

# Richmond, Virginia

Multifamily Housing Update

January 2008

## EXECUTIVE SUMMARY

**R**ichmond's diversified economy separates it from the large pack of slow-growing, low-volatility mid-size state capitals. In addition to the stabilizing influences of employment concentrations in the socially-funded industries (government, education and health care), the Richmond economy benefits from the dynamic qualities associated with its competitive, export-oriented manufacturing sector; strong finance and banking presence; robust high tech services sector; steady inflow of foreign investment and healthy tourism flows. As a result, River City's job and output growth consistently outperformed the national average in recent years, while the unemployment rate dipped into the low three-percent range.

After three consecutive years of payroll growth exceeding 10,000 jobs, Richmond was well on its way to a fourth at mid-year, having added jobs at a 12,300 (2.0%) pace through June. Hiring was paced by the consistent construction and business and health care service sectors, augmented by expansion in the hospitality, retail and personal services sectors. In addition, booming global trade fueled rapid growth in the wholesale and transportation industries, which combined to produce a net of 2,400 new jobs.

But hiring came to an abrupt halt in 2H07. Year-over-year growth dropped to a rate of 7,000 jobs per year in 3Q07 and further to a 2,100-job pace in the 3 months ended in November. November payrolls rose only 300 from 2006 and were down nearly 7,000 from the June peak. Headcount growth was down across the board but most severely in the typically dependable skilled and personal services, transportation, and trade sectors.

The late-year slump will hold metro payroll growth to about 8,200 (1.3%) jobs in 2007. The **RED CAPITAL** payroll model extrapolates from the

late-year weakness to produce a soft 2008 projection. The forecast interval ranges from 1,000 to 5,000 jobs, with mid-point of 3,000 (0.5%).

Third quarter apartment demand was strong in spite or perhaps because of the onset of slower job growth. Tenants net leased 403 units, raising year-to-date absorption to 755 units. In the absence of supply, average vacancy fell another 60 basis points to 6.6% in 3Q, bringing the y-t-d aggregate to 100 bps.

Owners flexed their pricing power, hiking asking and effective rents 1.4% sequentially. Over-the-year, effective rents increased \$35 (5.0%), representing the largest absolute and percentage gain in Richmond rents since 1997.

Although Reis expect supply levels to remain in check the service anticipates a decline of net apartment demand, contributing to slower occupancy and rent trends through the end of the decade. Reis anticipate average occupancy to fall 20 bps per year through 2009 to 93.1%, and rent trends to decelerate to 3.1% in 2008 and 2.8% in 2009, considerably slower than the 3.5% and 3.4% U.S. metro averages.

Similar to other secondary markets, trade in Richmond assets was slower in the second half. Loopnet identified only one trade valued at \$5mm or more closed after June. The transaction involved a recent construction luxury project called Creek's Edge. Value was set at \$32mm, representing \$160,000 per unit. Reis reported no 2H07 sales.

Yields derived from 2007 B and A-properties varied from 5.8% to 6.2%. Unit prices ranged from approximately \$70m to \$90m. In light of the modest rent and occupancy gains projected by Reis, total returns and return profiles likely fall below the **RED 50** norm. We prefer neighboring Norfolk, one of our favorite markets, but assign a solid "opportunistic" rating to Richmond.

## SNAP SHOT

|                                   | Y-o-y change | Projected 2008 |
|-----------------------------------|--------------|----------------|
| Vacancy<br>(6.6% - 3Q07)          | ↓ 30 bps     | ↑ 20 bps       |
| Effective Rents<br>(\$729 - 3Q07) | ↑ 5.0%       | ↑ 3.1%         |
| Cap Rate<br>(8.1 - 3Q07)          | ↔ Unchd      | ↔ Unchd        |
| Employment<br>(635.1m - 3Q07)     | ↑ 7.0m       | ↑ 3m           |

## KEY POINTS

- Richmond enjoyed a typically vigorous first half of 2007, creating jobs at a 12,300 (2.0%) year-over-year pace. But the economy went off song in the summer and sputtered to a near standstill in the fall. Metro payrolls declined 6,600 jobs from June to November, a sharp contrast to the 2,800 job advance recorded in the same period of 2006. Payrolls were nearly flat year-over-year in November, reflecting mass layoff events in finance, health care and social assistance.
- Weaker growth in business and health care services contributed to the slowdown. Job cuts were recorded in the medical, personal and food services categories, inferring that state Medicare cuts were a principal cause.
- Metro home prices continued to rise faster than the nation. The NAR report that the median priced metro home traded at \$238,800 in 3Q07, up 3.2% y-o-y versus -2.0% nationally. Prices rose 11.7% in 2006.
- Average occupancy is up 100 bps since December 2006, reaching 93.4%. Strong demand helped owners hike effective rent by 5.0% since 3Q06, a level that would rank Richmond 12th in the **RED 50**.



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