

# ApartmentResearch

M A R K E T U P D A T E

Marcus & Millichap

Southeast Virginia

Fourth Quarter 2009

## DEMAND STRONG FOR ASSETS IN STABLE NORFOLK MARKET

Steady employment-generated demand, combined with negligible supply additions, will keep apartment vacancy in the Norfolk/Hampton Roads market near current levels into 2010. Since the beginning of the year, metrowide employment has declined just 1 percent, compared to the nationwide drop of 2.8 percent, and the worst of the job cuts may be over; total employment in the metro was expected to increase by about 700 positions in the third quarter. While waning housing demand due to soft economic conditions drove negative absorption in the second half of last year and the first quarter of 2009, demand has since stabilized in line with the job market. As a result, vacancy has settled in a still-healthy range and is projected to improve in mid-2010, when payrolls begin to expand. On the supply side, the pace of apartment deliveries will moderate through year end, and a slight increase in activity is forecast for 2010. Looking forward, most completions over the next two years will occur in the Norfolk and Kempsville/Bayside submarkets, although pent-up demand should limit the effects on vacancy and rents.

Investment activity remains minimal in the local apartment market due to a persistent expectations gap between buyers and sellers. Unlike in many East Coast metros, cap rates in Norfolk/Hampton Roads have yet to increase substantially; this steadiness is due primarily to limited distress and owners' unwillingness to sell cash-flowing assets. Currently, initial yields for Class A properties average in the high-7 percent to mid-8 percent range, while Class B assets are trading with cap rates in the high-8 percent range to above 10 percent. First-year returns for both classes are up about 50 basis points over the last year. Out-of-area buyers, particularly from Washington, D.C., Philadelphia and New York City, continue to target apartment assets in Norfolk/Hampton Roads, attracted by the market's stability, which stems largely from its significant military and government presence. With demand remaining steady for local properties, owners may want to consider selling while cap rates are in their current ranges.

### 2009 ANNUAL APARTMENT FORECAST



**Employment:** This year, total employment in the Norfolk/Hampton Roads metro area is expected to decrease 1 percent, or by 7,800 jobs. In 2008, approximately 9,500 positions were lost, a decline of 1.3 percent.



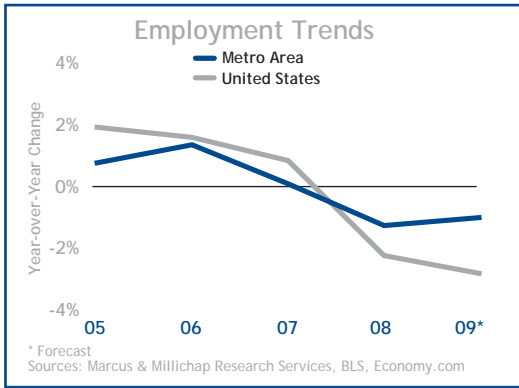
**Construction:** Projects containing nearly 700 units are slated to come online in 2009, following the delivery of 1,400 units last year. Over the past five years, completions have averaged 1,100 units annually.



**Vacancy:** Despite a decline in construction activity, weaker employment will contribute to a rise in vacancy this year. Vacancy is forecast to reach 6.5 percent, 90 basis points higher than the rate at year-end 2008.



**Rents:** Asking rents are forecast to drop 1.1 percent to \$848 per month in 2009, while effective rents will increase 1.3 percent to \$822 per month. Last year, asking rents gained 2.8 percent, and effective rents pushed up 3.6 percent.

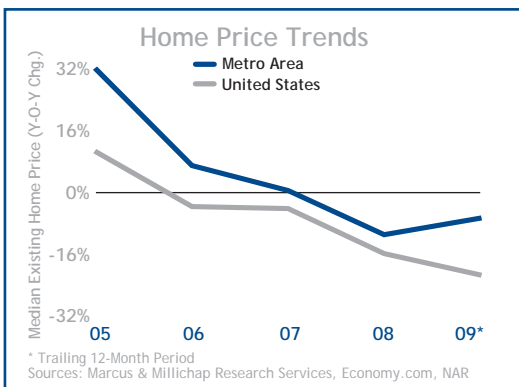


## ECONOMY

- ◆ Local employers were on track to add nearly 700 jobs to head counts in the third quarter. Year to date, total employment has decreased by 7,600 positions, or 1 percent, compared with the elimination of 7,200 workers in the first nine months of 2008.
- ◆ The education and health services industry has added the most jobs since the beginning of the year. Approximately 3,500 positions have been created in the sector during that time, an increase of 3.8 percent.
- ◆ As of the third quarter, the unemployment rate in Norfolk/Hampton Roads was 6.9 percent, up from 5.5 percent at year-end 2008 but still low compared to the national average of nearly 10 percent.
- ◆ **Outlook:** This year, total employment in the Norfolk/Hampton Roads metro area is expected to decrease 1 percent, or by 7,800 jobs. In 2008, approximately 9,500 positions were lost, a decline of 1.3 percent.

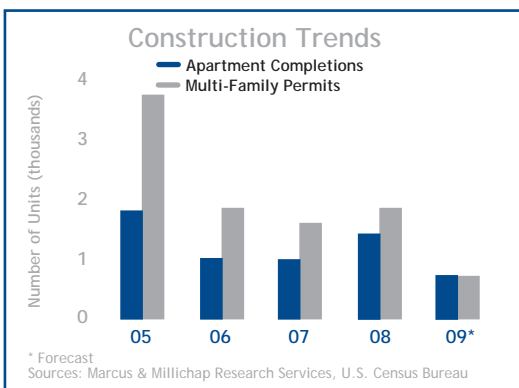
## HOUSING AND DEMOGRAPHICS

- ◆ Permits for approximately 680 units of multi-family housing were expected to be issued during the 12 months ending in the third quarter, down 70 percent from the preceding annual period. Nearly 2,500 permits for single-family housing have been issued in the last year, a drop of 28 percent.
- ◆ The median price of an existing single-family home reached an estimated \$206,000 in the third quarter, a 6.6 percent decrease from one year earlier. Demand has slowed in response to moderating for-sale market fundamentals, causing a 14 percent decline in single-family velocity.
- ◆ The metro's median household income of \$53,000 per year exceeds the minimum of \$49,000 required to purchase a median-priced home.
- ◆ **Outlook:** Limited housing demand and foreclosure activity will moderate the single-family housing market recovery. As a result, more people will opt for apartments until housing prices stabilize, which is not likely to occur until after this year.



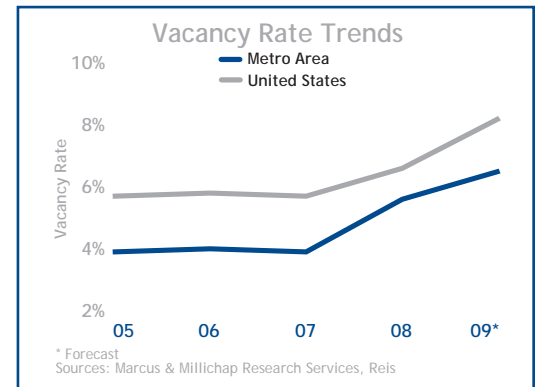
## CONSTRUCTION

- ◆ Approximately 800 units were completed in the Norfolk/Hampton Roads market during the 12 months ending in the third quarter, expanding rental stock by 0.9 percent. In the preceding year, 1,200 units were added.
- ◆ There are currently 11 projects under construction in the metro, totaling about 1,600 units. Most of the development activity is occurring in the Norfolk submarket, where four projects totaling about 900 units are under way.
- ◆ The planning pipeline contains approximately 5,400 units, although limited construction financing and weaker economic conditions will likely delay many of these developments.
- ◆ **Outlook:** Nearly 700 units are slated to come online in 2009, following the delivery of 1,400 units last year. Over the past five years, completions have averaged 1,100 units annually.



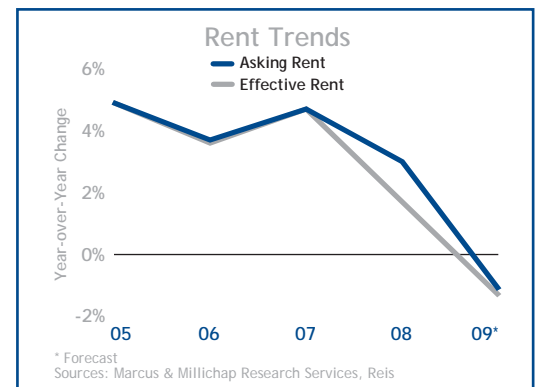
## VACANCY

- ◆ Vacancy increased 130 basis points year over year to 6.2 percent in the third quarter, the highest rate recorded this decade. In the previous 12 months, vacancy rose 110 basis points.
- ◆ In the Class A sector, vacancy has pushed up 70 basis points to 6.6 percent since the beginning of 2009. The rate is also 150 basis points higher than one year ago as a result of steady supply growth and ongoing job losses in high-paying employment sectors.
- ◆ The vacancy rate in the lower tiers has increased 130 basis points in the last year to 6 percent. The rise is the result of continuing weakness in the economy, most notably in the construction and manufacturing sectors.
- ◆ **Outlook:** Despite a decline in construction activity, weaker employment will contribute to an uptick in vacancy this year. Vacancy is forecast to reach 6.5 percent, 90 basis points higher than the rate at year-end 2008.



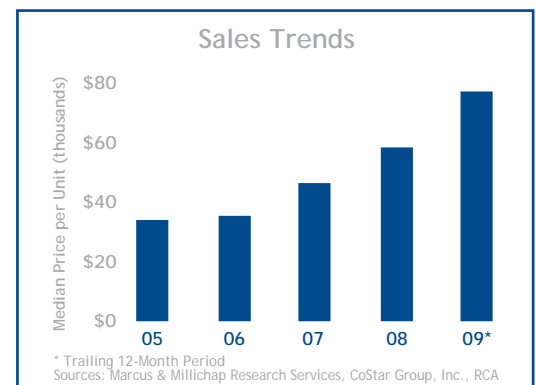
## RENTS

- ◆ During the 12 months ending in the third quarter, asking rents pushed up 0.8 percent to \$863 per month, and effective rents declined 1 percent to \$830 month. In the previous year, asking and effective rents rose 4.0 percent and 3.2 percent, respectively.
- ◆ Class A asking rents have gained 0.5 percent over the last year to \$1,004 per month. Asking rents in the lower tiers were \$757 per month in the third quarter, up 0.8 percent year over year.
- ◆ Concessions continue to tick higher due to rising vacancy. As of the third quarter, concessions were 3.8 percent of asking rents, up from 2.1 percent of asking rents one year earlier.
- ◆ **Outlook:** Asking rents are forecast to drop 1.1 percent to \$848 per month in 2009, while effective rents will rise 1.3 percent to \$822 per month.



## SALES TRENDS\*\*

- ◆ Transaction velocity has declined 35 percent over the past 12 months. The Norfolk submarket registered the most significant drop in activity, logging a 50 percent slowdown.
- ◆ The median price of properties sold in the last year was \$76,800 per unit, up 34 percent from the preceding 12-month period. The rise is partly attributable to a higher number of sales in higher-demand submarkets such as Virginia Beach and Williamsburg.
- ◆ In the past 12 months, cap rates have averaged in the high-6 percent to mid-7 percent range for Class A properties and the high-7 percent to mid-8 percent range for Class B assets. Cap rates in both classes have ticked up about 75 basis points in that time. Rising vacancy rates and concession increases will likely encourage investors to seek higher initial yields.
- ◆ **Outlook:** Investment activity will be limited into 2010, as owners are still hesitant to list cash-flowing assets. Near-term activity will center on areas where tenant demand is steady and supply-side threats are minimal, such as Williamsburg and Virginia Beach. Also, the presence of government and military employment should bode well for Norfolk apartment operations, sustaining buyer interest.



\*\* Data reflect a full 12-month period, calculated on a trailing 12-month basis by quarter.

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## CAPITAL MARKETS

By WILLIAM E. HUGHES, SENIOR VICE PRESIDENT, MARCUS & MILLICHAP CAPITAL CORPORATION

- ◆ Compared to other core property sectors, apartments have fared best due to the availability of financing through government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. Recent modifications to GSE guidelines will impact lender decisions, however, as borrower requirements include more substantial apartment ownership experience.
- ◆ Loan-to-value requirements range from 55 percent to 75 percent. Portfolio lenders are issuing loans at all-in rates of 6.00 percent to 6.75 percent for a five-year term and 6.9 percent to 8.0 percent for a 10-year term. Rates among agency lenders are roughly 150 basis points to 175 basis points lower. The government recently assumed full control of Fannie Mae and Freddie Mac, which may boost confidence in the GSEs, putting downward pressure on rates, but it also creates several near-term uncertainties.
- ◆ Delinquencies will rise further as a wave of maturities approaches; however, at-risk borrowers may find lenders amenable to loan extensions/modifications. Furthermore, Freddie Mac is under way on its second securitization of multi-family debt this year, and the government's TALF program is expected to at least provide a much-needed spark to the traditional CMBS market.

## SUBMARKET OVERVIEW

- ◆ The Norfolk submarket is expected to receive the majority of new inventory over the next two years as developers target residential pockets near military employment and the central business district. Through 2011, nearly 800 units, or 6 percent of existing stock, will be added in the submarket.
- ◆ Class A apartments in Newport News are operating at an average vacancy rate of under 5 percent, almost 200 basis points below the average marketwide Class B/C vacancy rate. Minimal new construction should keep vacancy in the area's top-tier properties near 5 percent over the next year.
- ◆ CooperVision will close its West Ghent plant in late 2010, leaving 750 employees with without work and potentially decreasing renter demand in the Norfolk submarket.

## SUBMARKET VACANCY RANKING

Rank	Submarket	Vacancy Rate	Y-O-Y Basis Point Change	Effective Rents	Y-O-Y % Change
1	Chesapeake	4.7%	90	\$829	-2.3%
2	Norfolk	4.8%	170	\$751	-2.3%
3	Lynnhaven/Oceana	5.6%	-30	\$927	-2.6%
4	Kempsville/Bayside	5.8%	80	\$935	0.3%
5	Newport News	6.0%	140	\$742	-1.3%
6	Portsmouth/Suffolk	7.0%	110	\$744	-0.4%
7	Hampton/York	9.1%	420	\$882	0.2%
8	Williamsburg	9.4%	-250	\$893	-3.1%