

Norfolk, Virginia

Multifamily Housing Update

February 2008



EXECUTIVE SUMMARY

Businesses in the Virginia Beach - Norfolk - Newport News MSA hired a net of 12,300 (1.6%) workers in 2007, up from only 6,100 (0.8%) net new jobs in 2006. Aggressive expansion by construction and business service firms was largely responsible. Combined, establishment payrolls advanced by 600 in 2006 and 4,200 in 2007.

Faster job growth contributed to a decline in the unemployment rate from an already low 3.3% in 2006 to 3.2% in 2007. Labor market tightness allowed metro wages to increase 4.3% in 2006 and we estimate that wage growth approached 4.7% in 2007. By comparison, wages increased nationally at a rate of 4.6% in 2006 and 4.8% (estimated) in 2007.

RED expect job growth to accelerate in 2008. Our econometric model generates a point estimate of 16,000 (2.1%) new jobs in 2008 and 14,000 (1.8%) in 2009. Economy.com, however, are comparatively pessimistic. The service forecast net reduction of -880 (-0.1%) payroll jobs in 2008.

The metro housing market was relatively stable in 4Q07. The median single-family home price increased 0.3% y-o-y to \$236,000, ranking 70th among the 156 metros tracked by the NAR. The Virginia Association of Realtors report that metro sales velocity fell 13.7% in 2007 as compared to a 15.3% reduction statewide.

The apartment occupancy rate fell 10 basis points sequentially to 96.1% in 4Q07, ranking 7th highest among the **RED** 50. The slight drop in occupancy was attributable to weak demand as only 51 net leases were signed. Conversely, developers delivered 156 units to the market.

Effective rents rose 1.0% in 4Q07, down from 1.2% in the previous quar-

ter. Y-o-y effective rent growth rose to 5.0%, the strongest rate recorded since 3Q05. The value of the average concession package was 1.3% of asking rent, the lowest ratio among the **RED** 50.

Owing to a weak job growth outlook, courtesy of Economy.com, Reis forecast occupancy to decrease 40 bps to 95.7% in 2008. This weakness is also expected to limit effective rent growth to only 3.3%, far below the rates observed recently. **RED** are more optimistic, however; we expect job gains rather than losses which will support stronger demand and faster-than-forecasted rent growth.

With regard to submarkets, Reis expects the sharpest occupancy declines in Kempsville / Bayside (-150 bps), Norfolk (-130 bps) and Williamsburg (-100 bps) by year-end 2009. Only the Chesapeake submarket is expected to experience occupancy improvement over the forecast period.

Real Capital Analytics report that 27 investor grade properties were traded in the Norfolk / Richmond region in 2007. Sales volume totaled \$591 million, a 35% increase from 2006. The source calculates an average price per unit of \$92,826 and an average cap rate of 6.1%.

We have consistently touted Norfolk as one of the best apartment markets in the US. But Reis are pessimistic about future fundamental performance, a development worth noting. Using the Reis forecasts as our base case assumptions, the expected generic metro asset 5-year holding period total return is 5.7%. Under more optimistic assumptions, the total return rises to nearly 7.0%, ranking 17th among the **RED** 50. In our view, Norfolk remains an "*Accumulate*" market but if Reis are right, investors should proceed with caution.

SNAP SHOT

	Y-o-y change	Projected 2008
Vacancy (3.9% - 4Q07)	↓ 10bps	↑ 40bps
Effective Rents (\$821 - 4Q07)	↑ 5.0%	↑ 3.3%
Cap Rate (6.8% - 4Q07)	↑ 20bps	↔ unch
Employment (787.0k - 4Q07)	↑ 15.8k	↑ 16k

KEY POINTS

- The metro vacancy rate increased 10 basis points sequentially to 3.9% in 4Q07. The rate decreased 10 basis points year-over-year.
- Asking and effective rents increased 4.7% and 5.0% year-over-year, respectively. Reis expect effective rent growth to decelerate to 3.3% in 2008.
- According to the National Association of Realtors, the median home price rose 0.3% year-over-year to \$236,000 in 4Q07. The state association reports that metro home prices increased 2.0% year-over-year to \$235,000 in December.
- Twenty-seven investor grade multifamily assets traded in 2007, totaling \$591 million in sales proceeds. This compares to 22 trades and \$406 million in volume in 2006. The average price per unit increased 5% to \$92,826 and the average cap rate was 6.1%.
- **RED** affirms its cautious "*Accumulate*" ranking to Norfolk assets. If the market outperforms the Reis forecasts, as we expect, current pricing is attractive for acquirers.