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THE WEEKLY UPDATE ON THE INSTITUTIONAL MARKETPLACE

Defense Boost Seen Lifting Va. Office Markets

The prospect of a rebound in U.S. military spending has brightened the outlook for Northern Virginia office markets that were hard-hit by defense-sector cutbacks.

The Rosslyn-Ballston corridor, with its heavy concentration of defense contractors, saw vacancy rates double in recent years due to the one-two punch of base closings and federal budget sequestration. The slowdown in leasing made it difficult to value and sell properties.

Now, owners and brokers alike are finding cause to be optimistic. The election of **President Trump,** putting both the executive and legislative branches in Republican hands, and the administration's plans to increase defense spending signal a likely resurgence in leasing.

Property owners already are seeing positive signs. "It is more than a potential," said **Bruce Lane,** co-founder of **Meridian Group** of Bethesda, Md. The firm began investing in Northern Virginia offices in 1999 and has stepped up those efforts since 2012. In the last few months, he's seen an uptick in tenant tours in the area. "In general, the confidence level of [prospective tenants] is much greater," Lane said.

The White House said last week that Trump's budget proposal for the next fiscal year would increase defense spending by $54 billion, or roughly 10% from the current level. The expectation is that Northern Virginia would benefit from the boost, as companies that provide research and other services to the Pentagon look to expand.

"Virginia is the R&D epicenter of defense, not just nationally, but globally," said **John Sikaitis,** a managing director of office research in **JLL's** Washington office. "Virginia is the real winner."

For the past several years, those ties to defense spending were problematic. From 2011 through 2016, the average annual occupancy rate for office space in the Rosslyn-Ballston area was 80% — compared with a 91% average for the previous 15 years, according to JLL. At the end of last year, it stood at 77%.

The falloff in leasing corresponded with the restraints on military spending imposed by the Budget Control Act of 2011. That came on the heels of a base-closings initiative that led to cuts in **Defense Department** leasing.

Along with Trump's call for a defense buildup, there are other positive signs for improved occupancy in Northern Virginia. For one, some existing supply is being taken offline, as older properties deemed functionally obsolete are redeveloped. What's more, expanding industries such as cyber-security are poised to take up more space, said **Drew Flood,** a broker at **Cushman & Wakefield.**

In addition, close-in suburbs are likely to benefit from a general upswing in Washington-area leasing as lobbyists gear up for potential major legislative action after six years of divided government.

"When Congress is functional and they are approving legislation, [Greater Washington] tends to be not just a growth market, but a boom town," said Sikaitis at JLL. The firm's research shows that over the last 15 years, the market has absorbed 36.5 million square feet of office space during the six years when the presidency and Congress were in partisan alignment — and lost 6 million sf of occupancy in the nine years when the branches were divided.

Investors looking at the Rosslyn-Ballston area say this could be a good time to get in, when buildings can be acquired at below-replacement cost and at yields higher than better-performing submarkets in the region.

"I feel very, very good about buying now," said **Robert Murphy,** co-founder and managing principal of **MRP Realty** of Washington. He expects institutional investors to re-enter the market within 24-30 months, after a few quarters of positive net absorption. "Ideally there will be a pretty good execution for us."

Already, buyers are willing to price less risk into deals currently on the block.

"Six months ago, we were getting killed on worst-case scenario," said **Eric Berkman,** a broker at Cushman. Investors then were underwriting any defense-related tenants as likely to vacate when their leases expired, he said. "But now the thinking is maybe these guys aren't going to leave. It's starting to change right in front of your eyes." ❖