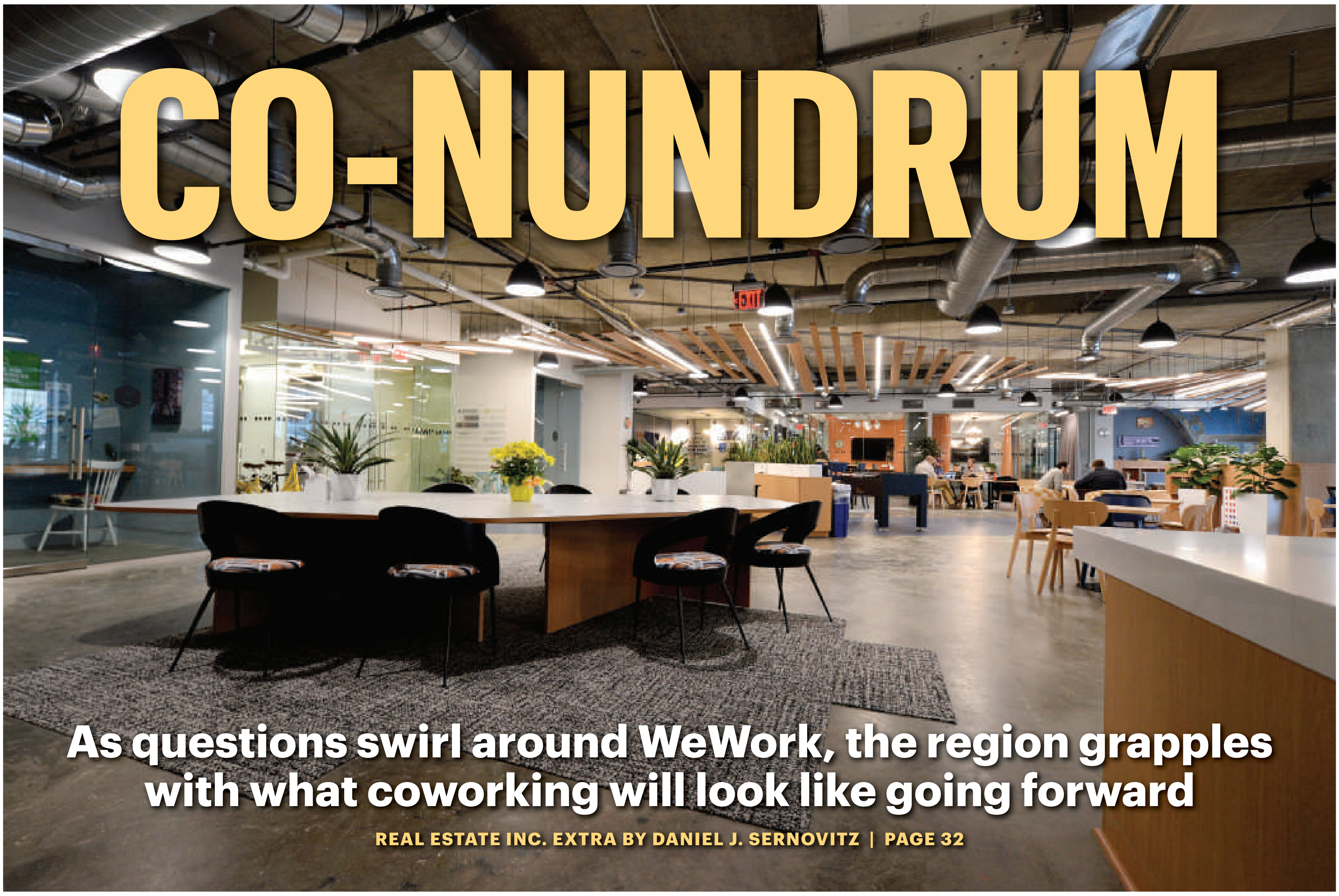
Turnaround time

MoCo Council's president lays out eco devo game plan

ALEX KOMA, 24



INNOVATION & HEALTH

Whitman-Walker to build in Southeast

The health nonprofit signed a lease to stand up a new health center on the St. Elizabeths campus to replace its aging Max Robinson facility. **SARA GILGORE, 12**

MONEY & TECH

What's on the horizon for Skyline?

A New York company snapped up the aging office complex in Baileys Crossroads with plans to revitalize it and, if approved, bring in some multifamily. **DANIEL J. SERNOVITZ, 20**

HQ2 ONE YEAR IN

TAKE OUT THE GROWTH CHART, HQ2

Amazon's second headquarters may not be humming quite yet, with only about 200 staffers reporting for duty. But Arlington's office market and site plans, oh, how you've grown! **SPECIAL REPORT, 28**

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REAL ESTATE INC. EXTRA

WORK IN PROGRESS

Whether or not WeWork is around tomorrow, coworking still will be. Here's what that might look like.

BY DANIEL J. SERNOVITZ
dsernovitz@bizjournals.com

Coworking definitely held some perks for Kelly Speakes-Backman.

Her nonprofit, the Energy Storage Association, spent nearly a year at WeWork's Metropolitan Square location, a block east of the White House. The space was certainly easy enough for her 10 staffers to move into while the association searched for a more permanent home. A slew of office amenities were at hand, and the food and beverage options didn't hurt.

But then that distracting disco music would waft in from the adjacent workstation at the wrong time.

"If I needed to have a conference call with my board, I would hear Donna Summer in the background," said Speakes-Backman, CEO of the association. But as for the rest, "the coffee was awesome. The acoustics were not great. It definitely had a distinct vibe about it, which, in some cases, kind of works. If you're looking for a place that encourages creativity and social interaction with folks of your ilk, that's awesome. For us, it didn't really work for all of us."

The ESA, which advocates for the energy producer and storage industry and worked with Sam Heiber of Cresa Washington on its search, finally moved out of WeWork at the end of 2018. Much to Speakes-Backman's glee, it had signed a roughly 2,000-square-foot lease in another building closer to Mount Vernon Triangle.

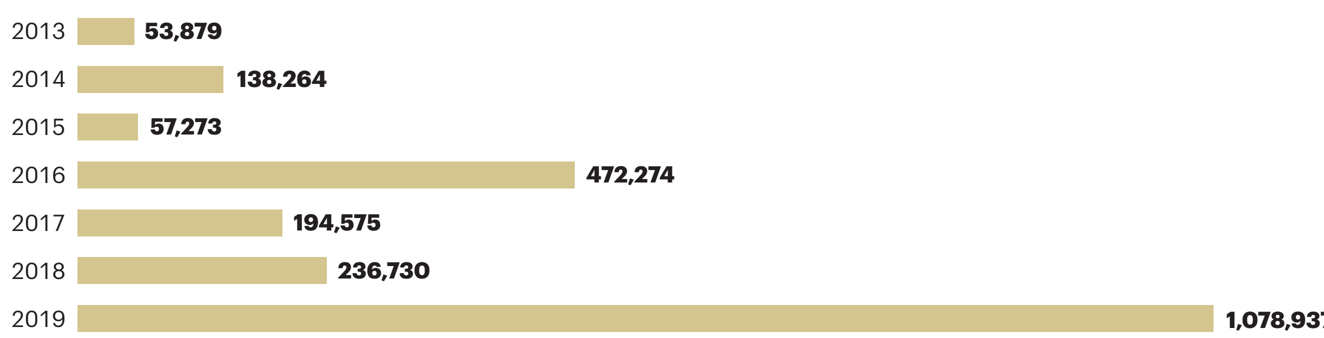
Her story is not uncommon, even if her particular experience about coworking may be – businesses, large and small, have increasingly turned to the rapidly growing flexible space industry while sorting out long-term plans. In the wake of the sinking ship that was the 2012 D.C. office market, coworking, and WeWork specifically, served as a sorely needed life raft as the city's biggest tenants began opting for floor plans that did more with less space. In June, the District's flexible office space jumped 66% year over year, according to CBRE Group, making the nation's capital one of the fastest-growing markets. The number of local providers has ballooned tenfold from three in 2013 to 31 today, per Cushman & Wakefield,

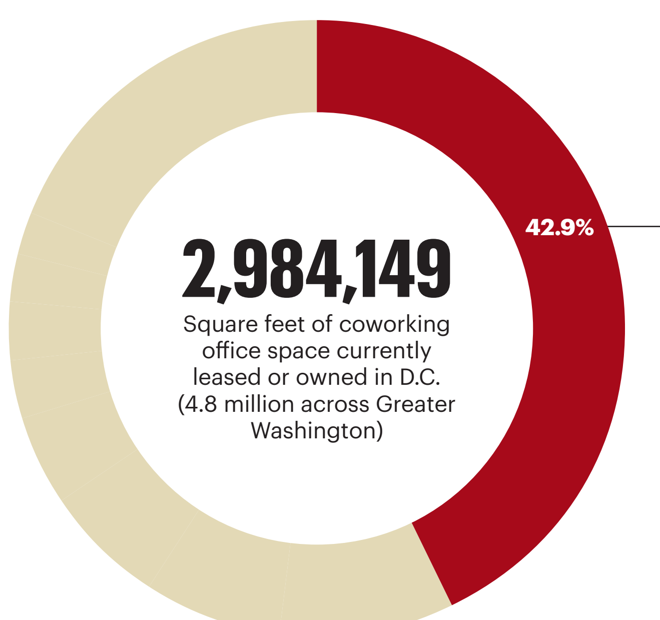
CONTINUED ON PAGE 34

THE RISE OF COWORKING

This chart shows just how much the amount of flexible workspace has grown in the District in the last seven years. This year alone, D.C. added nearly as much new coworking space as it did in all five of the previous years.

LEASED SQUARE FEET ADDED EACH YEAR IN DISTRICT



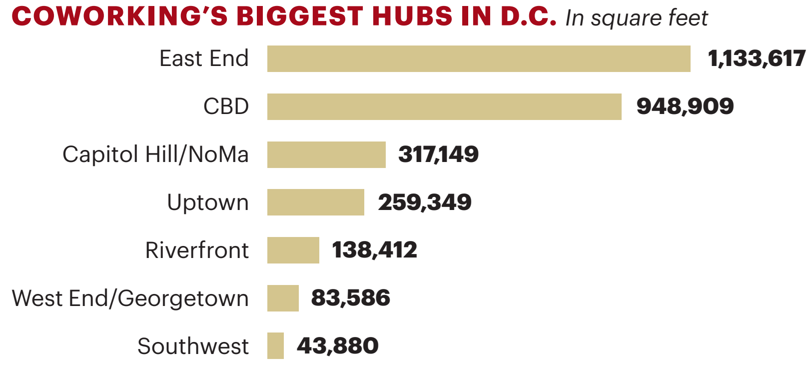


TOP PROVIDERS IN DISTRICT

WeWork clearly dominates the coworking landscape in the District with well more than four times the total square feet of the next flexible space provider.

Company	Square feet	Percent
WeWork	1,280,321	42.9%
Regus	277,628	9.3
MakeOffices	209,614	7.0
Convene	192,219	6.4
Carr Workplaces	138,872	4.7
SPACES	95,302	3.2
AdvantEdge	85,780	2.9
D.C. Workspaces	79,185	2.7
Metro Offices	66,982	2.2
All others	558,246	18.7

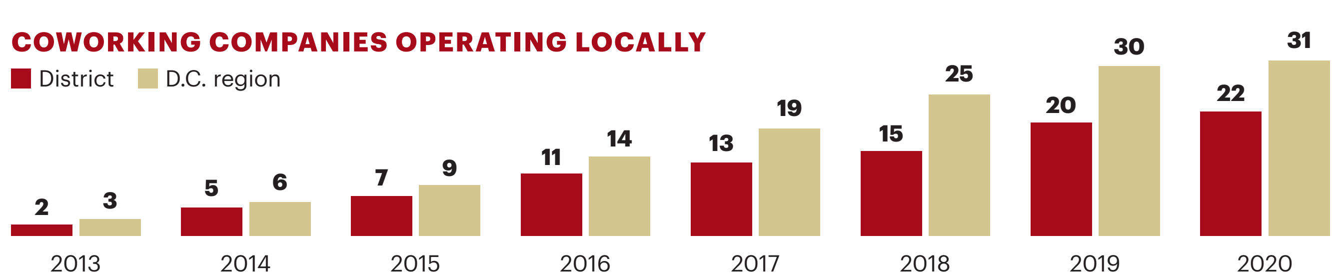
COWORKING'S BIGGEST HUBS IN D.C. *In square feet*



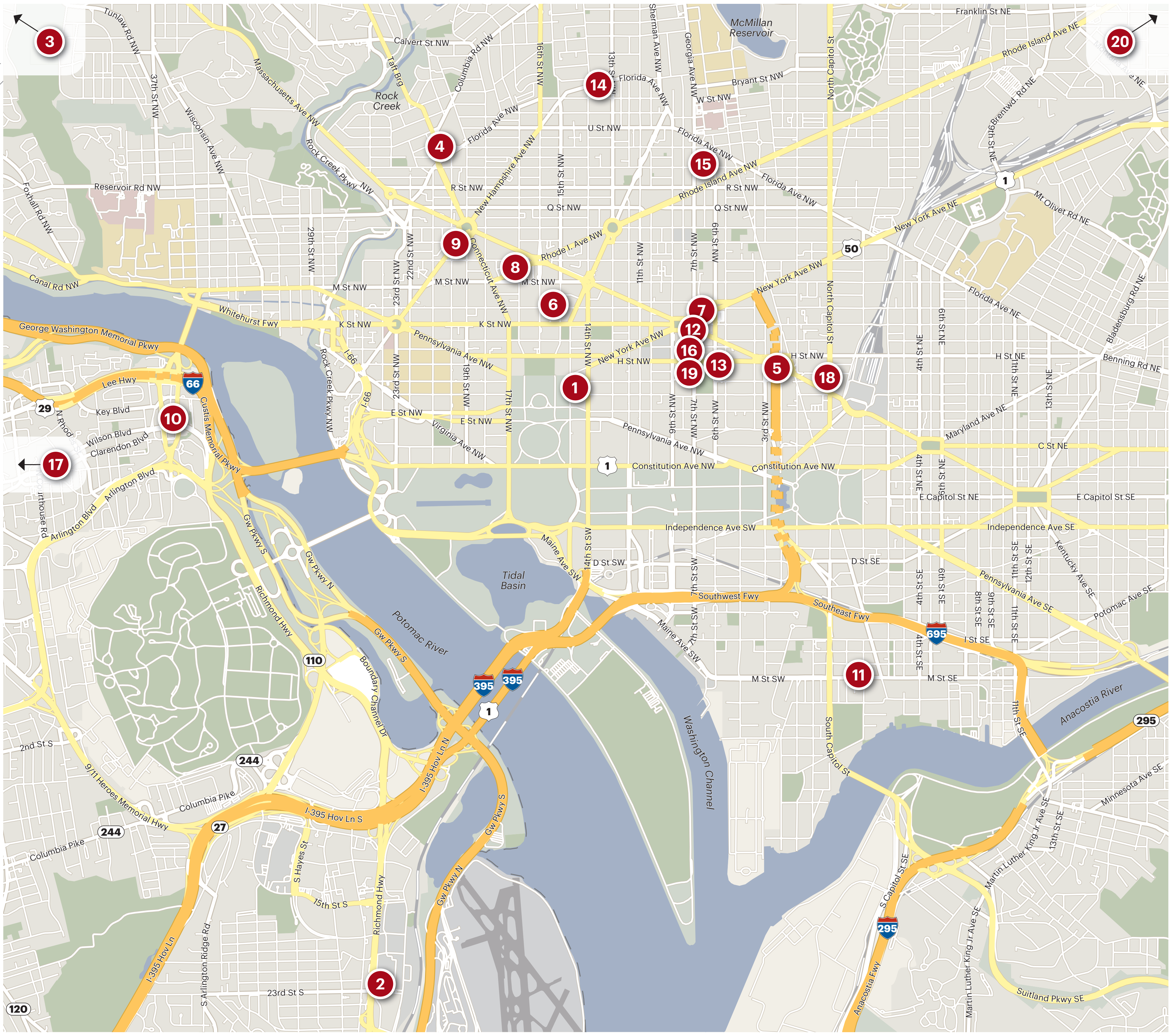
INCREASED MOMENTUM

Year	Providers opening new locations	Locations opened
2013	2	2
2014	3	5
2015	3	6
2016	7	15
2017	4	10
2018	7	10
2019	8	16

COWORKING COMPANIES OPERATING LOCALLY



SOURCE: Cushman & Wakefield



ON THE MAP

WHERE IN THE WASHINGTON REGION IS WEWORK?

Wondering which building owners are most on the hook for WeWork spaces in the region? Here's a breakdown of where WeWork has landed in Greater Washington, in which buildings, for how much space — and answering to which landlord.

	Building	Location	Square footage	Landlord
1	Metropolitan Square	655 15th St. NW	226,000	Boston Properties
2	Crystal City WeWork/WeLive	2221 S. Clark St.	165,000	JBG Smith Properties
3	1775 Tysons	1775 Tysons Blvd.	154,000	Lerner Enterprises
4	Universal North	1875 Connecticut Ave. NW	122,000	JBG Smith Properties
5	Capitol Crossing	200 Massachusetts Ave. NW	111,000	Property Group Partners
6	Midtown Center	1100 15th St. NW	110,000	Carr Properties
7	655 New York Ave. NW	655 New York Ave. NW	107,000	Brookfield Properties/Douglas Development Corp.
8	1701 Rhode Island Ave. NW	1701 Rhode Island Ave. NW	104,000	Exan Capital
9	Robert S. Strauss Building	1333 New Hampshire Ave. NW	100,000+	The Meridian Group/WeWork Property Investors
10	Central Place	1201 Wilson Blvd.	83,300	JBG Smith Properties
11	80 M St. SE	80 M St. SE	69,000	Columbia Property Trust
12	Anthem Row	700 K St. NW	66,500	The Meridian Group
13	Chinatown (II)	777 Sixth St. NW	54,000	Bentall Kennedy
14	Manhattan Laundry	1342 Florida Ave. NW	51,000	Douglas Development Corp.
15	Wonder Bread Factory	641 S St. N	32,903	Douglas Development Corp.
16	The Apollo	810 Seventh St. NW	32,000	810 Seventh Avenue SPE LLC
17	Arlington Gateway	901 N. Glebe Road	29,000	Piedmont Office Realty Trust
18	660 N. Capitol St. NW	660 N. Capitol St. NW	24,600	Republic Properties
19	Chinatown (I)	718 Seventh St. NW	21,350	Douglas Development Corp.
20	University of Maryland, Discovery District	7761 Diamondback Drive, College Park	18,750	Chesapeake Realty Partners/War Horse

SOURCE: WeWork information, media reports

REAL ESTATE INC. EXTRA

CONTINUED FROM PAGE 32

with another 2 million square feet of coworking space set to open in the next year or so.

But now that life raft is starting to take on water. In a saga that's played out before a wary public, coworking's biggest titan, WeWork, pulled out of its initial public offering plans 47 days after filing them. Its valuation plummeted by billions of dollars and lease obligations rose to $47.2 billion, sending its future into a murky fog. In D.C., WeWork has consumed more than 1.2 million square feet of office space, making it the city's largest private office tenant and leaving the region's real estate market vulnerable, uncertain of what happens next if the company buckles.

WeWork said it remains on a growth path. But regardless of what lies ahead for the goliath, industry observers say there's a future to flexible office space. They expect a thinning of the coworking herd as dominant players gobble up smaller ones, similar to what we've seen in the hospitality industry. And they expect the model to shift, in some cases to where landlords themselves take more active roles.

"I think there are companies that only see the rosy side of the equation. There will be people who rush in, and their due diligence is not as strong," said Michael Burke, vice president of real estate and development at shared meeting and workspace provider Convene, describing new entrants to the coworking market. "It takes a lot of capital to grow. And there will be consolidation."

Will We survive?

This much we know: WeWork may require some reworking.

WeWork signed its first two leases in D.C. in 2013 – for nearly 54,300 aggregate square feet in Chinatown and Shaw. After that, its appetite for growth seemed insatiable, taking down whole floors and even, in the case of 1701 Rhode Island Ave. NW, a whole building. That 104,000-square-foot building is now owned by Exan Capital, which bought it for $119 million from developers Akridge and Alcion Ventures LP after the WeWork lease.

Today, the exposure of Greater Washington's office market to WeWork spans from the University of Maryland's College Park campus to Lerner Enterprises' 1775 Tysons Blvd. The company has committed to blocks of more than 100,000 square feet in projects like Carr Properties' The Wilson in Bethesda and Property Group Partners' Capitol Crossing near Union Station.

While its footprint in New York and San Francisco is higher than in D.C. – totaling close to 8.9 million and 1.6 million square feet, respectively – WeWork said in its public filings that a majority of its U.S. revenue comes from five markets: San Francisco, New York, Boston, Los Angeles and, yes, D.C.

But then came the IPO from WeWork's parent, The We Co. In mid-August, the company revealed a staggering gap: In the prior three and a half years, it recorded $4.7 billion in total revenue – and nearly an equal amount, $4.2 billion, in combined losses, 86% of that because of its WeWork business. A full 70% of its locations thus far weren't seeing recurring revenue or positive cash flow, it said.

In the tumultuous months since, investors pulled back from the company, CEO Adam Neumann resigned and its biggest backer, Japan's SoftBank, offered a much smaller recapitalization than its previous pledge. At the end of September, We Co. canceled its IPO and its one-time

MotoRefi's Kevin Bennett said he found a coworking hybrid of sorts in CoveHQ.

JOANNE S. LAWTON / STAFF

SPOTLIGHT

STARTUP FINDS FIT IN CUSTOM COWORKING

This was a big year for Arlington auto refinance company MotoRefi. It spread to more than 40 states across the country and completed a $4.7 million seed round with high-profile supporters.

Not bad for a company launched in 2016 and incubated in the Alexandria space of one of its backer, QED Investors. It subleased about 3,000 square feet in Ballston in 2018 before needing more room for its 30 people. But CEO Kevin Bennett didn't want to lock into a long-term lease that didn't take into account even its short-term growth.

This past summer, it moved into space specially designed for it at 1010 N. Glebe Road in Ballston by coworking provider Cove. It's part of a new concept called coveHQ, which debuted early this year at 1730 Rhode Island Ave. NW. Under that model, Cove built out, furnished and manages 10,000 square feet for MotoRefi, handling everything from WiFi to printer paper — and more square footage as needed.

"Our space needs are going to continue to evolve," Bennett said, "and as long as we're evolving, we need a partner that can evolve with us."

It's an example of how coworking has gone beyond the millennials or one-person shops to serve larger employers. It's shed its grown-up toys and taken on more of a professional flare. Coworking is also getting into the customization business — a trend Bennett said will draw more companies over traditional office leases.

"You're seeing the market evolve into this kind of custom, flexible headquarters space," Bennett said. "I really think it's the future of the market and more and more real estate will look like this."

In the case of MotoRefi, Bennett's fifth startup in the D.C. area, he had ruled out a former haunt, WeWork, for several reasons, including its premium fees to take more space. He also wanted a home clearly branded as MotoRefi's, not one shared by many users.

At One Ballston Plaza at 1010 N. Glebe Road, The Meridian Group also extended its partnership with Cove to offer Commons, a platform that offers coworking perks to all of the building tenants.

"We were looking for something that we thought would give us a competitive advantage," said Katie Yanushonis, a senior vice president at Meridian. "It was not just space — it's space plus service."

Beyond Commons, Meridian serves as a landlord and joint-venture partner with WeWork at 1333 New Hampshire Ave. NW in the District and as a landlord to Spaces at The Boro in Tysons. It's no wonder that building owners are taking these routes to help confront elevated office vacancy rates in the region and challenges in attracting and retaining tenants.

"I do think these owners are forward-thinking in terms of not just the next three months, but how do we plan for the next three years?" said Cove CEO and co-founder Adam Segal. "At the end of the day, it's all about creating a very engaging tenant relationship that's going to last you far beyond any lease renewal."

– Daniel J. Sernovitz

> "Our space needs are going to continue to evolve and as long as we're evolving, we need a partner that can evolve with us."
>
> **KEVIN BENNETT,** CEO, MotoRefi

$47 billion valuation disintegrated. Critics have called into question its model of subsidized month-to-month memberships and steep real estate buildout costs for spaces it has leased but are not yet generating revenue, and certainly are a long way from profits.

It has already nixed earlier plans to open a new location in the Seattle area. Closer to the Capital Beltway, rumors are circulating about whether it may back out of at least two D.C. locations. Few are in agreement about its 2020 path. Industry observers such as Cushman & Wakefield expect WeWork to slow its expansion in 2020 with no new locations.

Ask WeWork, and they project more growth. "WeWork is the largest private tenant of office space in D.C., providing our members with well-designed, economic workspace that supports their growth. We expect to continue to grow our core business here, bringing members to newly opened buildings like 1701 Rhode Island NW and opening others in Q4 and the year ahead," a company spokesperson emailed in a statement for this story, declining to comment further.

How big is the baggage?

Here's what we know: WeWork could certainly get its financial house back in order. But if it collapses, it could tie up hundreds of thousands of square feet of office space across the region.

Some WeWork landlords say they're watching and, if necessary, girding themselves for any impact. But so far, they say, their D.C.-area locations are still doing well. And, many assert, WeWork isn't a big enough driver within their own financials to drag them down.

In all, coworking space providers made up 2.1% of the District's office market in the second quarter, according to CBRE data, causing some to argue that any potential harm to local landlords will likely be minimal. Across the board, shared workspaces collectively represent just 1.6% of all office space in the U.S., though that percentage is higher in markets like New York, at 3.6%, and San Francisco, at 4%, according to CBRE.

Among the local landlords is Douglas Development Corp., which first brought WeWork to D.C. with leases at Chinatown Row and the Wonder Bread Factory. Those two properties, along with a third lease at Douglas Development's Manhattan Laundry building, are tied to a balance of $93.26 million in commercial mortgage-backed securities debt, according to Trepp LLP. Though, that's a drop in a $3.8 billion bucket of national CMBS debt slated to expire between 2024 and 2035 tied to office properties leased in part to WeWork, per Trepp. San Francisco, in comparison, carries $379.95 million in CMBS debt tied to the coworking company.

But Douglas Development hasn't seen cause for worry. "For us, they've been very good tenants and have never failed to meet any obligation that they've committed themselves to," said Norman Jemal, Douglas' managing principal.

"There's a lot of speculation about what might happen, but my three locations, they're not full tenant users," Jemal said. "They're only a small part of the revenue in each one of them, and I would look at them as assets for the organization. We've absolutely seen tenants coming out of WeWorks moving into some of our spaces."

For Boston Properties, WeWork is one of the real estate investment trust's top 20 tenants nationwide, occupying large chunks of space in buildings like D.C.'s Met Square. At the same time, the Boston-based developer said, WeWork is responsible for only a little more than 1% of the company's total revenue.

"Though we believe the shared workspace market has growth potential, we anticipate a pause given recent capital raising challenges in the industry," Boston Properties CEO Owen Thomas said on an Oct. 30 earnings call with analysts. "WeWork has built an important market position in the industry and has the potential for further growth, assuming it executes well with the proceeds from its recent recapitalization."

At Carr Properties, coworking represents less than 5% of the rent roll it collects from its roughly 4 million-square-foot portfolio, said CEO Oliver Carr III. And he said he has not received any indication that WeWork won't move forward with plans to open at Carr's Bethesda project or Midtown Center, where WeWork has committed to lease space.

Beyond its 66,500-square-foot lease with WeWork at 700 K St. NW,

CONTINUED ON PAGE 36

AT THE GSA

THE FEDS IN COWORKING SPACE? IT COULD HAPPEN.

One of the country's largest consumers of office space in the country, the federal government, has thus far held out from turning to coworking space providers.

But that could soon change, as the General Services Administration plans to issue a "Federal Workspace as a Service" solicitation in the first quarter of 2020 that would create an alternative to traditional leases. The national indefinite delivery/indefinite quantity contract would then enable the GSA to quickly take space to roll out new programs or initiatives without getting locked into a lease term of a decade or more.

The concept seems ripe for agencies that need space quickly, such as the Federal Emergency Management Agency when its personnel needs to provide hurricane disaster relief. The challenge, former GSA Public Buildings Service Commissioner Dan Tangherlini said, is getting buy-in from within the GSA and its partner agencies to embrace coworking as a valid option.

"I actually think it's probably a better, faster entry point. The problem is going to be finding champions," Tangherlini said during an on-stage interview at the Global Workspace Association's September conference at MGM National Harbor in September.

The federal government typically lags the private sector when it comes to commercial real estate trends, including the current densification and open workspaces that are still playing out with new GSA space requirements. Tangherlini, who oversaw the GSA's real estate portfolio from 2012 to 2015, said it's been a heavy lift to just slim down the federal footprint, per an Obama administration mandate.

"I absolutely think it's going to happen," Tangherlini said. "It's going to take a lot longer than a lot of people want it to."

– Daniel J. Sernovitz

Coworking will come to federal space, said Dan Tangherlini.

FILE PHOTO

THE FOUR FORMS OF COWORKING

While the predominant relationship between flexible space providers and commercial real estate owners has been one of tenant and landlord, several alternatives have emerged between those two parties, including coworking as a paid service. Here's a look at four basic models:

TRADITIONAL

A coworking company leases space directly from a landlord and generates income from membership agreements to occupy smaller portions of that space. The model is often easier for a landlord to finance and creates the potential for members to graduate into direct leases with the landlord. But this holds some downsides for landlords, including limited transparency into the membership base and the loss of additional revenue if those members remain in the coworking space.

PARTNERSHIP

A coworking provider and landlord form a partnership and share in any profits from the operation or loss of the coworking space. An example is the partnership between The Meridian Group and WeWork Property Investors to acquire 1333 New Hampshire Ave. NW, where WeWork preleased 30% of the 350,000-square-foot building. The model offers the landlord more say over how the space is used — and more risk if the location is not profitable or the coworking provider encounters financial challenges.

OPERATING AGREEMENT

A coworking provider is brought in to manage space for a fee, as is the relationship between Cove and Meridian for Commons at 1010 N. Glebe Road. This model offers tenants the same level of coworking service and amenities, but enables landlords to focus on other things. Though, this adds complications for certain owners, such as real estate investment trusts, because it is viewed as an added expense. Another potential concern is if the coworking company doesn't share in the financial upside, then it lacks an incentive to operate it at the highest level of service.

LANDLORD AS PROVIDER

An owner creates its own coworking brand, such as WaveOffices from Carr Properties on a local level and Tishman Speyer with its Studio brand or Flex by BXP at Boston Properties on a national level. This model gives the building owner full control over the coworking spaces and direct contact with its tenants. That can be a pro or con depending on the landlord's resources and expertise.

SOURCE: CBRE, Global Workspace Association

REAL ESTATE INC. EXTRA

CONTINUED FROM PAGE 35

The Meridian Group went a step further, partnering with WeWork's real estate arm to acquire 1333 New Hampshire Ave. NW, where WeWork has committed to leasing more than 100,000 square feet. The company has not given any signs of backing away from either of those commitments, said Katie Yanushonis, senior vice president at Meridian. At the same time, she said, WeWork is only one of several coworking iterations in Meridian buildings, including Cove and Spaces. The developer has also been weighing whether to establish its own in-house coworking brand.

"That conversation is constantly evolving," Yanushonis said. "Our thought was we really like Cove and we'd like to expand that relationship, but that doesn't preclude something that Meridian might do for ourselves."

Carr Workspaces is the second-largest provider of coworking spaces in the region.

Warding off pain

Most landlords in the D.C. area are savvy enough not to lease too much space in a single building or across their portfolios to any one user or user type – that helps minimize the effects of losing a tenant to bankruptcy, said Vernon W. Johnson III, a partner at Nixon Peabody LLP who specializes in real estate and leasing issues. This wouldn't be the region's first rodeo, after all. It faced similar blows when law firm Dewey & LeBoeuf filed for bankruptcy and Howrey LLP's partners voted to dissolve.

Additionally, landlords should thoroughly vet a prospective tenant's financial position and business plan and, in turn, require a larger security deposit for higher-risk tenants, Johnson said.

JBG Smith Properties is one that exacts a higher burden on its seven coworking tenants, which have gobbled up a combined 525,000 of the Chevy Chase developer's square feet across nine locations, including the combined WeLive-WeWork complex in Crystal City. Collectively, coworking comprises 3.5% of JBG Smith's total operating portfolio by square footage and 4% of its rental revenue.

"Thus far, all of these locations have performed well, but as we do with any commercial tenant, when we sign leases with coworking and flexible space providers, we focus on lease security and downside protection," JBG Smith CEO Matt Kelly wrote in a Nov. 5 letter to shareholders that accompanied its third-quarter earnings. "Due to their credit profile and relatively short operating history, we have required our coworking tenants as a group to provide us with significantly more lease security than noncoworking tenants in our portfolio."

In a worst-case scenario, landlords can take legal steps to recover losses in the event of a bankruptcy, but that can be a drawn-out process and it's no guarantee the tenant will have sufficient assets to pay out all of its creditors.

"You could get a large judgment that you can't recover on, so these situations do create significant situations for landlords and could have a significant impact on their incomes," Johnson said. "I think most landlords, on the front end, try to protect themselves by making sure that they're not too much at risk with a single industry or a single tenant."

An evolving industry

WeWork's grand entry set the stage for other providers. And many of those spaces are likely not going anywhere, no matter WeWork's fate. They just may operate a bit differently.

The industry has since spawned all sorts of niche players, including coworking brands catering to women, blue chip companies, and even suburbanites. That gets lost sometimes when people just focus on WeWork, said Mark Gilbreath, CEO of online flexible workspace LiquidSpace and president of the Global Workspace Association.

"There's an underlying truth that, to some observers, may be precluded by the WeWork story, which is the story of one particular user in the larger flexible space market," Gilbreath said. "There are thousands of operators that are delivering similar truths, similar value to the market."

> "We're very much in growth mode. We're going to do it wisely, not just opening locations with landlords on every corner."
>
> **AUSTIN FLAJSER,** president of Carr Workplaces and president and CEO of Carr Cos.

While WeWork grew by leaps and bounds, many of its competitors have opted for more of a slow-growth method. Among them is Carr Workplaces, a coworking brand founded in 2003 by real estate developer Oliver T. Carr Jr., the father of Carr Properties' current chief executive. The business – part of the larger Carr Cos., which also operates Carr Hospitality and Carr City Centers but is separate from Carr Properties – has nearly 30 locations across the U.S., and 18 in the region.

The business has survived, and built a loyal base, by staying small and nimble, said Austin Flajser, president of Carr Workplaces and president and CEO of Carr Cos. The company's sweet spot is a third of the average size of a WeWork location.

"We're very much in growth mode," he said. "We're going to do it wisely, not just opening locations with landlords on every corner."

These days, it's not enough just to provide physical spaces. The 2.0 version of the flexible space industry is as much a service provider, engaging with tenants in a way that traditional landlords hadn't before. Another key is to help foster a sense of community – think memberships on local boards and participation in neighborhood events – while remembering that members aren't

JOANNE S. LAWTON / STAFF

IN THE INDUSTRY

PROVIDERS HOME IN ON NICHE POPULATIONS

You've probably heard of Regus, Carr Workspaces and WeWork. But they're just a few of the more than 30 flexible space companies active in the D.C. region. Many others have carved niches catering to different pieces of Greater Washington's business community. Here's a look at some of those specialized players.

1 ALX COMMUNITY

It launched from Founders Hall in 2018 with a focus on Old Town Alexandria, expanding to a second location in the Torpedo Factory office building at 201 N. Union St. earlier this year.

2 BRICKYARD

Venture capitalist Paul Singh and Ann Orem, director of real estate for Chantilly-based Clark-Hook Corp. came together to launch Brickyard to tap into Greater Washington's suburban markets. It first opened in Ashburn, followed this year by Chantilly and Woodbridge.

CHISEL

It's a coworking space for lawyers, launched in 2017 by law firm FH+Ho from inside its Tysons office at 1751 Pinnacle Drive.

3 EASTERN FOUNDRY

The company fashioned itself as an incubator for federal contractors with an initial location in Crystal City. Demand proved so strong in this government town that it expanded fast, first within 2011 Crystal Drive, and then with a second spot at 1100 Wilson Blvd. in Rosslyn.

SYMBIOSIS LLC

This startup by Arun Mallikarjunan and Subha Nagasubramanian caters to the medical profession, specifically physicians and health care providers. It launched from 1331 H St. NW in downtown D.C., where Nagasubramanian has her own practice, Capitol Physical Therapy.

THE WIN

This New York-based coworking provider launched in 2016 as an option for women business owners and leaders. It counts more than a dozen locations, including D.C., where it opened in 2018 at 1056 Thomas Jefferson St. NW in Georgetown.

1

2

3

FILE PHOTOS

there to play, but rather to get work done, Flajser said.

"We're not just marketing on a macro level. We ask our general managers and managers to get involved in the communities that we're in," he said.

Even longtime flexible workspace brands have come to this conclusion. While the days of dart boards and kitchen kegs are making way for a more professional atmosphere, coworking spaces say they can't survive on just offering rows of office spaces anymore.

"One of the things we think is different this time around is the obvious quality and feel of the concepts," Nate Edwards, senior director of research for Cushman & Wakefield's D.C. region. "As opposed to being 'shared offices,' the focus is on the branding, the attraction and retention of employees."

The parent company of Regus, which debuted in 1989 in Belgium, has more recently sought to step up its community outreach through its more contemporary Spaces brand, which launched in D.C. in 2008 with nearly 44,000 square feet at Douglas Development's Uline Arena. IWG PLC acquired Regus in 2014.

"We recognized that the evolving customer did want a more collaborative work environment than a traditional flexible workspace such as Regus," said Michael Berretta, vice president of network development for IWG, which operates about three-dozen Regus and Spaces locations in the D.C. area. "With Spaces, we created a more collaborative, open, contemporary work environment, but still to the same high degree of service."

The landlord factor

The rise in coworking has spurred yet another player to get into the game: traditional landlords.

Take Carr Properties, which launched its WaveOffice brand in 2017 with a location in Clarendon, and Washington Real Estate Investment Trust with its Space+ concept rolled out last year. Boston Properties offers its Flex by BXP while Hines announced Hines Squared earlier this year.

WashREIT is beta testing a new program that will enable its tenants' employees to do everything from getting cars detailed to reserving a spot in a fitness class with a smartphone app. Landlords are having to catch up, and technology is playing a big part of it, said Anthony Chang, vice president of asset management at WashREIT.

"We, as owners of assets, are changing our thinking about how those users are experiencing that space," he said. "It's not just a box-checker anymore. It's how does it feel and does it help them with recruitment and business development?"

WashREIT has not signed on with any outside coworking providers as tenants, though Chang said that's mainly because the right deal hasn't come along yet. Many of the vacant spaces in its buildings are in smaller blocks than would accommodate a coworking mammoth like WeWork.

Other landlords are embracing coworking space providers as part of a larger mix of services they offer tenants. At Park Place, a Rosslyn office building at 1655 Fort Myer Drive that Altus Realty acquired in October for $66.5 million, there's already a Regus. But Altus now plans to add a flexible space concept it is calling Framework as a short-term option of three to five years for tenants once they outgrow coworking spaces but aren't ready for a long-term lease. It's a concept Altus Partner Charlie Kehler anticipates will become more widely accepted in the coming years by federal contractors that need to take on additional space for short-term functions.

"What we're finding is tenants are entering the market with less and less of a lead time to find new space," Altus' Kehler said.

Still other landlords say the best route is one of partnership with a coworking provider that's better at incubating or interacting on a retail level with their smaller tenants.

"That segment of the market was very poorly served by the real estate development community, and I think those coworking places that are coming into the market just opened up a door for organizations that really wasn't available before," said Bob Fox, founder and managing principal of Fox Architects. "You're going to see that continue to grow and evolve. You're seeing more players entering the mix. I think you're seeing some stratification of the level of space that's being provided."