








KNIGHT DORIN & ROUNTREY

2006 Market Participant Survey



of Central Virginia

CENTRAL VIRGINIA MARKET INSIGHT – 2006

-  Market optimism is evident with 48% of survey respondents expecting that real estate market conditions will remain the same for 2006, 36% indicating that conditions will be even better and only 16% saying that 2006 will be worse than 2005.
-  Vacancy expectations for all property types decreased, except apartments which increased, but are still at a healthy 6.3%. Furthermore, the limited amount of new construction coupled with the condominium conversions should cause the market to get tighter.
-  Going-in cap rates are expected to come in 50-90 basis points lower than in 2005. The aggregate overall cap rate expectations from all property types in this survey now average below 8.5%.
-  Unleveraged IRR (discount rate) expectations have abruptly separated from the cap rate trend and reversed the downward trend of recent years – averaging about 10.9% this year. This represents a significant increase of 45 basis points higher than our 2005 survey suggested. This is a curious tack since overall cap rates are expected to continue declining during the same time period. This counterintuitive shift can be explained by income projection models that have become more optimistic – betting on future income and value growth to “bring home the bacon”.
-  Mortgage financing is expected to remain adequate in 2006 for all property types. It is interesting to note that there is marked decline in the mortgage abundance score - suggesting growing caution from the lending community.
-  Apartments cap rates are projected to decline further in 2006 despite increasing vacancy rates and increasing target yield requirements. This unlikely combination of trends could be a side effect of aggressive apartment sale prices motivated by future condo conversion plans. First time home buyers and young professionals have moved beyond just seeking affordable housing. They have joined or become “new investors” with a gold-rush mentality to “buy now or miss the boat”. Seasoned market observers are starting to wave red flags.....
-  Marketing times are projected to increase – across the board.

EXPECTATIONS

Outlook for 2006– Our local experts are mostly optimistic as noted above and in the detailed charts that follow. They are surely not predicting gloom and doom for the economy or real estate markets in 2006. Low interest rates, a low inflation rate, unprecedented low cap rates and demographics have pushed up commercial and residential real estate values tremendously over the past 5 years. The market seems to have accepted the relatively low mortgage rates as a permanent condition. But not all indicators are rosy. For the first time in many years our experts predict increasing real estate discount rates (moving up from historic lows of 2005). This coupled with increasing marketing time projections and more caution on the part of lenders might suggest the market will finally start to cool down in the foreseeable future.

The Real Estate Market Survey is an annual publication of Knight, Dorin & Rountrey. This is our 14th year publishing the survey. Each year we send our survey questionnaire to over 200 of the most active and respected commercial real estate professionals in Central Virginia. The survey participants include real estate brokers, developers, investors, consultants and lenders.

We hope this survey proves useful and welcome your comments and suggestions.

INVESTMENT CRITERIA

Office Market				
CATEGORY	2005 Range	2005 Average	2006 Range	2006 Average
Holding Period (Years)	3.0-10.0	7.3	3.0 – 15.0	7.7
Income (Growth Rate)	1.75%-4.0%	2.8%	1.5% – 3.0%	2.6%
Operating Expenses (Growth Rate)	2.0%-3.0%	2.7%	2.0% – 3.0%	2.9%
Vacancy Loss	5.0%-11.0%	6.8%	5.0% – 8.0%	6.3%
Going-In Capitalization Rate	8.0%-10.5%	9.1%	7.5% – 9.5%	8.4%
Terminal Capitalization Rate	9.0%-11.0%	9.8%	8.5% – 10.0%	9.1%
Discount Rates (Unleveraged IRR)	7.0%-12.0%	10.8%	10.0% – 15.0%	11.5%
Equity Yield (Leveraged IRR)	10.0%-18.0%	14.1%	13.0% – 22.0%	17.3%
Tenant Retention Rates:				
Class A	60.0%-90.0%	76.5%	70.0% – 85.0%	77.9%
Class B	50.0%-90.0%	71.7%	65.0% – 75.0%	69.3%
Months vacant between tenants:				
Class A	3.0-12.0	6.6	2.0 – 8.0	5.0
Class B	3.0-12.0	7.4	3.0 – 12.0	7.86
Retail Market				
CATEGORY	2005 Range	2005 Average	2006 Range	2006 Average
Holding Period (Years)	3.0-10.0	7.6	5.0 – 20.0	7.7
Income (Growth Rate)	2.0%-5.0%	3.4%	2.0% – 4.0%	3.1%
Operating Expenses (Growth Rate)	2.0%-3.0%	2.7%	1.0% – 3.0%	2.5%
Vacancy Loss	5.0%-7.0%	5.7%	3.0% – 7.0%	4.8%
Going-In Capitalization Rate	7.0%-10.0%	8.7%	7.0% – 9.0%	8.2%
Terminal Capitalization Rate	9.0%-10.0%	9.6%	8.0% – 10.0%	8.9%
Discount Rates (Unleveraged IRR)	6.0%-12.0%	10.4%	9.0% – 12.0%	10.5%
Equity Yield (Leveraged IRR)	10.0%-18.0%	14.1%	10.0% – 15.0%	13.0%
Tenant Retention Rates:				
Neighborhood	70.0%-95.0%	80.5%	60.0% – 95.0%	80.0%
Community	70.0%-90.0%	82.1%	65.0% – 95.0%	80.7%
Months vacant between tenants:				
Neighborhood	2.0-6.0	4.7	2.0 – 6.0	4.33
Community	3.0-6.0	5.0	3.0 – 6.0	4.14
Apartment Market				
CATEGORY	2005 Range	2005 Average	2006 Range	2006 Average
Holding Period (Years)	5.0-10.0	8.8	7.0 – 10.0	8.5
Income (Growth Rate)	2.5%-4.0%	3.2%	2.5% – 4.0%	3.4%
Operating Expenses (Growth Rate)	2.0%-4.0%	2.8%	3.0% – 3.0%	3.0%
Vacancy Loss	2.0%-7.0%	4.4%	4.0% – 8.0%	6.3%
Going-In Capitalization Rate	6.0%-10.5%	8.6%	7.0% – 8.8%	7.7%
Terminal Capitalization Rate	8.0%-10.5%	9.5%	7.5% – 9.0%	8.2%
Discount Rates (Unleveraged IRR)	5.0%-15.0%	10.3%	10.0% – 11.5%	10.6%
Equity Yield (Leveraged IRR)	8.0%-15.0%	12.6%	12.0% – 12.0%	12.0%

Industrial Market				
CATEGORY	2005 Range	2005 Average	2006 Range	2006 Average
Holding Period (Years)	5.0-10.0	8.6	7.0 – 15.0	9.3
Income (Growth Rate)	2.0%-4.0%	2.6%	0.0% – 4%	2.4%
Operating Expenses (Growth Rate)	1.5%-3.0%	2.5%	1.0% – 3.0%	2.7%
Vacancy Loss	3.0%-10.0%	6.5%	3.0% – 10.0%	5.9%
Going-In Capitalization Rate	9.0%-10.0%	9.5%	7.5% – 10.0%	8.7%
Terminal Capitalization Rate	9.0%-12.0%	10.1%	8.0% – 10.3%	9.2%
Discount Rates (Unleveraged IRR)	5.0%-12.0%	10.4%	10.0% – 13%	10.9%
Equity Yield (Leveraged IRR)	9.0%-16.0%	13.6%	12.0% – 18.0%	14.8%
Tenant Retention Rates:				
Office/Whse.	60.0%-90.0%	74.1%	70.0% – 95.0%	78.3%
Distribution	50.0%-90.0%	70.0%	65.0% – 85.0%	75.0%
Months vacant between tenants:				
Office/Whse.	3.0-12.0	7.0	2.0 – 12.0	6.63
Distribution	5.0-18.0	9.2	3.0 – 12.0	7.83

LAND LEASE RATES

	Range	Average
Cap Rate (with flat rent)	6.0% - 10.0%	8.40%
Cap Rate (average 2% ann. escalation)	5.5% - 9.0%	7.61%
Subordination Impact?	75 – 200 basis points	
Credit Impact?	75 - 200 basis points	

RESERVES, LEASING COSTS, AND TI'S

Include in Cap Rate Analysis	Yes	No
Reserves for Replacement	73.7%	26.3%
Leasing Commissions	78.9%	21.1%
Tenant Improvement Costs	44.4%	55.6%

COST OF SALE

Price Range	Low	High	Average
<\$500K	2.0%	10.0%	6.1%
\$500K to \$1M	2.0%	8.0%	5.4%
\$1M to \$3M	1.0%	8.0%	4.6%
\$3M to \$5M	1.0%	6.0%	3.6%
>\$5M	1.0%	6.0%	2.9%

ENTREPRENEURIAL PROFIT

Basis	Year	Low	High	Median
Improvements Only	2006	10%	25%	15%
	2005	10%	30%	15%
	2004	10%	20%	13%
	2003	5%	15%	10%
	2002	10%	30%	20%
	2001	12%	20%	15%
	2000	4%	30%	15%
Land and Improvements	2006	8%	35%	15%
	2005	8%	30%	15%
	2004	10%	25%	14%
	2003	10%	20%	13%
	2002	10%	30%	16%
	2001	11%	20%	12%
	2000	4%	35%	13%
Gross Sales	2006	12%	50%	24%
	2005	15%	30%	25%
	2004	15%	33%	22%
	2003	10%	25%	18%
	2002	25%	35%	30%
	2001	20%	33%	25%
	2000	5%	30%	25%

LOT PRICE RATIOS

Improved Property Price	Lot Value Ratio Range as % of Total Price					Median				
	2002	2003	2004	2005	2006	2002	2003	2004	2005	2006
\$150-\$200K	20-35%	20-25%	20-30%	18-32%	15-30%	25%	25%	24%	25%	26%
\$200-\$300K	20-30%	20-30%	20-30%	20-35%	18-35%	25%	25%	24%	24.5%	25%
Over \$300K	20-30%	20-35%	18-30%	19-37%	20-35%	25%	22%	22%	22%	25%

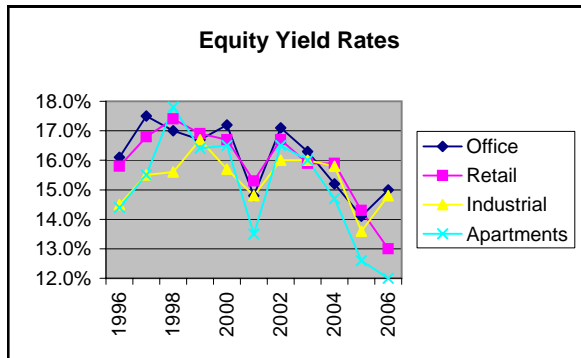
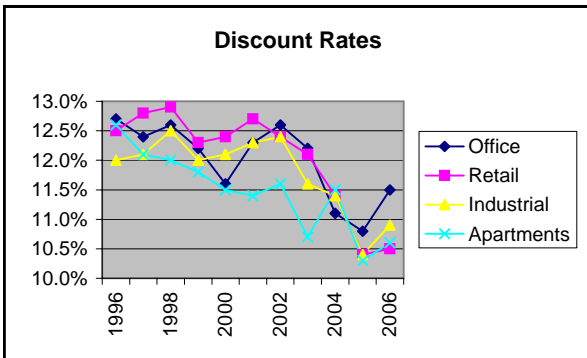
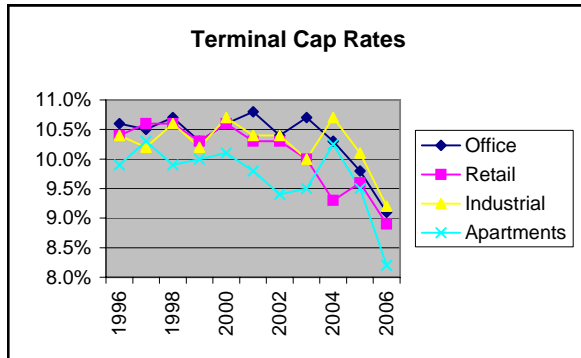
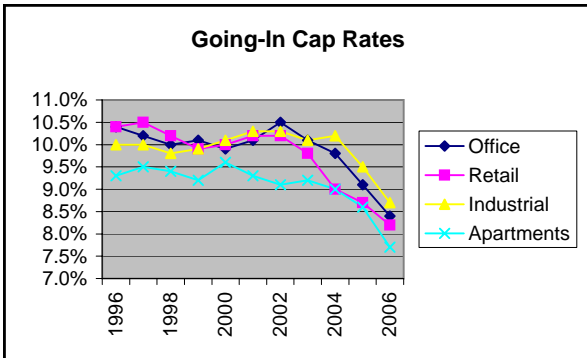
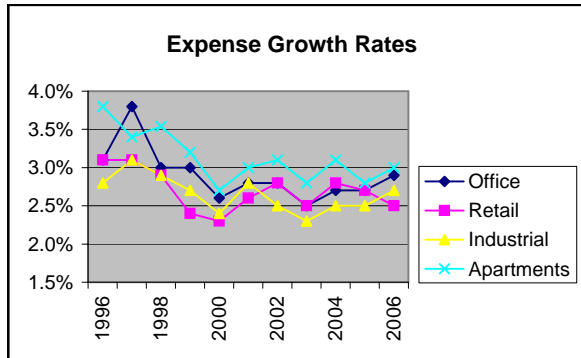
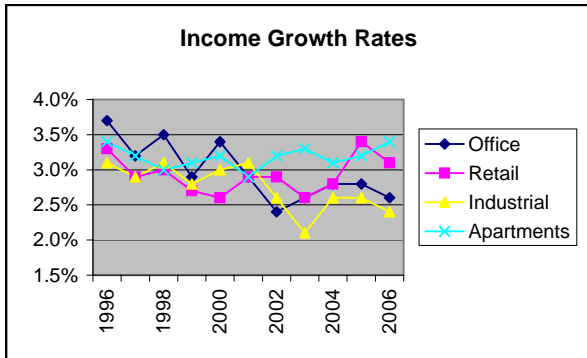
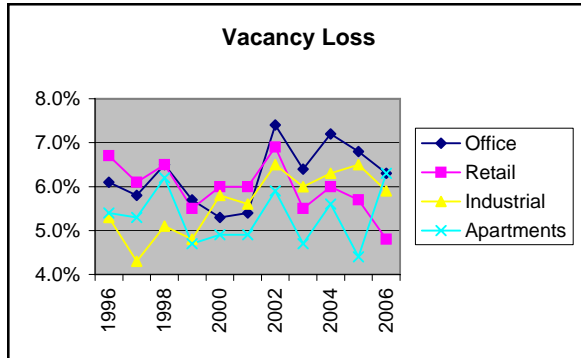
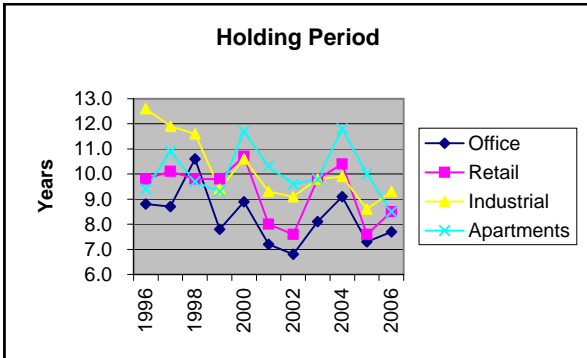
AVAILABILITY OF MORTGAGE FINANCING

Property Type	Past 12 months	Next 12 months
Apartments	2.8	2.6
Hotels	2.4	2.1
Industrial	2.6	2.4
Office	2.5	2.3
Retail	2.8	2.5
Residential (A & D)	2.6	2.2
Rating Scale:	1 = Inadequate	2 = Adequate
		3 = Abundant

REAL ESTATE LIQUIDITY – MARKETING PERIOD

Property Type	% of Responses		
	< 6 Months	6-12 Months	> 12 Months
Retail			
Free-standing single user retail	60.0%	33.3%	6.7%
Small unanchored retail center	33.3%	60.0%	6.7%
Neighborhood retail center	40.0%	60.0%	0.0%
Community retail center	40.0%	46.7%	13.3%
Regional retail center	54.5%	36.4%	9.1%
Multi-family			
Apartment (> 120 units)	57.1%	35.7%	7.1%
Apartment (< 120 units)	66.7%	33.3%	0.0%
Office			
Large - well leased	33.3%	58.3%	8.3%
Large – poorly leased	15.4%	46.2%	38.5%
Small – well leased < 20,000 sf	50.0%	50.0%	0.0%
Small – poorly leased < 20,000 sf	8.3%	50.0%	41.7%
Industrial			
Small single user	50.0%	42.9%	7.1%
Multi-tenant flex/bulk distribution	7.1%	85.7%	7.1%
Manufacturing Buildings	7.7%	23.1%	69.2%
Special use properties			
Banks, historic, churches, etc.	9.1%	36.4%	54.5%
Land			
Single family development	58.8%	35.3%	5.9%
Multi-family development	42.9%	57.1%	0.0%
Retail	20.0%	53.3%	26.7%
Office	18.2%	72.7%	9.1%
Industrial	9.1%	54.5%	36.4%
	No Change	Increase	Decrease
Marketing period change from 2005	68%	32.0%	0.0%

**CENTRAL VIRGINIA
MARKET SURVEY HISTORICAL SUMMARY 2006**
(Response Averages)



Knight, Dorin & Rountrey
Real Estate Analysts
9097 Atlee Station Road, Suite 103
Mechanicsville, VA 23116
(804) 427-6001 Fax: (804)427-6004
Copyright © 2006

CORPORATE PROFILE KNIGHT, DORIN & ROUNTREY REAL ESTATE ANALYSTS

REAL ESTATE MARKET KNOWLEDGE

- Leading real estate appraisal and consulting company founded in 1986
- Strong network with other real estate professionals
- Comprehensive commercial real estate transaction database covering most of the developed areas of Virginia (outside of Northern Virginia)
- Over 1,000 commercial lease and sale transactions analyzed annually
- Clients – include financial institutions, government agencies, law firms, investors, developers, and major corporations

COMMERCIAL APPRAISAL SERVICES FOR

- Office, retail, industrial, apartment, subdivision, and special purpose properties
- Mortgage, securitization, investments, and exchanges
- Buyer, seller, tenant – decision support analysis
- Estates, trusts, partitions, partial interests, valuation subject to environmental impairment
- Portfolio evaluation
- Appraisal reviews
- Litigation support
- Bankruptcy
- Estate planning

MARKET COVERAGE – VIRGINIA

- Richmond-Petersburg MSA
- Norfolk-Newport News-Virginia Beach MSA
- Williamsburg Area
- Charlottesville MSA
- Roanoke MSA – Shenandoah Valley Area
- Outer Banks – Northeastern North Carolina Area

OWNER

Edward G. Knight, MAI, SRA

PROFESSIONAL STAFF

J. Parks Rountrey, MAI, SRA
William A. Hopkins, Jr., MAI, SRA
Joseph W. Smith, III, MAI
Michael S. Larson
Michael A. Knight
A. Kyle Wakefield

ADVISORY & CONSULTING SERVICES

- Market studies
- Feasibility analysis
- Project development analysis
- Litigation support
- Highest and best use analysis
- Lease analysis
- Asset evaluation
- Strategic planning
- Due diligence research and advice
- Site selection
- Land use analysis

Contact Us

Knight, Dorin & Rountrey
Real Estate Analysts

9097 Atlee Station Road, Suite 103
Mechanicsville, Virginia 23116

For more information call 804-427-6001 or e-mail

E-mail address: bknight@kdrrealestate.com