Too Much Of A Good Thing? Multifamily Housing In Hampton Roads

TOO MUCH OF A GOOD THING?
MULTIFAMILY HOUSING IN HAMPTON ROADS

We talk virtually every day about how renting is becoming less and less affordable. I think the answer is just that housing is becoming less and less affordable and renting is the more affordable of the two.
– David Brickman, executive vice president and head of Freddie Mac Multifamily

In 1931, James Truslow Adams, an American historian, coined the term "American dream," defining it as "that dream of a land in which life should be better and richer and fuller for everyone, with opportunity for each according to ability or achievement." Over time, this vision of America permeated the national conversation and was distilled to a simple message: If you work hard and stay out of trouble, you can achieve whatever your heart desires.

An integral part of the American dream has been homeownership. A 2017 survey by ING Group, a Dutch multinational banking and financial services organization, echoed this sentiment with 68 percent of respondents viewing homeownership as a symbol of success and 60 percent of renters preferring to own their own home.[1] These attitudes may be changing. A February 2018 survey by Freddie Mac, a public government-sponsored enterprise, found that 67 percent of renters viewed renting as more affordable than owning and 54 percent thought renting was a good choice for their financial situation.[2] Is the archetypical white picket fence fading as part of the American dream?

While median housing prices in Hampton Roads have not increased as rapidly as other markets in the United States since the end of the Great Recession in 2009, housing prices have trended upward. The number of existing homes sold in May 2018 increased by 5 percent relative to May 2017, while the active inventory of available homes declined by 9 percent over the same period. The average number of days on market also fell from 68 in May 2017 to 57 in May 2018, and the median sales price increased by $10,000, or 4.6 percent, over the one-year period.[3] Good news for homeowners, potentially bad news for those looking to buy their first home.

If owner-occupied housing is becoming relatively more expensive, then we would expect an increase in the demand for multifamily housing. While apartments are typically not as large as single-family homes, there are potential benefits. The bare studio with a shared bathroom is a thing of yesteryear. New upscale apartments include on-site gyms, resort style pools, grilling stations and business centers, great amenities that were once considered beyond the reach of most renters. Renters also appear to be more satisfied with their lot in life. Not only were more than two-thirds of surveyed renters satisfied with their rental experience, but these renters also indicated they didn't plan to move, even if their rent increased (Freddie Mac, February 2018).

Multifamily housing is an important part of the housing market in Hampton Roads. More than one-third of households in the region rent. CoStar, a commerical real estate analytics company, estimated that there were 108,000

1 ING (November 2017), "Home ownership – a smarter choice? Buying out of reach for many people in Europe," https://www.slideshare.net/ING/ing-international-survey-homes-and-mortgages-2017-rent-vs-own.
2 Freddie Mac (February 2018), "Profile of Today's Renter," https://mf.freddiemac.com/research/insight/20180404_preference_for_renting.html

3 Real Estate Information Network, 2018, where Hampton Roads is defined as the counties of Isle of Wight, James City, Southampton, Surry and York, and the cities of Chesapeake, Franklin, Williamsburg, Hampton, Newport News, Norfolk, Poquoson, Portsmouth, Suffolk and Virginia Beach.

market-rate apartment units, with a valuation of $12.5 billion, in Hampton Roads at the end of the second quarter of 2018.

In this chapter, we explore the changing demographics of homeownership and whether the American dream should now include renting, in addition to ownership. We explore how builders have responded to changing preferences and circumstances by shifting construction portfolios and whether this has affected multifamily housing availability in Hampton Roads. As announcements of new multifamily construction projects in the region continue, we ask whether there is sufficient demand to fill current and projected units. Lastly, we delve into several submarkets in Hampton Roads.

Homeownership: Central To Rights And Public Policy

Homeownership is part of the American ethos, lauded in popular culture and public policy. Owning a home is typically the result of years of hard work, a symbol of personal success, and offers significant rights to do as one wishes to the real property in question. **In the United States, people typically own real property in fee simple interest, the maximum ownership interest possible under law. With limited exceptions, the fee simple interest owner possesses the title to the real property and can use, modify and dispose of the property as they wish. Sir Edward Coke, a barrister, judge and politician in Renaissance England, eloquently expressed this concept in 1604: "That the house of everyone is to him as his Castle and Fortress as well for defence against injury and violence, as for his repose."**

The U.S. Constitution protects private property rights primarily through the Fifth Amendment's Just Compensation clause: ". . . nor shall private property be taken for public use without just compensation." Simply put, the government typically can only take private property through two mechanisms: by condemning the property and seizing the title from the owner (eminent domain) or through regulations that, in effect, limit the ability of owners to enjoy the fruits of their private property (regulatory taking). Recent decisions by the U.S. Supreme Court of the United States have taken an increasingly dimmer view of regulatory limitations on private property, embracing the view that a home is indeed a castle.

Public policy continues to reinforce the goal of homeownership. Homeowners may deduct mortgage interest costs associated with buying, constructing or improving a first home (and second home, in some cases) from their federal tax returns for mortgages up to $750,000. Homeowners may also deduct some or all property taxes associated with their primary residence, subject to the cap of $10,000 in combined state and local income taxes, state and local sales taxes, and property taxes. While these limits are lower than in recent years due to the passage of the Tax Cuts and Jobs Act of 2017, it should be clear that homeowners are subsidized through the tax system for their housing consumption. **Renters receive no such tax relief.**

The preference for homeownership extends beyond the tax code. Ginnie Mae, a wholly owned government corporation, provides market liquidity to federally sponsored mortgage lending programs. While many may not have heard of Ginnie Mae, it recently announced that its total outstanding principal balance on mortgage-backed securities was $1.96 trillion in May 2018, not a trivial sum (Ginnie Mae, June 2018). The federal government also provides secondary mortgage markets with liquidity through two government-sponsored enterprises, Fannie Mae and Freddie Mac. These organizations buy mortgages on the secondary market, combine them into a mortgage-backed security and then sell the security to investors. As a result, the supply of capital available for lending increases, mortgage interest rates are lower than they would be otherwise and it becomes cheaper to use a mortgage to purchase a home.

Fannie Mae and Freddie Mac are not small enterprises, with $109 billion and $67 billion in revenue in 2017, respectively. From January to May 2018, 96 percent of residential mortgage-backed securities in the United States were issued by Fannie Mae, Freddie Mac or other federal agencies (Urban Institute, June 2018).

If you have a mortgage on your home, your mortgage has likely been bought, packaged and sold by one of these institutions. For better or worse, the federal government is more involved in mortgage-backed securities than at any time prior to the Great Recession.

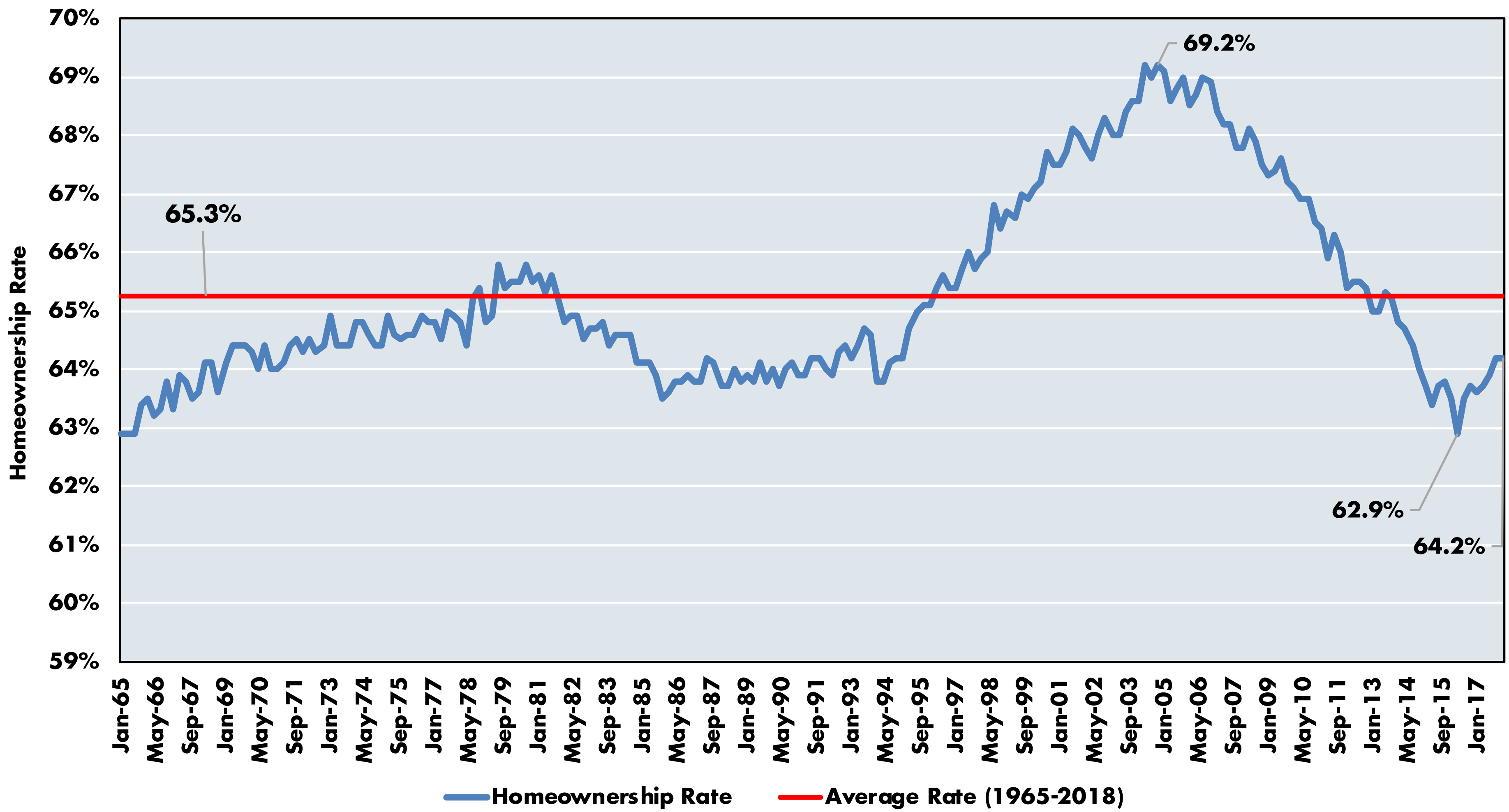
How Have Homeownership Rates Changed Over Time?

Yet, for all these interventions in the residential housing market, the country's homeownership rate has hovered around its long-term average of 65 percent since 1965. The U.S. Census Bureau tracks homeownership and, as illustrated in Graph 1, the homeownership rate increases during economic expansions and declines, as one might suspect, during economic contractions. Prior to the Great Recession, which began in December 2007, the homeownership rate peaked at 69.2 percent in the second quarter of 2004, falling thereafter to a low of 62.9 percent in the second quarter of 2016. At the end of the first quarter of 2018, the homeownership rate for the United States was 64.2 percent, still below the long-term average. **Despite billions (if not trillions) of dollars invested in public policy efforts, homeownership rates remain stubbornly persistent.**

Graph 2 paints a picture of declining homeownership rates in Hampton Roads from a peak of almost 73 percent in the fourth quarter of 2005 to a low of about 54 percent in the second quarter of 2016. While we recognize that homeownership rates are more volatile at the metropolitan level, they clearly trended downward in Hampton Roads from 2005 to 2016. We can attribute some of this decline to the aftereffects of the Great Recession, the impact of sequestration and relatively stagnant job creation in Hampton Roads. **The good news is that homeownership rates have rebounded from their lows, reaching a high of 66 percent in the second quarter of 2017.** Rates declined in the latter half of 2017 and into the first quarter of 2018, but we expect improvement in the latter half of 2018 as the regional economy improves.

GRAPH 1

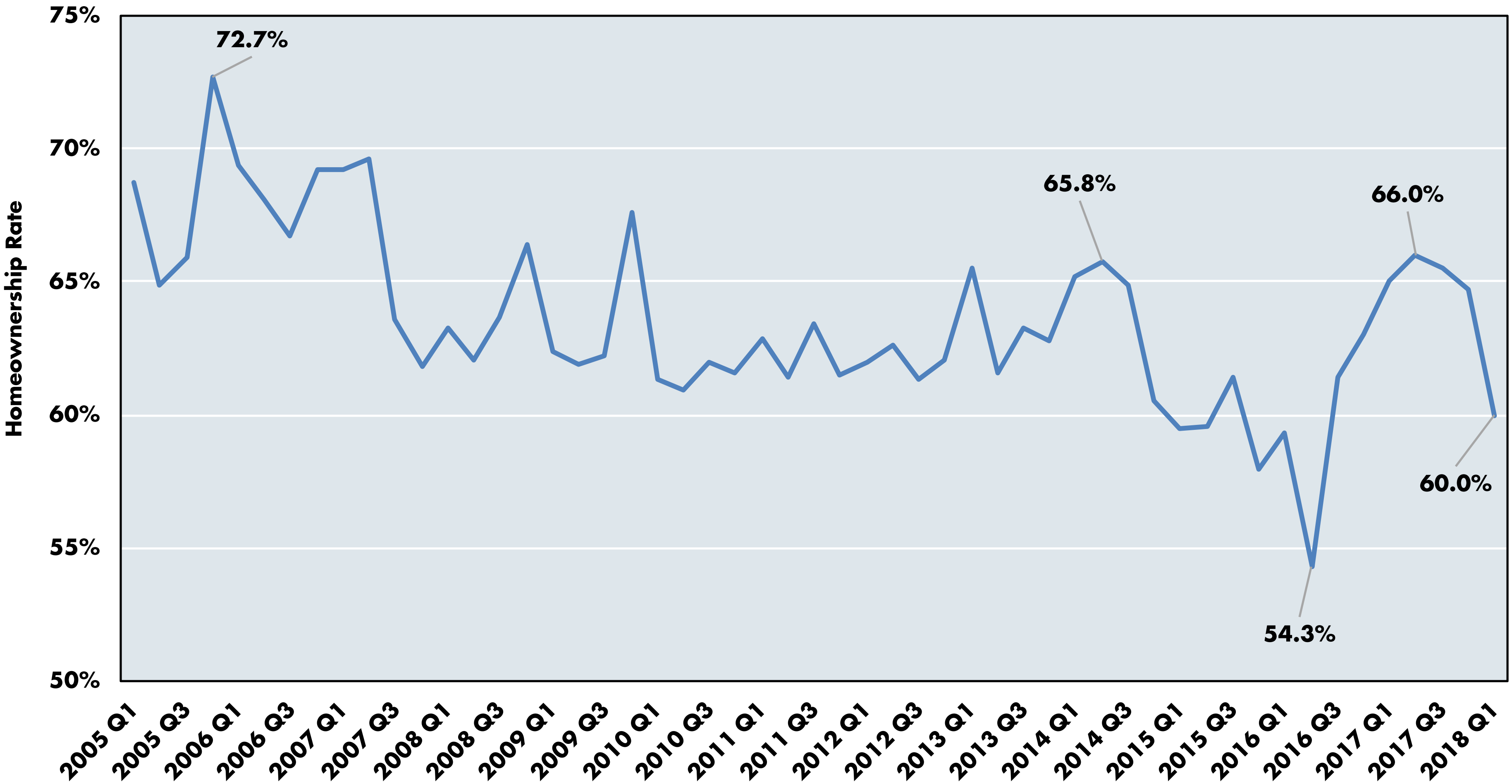
HOMEOWNERSHIP RATES IN THE UNITED STATES, 1ST QUARTER 1965 TO 1ST QUARTER 2018



Source: U.S. Census Bureau (2018), Housing Vacancies and Homeownership

GRAPH 2

HOMEOWNERSHIP RATES IN HAMPTON ROADS, 1ST QUARTER 2005 TO 1ST QUARTER 2018



Sources: U.S. Census Bureau (2018), Current Population Survey, Quarterly Vacancy and Homeownership Rates by State and MSA, and the Dragas Center for Economic Analysis and Policy, Old Dominion University

Homeownership Across The Generations

What evidence is there that millennials and Gen Xers are owning homes at a lower rate than previous generations? Table 1 presents homeownership rates by birth cohort from the U.S. Census. For example, the homeownership rate for those born between 1956 and 1960 was 37.7 percent when these individuals were between 25 and 29 years old. Compare this to people born between 1986 and 1990, whose homeownership rate was only 31.7 percent when they were between 25 and 29 years old. This decline is present in almost every age cohort. **A person born between 1986 and 1990 was 6 percent less likely to own a home than someone born between 1956 and 1960. This decline is present in almost every age cohort. Younger people today are less likely to own a home compared to previous generations when they were the same age.**

Demographics In Hampton Roads

According to the U.S. Census, 636,750 households, comprising 1.7 million people, called Hampton Roads home in 2016.[4] Sixty-one percent of households lived in owner-occupied housing while 39 percent occupied rental housing. With an average household size of 2.51 individuals per rental household, about 623,000 people live in rental housing in Hampton Roads, or approximately 36.3 percent of the population.

Compared to the United States, more households rent in Hampton Roads and the pool of potential renters is a larger segment of the overall population. **As shown in Graph 3, 38.8 percent of the Hampton Roads population is in the "sweet spot" for the multifamily housing market (ages 18-44), compared to 36.2 percent of the U.S. population in 2016. Not only is the potential rental market larger in Hampton Roads as a percentage of the population, but the region also skews younger than the U.S., in part due to the large military presence.**

Given the transient nature of military assignments, many active-duty service members choose to rent rather than own. There are some unique protections for military service members, mostly due to the Servicemembers Civil Relief Act. The law provides a variety of protections for active-duty service members, to include the immediate termination of a lease due to deployment or reassignment to another military post.[5] Challenges aside, members of the military are often sought by rental property owners due to their steady income, maturity and conduct.

4 U.S. Census, 2012-2016 American Community Survey, 5-Year Estimates.
5 For further information, see https://www.justice.gov/servicemembers/servicemembers-civil-relief-act-scra.

TABLE 1

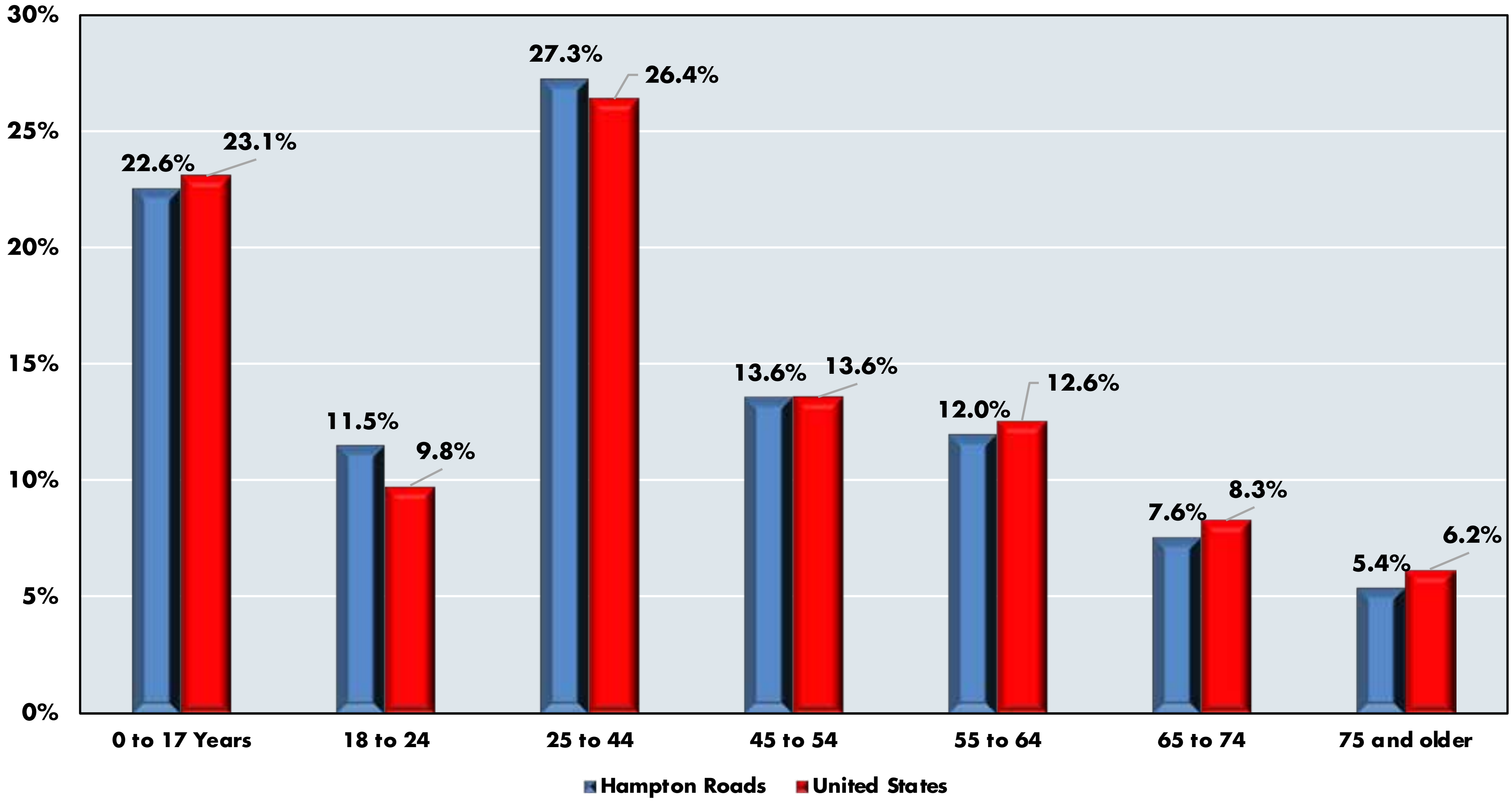
HOMEOWNERSHIP RATES FOR THE UNITED STATES BY BIRTH COHORT, 1985-2015

	25 to 29 Years	30 to 34 Years	35 to 39 Years	40 to 44 Years	45 to 49 Years	50 to 54 Years	55 to 59 Years	60 to 64 Years
Born 1946 to 1950	..	..	65.4%	69.8%	73.7%	78.5%	80.6%	80.4%
Born 1951 to 1955	..	54.0%	63.0%	68.6%	74.7%	78.3%	77.7%	76.2%
Born 1956 to 1960	37.7%	51.8%	62.1%	70.6%	75.0%	75.0%	74.7%	76.9%
Born 1961 to 1965	35.2%	53.1%	65.0%	71.7%	75.0%	75.0%	74.7%	..
Born 1966 to 1970	34.4%	54.6%	66.6%	67.9%	68.0%	..	..	..
Born 1971 to 1975	38.1%	56.8%	61.9%	61.6%	..	..	..	..
Born 1976 to 1980	40.9%	51.6%	55.3%	..	..	..	..	..
Born 1981 to 1985	36.8%	45.9%	..	..	..	..	..	..
Born 1986 to 1990	31.7%	..	..	..	..	..	..	..

Source: U.S. Census, 2017, "Homeownership Rates for the United States"

GRAPH 3

POPULATION DISTRIBUTION IN HAMPTON ROADS AND THE UNITED STATES, 2016



Source: U.S. Census, Table S0501, 2012-2016 American Community Survey Estimates

Residential Construction In Hampton Roads

With changing preferences, demographics and financial conditions, we might expect the demand for multifamily housing to change over time. Developers, in response, would shift their portfolios to build more multifamily housing and reduce construction of single-family homes. We have seen this response in the United States over the last decade, and this shift appears to be more pronounced in Hampton Roads.

Graph 4 provides information on building permits issued for single-family and multifamily residences. We created an index that is equal to 100 in 1997. In 2005, the annual volume of permits for buildings of five or more units was about 180 percent more than in 1997. New building permits were about 20 percent higher in 2005 compared to 1997. The paths diverged after 2005, with new permits for housing falling, such that in 2017, the number of annual permits was approximately 31 percent below that in 1997. On the other hand, permits for multifamily housing initially declined after the Great Recession but remain 45 percent above where they were in 1997. **Developers continue to build multifamily units rather than single-family units.**

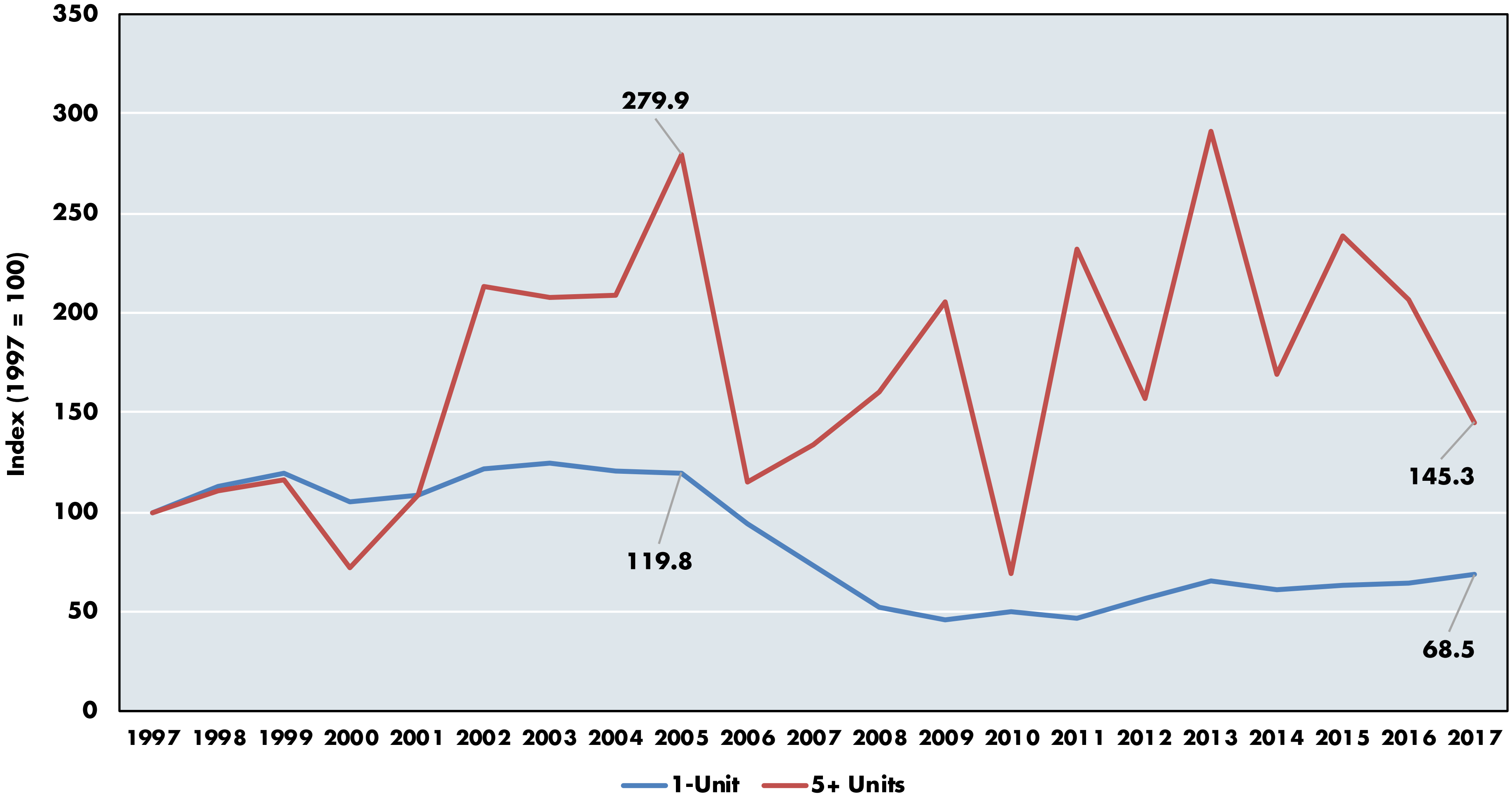
One potential critique of building permit data is that some building permits may not translate into actual construction. Permits for buildings with five or more units may also include multifamily units, condominiums and townhomes. **Graph 5 illustrates that building permits and construction closely follow each other, especially after the Great Recession. From 2005 to 2017, there were 26,494 building permits for buildings with five or more units and there were 24,137 multifamily units constructed or under construction in this period. About 90 percent of building permits for five or more units in Hampton Roads were for multifamily units.**

With new construction, the supply of multifamily residences has increased over the last decade and is forecasted to increase through 2022. Graph 6 shows that the supply of apartments rose from about 93,000 in 2006 to almost 109,000 in 2017, an increase of 16.6 percent. **CoStar forecasts that apartment construction will continue apace, growing annually at a rate of 5.9 percent through 2022. By 2022, Hampton Roads will approach 115,000 market-rate multifamily housing units.**

As the multifamily housing market adjusts over the coming years, there is a measure of good news. If move-outs exceed move-ins, then the supply of available apartments increases. Graph 7 shows that increases in supply outstripped increases in demand for multifamily housing for most years from 2006 to 2016. As developers restrain new construction in the coming years, the market will adjust, reducing the number of vacant multifamily units.

GRAPH 4

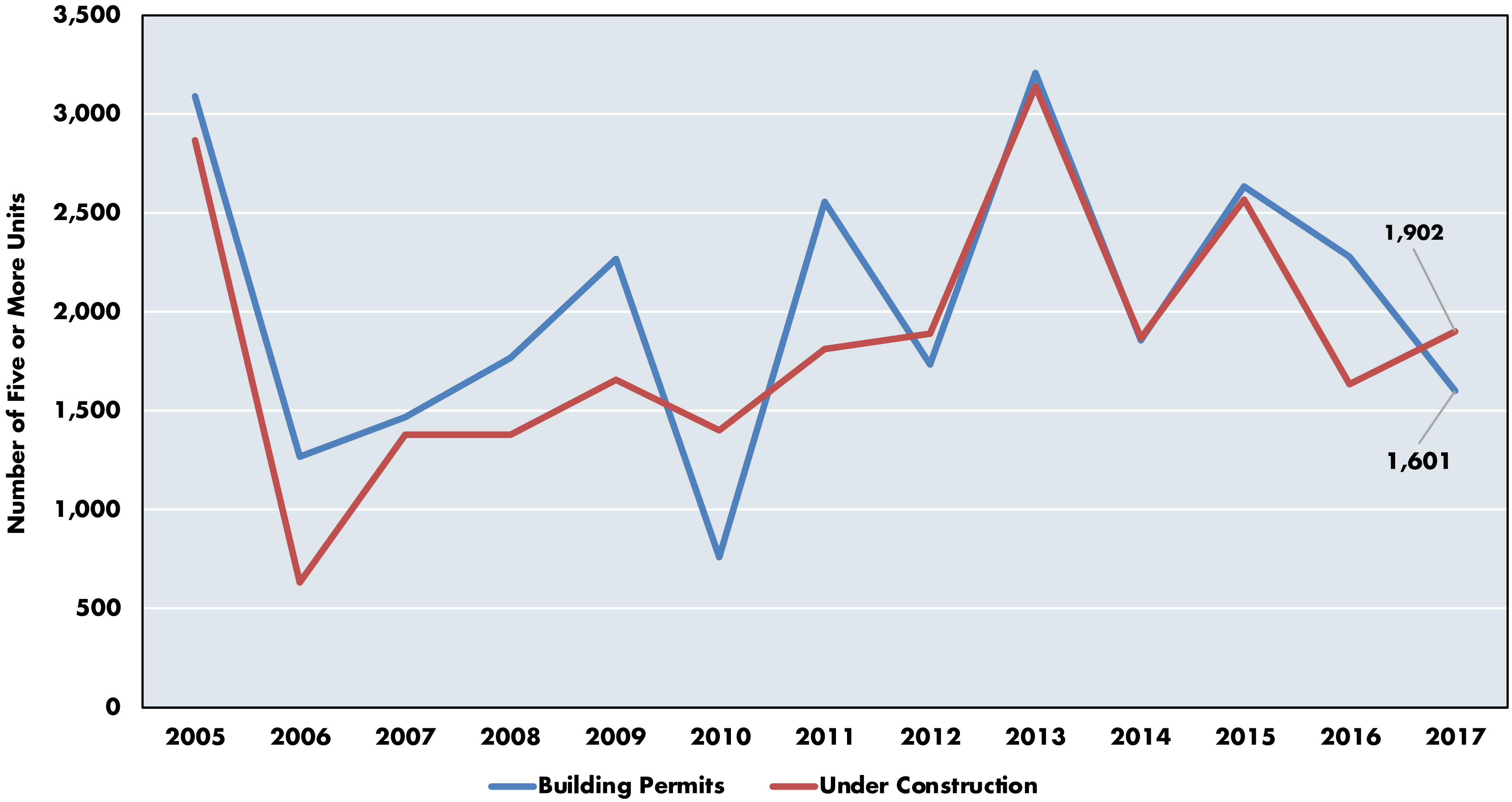
INDEX OF ANNUAL BUILDING PERMITS FOR ONE UNIT AND FIVE OR MORE UNITS: HAMPTON ROADS, 1997–2017



Sources: U.S. Census Bureau, Residential Construction Branch, and the Dragas Center for Economic Analysis and Policy, Old Dominion University

GRAPH 5

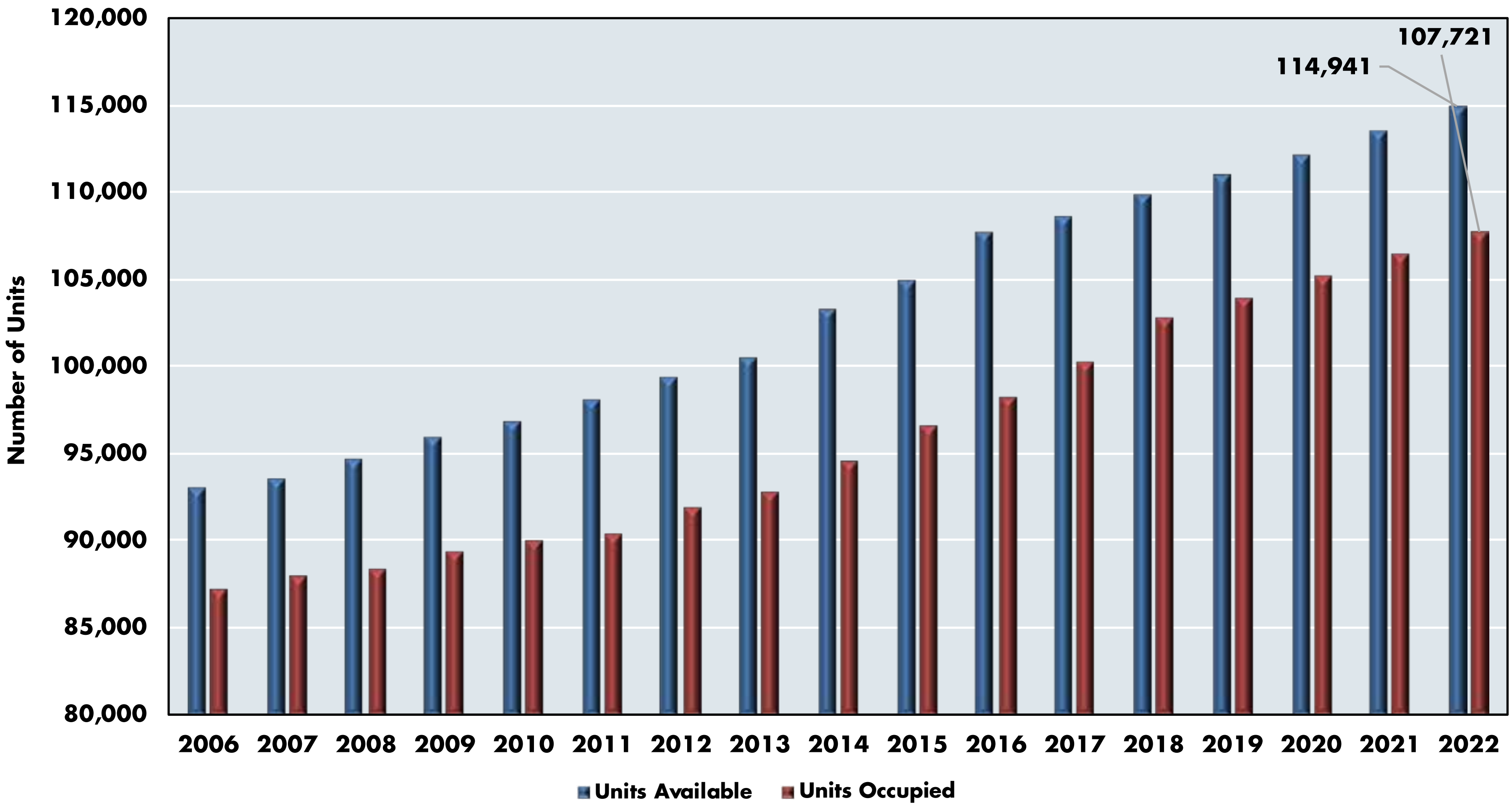
BUILDING PERMITS AND NEW CONSTRUCTION OF BUILDINGS WITH FIVE OR MORE UNITS: HAMPTON ROADS, 2005-2017



Sources: Building permit data are from the U.S. Census Bureau, Residential Construction Branch. Under-construction data are from CoStar Market Analytics.

GRAPH 6

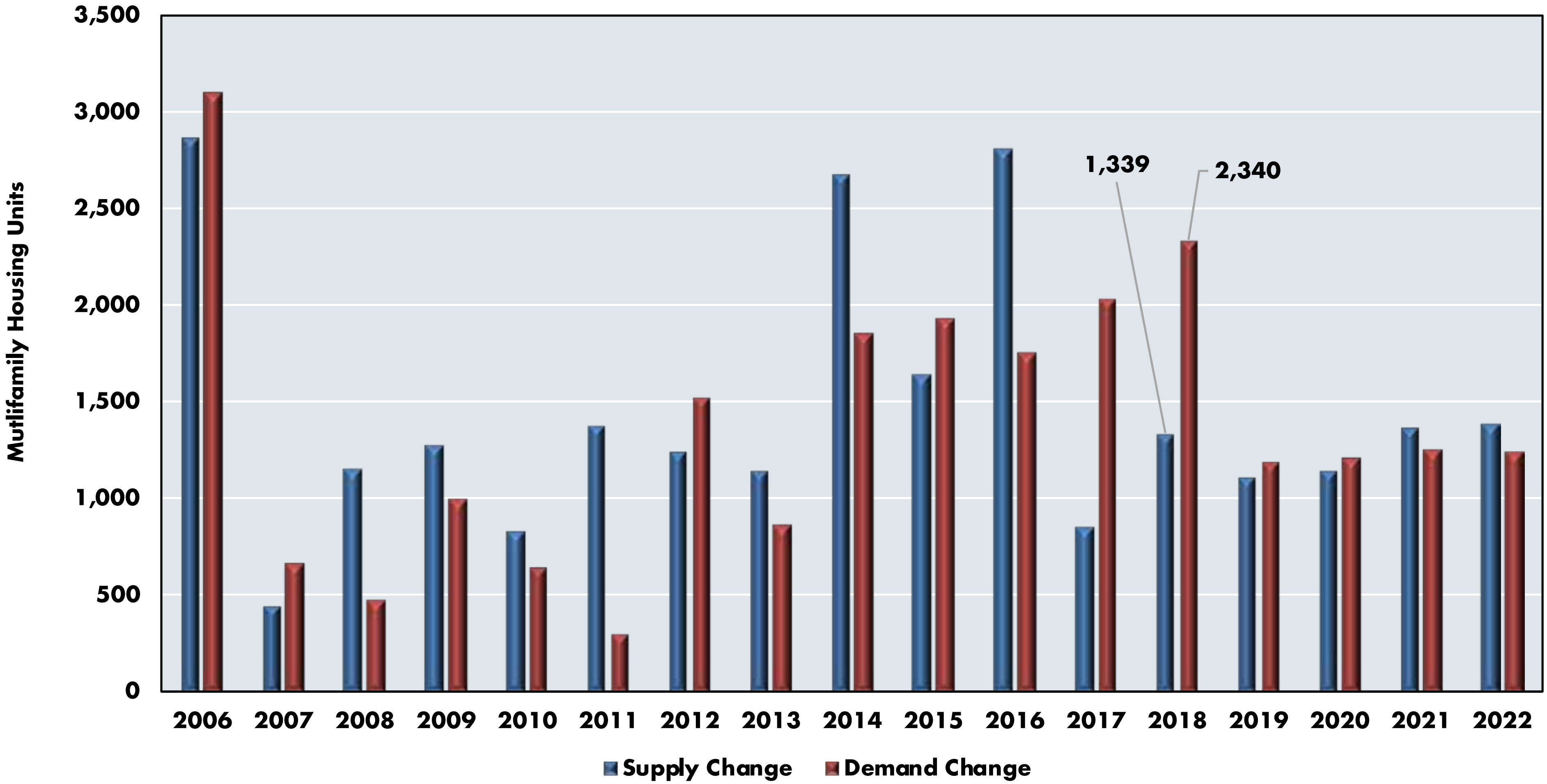
MULTIFAMILY UNITS AVAILABLE AND OCCUPIED: HAMPTON ROADS, 2006-2022



Sources: U.S. Census, CoStar Market Analytics and the Dragas Center for Economic Analysis and Policy, Old Dominion University

GRAPH 7

CHANGES IN SUPPLY AND DEMAND FOR MULTIFAMILY HOUSING: HAMPTON ROADS, 2006-2022



Sources: U.S. Census, CoStar Market Analytics and the Dragas Center for Economic Analysis and Policy, Old Dominion University

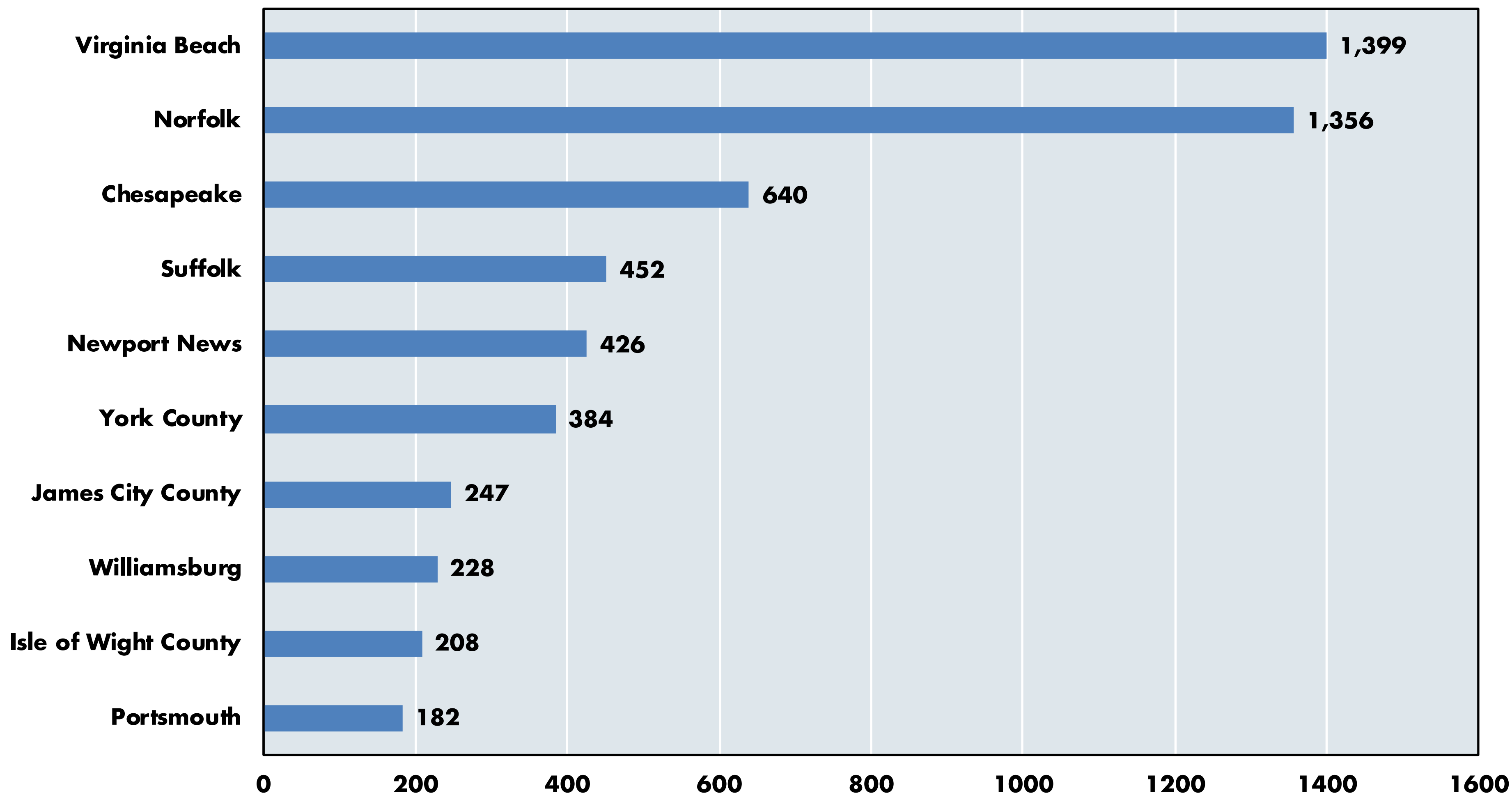
New Multifamily Housing And Vacancies In Hampton Roads

Most localities in Hampton Roads have seen increases in the supply of multifamily housing over the last decade. As one might expect, the larger cities and counties have seen more mutlifamily deliveries. Graph 8 illustrates that Virginia Beach and Norfolk have each added more than 1,300 multifamily units since 2015, trailed by Chesapeake with 640 units and Suffolk with 452 units. While Isle of Wight's new deliveries amounted to a 37.5 percent increase in mutlifamily inventory, Virginia Beach's absolute increase was 6.7 times larger than Isle of Wight.

Graph 9 displays the vacancy rate for multifamily housing in Hampton Roads and the United States from 2006 to 2022. Vacancy rates in our region have increased over the past decade, peaking at 8.7 percent in 2016. The corresponding slowdown in building permits shown in Graph 5 is forecasted to lower vacancy rates to 6.3 percent by 2022.

GRAPH 8

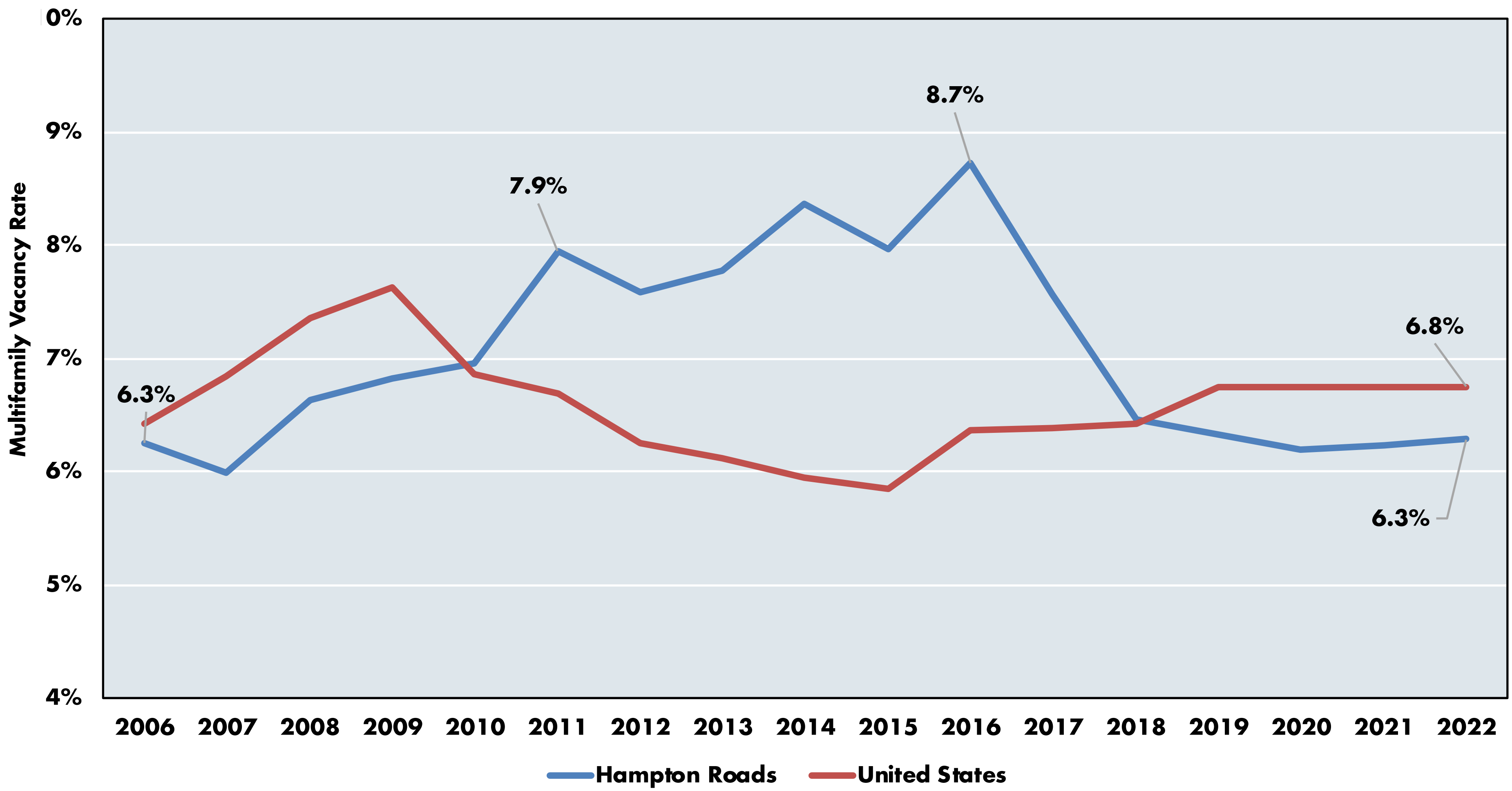
NET NEW MULTIFAMILY DELIVERIES, 2015-2017



Sources: CoStar Market Analytics and the Dragas Center for Economic Analysis and Policy, Old Dominion University

GRAPH 9

MULTIFAMILY VACANCY RATE IN HAMPTON ROADS AND THE UNITED STATES, 2006-2022



Sources: CoStar Market Analytics and the Dragas Center for Economic Analysis and Policy, Old Dominion University

Apartment Affordability In Hampton Roads

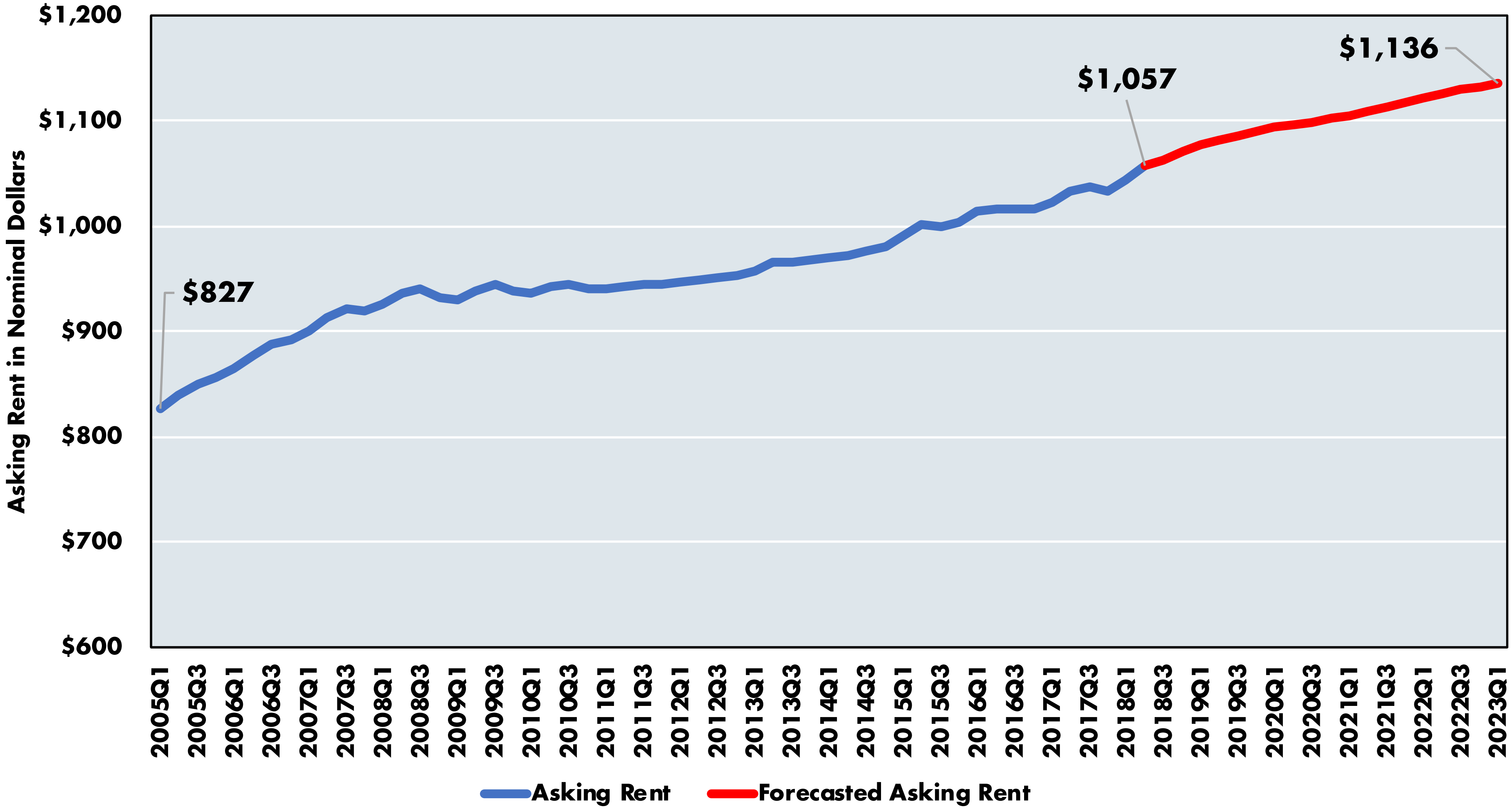
Higher vacancy rates in Hampton Roads may not be good news for owners and developers of multifamily housing but are providing a measure of relief to renters, especially compared to Richmond and Northern Virginia. Average rents as of the second quarter of 2018, however, topped the $1,000 per month benchmark due to new construction of luxury apartments. Newer, luxury apartments rent at a premium relative to existing apartment stock, so the rise in rent is more closely tied to improving quality than increasing scarcity.

Graph 10 shows that asking rents in Hampton Roads were $1,057 per month, on average, at the end of the second quarter of 2018. Rents in Hampton Roads remain lower than in nearby metropolitan areas such as Richmond ($1,073 per month), Raleigh ($1,098 per month) and Charlotte ($1,107 per month). On average, the highest rents in Hampton Roads are in Chesapeake ($1,175 per month), Virginia Beach ($1,151 per month) and Norfolk ($1,024 per month). The most affordable rents are in Newport News ($921 per month), Portsmouth ($953 per month) and Hampton ($973 per month).

Vacancy rates, much like rental rates, vary by locality in Hampton Roads. As shown in Graph 11, with a vacancy rate of 3.5 percent in the second quarter of 2018, it should be no surprise that multifamily units are being built rapidly in Isle of Wight County. York County, on the other hand, had more than 12 percent of units vacant, suggesting that the market is currently overbuilt relative to demand. For the cities in Hampton Roads, Williamburg has the lowest vacancy rate of about 3.8 percent and Newport News has the highest rate at 8.3 percent. With the recent news about new shipbuilding and hiring at Newport News Shipbuilding, it would not be surprising to see vacancy rates decline in Newport News and Hampton in the coming months.

GRAPH 10

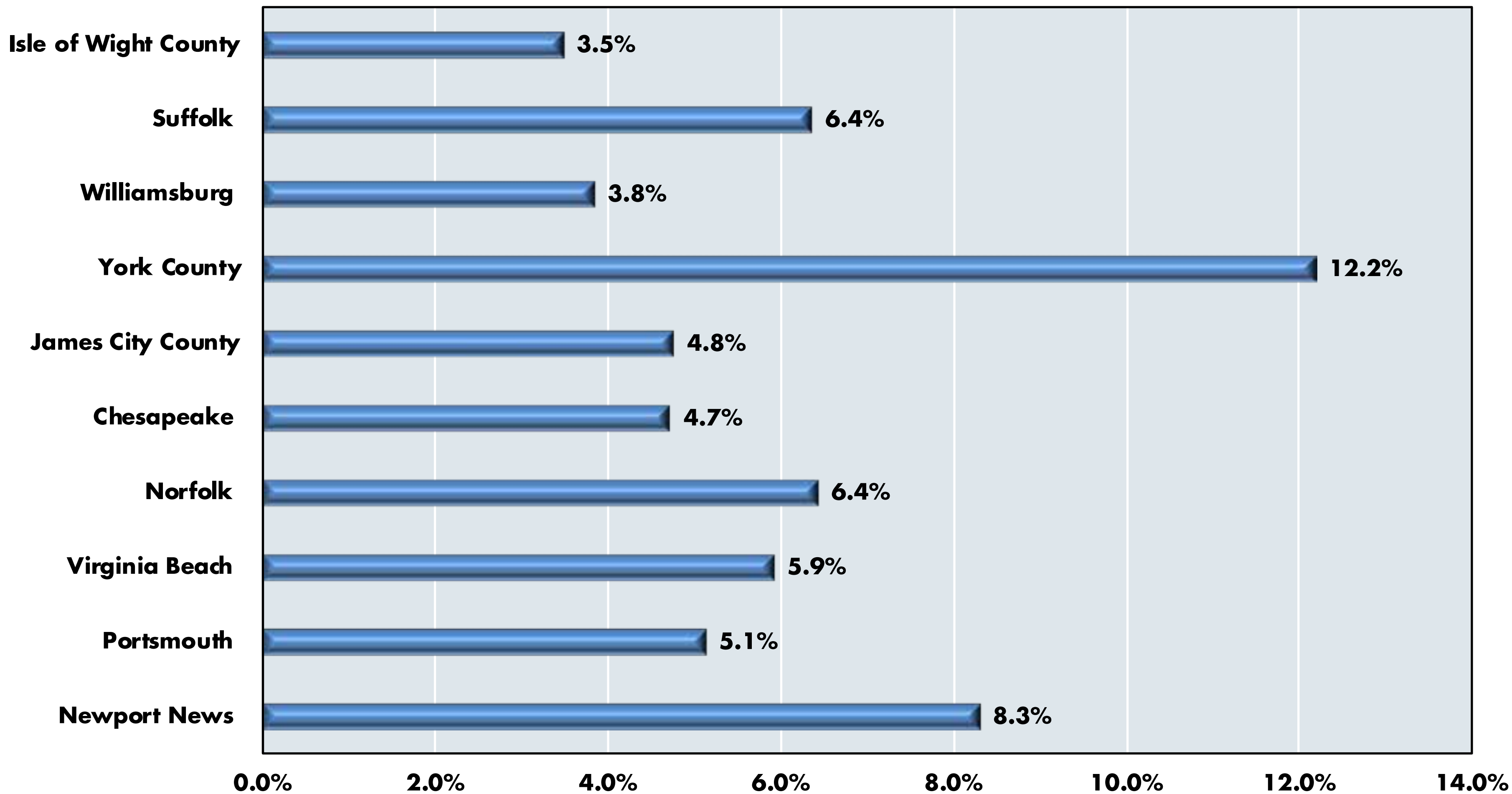
ASKING RENTS: HAMPTON ROADS, 1ST QUARTER 2006 TO 4TH QUARTER 2022



Sources: CoStar Market Analytics and the Dragas Center for Economic Analysis and Policy, Old Dominion University

GRAPH 11

VACANCY RATES: HAMPTON ROADS, 2ND QUARTER 2018



Sources: CoStar Market Analytics and the Dragas Center for Economic Analysis and Policy, Old Dominion University

Luxury Apartments: Living In Style

Not all new housing is created equal. New multifamily housing units may appear similar to older apartment builds in shape but often are crafted with a range of amenities in mind. Not only are more upscale properties entering the market, but, in some cases, developers are transitioning pre-existing structures into multifamily housing.

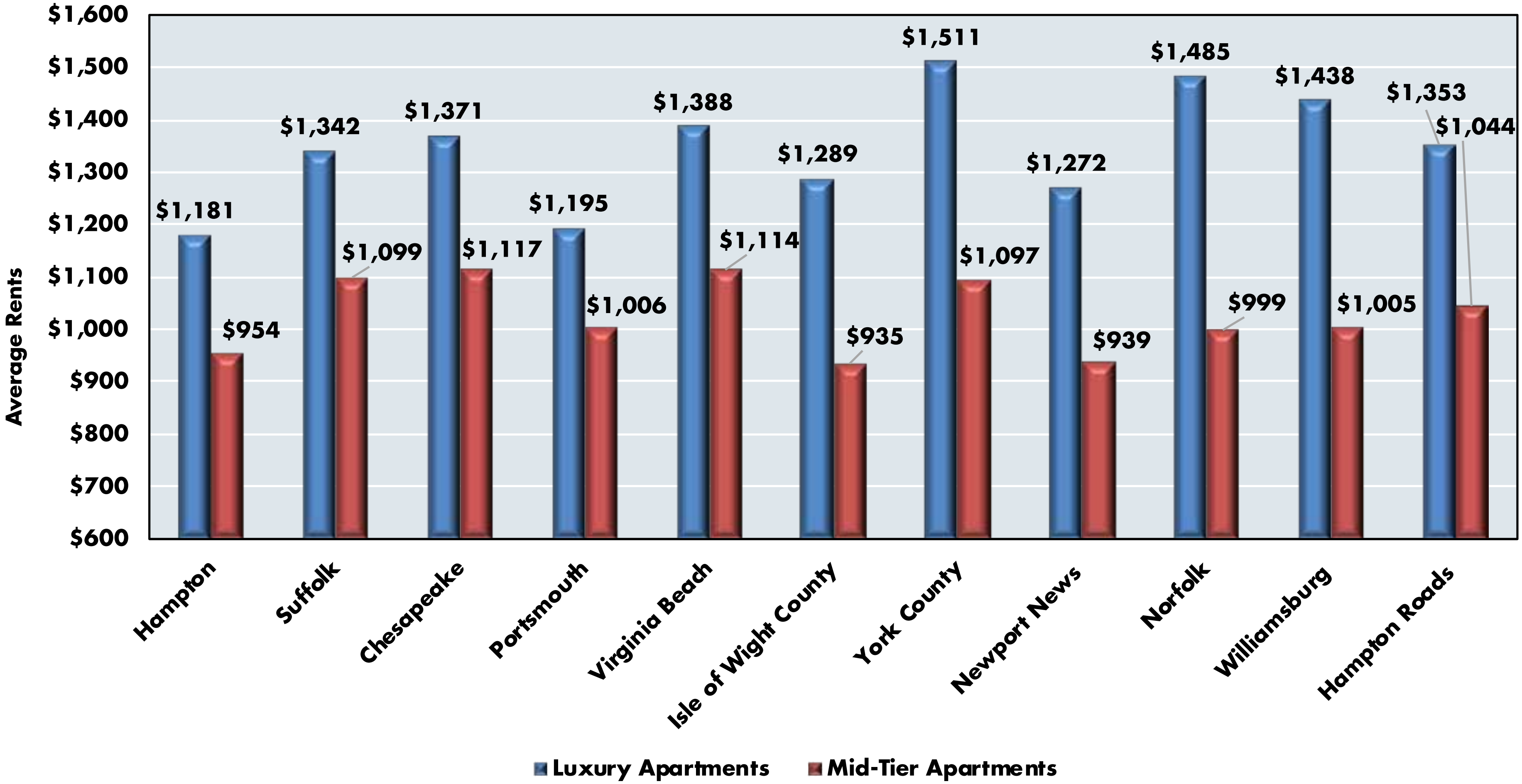
In recent years, developers have been buying existing and blighted real estate for conversion opportunities and are often granted historic tax credits for improving obsolete real estate and turning it into upgraded housing. For example, the Hampton Roads Housing Co. converted the former Kempsville High School building in Virginia Beach into multifamily housing of 168 units, with asking rents starting at around $1,495 a month.

"Buddy" Gadams' Marathon Development Group has been active in Hampton Roads, particularly in Norfolk, where the developer has delivered several new apartment properties. Marathon Development's most recent significant projects are the Edge @ 450 apartments and 1 Commercial Place, both located in downtown Norfolk. The former Bank of America building at 1 Commercial Place, a $90 million conversion of a 24-story office tower into 275 luxury apartments branded as the Icon at City Walk Apartments, opened in the first quarter of 2018.

Graph 12 shows rents in luxury apartments and mid-tier apartments as of the second quarter of 2018. Luxury apartments rented for an average of $1,347 a month while mid-tier properties rented for an average of $1,024 a month. Rent levels in low-tier properties averaged $870 a month.

GRAPH 12

AVERAGE RENT FOR LUXURY AND MID-TIER RENTAL PROPERTIES, 2ND QUARTER 2018



Sources: CoStar Market Analytics and the Dragas Center for Economic Analysis and Policy, Old Dominion University. Luxury apartments are 4- and 5-star rated, while mid-tier apartments are 3-star rated.

Final Thoughts

Affordability is in the eye of the beholder. What we might consider to be expensive in Hampton Roads is unobtainable in many other metropolitan areas. Consider that a recent article (by the real-estate blog network Curbed) comparison-shopped what $4,500 a month would rent you in San Francisco (not much), and you obtain a picture of affordability that depends on where you live.[6]

It is unlikely that we will return to the homeownership rates seen prior to the Great Recession. Baby boomers will downsize over the coming years, while many millennials and Gen Xers are financially constrained by debt and other obligations. These financial considerations will undoubtedly dampen demand for owner-occupied housing relative to rental housing.

Changing preferences also play a role as evidenced by the number of Gen Xers and baby boomers who state that they prefer renting to owning. Homeownership rates will continue to rise with age, albeit at a slower pace than for previous generations. This bodes well for the multifamily-rental housing sector, and we should expect developers to continue to shift their portfolios in the direction of rental housing. Renting, in the minds of many, is easier and less risky than owning. The homeownership ethos is subtly shifting over time.

Is there "too much" multifamily housing in Hampton Roads? While developers may have increased inventories rapidly earlier in the decade, slower rates of construction and increasing demand are evidence of the market self-correcting. The evidence suggests that vacancy rates in Hampton Roads will fall below those for the United States in coming years. With changing preferences in favor of multifamily housing and improving growth, it may be time for developers to increase, rather than constrain, construction.

What if the rent is considered too high? We typically loathe recommending government interventions, and the multifamily market is no exception in this regard. If there are concerns about affordability, then we recommend increasing incomes through improvements in workforce education and training, rather than distorting markets through government intervention, whether explicit (rent control) or implicit (housing requirements for developers). These distortions often benefit a small number of people at a significant cost to the taxpayer.

Our dreams define and make us. The evolving American dream today may place less emphasis on homeownership and more emphasis on finding the right place to call home. For an increasing number of residents of Hampton Roads, this means renting is now part of our shared dream of being in a better place to live and work.

6 https://sf.curbed.com/2018/6/26/17504312/what-4500-rents-you-in-san-francisco-right-now.