Construction is underway at WestEnd Alexandria. This rendering shows two of the first residential buildings, set to open in 2025.

ALEXANDRIA STATE OF THE MARKET

2022 YEAR-END REPORT

Despite economic headwinds, Virginia Tech continued construction of its Innovation Campus, holding a topping out ceremony in early 2023.

DEVELOPMENT TRENDS

- Due to volatile interest rates, the lending activity from large banks became nonexistent toward the end of the year, thus opening the opportunity for community and regional banks to take a larger share of the lending market. Overall, the number of loan closings dropped 4.7% over the prior year.
- Retail development has been limited to single-tenant build-to-suits and ground-floor retail spaces in mixed-use projects.
- Office development has become virtually nonexistent. Developers are struggling to obtain financing due to the lack of significant prelease commitments and the uncertainty of future space utilization. Any new development will likely be build-to-suit and/or require at least 70% of the project to be preleased.
- Development is expected to slow, and some projects will stall as rising construction costs, labor shortages, and increasing interest rates decrease developers' return on investment.

Source: Bisnow, JLL, Deloitte

NOTEWORTHY FUTURE PROJECTS

1101 King Street
OLD TOWN

Office-to-residential conversion owned by American Real Estate Partners, who plans to redevelop it into 210 residential units with ~17,500 SF of ground floor office and retail. Cooper Carry will lead the design of the asset's repositioning.

424 N. Washington Street
OLD TOWN

Potomac Crescent Waldorf School will relocate into this ~10,000 SF former office building, which will provide programming for approximately 155 kindergarten through 5th grade students.

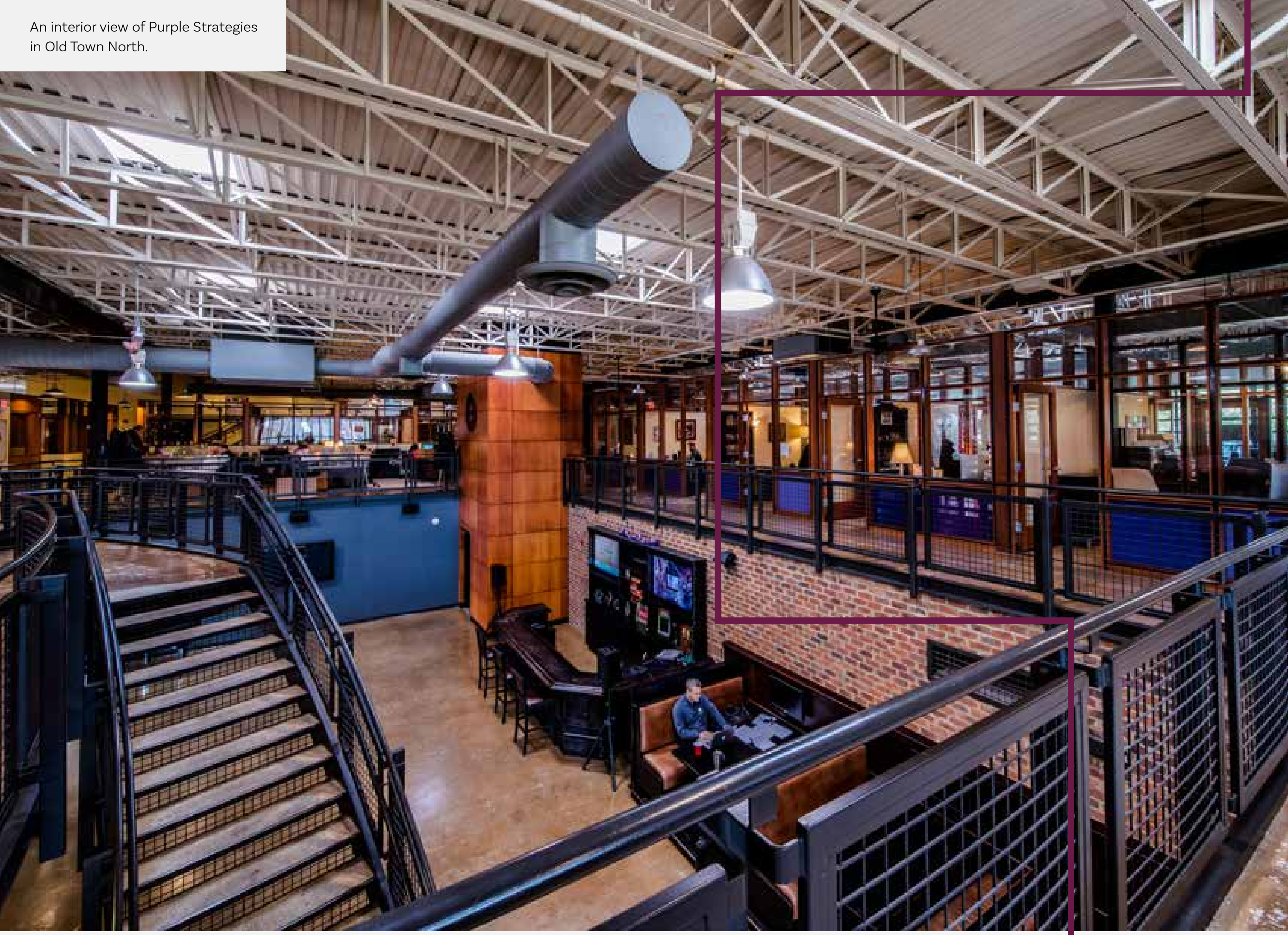
625 First Street
OLD TOWN NORTH

After being acquired by Electra America Hospitality Group in 2021, this former Holiday Inn in the Old Town North neighborhood is being renovated into the luxurious Hotel AKA. Designed by architect Piero Lissoni, this project will feature 180 rooms and first-class amenities such as a Zen garden, café, lounge, and cinema.

901 N. Pitt Street
OLD TOWN NORTH

Carr Properties will convert this existing three-story office building to an eight-story, 377,369 SF multi-family building. It will feature ~250 units with 5,700 SF of retail and a 6,500 SF arts anchor on the ground floor. Approximately 16 of the residential units are proposed to be affordable at 50% of the area median income.

An interior view of Purple Strategies in Old Town North.



OFFICE UPDATE

2022 OFFICE TRENDS

In 2022, office leasing activity declined throughout the region as post-pandemic questions on office space utilization went unanswered and the potential for a future recession remained. With the federal government still waffling on its own return to office policy, the region's largest economic driver only adds to the uncertainty around the future of the office market.

Rising interest rates, inflationary pressure, and construction costs—increases of as much as 14% by some estimates—are major hurdles to office leasing as they continue to drive up the cost of build outs and relocating, despite the relative recovery of supply chain issues. Landlords are attempting to recover these costs in the form of increased rent and longer lease terms.

Sources: Cushman, Transwestern, CBRE

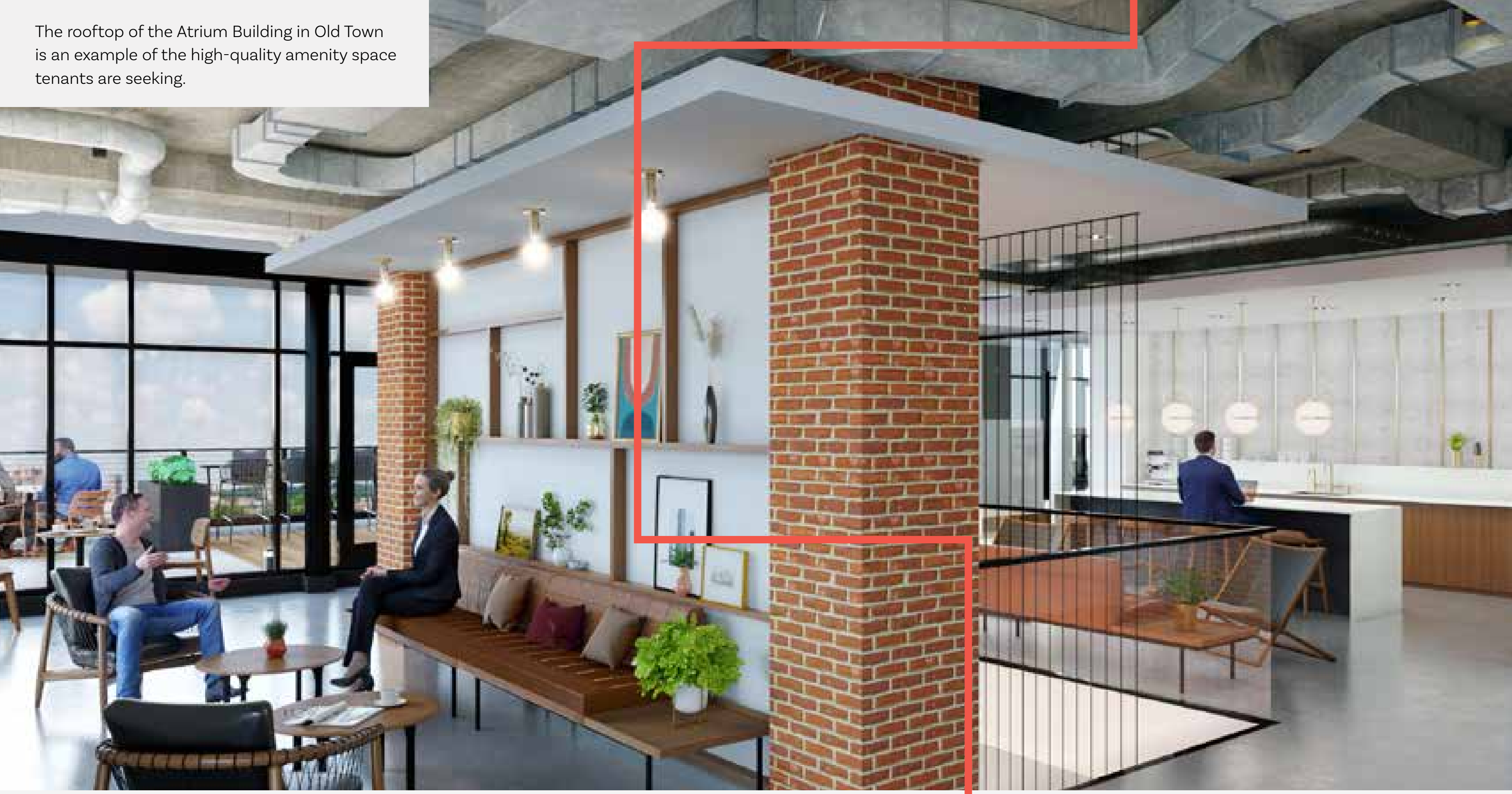
NET ABSORPTION +474,581 SF

- Significant positive net absorption in the Alexandria market can be attributed to the delivery of the approximately 370,000-square-foot headquarters building for the Institute for Defense Analyses (IDA) at 701 E. Glebe Road in Potomac Yard. The IDA relocated from 4850 Mark Center Drive, which the City of Alexandria purchased to consolidate City offices, including the entire Department of Community and Human Services.
- Without the IDA building delivery, the Alexandria office market remained stagnant with less than 1% of net positive absorption.
- The Washington metro area office market showed negative net absorption of approximately 984,465 square feet during 2022. This decline is primarily due to companies allowing their leases to lapse and beginning to shift to remote or hybrid work environments.
- According to Kastle Systems, in-office occupancy was approximately 45% by the end of 2022, up from 7% at the beginning of the year. While space utilization is expected to rise steadily in 2023, negative net absorption is likely to continue as companies continue to right-size their office footprints. The absorption rate will be slightly offset, though, as offices convert to other uses and are removed from inventory.

VACANCY RATE 14.2%

- The vacancy rate in Alexandria remains relatively unchanged over the past 12 months; however, it does not reflect a stabilized market. Leasing volume has dramatically decreased and will likely continue as the demands for more flexibility and hybrid work remain the norm. The vacancy rate is offset by the delivery and full occupancy of the 370,000-square-foot Institute for Defense Analyses headquarters building.
- In 2022, the GSA announced that the U.S. Patent and Trademark Office renewed their lease for a 5-year term but would reduce its approximately 2.5 million-square-foot campus by 760,000 square feet, or one-third of its leased portfolio within the Carlyle office neighborhood in 2024.
- This announcement is offset by the news that Five Guys will relocate its 40,000-square-foot corporate headquarters to the same submarket, a relatively lateral move from its existing headquarters in Woodbridge, Virginia. The lease is smaller than the company initially sought pre-pandemic.

Sources: Costar, Newmark, Kastle Systems



The rooftop of the Atrium Building in Old Town is an example of the high-quality amenity space tenants are seeking.

OFFICE UPDATE

FUTURE TRENDS

- With office utilization patterns still uncertain, organizations will look for flexibility by seeking shorter lease terms to determine optimal office needs. Many companies expect that the next three years will be a critical time to redefine workplace strategy and create flexible, tech-enabled spaces.
- While the "hub and spoke" model—a central headquarters with smaller offices closer to employees homes—was considered during the pandemic in an effort to retain top performers, the creation of these smaller offices will soon become cost prohibitive, especially in light of rising construction costs.
- Expect vacancy rates to rise as tenants reevaluate their space needs and begin retracting their footprints. This trend may be offset slightly by office conversions of Class B and C product to other uses, which would decrease inventory over the coming years.
- For employees, the purpose of coming to the office has evolved, and now the design of offices will take on an even more important role: Think experiential retail for office. Office users will require dynamic collaboration spaces for employees to connect with co-workers, be that in-person or through a seamless a technological experience.
- As evidence of that trend, the regional "flight to quality" trend continues, with trophy office space reporting the lowest vacancy rate among asset classes. Companies continue to reimagine their space needs by foregoing larger footprints in favor of quality and amenities in both the building and the surrounding neighborhood.

Sources: Commercial Observer, Transwestern, Costar, Newmark, JLL

NOTABLE LEASE TRANSACTIONS

Five Guys	1940 Duke Street	39,673 SF
Regus	211 N. Union Street	17,083 SF
(ISC)2	44 Canal Center Plaza	13,801 SF
National Beer Wholesalers	277 S. Washington Street	12,838 SF
Leonardo Helicopters	201 N. Union Street	10,758 SF
Potomac Waldorf School	424 N. Washington Street	10,672 SF

NOTABLE OFFICE SALES

515 King Street	$12M ($145/SF)	Brookfield Properties to Douglas Development
1801 N. Beauregard Avenue	$10.3M ($83/SF)	Grubb Properties to Urban Investment Partners
1555 King Street	$10M ($334/SF)	Bernstein Management Corporation to the Salvation Army Potomac Division
1703 N. Beauregard Avenue	$17.9M ($245/SF)	Association for Supervision and Curriculum Development to Alexandria City School Board

RETAIL UPDATE

NATIONAL RETAIL TRENDS

- Despite economic headwinds, retail property fundamentals have remained strong. Nationwide, retailers have continued to open more stores than they have closed. Vacancy rates fell across all major metros except San Francisco, as the development of new product was constrained by rising interest rates, and older product was removed from the supply.
- Retail continues to trend toward experiential uses, which made up 15% of all leasing activity in 2022, an increase of about 9% over the previous year. The average retail lease size remained stagnant over the prior year at approximately 3,200 SF. The trend of revitalizing vacant shopping mall spaces into mixed-use projects also continued.
- While multi-tenant retail significantly outperformed other sectors, total retail leasing volume dropped from the previous year. Single-tenant retail showed the largest decline in transaction volume due to the rising cost of debt. While leasing volume decreased over the prior year, retail rents grew by 5% over the prior year with the highest increases achieved in neighborhood and strip mall centers. The demand for medium and larger spaces was driven primarily by discounters like Costco.
- Inflation reached its highest level in 40 years in June. Rising gas and food prices continue to be a major concern for Americans, especially lower- and middle-income families who have been disproportionately affected. Consumer confidence decreased over the past year, and spending trended toward daily necessities and discount retailers.
- Retail refinancing volume hit its lowest point since 2011 as large banks, life insurance companies, and CMBS lenders pulled back from commercial real estate. Retail, however, remains an attractive investment class because of strong sector fundamentals, risk-adjusted returns, and relative availability of lender participation.

Sources: JLL, Deloitte

HIGHLIGHTED RESTAURANTS

LOCALLY SERVING SIT-DOWN

Railbird Kitchen	804 N. Henry Street
Matt & Tony's	1501 Mount Vernon Ave.
Michael's on King	703 King Street

CAFES

St. Elmo's Coffee	1536 Kenwood Ave.
District Biscuit	3401 Mount Vernon Ave.
Lily's Chocolate & Coffee	631 King Street
Sprig's Coffee & Pastry Café	2050 Ballenger Ave.
Fresh Baguette	1101 King Street

REGIONAL CONCEPTS

Ted's Bulletin	2424 Mill Road
Andy's Pizza	107 N. Fayette Street
Hangry Joe's Hot Chicken	3227 Duke Street
Bollywood Masala	211 King Street
Falafel Inc.	726 King Street

ECONOMIC UPDATE

ECONOMIC TRENDS IN THE WASHINGTON METRO REGION

- There has been a massive downturn in the U.S. GDP since the beginning of the pandemic. Consumer confidence has weakened the economy and, in turn, taken a toll on consumer spending. A lack of consumer spending and overall confidence in the market could trigger a recession.
- In the last quarter of 2022, the savings rate was close to historic lows, and households have increased reliance on credit cards and loans. Spending power will likely decrease as consumers choose to pay down balances as the cost of borrowing rises.
- The rapid increase in home mortgage rates due to Federal Reserve interest rate hikes has cooled the home resale market, evidenced in both units sold and sale price stagnation. Additional interest rate increases are expected in 2023, which will further slow housing production and resales. These higher interest rates are expected to weaken the labor market and increase unemployment numbers.
- The Washington, DC, area's economy slowly recovered in 2022, but has not fully recovered its pre-pandemic employment base. While productivity metrics increased in 2020, this indicator is due to the reduction in lower-paying, service-related jobs. Removal of lower-paying jobs increased average wages in the region. Despite improving average wage metrics, inflation has caused a decline in real earnings and the continuance of wage pressure.
- Job opening rates are still high, and there are more hires than separations in the region. The labor force participation (LFP) rate has dropped and not fully recovered to its historic average of 66% because workers permanently left the labor market due to a shift in caregiving responsibilities. This lack of participation in the workforce is limiting the Northern Virginia region's output capabilities, and employment demands are still high regardless of qualification levels and skills. An average of two jobs are advertised for every one unemployed worker.

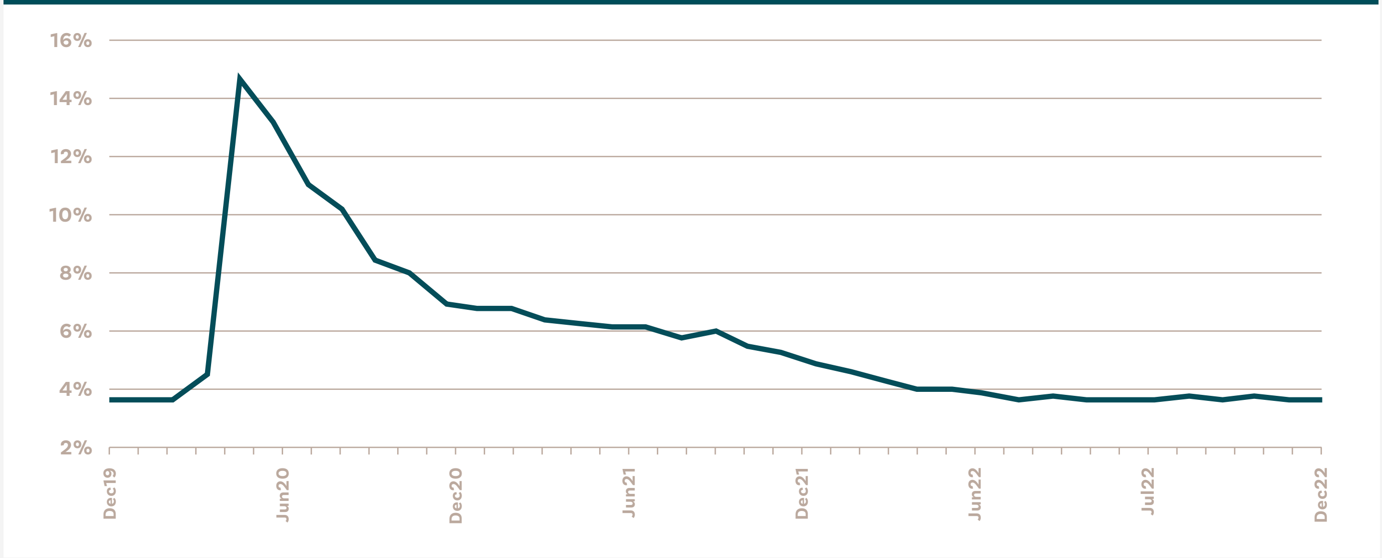
Sources: The Stephen S. Fuller Institute, Costar

FUTURE OUTLOOK

The Washington metro region's slowing population growth is primarily due to an increase in net outward migration, as more people are moving out of the region than moving in, especially among those ages 25–35. This change is primarily due to lack of affordable housing for the middle class and the high cost of living in Northern Virginia relative to other emerging markets. Additionally, the increase in remote work has reduced the requirement to be physically located in the Washington Metropolitan Area.

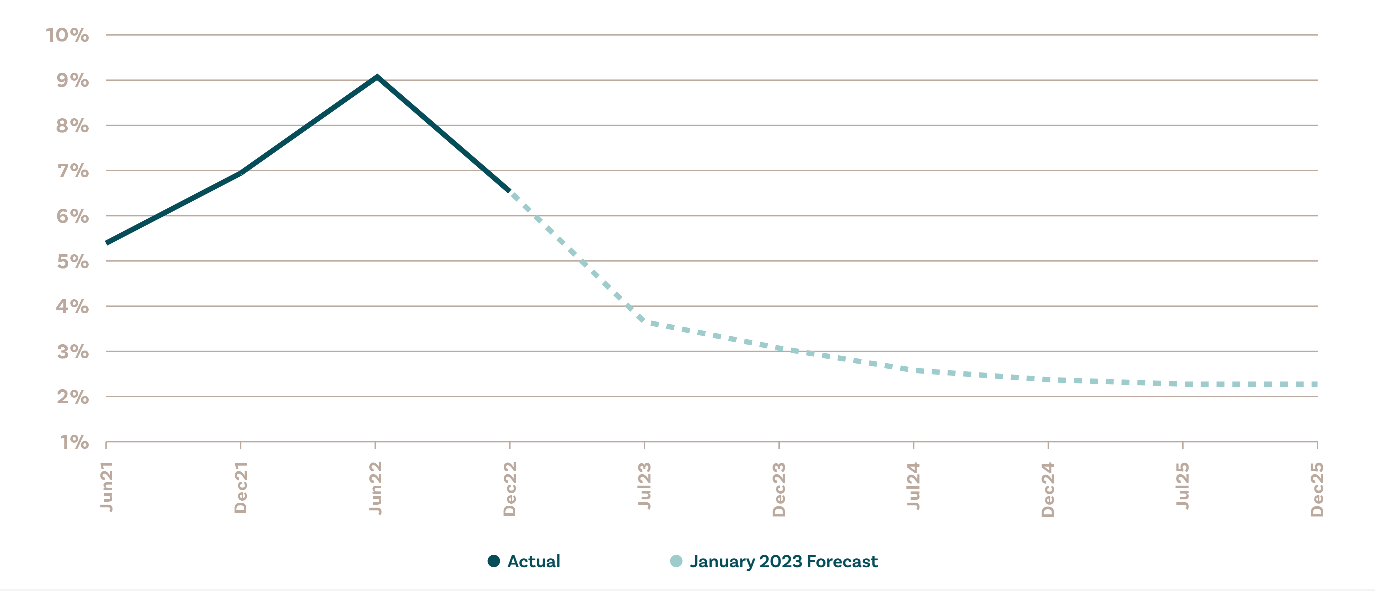
In the foreseeable future, construction will likely stall or decline due to rising interest rates, construction costs, and supply chain issues. Reduced cost of capital in the form of declining interest rates or creative financing solutions will be necessary to move projects forward.

Chart 1. Unemployment Rate, Seasonally Adjusted, December 2019–December 2022



Sources: The Stephen S. Fuller Institute, Costar

Consumer-Price Increase, Year-Over-Year Percentage Change



Sources: Labor Department (actual); Wall Street Journal Economic Forecasting Survey of 71 economists, Jan 6–10, 2023 (forecast)

A view of the the Braddock Road Metro neighborhood shows the construction of Platform Alexandria, which delivered in 2022.

RESIDENTIAL UPDATE

NATIONAL AND REGIONAL RESIDENTIAL FORECAST

While wages are rising, buying power has stayed flat due to the impact of inflation. Tightening inventories and higher prices continue to make it difficult for first-time buyers and working families to purchase homes. The pressure has caused multifamily occupancy rates to remain high with significant rent increases over 2021.

Prices of homes in the Northern Virginia region are expected to continue to rise but at a more moderate pace than in the past 12 to 18 months.

Available housing inventory has declined as upward pressures on mortgage rates have tempered price increases.

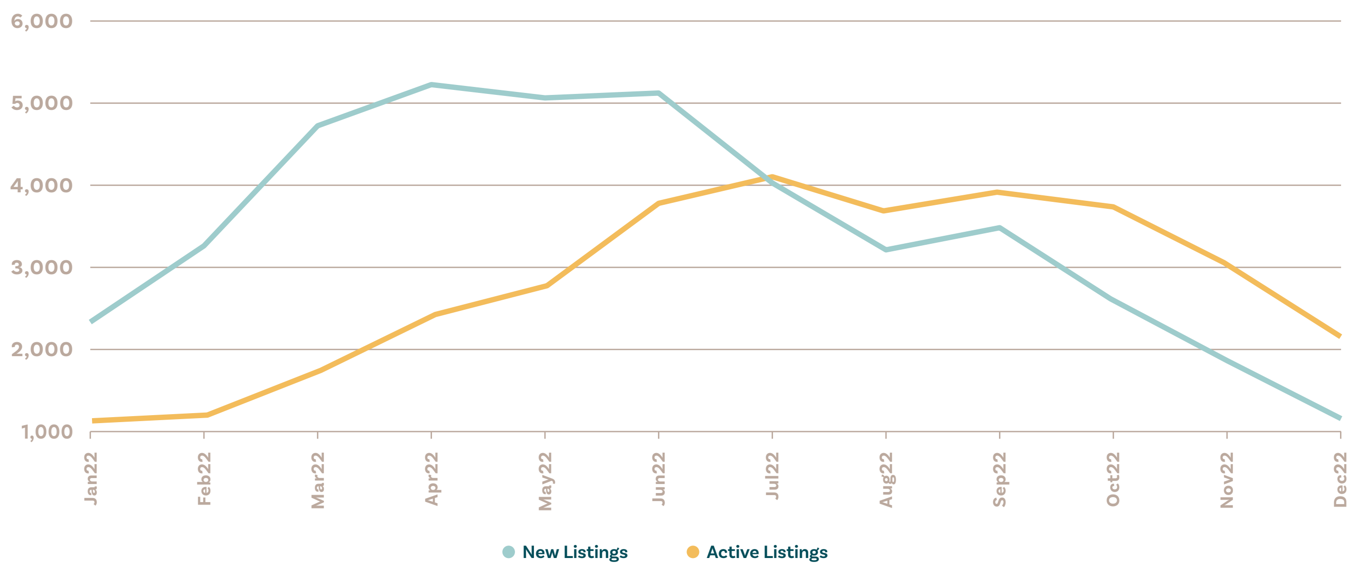
Peak sales activity occurred in early spring 2022, but the rest of the year was unable to keep pace with the unsustainable levels of the previous year. As evidenced by increased days on the market, the housing market has softened, and rising mortgage rates are impacting affordability.

Unit sales decreased over the prior year, and total single-family homes and townhomes sold in 2022 will be ~25% down from 2021. The market return to more normal seasonal patterns is forecasted to continue in 2023.

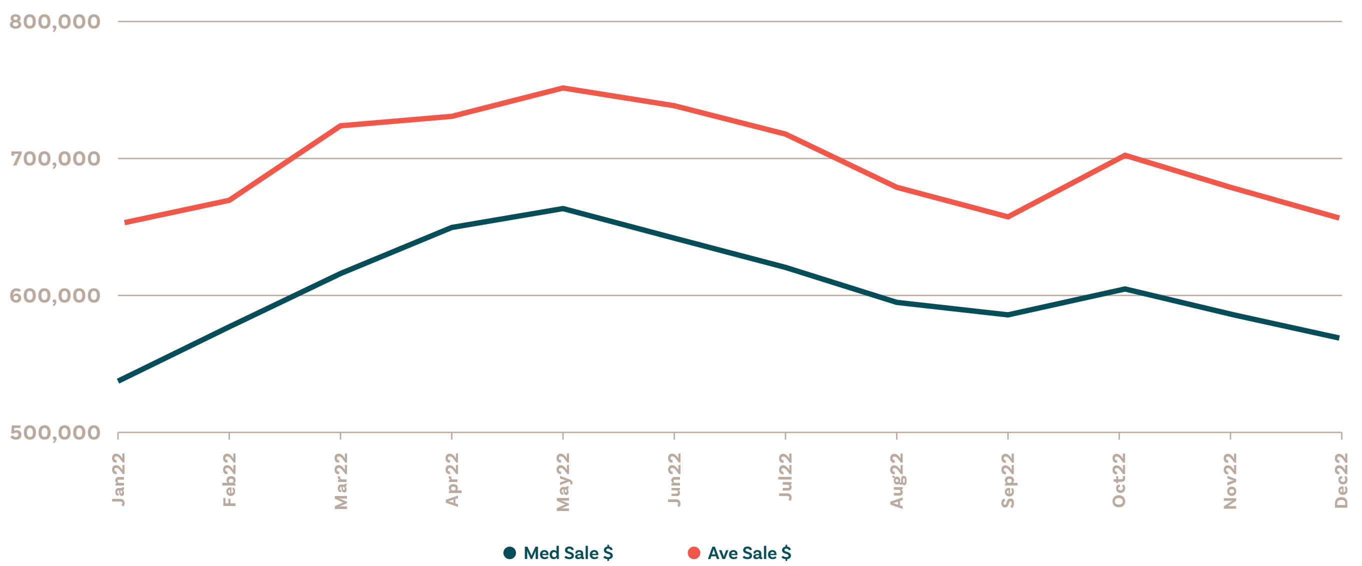
Source: NVAR

RESIDENTIAL UPDATE

Market Activity | Northern Virginia



Market Activity | Northern Virginia



Source: ShowingTime. Data provided by Bright MLS as of January 6, 2023

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This publication is part of our research and data series on the City of Alexandria. This report is released twice a year and provides the latest updates on the City's economy, the status of different development projects, insights into the office and retail markets, and residential sales patterns. With this information, we hope to provide a comprehensive snapshot of the City of Alexandria for real estate professionals, business owners, and the general public. If you would like an update on any of this information between our major publications, please feel free to reach out to us.