HAMPTON ROADS PLANNING DISTRICT COMMISSION

THE HAMPTON ROADS ECONOMIC QUARTERLY

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The Region's Real Estate Market

Both new and existing home sales have accelerated nationally, encouraging discussion regarding the bottom of the housing market. Unfortunately, talk about 'the bottom' can be fraught with inaccuracies, where many commentators can misinterpret both the nature of a housing bottom as well as the proximity of the market bottom.

What will the bottom of the housing market look like?

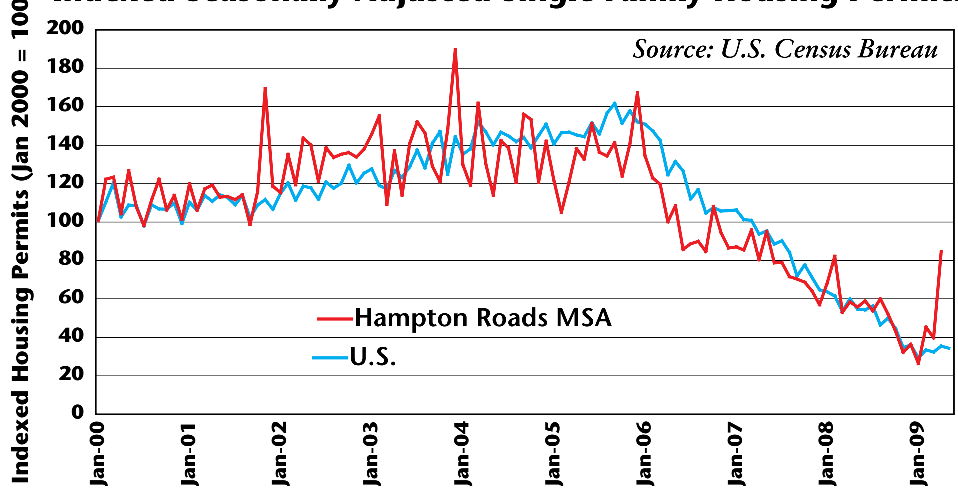
Actually, it is not one bottom, but two, and these bottoms typically don't occur simultaneously.

The first bottom occurs when housing starts and new home sales stop declining, i.e. a construction bottom. The construction industry, as measured by fixed residential investment, played a large role in the economic growth after the 2001 recession. When the residential real estate market slowed, it resulted in significant job loss, both regionally and nationally. While the real estate market will not return to the fevered pitch of the bubble years, a return to normal levels of construction will be instrumental in expanding Gross Regional Product. The decrease in fixed residential investment over the past two years has drained GDP by 1% annually and, more recently, the fall in fixed residential investment contributed to 25% of the decline in GDP in the first quarter of 2009. Some indicators suggest that a bottom in construction is near, which has lead to mistaken calls that the market has reached a second bottom-where existing home prices have stopped declining.

Currently, the excess of supply and the limited demand for homes suggest that market prices should be lower in order to clear the housing market. Sticky housing prices are preventing the market from clearing, resulting in atypically high levels of inventory, freezing the housing market. Historically, every housing bust has separated the bottom into these two distinct categories, and they have often occurred more than a year apart.

Unfortunately, housing bottoms are not trampolines, and the end of a declining market does not imply it will quickly return to long term trends. Employment at both the national and regional levels remains extremely weak. With national unemployment already above 9%, it will be difficult for the housing market to accelerate until employment recovers. New household

Indexed Seasonally Adjusted Single Family Housing Permits



Bank Owned Homes by Locality

Chesapeake	400	Franklin	33	Gloucester	31	Poquoson	57
Norfolk	534	Isle of Wight	5	Hampton	228	Williamsburg	114
Portsmouth	317	Southampton	23	James City	125	York	208
Suffolk	170	Surry	1	Newport News	358		
Virginia Beach	673						

Hampton Roads Total: 3277

Source: RealtyTrac

formation will eventually tighten the inventory of existing homes, but with the moderate level of population growth, this will not occur over the next few years. Fortunately, demographics will encourage growth over time as the baby-boom-echo generation reaches its peak years of household formation in the region by 2015.

Have the region and the nation hit bottom?

Since there is more than one bottom to the housing market, determining where the market is requires two separate analysis.

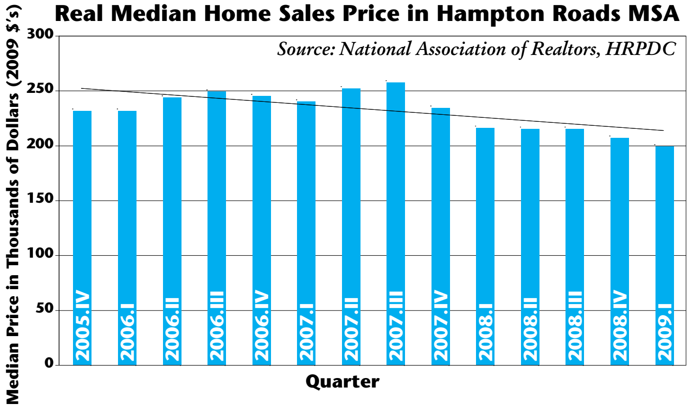
Four data sets are used to measure the construction market: new permits, housing starts, home sales as a percentage of inventory, and fixed residential investment in terms of GDP. Housing permits have recovered from January lows, and regionally they have attained 73% of the fifteen year average. This would cautiously suggest that construction employment should slowly start growing in Hampton Roads, and that new home production should begin to pick up in the region. A current estimate on the inventory of new houses available on the market in Hampton Roads stands at approximately 6.7 months, which is about the historical average. The nation currently has 10.2 months of new houses at the current rate of sales, suggesting the nation is experiencing a much slower construction recovery (though this primarily reflects the states most impacted by the bubble).

Following historical trends, the existing home price bottom appears to be at least several months away. While existing home sales have picked up both regionally and for the nation, there are significant challenges to that market maintaining its current price point. First is the level of distressed homes represented in the sales; fully a third of the national sales and a quarter of Hampton Roads' existing home sales involved either a foreclosed home or a short sale. Further, homes owned by banks in Hampton Roads constitute 24.5% of the current existing homes listings, and home sales by financial institutions do not suffer from price stickiness (i.e. the homes banks are selling are more likely to reflect the true market price).

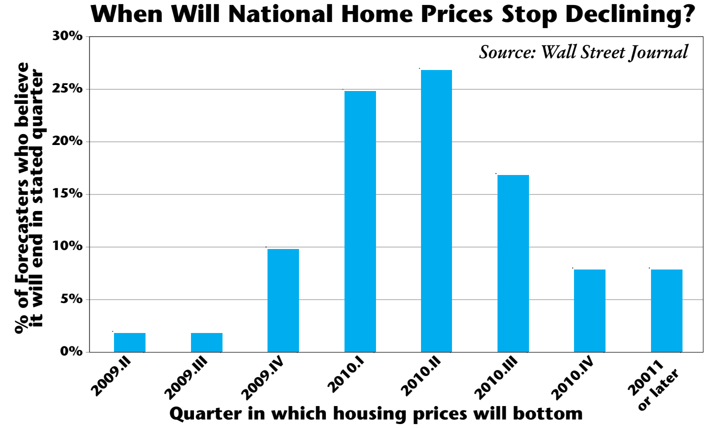
Months of supply have decreased both locally (9.3 months) and nationally (9.6 months), but this does not account for the shadow inventory which are homeowners who are intending to sell their homes, but are waiting for the market to pickup before they list their property. Also, most of the home sales are occurring at the lower end of the price range, with homes under $250,000 in value representing 60% of the year-to-date sales in Southeastern Hampton Roads, and 68% of the sales on the Peninsula.

Despite positive developments in the broader housing market, existing regional home prices will continue to be weak, negatively impacting consumers and assessments. Home prices impact the financial firms who invested in mortgages, as well as consumers who have put equity into their homes, but are unable to access that equity to smooth consumption (and thus retail sales). Long term growth in housing prices will likely be driven by the aging of the echo boom population in Hampton Roads which has already begun as the oldest members of that generation just turned 30 and should begin household formation. Thus, while Hampton Roads has likely attained the bottom in construction, the bottom in the housing market still has not been achieved.

Real Median Home Sales Price in Hampton Roads MSA



When Will National Home Prices Stop Declining?



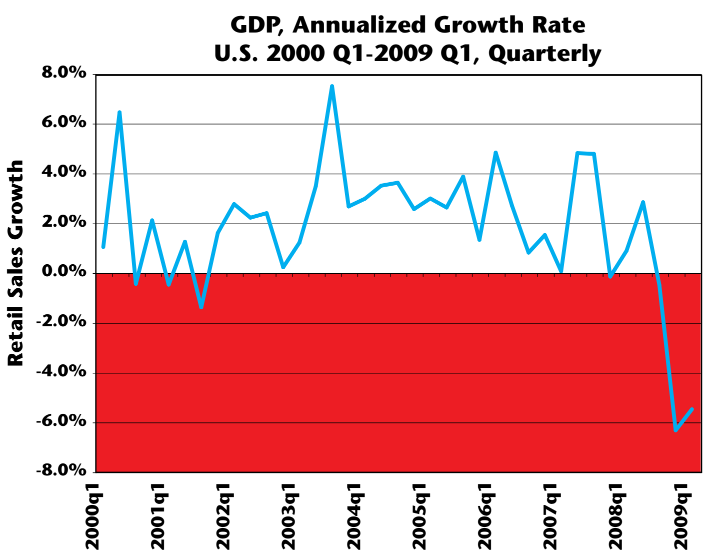
Economic Outlook in Hampton Roads

It is evident that weakness persists in the Hampton Roads economy. The regional economy typically follows national activity, and U.S. Gross Domestic Product has shrunk at a 5.9% annualized rate over the past two quarters. Currently, the Blue Chip Economic Forecast indicates the GDP is expected to shrink by only 1.7% in the second quarter of 2009, and the national economy will begin growing again in the third quarter of the year. It also forecasts growth to be below long term averages for some time, and that recouping this recession's output gap will take a significant amount of time.

The Hampton Roads labor market continues to suffer from considerable weakness. Employment has been declining every month since January 2008, and is down 1.7% since May 2007. The unemployment rate has climbed up to a seasonally adjusted 7.0%, 3.2% higher than it was in April of 2007. The region's unemployment rate did decrease from April to May, but as the national rate increases, it is difficult to tell if local figures are merely an anomaly or represent an easing of the region's labor market woes. Since initial unemployment claims, which lead other labor market indicators, continue to rise, it appears that unemployment rates have yet to hit a plateau.

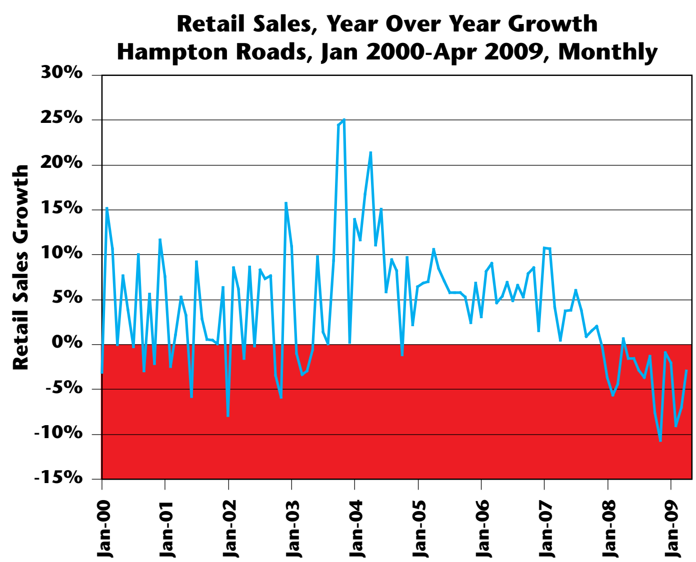
Economic recovery usually comes from personal consumption expenditures (PCE) and fixed residential investment. Regional housing permits have rebounded off the January lows, but are still 26% below the 15 year average for the region. While it looks like housing will stop being a drag on gross product, the housing market does not currently have the power to drive growth. Retail sales are the best measure of PCE for the region, and retail sales growth has been negative year over year since the recession began in December 2007. Retail has varied from between -7% and around -3% (where it currently stands), but year over year growth will need to return before we can expect it to drive economic recovery. When jobs return and consumers regain their confidence, increases in PCE will soon follow.

Hampton Roads Economic Indicators



Source: Bureau of Labor Statistics

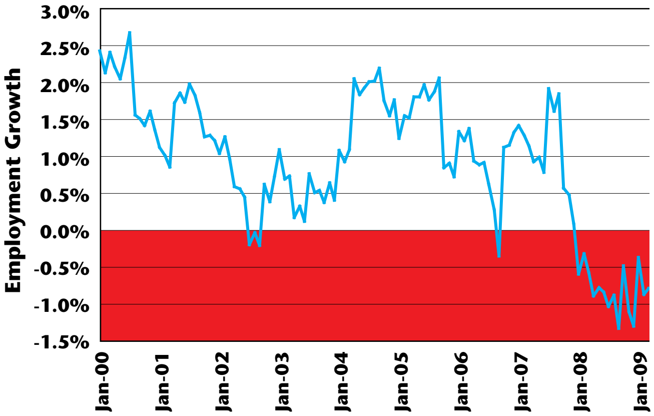
GDP: Gross Domestic Product combines consumption, investment, net exports and government spending to determine the size and general health of the economy. Changes in the nation's GDP tend to be reflected in Hampton Roads' gross regional product. The nation has experienced three consecutive quarters of falling GDP, and in the past two quarters GDP has contracted at annual rate of greater then 5%.



Source: Virginia Department of Taxation

Retail Sales: Retail sales, as measured by the 1% local option sales tax, serves as an indicator for consumption in the region. Since consumption composes 70% of economic activity in the US, the growth or decline of retail sales gives a strong indication of the direction of the local economy. Retail sales have continued to be lower than last year's numbers. Regional sales were much weaker in February and March then in April, but it is unclear whether this signals economic growth or a single month bump as a result of income tax refunds.

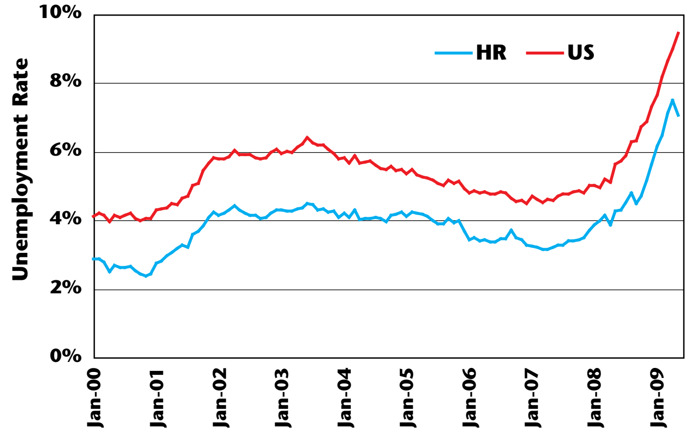
Employment, Year Over Year Growth
Hampton Roads, Jan 2000-May 2009, Monthly



Source: Bureau of Labor Statistics

Employment: Non-agricultural employment is considered the best estimator for labor market activity by the National Bureau of Economic Research. Employment numbers have been revised downward for the past year, and rather than strong employment growth previously indicated, the region has seen contracting payrolls since the start of this recession. Employment is down 1.7% since May of 2007.

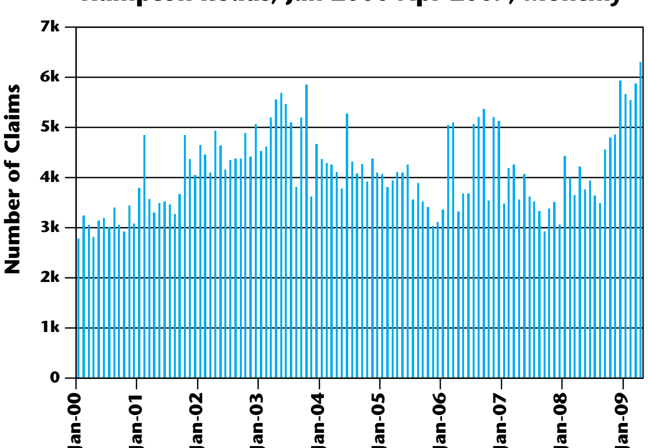
Unemployment Rate, Seasonally Adjusted
U.S. & Hampton Roads, Jan 2000-Apr 2009, Monthly



Source: Bureau of Labor Statistics

Unemployment Rate: This is the percentage of the population who are actively seeking work, but are unable to obtain a position. The unemployment rate has been rising in both the nation and Hampton Roads since April 2007. Hampton Roads' unemployment level remains below the nation's, and the past month saw a gap of 1.9% between the region and the nation's unemployment rate.

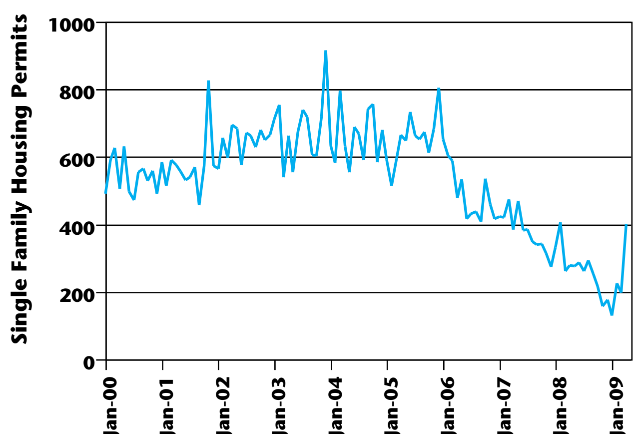
Initial Unemployment Claims, Seasonally Adjusted
Hampton Roads, Jan 2000-Apr 2009, Monthly



Source: Virginia Department of Labor

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 continued to increase over the past six months, which correlates with an increasingly weak employment outlook for the short term in Hampton Roads.

Single Family Housing Permits, Seasonally Adjusted
Hampton Roads, Jan 2000-Apr 2009, Monthly



Source: U.S. Census Bureau

Single Family Housing Permits: Permit data indicates the level of construction employment and confidence regarding the future trajectory of the local economy. However, there is currently such a large inventory of unsold homes that it precludes its usefulness as a measure of economic sentiment. Recently permitting activity has increased in Hampton Roads, but it remains well below long term average of 541 permits a month.