Hampton Roads Economic Quarterly

Volume 06, Issue 02 July 21, 2015

About this Document:

Preparation of this document was included in the HRPDC Unified Planning Work Program for Fiscal Year 2015 that was approved by the Commission at its Quarterly Meeting on June 19, 2014.

If you would like to be included on the electronic distribution list, please contact:

James Clary
jclary@hrpdcva.gov
(757) 420-8300

HRPDC
723 Woodlake Drive
Chesapeake, VA 23320

Available for download, visit **www.hrpdcva.gov**

Hampton Roads Housing Market Lags that of the Nation

By James Clary, Senior Economist

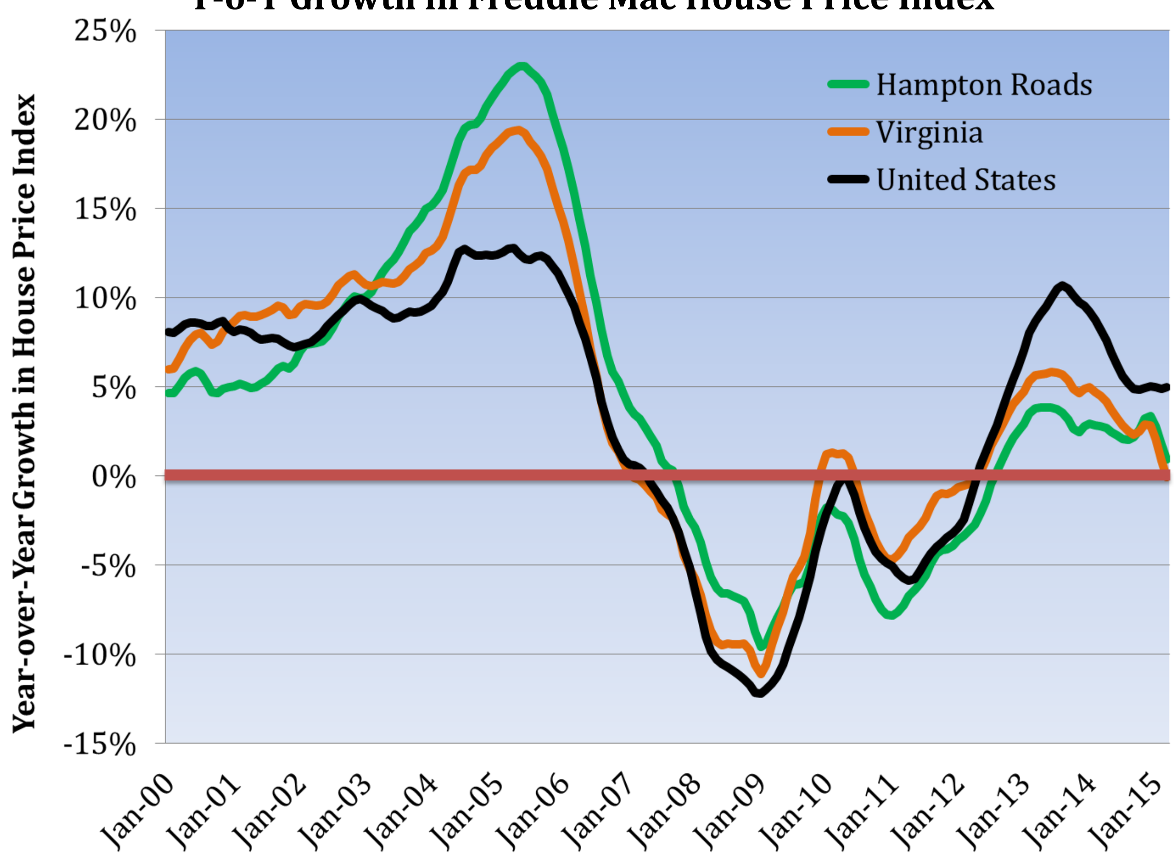
The real estate market interacts with the regional economy through several channels: a cost to workers (and employers), a method of growing household wealth, an industry that creates employment, and as a driver for retail & wholesale sales in the region.

Hampton Roads experienced a 22% decline in home prices between September 2007 and August of 2012, similar to the decline experienced by the nation (-25%). The recovery has been far more tepid regionally, as home prices have only appreciated by 7% in Hampton Roads as compared to the 20% growth in home prices nationally.

Freddie Mac House Price Index (FMHPI)

The FMHPI measures the repeat sales of homes, to measure the change in underlying home values in a community (new homes might potentially be very different than the existing housing stock in terms of amenities or square footage). Additionally, the FMHPI only tracks conforming home sales, which are far more typical of the housing market (conforming loans in Hampton Roads are those for less than $417,000).

Y-o-Y Growth in Freddie Mac House Price Index



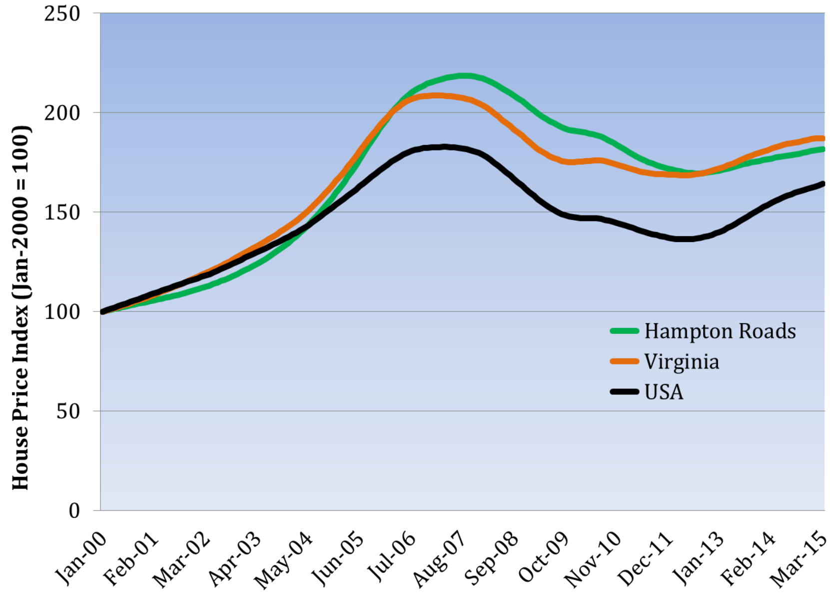
Source: Freddie Mac House Price Index, HRPDC

Factors Leading to the Weaker Regional Recovery in Home Prices

Two major factors are contributing to the weaker than expected recovery in the regional real estate market.

Firstly, both Hampton Roads and the Commonwealth experienced a larger increase in house prices during the real estate boom of the past decade. While home prices did not recover as quickly regionally or throughout the Commonwealth (+11%) as they did nationally, prices remain significantly higher in Hampton Roads (+82%) and Virginia (+87%) with respect to January 2000 values than the national price levels (+64%).

Freddie Mac House Price Index



Source: Freddie Mac House Price Index, HRPDC

Secondly, Hampton Roads' employment has experienced far more modest growth than the nation overall. Starting in January 2012, the housing markets that experienced higher levels of home price appreciation were those that had experienced the most significant declines in prices during the recession (driven in part by investors and cash buyers). In July 2014, the rebound effect had exhausted itself, and home price appreciation was once again tightly correlated with strong employment growth. Hampton Roads employment has grown slowly over the past year, adding 4,100 jobs (+0.5%), whereas U.S. employment grew by 2.2% between May 2014 and May 2015.

Hampton Roads Employment Underperforms the Nation

Different Employment Experiences Year-Over-Year

U.S. Grew 2.2%

Reference MSAs Averaged 2.2%

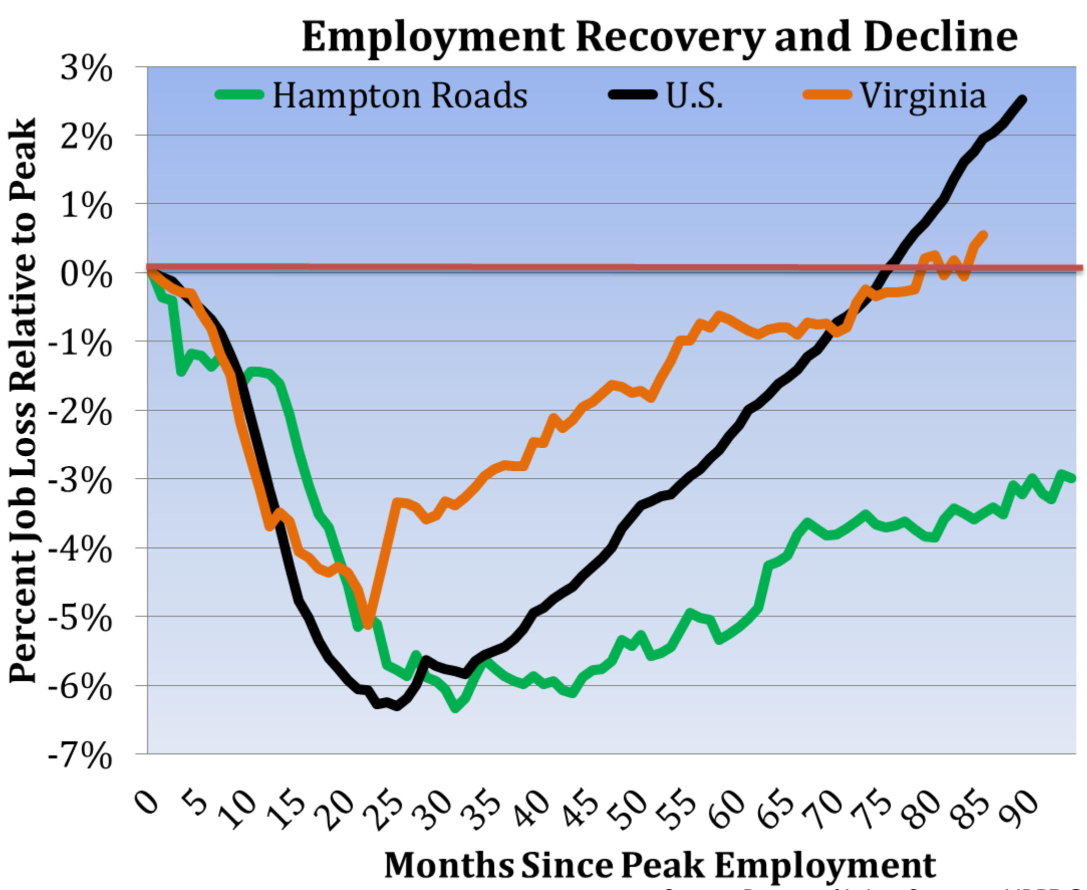
Hampton Roads Grew 0.5%

Pre-Recession Peak

U.S. is 2.5% **above** its previous peak in January 2008

Reference MSAs Averaged 3.0%

Hampton Roads is 3.0% ***below*** its prerecession peak in July 2007



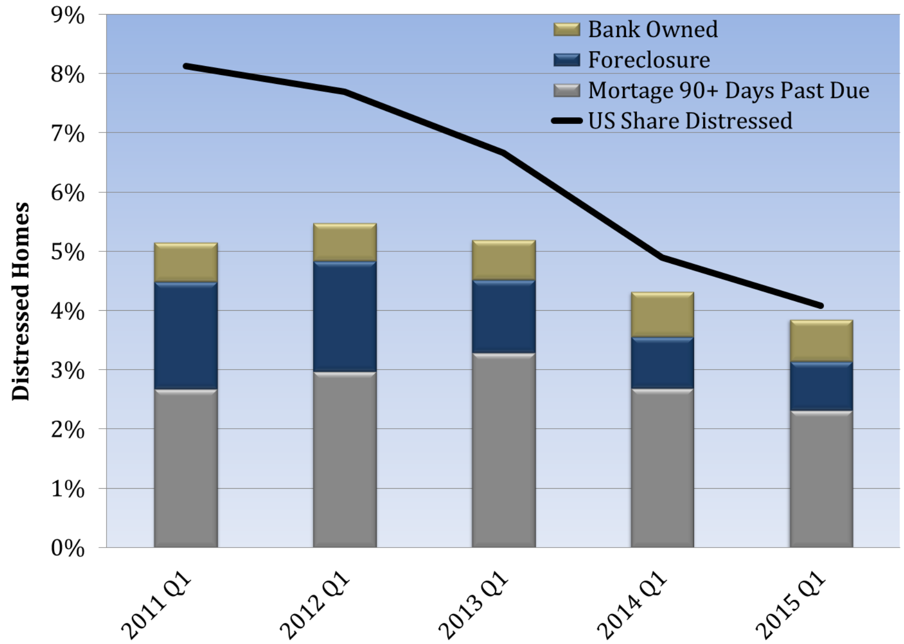
Source: Bureau of Labor Statistics, HRPDC

Problems Caused by Slow Growth in Home Prices

All else equal, low home price appreciation would be a positive, as it would indicate that the region provides a lower cost of living and would thus be more competitive economically. All else is not equal however.

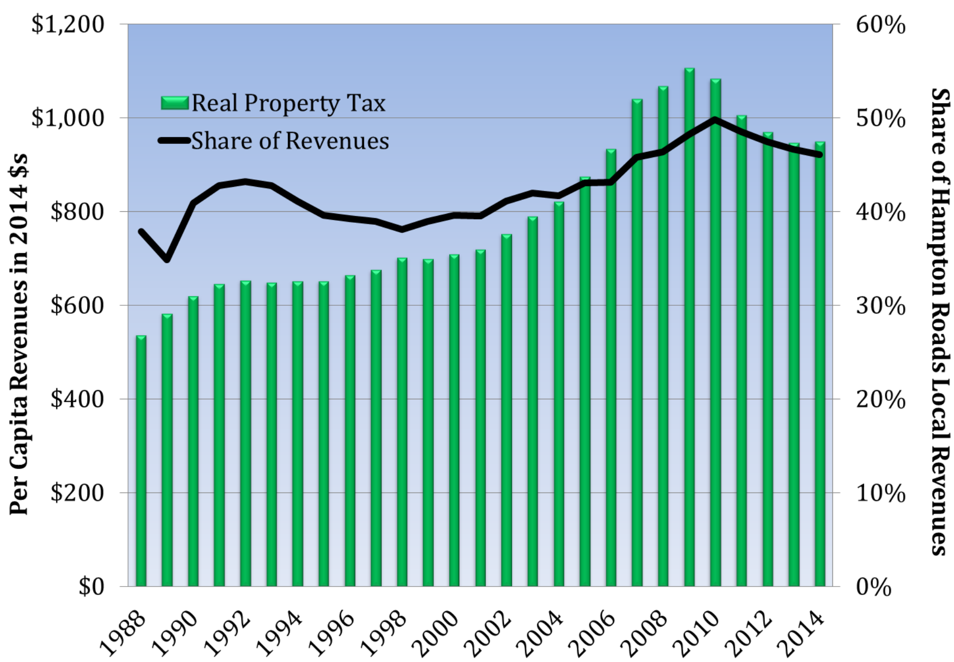
Underwater homes, where the value of the home was less than the debt owed on the mortgage, were a significant issue in the market for the first time during the price correction. The combination of lower levels of down payments and falling house prices left many homeowners underwater. This lead to issues as homeowners faced impediments to selling their homes. While the percentage of distressed homes has declined in the Hampton Roads region, the nation has seen a far greater decline in the percentage of homes that are either bank-owned, in foreclosure, or have mortgages 90+ days past due. Another issue stems from the nature of local government finances in Hampton Roads. Real property taxes generate 46% of local government revenues in this region, but that has declined from its peak in 2009. Inflation-adjusted per capita tax collections have declined from $1,107 in 2009 to $950 in 2014 (2014 Dollars). Property taxes, particularly on real estate, are the most economically efficient way for a government to raise revenue; however, if those revenues do not keep pace with the costs of services, then other revenue streams will need to be utilized, or services cut.

Hampton Roads Percentage of Distressed Owner-Occupied Homes



Source: Federal Reserve Bank of Richmond, McDash Analytics , HRPDC

Real Property Taxes & Local Finances in Hampton Roads



Source: Virginia Auditor of Public Accounts, HRPDC

Real Property Taxes generated

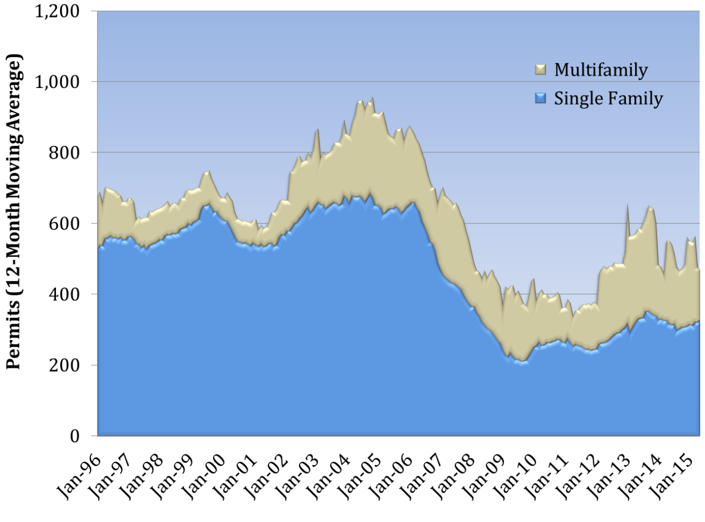
46%

of Hampton Roads local revenues, or

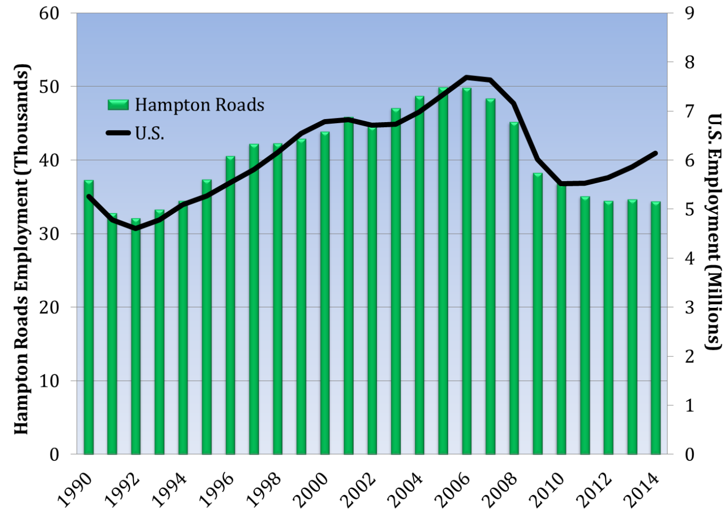
$950

Per resident in 2014

Construction Permits and Construction Employment in Hampton Roads



Source: U.S. Census Bureau, HRPDC



Source: Bureau of Labor Statistics, HRPDC

Construction and Employment

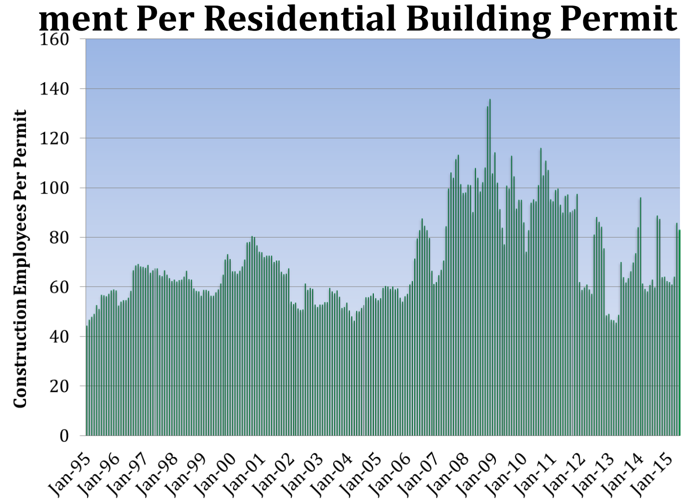
Starting in 2006, the level of building permits issued in Hampton Roads fell precipitously, as builders responded to weakness that already started to manifest itself in the regional real estate market. The level of permitting fell by almost a third between 2006 and 2009. A striking feature of the current construction market comes from the increased role that multifamily housing plays in the overall level of permitting. Building permits with multiple units constituted 30% of building permits in the 12 months ending in May, slightly above the long-term average of 25%. As recently as January 2013, multifamily rose to 50% of the building permits issued by local governments regionally. Nationally, multifamily permits have gone from 28% of permits issued to almost 40% of permits issued over the past two years. One interesting impact of the move to multifamily construction is that it uses labor more efficiently. As a result, building multifamily units employs fewer construction workers than an equivalent number of single family units.

Construction, following the overall economic recovery, has been stronger at the national level than in Hampton Roads. Building permits nationally are only 9% below their long-term average, while in Hampton Roads permitting still lags the long-term average by 27%. Construction follows a similar pattern, and while construction employment has grown nationally, regional construction employment has been essentially flat between 2010 and the end of 2014. The level of construction employment to residential construction has historically been very consistent in the region, with the only deviation occurring after the housing correction, when non-residential construction took on a more significant role.

Construction's Role in the Economy

The new home market serves an important role in the regional and national economy. First, along with retail sales, new home construction plays an important role in pulling an economy out of a recession. This results both because of the benefit generated during construction of new homes, and after the purchase of new homes a range of other purchases typically follow delivering a boost to retail sales. Secondly, construction employment provides an important entrance to the labor market for many individuals whose education does not extend beyond high school. Nationally, construction has begun outpacing manufacturing as the industry for workers to enter the goods producing sector of the economy.

Hampton Roads Construction Employment Per Residential Building Permit



Source: U.S. Census Bureau, Bureau of Labor Statistics, HRPDC

Hampton Roads Economic Outlook:

Tepid Recovery Continues to be… Tepid

By James Clary, Senior Economist

Hampton Roads continues to watch, rather than participate, in the national economic recovery. While employment slowly improves year-over-year, the region continues to undergo significant periods within each year without real growth, and has exhibited nothing approaching the consistent & sustained growth that the nation has experienced since the beginning of the recovery (see the chart of Page 2).

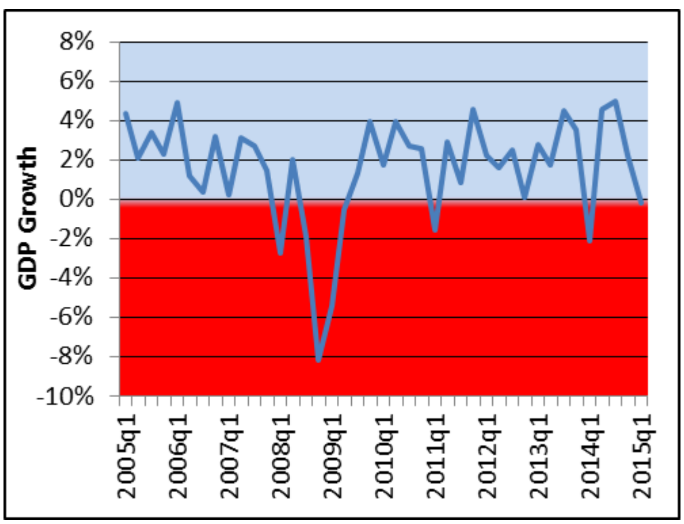
National decisions about the Department of Defense (DoD) will continue to drive the region's short-term economic outlook. While it appears that Congress is moving to increase the DoD budget, political risk will remain until the FY2016 budget and appropriations are enacted.

The first signs of regional recovery will come through an increase in regional retail sales and in residential construction activity, but no catalyst has emerged to drive growth in either of these areas. Retail sales have grown recently to $1.82B per month (May 2015), but this is the same level of sales as seen in October 2014 (seasonally adjusted). Housing, as detailed in the main article, seems to be waiting on an employment recovery, and thus will likely follow rather than drive growth during this cycle.

Hampton Roads Economic Indicators

GDP, Annualized Growth Rate

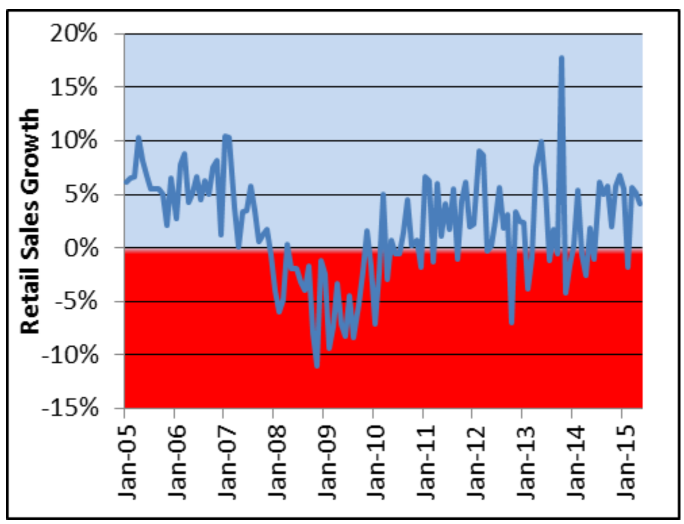
United States, 2005Q1 – 2015Q1, Quarterly



Source: Bureau of Economic Analysis, HRPDC

Retail Sales, Year over Year Growth

Hampton Roads, Jan 2005– May 2015, Monthly



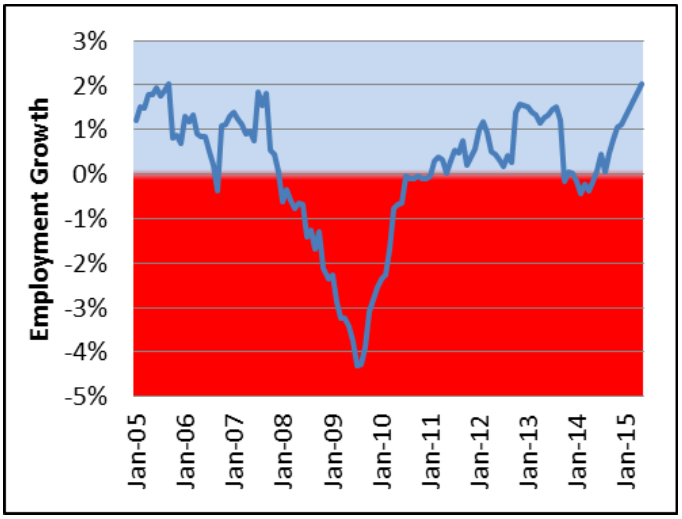
Source: Virginia Department of Taxation, HRPDC

GDP: Gross Domestic Product combines consumption, investment, net exports, and government spending to determine the size and general health of the economy. GDP growth again went negative in the first quarter of the year, declining at annualized rate of -0.2%, as the harsh weather impacted business activity in the Northeast and supply chains throughout the country. As with the previous year, economic growth is forecasted to return in the second quarter.

Retail Sales: Hampton Roads' retail sales, as measured by the 1% local option sales tax, serve as an indicator for consumption in the region. Since consumption composes 68% of economic activity in the U.S., the growth or decline of retail sales gives a strong indication of the direction of the local economy. Regional retail sales continue to hover just above the pre-recession peak ($1.81B per month). Retail sales are another measure where the nation has outperformed the region, as national retail sales are 15.9% above their prerecession peak (as compared to Hampton Roads sales which are only 1.2% above its previous peak).

Employment, Year over Year Growth

Hampton Roads, Jan 2005 – May 2015, Monthly

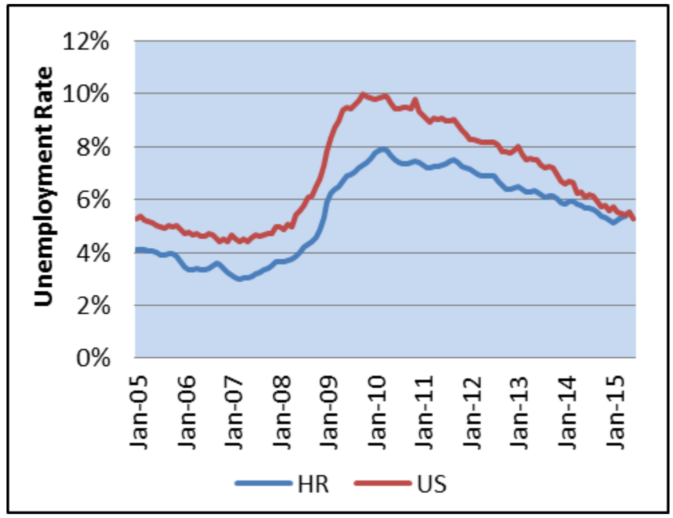


Source: Bureau of Labor Statistics, HRPDC

Employment: Non-agricultural civilian employment figures are considered the best estimate of labor market activity by the National Bureau of Economic Research. The graphic above shows that regional employment is now 2.0% above the May 2014 levels, but that paints an unrealistic picture of the region's recent employment experience. May 2014 was the end of a five month period where the region lost employment, and matching the weakness in the unemployment rate, employment has been flat regionally since November 2014.

Unemployment Rate, Seasonally Adjusted

U.S. & Hampton Roads, Jan 2005– May 2015, Monthly

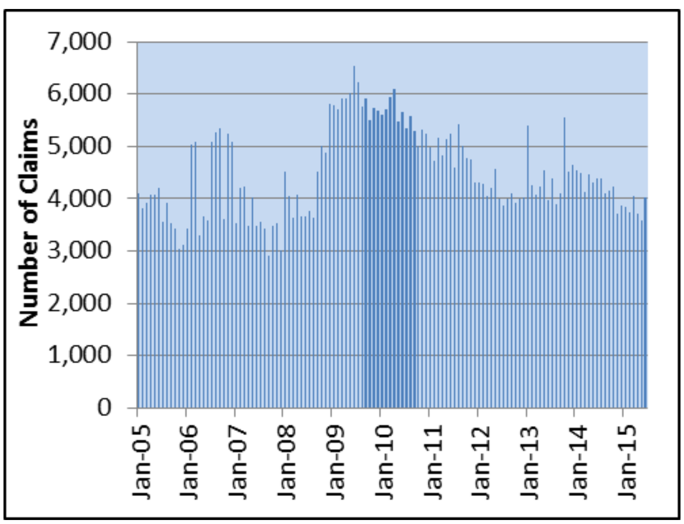


Source: Bureau of Labor Statistics, HRPDC

Unemployment Rate: The unemployment rate is the percentage of the population which is actively seeking work, but is unable to obtain a position. The regional unemployment rate has increased significantly since the beginning of 2015, going from 5.1% in January to 5.5% this May. This presents an unfavorable contrast with the U.S. unemployment rate, which fell from 5.7% in January, to 5.3% in June, and for the first time in 18 years the national unemployment rate is below that of Hampton Roads.

Initial Unemployment Claims, Seasonally Adjusted

Hampton Roads, Jan 2005 – Jun 2015, Monthly

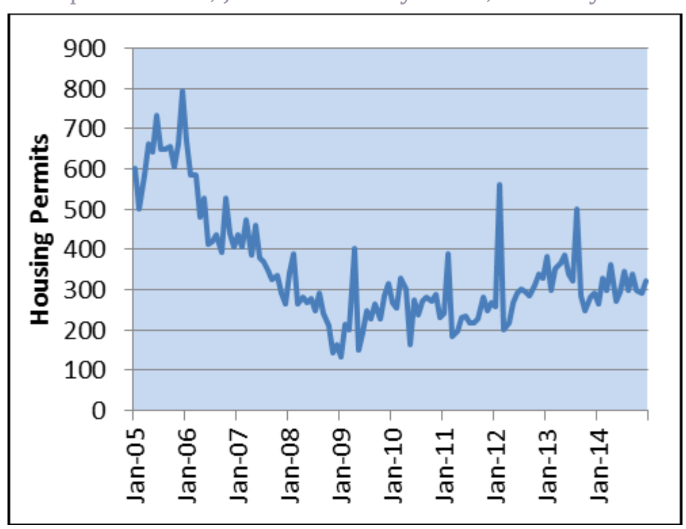


Source: Virginia Department of Labor, HRPDC

Initial Unemployment Claims: The number of Initial Unemployment Claims is a leading economic indicator, reflecting those who are forced to leave work unexpectedly, and thus revealing the strength of the job market with little lag time. Initial unemployment claims have fallen significantly below their long-term average, reflecting the improving outlook for the labor force in Hampton Roads. Lower claims are associated with both fewer firings and greater opportunities for those who lose their job.

Single Family Housing Permits, Seasonally Adjusted

Hampton Roads, Jan 2005 – May 2015, Monthly



Source: U.S. Census Bureau, HRPDC

Single Family Housing Permits: Permit data signals the level of construction employment and confidence regarding the future trajectory of the local economy. Single family permitting in Hampton Roads remains 26% below the long-term average. This low level of permitting reflects a mixture of factors impacting the real estate market (see the main article), and weakness in residential investment is expected to continue into the near future.