The Pinkard Fund

Investor Update July 2013

Market Update

Apparently sequestration is not going to bring Washington to its knees nor send the country back into recession. While there are individual cases of painful cuts for sure, it is remarkable that so much money can be cut from the budget with such little macro impact. Perhaps these cuts were expected or perhaps they actually provide a boost to the economy through a reduction in the deficit. Whatever the reason, we see less concern about the local economy here in Washington. The region continues to create jobs at a rate of approximately 40,000 per year and real estate investors remain at the table.

Last quarter we wrote about the increase in leasing concessions in the office market. This trend is continuing across the area. Tenants committing to ten year leases downtown are receiving as much as $90 per square foot in tenant improvement allowances and 12 months of free rent. The Northern Virginia office market had slight negative absorption in the second quarter and also experienced a rise in concessions. While the majority of the BRAC relocations have already occurred, their effect continues to be a drag on the market. Vacancy rates remain above 16% in Northern Virginia and there are a lot of obsolete and empty office buildings which will be difficult to lease in this environment. Investment opportunities are available for those who have a longer investment horizon and can bring a creative approach to repositioning or re-purposing these assets.

We are beginning to see the first vestiges of the long predicted softening in the apartment market across the region. While tenant demand remains quite robust, the amount of supply delivering has caused rental increases to flatten and concessions to rise slightly. This appears to be a bigger issue in DC than in Northern Virginia. We predict this trend will have a soft landing because of the continued strong demand across the region as population growth continues. The apartment vacancy rate is expected to rise in 2014, but not enough to cause serious concern.

Several apartment projects sold in the second quarter at record high prices per unit, including The District ($512,000 per unit) and 14 W ($476,000 per unit) in DC and Grayson Flats in Arlington ($492,000 per unit). We have yet to see any reduction in pricing due to higher interest rates, reflecting investors' continued confidence in the long term strength of the market.