PARKER REAL ESTATE ADVISORS

ASPECT | 2023: Winter Edition

RISK AND LIQUIDITY

Dulles Region Commercial Real Estate: Semiannual Insights

MACRO AND MARKET SUMMARY

MACRO

Risk is no longer free. Value loss as a result of increased costs of capital will challenge investors, owners and lenders in 2023. Success will favor ownership entities with proven, project level operating expertise.

MARKET

While Loudoun is performing better than the Dulles Region submarkets east of Route 28, office and retail investments are experiencing early signs of pressure as leasing activity continues to slow and liquidity remains tight.

OUTLOOK AND SOLUTIONS

Supply:

Continuing high levels of vacancy and, more importantly, availability in the Western Fairfax submarkets will depress rental rates, a reprise of the experience navigated during the Global Financial Crisis ("GFC"). Eastern Loudoun submarkets will be impacted in 2023 to a lesser extent. A welcome, accompanying factor is that developers are not breaking ground on new office product.

Leasing Demand:

Net absorption will slow in office and retail asset classes as tenants reduce footprints. Deal volume and deal size will be reduced across every submarket. Spreads between Class A assets and B/C assets will tighten. In an effort to increase occupancy, owners will compete on price and provide larger rent concessions to tenants.

Sales:

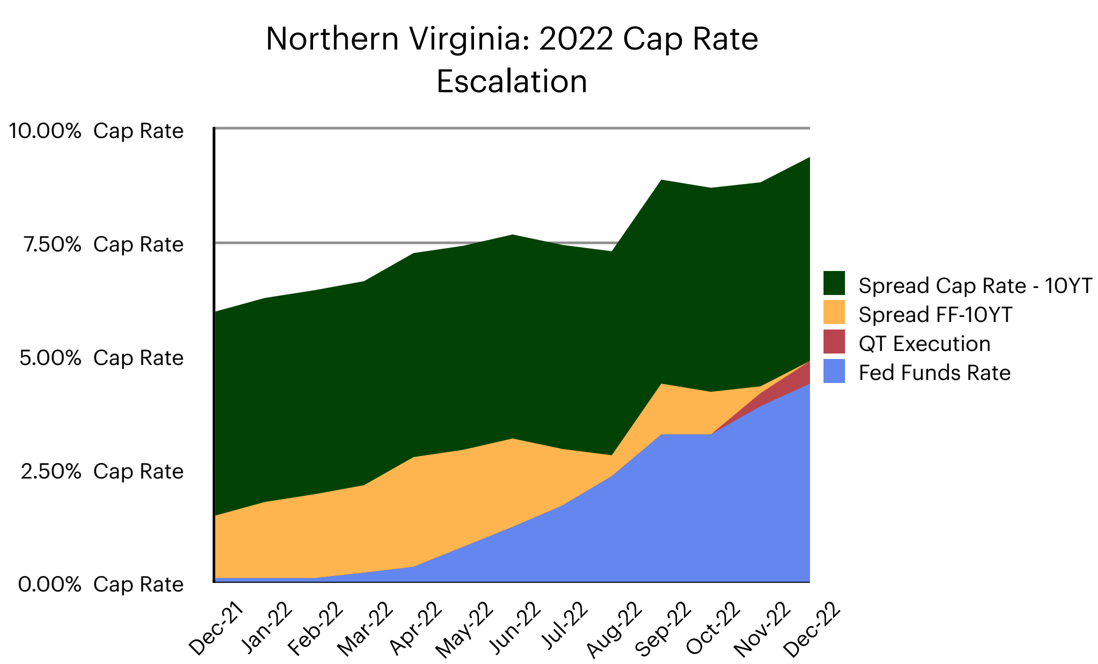
Sales volume stalled in Q4 2022 and is unlikely to accelerate in 2023. The "bid - ask" spread will not converge until there is agreement on the direction of inflation, interest rates, and risk premiums, and, more importantly, the duration of this elevated rate environment. Liquidity will return to debt markets but under terms quite different than those available during the prior 12 years.

Rates:

Cap rates have already risen by more than 150 bps, reflecting the overall increase in costs of capital. The escalation in cap rates will become more transparent as new sales are executed at values lower than those modeled at acquisition. 2023 appraisals will reflect the value erosion and invite lenders to stress test their loan portfolios.

MACRO: RISK AND LIQUIDITY

The rapid rise in the cost of capital during the last 12 months has elevated the risk to owners and lenders as both implied cap rates and interest rates have jumped by historically significant amounts. In turn, many investors are balancing risks, unable to realize the pro forma return at sale and unable to refinance without contributing additional equity. Simultaneously, liquidity has dried up. The fourth quarter of 2022 was defined by fewer and smaller sales transactions in a market where lenders became increasingly more cautious. The next twelve months are unlikely to present a different fact set when many DSCR and LTV covenants are examined.



Source: FOMC policy statements on September 21, 2022 and December 15, 2022, Parker Real Estate Advisors, FRED/St. Louis Fed, The Atlanta Fed, CBRE US Research

In this edition of Aspect we explore the factors that are changing how owners, investors, and lenders must respond to preserve and grow value in a market that no longer resembles the one navigated since 2010, including:

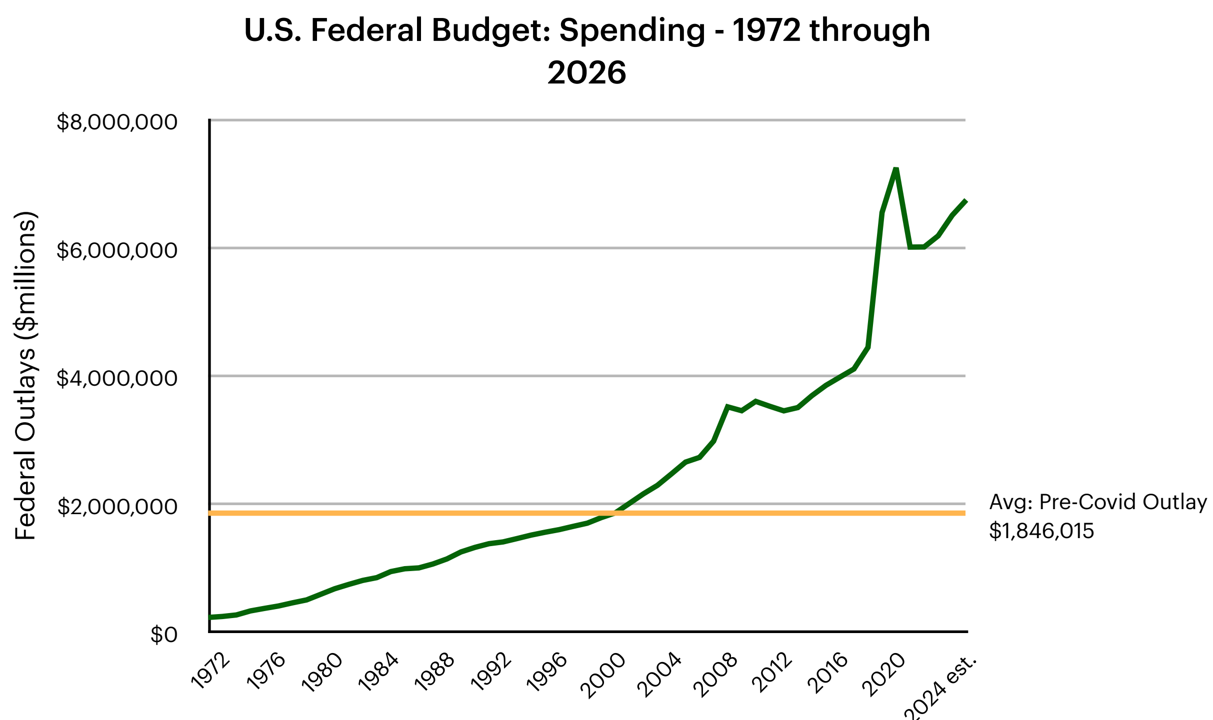
- NOI stresses through 2025, the three year period during which the Fed intends to hold the Fed Funds Rate above 3% and recession is a possible result;
- The importance of non-bank financing, particularly in the form of a bridge or preferred-equity instrument to support existing, stressed, capital structures;
- Specific risks to the office sector where, despite recent publicity, alternative use options are limited and demand is declining;
- The renewed importance of project-level, operating expertise to maximize NOI, thereby creating and preserving value in longer term; and
- Superior Dulles Region growth fundamentals relative to other U.S. markets and why the underlying economic strength of the region provides a case for optimism.

MACRO: STIMULATIVE FISCAL SPENDING

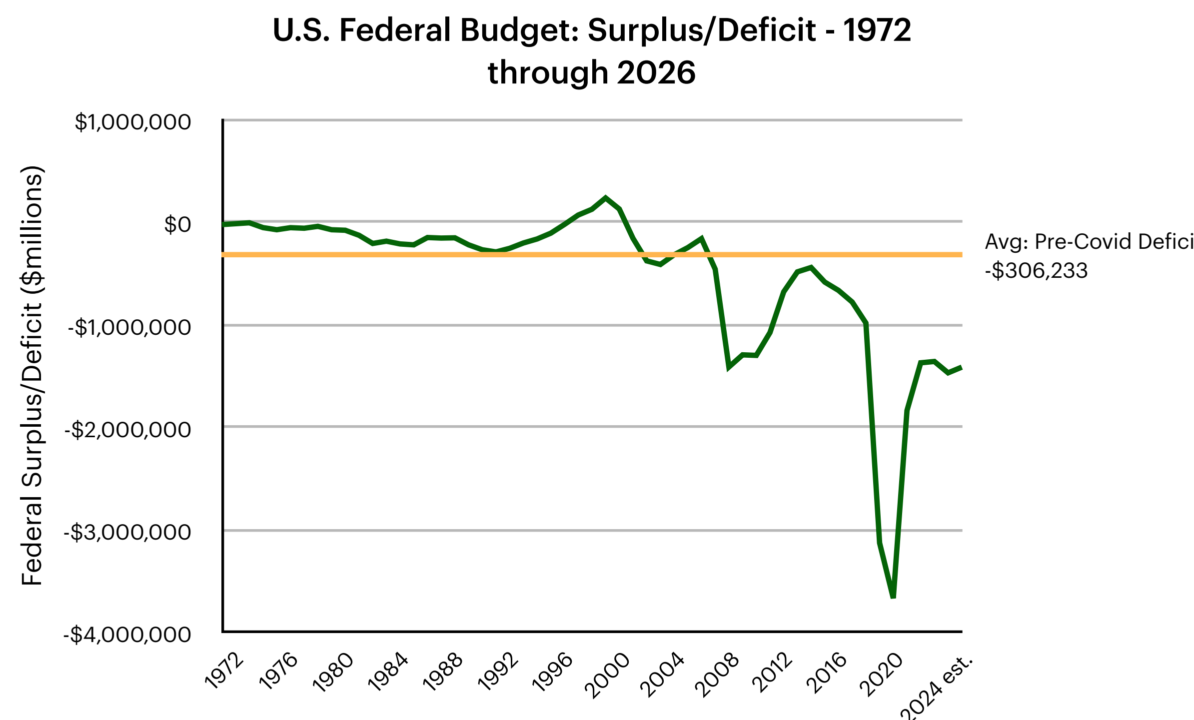
We believe that, unlike its stimulative intervention to contain the damage experienced during the GFC, the Fed will not drop rates back to zero. Following the most recent two Federal Open Market Committee ("FOMC") meetings, the Fed indicated its intent to keep rates above 3% through 2025. While well below the targeted 5% for 2023, funds rates above 3% would represent a 250 bps increase over the average rate since 2012. Well documented is that the Fed's actions are informed by a fear of continuing, elevated levels of inflation (particularly if wage inflation creeps into the domestic economy) and by fiscal policies that are resulting in historically high federal deficit levels.(see charts below) Note specifically the significant deficits projected through 2024 and the next election.

Less well reported are the structural constraints that the Fed and other central banks are facing. In the near term, policy decisions to fund Defense capabilities in response to growing geopolitical threats, addressing the needs of aging populations, and meeting global, green infrastructure commitments will be stimulative. As it acts to restrain inflation below 3%, the Fed is unlikely to set its targets below 1.00% again and/or re-introduce Quantitative Easing ("QE").

The disconnect for many has been the expectation that, facing a probable recession and slowing GDP, the Fed will, again, embrace an accommodative monetary policy. In fact, this option is less available than in the past given counterbalancing fiscal policies that are already authorized.



Source: U.S. Department of Treasury, USA SPENDING



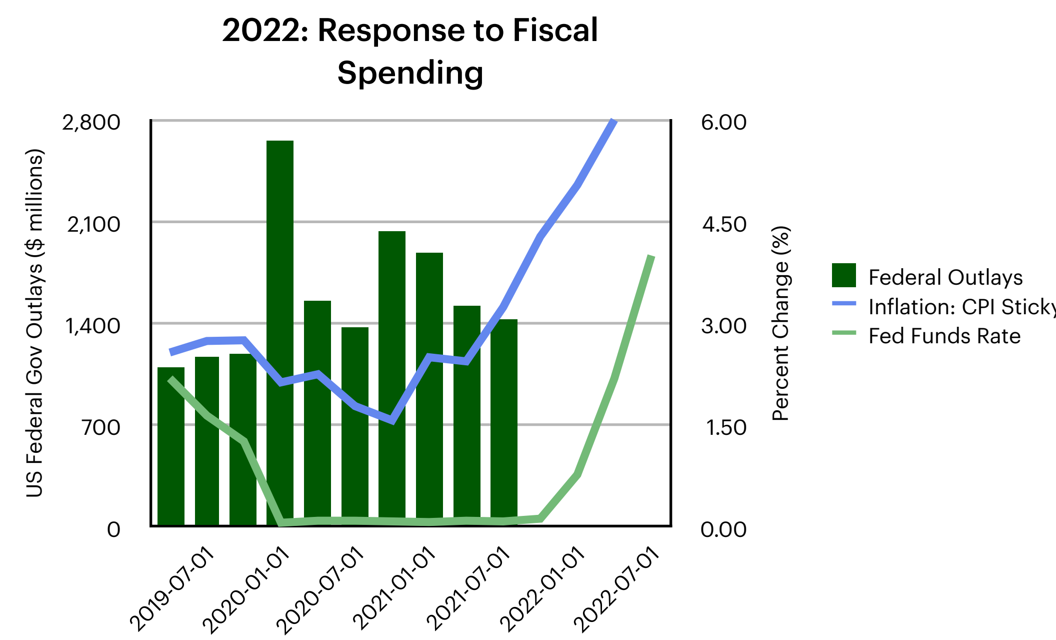
Source: U.S. Department of Treasury, USA SPENDING

MACRO: FINANCIAL IMPACTS OF COVID RESPONSE

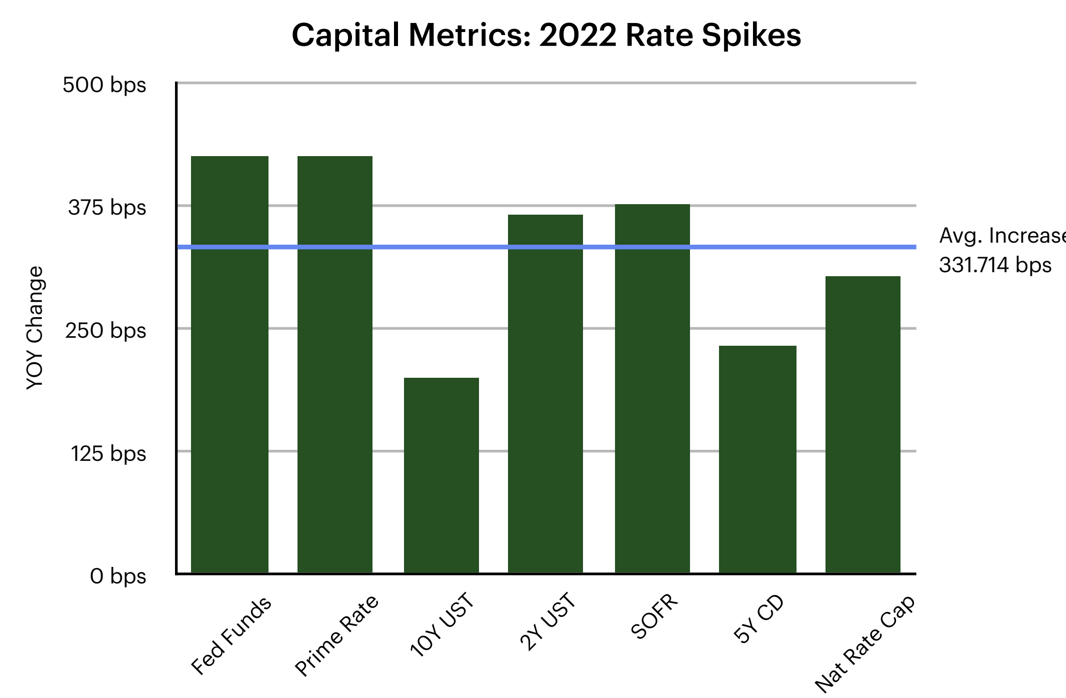
As noted above, the response to the pandemic in early 2020 was a massive infusion of liquidity by governments around the globe. In the U.S., more than $4.5 trillion was injected to catalyze demand during 2020 and 2021. Many assumed that this response was, in scale, similar to the bailouts of Bear Stearns, Freddie Mac, Fannie Mae and AIG during the Global Financial Crisis. However, Covid-related outlays dwarf all previous rescue initiatives.

Predictably, inflationary pressures surfaced in 2021 (see chart to right) inviting a response by the Fed (which assumed inflation would be"transitory") to raise rates in 2022. After more than ten years of "free" money, the cost of capital increased by more than 300 bps (see chart - Capital Metrics: 2022 Rate Spikes - to the right).

The cost and the terms of accessing both debt and equity have changed and are unlikely to return to prior levels. Already, the combination of higher rates and higher rates for a longer duration has eroded investor value and threatens loan stability across all asset classes.



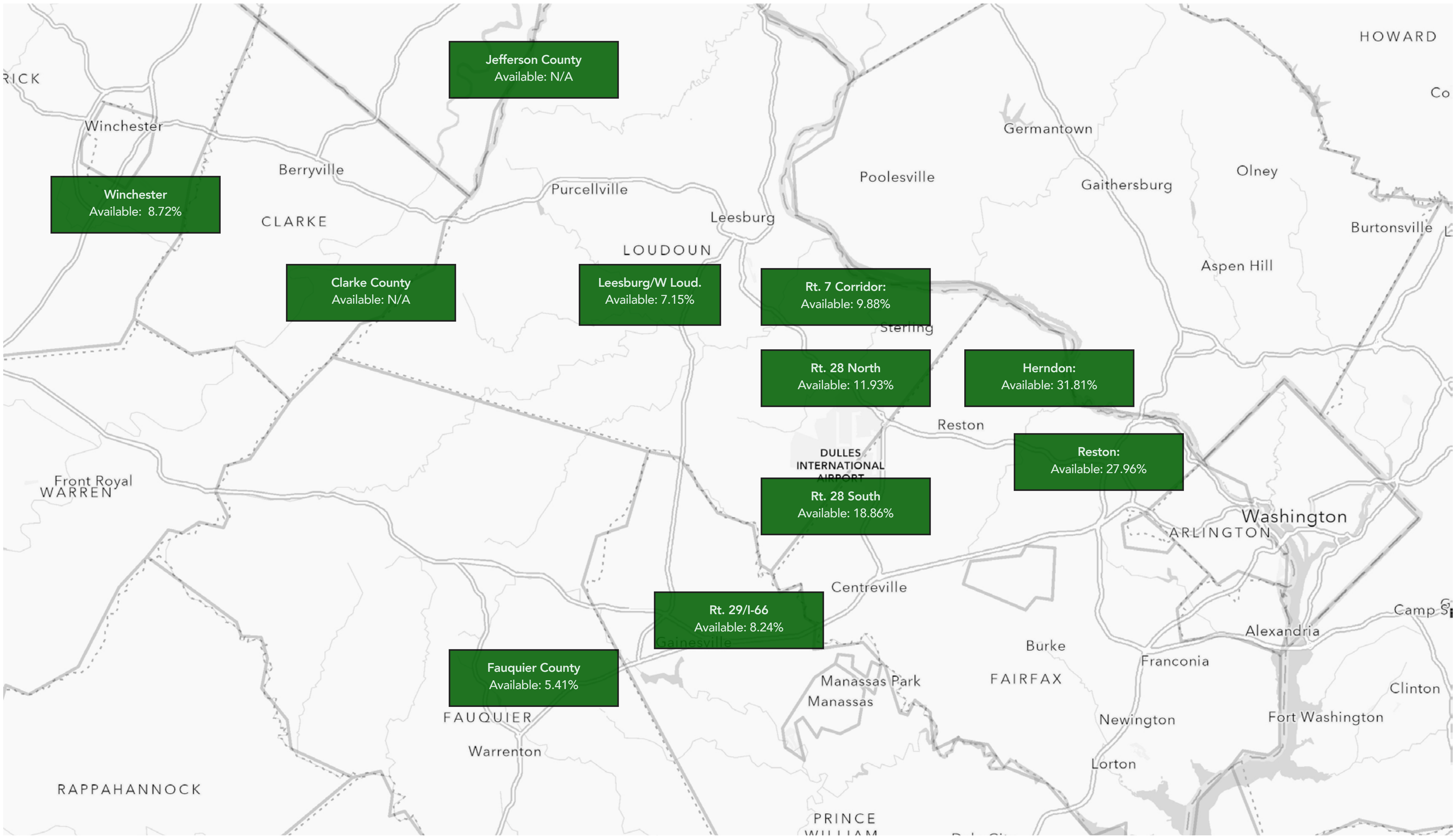
Source: FOMC policy statements on September 21, 2022 and December 15, 2022, FRED/St. Louis Fed, The



Source: FOMC policy statements on September 21, 2022 and December 15, 2022, Chatham Financial, FRED/St. Louis Fed, The Economist.

MARKETS: DULLES REGIONAL MARKET

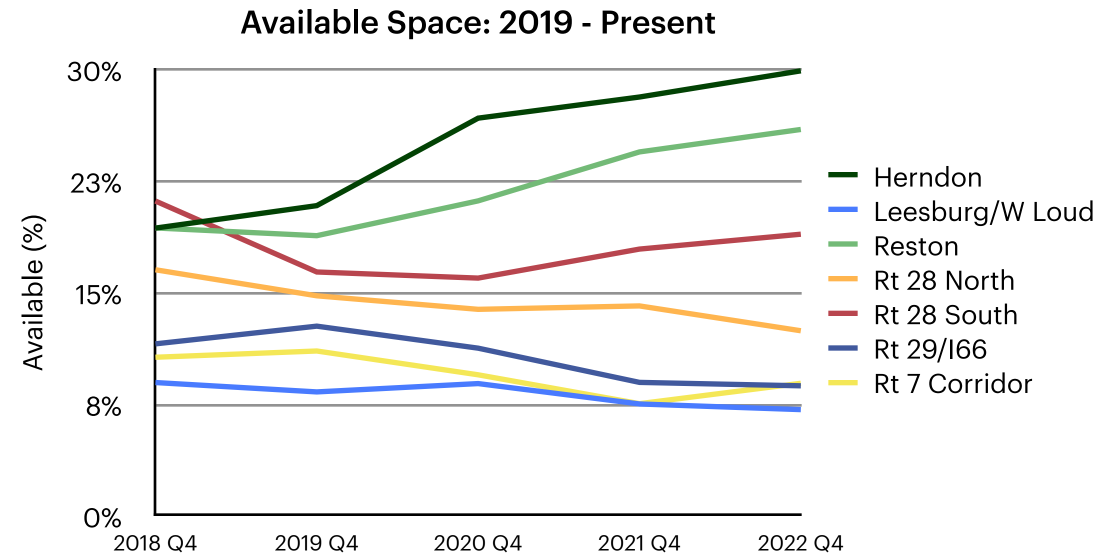
OFFICE SPACE AVAILABILITY BY DULLES REGIONAL SUBMARKET: JANUARY 2023



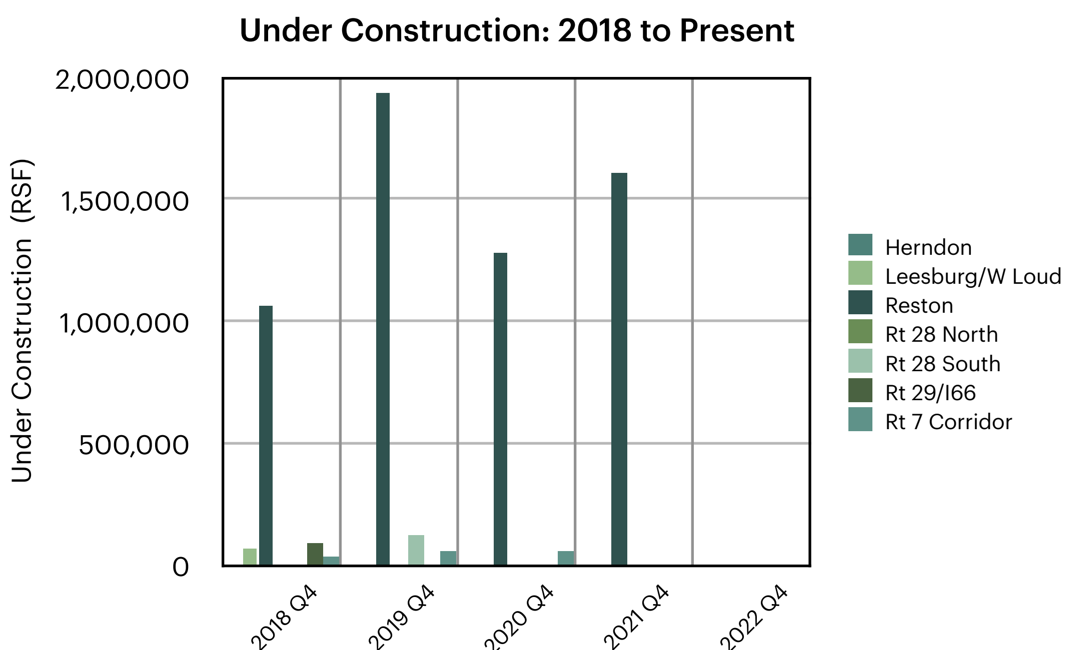
2022 MARKETS: SUPPLY

TALE OF TWO MARKETS

- East of Route 28 the amount of space being marketed has risen significantly since 2019. West of Route 28 the available rate remains below 15%.
- Five of seven submarkets performed better than the 10 year average during Q4 2022, but availability in Herndon and Reston exceeds trend by 800 bps and 500 bps respectively.
- Submarkets west of Route 28 are typically populated by smaller office tenants who have not contracted in the same way as those in more mature markets. It is not clear that this trend will continue in 2023 and 2024.
- New supply is not an immediate factor. No projects are under construction and, with the exception of "build-to-suit" projects, new development is unlikely.



Source: Costar



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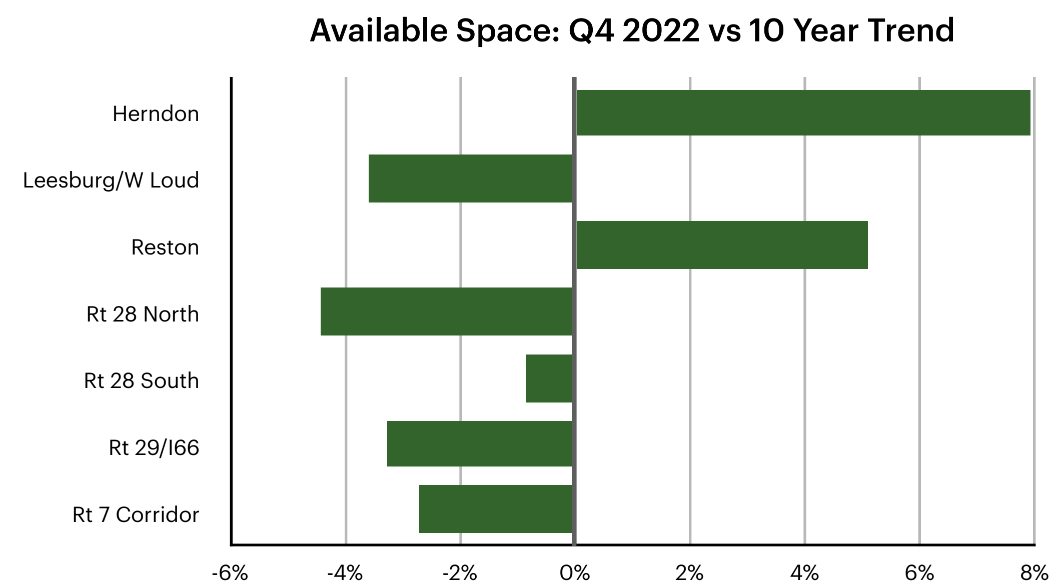
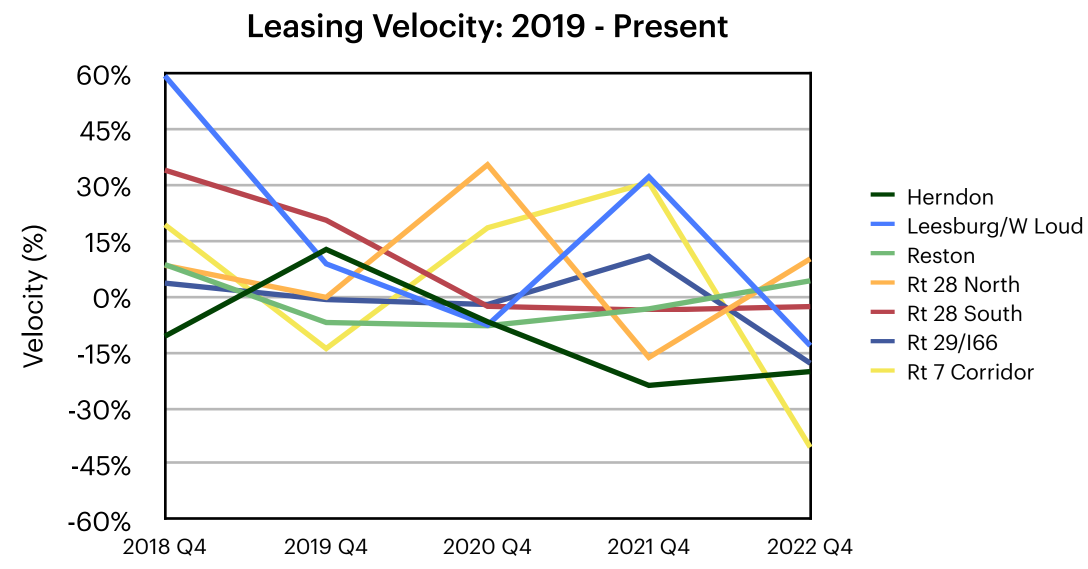


Source: Parker Real Estate Advisors, Costar

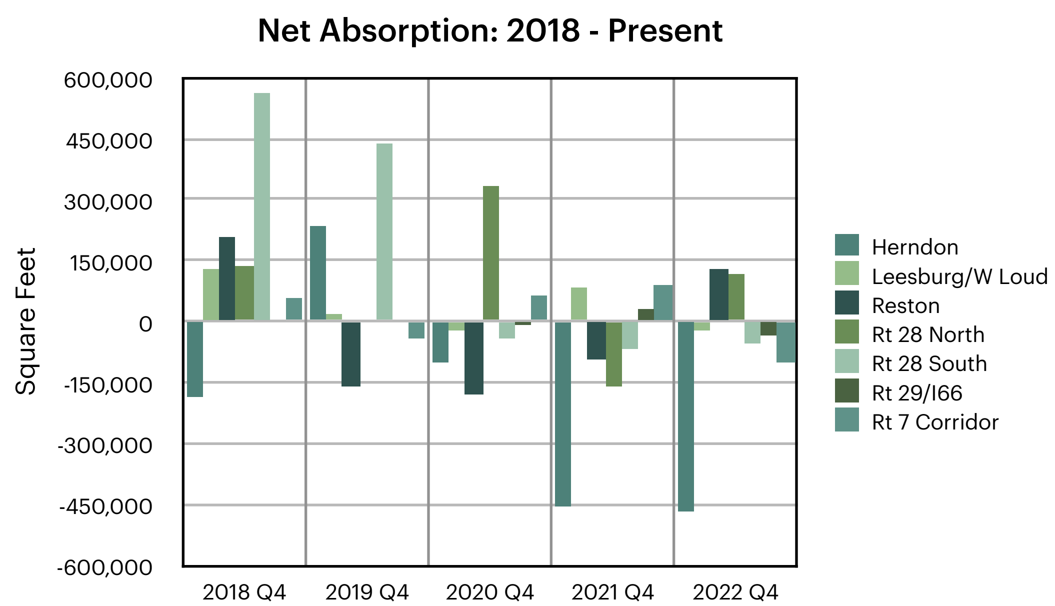
2022 MARKETS: DEMAND

DECLINING METRICS FOR OFFICE DEMAND

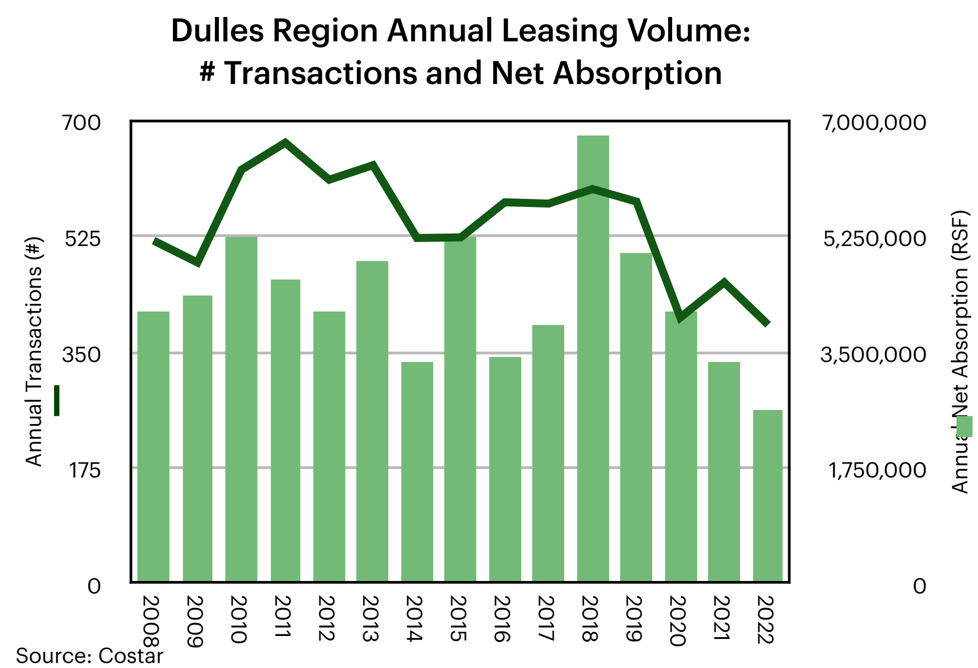
- Office demand is declining by every measure.
- Five of the seven submarkets reported negative net absorption in Q4 2022.
- Leasing velocity is negative to the ten year trend in six of the seven submarkets.
- The aggregate number of transactions in 2022 is 28% lower than trend.
- The aggregate volume of square feet leased is 39% lower than trend.



Source: Parker Real Estate Advisors, Costar



Source: Parker Real Estate Advisors, Costar



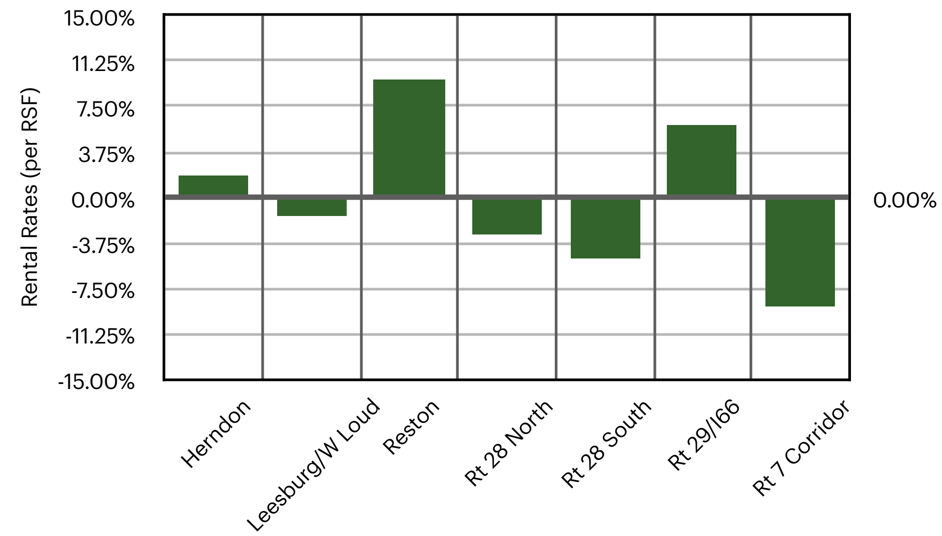
Source: Costar

2022 MARKETS: RENTAL RATES

BUILDING CLASS SPREADS ARE COMPRESSING

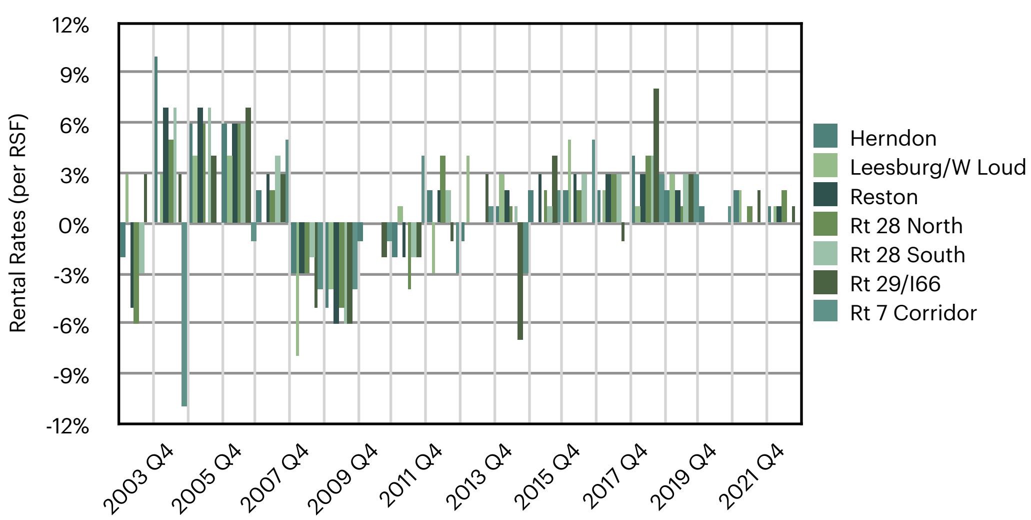
- The Class A - Class B/C spread vs trend is negative in four of the seven submarkets making Class A product relatively more attractive.
- Year over Year B/C rental rate increases slowed in 2022, reflecting falling demand and rising vacancy rates.
- Note that Class A Rents in Reston and Herndon remain more than 15% higher than Class B Rents, a spread we expect will tighten in 2023.
- Institutional owners are providing relatively larger concession packages, including richer TI allowances. By comparison, many local ownership entities are marketing space "as-is" or limiting the scope of proposed buildouts as cash flows decrease..

Class A v B/C % Spread: Q4 2022 Discount from Trend



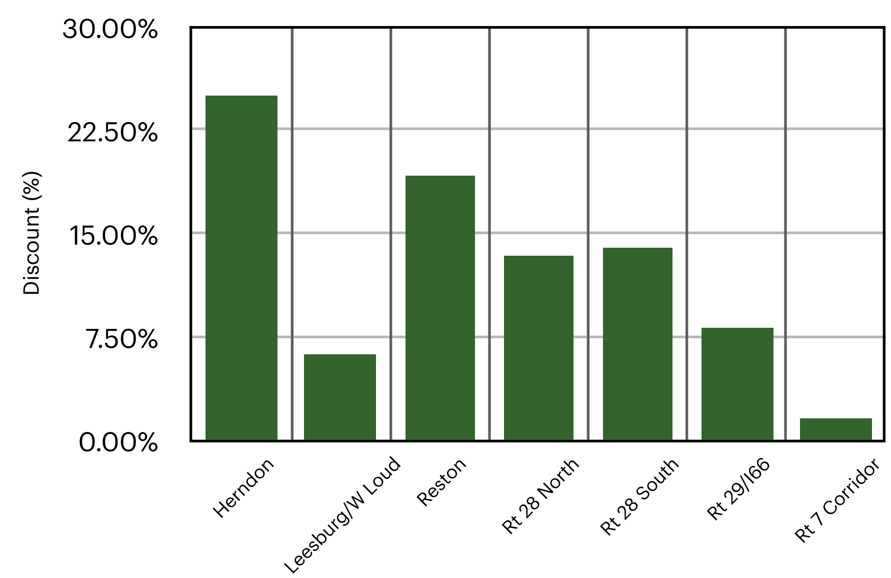
Source: Parker Real Estate Advisors, Costar

YOY Rental Rate Increase: Class B/C



Source: Parker Real Estate Advisors, Costar

% Discount: Class B/C from Class A Rates



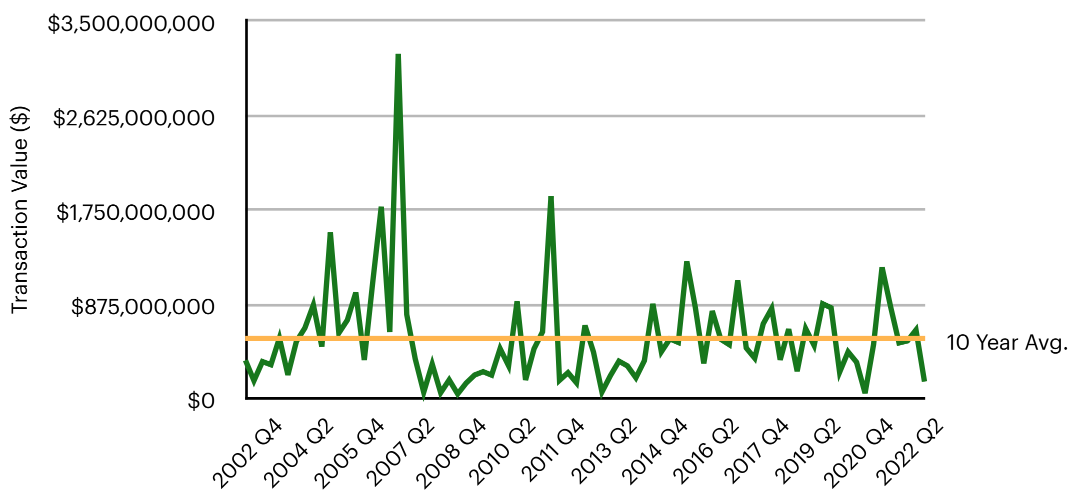
Source: Parker Real Estate Advisors, Costar

2022 MARKETS: INVESTMENT SALES

VANISHING LIQUIDITY & FEWER TRANSACTIONS

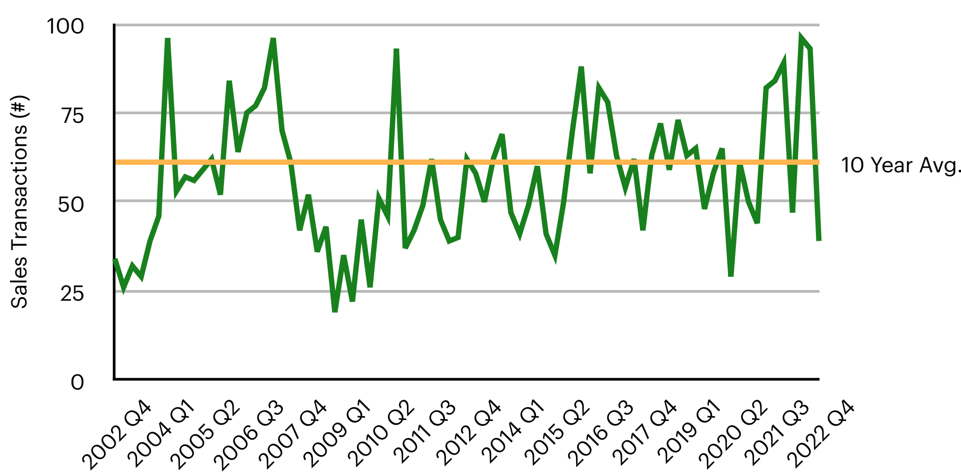
- As both cap rates and the cost of debt increased, transaction velocity slowed.
- Transaction value in Q4 2022 was 71% lower than the 10 year average and lower than 54 of the previous 60 quarters.
- The aggregate square footage traded also declined in the last quarter. Q4 performance was 74% less than trend.
- 39 transactions were reported in Q4, a 36% decrease from trend.

Sales Transaction Value ($):Quarterly Since 2002



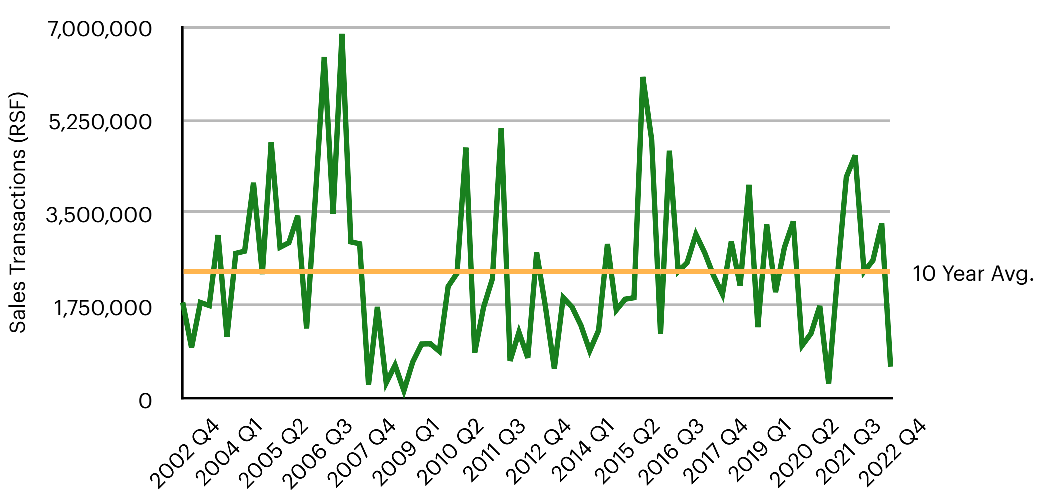
Source: Parker Real Estate Advisors, Costar

Sales Transaction Volume (#): Quarterly Since 2002



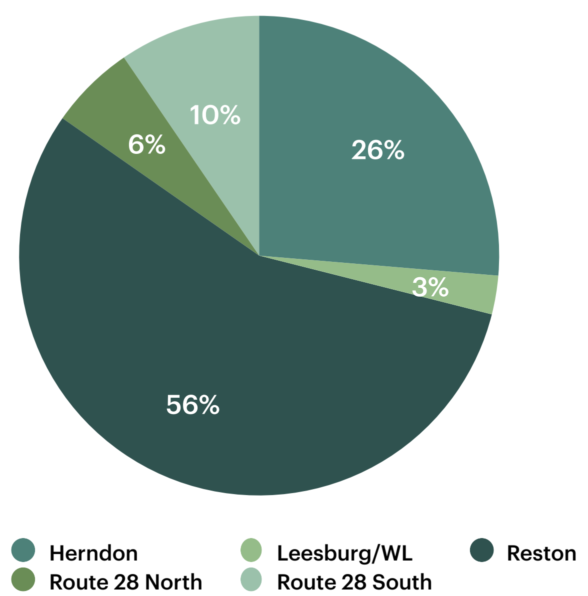
Source: Parker Real Estate Advisors, Costar

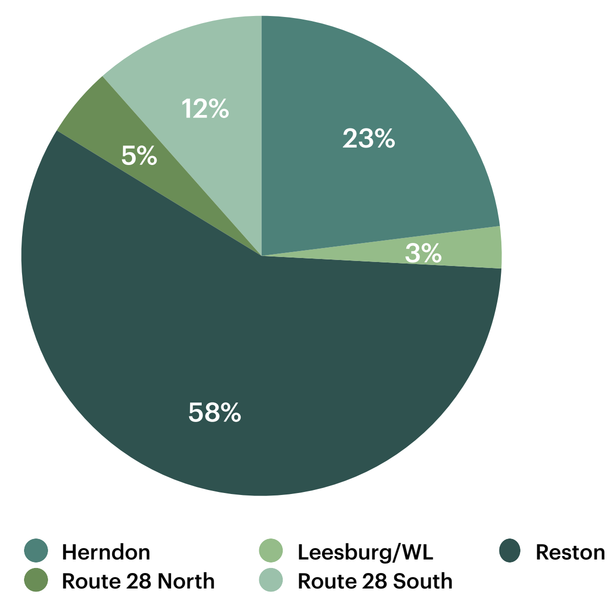
Sales Transaction Volume (RSF): Quarterly Since 2002

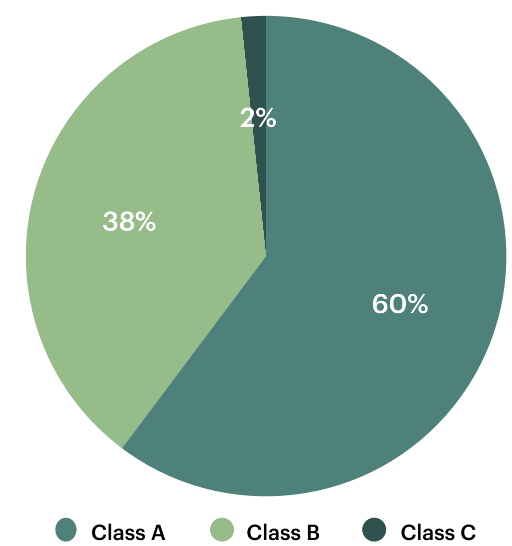


Source: Parker Real Estate Advisors, Costar

2022 MARKETS: INVESTMENT SALES



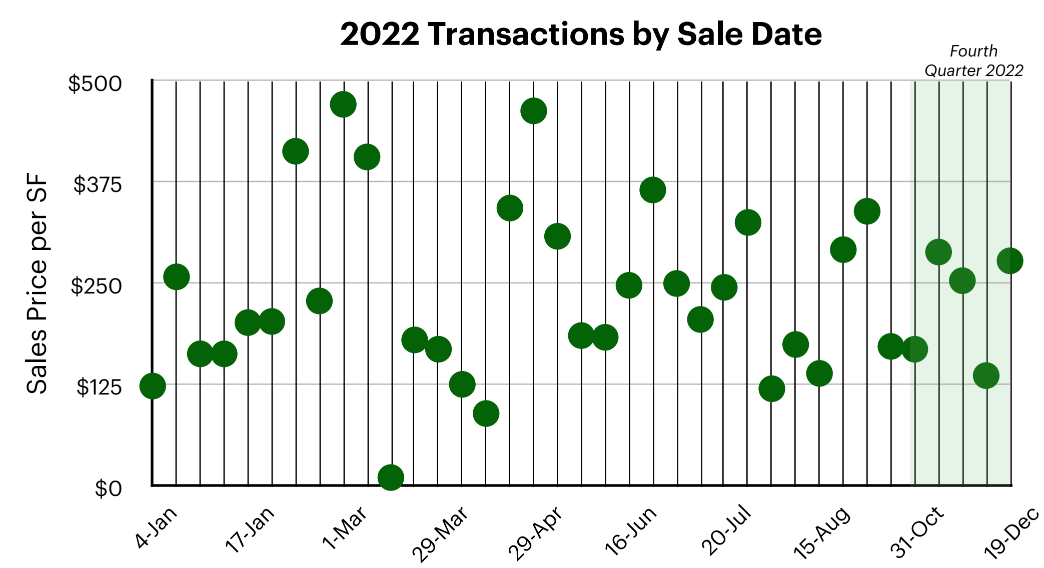




2022 Dulles Region Sales Transactions

Market	RSF	Transactions Considered	Value	Price/SF
Herndon	587,828	3	$119,200,000	$203
Leesburg/West Loudoun	58,318	10	$14,640,000	$251
Reston	1,245,058	15	$299,939,059	$241
Route 28 Corridor North	128,622	3	$24,439,000	$206
Route 28 Corridor South	212,723	5	59,720,000	$281

Source: Parker Real Estate Advisors, Costar, MSCI Real Capital Analytics



Source: Parker Real Estate Advisors, Costar, MSCI Real Capital Analytics

OUTLOOK

INTEREST RATES: DURATION AND SPREAD

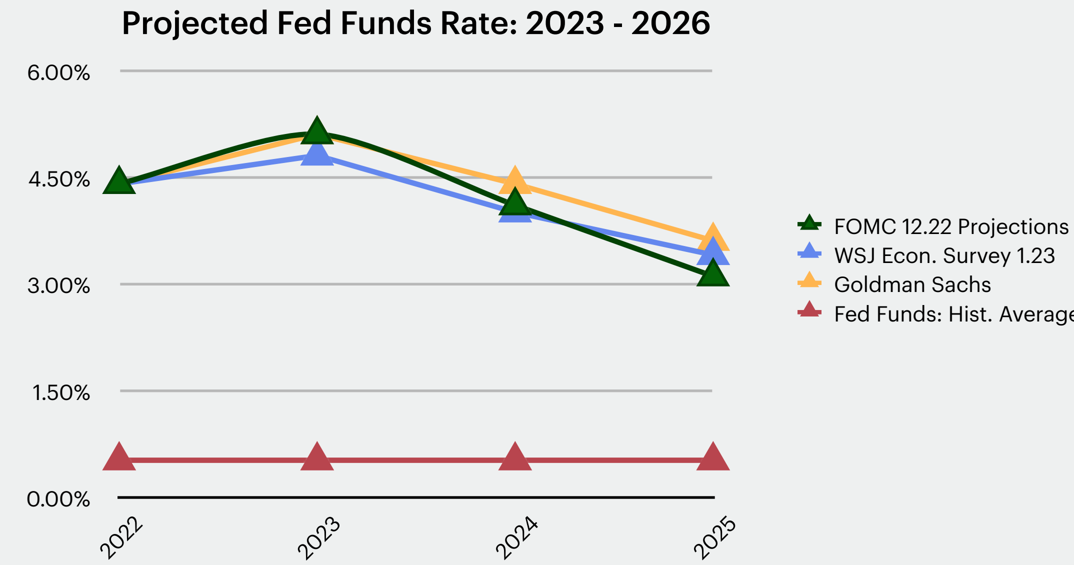
For the last 15 years "free" money and falling cap rates provided real estate investors with multiple opportunities to profit on the arbitrage between the acquisition rate and the exit rate. At the end of 2022 the Fed Funds Rate target range was between 4.25% and 4.5% while the average rate since 2010 is only .53%. In January 2026 the Fed Funds Rate is assumed to be 250 bps above that historical average. The 10 Year Treasury rate is also estimated to remain higher in the mid-term, however the spread between trend and forecasted rates is only +/-100 bps, as the markets continue to price in rapidly falling inflation and a more accommodative Fed.

Today's rules tip the execution of past strategies on their heads. Considering the change in leverage and the increased cost of debt and equity, the weighted cost of capital has risen by more than 200 bps.

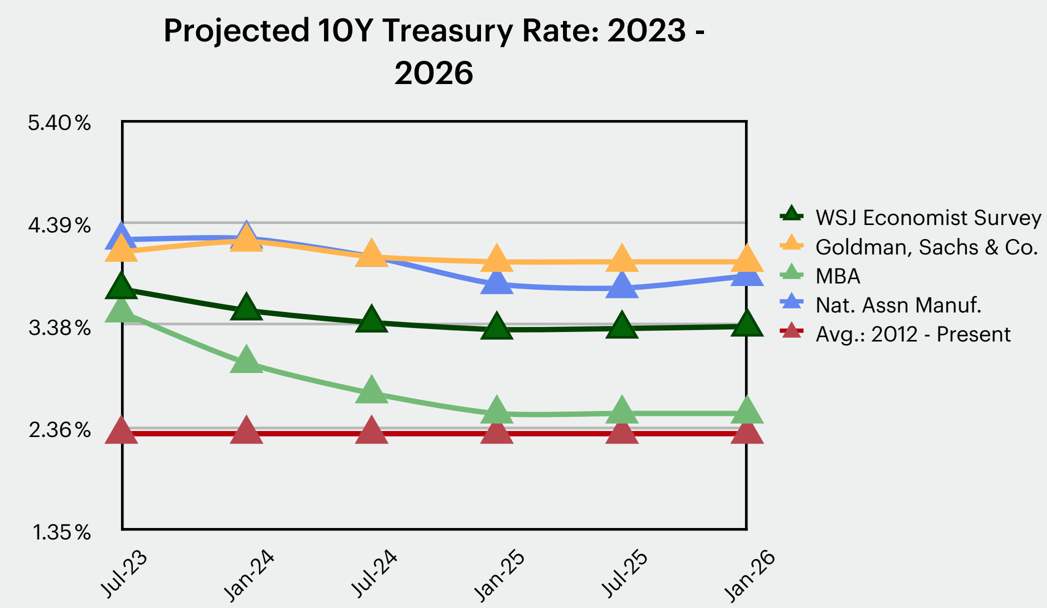
IMPACTS OF HIGHER COSTS OF CAPITAL

PARTY	IMPLICATION	OPPORTUNITY
Owner/Operator	Cap Rate increases are reducing sales value of properties while higher interest rates are impeding refi.	Limited impact on owners with high occupancy, long term credit leasing and no imminent loan maturity. Value created by attending to NOI growth.
Lender	LTV questions emerge as appraisals reset. Falling NOI will impact DSCR. At the same time new loans must account for banks' cost of capital.	New loans will have less leverage, recourse, and be set at higher rates. Opportunity for non-bank lenders who understand regional market risk.
Equity Investment	New deals will carry higher weighted cost of capital, making it more difficult to bridge the "bid-ask" spread.	Elevated returns available when interest rates and/or cap rates decline in longer term.
Bridge Capital	Pressures on sponsors of existing deals can be addressed by introduction of new capital.	Underlying strength of Dulles Region markets provides good risk adjusted returns.

CONTEXT



Source: Federal Reserve Board Open Market Committee, Wall Street Journal Survey of Economists, Goldman Sachs, FRED Data/Federal Reserve Board St Louis.



Source: Wall Street Journal Survey of Economists, Goldman Sachs, Mortgage Bankers Association, National Association of Manufacturers, FRED Data/Federal Reserve Board St Louis.

OUTLOOK

DRIVERS

The Dulles Region is defined by a growing, relatively affluent, well educated population, many of whom work in the region as well. The presence of a robust federal contracting presence, particularly related to DOD and Intelligence based activities serves to underpin the regional economy.

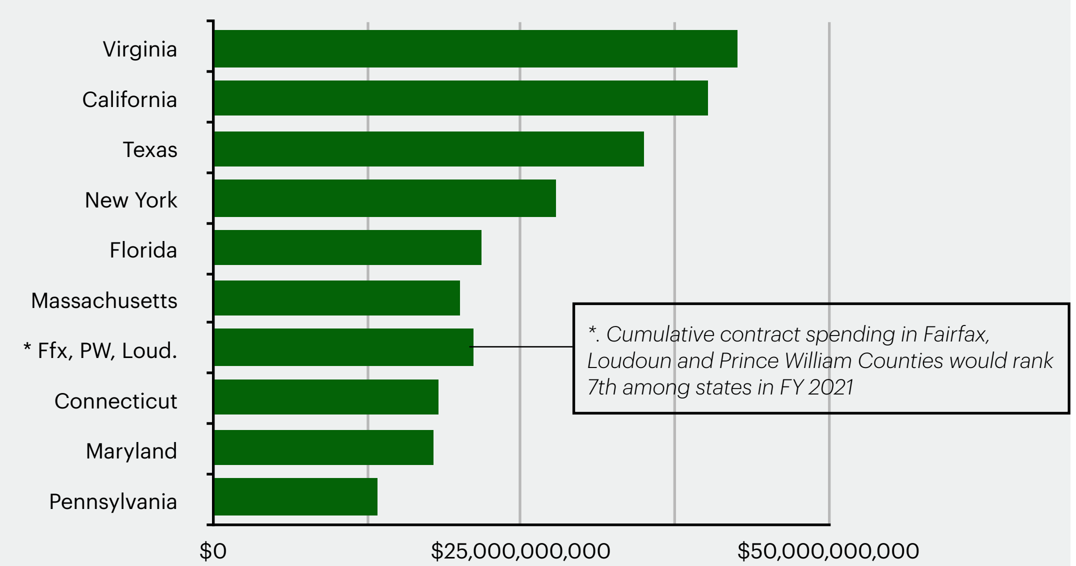
2023 Dulles Regional Drivers

DRIVER	COMMENT	LOCATIONAL IMPACT	2023 TREND
Data Center Demand	Continuing demand for land to develop DC pushing per acre values above $2.5M	Loudoun County and Prince William Counties	↑
Rail To Dulles	Infrastructure completed in late 2022 but limited upside in near term for real estate investment.	Loudoun County & Fairfax County	→
Defense Spending Authorization	Growth likely in cybersecurity, GPS-Intelligence and systems integration, supporting office demand	Loudoun, Fairfax & ,Prince William Counties	↑
Population Growth	I-81 Corridor and WV Panhandle growth rates reflect available, well priced housing stock	Winchester, Fauquier, Frederick City, VA, Loudoun, Western PW Counties	↑
Job Growth	Median job growth for region was 2.09% through June 2022, returning to trend. Question is recession.	Fairfax, Loudoun, Prince William, Jefferson, Frederick VA,, Clarke and Fauquier Counties	→

CONTEXT

- Aggregate FY 2021 DOD contract spending for Loudoun, Fairfax and Prince William Counties would rank 7th among all states.
- Forbes ranks Loudoun and Fairfax Counties first and second nationally in Median Household Income.
- Loudoun, Jefferson and Berkeley Counties are among the 120 fastest growing counties in the U.S. through 2027.
- Loudoun houses the largest concentration of data centers in the world.

FY 2021 DOD Contract Spending



Source: U.S. Department of Defense, Office of Local Defense Community Cooperation, “Defense Spending by State FY 2020.”

OUTLOOK

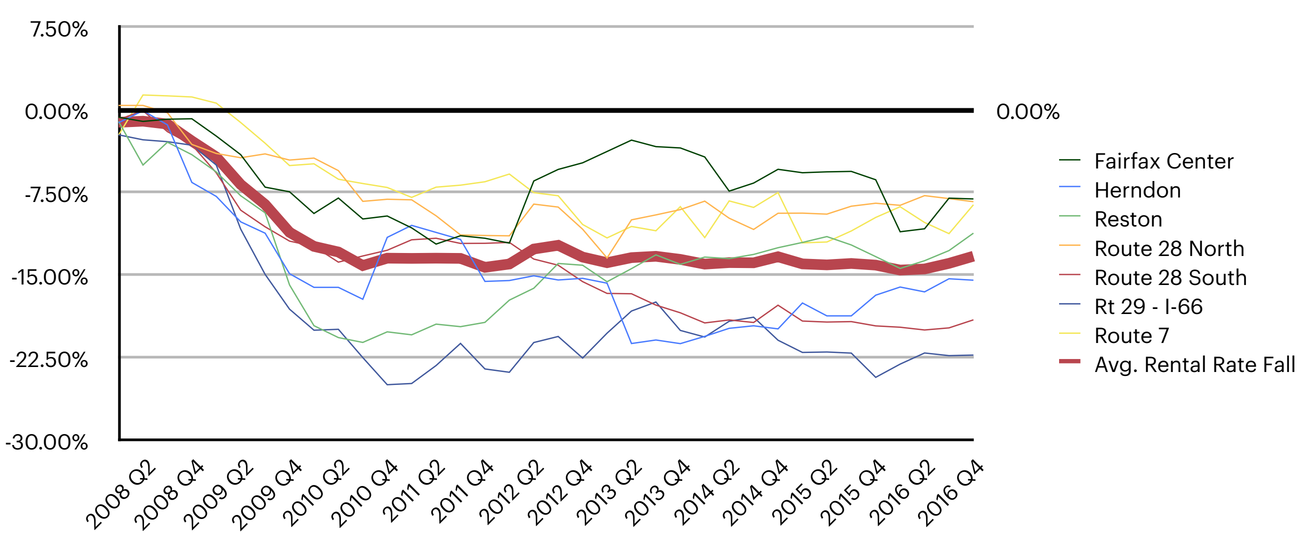
MARKET: VACANCY AND NOI

The NOI in many office projects is already under siege as occupancy and rental rates have moved downward. In 2023, office vacancy will continue to rise as demand remains muted. Western Fairfax and the Route 28 Corridor are, today, the most stressed. This trend will continue. We believe that, as leases roll during 2023, tenants will elect to reduce their office footprint between 10% and 20% and migrate to Class A buildings as relative rental rates compress. Should the economy fall into a recession, the impact will be magnified.

- NOI Impact: An extended duration of reduced or flat rental rates and elevated vacancy rates is likely to mirror the trend experienced in the Global Financial Crisis (see chart below).

- NOI Impact: Recession related job loss would decrease demand further with a related negative pressure on net absorption resulting in outcomes similar to those experienced between 2008 and 2013 when rates fell 14% and vacancy climbed by 20%.

Dulles Region % Rental Rate Fall from Peak: 2008 - 2017



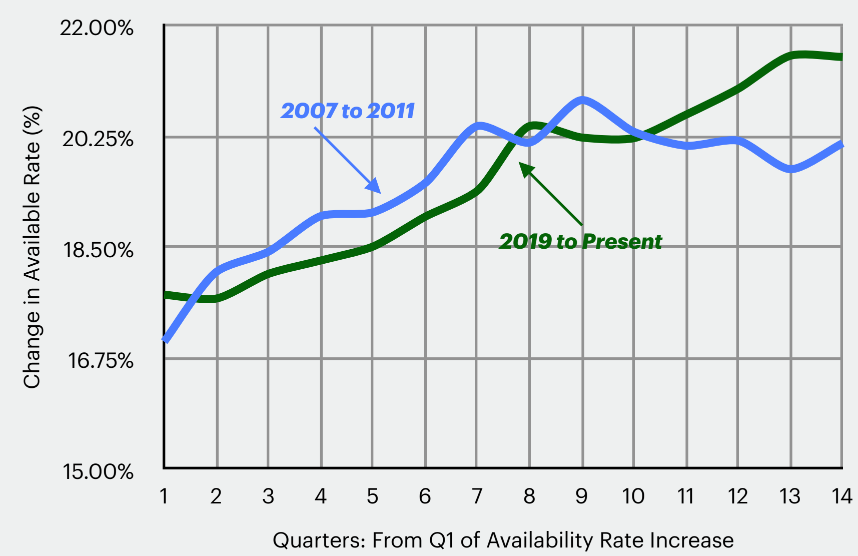
Source: Parker Real Estate Advisors, Costar

CONTEXT

2023 Projected Availability by Submarket

	Available Q4 2022	Projected Avail. Q4 2023	Projected Avail. Q4 2023 w/ Recession
Herndon	31.81%	37.38%	45.27%
Reston	27.96%	30.76%	32.86%
28 North	11.93%	15.42%	16.31%
28 South	18.86%	24.35%	24.72%
Rt 29/I-66	8.24%	12.05%	12.39%
Route 7	9.88%	13.39%	14.24%

Available Office (%): GFC Period vs Present



Source: Parker Real Estate Advisors, Costar

OUTLOOK

ASSET VALUATION

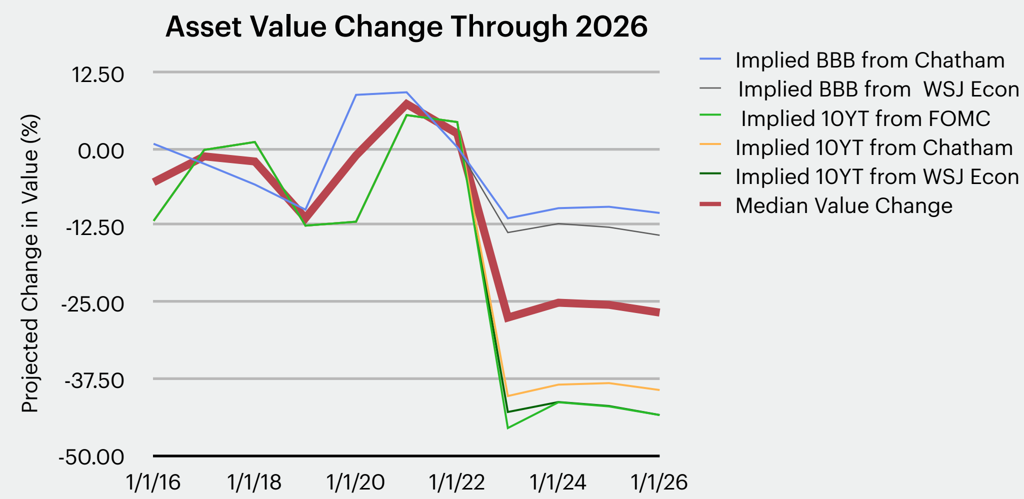
As noted on page 13 above, relative to other national markets, the Dulles Region Market will continue to attract investment because of the fundamental drivers, including population growth, infrastructure investment, GDP growth, high median family income, an expanding employment base and a highly educated workforce. <u>Longer term value relative to other U.S. markets is considerable.</u>

That said, the rise in the risk adjusted cost of capital has increased cap rates since the summer. The 150 bps to 250 bps rise has, in turn, reduced values by an average of 25% (see chart to right). Because deal volume slowed there were fewer sales comps to confirm this trend. However, the recent rise in real estate tax appeals to lower assessments speaks clearly and loudly. This fall in value will not be reversed in 2023. Appraisers will catch up in the first half of the year.

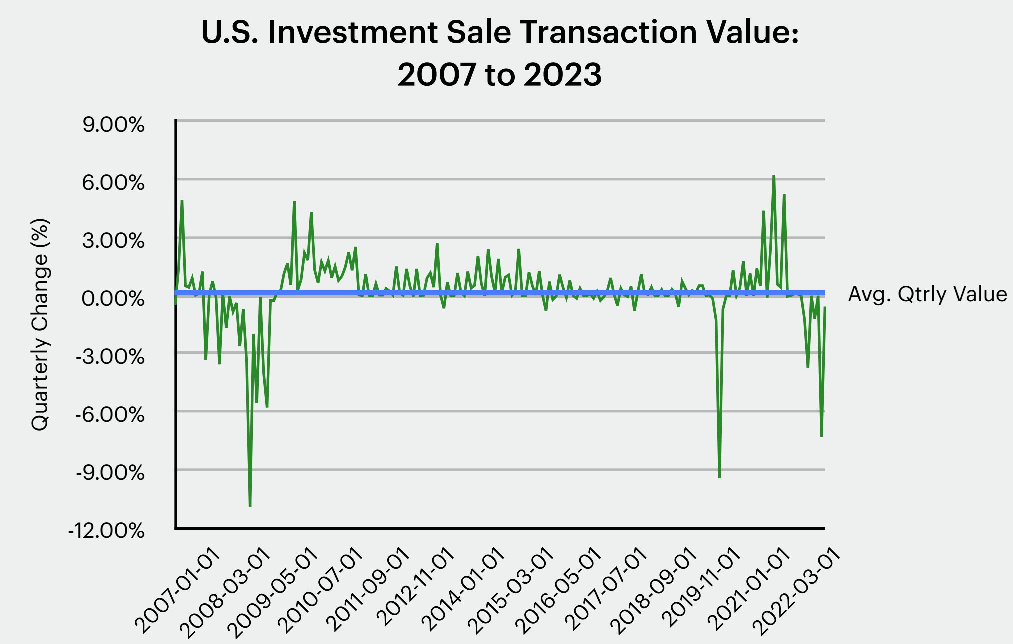
Nationally, Green Street and RCA reported that Q4 2022 transaction value fell precipitously. Moreover, the lack of liquidity reduced both demand and the associated offering price for many assets, a condition likely to persist in 2023.

ASSET CLASS	OBSERVATION	2023 OUTLOOK
Office	Weakening demand and downward rental rate pressures.	Value damaged as NOI falls and cap rates increase.
Retail	Consumer spending falls modestly as economic conditions tighten injuring smaller retailers.	Value supported by underlying demographic fundamentals but NOI growth limited by recession.
Industrial	Land cost escalation because of data center development limits new development.	Continued demand for product to serve growing population supports continued aggressive pricing.
Flex	Remains a product of choice for many smaller office users. Supply limited.	Value for flex will be supported by high land costs and elimination and re-purposing of existing product.

CONTEXT



<u>Note:</u> The fall in asset value comes in response to the upward movement of cap rates that commenced in 2022.. The cap rate trends outlined above reflect both a 450 bps spread from forecasted 10Y Treasuries and a 250 bps spread from forecasted BBB Corporate Rates .**<u>Source:</u>**Wall Street Journal Survey of Economists, Chatham Financial, FRED Data/Federal Reserve Board St Louis, Parker Real Estate Advisors, ICE BofA BBB US Corporate Index



Source: Green Street, Green Street Commercial Property Index

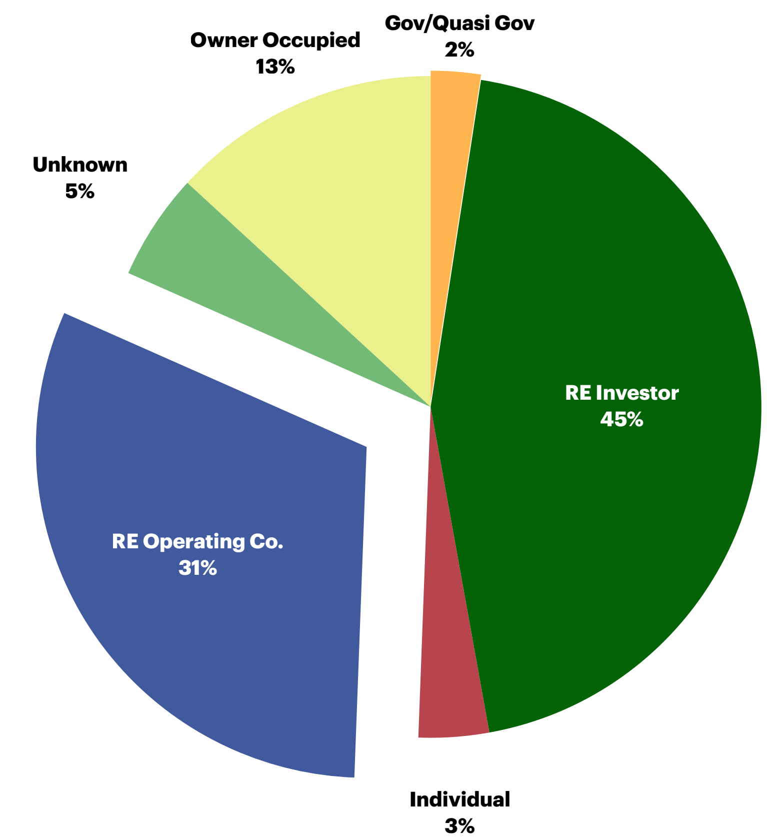
2023 STRATEGIES

STRATEGIES

Dulles Region: 2023 Investment and Project Operating Strategies

RISK MITIGATION : OWNED ASSETS	ACQUISITION TARGETS	DEBT AND EQUITY PLACEMENT	APPLICATION OF EXPERTISE
Exit office investments - rip off band aid	Infill small industrial and flex	Bridge capital addressing 25% hole in capital stack	NOI preservation, including contract rebid, energy management, pro-active releasing programs
Exit long term vacancy	Value-add retail for repositioning	Owner occupied assets with underlying credit	Entitlement of sites for future data centers and conversions
Exit condo strategies in favor of lease structure	Leesburg/ Purcellville smaller deal size & longer term hold	Local and county gov-tenanted credit	Design as a value creator/presever
Employ non-traditional refinance vehicles where available	Debt and Discounted Debt	Leesburg due to underlying stability	Reconsideration of interior design in historic buildings to maximize useable area
Increase tenant demand for one story office by adding loading	Medical office investment on hospital campus'	Medical Office and Lab Uses	Multiyear, value add, CAPEX plans for longer term holds
	Submarkets where cap rates will decline earliest.	Pool Funds in 2023 for future investment opportunities	Residential development in Jefferson County

Dulles Region: Ownership Type



During a Time When Project Operating Expertise is at a Premium Only 31% Have Significant Experience

VARIABLES

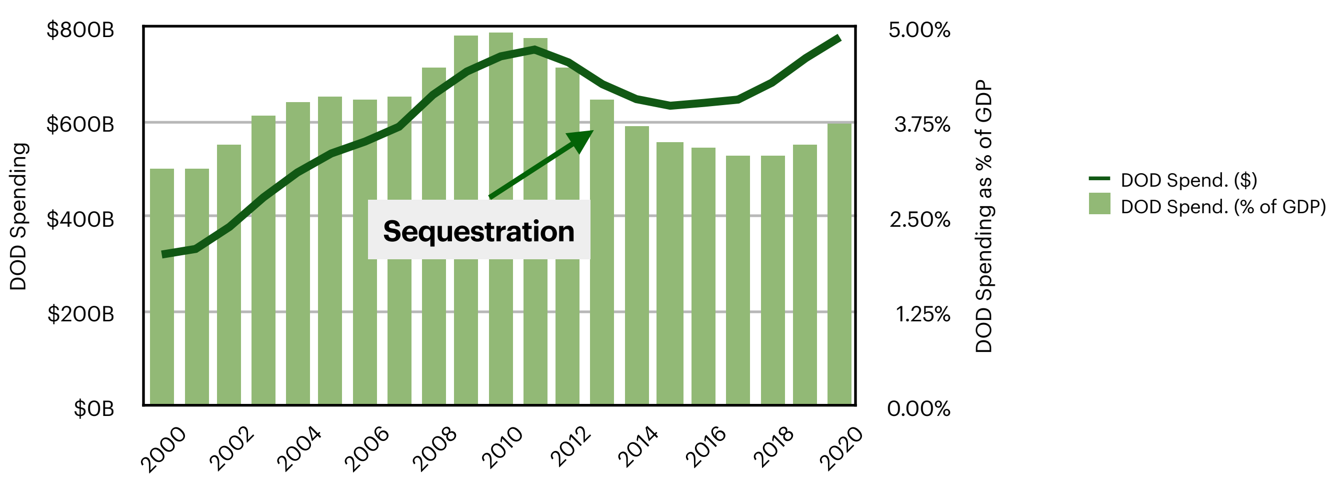
CONSIDERATIONS

Recession: The January 2023 WSJ survey of economists indicated that the majority believe a recession is likely in the next 12 months (right). A recession would impact demand for retail and industrial assets as well as office.

Impact of Buildings with Availability Greater Than 20%: : In the Dulles Region there are 129 assets in this set; *the total set has an availability rate of 56.7%*. See chart at lower right. These buildings are and will continue to place a drag on the market, reducing average market rental rates. As some become REO with a reset basis with lower asking rental rates, they will attract demand away from other properties.

Defense Spending: Defense spending is not being cut. U.S. interests in Ukraine, the Persian Gulf, Taiwan and North Korea require a larger financial commitment. Unlike 2012 through 2017 (below), Sequestration is off the table. Spending will not decline in ways that impact this region. Rather, expect Defense contracting to continue to grow.

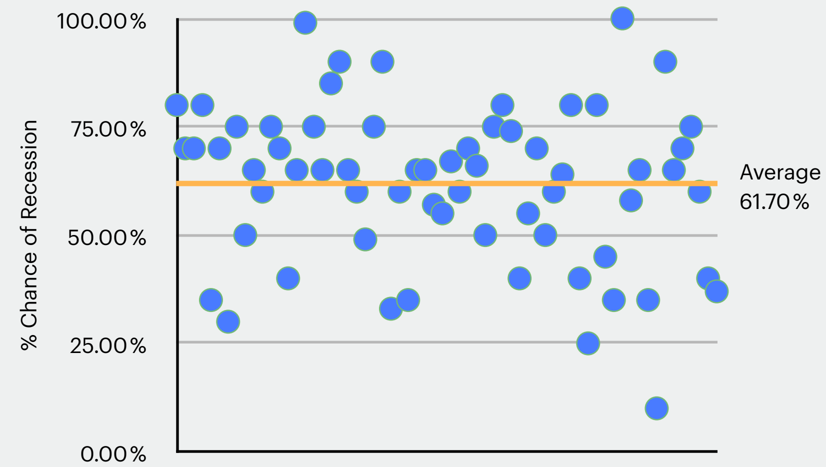
U.S. Department of Defense Budget



Source: Macrotrends, United States Military Spending

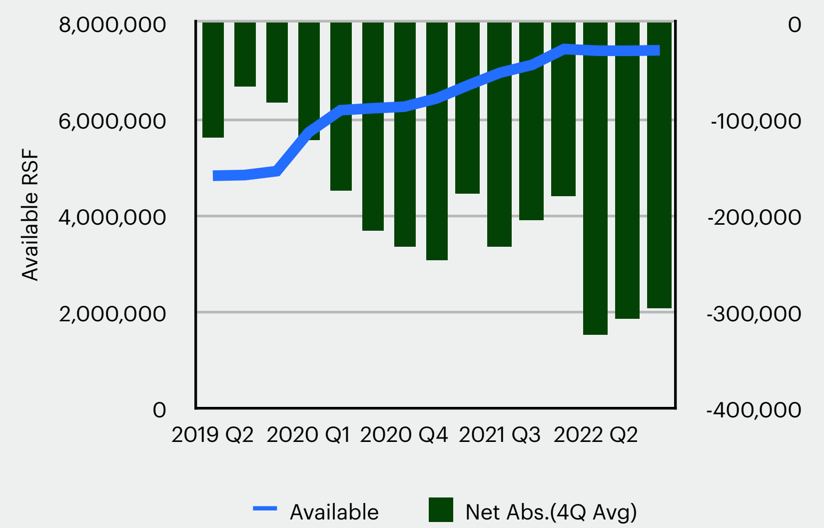
CONTEXT

WSJ January Survey: % Chance of Recession in 12 Months?



Source: Wall Street Journal, Survey of Economists, January 2023

Dulles Region Buildings: Availability Greater than 20%



Source:Parker Real Estate Advisors, Costar

EXPERTISE AND FLEXIBILITY

PARKER REAL ESTATE ADVISORS

Parker Real Estate Advisors is a 4 year old, Loudoun-based advisory firm created to assist clients position and manage their real estate interests. Our goal is to maximize financial performance while reducing the risks and costs that accompany ownership, equity investment and lending.

Market research and the careful analysis of that research are central to the firm's values, and are foundational in the development of all asset strategies. Tactically, broad-based expertise and ground level experience are leveraged to execute considered solution plans that align with our clients' goals

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DAVID W. PARKER

PARKER REAL ESTATE ADVISORS

Mr. Parker has provided asset management and real estate advisory services to corporate and institutional clients for more than 35 years. Additionally, he has overseen the expansion and strategic direction of three real estate companies, increasing revenue and profit in each instance. Most recently Parker was a partner with the PMRG, a Houston-based, national real estate investment firm, where he oversaw all business activities for a 35 million square foot portfolio on the East Coast, and Market Leader for the Washington DC Metro Area at Colliers International.

Parker has acquired, repositioned, sold, and managed more than 42 million square feet with a value in excess of $5B, including office, industrial, medical office, and mixed-use commercial real estate regionally and nationally.

He is a former Chairman of the Loudoun County Economic Development Commission and President of the Dulles Area Transportation Association and has served as a commissioner on the Loudoun IDA/EDA, and on the boards of the Loudoun Chamber of Commerce, Loudoun Cares and the Loudoun Impact Fee Task Force.

Parker received a BA from Williams College and studied economics at Columbia University. He and his wife, Mary, have lived in Loudoun County for more than 25 years.

David W. Parker

WILLIAM E. KAYE

PARKER REAL ESTATE ADVISORS

In more than 30 years of commercial real estate brokerage, Mr. Kaye has participated in the sale of over 10 million square feet of office and industrial space, building valued in excess of $10 billion. He enjoys long standing relationships with both private and institutional investors. He has been involved in transactions throughout the Mid-Atlantic regions, with his primary focus being the Washington, DC Metropolitan Area. Mr. Kaye led the Colliers International capital markets group for 10 years. Additionally, , Bill worked at the Trammell Crow Company (and with CBRE post-acquisition). He began his career at Barnes, Morris and Pardoe, a premier real estate services firm based in Washington, DC.
A native of Middleburg, Bill holds a BA from the University of Virginia and is a member of the Greater Washington Commercial Association of Realtors. He was recognized nationally as Trammell Crow Company's Brokerage Top Producer from 1999 to 2006 and awarded the GWCAR's Northern Virginia Sale of the Year in 2002.

When not in Middleburg, Bill lives in Northwest Washington, D.C. with his wife, Ann, and their two sons.

William E. Kaye