

## THE ECONOMY

*An uncertain future.* “Healthy defense spending means 2019 should extend a period of economic growth for Hampton Roads,” noted *The Virginia-Pilot* earlier this year citing a forecast by Old Dominion University [ODU]. “But, [the forecast] said diversifying the local economy would be even better.” These have been the issues for a long while. With the local economy heavily dependent on the military (Hampton Roads—the name itself is a nautical term—hosts five major naval bases including Norfolk Naval Base, the world’s largest), the defense budget increases implemented under the Trump administration have been music to the ears of the Hampton Roads economy. Persistent anxiety over the earlier policy of base closings and contractions (remember BRAC?) has been much alleviated.

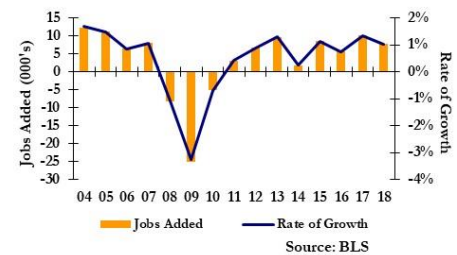
Still, the lopsided local economy remains vulnerable to trends in the defense sector and the defense budget, which are changeable. Thus, the recent boost given to Hampton Roads does not address an underlying liability—the lack of substantial diversification. Thus, while local employment “has increased, household incomes continue to rise, and local GDP continues to surge thanks to wins in defense spending, tourism, and health services,” notes Cushman & Wakefield/Thalhimer, “Washington storm clouds will continue to be on the horizon in a market so impacted by the federal political landscape.” Further, the local economy lacks the business infrastructure—a broad-based core of corporate tenants, a substantial high-tech sector, a well-educated work force, for example—that would support ample diversification. Skilled young people continue to depart the area. Thus, noted ODU in an October report, “Hampton Roads’ economic recovery features an uncertain future.”

Accordingly, the recent boost given by the defense sector is not transformative and leaves the local economy as dependent as ever on budgeting for defense. Indeed, private non-defense-related job growth has remained sluggish. According to U.S. Bureau of Labor Statistics (BLS) data, it took until late 2017 for average annual non-farm employment in the Hampton Roads Metropolitan Statistical Area (MSA) to return to pre-recession levels. Preliminary total non-farm employment in the local MSA as of November 2019, reflecting a mix of gains and losses among individual sectors, was up just 0.9% year-over-year, a gain of 7,200 jobs net. The October-to-October increase was 4,500 jobs (0.6%).

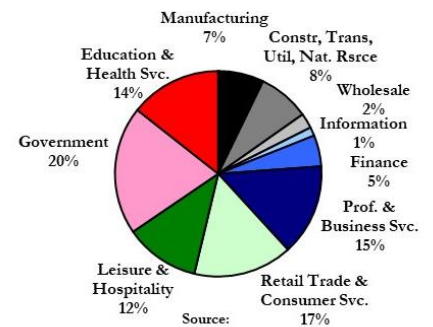
### Employment:

- The BLS reports a seasonally unadjusted unemployment rate of 2.7% in October 2019 for the Virginia Beach-Norfolk-Newport News MSA, down from 3.0% one year earlier.
- Moody’s *Economy.com* reports a third quarter 2019 average household income of \$133,349 for Norfolk. Average household incomes of \$161,142 and \$143,029 are reported for the top metros in the nation and South Atlantic region, respectively.

### Employment Growth:



### Employment By Sector:



Much of the recent weakness has been located in the Trade, Transportation, and Utilities and Professional and Business Services sectors. Employment in the former as of November was down fully 2,200 jobs from 12 months prior, a decline of 1.7%, while the latter saw a net loss of 1,700 jobs for a 1.5% decline. Notably, however, employment in the latter's Professional, Scientific, and Technical Services subsector, perhaps a reflection of defense sector activity, grew by 2,700 jobs November-to-November for a hefty 5.2% increase. Interestingly as well, the Government sector as a whole shrunk by 1,600 jobs—a 1.0% loss—even as the Federal Subsector added 1,500 net for a 2.6% gain.

The period's strongest job creator was the Mining, Logging, and Construction sector (mainly Construction), which grew by 4,700 jobs for a gain of fully 12.5%; it was the highest *rate* of job growth as well. Leisure and Hospitality, accounting for fully 14.4% of total private non-farm employment, followed with 3,700 added net—growth at 4.2%—while the Manufacturing and Education and Health Services segments each grew by 1,600 jobs for respective increases of 2.8% and 1.4%.

Population growth proceeds at a crawl. According to data provided by Moody's Economy.com, the population of the local MSA, now counted at about 1.74 million, increased by only 0.3% (about 5,000 persons) in 2018, a rate of growth low enough or nearly so to indicate net emigration. Growth at 0.4% (about 7,000 persons) currently is expected for 2019.

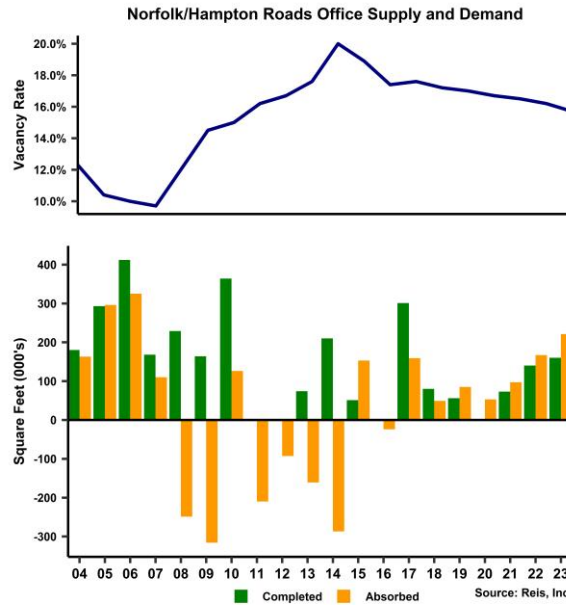
## **OUTLOOK**

While increases in defense spending bring some relief, reduce anxiety, and produce some new jobs, they neither alter the basic composition of the Hampton Roads economy nor eliminate its embedded liabilities. ODU “urges” Hampton Roads leadership to “look for opportunities to diversify the local economy.” On a large scale, though, that’s easier said than done. Slow growth and the related lack of diversification are likely to remain long-term trends here. “The 2020 presidential election, a potential withdrawal from Afghanistan, the continued rise of China, the challenge of North Korea and uncertainty in the Middle East will challenge defense budgets,” stated Robert M. McNab, director of ODU’s Dragas Center for Economic Analysis and Policy.

## THE REAL ESTATE MARKET

### OFFICE

With little corporate expansion or relocation and only a small white-collar employment sector, Hampton Roads hosts a small general purpose, multi-tenant office market counted by Reis at just 17.6 million square feet. A total of 10.1 million qualify as Class A. Inventory is widely distributed among several submarkets. The two in Virginia Beach combined and the Norfolk submarket, both on the south side, claim respective totals of 6.4 million and 4.2 million square feet. On the Peninsula, the Newport News/Hampton submarket hosts 4.3 million.



In a market that tends to see little action, there is now a new phenomenon—expansion in the coworking sector, a new trend seen across the nation, “The buzz of coworking and shared office... has finally arrived in Hampton Roads,” stated Cushman & Wakefield/Thalhimer in a recent report in the local market. Coworking firms Gather, Novel Coworking, and Percolator have opened or soon will open locations in downtown Norfolk. “The saturation in the Downtown Norfolk market is spurring on companies like Gather, Venture X, Industrious, and rumors of WeWork to explore other submarkets across the region.”

Recent construction, meanwhile, has been meager amid anemic demand. The 301,000 square feet of general-purpose space that completed construction in 2017 was the largest single-year total since 2010. Net absorption trailed at 159,000. The year 2018 followed with the delivery of only 80,000. Net absorption for the year ran at 49,000. The first three quarters of 2019 followed with the delivery of a single small project, the 56,400-square-foot Beacon One, which completed during the first quarter

### Special Real Estate Factors:

- Office:** “There are several large blocks of contiguous square footage including Norfolk Southern, Dominion Enterprises, and several former retail boxes that are inflating overall vacancy numbers above true market fundamentals.” So states Cushman & Wakefield/Thalhimer, assessing according to its own data and criteria, in its third quarter report on the local market, “Almost every submarket is a landlord favorable market, especially on existing tenant renewals as landlords look past sluggish absorption and continue to push rents.”
- More.** “The significant negative absorption numbers in Norfolk were a result of the Norfolk Southern headquarters being listed [Reis does not yet include the 300,000 square feet thus entailed; while available, the space remains occupied], the Nordstrom retail box marketed as office space, and the former Farm Fresh opportunity at 260 Boush Street that is currently under contract.”

in Newport News. Year-to-date net absorption through three quarters was 104,000 square feet, 52,000 of which is attributed to the third.

Current non-medical-office space construction includes the \$83 million, 260,000-square-foot Ferguson Town Center Campus in Newport News, for and by Ferguson Enterprises. In January 2019, meanwhile, Summit Pointe Realty LLC announced that it had commenced development of the first three blocks of the second phase of its \$300 million Summit Pointe mixed-use development at the Greenbrier community in Chesapeake, *PRNewswire* reported at the time. A 150,000-square-foot office building with ground floor retail is included. A 325,000-square-foot owner-occupied headquarters for Dollar Tree completed at the same development in August last year.

The biggest news in the recent history of this market, however, was not favorable. *Fortune 500* railroad giant Norfolk Southern announced last December that it would relocate its headquarters from 3 Commercial Plaza (a.k.a. Norfolk Southern Tower) in the Norfolk Central Business District (CBD) to a new facility in Atlanta, evacuating 331,000 square feet by summer 2021. The emptied space could represent an opportunity, say optimistic observers (see *Special Real Estate Factors* for related commentary). Work on the firm's new Atlanta site began in March 2019.

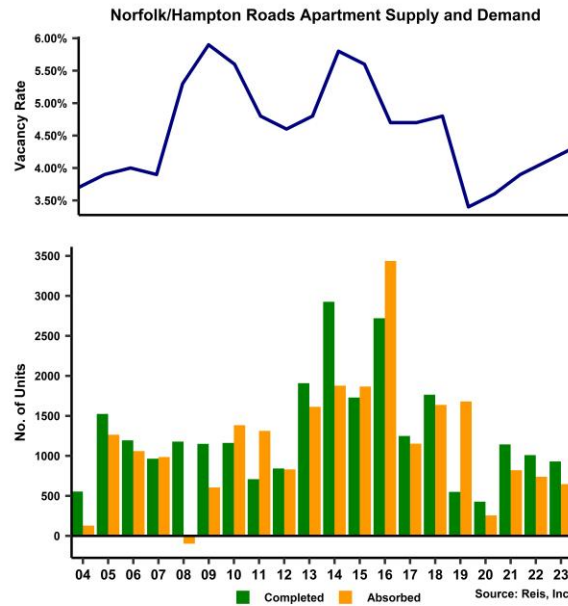
Quarter-end vacancy was 16.8%, down 30 basis points for the period and down 40 year-to-date after a loss of 40 through 2018. The Class A vacancy rate for the quarter, at 13.1%, was down 50 basis points year-to-date following a 60-basis-points decline through 2018.

Rent growth slipped to a certain extent in 2018 but has picked up somewhat in 2019. Growth, though, is not strong and rents are not high. At \$20.32 psf and \$16.78 psf, average asking and effective rates in the third quarter were up 0.9% and 1.0% year-to-date following increases of 1.0% and 1.3% all told in 2018. The third quarter Class A mean asking price, at \$22.31 psf, was up 0.9% year-to-date after 2018's increase at 0.7%.

- *While there are a few bright spots, the basic low-key profile of the local market likely will remain in place. The 56,000 square feet of new space for 2019, already online, are expected to face net absorption below 100,000. The vacancy rate would close at about 17.0%. Rent growth at about 1.5% is expected. Another low-key performance is expected for 2020.*

## APARTMENT

The large annual market-rate apartment construction completion totals seen in Hampton Roads since 2013 will be followed by a more modest sum in 2019 (currently projected at 549 units). Demand, though, has been strong relative to new supply. The 7,459 units that delivered over the four-year span ending with 2018 met with 8,090 units of net absorption. Totals for 2018 alone were 1,764 and 1,636. Much of local apartment development is undertaken by local firms.



The first three quarters of 2019 followed with only 453 units of new supply, all of which arrived during the third quarter in three projects led by the Clairmont at Harbour View Station complex in Suffolk. Local firm Kotarides Development is the developer. Also coming online during the quarter was the 132-unit second phase of the Nexus Flats complex in Virginia Beach. The 136-unit first phase completed in late 2018. Net absorption year-to-date through the third quarter, at 1,313 units, ran well ahead of same-term new supply. The third quarter net alone was 362 units.

Also completing in 2018, meanwhile, was the \$90 million, 24-story, 270-unit Icon at City Walk Tower in downtown Norfolk, the development of the iconic 1 Commercial Place office building. A second, companion office tower has been renovated. Local firm Marathon Development is the developer. See *Special Real Estate Factors* for more on Marathon and the large role it plays in the local apartment market.

Current market-rate construction consists of a combined total of 1,383 units. The newest and largest, breaking ground in December 2019, is the 15-story, 266-unit 27th Street and Atlantic Avenue tower at that Virginia

### Special Real Estate Factors: *Continued*

- Apartment:** “Thought downtown Norfolk couldn’t possibly need more apartments?” queries *The Virginian-Pilot* in a late-October article. “The developer largely responsible for turning the area into a place where several thousand people live and work, including converting the former Bank of America office tower into residences, says there’s still plenty of demand.” The developer at issue, in the person of Frank “Buddy” Gadams, is Norfolk-based Marathon Development Group, now “planning to build two more apartment complexes, this time from the ground up” (Marathon is responsible for the 2018 redevelopment of the 1 and 2 Commercial Place towers into apartment—Icon at CityWalk—and office uses).
- More.** One of the new projects would be near the Neon District on land acquired in late-2016. The other “would sit next to his high-rise Icon apartment tower near Waterside Drive. Together, they would bring more than 500 more apartments to the downtown Norfolk area.” And another developer plans to build 170 units in what is now The Virginian-Pilot headquarters on West Brambleton Avenue.” Gadams “expects to submit plans to the city within 60 days. Each project will cost more than \$50 million to build.” “Interest rates are at record lows and

Beach address. Virginia Beach-based Armada Hoffer Properties, developer of Virginia Beach Town Center, is the developer. Due online in January, also in Virginia Beach, is the 282-unit Mezzo Apartment Homes complex. Regional firm Atlantic Dominion Distributors is the owner. Breaking ground in June, also in Virginia Beach, is locally-based Franklin Johnston Group's 244-unit Coastal 61 at Oxford Village complex.

With only small fluctuations, apartment vacancy has run at or below 5.0% since the third quarter of 2016. It dipped below 4.0% in the second quarter of 2019. The rate in the third quarter was 3.7%, up 10 basis points for the period but down 110 year-to-date after a flat performance overall through 2018. The rate could slip additionally during the final quarter. While nearly all recent market-rate construction qualifies as Class A, quarter-end vacancy in that sector was only 3.6%, down 110 basis points year-to-date following a 10-basis-points increase through 2018.

Rent growth has been mainly favorable. At \$1,087 and \$1,045 per month, asking and effective averages for third quarter were up 1.7% and 1.3% year-to-date following increases of 3.4% and 3.1% all told in 2018. Third quarter growth rates were 0.6% for both averages. The Class A asking average was \$1,238 per month, up 1.3% year-to-date after a 2.8% increase through 2018.

- *The 549-unit market-rate completion total projected for 2019, smallest in a year since 2001, is expected to meet with some 1,700 units of net absorption. The vacancy rate would slip to about 3.5%. Gains at approximately 2.0% are expected for average rents for the year. A flat performance currently is expected for 2020.*

### Special Real Estate Factors:

*Continued*

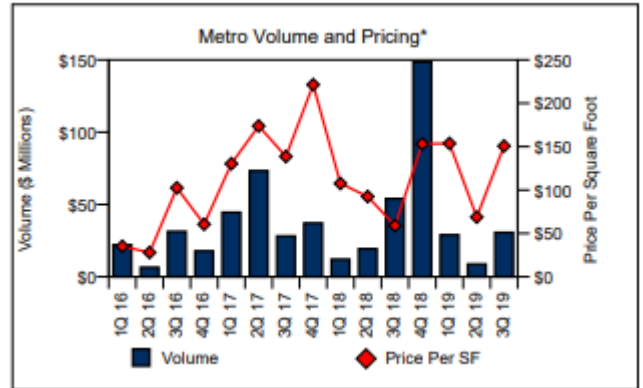
*demand is very robust for housing," noted Gadams in an email. "The opportunity is large at this point and time." The Federal Reserve has cut the interest rate twice this year and is expected to do so again, adds the article.*

## TRANSACTION ANALYTICS

### Office

Thirteen office property sales were completed during 2018 for a combined total of \$233.8 million at a low average price of \$106 psf. The first three quarters of 2019 followed with the sale of eight properties for a combined total of \$68.2 million at a mean price of \$132 psf. The third quarter total for three transactions was \$30.6 million at \$151 psf. The 12-month rolling cap rate per quarter-end was 6.7%, down from 6.8% four quarters prior.

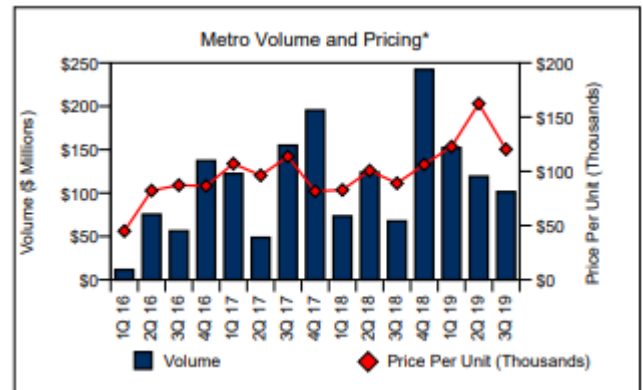
In the third quarter's largest sale, Hampton Roads Connector Partners paid FHC Property Holdings LLC \$12.97 million (\$150 psf, NRA) in August for the 86,700-square-foot Riverside Corporate Center multi-tenant office building in Norfolk.



### Apartment

Twenty-five apartment property sales closed during 2018 for a combined total of \$506.7 million at an average selling price of \$98,000 per unit. The total for the first three quarters of 2019 for 13 transactions was \$372.4 million at \$132,000 per unit. The third quarter sum was \$101.3 million at \$120,000 per unit for four deals with an average cap rate of 5.6%. The 12-month rolling cap rate per quarter-end was 5.3%, down from 6.6% four quarters prior.

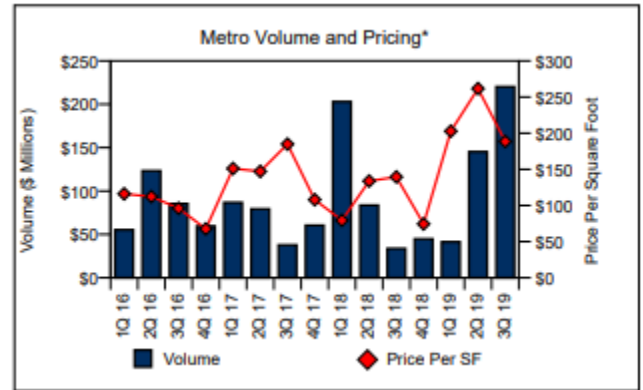
In the third quarter's largest deal, Capital Square 1031 paid Runnymede Corporation \$48.6 million (\$215,044 per unit) for the 226-unit Saltmeadow Bay market-rate rental complex in Virginia Beach. The sale closed in August at a 5.1% cap rate.



## Retail

A sum of \$364.7 million were exchanged in 56 retail property transactions during 2018, up from the totals reported for 2017. The first three quarters of 2019 saw \$406.5 million change hands in 35 deals. The total for the third quarter alone for 16 transactions was \$220.1 million. Average selling prices for the quarter and first three of the year were \$188 psf and \$211 psf. Averages for 2018 and 2017 were \$91 psf and \$141 psf. Mean cap rates measured quarterly recently have been erratic. The rate in the third quarter was 8.3%, up from 6.7% the quarter before and from 4.3% a year earlier. The 12-month rolling cap rate per the end of the third quarter was 6.5%, down from 8.1% 12 months prior.

In the third quarter's largest deal, largest in a year as well, Acadia Realty Trust paid locally-based Divaris Real Estate Inc. \$87.0 million (\$208 psf) for 419,089 square feet of the 505,699-square-foot Landstown Commons Shopping Center power center in Virginia Beach. The sale closed in September at an 8.4% cap rate. The center's 86,610-square-foot Kohl's store was not included in the sale.





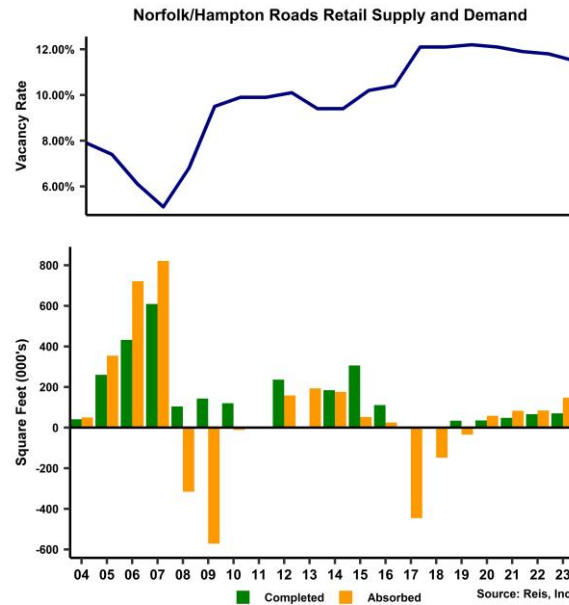
## RETAIL

Prior to the recession, Hampton Roads went through a period of unusually active retail real estate construction focused heavily on large power centers. Local development, reflecting the changes in retailing seen across the country, including numerous store closings, has been slow since (see *Special Real Estate Factors* for related commentary).

There have been a few significant items in the recent period, however. IKEA opened a 331,000-square-foot store in April 2019 in Norfolk. In the same area, a hot zone for retail, Simon Property Group's 332,000-square-foot Norfolk Premium Outlets outlet center completed in 2017. In addition, Cushman & Wakefield/Thalhimer has noted interest in the area on the part of "national brands."

The market, all the same, maintains a low profile. No retail space of any description completed construction metrowide in 2018. While 2019 followed with 447,600 square feet, most of that volume belongs to the IKEA store cited above and to a 113,000-square-foot freestanding Wegmans store, which opened in Virginia Beach in March. No retail projects were under construction per the date of this report. Another large one, however, is in the pipeline. Thus, a March 2021 completion date is given for the 500,000 square feet of retail planned for the Summit Pointe mixed-use development in Chesapeake. Dollar Tree Properties is the developer.

Until the 21,000-square-foot Shoppes at Lake Wright neighborhood center from developer Apple Retail delivered in Norfolk in May, no community or neighborhood center projects had completed construction since 111,000 square feet arrived in 2016. Following in August were 13,000 square feet of neighborhood center space at the Little Neck development in Virginia Beach. Net absorption in this sector, meanwhile,



### Special Real Estate Factors: *Continued*

- Retail:** "Notable announcements" during the third quarter included Dick's Sporting Goods decision not to renew its lease and to close its store in Virginia Beach Town Center, states Cushman & Wakefield/Thalhimer's third quarter report on the local market: However, the landlord is reporting that a replacement for Dick's has been lined up. "K-Mart will close its last two Virginia stores located in Chesapeake and Yorktown. Two Farm Fresh stores that were acquired by private operators have elected to terminate their leases and close their doors, one in Virginia Beach, and the other in Norge."
- More. "GNC and Forever 21 recently announced store closings that may impact the Hampton Roads market. GNC will close 900 stores (1.5 million square feet) around the country. Although a list of specific stores has not been released at this time, GNC currently has 30 stores throughout Hampton Roads. Forever 21 will close 178 stores (6 million square feet), with one of them being located within MacArthur Mall." In January 2020, Pier 1 Imports announced that it would close 450 of the 936 stores it operates nationwide. The future of the retailer's five stores in Hampton Roads was uncertain per the date of this report.

has been poor. A total of negative 594,000 square feet over the two-year span 2017-2018 (a portion of that loss in occupancy, however, was a statistical effect of the 2018 removal of some product from the inventory count). The first three quarters of 2019 followed with negative 25,000.

The third quarter community-neighborhood shopping center market vacancy rate was 12.2%, up 20 basis points for the period and up 10 year-to-date. At \$16.29 psf and \$13.58 psf, third quarter average asking and effective rents were up 0.6% and 0.5% year-to-date following 2018's gains of 1.4% and 1.5%. Growth rates in the third quarter were negative at 0.2% and 0.3%.

Hampton Roads power center vacancy, also somewhat elevated, ended the third quarter at 7.7%, up 10 basis points for the period and up 90 year-over-year. The national third quarter power center vacancy rate was 6.3%, down 30 basis points year-over-year. The mean asking lease rate for local non-anchor power center space for the quarter was \$21.84 psf, up 3.1% for the period, up 4.2% year-over-year.

- *Community-neighborhood center net absorption at about minus 35,000 square feet is expected for 2019 alongside the year's 34,000 square feet of new supply (already online, as described). Vacancy would hold steady. Rent growth below 1.0% on average is anticipated.*

### Vacancy

Sector	3Q19	3Q18	Chg
Office	16.8%	17.8%	-100 bps
Apartment	3.7%	4.3%	-60 bps
Retail	12.2%	12.3%	-10 bps

### Rents

Sector	3Q19	3Q18	Chg
Office	\$20.32 psf	\$19.99 psf	1.7%
Apartment	\$1,087 month	\$1,060 month	2.5%
Retail	\$16.29 psf	\$16.07 psf	1.4%

For additional information on up to 275 markets for the four principal property types plus specialty sectors, visit [www.reis.com](http://www.reis.com).

## About Reis

Reis provides commercial real estate market information and analytical tools to real estate professionals through its Reis Services subsidiary. Reis Services, including its predecessors, was founded in 1980. Reis maintains a proprietary database containing detailed information on commercial properties in metropolitan markets and neighborhoods throughout the U.S. The database contains information on apartment, office, retail, warehouse/distribution, flex/research & development, self storage, seniors housing properties and affordable housing, and is used by real estate investors, lenders and other professionals to make informed buying, selling and financing decisions. In addition, Reis data is used by debt and equity investors to assess, quantify and manage the risks of default and loss associated with individual mortgages, properties, portfolios and real estate backed securities. Reis currently provides its information services to many of the nation's leading lending institutions, equity investors, brokers and appraisers.