

KNIGHT DORIN & ROUNTREY

Central Virginia

2013 Real Estate Market Participant Survey



21st Year Edition

CENTRAL VIRGINIA MARKET INSIGHT – 2013

Commercial Real Estate Market Outlook for 2013 – There are multiple bright spots to consider in Richmond’s economic future. There are also issues of concern that can be gleaned from the data in this year’s survey. The Richmond Area economy improved in 2012 by most measures, and 2013 is expected to be better than 2012 for CRE. Our survey indicated that 65.2% of the respondents thought the market would be better and 34.8% thought it would be the same – none indicated that it would be worse. But, as of the end of 2012 the Richmond area still had only gained back 50% of the jobs lost in the most recent recession. Nationally, growing unsustainable government deficits and mounting government debt remain a source of much concern relative to the long term economic outlook. The highly watched University of Michigan’s Consumer Sentiment Index is designed to assess near-time consumer attitudes on the business climate, personal finance, and spending. The index stood at 76.4 as of April 2013. The average since its inception in 1978 is 85.2 while the average during the past five recessions was 69.3. So we currently stand about halfway between a recessionary index and an average index. This puts the national feeling in perspective.

CRE continues to benefit from low interest rates, increasing risk tolerance and the lack of attractive alternative investment yields. Comparing this year’s investment criteria results to the past year – the Industrial market shows the most negative trends and the Apartment Market the most positive. The general downward trend in cap rates we saw in 2010-12 is expected to reverse in 2013 (except for Apartments). National surveys generally showed that cap rates on investment grade properties stabilized by the end of 2012 after falling the prior two years. The shift in our survey’s average cap rates may actually reflect an increasing proportion of transactions on properties that have some risk. In the past – the lack of financing for non-prime properties precluded many potential transactions.

Increasing cap rates and decreasing discount rates in Office, Retail and Industrial markets show compression of the spread. The spread between these two rates generally reflects the anticipated rate of income and value growth. So our experts may be suggesting lower prospects for growth of income and value in the future. That story line is also supported by the projections of expenses growing faster than income in 2013 for most property types.

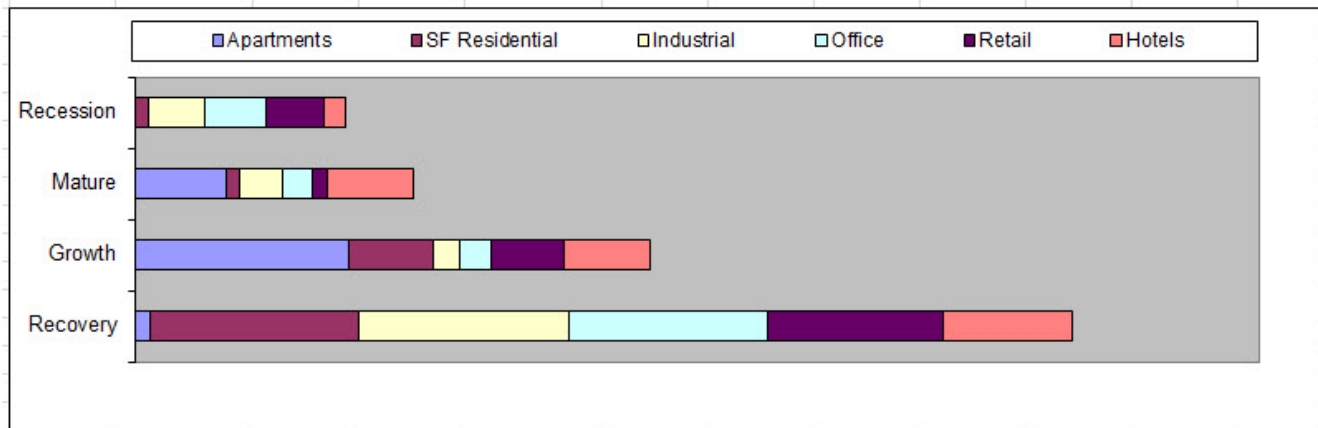
Some of the notables in our 2013 survey include:

- Overall Cap Rates for CRE are anticipated to increase 10 to 70 basis points in 2013. Apartments are the exception - anticipated to decline 30 basis points in 2013.
- Unleveraged Discount Rates are anticipated to generally decline in 2013 – except for Industrial.
- Vacancy rates were mixed, but Retail vacancy expectations declined by a whopping 1.6 %.
- Mortgage financing availability is expected to continue to improve in 2013 and is now regarded as nearly adequate with a few results above and a few results below the adequate rating.
- The ratio of lot price to housing package price shows a dramatic decline from 25% to 20% for this year as housing package prices have been increasing faster than lot prices. This may be partly due to long term builder contracts negotiated in a time of excess inventory and deals made by developers struggling for liquidity. Based on historical data there is room for lot prices to climb significantly over the next few years and move back towards 25% - if the strong new home sales trends of 2012 continue.

CURRENT STAGE OF REAL ESTATE MARKET CYCLE

	Recovery	Growth	Mature	Recession
Apartments	4.8%	66.7%	28.6%	00.0%
Single Family Residential	65.2%	26.1%	4.3%	4.3%
Industrial	65.2%	8.7%	13.0%	17.4%
Office	61.9%	9.5%	9.5%	19.0%
Retail	54.5%	22.7%	4.5%	18.2%
Hotels	40.0%	26.7%	26.7%	6.7%

With the exception of Apartments, the results show that the highest percentage of participants believe we are now in the Recovery stage for all property types. Apartments were the only category where no one indicated recession and the highest percentage indicated Growth. Industrial, Office and Retail still had a significant percentage of participants indicating Recession. This is a marked shift from recent years where most property types were rated strongly in the Recession part of the cycle.



INVESTMENT CRITERIA

Office Market				
CATEGORY	2012 Range	2012 Average	2013 Range	2013 Average
Holding Period (Years)	5.0-10.0	7.4	5.0 – 10.0	8.2
Income (Growth Rate)	1.0% - 3.0%	2.2%	2% - 3.0%	2.4%
Operating Expenses (Growth Rate)	1.0% - 3.0%	2.1%	1.0% - 3.0%	2.4%
Vacancy Loss	5.0% - 12.0%	8.6%	5.0% – 12.0%	8.7%
Going-In Capitalization Rate	7.5% - 10.0%	8.8%	8.0% - 10.0%	9.0%
Terminal Capitalization Rate	8.5% - 10.5%	9.5%	7.0% - 11.0%	9.2%
Discount Rates (Unleveraged IRR)	8.0% - 12.0%	10.4%	8.0% - 12.0%	10.0%
Equity Yield (Leveraged IRR)	12.0% - 18.0%	13.7%	10.0% - 18.0%	12.9%
Tenant Retention Rates:				
Class A	60% - 75%	69%	60% - 80%	74%
Class B	50% - 40%	63%	60% - 70%	64%
Months vacant between tenants:				
Class A	6.0 – 12.0	8.0	3.0 – 20.0	9.4
Class B	6.0 – 16.0	10.7	6.0 – 24.0	12.6

Retail Market				
CATEGORY	2012 Range	2012 Average	2013 Range	2013 Average
Holding Period (Years)	5.0 – 10.0	8.0	5.0 – 20.0	9.9
Income (Growth Rate)	1.0% - 3.0%	1.6%	2.0% - 3.0%	2.4%
Operating Expenses (Growth Rate)	1.0% - 2.0%	2.0%	2.0% - 3.0%	2.6%
Vacancy Loss	8.0% - 15.0%	11.0%	5.0% - 15.0%	9.4%
Going-In Capitalization Rate	7.5% - 10.0%	8.7%	7.5% - 10.0%	8.8%
Terminal Capitalization Rate	8.5% - 10.0%	9.3%	8.0% - 11.0%	9.4%
Discount Rates (Unleveraged IRR)	9.0% - 13.0%	10.7%	9.0% - 12.0%	10.5%
Equity Yield (Leveraged IRR)	11.0% - 18.0%	13.8%	12.0% - 18.0%	13.5%
Tenant Retention Rates:				
Neighborhood	40% - 80%	59%	20% - 80%	64%
Community	50% - 85%	68%	30% - 80%	67%
Months vacant between tenants:				
Neighborhood	3.0 – 18.0	10.4	3.0 – 24.0	11.9
Community	6.0 – 12.0	10.4	6.0 – 24.0	11.2

Apartment Market				
CATEGORY	2012 Range	2012 Average	2013 Range	2013 Average
Holding Period (Years)	8.0 – 12.0	10.0	7.0 – 10.0	9.0
Income (Growth Rate)	2.0% - 5.0%	3.4%	2.0% - 3.0%	2.7%
Operating Expenses (Growth Rate)	1.0% - 3.0%	2.0%	3.0% - 3.0%	3.0%
Vacancy Loss	4.0% - 8.0%	6.0%	3.0% - 10.0%	5.7%
Going-In Capitalization Rate	6.0% - 8.0%	7.1%	6.0% - 7.5%	6.8%
Terminal Capitalization Rate	7.0% - 9.0%	7.9%	7.0% - 8.0%	7.5%
Discount Rates (Unleveraged IRR)	8.5% - 10.5%	9.6%	8.0% - 9.0%	8.8%
Equity Yield (Leveraged IRR)	10.0% - 14.0%	11.8%	10.0% - 14.0%	11.8%

Industrial Market				
CATEGORY	2012 Range	2012 Average	2013 Range	2013 Average
Holding Period (Years)	5.0 - 10.0	8.9	7.0 - 10.0	8.6
Income (Growth Rate)	0% - 3.0%	1.8%	1.0% - 3.0%	1.8%
Operating Expenses (Growth Rate)	1.0% - 3.0%	2.3%	1.0% - 3.0%	2.2%
Vacancy Loss	7.0% - 12.0%	9.6%	10.0% - 15.0%	10.7%
Going-In Capitalization Rate	7.0% - 10.0%	8.9%	8.5% - 12.0%	9.6%
Terminal Capitalization Rate	8.0% - 12.0%	9.5%	8.0% - 12.0%	10.0%
Discount Rates (Unleveraged IRR)	8.0% - 12.0%	10.5%	9.0% - 12.0%	10.9%
Equity Yield (Leveraged IRR)	10.0% - 18.0%	13.6%	11.0% - 18.0%	13.7%
Tenant Retention Rates:				
Office/Whse.	60% - 70%	68.0%	50% - 80%	69%
Distribution	60% - 75%	68.3%	50% - 80%	71%
Months vacant between tenants:				
Office/Whse.	6.0 – 12.0	10.4	6.0 – 24.0	13.0
Distribution	6.0 – 18.0	10.6	6.0 – 36.0	16.0

LAND LEASE RATES

	Range	Average	Change From 2012
Cap Rate (with flat rent)	6.00% - 9.00%	7.20%	-140 basis point
Cap Rate (average 2% ann. escalation)	6.50% - 8.00%	6.63%	-62 basis points

RESERVES, LEASING COSTS, AND TI'S

Include in Cap Rate Analysis	Yes	No
Reserves for Replacement	85%	15%
Leasing Commissions	40%	60%
Tenant Improvement Costs	40%	60%

COST OF SALE

Price Range	Low	High	Average
<\$500K	3%	10%	6.0%
\$500K to \$1M	3%	7%	5.0%
\$1M to \$3M	2%	6%	4.0%
\$3M to \$5M	2%	6%	4.0%
>\$5M	1%	5%	3.0%

ENTREPRENEURIAL PROFIT

Basis	Year	Low	High	Median
Improvements Only	2013	10%	20%	15%
	2012	10%	18%	14%
	2011	10%	15%	11%
	2010	10%	20%	15%
	2009	10%	25%	15%
	2008	8%	20%	12%
	2007	10%	18%	15%
Land and Improvements	2013	8%	20%	10%
	2012	5%	15%	10%
	2011	10%	25%	15%
	2010	10%	30%	15%
	2009	10%	20%	14%
	2008	10%	15%	10%
	2007	9%	25%	16%

LOT PRICE RATIOS

Improved Property Price Range	Lot Value Ratio Range as % of Total Price					Median				
	2009	2010	2011	2012	2013	2009	2010	2011	2012	2013
Starter Housing \$200-\$300K	20-30%	20-35%	20-25%	20-25%	18-30%	28%	25%	24%	25%	22%
Move Up Housing \$300-\$400K	20-28%	20-30%	20-25%	20-27%	15-25%	25%	22%	25%	24%	20%
Luxury Housing \$400-600K	20-28%	20-25%	20-30%	20-30%	14-25%	23%	23%	25%	25%	20%
High End Luxury Housing Over \$600K	20-25%	20-25%	20-25%	20-30%	18-25%	20%	22%	25%	27%	20%
Townhouse			25-33%	25-30%	20-30%			28%	25%	20%

AVAILABILITY OF MORTGAGE FINANCING

Property Type	Past 12 months	Next 12 months
Apartments	2.7	2.5
Hotels	1.8	1.7
Industrial	1.8	1.9
Office	1.8	2.0
Retail	2.0	2.0
Residential (A & D)	1.3	1.6
Rating Scale:	1 = Inadequate	2 = Adequate
		3 = Abundant

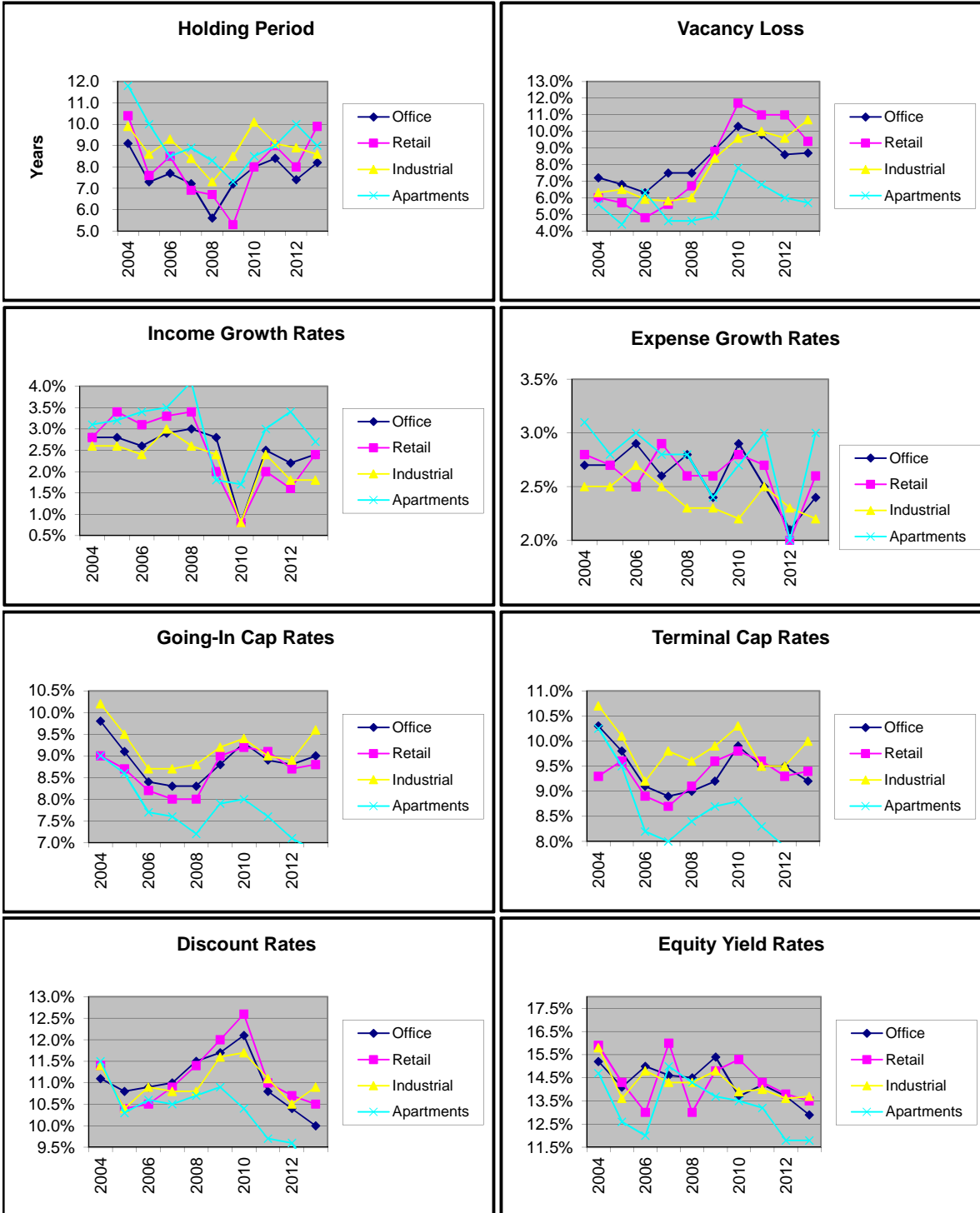
REAL ESTATE LIQUIDITY – MARKETING PERIOD

Property Type	% of Responses		
	< 6 Months	6-12 Months	> 12 Months
Retail			
Free-standing single user retail	44.4%	44.4%	11.2%
Small unanchored retail center	27.8%	44.4%	27.8%
Neighborhood retail center	33.3%	55.6%	11.1%
Community retail center	22.2%	61.1%	16.7%
Regional retail center	22.2%	50.0%	27.8%
Multi-family			
Apartment (> 120 units)	70.6%	29.4%	0.0%
Apartment (< 120 units)	62.5%	37.5%	0.0%
Office			
Large - well leased	58.8%	41.2%	0.0%
Large – poorly leased	11.8%	11.8%	76.5%
Small – well leased < 20,000 sf	33.3%	66.7%	0.0%
Small – poorly leased < 20,000 sf	0.0%	25.0%	75.0%
Industrial			
Small single user	23.5%	58.8%	17.6%
Multi-tenant flex/bulk distribution	12.5%	62.5%	25.0%
Manufacturing Buildings	0.0%	25.0%	75.0%
Special use properties			
Banks, historic, churches, etc.	6.3%	31.3%	62.5%
Land			
Single family development	14.3%	21.4%	64.3%
Multi-family development	35.7%	50.0%	14.3%
Retail	12.5%	31.3%	56.3%
Office	0.0%	29.4%	70.6%
Industrial	0.0%	17.6%	82.4%

	No Change	Increase	Decrease
Marketing period change from 2012	65%	0%	35%

This Real Estate Market Survey is an annual publication of Knight, Dorin & Rountrey. *This is our 21st year publishing the survey.* At the beginning of 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.

**CENTRAL VIRGINIA
MARKET SURVEY HISTORICAL SUMMARY 2013**
(Response Averages)



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
- Fredericksburg Area
- Williamsburg Area

OWNER

Edward G. Knight, MAI, SRA

PROFESSIONAL STAFF

J. Parks Rountrey, MAI, SRA
William A. Hopkins, Jr., MAI, SRA
Michael A. Knight
M. Cheryll Morey
James A. Wood, Jr.
Harry F. Hoffmann, Jr.

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

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