

KNIGHT DORIN & ROUNTREY

Central Virginia

2014 Real Estate Market Participant Survey



22nd Year Edition

CENTRAL VIRGINIA MARKET INSIGHT – 2014

Commercial Real Estate Market Outlook for 2014 – The Richmond Area economy improved slightly in 2013 by most measures, and our experts believe 2014 will be a good year for CRE also. Our survey indicated that 68.8% of the respondents thought the market would be better and 31.2% thought it would be the same – none indicated that it would be worse. The mood is slightly optimistic with more consensus of opinion than we have seen in years. Local experts see a stable to moderately improving CRE environment.

As of the end of 2013 Central Virginia had finally gained back the full number of jobs that had been lost in the most recent recession. Nationally, unemployment came down substantially during the year ending April 2014, but mostly due to reduced numbers participating in the workforce. Many have become discouraged and have given up looking for jobs. The total number of US jobs is just not keeping pace with the growth in the adult population. Huge government deficits and mounting government debt remain a source of much concern relative to the long term economic outlook for the US and Central Virginia. Nationally, the University of Michigan's Consumer sentiment index stood at 80 as of March 2014. The average since its inception in 1978 is 85.2. During non-recessionary years the average is 87.6. The average during the five recessions is 69.3. So the spring 2014 sentiment number puts us about ten points above the average recession mindset but still well below the non-recession average sentiment.

CRE continues to benefit from low interest rates, increasing risk tolerance and the lack of attractive alternative investment yields. Comparing this year's local investment criteria results to the past year – the trends are mostly positive. The general downward trend in cap rates we saw in 2010-13 is expected to moderate, but continue to decline slightly in 2014.

National surveys generally showed that cap rates and discount rates on investment grade properties had pretty much flattened out (stabilized) by the end of 2013 after falling the prior three years. National investment grade cap rates and discount rates are predicted to remain relatively stable for 2014 – while the local market is still expected to see cap rates decline further in 2014. This may just be Richmond's typical time lag behind national markets.

Relatively low cap rates and discount rates across all property types reflect the impact of very low interest rates and the acceptance of a new normal - with relatively low yield expectations in the investment and financial markets. Our experts also predict lower prospects for growth of CRE income and expenses in the near future. "Moderation" is a tag-word that seems to fit the recent and anticipated trends in CRE.

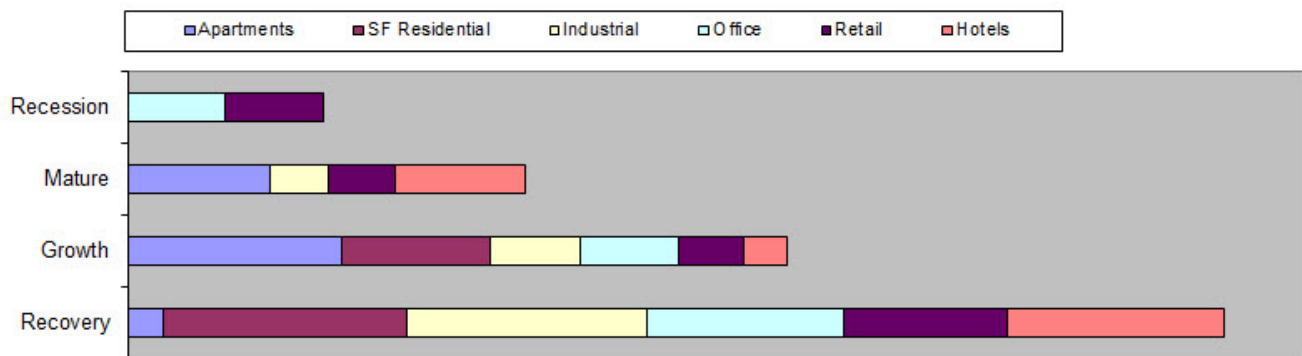
Some of the notable predictions in our 2014 local survey include:

- Overall Cap Rates for CRE are anticipated to decrease 20 to 50 basis points in 2014.
- Unleveraged Discount Rates are also anticipated to generally decline in 2014.
- Vacancy rates are mixed, but industrial vacancy expectations declined by a whopping 1.7 %.
- Mortgage financing availability is expected to continue to improve - and is now rated as adequate or better for all property types in 2014.
- The ratio of the lot price to total home package price shows a significant increase this year (after dipping last year) as the supply of finished lots has been reduced and lot prices have increased significantly. Based on historical data the ratios are getting back to normal in 2014.

CURRENT STAGE OF REAL ESTATE MARKET CYCLE

	Recovery	Growth	Mature	Recession
Apartments	9.1%	54.5%	36.4%	0.0%
Single Family Residential	62.0%	38.0%	0.0%	0.0%
Industrial	61.5%	23.0%	15.0%	0.0%
Office	50.0%	25.0%	0.0%	25.0%
Retail	41.7%	16.7%	16.7%	25.0%
Hotels	55.6%	11.1%	33.3%	0.0%

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. 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	2014 Range	2014 Average	2013 Range	2013 Average
Holding Period (Years)	5.0-10.0	7.3	5.0 – 10.0	8.2
Income (Growth Rate)	2.0% - 3.0%	2.3%	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% - 10.0%	8.3%	5.0% – 12.0%	8.7%
Going-In Capitalization Rate	8.0% - 10.0%	8.7%	8.0% - 10.0%	9.0%
Terminal Capitalization Rate	8.5% - 11.0%	9.5%	7.0% - 11.0%	9.2%
Discount Rates (Unleveraged IRR)	8.5% - 12.0%	10.0%	8.0% - 12.0%	10.0%
Equity Yield (Leveraged IRR)	10.0% - 18.0%	12.7%	10.0% - 18.0%	12.9%
Tenant Retention Rates:				
Class A	60% - 75%	68%	60% - 80%	74%
Class B	60% - 65%	63%	60% - 70%	64%
Months vacant between tenants:				
Class A	3.0 – 12.0	8.2	3.0 – 20.0	9.4
Class B	4.0 – 18.0	11.5	6.0 – 24.0	12.6

Retail Market				
CATEGORY	2014 Range	2014 Average	2013 Range	2013 Average
Holding Period (Years)	5.0 – 10.0	8.3	5.0 – 20.0	9.9
Income (Growth Rate)	1.5% - 3.0%	2.3%	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% - 10.0%	9.0%	5.0% - 15.0%	9.4%
Going-In Capitalization Rate	7.5% - 10.0%	8.6%	7.5% - 10.0%	8.8%
Terminal Capitalization Rate	8.0% - 11.0%	9.2%	8.0% - 11.0%	9.4%
Discount Rates (Unleveraged IRR)	9.5% - 12.0%	10.3%	9.0% - 12.0%	10.5%
Equity Yield (Leveraged IRR)	11.0% - 18.0%	13.2%	12.0% - 18.0%	13.5%
Tenant Retention Rates:				
Neighborhood	65% - 80%	72%	20% - 80%	64%
Community	70% - 75%	73%	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	10.0	6.0 – 24.0	11.2

Apartment Market				
CATEGORY	2014 Range	2014 Average	2013 Range	2013 Average
Holding Period (Years)	5.0 – 10.0	7.5	7.0 – 10.0	9.0
Income (Growth Rate)	1.5% - 3.5%	2.5%	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% - 7.5%	6.6%	6.0% - 7.5%	6.8%
Terminal Capitalization Rate	6.8% - 9.0%	7.4%	7.0% - 8.0%	7.5%
Discount Rates (Unleveraged IRR)	8.0% - 9.5%	8.7%	8.0% - 9.0%	8.8%
Equity Yield (Leveraged IRR)	10.0% - 15.0%	11.6%	10.0% - 14.0%	11.8%

Industrial Market				
CATEGORY	2014 Range	2014 Average	2013 Range	2013 Average
Holding Period (Years)	7.0 -10.0	8.5	7.0 - 10.0	8.6
Income (Growth Rate)	1% - 3.0%	2.4%	1.0% - 3.0%	1.8%
Operating Expenses (Growth Rate)	1.0% - 3.0%	2.3%	1.0% - 3.0%	2.2%
Vacancy Loss	5.0% - 8.0%	9.0%	10.0% - 15.0%	10.7%
Going-In Capitalization Rate	8.0% - 11.0%	9.1%	8.5% - 12.0%	9.6%
Terminal Capitalization Rate	8.5% - 11.0%	9.6%	8.0% - 12.0%	10.0%
Discount Rates (Unleveraged IRR)	8.5% - 12.0%	10.4%	9.0% - 12.0%	10.9%
Equity Yield (Leveraged IRR)	11.0% - 18.0%	13.3%	11.0% - 18.0%	13.7%
Tenant Retention Rates:				
Office/Whse.	65% - 80%	70.0%	50% - 80%	69%
Distribution	60% - 80%	71.2%	50% - 80%	71%
Months vacant between tenants:				
Office/Whse.	3.0 – 12.0	8.2	6.0 – 24.0	13.0
Distribution	4.0 – 33.0	12.2	6.0 – 36.0	16.0

LAND LEASE RATES

	Range	Average	Change From 2012
Cap Rate (with flat rent)	6.00% - 9.00%	7.17%	-3 basis points
Cap Rate (average 2% ann. escalation)	6.00% - 8.50%	6.55%	-8 basis points

RESERVES, LEASING COSTS, AND TI'S

Include in Cap Rate Analysis	Yes	No
Reserves for Replacement	73%	27%
Leasing Commissions	55%	45%
Tenant Improvement Costs	45%	55%

COST OF SALE

Price Range	Low	High	Average
<\$500K	3%	10%	6.5%
\$500K to \$1M	3%	10%	6.2%
\$1M to \$3M	2%	10%	5.2%
\$3M to \$5M	2%	10%	4.3%
>\$5M	1%	6%	3.1%

ENTREPRENEURIAL INCENTIVE

Basis	Year	Low	High	Median
Improvements Only	2014	10%	20%	15%
	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	2014	8%	18%	12%
	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%
Gross Lot or Unit Sales	2014	25%	50%	30%

LOT PRICE RATIOS

Improved Property Price Range	Lot Value Ratio Range as % of Total Price					Median				
	2010	2011	2012	2013	2014	2010	2011	2012	2013	2014
Starter Housing \$200-\$300K	20-35%	20-25%	20-25%	18-30%	15-30%	25%	24%	25%	22%	28%
Move Up Housing \$300-\$400K	20-30%	20-25%	20-27%	15-25%	17-30%	22%	25%	24%	20%	23%
Luxury Housing \$400-600K	20-25%	20-30%	20-30%	14-25%	18-25%	23%	25%	25%	20%	23%
High End Luxury Housing Over \$600K	20-25%	20-25%	20-30%	18-25%	20-28%	22%	25%	27%	20%	22%
Townhouse		25-33%	25-30%	20-30%	15-32%		28%	25%	20%	25%

AVAILABILITY OF MORTGAGE FINANCING

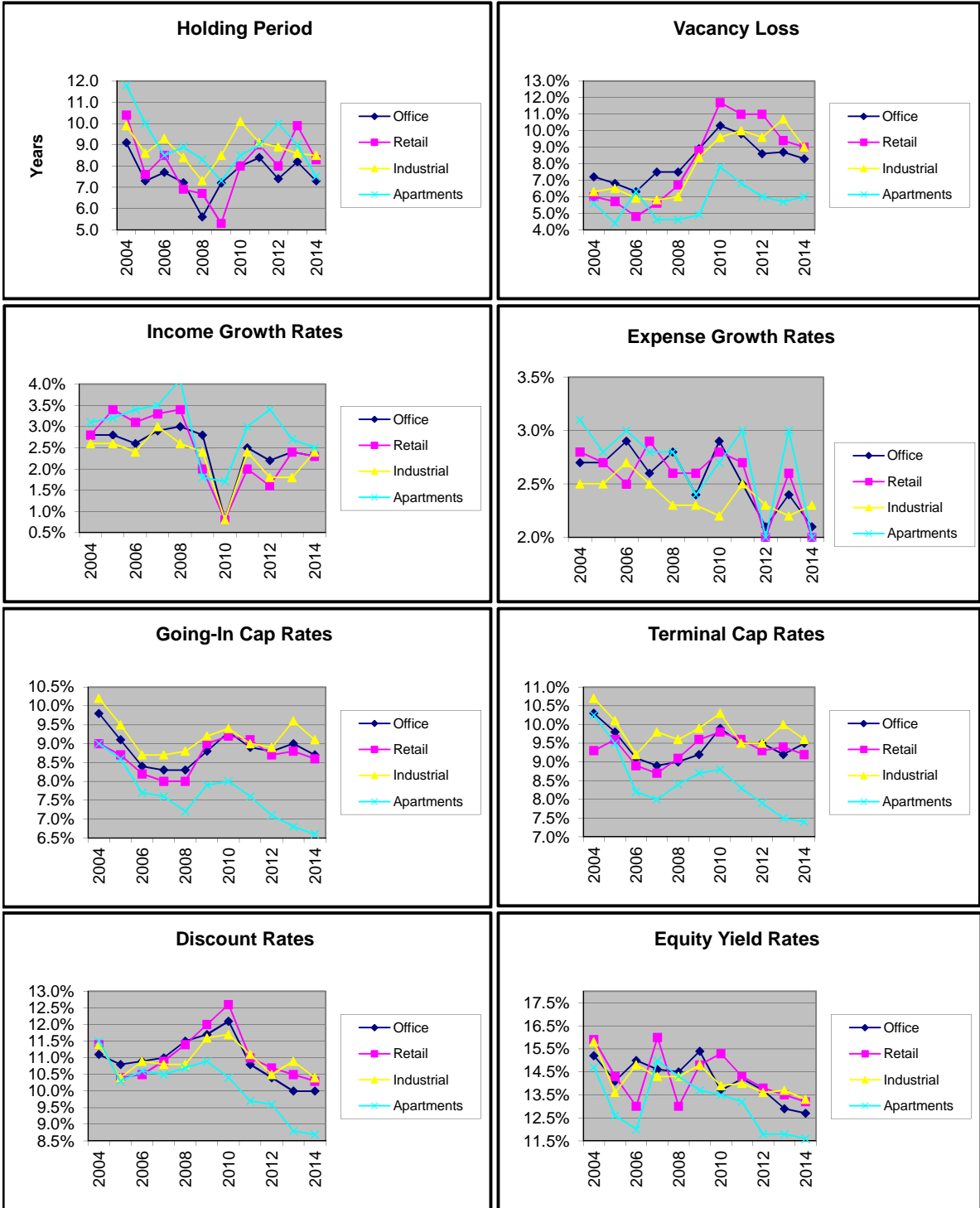
Property Type	Past 12 months	Next 12 months
Apartments	2.6	2.6
Hotels	2.0	2.2
Industrial	2.0	2.1
Office	1.9	2.1
Retail	2.1	2.4
Residential (A & D)	1.4	2.0
Rating Scale:	1 = Inadequate	2 = Adequate
		3 = Abundant

REAL ESTATE LIQUIDITY – MARKETING PERIOD

Property Type	% of Responses		
	< 6 Months	6-12 Months	> 12 Months
Retail			
Free-standing single user retail	57.1%	42.9%	00.0%
Small unanchored retail center	42.9%	42.9%	14.3%
Neighborhood retail center	20.0%	80.0%	00.0%
Community retail center	33.3%	33.3%	33.3%
Regional retail center	33.3%	33.3%	33.3%
Multi-family			
Apartment (> 120 units)	50.0%	50.0%	00.0%
Apartment (< 120 units)	75.0%	00.0%	25.00%
Office			
Large - well leased	66.7%	33.3%	00.0%
Large – poorly leased	16.7%	16.7%	66.7%
Small – well leased < 20,000 sf	71.4%	28.6%	00.0%
Small – poorly leased < 20,000 sf	14.3%	42.9%	42.9%
Industrial			
Small single user	42.9%	57.1%	00.0%
Multi-tenant flex/bulk distribution	14.3%	71.4%	14.3%
Manufacturing Buildings	0.0%	28.6%	71.4%
Special use properties			
Banks, historic, churches, etc.	0.0%	33.3%	66.7%
Land			
Single family development	60.0%	00.0%	40.0%
Multi-family development	66.7%	16.7%	16.7%
Retail	00.0%	40.0%	60.0%
Office	0.0%	20.0%	80.0%
Industrial	0.0%	33.3%	66.7%

This Real Estate Market Survey is an annual publication of Knight, Dorin & Rountrey. ***This is our 22nd 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 2014**
(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

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Harry F. Hoffmann, Jr.
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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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