INVESTMENT

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OLD DOMINION UNIVERSITY

HAMPTON ROADS
REAL ESTATE
MARKET REVIEW

2010

GENERAL Overview

Most people involved in the commercial real estate investment market are relieved that 2009 is over. We began 2009 not knowing how far we had to fall, and we begin 2010 feeling like we are coming up from the bottom.

2009 will be remembered nationally as the transition year from the initial panic of the financial markets and historic economic recession to hopefully the bottom of the investment market. Real estate investors realized during 2009 that the "super-cycle" of debt financing was over for the foreseeable. Going forward, real estate investments will require much more equity than in the fantastic investment sales run during 2005, 2006, and 2007.

Investors are expected to have renewed interest in commercial real estate beginning in 2010. Many predict that the sector will benefit strongly as the economy recovers and capital flows return. Well-managed commercial real estate should continue to offer returns higher than bond investments. The 20%-plus returns reported during the top of the investment cycle will be far less likely obtained with the more conservative underwriting in place during 2010.

While some investors may try to "buy at the bottom," most experts believe that investors should instead focus on solid value investing no matter the exact market timing. Assets with stable cash flows and credit tenants without significant capital needs will remain in high demand with the debt markets showing signs of solidifying for these specific properties. Assets that have high vacancy, extensive pending lease expirations, and/or significant deferred maintenance will find the capital markets remaining very difficult during 2010.

The Hampton Roads region has out-performed many national industry benchmarks and should compete well for investment capital considering all Mid-Alantic and Southeast markets. Numerous substantial investment transactions did occur during 2009, and most experts predict more should occur during 2010.

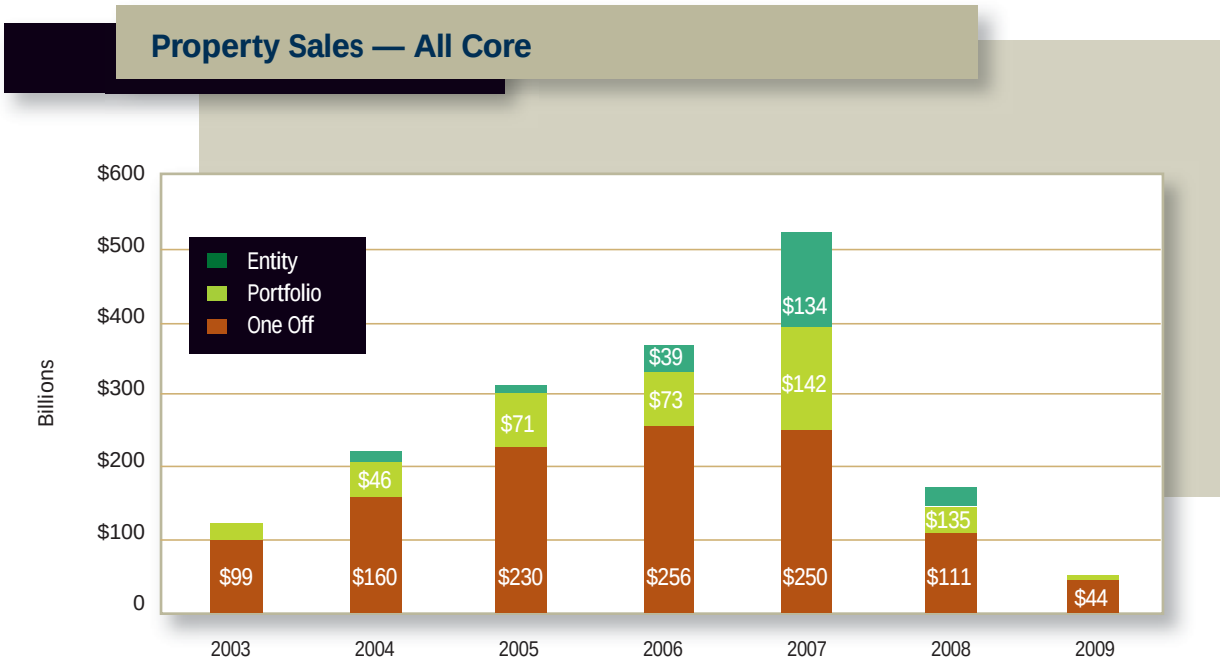
Capital Markets During 2009

2009 was a very slow year for investment sales brokers nationwide. The $52 billion in 2009 deal volume was a 90% drop from the $522 billion tracked just two years earlier. In fact, the 2009 deal volume was the lowest in nearly a decade as the historical graph below illustrates. The good news is that the volume and activity were noticeably stronger in the fourth quarter of 2009, perhaps building momentum for an even better 2010.

As 2009 dragged on, investors were able to achieve even better pricing towards the end of the year for the assets that closed. Value declines are widely reported to average more than 40% off pricing peaks recorded during 2007. Cap rates on all properties climbed, with only multi-family properties and assets in top tier markets having sale pricing that remained close to previous years. The unique availability of multi-family financing, in large part explains this relative outperformance by one property type. The stronger relative pricing in top tier markets (i.e. Washington, D.C.) can be attributed to the presence and interest of institutional and foreign buyers who tend to be less reliant on individual asset debt financing.

There is, however, a general feeling that buyers and sellers are beginning to have more common ground on what fair sales prices should be. The technical term for this is the "Bid-Ask Gap" and, by many accounts, it is becoming narrower as we begin 2010. Of course, many opportunistic buyers continue to believe that sales prices have to fall further to make investments worthwhile. Any significant jump in volume will require a return of larger deals and portfolio transactions which have remained low to date with the limited large-financing options available. Investors with cash are poised to take advantage of highly attractive buying opportunities at cyclical lows, while distressed owners continue to hold off on selling into this market if possible.

Capital Markets Activity Remains Limited



Source: Real Capital Analytics, January 2010

Growth In Distressed Assets Continues

The most prominent investment market story of 2009 was the steady growth in distressed assets. The chart below illustrates that commercial real estate loan balances that were higher than the value of the underlying assets grew dramatically during 2009 to a level up four-fold from year-end 2008. Furthermore, for as bad as it has been to date, predictions are that 60% of loans maturing between 2012 and 2014 will also have negative equity. Real Capital Analytics reports that over $160 billion of significant commercial real estate mortgages are currently in default; a potentially large percentage of $500 billion of commercial real estate mortgages scheduled to mature over the next few years may be in default as well. Loan extensions executed in 2010 and 2011 will help borrowers in the near term, but they also contribute more risk to the system in the years ahead.

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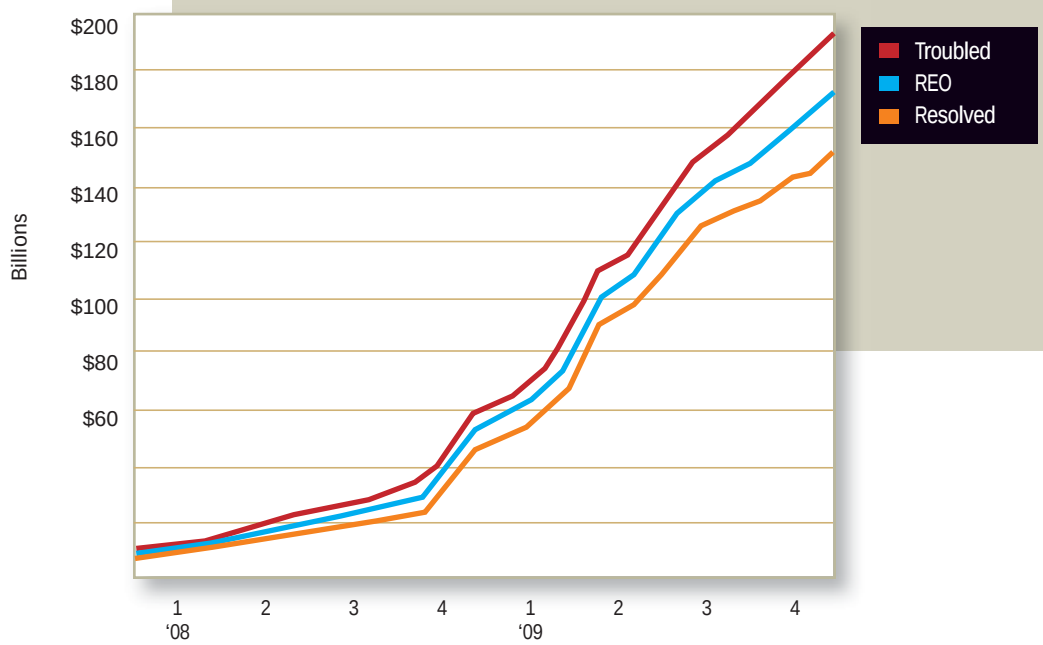
The United States government has implemented programs potentially beneficial to the industry. The combined $1.5 billion TARP program and stimulus package have provided some stability to the financial markets, but long-term benefits remain unclear. Credit flow certainly has not returned freely, and most real estate owners remain highly frustrated with the difficulty of getting a loan. An October 2009 bank regulator policy statement called "Prudent Commercial Real Estate Loan Workouts" encourages loan modifications and extensions for creditworthy borrowers which helped avert further 2009 problems.

Many owners of distressed assets are asking the extremely difficult question of "Is it the best use of my cash to invest it back in this deal I already own?" Real estate professionals are hoping that economic fundamentals and asset pricing rebound more quickly than most economists expect. A recovery will help more loans be re-financeable without dramatic equity infusion.

Cumulative CRE Distress



Source: Real Capital Analytics, January 2010

The Commercial Real Estate Lending Market Today

Conservative underwriting remains the standard with lower leverage capital not even available for all deals. The deals most likely to be financed have substantial owner equity, high-quality sponsors, high-quality assets, and stable tenancy. Deals not meeting any of these criteria will face tough challenges to find a loan that will meet owner objectives. For the foreseeable future, cash will remain king when it comes to securing a loan. The cautious approach to lending by institutions that are in the lending market is a large part attributable to the current state of bank balance sheets and the underlying fundamentals of the economy and the real estate industry.

Bank balance sheets are already overloaded with all types of real estate loans, many with a high volume of troubled assets. The FDIC estimates that 60% of loans held by banks during 2009 were property-based (including both residential and commercial assets). Many banks are closely monitoring their capital ratios as delinquency rates continue to rise.

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Many experts believe that financing will become more available as the national job market improves. With over eight million jobs lost during the United States recession so far, the employment markets have considerable ground to make up. The resurgence in real estate fundamentals, such as rents and occupancies, will unfortunately lag the resurgence in the overall economic recovery.

Loans are most readily available for multi-family assets which benefit from the active and less conservative approach to date of Government Sponsored Enterprise ("GSE") lending. The primary GSE's are known as Fannie Mae and Freddie Mac. Unfortunately, there are no GSE's making loans on other commercial property types such as office buildings and shopping centers.

One common method of addressing more conservative lender underwriting seen frequently during 2009 was the offer of seller financing. Seller financing is a form of lending in which the seller makes a secured loan to the buyer to finance a portion of a property's sale price. Favorable terms such as "below-market interest rate" and "interest only" is included in seller financing in many cases. Clearly, many owners who want to be sellers do not want to wait for the lending markets to recover such that seller financing would no longer be necessary.

2009 Transactions in Hampton Roads

Like all national markets, Hampton Roads saw a dramatic decline in investment sales volume in 2009 versus recent years. Frozen credit markets and concerns of when market fundamentals will begin to improve contributed to lower capital flows across all property types.

That being said, by many reports the Hampton Roads area has maintained employment levels far better than many other regions of the country. The military and port presence in Hampton Roads, combined with our relatively diverse local economy, has helped the area remain stable and attract real estate investors looking for less risk relative to other more volatile markets.

The Emerging Trends in Real Estate 2010 survey, undertaken jointly by PricewaterhouseCoopers and Urban Land Institute, ranked Hampton Roads favorably among over 50 nationally-tracked markets. Among the ranking of "U.S. Markets to Watch" in terms of commercial/multi-family investment, Hampton Roads was ranked ahead of many prominent Mid-Atlantic and Southeast markets including Baltimore, Orlando, Miami, Jacksonville, and Tampa.

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The chart below summarizes the 11 commercial transactions closed in Hampton Roads in 2009 with sale prices of $5 million or more. Three of the largest four sales were multi-family, which is logical given the stronger debt availability for this asset class. It is also noteworthy that three of the qualifying transactions (one office asset and two retail assets) were sales to owner-occupants, a recent national trend.

2009 Sales Transactions In Hampton Roads Of $5 Million Or More

Property Name	Property Type	Purchase Price	Size	$/Size	Purchaser	Seller
Springhouse @ Newport	Multi-Family	$29,250,000	432 Units	$67,708	Bluerock RE, LLC	AIMCO
Harbour View East	Retail	$23,201,954	91,237 SF	$254	Halvorsen Real Estate	Landonomics
The Townes @ Jones Run	Multi-Family	$23,000,000	300 Units	$76,667	Breeden Company	Newport Housing, LP
Woodshire Apartments	Multi-Family	$22,100,000	288 Units	$76,736	Harbor Group International	AIMCO
Lynnwood Plaza	Office	$7,800,000	8,1445 SF	$96	ADS Tactical	Parkway Properties
London Bridge Shopping Center	Retail	$7,250,000	118,705 SF	$61	River City Capital, LLC	First Republic Corporation
5112 Virginia Beach Boulevard	Retail	$6,000,000	89,000 SF	$67	Restaurant Depot	Virginia Beach Associates, L.P.
Country Club Apartments	Multi-Family	$5,590,000	102 Units	$54,803	Country Club Estates, LLC	Estate of Billie D. Gordon
875 Middle Ground Boulevard	Industrial	$5,161,370	62,052 SF	$83	Advanced Technologies	Dean Parkinson
Greenbrier Portfolio	Industrial	$5,150,000	60,200 SF	$86	J & G Greenbrier Properties	WBS Realty Greenbrier
110 S. Independence Boulevard	Retail	$5,000,000	38,414 SF	$130	City of Virginia Beach	Cardinal Capital