WASHINGTON, DC METRO RETAIL OUTLOOK
YEAR-END 2012
A QUARTERLY PUBLICATION OF DELTA ASSOCIATES, SPONSORED BY THE RAPPAPORT COMPANIES

A SUMMARY AT YEAR-END 2012

WASHINGTON AREA ECONOMY SNAPSHOT

• Job Growth: 37,400 new jobs during the 12 months ending October 2012.
• Unemployment Rate: 5.1% at October 2012, compared to the U.S. rate of 7.9% at October 2012.
• Job Growth 2012-2016: to average 41,600 per annum.

WASHINGTON AREA RETAIL MARKET SNAPSHOT

• Grocery-Anchored Vacancy Rate: 4.9% at year-end 2012, down from 5.5% one year ago.
• Grocery-Anchored Asking Rents: up 1.2% during 2012.
• Retailers doing more with less: 600 retail jobs were shed during the 12 months ending October 2012.
• Grocers, discounters, gyms, restaurants, and household goods stores have been actively signing deals in the Washington metro area during 2012.
• Neighborhood Shopping Center Development: 2.5 million SF under construction or renovation at December 2012.

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ECONOMY AND OUTLOOK

The Washington metro area continues its economic expansion at a slower pace than prior expansion periods. The slow growth is due to the uncertainty associated with Federal austerity and the threat of sequestration – a reduced Federal budget that begins January 2013. Despite the 2012 election having passed, no decision has been made at the time of this writing about the outcome of sequestration – leaving companies and consumers on edge.

Despite this, the Washington metro area continues to experience growth due to strengths embedded in the regional economy such as a highly educated work force, a diversified economy (as compared to the dependence of the region on the Federal establishment in the 1970s), growing tech and health care industries, a high quality of life, a strong housing market with sustained values, and as a destination for corporate and association headquarters moves.

Although the Washington metro area added 37,400 jobs during the past 12 months, other metro areas continue to outpace it in job gains. New York, Los Angeles, and Houston topped job growth, spurred by growth in Professional/Business Services.

### RETAIL PAYROLL JOBS

**Washington Metro Area**

<table>
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<tr>
<th>YEAR</th>
<th>RETAIL EMPLOYMENT</th>
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<tr>
<td>2006</td>
<td>270,200</td>
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<td>2008</td>
<td>265,500</td>
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<td>2009</td>
<td>251,600</td>
<td>(13,900)</td>
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<tr>
<td>2010</td>
<td>254,800</td>
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<tr>
<td>2011</td>
<td>256,300</td>
<td>1,500</td>
</tr>
<tr>
<td>2012*</td>
<td>253,700</td>
<td>(600)</td>
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*Employment total at October 2012; change reflects the 12 month period ending October 2012.*


The Education/Health sector was the leader in job growth in the Washington metro area during the past 12 months, adding 12,000 jobs. The retail sector shed 600 jobs in the Washington metro area, a decline of 0.2%, during the 12 months ending October 2012. This compares to a national rise of 1.0%. Considering the continued expansion of retailing in the Washington region, this payroll reduction is a real testament to the industry’s drive to efficiency – to do more with less.
We expect the Washington metro area economy to progress slowly during 2013. Growth will be sluggish compared to past recovery cycles, as consumers and businesses remain cautious about the economy. We expect economic conditions in the Washington region to improve after the start of 2013, as the outcome of the Federal budget is better established.

In consultation with Dr. Stephen Fuller of George Mason University, we estimate that 36,000 payroll jobs will have been added to the Washington metro area economy during 2012, when the figures are finalized. We expect the Northern Virginia substate area to be the leader in job growth with 18,000 new jobs in 2012. The Suburban Maryland and District substate areas should produce 6,200 and 11,800 new jobs, respectively. We project job growth in the Washington metro area to gain traction during 2013, as 42,000 new jobs will be added to the economy. Private sector firms relocating operations to the Washington area will bolster local employment in the period ahead.

From 2012 to 2016, we expect the Professional/Business Services sector to create over 46,500 jobs. We expect most of these positions to be created in the Management, Scientific, and Technical Consulting Services and Computer Systems Design andRelated Services sectors. We project the Education/Health andLeisure/Hospitality sectors to closely follow in job growth, adding45,500 and 37,000 positions through 2016.

Three of these employment categories alone (Professional/Business Services, Education/Health, and Financial Services) will generate demand over the next five years for 23 million SF of office space and tens of thousands of Class A apartments. This in turn creates demand for retail. Through 2016, spurred by rising job gains in other sectors, the retail sector is projected to grow 9,500 jobs to support a robust retail industry.

**RETAIL MARKET CONDITIONS**

The Washington metro area has over 135 million SF of shopping center retail space, inclusive of all types of retail, in over 1,200 shopping centers. Just over half of the Washington area shopping centers are over 25 years old, while only 14% are aged ten years or less. Although new retail projects have entered the market, older centers remain the bulk of retail space – providing opportunity for renovation and upgrade.
The metro area has 27.5 SF of shopping center retail space per capita as of year-end 2012, compared to the national average of 23.7. Although Northern Virginia and Suburban Maryland are above the national and Washington metro averages, the District remains underserved at just 8.0 SF of shopping center retail space per capita, as population growth outpaces retail development – an obvious opportunity for retail developers and retailers alike.

**GROCERY-ANCHORED SHOPPING CENTER MARKET CONDITIONS**

Given the demand for groceries at all points of the economic cycle, grocery-anchored shopping centers maintain the greatest stability compared to other retail property types. Therefore, the analysis that follows is focused on grocery-anchored shopping centers.

Of the total retail inventory in the Washington metro area, 55.8 million SF is located in 317 grocery-anchored shopping centers, which is just under half of the total shopping center retail inventory in the metro area.

The grocery-anchored shopping centers inventory is down from 57.6 million SF at year-end 2011, as a handful of grocery stores shuttered within centers over the past year and were therefore removed from the inventory. Notably, Delhaize America has been closing underperforming Food Lion stores, which includes Bloom and Bottom Dollar stores. Of the 113 stores that closed nationwide, eight closed in the Washington metro area. As centers sign a grocery store as a tenant, the center will return to our inventory.

We perform an annual year-end survey of over 300 Washington area grocery-anchored shopping centers, and tabulate vacancy and rent data. The adjacent charts summarize trends from 1999-2012.

The metro-wide vacancy rate for grocery-anchored shopping centers edged down to 4.9% at year-end 2012, from 5.5% at year-end 2011. The vacancy rate in Suburban Maryland declined to 4.5% at year-end 2012, from 5.6% one year ago. Northern Virginia vacancy was 5.3% at year-end 2012, down slightly from 5.5% one year ago. The Suburban Maryland vacancy rate experienced a sharper decline over the past year, as a handful of larger deals were inked and a handful of centers with elevated vacancy rates were removed from our inventory due to a vacating grocery store. In addition, the Suburban Maryland inventory is smaller compared to Northern Virginia, which makes the vacancy rate more volatile.
The core and inner ring submarkets both experienced a 70 basis point decline over the past year, as newer, closer to the core centers are in demand due to tenants trading up in quality. Both the core and inner ring submarkets hold vacancy rate averages that are under the Washington metro area vacancy rate of 4.9% at year-end 2012. This compares to the outer ring experiencing a 60 basis point decline in vacancy. Despite this decline, the outer ring submarkets remain above the Washington metro area vacancy rate at year-end 2012.

### Vacancy Rates

**Grocery-Anchored Shopping Centers**

<table>
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<tr>
<th>JURISDICTION</th>
<th>2012</th>
<th>2011</th>
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<tbody>
<tr>
<td>Core</td>
<td>4.3%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Inner Ring</td>
<td>4.1%</td>
<td>4.8%</td>
</tr>
<tr>
<td>Outer Ring</td>
<td>7.3%</td>
<td>7.9%</td>
</tr>
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</table>

**Washington Metro**

4.9% 5.5%


**Rental rates at grocery-anchored centers increased 1.2% in 2012**, after rising 2.1% in 2011. Metro-wide average in-line tenant rents were $32.04/SF at year-end 2012, compared to $31.65/SF at year-end 2011. Suburban Maryland rents were $32.30/SF, a 1.4% rise from year-end 2011. Northern Virginia rents were $31.47, up 1.0% from year-end 2011.

The core submarkets experienced a 2.3% rise in asking rents during 2012, as tenants sought to remain in the core. Also, this area has limited availability, with just under 200,000 SF of available space on the market. The inner and outer rings experienced rent increases at a less robust pace, 0.9% and 1.6%, respectively, as these submarkets have less demand and a greater amount of available inventory. Of note, the inner ring has the most available SF at 1.6 million SF.

### Asking Rents

<table>
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<th>JURISDICTION</th>
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<th>YR % CHANGE</th>
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<tr>
<td>Core</td>
<td>$42.30</td>
<td>2.3%</td>
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<tr>
<td>Inner Ring</td>
<td>$32.49</td>
<td>0.9%</td>
</tr>
<tr>
<td>Outer Ring</td>
<td>$26.98</td>
<td>1.6%</td>
</tr>
<tr>
<td>Washington Metro</td>
<td>$32.04</td>
<td>1.2%</td>
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</table>


Source: Delta Associates; December 2012.
Overall, newer grocery-anchored shopping centers outperformed market averages during 2012. Centers built after 1999 in the Washington metro area hold a 4.6% vacancy rate at year-end 2012, a 190 basis point decline from 6.5% at year-end 2011. Centers built in 1999 or earlier hold a 5.0% vacancy rate at year-end 2012, a 20 basis point decline from 5.2% at year-end 2011.

Grocers, discounters, gyms, restaurants, and household goods stores have been actively signing deals in the Washington metro area during 2012. We expect the vacancy rate to decline during 2013. Although some underperforming retailers will close, there will be new and expanding retailers looking to take the vacated space. Top tier shopping centers in prime submarkets will have greater ease backfilling space.

NEW DEVELOPMENT

There are 10 notable grocery-anchored shopping centers, totaling 2.5 million SF, under construction or renovation in the metro area at December 2012. A handful of notable projects are under development:

- **Cathedral Commons**: Bozzuto and Southside Investment Partners have started redeveloping a Giant Food store along Wisconsin Avenue near the National Cathedral in the District of Columbia. The $130 million project, Cathedral Commons, will include 128,000 SF of retail – inclusive of a new 56,000 SF Giant Food store, 137 apartments and 8 townhomes. The project is scheduled to be completed by year-end 2013.

- **Dunn Loring Metro**: JBG has started on a mixed-use project near the Dunn Loring Metro station in Fairfax County, VA. Once completed, the project will include 628 residential units, 75,000 SF of ground-floor retail, and a 50,000 SF Harris Teeter.

- **Dulles Landing**: Beatty Management Companies started on Dulles Landing, a 600,000 SF mixed-use development project, located in Loudoun County during the 3rd quarter. Walmart, with a grocery component, will anchor the center. The project is scheduled to be completed by Fall 2013.

- **Laurel Town Center**: Lerner Enterprises and the Tower Companies have started demolition on Laurel Mall, a mall that gradually lost shopper traffic. On the site, the companies plan to build Towne Center at Laurel, a mixed-use development that will include 435 residential units and 400,000 square feet of retail, including a grocery store and a movie theater. The $130 million project is projected to deliver by the fall of 2014.
There are additional grocery-anchored shopping centers in the planning stages that are not included in the adjacent table, some of which may deliver by 2013/2014. As lending continues to loosen, groundbreakings should continue to rise. Given the long-term demand for goods in the metro area, we believe developers will look to deliver new product by 2014, as the market strengthens further.

At year-end 2012, to construct a shopping center in the Washington metro area, the minimum rent needed was $24.00/SF, on a triple net basis, up from $22.00/SF one year ago. The current average asking rent for grocery-anchored shopping centers at year-end in the metro area is $32.14/SF, indicating rents can be met at newly constructed centers. In fact, the average rent in each surveyed jurisdiction currently exceeds this $24.00/SF threshold.

Cash-on-cost return requirements for shopping centers declined to 8.8% in 2012, from 9.1% one year ago, as investors have remained confident in the Washington area market – particularly for retail. With low mortgage rates, investors are more willing to accept lower rates of return.

We expect few spec projects to move forward in the near-term. Rather, projects with notable pre-leasing and financing in place will be the norm. However, given the long-term demand for goods in the metro area, we believe developers will look to deliver new product during 2014, as the market strengthens.
There were eight notable investment sales of grocery-anchored shopping centers in the Washington metro area suburbs from January through November 2012. Sales volume totaled $453 million ($301/SF) from January through November 2012, compared to $454 million ($276/SF) during all of 2011.

Most recently, Katz Properties purchased Festival Shopping Center in Prince William County for $15.8 million ($134/SF) in August 2012. This center is anchored by Global Food. This deal follows the purchase of Westgate Plaza in Prince William County for $33.8 million ($207/SF) at the start of the year. Westgate Plaza is anchored by Giant Food.

Grocery-Anchored Shopping Centers scored a 6.4 for investment worthiness in 2012, up from 6.1 in 2011, according to respondents to our annual Market Maker survey. Grocery-anchored shopping centers are typically a favorite with investors during soft economic periods, since consumers still need groceries and basic goods during lean times. In addition, consumers are increasingly shifting to online shopping. This shift impacts malls and power centers moreso than grocery-anchored shopping centers, concentrating the attention of retail investors on grocery-anchored shopping centers.

Our Market Maker Survey respondents noted that cap rates for Class A grocery-anchored shopping centers have declined to 6.39% at October 2012, from 6.42% one year ago. This decline is a result of low interest rates and increased demand for quality Washington metro real estate assets. We expect demand for quality assets to rise as...
equity-laden investors take advantage of this market. Given the tepid nature of the economy, we believe any further decline in cap rates during 2013 is likely to be modest. Therefore, most price increases will likely be earned from property performance improvement.

THE BOTTOM LINE

We expect the Washington metro area retail market to continue its recovery during 2013. The automatic across-the-board Federal budget cuts remain a dagger over the heads of businesses and consumers at the time of this writing. This uncertainty has hampered economic growth. We believe the cuts will not take place as scheduled. Rather, we expect a bill will be passed either for a delay until after 2013 or a less aggressive alternative plan to start in 2013. Either way, the region is in for slower growth than it is used to in an expansionary cycle.

We project hiring to remain focused on high-skilled positions, particularly within the Professional/Business Services sector, which should generate 46,500 new jobs through 2016. This sector generates high-wage jobs – the type that spend retail dollars, occupy office space, buy homes, and rent Class A apartments.

As the economy gradually improves, consumers will regain confidence, which will help stimulate retail spending to keep the vacancy rate lowered in the Washington metro area. We expect the vacancy rate for grocery-anchored shopping centers to remain low during 2013, as new retailers enter the Washington metro market and existing retailers look to expand. As demand improves, we expect asking rents to rise by approximately 2.0% to 3.0% during 2013.

We expect the core and inner ring submarkets to rebound at a faster clip, compared to the outer ring submarkets, as close-in centers have been able to keep and lure quality tenants. We expect investors to target core, stable, community/neighborhood centers.

Given demand for Class A space, we believe property owners will continue to invest, where the cash is available, in repositioning existing under-performing assets – either upgrading or transforming shopping centers. Currently, tenants seeking space are interested in newer, Class A space with high foot traffic. Centers that focus on everyday needs, such as groceries and other necessities, remain successful during economic downturns or slow-growth periods.

Given high disposable incomes and a solid, highly educated employment base in the area, we expect the Washington area retail market to remain one of the premier retail markets in the nation.
DELTA ASSOCIATES

Delta Associates is a firm of experienced professionals offering consulting, valuation, and data services to the commercial real estate industry for over 30 years. The firm’s practice is organized in four related areas:

1. **Valuation** of partial interests in commercial real estate assets.
2. **Consulting**, research and advisory services for commercial real estate projects, including market studies, market entry strategies, asset performance enhancement studies, pre-acquisition due diligence, and financial and fiscal impact analyses.
3. **Litigation support**, including dispute resolution, from forensic fact-finding to mediation and expert witness services. Damages, material adverse change, and contract disputes are specialties.
4. **Subscription data** for selected metro regions for office, industrial, retail, condominium, and apartment markets.

For more information on Delta Associates, please visit [DeltaAssociates.com](http://DeltaAssociates.com).

Delta’s Retail Practice Team includes: David Parham, Senior Vice President; Alexander (Sandy) Paul, National Research Director; and Elizabeth F. Norton, Mid-Atlantic Research Director.

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THE RAPPAPORT COMPANIES

For more than 25 years, The Rappaport Companies has provided Washington, D.C., Maryland and Virginia with professional real estate services centered exclusively on the retail segment. Founded by Gary D. Rappaport, SCSM/SCLS/SCMD/SCDP, The Rappaport Companies provides the following services for some of the area’s most prominent landlords, retailers, asset managers, commercial real estate companies and financial institutions:

- Property Management
- Landlord & Tenant Representation
- Construction Management
- Marketing
- Consulting & Receivership Services
- Development

Mr. Rappaport is a past Chairman and Trustee of the International Council of Shopping Centers (ICSC). He serves on the Washington, D.C. Economic Partnership Board and is the author of “Investing in Retail Properties,” which explains how to structure real estate partnerships for sharing capital appreciation and cash flow. The information contained in the book is the basis for classes he teaches for ICSC’s University of Shopping Centers and Executive Learning Series and as a guest instructor at Johns Hopkins, Georgetown, American and George Mason universities.

Led by President Henry Fonvielle, the Rappaport Retail Brokerage team of Bill Dickinson, Michael Howard, Melissa Webb, John Hayden, Susan Bourgeois, Will Collins, Kristin Perry, Pat O’Meara, Jim Farrell, Michael Kang, Jason Yanushonis, Shawn Carrington, and Lindsey Floyd includes the region’s top experts in the retail industry.

<table>
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<tr>
<th>PROPERTY MANAGEMENT, CONSULTING &amp; RECEIVERSHIP:</th>
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<th>LEASING &amp; BROKERAGE:</th>
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<td>Larry Spott</td>
<td>Henry Fonvielle</td>
</tr>
<tr>
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<td>Executive V.P. Dev.</td>
<td>President</td>
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