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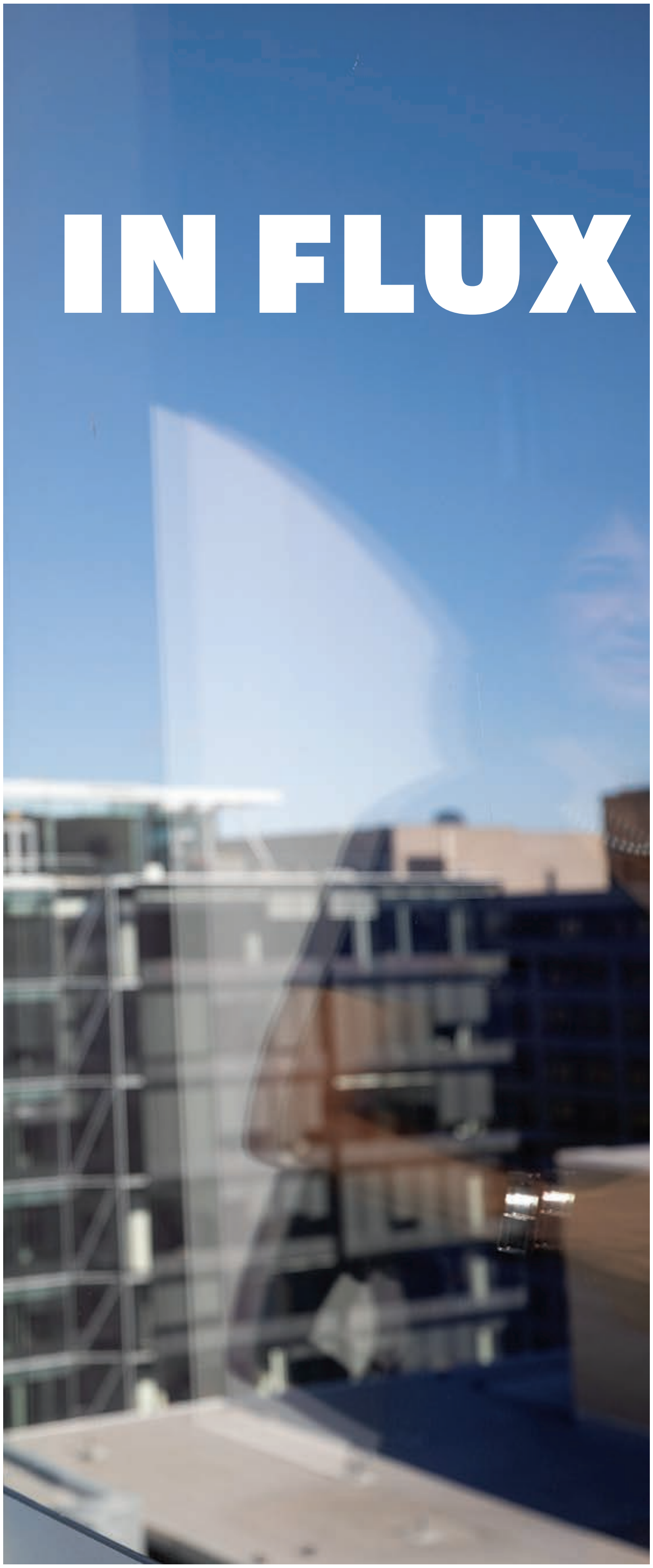
Liz Espín Stern, managing partner of Mayer Brown's D.C. office, opted to bring employees back to the firm's 1999 K St. NW digs – but the space has been revamped to highlight more collaborative hubs.



IN FLUX SPACE

LOCAL REAL ESTATE IS CHANGING FAST — WITH DOZENS MORE MEGALEASES STILL UP IN THE AIR

BY TRISTAN NAVERA | tnavera@bizjournals.com | @TristanNavera

The lights have just switched back on at Mayer Brown LLP's offices along the District's K Street corridor, where the law firm has stood since 2007. But when its employees finally converge there again, they will do so in a very different space.

Mayer Brown opted, just weeks before Covid hit, to renew its lease at 1999 K St. NW. But the firm took advantage of the months of emptiness through the pandemic to negotiate some financial help from landlord Deka Immobilien GmbH for a large-scale upgrade. Today, its 175,000-square-foot layout, designed by Gensler, is completely different, reflecting the Covid-era paradigm shift toward more gathering places, according to Liz Espín Stern, the firm's D.C.-area market leader.

"We were looking for a better use of our space, as opposed to simply reducing our space," she said. For example, "collaboration zones where individuals might step out of their offices and have a café or hub to brainstorm."

That's meant more than just refreshed furnishings and new windows. The new look forgoes a simple open-office layout or traditional cube farm completely, opting for more of a clubhouse feel. A one-floor conference area has been spread across two floors, with breakout rooms, conference rooms and a café area that aspires to be more social hub than traditional breakroom.

It may take some time for the law firm's 286 D.C. employees to adjust, but Espín Stern thinks it will be easier than many think. After all, she expects such office environment changes to be widespread – and permanent.

"All of that evolution of how we use offices will occur over time," she said. "Our objective now is to address the need for individuals to connect more frequently. We've heard that very vocally from our associates, as well as our lateral partners, while they've been remote."

Mayer Brown is one of several large local employers whose lease expiration coincided with a Covid-19 pandemic that emptied offices overnight. Now, millions of square feet of major office leases are coming due in the next few years in Greater Washington – almost 10 million square feet across 38 major leases alone, with about a quarter sunsetting next year. We already know a few that are uprooting, while others may still renew their leases, but the bottom line is: There's much near-term real estate at stake in a market that's already suffered a ton of uncertainty.

Companies are watching one another and taking notes as Covid drags on, but still few have returned full bore to the office of the past. And from the landlord side, whether it's raining down concessions or reining in costs as vacancy rates spike, the hunt is on to bring those tenants back.

"It is a tenants' market to be sure,"

said Harry Dematatis, senior vice president at NAI KLNB, "and one of the strongest ones in years."

Tenant's trump cards

Greater Washington's office real estate is in a historic slump. D.C.'s office vacancy in the third quarter of the year topped 18.2% for the first time, per CBRE data.

On the ground, foot traffic in September showed only about 32% of employees in Greater Washington are actually checking into their office buildings, according to a Cushman & Wakefield study that tracked access card usage in buildings around the region. That office attendance wavered in late summer as the Delta variant forced many companies to rethink their return-to-work plans.

A few big employers have sent chilling signals. PricewaterhouseCoopers LLP, which once held multiple, large swaths of office space across the region, announced it would let 40,000 of its 55,000 employees globally work permanently from home. It said it would honor its last D.C. lease – 200,000 square feet at 655 New York Ave. NW. But it's unknown whether it will attempt to sublease any space or how many of its employees might relocate to less expensive cities long-term.

Meanwhile, Choice Hotels International Inc. opted to relocate its Rockville home to one nearly half its size in North Bethesda (see Page 14).

And the General Services Administration agreed to a 1.2 million-square-foot lease for a new Securities and Exchange Commission headquarters to be built by Douglas Development Corp. and Midtown Equities at 60 New York Ave. NE,

EMAN MOHAMMED / WBJ

Newmark's Bill Hill said the feds are shaving down their footprints.

rather than stay in its current, 1.3 million-square-foot Station Place offices, where it lived for just a single lease cycle. At the new location, the agency is slated to pay $1.3 billion in rent if it stays for 25 years, but it also demanded, and scored, two chances to purchase the building – one after 15 years and the other after 25 years.

Industry insiders see it as a warning sign for landlords: Cost is king. By seizing on the opportunity to purchase – a bid requirement unsuccessfully contested by the SEC's current landlord, Property Group Partners – the federal government is likely to save money in the long term. It signals that the GSA would opt for lower expenses over longer-term leases, in this case resulting in a mammoth empty office in Station Place that could hike the city's vacancy rate by another full point, said Darian LeBlanc, executive vice chair at Cushman & Wakefield's federal real estate group.

WHO'S ON DECK?

About 10 million square feet in local leases expire by 2024, per Newmark. While some tenants could renew, and a few already plan to relocate like Wiley Rein, WilmerHale and Choice, you can see the hot spots here.

LEASE RENEWS IN...

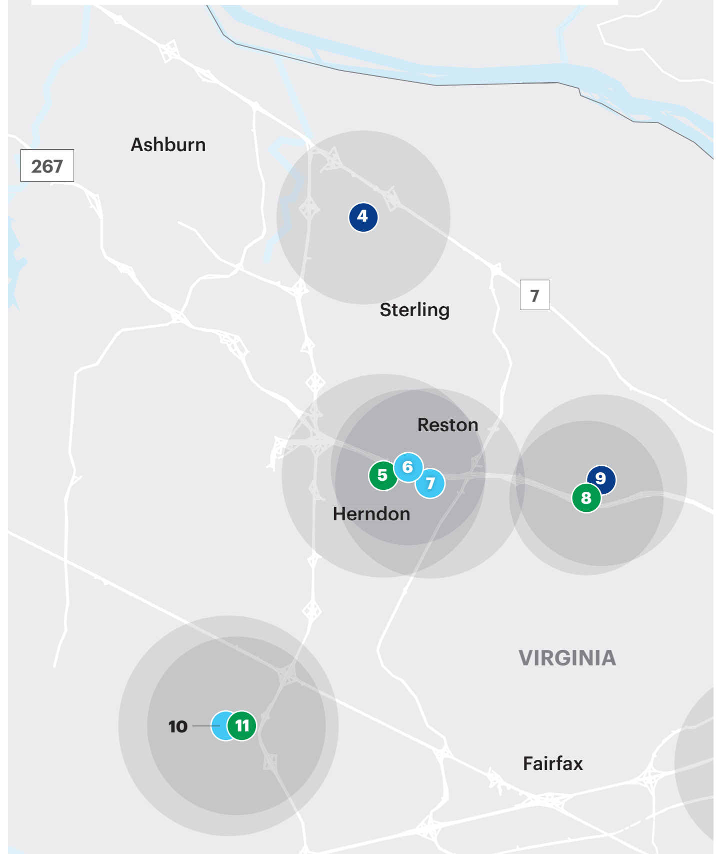
● 2022 ● 2023 ● 2024

HOW TO READ THIS MAP:

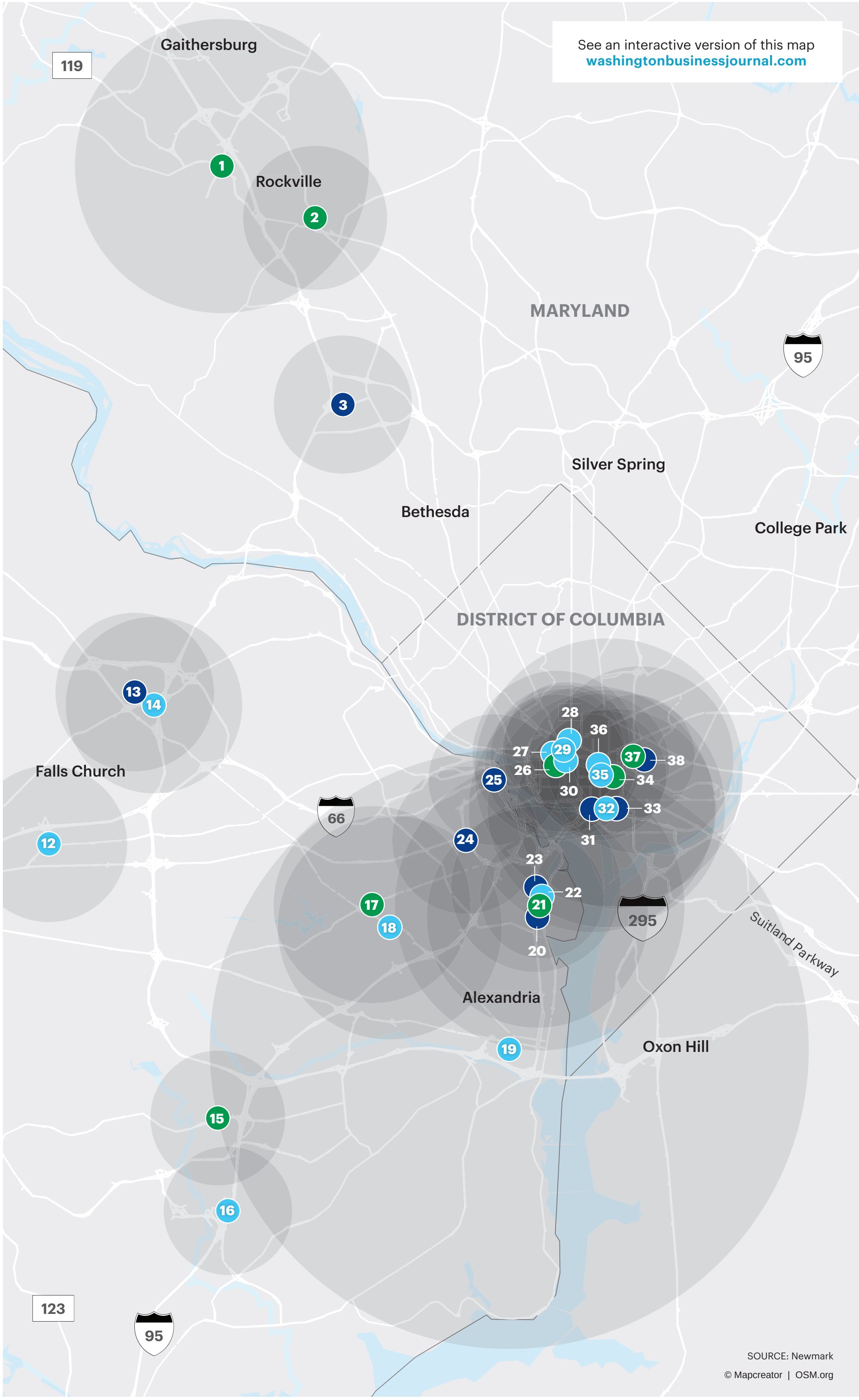
Color shows year the lease expires

Size of circle depicts lease size in sq. feet

Number corresponds to list at bottom of map with tenant name and square footage



TENANT	LEASE SQ. FT.
1. National Cancer Institute	574,614
2. Choice Hotels International	137,778
3. NIH	126,626
4. Savvis	135,000
5. Volkswagen of America	185,000
6. Amazon	108,206
7. Harris Corp.	161,359
8. General Dynamics	106,579
9. GSA	131,388
10. TASC	216,675
11. SI International	142,477
12. ICF International	162,409
13. KPMG	167,025
14. Intelsat	206,978
15. U.S. Department of State	120,620
16. General Dynamics	109,600
17. GSA *(Department of Defense)*	258,248
18. GSA *(Social Security Administration)*	334,103
19. U.S. Patent and Trademark Office	2,386,940
20. Environmental Protection Agency	326,057
21. GSA *(Department of Defense)*	558,187
22. Federal Emergency Management Agency	102,238
23. Amazon	191,834
24. Arlington County	144,740
25. Raytheon	114,612
26. WilmerHale	133,878
27. Wiley Rein	191,314
28. Wiley Rein	143,926
29. Baker & Hostetler	100,000
30. Pillsbury Winthrop Shaw Pittman	105,000
31. GSA *(Immigration Customs & Enforcement)*	403,847
32. GSA *(Federal Housing Finance Agency)*	375,260
33. GSA *(Small Business Administration)*	266,193
34. GSA *(Department of Justice)*	477,473
35. Troutman Sanders	113,000
36. Smithsonian Institution	133,984
37. CareFirst BlueCross BlueShield	233,000
38. GSA *(IRS)*	100,484



"It's certainly just an enormous shift in the commercial real estate balance generally," he said. "It's almost unprecedented for an agency of that size to relocate after only one lease cycle, so it's highly unusual, but a credit to [Douglas Development President Doug] Jemal."

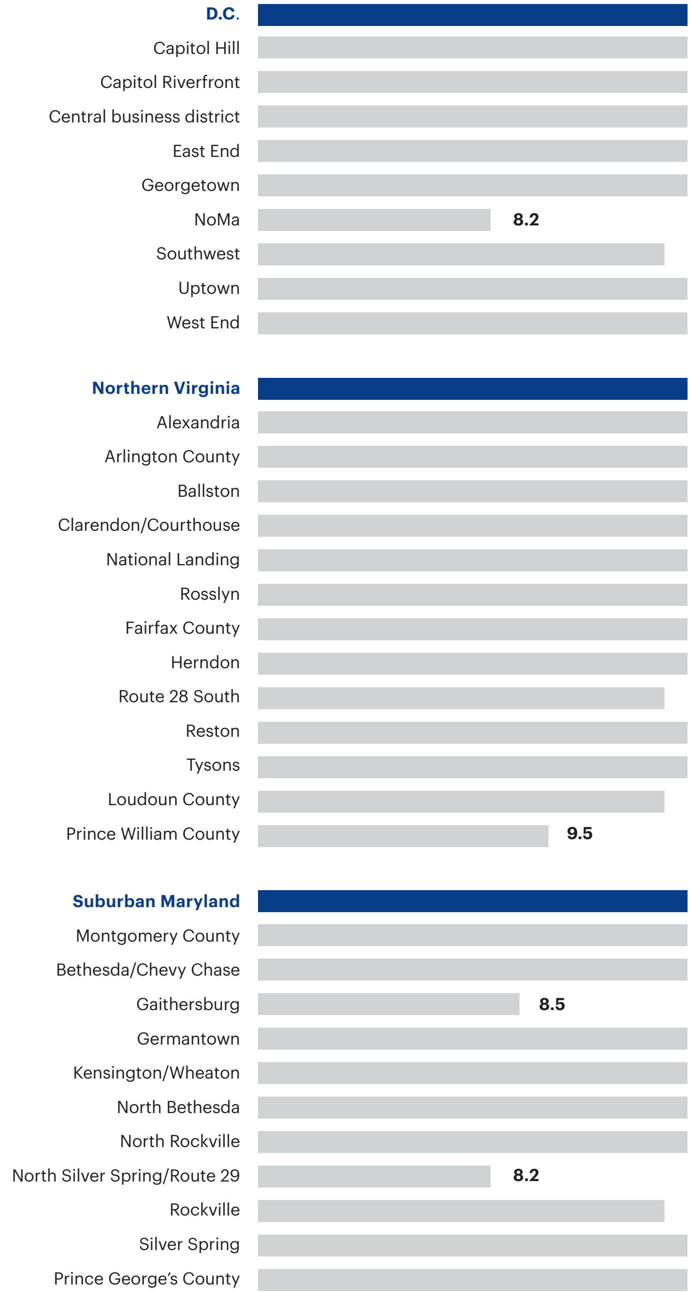
The space concerns come as the GSA has already slashed its real estate footprint across the region. From 2014 to 2019, the GSA cut its D.C.-area leased portfolio from 57.8 million square feet to about 49.1 million, and the consolidation could continue given the monster leases up for grabs in the next few years, including its largest by far, 2.4 million square feet leased for the U.S. Patent and Trademark Office at the Dulany Street Complex in Alexandria (see left). That lease is due in 2024, while the Department of Defense's 558,000-square-foot lease at 2530 Crystal Drive is set to expire in 2023.

GSA Administrator Robin Carnahan affirmed as much in keynote remarks she made Oct. 20 at Government Executive's State of the Federal Workforce annual event. She said she expected a longer-term mix of remote and in-person work, noting that 60% of GSA leases are coming due in the next five years and that "now is the perfect moment to experiment and try new things," whether it's an "office-in-a-box" with all the tech hardware and software to work remotely or new coworking spaces similar to a FlexHub site it's setting up at its own headquarters at 1800 F St. NW. She also pushed use of occupancy monitoring systems at its buildings "to help understand current usage and to predict future demands on real estate."

BY THE NUMBERS

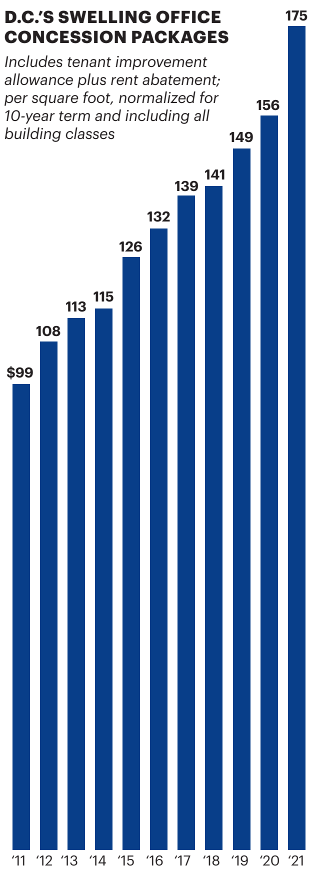
AS VACANCIES RISE, SO DO THE OFFERS

Landlords have watched local vacancy rates climb this year, with some markets in clearly more leasing pain than others, per CBRE's third-quarter vacancy rates shown at right. So far, the answer has been to throw more money at the problem: upping the concessions game to lure, or keep, a tenant at their addresses (see below). But given the cost of concessions skyrocketed 12% from 2020 to 2021 — after averaging closer to 5% annual growth before that — experts question whether that's sustainable.



D.C.'S SWELLING OFFICE CONCESSION PACKAGES

Includes tenant improvement allowance plus rent abatement; per square foot, normalized for 10-year term and including all building classes



SOURCE: CBRE

"You see the government following the private sector in embracing a need for flexibility, which is why you see them embracing things like coworking while they continue this plan to densify office," said Bill Hill, a Newmark broker focused on federal real estate. "We could see more moves that push them to less space."

Big concession stands

Ultimately, however, it's large private-sector employers that will set the tone other companies follow. And for them, it's about getting more bang for their buck.

Office negotiations usually entail some concessions – which take the form of either rent discounts or a "tenant allowance" to let the occupier upgrade its office space. CBRE data shows the concessions have risen sharply since the pandemic began.

"It's not unusual to see a tenant get two years of free rent. But we're seeing some leases push that closer to three, and that's got a huge impact on a landlord's margins," Dematatis said. "At a certain point, you have to make money, but it's that or lose the tenant."

When Covid-19 began, many employers signed short-term lease extensions to kick the can down the road until they could better determine their permanent space needs. Now that they've had 18 months to analyze that, they're coming back to the bargaining table, Dematatis said.

And they've got long wish lists now, brokers said. While some of the items topping those lists aren't necessarily new, the discussion is more serious than ever before, said Marc Tasker, an NAI KLNB principal. He pointed to an emphasis on location – it need not be downtown, he said, but they do want urban areas with transit, restaurants and activities.

"The stats only tell part of the story, because some kinds of office space are empty, whereas others aren't," Tasker said. "Office space in good locations where you can walk to things isn't empty."

Newer office space with more technology options will see more success, he said, but the environment matters too. Large windows that fill a room with outdoor light. Buildings that lend themselves to customization instead of feeling dated. And lots of outdoor spaces.

"Office space with outdoor patios and rooftops and balconies, that space isn't empty," Tasker said. "A few years ago, those were bonuses that were nice to have. Now they're essential."

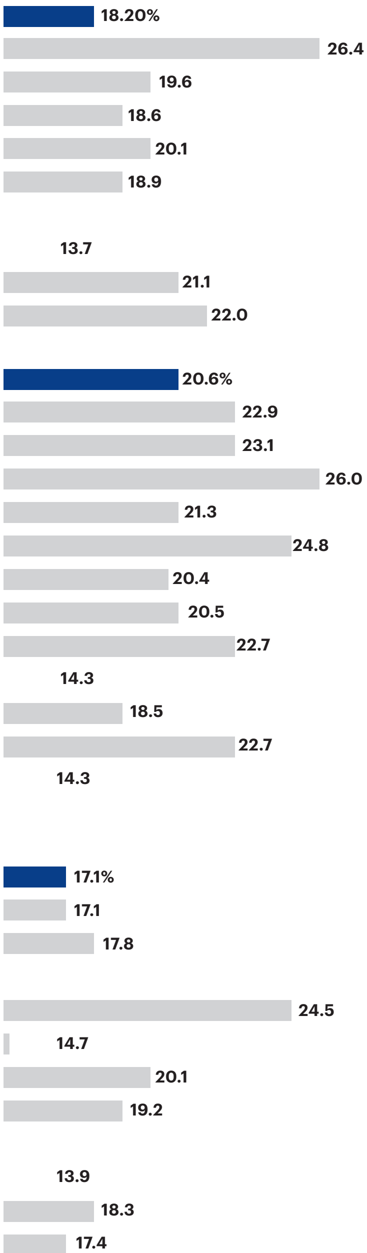
And these tenants can get away with being choosy nowadays – lest the landlords let them get away entirely. For law firm Sterne Kessler Goldstein & Fox PLLC, which shrunk its new lease by 50,000 square feet to move two blocks to 1101 K St. NW, its leaders didn't want to disrupt the commute for its 382 employees. But it did want penthouse space, COO Rob Burger said.

"We were really thinking about the kind of workplace we wanted to design," he said. "If we'd have had that penthouse or rooftop at our current place, I don't know, we might have stayed."

'Free-range workplace'

Whether or not a tenant moves, most likely it's considering upgrades to its space – and it's putting interior architects on call.

Office spaces are another "perk" to compete for a talent pool, and in the Covid era, that means having the workspace take on more of the comforts of working from home, said Duncan Lyons, design director in Gensler's D.C. office.



SOURCE: CBRE

Since the pandemic began, Gensler has examined new ideas for office and building design as client demands have morphed, Lyons said. Companies have asked for garage door-style walls that can open the whole office to Mother Nature in warmer months, as well as heated patios in the winter. Ground-floor space, once popular only with retailers, is getting a second look because it has a more direct connection to the outside world. Plus, there are the perimeter hallways that almost act like walking tracks.

Lyons termed the new spaces a "free-range workplace" – noting Steve Jobs' famous habit of taking long walks while holding meetings.

"You can sit, stand or move while working in this protected, temperate place," Lyons said. "Or none of them. The point is that you let people work how they want to."

It's also a chance to double down on the things important to an individual company. Teass\Warren Architects and Moody Graham Landscape Architecture thought for a long time about office needs before the two firms decided to "co-habitate" in the 5,000-square-foot penthouse of 609 H St. NE this summer.

There, 25 employees now access two patios and interiors laden with plants. And that's not just because the principals like plants – more so, it's a reminder that today's offices call for more natural settings, said Moody Graham Principal Ryan Moody.

Though, not every company wants to downsize. Consider that Mayer Brown's newly re-signed lease kept the same amount of office space the company was using before, at 175,000 square feet. But its interior overhaul stemmed from a need to build more social space, especially for its youngest employees, Espín Stern said. In the end, she said, the younger people, oftentimes the future of the firm, struggled the most while working at home alone. And as she looks to grow and staff up the firm's core practices, she said those younger employees are more likely to look for an office space that allows them to meet and learn and expand their skills.

"In a year from now, we might talk about more flexible use of space as we continue to grow," she said. "Right now, though, we see more opportunities for mentoring and brainstorming, and just achieving more when we work together."

STERNE, KESSLER, GOLDSTEIN & FOX PLLC

Rob Burger of Sterne Kessler said law firms are turning remote-enabled.

A CLOSER LOOK

A BIG TENANT CLASS FOR D.C. STARTS TO THINK SMALLER

Several D.C. law firms have been on the move this year to new — and, more significantly, smaller — homes.

In the past three months alone, nine firms have inked leases for a combined 540,000 square feet in D.C., with all but one of them relocating to new digs.

More notably, many of these firms are downsizing, showing just how quickly the legal workforce has shifted during the Covid-19 pandemic — and dealing a significant blow to the local real estate landscape given its reliance on large law firm leases. In 2021 alone, local law firms have shed at least 239,750 square feet, 91% of that in the District and the remainder in Northern Virginia, as they either move or ink smaller leases in the same building, according to CBRE data.

"There's a lot of interest in what we're doing in the legal world," said Rob Burger, chief operating officer of Sterne, Kessler, Goldstein & Fox PLLC, which is downsizing its home by 42% to occupy 71,000 square feet at 1101 K St. NW next year. "We think this is how the law business is going to be in 10 years. It's got to be more remote-enabled and adaptable space."

The industry's largest dispenser of square footage thus far this year, per CBRE's data, is Gibson Dunn & Crutcher LLP, which announced Oct. 4 it signed a 16-year lease for 163,750 square feet, or more than half of the building being developed at 1700 M St. NW. The firm's 346 staff will move from its current 1050 Connecticut Ave. NW, where it has resided in 205,000 square feet since 2012. The company, which is dropping 20% of its total space with the move, didn't comment further.

CBRE data shows another eight law firms leased a combined 377,000 square feet in the third quarter. Katten Muchin Rosenman LLP is slimming from 72,300 square feet at 2900 K St. NW to 55,300 square feet at 1919 Pennsylvania Ave. NW, while Rothwell Figg Ernst & Manbeck PC is downsizing from 42,200 square feet at 607 14th St. NW to 31,200 square feet at 901 New York Ave. NW. Neither firm commented on their pending moves.

Within these smaller spaces, the firms are exploring new ideas about how to work. Chris Camarra, a partner at law firm Holland & Knight LLP, noted some firms are weighing plans for lawyers to share the same office, but to check in at different times of the week, during a Sept. 29 panel hosted by the Greater Washington Board of Trade.

"Firms have been looking at this for some time, and I think all of the professional services segment is experimenting," Camarra said.

Not every law firm is opting to downsize, though. CBRE noted, for instance, a new 15,000-square-foot office for Cincinnati's Taft Stettinius & Hollister LLP in the District, at 200 Massachusetts Ave. NW.

This comes at a time when some larger law firms are readying for big moves, or big decisions, on their own footprints. Wiley Rein LLC is expected to leave 335,000 square feet of leased space between 1776 K St. NW and 1750 K St. NW, both set to expire in 2024, for 166,000 square feet at 2050 M St. NW. WilmerHale's leases in the 1800 block of Pennsylvania Avenue NW come due in 2023, when it plans to move to 288,000 square feet at 2100 Pennsylvania Ave. NW. And Pillsbury Winthrop Shaw Pittman LLP has 105,000 square feet at 2000 17th St. NW expiring in 2024, Newmark data show. None elaborated on their plans.

– Tristan Navera