MAREMA
MID ATLANTIC REAL ESTATE MARKETING ASSOCIATION
ESTABLISHED IN 1976

The MarketPlace

1st Quarter 2024

PRESIDENT'S REMARKS….

"DELIVERING MORE IN '24"

- More Educational Opportunities
- More Networking Opportunities
- More MAREMA Member Collaboration
- More Listing Presentations being shared showing Commitment to the Group
- More Deals Getting Done
- More Income for MAREMA Members

MAREMA Membership Goals for 2024 are to increase Commercial Agents to 75 and maintain our Associate Members at 35 for a combined membership of 110 in 2024.

Managing the murky waters of Commercial Real Estate has become quite challenging in 2023 and into 2024. However, you can make a difference by becoming involved with this focused group of real estate practitioners. The synergy of working together to help one another be the best they can be by collaborating with like minded MAREMA members. Sharing best practices, leveraging your skills to help another will pay off in big dividends.

As members of the MAREMA group, we must develop our "Shared Value Network". Cooperation is the key to rising above the challenges of increased interest rates and limited inventory. I see more referrals being shared as it takes more than getting on the Internet and finding the product you need. Let's harness the power of collaboration in the marketplace.

I encourage each member of MAREMA to not look at what you don't have but look at what you could have if you reengage. You have not because you ask not! Ask your clients for listings, as it is a good time to get into the market based on the basic economic principle of Supply and Demand. Search deeper into off-market properties for those buyer needs.

Say Yes to Doing More in 2024! We have over 100 members ready to assist you in getting deals done.

Be blessed!

Jim Guisewhite

MAREMA 2024 Leadership Team

Jim Guisewhite
President

Peter Pokorny
Vice President

Wayne Hallheimer
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Fairfax Realty Select

Why "Special Purpose" Commercial Real Estate Properties Hold Their Value Regardless of Market Fluctuations

By: Joe Serafin

How Special Purpose Real Estate Properties Hold Their Value

In the world of real estate investment, certain properties stand out for their unique characteristics and resilience in maintaining value regardless of market fluctuations. These Special Purpose Real Estate properties, distinguished by their singular use or function, offer investors a distinct opportunity for stable returns and long-term financial security. Special Purpose Real Estate Properties are in short supply when compared to most property types. The demand for them remains fairly constant.

In this comprehensive exploration, we delve into the factors that contribute to the enduring value of Special Purpose Real Estate properties. We will also highlight specific special property types and specific market statistics to reinforce the point. Those statistics will also help our readers decide how knowing the detailed stats, when working with the right specialists, will deliver maximum results.

What Are Special Purpose Real Estate Properties?

Simply put, Special Purpose Real Estate properties are those that were designed and built or subsequently modified to meet a specific set of needs. The design, or modification, is intentional and specific. The building, therefore, has limited use. Its purpose-designed features deliver specific and possibly unique benefits to its owner or occupant.

A Primary Reason for Special Purpose Properties Holding Their Value

The alternative to purchasing a Special Purpose Real Estate property would be to invest in or lease a more general building and then spend unprofitable time and resources converting it to the required purpose. That, on its own, is one of the major reasons why such properties maintain their value despite how other market factors may impact other building types.

Examples of Special Purpose Real Estate Properties

There are many examples, including:

- Schools and Early Learning Centers

- Churches and other specific Religious Facilities
- Breweries
- Gas Stations
- Specialized Manufacturing Plants
- Environment-Controlled Warehouses
- Hospitals
- Nursing Homes
- Hotels
- Sports Complexes

How Do Passive Investors and Owner-Operators Benefit From Special Purpose Real Estate Buildings?

1. The Principle of Economic Rent. Passive investors know that a purpose-designed building in the right location will attract high lease income.Lessees know they will maximize the use of that design to speedily deliver the services to their specific market at a price the market will pay.

2. Owner-operators know that paying a higher $/SF for the right property in the right location enables them to deliver their profitable business purpose sooner. hey do not invest time and money in redesigning and repurposing a different building.

3. The basics of supply and demand come into play. There are fewer special purpose buildings than general purpose buildings. In the right location (such as Northern Virginia), there is an active supply of ready, willing, and able purchasers and lessees waiting for those buildings to come on the market.

4. Owner-operators who want to sell may well achieve maximum profit in two parts. They sell their correctly-valued business to one prospect and the special purpose building to another prospect. Some business owners are happy to buy an existing operation and lease the property. Passive investors own the building, agree to an NNN lease, and either make it a long-term part of their portfolio or know they can sell it later to another investor or to the current tenant.

Northern Virginia Special Purpose Building Statistics

Let’s take a look at recent Northern Virginia stats for Special Purpose buildings.

- Current Inventory stands at 262 million Sq Ft (MSF) (+1.1% on last year.)
- Under Construction: 7.3 MSF with an average SF of 253K per building.
- 12 Month Net Absorption: 1.3 MSF (+0.5%.)
- Market Sales Price: $268/SF. (+4.6%.)
- Sales Volume in the Past Year: $2.2B representing 426 properties sold.
- Market Asking Rent: $31.34/SF.
- Available Asking Rent: $34.00/SF.
- Vacancy Rate: 14.8%, or 38.7MSF.
- Market Cap Rate: 6.74%.

Northern Virginia School and Early Education Centers

- Current Inventory stands at 2 MSF (+1.0% on last year.)
- Under Construction: 41 KSF with an average SF of 13.7K per building.
- 12 Month Net Absorption: 52.8 KSF (+361.1%.)
- Market Sales Price: $457/SF (+3.6%.)
- Asking Price in the Past Year: $526/SF.

- Sales Volume in the Past Year: $15.4 M, representing six properties sold.
- Market Asking Rent: $39.24/SF.
- Vacancy Rate: 0.5%, or 10.7KSF.
- Market Cap Rate: 5.8%.
- 12 Month Occupancy at Delivery: 100%.
- 24-month Lease Renewal Rate: 91.6%.

What These School and Early Education Center Stats Tell Us

- The total inventory of school and early education center buildings is 701 in Fairfax, Loudoun, and Prince William County.
- In the past year, only six came on the market. A safe inference would be that the market these businesses serve is constant, even taking into account the issues recently associated with inflation and high-interest rates.
- The market sales price/SF for this sector increased by 3.6%. Few other CRE sectors recorded an increase.
- The asking rent per SF also increased (3.1%), resulting in a cap rate of 5.8%, compared to the special building market as a whole (6.75%.)
- 12-month occupancy at delivery was 100%.
- The 24-month lease renewal rate was 91.6%.

Those numbers reinforce the fact that the market for Special Purpose buildings, particularly schools and child care centers, is stable.

Church Building and Related Religious Facilities Statistics 2010 – 2023

There are currently 1,601 freestanding religious buildings in Northern Virginia.

Sales of church properties have fluctuated year-by-year since 2010, as have Sales Price/SF. We will look at the six most active years to provide a general picture.

- 2010 Sales Volume: $8.1M. Sales Price/SF ranged from $81.80 to $427.30.
- 2013 Sales Volume: $21.8M. Sales Price/SF ranged from $63.65 to $327.30.
- 2017 Sales Volume: $68.6M. Sales Price/SF ranged from $263.65 to $763.65.
- 2021 sales volume: $27.2M. Sales Price/SF ranged from $54.55 to $254.55.
- 2022 Sales Volume: $13.2. Sales Price/SF ranged from $100.00 to $281.80.
- 2023 Sales Volume: $14.9M. Sales Price/SF ranged from $209.10 to $572.70

Prices per SF are rounded to the nearest 5 Cents.

Serafin Real Estate Is Hyper-Focused on Special Purpose Properties

Serafin Real Estate is not only a recognized specialist in this market sector, but we are also a top-performing brokerage. We deliver a special kind of value to sellers, would-be investors, potential owner-operators, and lessees. Our in-depth knowledge of early education centers, schools, religious facilities, and breweries means we stand apart in both these subsectors and our geographical niche of Loudoun, Fairfax, and Prince William Counties.

Real estate-centered enterprises owe it to themselves to work with experts who can value both the business (when the business is to be sold) and the real estate. Special Purpose buildings carry a specific value that only experts understand well enough to value accurately.

Serafin RE's international database of specific investors and prospective owner-operators makes us the go-to brokerage for sellers looking to move on. Our detailed, segmented database enables clearly focused targeting of potential buyers and lessees. We directly link their goals to what is currently – and likely to be – on the market.

The Ground Lease Can Be An Effective Capital Tool For Real Estate Developers

Byron Smith, Sr., Esq., CCIM

Real estate development projects frequently require substantial capital investments. Developers utilize various sources to fund the investment capital that drives their ventures, aiming to optimize their cost of capital. One crucial factor that can significantly influence the cost of capital is the utilization of a ground lease. This article will explore the concept of the ground lease as a capital tool and will address how a ground lease can impact the cost of capital for real estate developers.

Understanding The Ground Lease:

A ground lease is a long-term NNN lease contract between a landowner and a ground tenant (e.g., the real estate developer) that grants the ground tenant the right to possess, use and develop the land for a specified period of time. In exchange for those rights, the ground tenant pays rent to the landowner over the entire term of the ground lease. Frequently, ground leases are used in situations where the landowner wishes to retain ownership of the land while allowing the ground tenant to construct improvements on the land such as commercial buildings or residential complexes using the developer's capital.

Benefits of a Ground Lease For the Developer:

There are several reasons why the real estate developer would consider a ground lease for its development project as opposed to the fee simple acquisition of the land. These reasons include:

- The developer is usually seeking a less expensive and longer-term form of financing for the land component of the transaction. A ground lease is frequently for a period of 30 to 99 years. Most traditional developer "take-out" financing is for a shorter period which may be between 5 and 10 years unless some type of government-sponsored entity financing is involved. At the end of the debt term, the debt must generally be refinanced at the current market rate. Because the ground lease is for a much longer period of time the ground lease can be a source of long-term, low-cost financing. While it is said that the ground lease provides low-cost financing for the land component of the investment, the reality is that the ground lease is not an actual "loan", but it does provide the right to use the land for a long term at a 'interest rate" that is lower than the rate that would be paid to amortize a mortgage loan for the same land component.

- The developer may be able to commit less equity capital to develop the property using the ground lease approach. When a developer acquires the land for development through a ground lease, the initial capital investment for the land component is significantly lower compared to purchasing the land outright. By way of example, if the developer is building on a parcel of land valued at $3,000,000 and the lender will only lend 65% of the purchase, then the developer's equity contribution will be $1,050,000 plus the associated costs of the acquisition of the land. If, however, the land is leased, then there is no initial capital investment and the initial annual ground lease payment may only be $150,000 assuming that the ground lease is based upon a 5% return on the land value.
- The return on the invested capital is frequently greater if the developer leases versus owns the land. The real estate developer's expertise is in creating a real estate improvement that can frequently generate an unleveraged return of 10%-14% or greater. On the other hand, land generally has an unleveraged return of 4%-6%. The wise developer will choose to place its capital in the improvement and not in the land.
- There is a significant tax benefit to the real estate developer if the land is leased as opposed to being owned. This is because federal tax law does not permit the ground owner to annually cost recover the land component of the investment in determining their annual taxable income. However, a real estate developer who is leasing the ground may deduct the cost of the annual lease payments in determining their annual taxable income.
- Often the land that the developer needs to develop the project may not be available for sale because the landowner is unwilling to sell the land or because of other restrictions on the sale that burden the land.

Conclusion:

The decision to enter into a ground lease agreement as part of the development project can have significant implications for a real estate developer's amount of required equity capital. By (i) reducing the initial investment requirement, (ii) increasing the return on equity capital, (iii) providing long-term, low-cost financing and (iv) providing a significant tax deduction, a ground lease can aid a developer in optimizing their capital structure and securing "land financing" on favorable terms. However, it is essential for developers to carefully evaluate the specific terms of the ground lease and assess its impact on the project's overall financial viability. By doing so, developers can leverage ground leases as a strategic tool to minimize the amount and the cost of the equity capital required and maximize the potential return on their real estate development investment.

Hot issues on HVAC systems And how to Keep your Cool

By: Peter Pokorny

OFFICE TENANTS RELY ON THEIR LANDLORD to operate maintain the building's HVAC system (heating, ventilation and air conditioning), during normal business hours at no charge, and only have to pay any expenses if they request HVAC service after normal business hours.
In contrast, tenants who lease retail, warehouse or flex space are ordinarily responsible for maintenance, repair and replacement of the HVAC system. This can result in unexpected costs, so tenants leasing such space need to understand their obligations and negotiate favorable terms whenever possible.

- **HVAC Condition** – Many retail and industrial leases require the tenant to take the space "as is" or only address minimal landlord work. As part of its due diligence, the tenant should check the condition of the HVAC system. This would include checking any maintenance records and age of the system.

- **Warranties** – The tenant should check to see if the landlord has a current valid warranty for the HVAC system. In some cases, a tenant may be able to negotiate that the landlord warrant to the tenant that the HVAC will not have any repair issues during the first 12-months of the lease term (and if there are any, that landlord will make the repairs at no cost to the tenant)

- **Repairs** – To avoid a costly repair bill, the tenant may try to limit its repair obligations to a specified dollar amount per year or per occurrence. Related to the issue of repair expenses are replacement costs, covered below.

- **Service Contracts** – The tenant should check to see if the landlord has a current valid service contract for the HVAC system. Typically landlords of retail and industrial properties require the tenant to enter into a service contract when the term starts. If the tenant is required to have a contract, will the landlord require the tenant to use an approved contractor? How often will the HVAC system have to be serviced? The tenant should make sure it understands the landlord's expectations to avoid problems.

- **HVAC Replacement Costs** – No tenant wants to find itself in the position of spending thousands of dollars on a new HVAC system that will last 10 years, if the tenant only has 2 years left in its lease term.

  - The tenant may attempt to negotiate, in its lease, that if ever the tenant has to replace the HVAC system, if the useful life of the replacement system is reasonably determined to

  - extend beyond the lease term, then the landlord should reimburse tenant for the landlord's share of such expense. The landlord's share of the expense would be based upon the percentage of the useful life that such replacement equipment will have after the lease expires.

- **Final Thoughts** – Maintenance, repair and replacement of an HVAC system can be very costly. An astute tenant will understand its obligations under the lease and will negotiate=favorable terms when it has the leverage to do so.

MAREMA WINTER HAPPY HOUR

MAREMA kicked off 2024 with a lively happy hour.

Its winter commercial real estate networking reception on Thursday February 8, 2024 took place in Tysons at Patsy's American in the Tierney ballroom. The room was spacious and complimentary appetizers and drinks were provided.

Over 80 members and guests socialized and discussed deals through the evening. Attendees included commercial real estate brokers, lenders, title companies, investors, attorneys, architects, developers, contractors, and others in the commercial real estate sector.

The next networking reception will be later this spring.

MAREMA would like to thank the sponsors for this event:

Capital Bank

Donofrio & Associates

MAREMA

The Networking Institute

Real Estate Counselors

Stewart Title

UPCOMING

EVENTS

MAREMA members meet on the

3rd Wednesday of each month

9:30 am - 12:00 PM

8230 Old Courthouse Road
Vienna VA 22182