

### **National Perspective Relative to CY 2013 Commercial Assessment Changes**

Unlike stocks, bonds, and other paper assets, which tend to fluctuate rapidly and react swiftly to economic sentiment, commercial real estate is viewed as a more predictable investment asset. Commercial real estate performance is also sensitive to economic shifts. However, changes tend to happen more slowly with assets usually encumbered with long-term leases which allow commercial assets to better weather downside risk.

The volume of commercial acquisitions in the City involving other commercial property classes was nominal during the course of 2012, with owners of performing assets unwilling to sell, except at a premium. For the most part, purchasers have a clear preference for Class A “core” investment-grade properties which has acted to compress capitalization rates and increase values. In 2013, there will be opportunities in Class B properties, which are generally older but maintain good management and quality tenants, as billions of dollars remain on the sidelines in search of risk adjusted performing assets.

As of January 1, 2013 there were a total of 2,627 commercial properties in the City. Due in large part to the increase in the multi-family rental apartment market, the assessed value of all commercial properties in the City increased \$640.67 million, or 4.55%, from \$14.06 billion in 2012 to \$14.71 billion in 2013.

For the purpose of analysis, the City divides the commercial real estate market in the City into the following classes of property: conventional office buildings; multi-family rental apartments; hotels/motels; industrial warehouses; traditional shopping centers; and general commercial.

### **Unemployment**

The City of Alexandria’s unemployment rate was 4.0% for November of 2012, just slightly higher than the previous year when it was 4.3% according to statistics compiled by the *U.S. Bureau of Labor Statistics*. The November 2012 unemployment rate for the Washington-Arlington-Alexandria Metropolitan Statistical Area was 5.3%. The Commonwealth of Virginia’s December 2012 unemployment rate was 5.5%. All of these rates are significantly lower than the national unemployment rate of 7.8%.

### **Office Market Overview**

The commercial office market can best be described as uneven with values posting only modest gains. While rents were stable, overall vacancy rates generally increased resulting in lower net operating incomes. This phenomenon was, to some extent, reported across all classes of office with property owners offering concessions such as periods of free or reduced rent and substantial build-out allowances in order to attract or retain tenants. Washington D.C. continues to be one of the most attractive global real estate, and even with these lower incomes, the region’s ability to weather economic downturns better than other major office markets in the country is a primary reason for its appeal among investors.

Proximity to Washington D.C. partially insulates the City of Alexandria from large swings in demand and price levels. The diversified tenant base and demand from the Federal Government have historically provided an element of stability in the market. Sub-markets located inside the Capital Beltway (I-495) continue to outperform their counterparts outside the ring and have

maintained tighter dynamics. Despite its strengths, market conditions in Alexandria have remained soft as weak tenant demand kept vacancy elevated. Growth can be primarily attributed to escalated rental rates of in-place leases. Political uncertainty and tenant rightsizing limited leasing and sales activity during 2012.

This property class is segmented by size and includes both large and junior office buildings containing less than 12,000 square feet. The base for this property type in CY 2013 increased 2.29%, or approximately \$104.15 million, from \$4.54 billion in CY 2012 to \$4.64 billion (Attachment 2, Page 2, Line 30, Column 5). The net increase to the base was a result of \$1.1 million in new growth complemented by \$103 million in appreciation.

Three commercial office properties in the City transferred during 2012. These sales are summarized in the table below. In addition to the sales that occurred in the City, staff researched and relied on recent sales of office buildings that occurred in neighboring Arlington and Fairfax Counties.

Property Location	Sale Date	Bldg. Size in Sq. Ft. Net Leasable Area	Consideration	Price/Sq.Ft. of NLA
1940 & 2000 Duke Street	7/24/2012	368,224	\$191,000,000	\$518.71
3601 Eisenhower Avenue	6/28/2012	143,707	\$31,250,000	\$217.46
1920 Ballenger Avenue	4/11/2012	57,761	\$17,091,200	\$295.90

According to statistics compiled by the *CoStar Group*, as of January 1, 2013, the City of Alexandria contained an office inventory of approximately 20.8 million square feet with a direct vacancy rate of 15.3% including Victory Center. Net of the vacant 605,000 square feet that comprises Victory Center, the overall direct vacancy rate is reduced to 11.3%. Northern Virginia as a whole has a vacancy rate of approximately 14.9%. Full service office rents in the City averaged \$30.87 per square-foot in the 4<sup>th</sup> quarter of 2012, compared to \$31.23 in the 4<sup>th</sup> quarter of 2011.

### **Multifamily Apartment Market**

Nationally and locally, the multifamily market showed continued growth throughout 2012. This growth has been based on increasing rental rates and declining vacancy rates, as well as capitalization rates that remained stable from the previous year. The *Apartment Research Market Report* for the Fourth Quarter of 2012 published by Marcus & Millichap states, “Vacancy remains tight and rents are advancing in the Washington D.C. metro despite slowing job growth and a spike in completions.”<sup>1</sup> The same report also states, “Led by a 4.0 percent rise in Virginia, asking rents in the metro will increase 3.5% this year to \$1,461 per month, surpassing the 2.4 percent rise in 2011. Leasing incentives will decline further as effective rents gain 4.4 percent to \$1,397 per month, an increase from a gain of 2.8 percent last year.”

<sup>1</sup> Merrey, Bryn. 2012. “Apartment Research Market Report: Washington D. C. Metro Area, Fourth Quarter 2012.” *Marcus & Millichap Real Estate Investment Services*.  
<https://www.marcusmillichap.com/services/research/webreports/WashingtonDC/Apartment.aspx>.

*The Multifamily Snapshot: DC Metro Third Quarter 2012* published by Cassidy Turley Commercial Real Estate Services states, “Job growth and increases in population in the Washington metropolitan area helped keep apartment fundamentals strong in the third quarter of 2012.”<sup>2</sup> The same report states that “Northern Virginia boasted the highest rental rate increase with a gain of 1.0% during the quarter.”

The City’s multi-family rental apartment market tax base increased 7.05% for CY 2013 (Attachment 2, Page 2, Line 26, Column 5) to \$5.7 billion. This represents a moderate increase from CY 2012 when this class increased \$760.2 million, or 16.83%, over the previous year. Overall, there is a \$377.3 million increase for CY 2013. New growth of \$61.9 million was complemented by \$315.4 million in appreciation.

Only one investment grade apartment, The Aventine of Alexandria, sold in the City in 2012. This property sold on November 27<sup>th</sup> for \$139 million or \$242,160 per unit. Several small apartment properties sold in the City, with sales prices ranging from \$208,000 to \$275,000 per unit.

### **Warehouse Market Overview**

The warehouse market in the City generally conforms to national and regional data. A decrease in capitalization rates, which generally correlates to an increase in values, was reported by both *PWC Real Estate Investor Survey* and *RERC Real Estate Report*. The *RERC Real Estate Report* shows a decrease or no change in capitalization rates for the first three quarters of 2012, and the *PWC Real Estate Investor Survey* reports year-over-year decreases in capitalization rates for all four quarters of 2012. The reported changes in capitalization rates were relatively minor, averaging approximately 21 basis points.

The industrial warehouse property tax base increased \$18.7 million, or 2.76%, for CY 2013 (Attachment 2, Page 2, Line 33, and Column 5) to \$697.5 million. This increase, though less than the increase for 2012, reflects the third year of moderate increases in assessed values for this property type. The number of properties classified as warehouse for assessment purposes has decreased for several years due to continued redevelopment.

Sales of warehouse properties are typically based on redevelopment potential, which would support that the warehouse supply will continue to decrease. Vacancy is concentrated in a few isolated areas, and shows little change from previous years. Redevelopment pressure may be influencing whether space is leased, or at least the length of the lease that the landlord is willing to sign.

### **Hotel, Motel and Extended Stay Market Overview**

During 2012, recovery in the City’s hotel market was uneven. The taxable base for this property type increased by 6.06%, or \$47.52 million (Attachment 2, Page 2, Line 34, Column 5), from

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<sup>2</sup> Brannigan, Philip. 2012. “Multifamily Snapshot: DC Metro, Third Quarter.” *Cassidy Turley Commercial Real Estate Services*.

[http://www.cassidyturley.com/Research/MarketReports/Report.aspx?topic=Washington\\_DC\\_Region\\_Multifamily\\_Snapshot\\_3rd\\_Quarter\\_2012&action=download](http://www.cassidyturley.com/Research/MarketReports/Report.aspx?topic=Washington_DC_Region_Multifamily_Snapshot_3rd_Quarter_2012&action=download).

\$784.37 million in CY 2012 to \$831.89 million for CY 2013. There are a total of 28 hotels in the City with an inventory of 4,922 rooms.

The Washington area was less affected than the national hospitality market due to the presence of the Federal Government and Alexandria's convenient location inside the Beltway. This effectively tempered the decline in hotel room demand during the last three years. Local hotel operators estimate that the Federal government makes up about 30% of demand in the City.

Hotels are considered to be leading economic indicators as they are generally operated on a day-to-day basis and respond quickly to changes in the national economy. Although several hotels in the City performed very well, the data summarized above indicates that CY 2012 overall was not a year of recovery for Alexandria hotels. While occupancy improved slightly, the other two indices fell from the prior years' data.

Income and Expense data received by the City for CY 2011 indicate that well located hotels, particularly near the King Street Metro station, in Old Town and North Old Town operate successfully for the most part. Hotels in less desirable locations, particularly in the West End of the City, have not fared as well.

While occupancy in CY 2012 increased approximately 1% from the previous year, revenue per available room (RevPAR) decreased 0.21% to \$102.95 on the whole.

<b>Measure</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
% Occupancy	72.6%	70.3%	71.0%
ADR	\$149.01	\$146.68	\$144.98
RevPAR	\$108.16	\$103.17	\$102.95
Source: Smith Travel Research - November 2012			

<b>Hotel Class</b>	<b>Percent of Change – CY 2011 to CY 2012</b>		
	<b>Occupancy</b>	<b>Average Daily Rate</b>	<b>RevPAR</b>
Upper Upscale	-2.3	-1.5	-3.7
Upscale/Upper-Mid	4.2	-1.7	2.4
Mid Sale/Economy	-1.3	-1.2	-2.5
Source: Smith Travel Research - November 2012			

The *Smith Travel Research* (STR) report summarizes the hotels in three categories: Upper Upscale; Upscale and Upper Midscale; and Midscale, Economy and Independent.

There was one sale of a hotel in the City in 2012. On December 7, 2012, the 49-room Best Western/Old Colony Hotel sold for \$6.5 million or \$132,653 per room. A representative of the buyers reported that the site has redevelopment potential as it is not developed to its maximum potential, and that redevelopment options will be studied, but for the immediate future it will continue to operate as-is.

The future outlook for the Alexandria hotel market remains mixed. On the positive side, the federal per diem allowance was increased for fiscal year October 2011 to September 2012, and it was widely reported that capitalization rates for hotel properties have compressed, particularly as compared to rates of return available from other investments. Negative factors include the continued uncertainty in the market concerning the Federal government's continuing budget/debt discussions.

### **Shopping Center Market Overview**

The CY 2013 taxable base for shopping center properties is virtually flat increasing 0.12% (Attachment 2, Page 2, Line 32, Column 5) from \$564.48 million in CY 2012 to \$565.15 million. The 2013 increase was entirely attributable to property appreciation of \$0.7 million. There was no new growth as of January 1, 2013 for this land use.

The City has 26 properties classified as shopping centers, the majority of which are considered neighborhood centers that are built around a supermarket as the principal tenant. Neighborhood centers range in size from 30,000 to 100,000 square feet.

Although Landmark Mall has continued challenges, the City's 25 other centers, including the 0.6 million square-foot Potomac Yard Center, have continued to perform well with high levels of occupancy and stable operating positions. It should be noted that the owners of the highly successful Potomac Yard Center are planning for the future redevelopment of the property with up to 7.5 million square feet of mixed-use space including office, retail, multi-family rental and hotel.

Income and Expense surveys supplied to the City indicate that the vast majority of vacancy and collection losses in the City's neighborhood shopping centers are attributable to smaller, in-line space, most suitable to smaller, local, non-credit tenancies. According to analysts at *Delta Associates*, the region's low vacancy is attributable to steady population growth, high incomes, and the fact that fewer people have lost jobs when compared to other metro areas.

The demand for grocery stores is constant at all points of the economic cycle. Therefore, it is not unusual that grocery-anchored shopping centers are more stable investments when compared to other retail property types. Despite the superior performance reported by the core submarkets, landlords are still coping with retaining tenants by renegotiating existing leases and offering concessions in the form of free rent and above standard fit-up allowances.

There were no shopping center sales in the City during 2012. However, there were two sales of a shopping center in 2011. On July 5, 2011 the 146,825 square foot Alexandria Commons shopping center sold for \$64.7 million, or \$450.00 per square foot. This is a one- and two-story center with both retail and office tenancies. The anchor tenants are a Giant supermarket and a

Staples office supply outlet. Occupancy at the time of sale was reported to be in excess of 96%. On December 28, 2011, the non-anchored Pickett Street Plaza transferred for \$6.1 million or \$280.00/SF. This center contains 21,800 square feet of in-line space leased to a variety of local tenants, and was fully leased at the time of sale.

It should also be noted that on December 17, 2011, the owners of the Arlandria Shopping Center on Mount Vernon Avenue received City Council approval for a Development Special Use Permit (DSUP) for a densely developed mixed-use retail and multi-family apartment project. The shopping center currently consists of a 54,265 square foot, strip center with a grocery store and a CVS as anchors tenants. Under the terms of the DSUP, the existing center will be demolished, and a new development consisting of approximately 53,254 square feet of retail space and 478 residential apartments located in two mid-rise buildings would be constructed in its place.

### **General Commercial Overview**

General Commercial properties typically contain uses such as small retailers, repair and service establishments, restaurants, and financial institutions. This property type is broadly defined as commercial properties that contain less than 12,000 square feet of space. The volume of sales in 2012 for this property type was modest, and provided a mixed message regarding the general trends. All property types were primarily valued for CY 2013 based on comparable sales in the City of Alexandria and in neighboring Metro area jurisdictions.

The base for this property type increased 2.89%, or approximately \$38.19 million, from \$1.32 billion in CY 2012 to \$1.36 billion in CY 2013 (Attachment 2, Page 2, Line 29, Column 5). These figures include junior office buildings containing less than 12,000 square feet which are considered part of the general commercial property class.

*The American Community Survey 2007-2011* indicated 3% population growth for the City of Alexandria from 2007 to 2011. The region, including the City, experienced above average population growth and below average unemployment when compared to the nation as a whole (4.0% November 2012). This, in addition to high income levels (\$82,748 Median Household Income) contribute to a strong local economy that is essential for the strength of this property type.