Rebounding, Albeit Slowly

REBOUNDING, ALBEIT SLOWLY

The Great Recession inflicted significant damage upon the citizenry of Hampton Roads. The Bureau of Labor Statistics reports that our regional rate of unemployment more than doubled from 3.4 percent in April 2008 to 8.2 percent in January 2010. Meanwhile, between 2007 and 2010, we lost almost 40,000 jobs in Hampton Roads (see Graph 1).

Even so, cushioned by Department of Defense (DOD) spending, our regional recession turned out to be milder than that of the nation. When the U.S. rate of unemployment topped out at 9.9 percent in March and April of 2010, this was considerably higher than our regional 8.2 percent peak.

DOD spending in Hampton Roads was indeed the key to our more sedate economic decline; it increased in our region by an average of 6.1 percent annually between 2000 and 2011. Unfortunately, this powerful growth engine began to sputter in 2012 and as Graph 2 indicates, absolute DOD spending in Hampton Roads in 2014 likely will barely exceed our 2011 level and actually be below our 2012 level.

DOD expenditures on military personnel have been a significant driving force in our regional economy for at least the last decade. One can observe in Table 1 that the *average* compensation of an active-duty military member in our region increased by more than 95 percent between 2001 and 2011, while average federal civilian employees' compensation increased a bit more than 54 percent, average state and local government employees' compensation by 39 percent, and average private non-farm employees' compensation by almost 31 percent. However, the political/economic energy for these DOD compensation increases is dissipating; it appears that the next wage increase will be 1 percent.

Note that the compensation data reported in Table 1 include the value of all fringe benefits received by active-duty personnel. Thus, an economic value is placed on all food, uniform and housing allowances, etc. Active-duty military wages did not increase by 95 percent between 2001 and 2011.

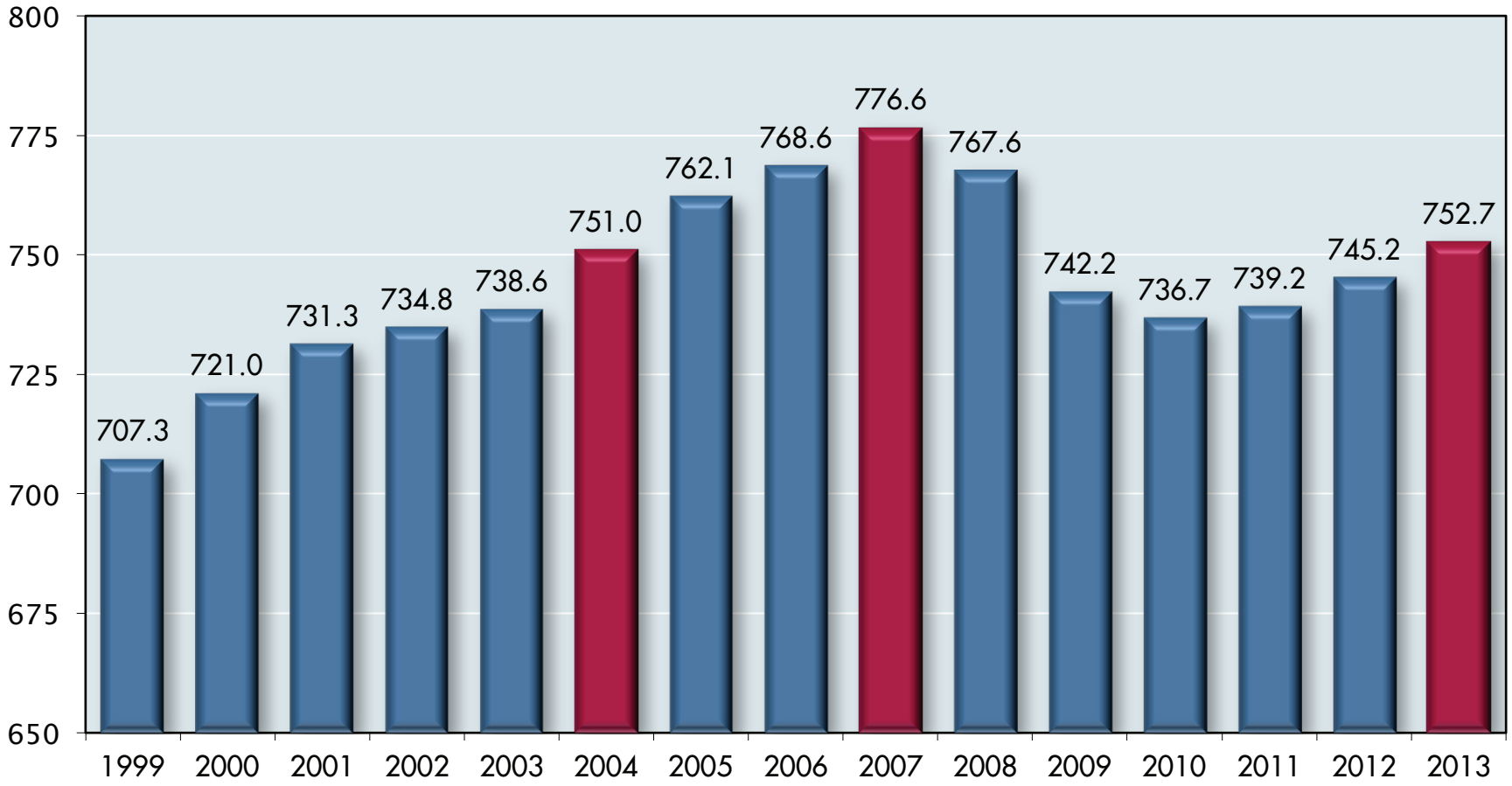
Ironically, the deceleration of defense spending has enabled us to achieve a long-sought regional goal – the diversification of our regional economy. As Graph 3 reveals, in 2014, we expect that only 42.2 percent of our regional economic activity will be directly and indirectly attributable to DOD spending; this would be down from our recent peak of 46.6 percent in 2011. Alas, we have achieved our economic diversification for the wrong reason – a decline in DOD spending rather than a spirited increase in our private-sector activity.

In any case, while we have been experiencing economic growth in Hampton Roads (roughly 1.54 percent over the past year after removing inflation), this has not translated to significant job growth. A review of Graph 1 demonstrates that we have yet to recover all the jobs we lost in the Great Recession. Our regional economic recovery has trailed that of both the Commonwealth and the United States. As Graph 4 illustrates, the country finally recovered all of the jobs it lost in the recession in May of this year and Virginia is less than 1 percent away from doing so. We, however, are sputtering along at almost 4 percent below our 2007 peak of 776,600 regional jobs.

There are, however, some bright spots in our regional economic picture. In the next few sections we will examine them and our prospects for the future.

GRAPH 1

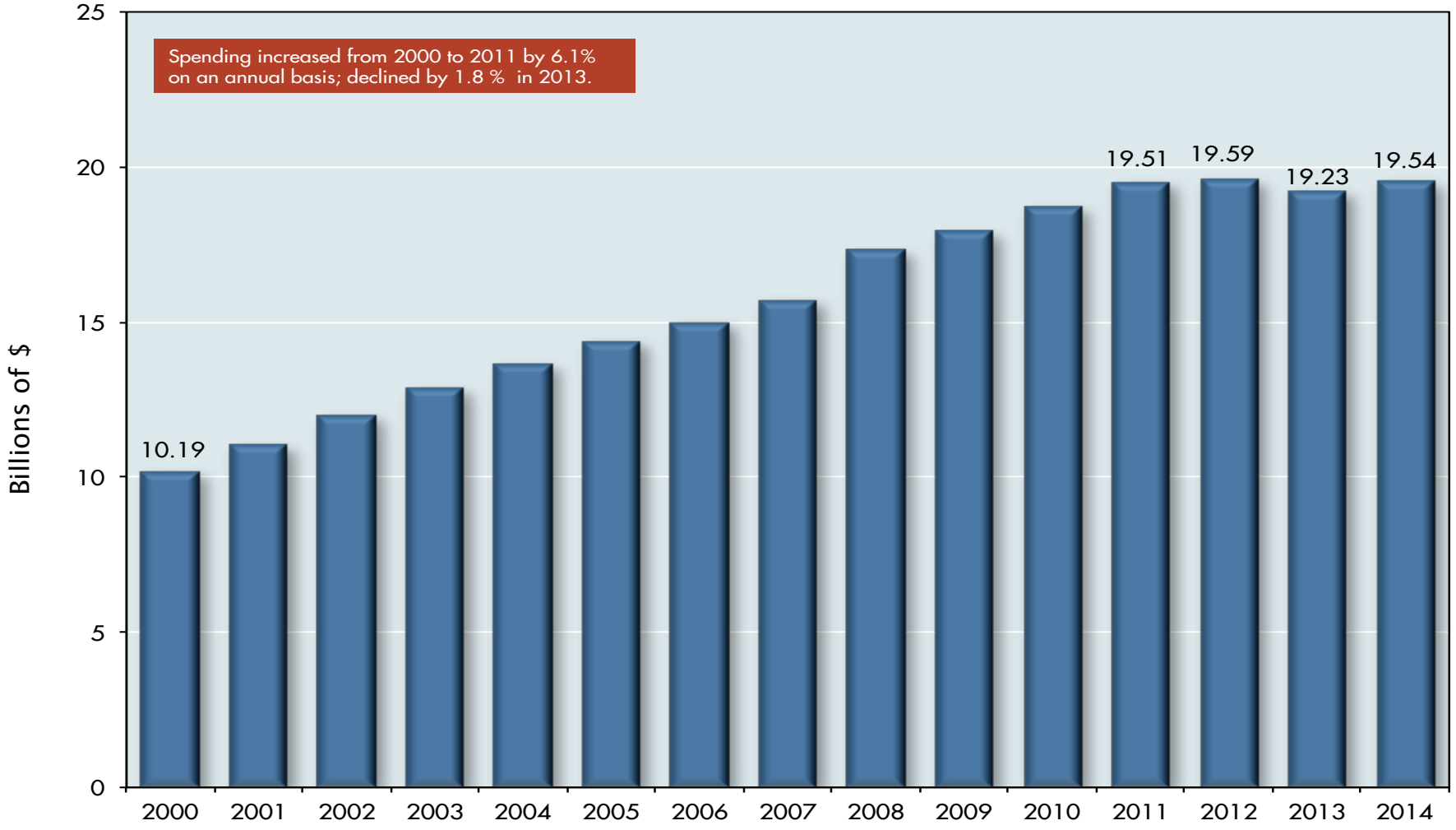
TOTAL CIVILIAN EMPLOYMENT IN HAMPTON ROADS, 1999-2013 (THOUSANDS OF JOBS)



Sources: U.S. Department of Labor CES data and the Old Dominion University Economic Forecasting Project. Not seasonally adjusted. Revised data March 17, 2014.

GRAPH 2

ESTIMATED DIRECT DOD SPENDING IN HAMPTON ROADS, 2000-2014



Sources: U.S. Department of Defense and the Old Dominion University Economic Forecasting Project. *Includes federal civilian and military personnel and procurement spending.

TABLE 1

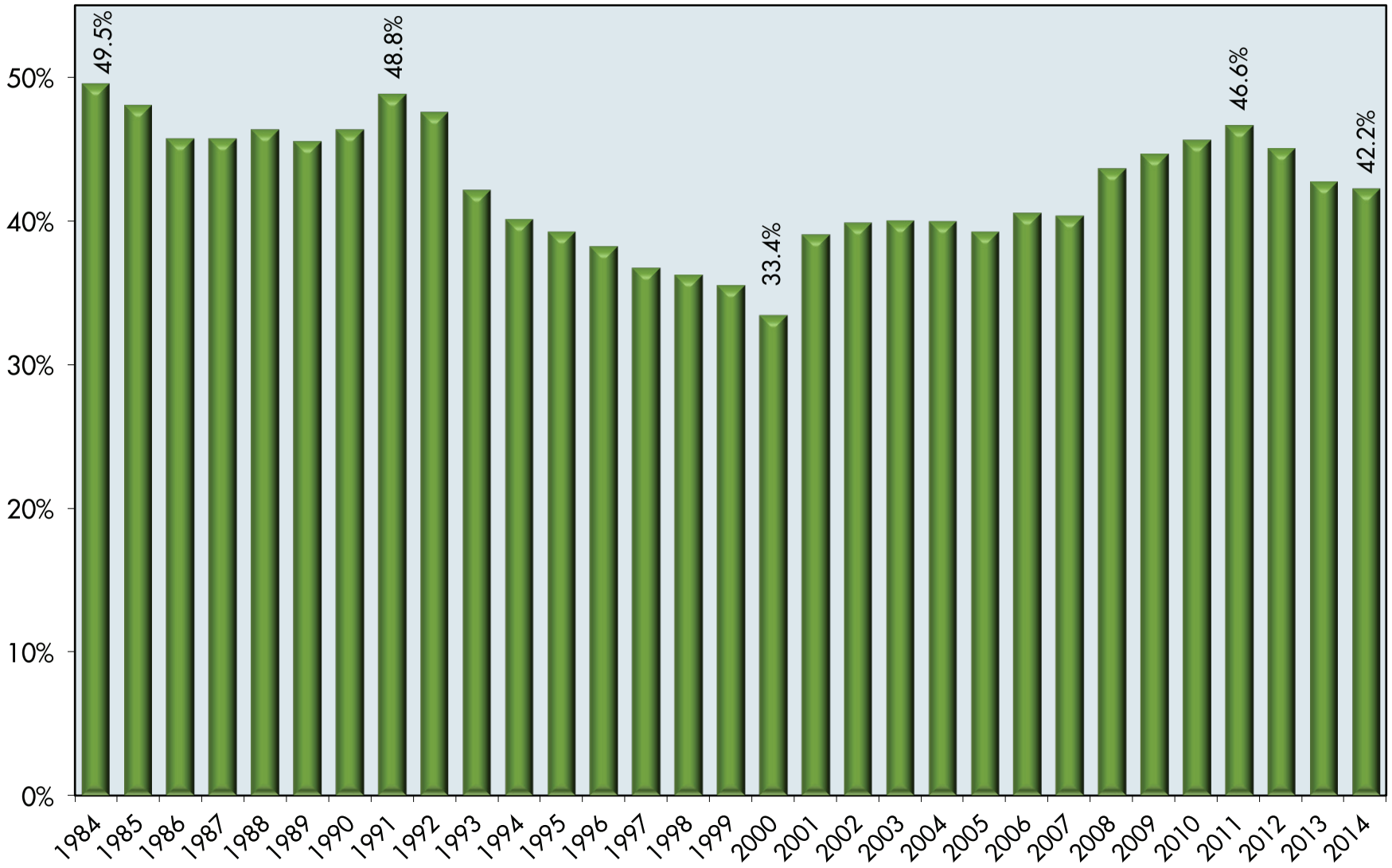
ESTIMATED AVERAGE COMPENSATION (WAGES, SALARIES AND FRINGE BENEFITS) FOR SELECTED CATEGORIES IN HAMPTON ROADS, 2001, 2011 AND 2012

	Earnings in 2001	Earnings in 2011	Earnings in 2012	Percent Increase 2001 to 2011	Percent Increase 2011 to 2012
Military	$47,077	$92,054	$93,346	95.5%	1.4%
Federal Civilian Government Employees	$63,631	$98,296	$98,166	54.5%	-0.1%
State and Local Government Employees	$40,251	$55,931	$56,334	39.0%	0.7%
Private Non-farm	$29,155	$38,166	$39,499	30.9%	3.5%

Sources: U.S. Bureau of Economic Analysis and the Old Dominion University Economic Forecasting Project

GRAPH 3

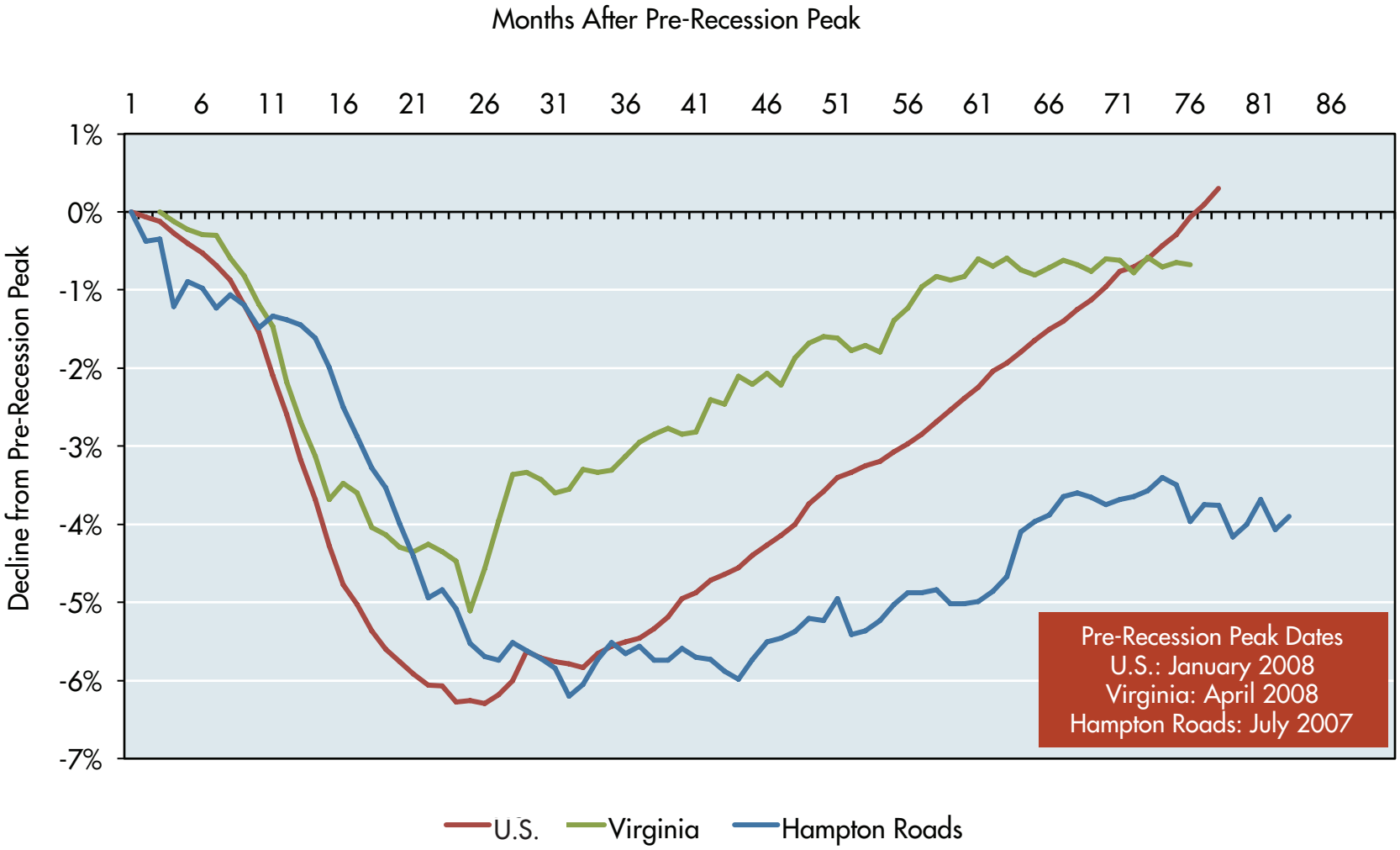
HAMPTON ROADS GROSS REGIONAL PRODUCT ATTRIBUTABLE TO DOD SPENDING, 1984-2014



Sources: U.S. Department of Defense, U.S. Department of Commerce and the Old Dominion University Economic Forecasting Project

GRAPH 4

RECESSION RECOVERY IN THE U.S., VIRGINIA AND HAMPTON ROADS MEASURED BY THE PERCENTAGE OF TOTAL JOBS RESTORED, 2007-2014*



Sources: Bureau of Labor Statistics and the Old Dominion University Economic Forecasting Project. *Data for 2014 are through May.

Defense Spending

In light of the data just presented, is it possible to pose DOD spending as a positive factor in our economic future? Yes, but primarily because over the next few years we will not experience the much more substantial reductions in defense spending that might have occurred.

In order to decipher what DOD spending is likely to be in the future, it is necessary to distinguish between "discretionary" DOD spending and "overseas contingency" DOD spending. Discretionary defense spending is best viewed as constituting the DOD's base budget. Overseas contingency defense spending relates to wars and conflicts that are thought to be temporary, for example, U.S. activities in Iraq and Afghanistan. In FY 2015, $85 billion is designated for such purposes.

There is, however, a third category worthy of note: "support" spending related to U.S. defense needs that includes certain expenditures in the Department of State, cyber security in the Department of Justice, nuclear security in the Department of Energy and the now famous Department of Veterans Affairs. Table 2 summarizes what has been happening to these three classes of defense or defense-related expenditures since FY 2009. With the exception of FY 2012 and FY 2013, support expenditures have been growing steadily over time and their growth is not likely to abate. This reflects both the continued growth of fringe benefit expenditures (including health) for active-duty and retired personnel and an increased emphasis on nonconventional warfare.

The three lines in Graph 5 illustrate the impact of DOD budget cuts in recent years. The blue line depicts discretionary DOD spending caps between FY 2012 and FY 2021 approved under the Budget Control Act of 2011. The red line illustrates the additional spending cap reductions – also known as sequestration – that were also set in place in the Budget Control Act of 2011. The green line reflects sequestration relief (increased DOD spending caps) that was approved in the Bipartisan Budget Act of 2013. The area of the green trapezoid is equal to $31.5 billion and represents DOD spending caps that have been restored for FY 2013 and FY 2014.

TABLE 2

TOTAL DEFENSE-RELATED SPENDING (IN BILLIONS OF $) IN FISCAL YEARS ENDING ON SEPT. 30 OF EACH YEAR

Fiscal Year	DOD Base Budget	Overseas Contingency	Support	Total
FY 2008	$686.0	$197.5	N.A.	N.A.
FY 2009	$513.5	$145.9	$149.2	$808.7
FY 2010	$530.1	$167.3	$159.5	$852.2
FY 2011	$528.1	$159.4	$165.0	$862.7
FY 2012	$530.4	$126.5	$159.3	$816.2
FY 2013	$495.5	$ 93.0	$163.8	$752.3
FY 2014	$496.0	$ 91.9	$168.6	$756.5
FY 2015	$495.6	$ 85.4	$175.4	$756.4

Source: http://useconomy.about.com/od/usfederalbudget/p/military_budget.htm

The salient point is that we were spared many of the sequestration cuts that had been scheduled for FY 2013 and FY 2014. The Bipartisan Budget Act of 2013 also provided a 1 percent pay increase for active-duty personnel and a 4.2 percent hike in housing allowances.

What does all this mean for Hampton Roads? In a nutshell, it's not going to be as bad as it might have been. Graph 6, which shows the region's median household income, demonstrates this. We've averted the largest DOD cuts, but smaller cuts remain. Further, Congress has blocked any consideration of closing military bases, so that potential problem is off the table, if only for a few years.

Of greater concern to us should be four potentially adverse trends relating to DOD spending. First, the total number of active-duty military personnel in our region continues to decline and is now about 20,000 below our numbers at the beginning of this century. The decline between FY 2010 and FY 2012 was relatively modest where the U.S. Navy was concerned – 1,133 fewer

active-duty individuals, or about 1.6 percent of its regional complement. However, we should not forget that active-duty personnel and their dependents buy homes, purchase automobiles, attend colleges, patronize restaurants, etc. We will feel the economic effects.

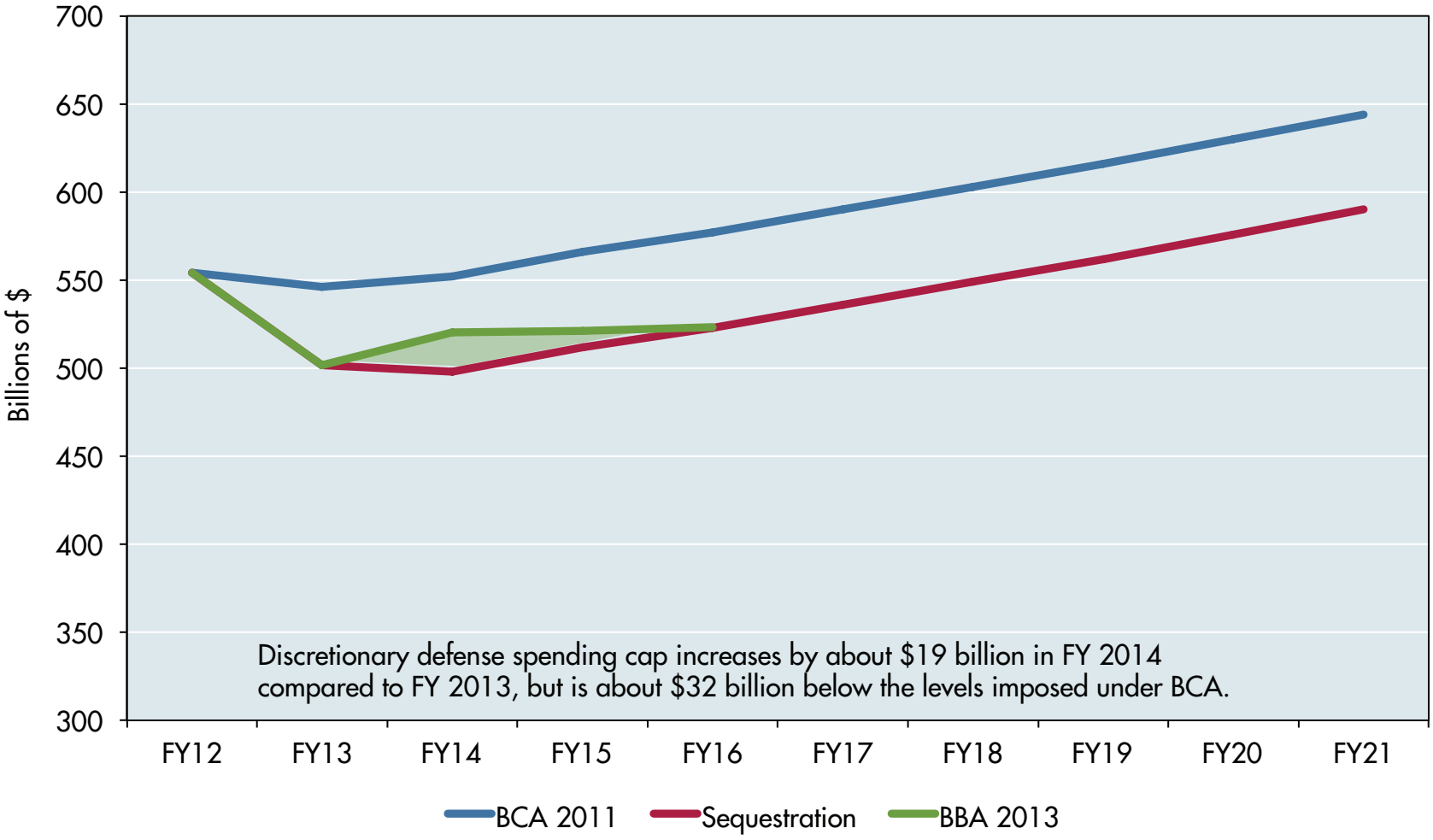
Second, the U.S. Navy continues to grow smaller in terms of the number of active ships in the fleet. In FY 2010, 72 ships were homeported in Hampton Roads, but this had fallen to 68 by FY 2012, continuing a long-term trend. Smaller ship numbers eventually translate into diminished ship repair and maintenance activity, which is a multibillion-dollar industry in our region. More than the Norfolk Naval Shipyard will be affected. Firms such as BAE Systems and Colonna's Shipyard will experience reduced business and subsequently find it challenging to refocus their attention toward non-DOD activities.

Third, the escalating costs of building and producing major defense assets, such as aircraft carriers and state-of-the-art fighter airplanes, mean that the DOD will not be able to purchase as many in the future. They're simply too expensive. This will result in lower levels of activity at firms such as Newport News Shipbuilding. In the long term, if fewer such assets are being produced, this also will accelerate the decline in the number of active-duty personnel and civilian counterparts employed by the DOD.

Fourth, the military challenges and conflicts the United States has confronted in the 21st century have not always matched up well with the powerful traditional military assets the country has the ability to deploy. We clearly have the most powerful military force on earth and any and all opponents shrink from entering any battlefield where the U.S. is able to deploy its traditional military assets, such as aircraft carriers, nuclear submarines and advanced fighter aircraft. However, growing in importance are anti-partisan and anti-terrorist operations, the use of Special Forces, cyber warfare and a variety of policing and prevention activities. If this trend away from the use of traditional military assets continues, it is likely to be disadvantageous for Hampton Roads, because we are substantially (though not totally) a traditional, conventional forces bastion.

GRAPH 5

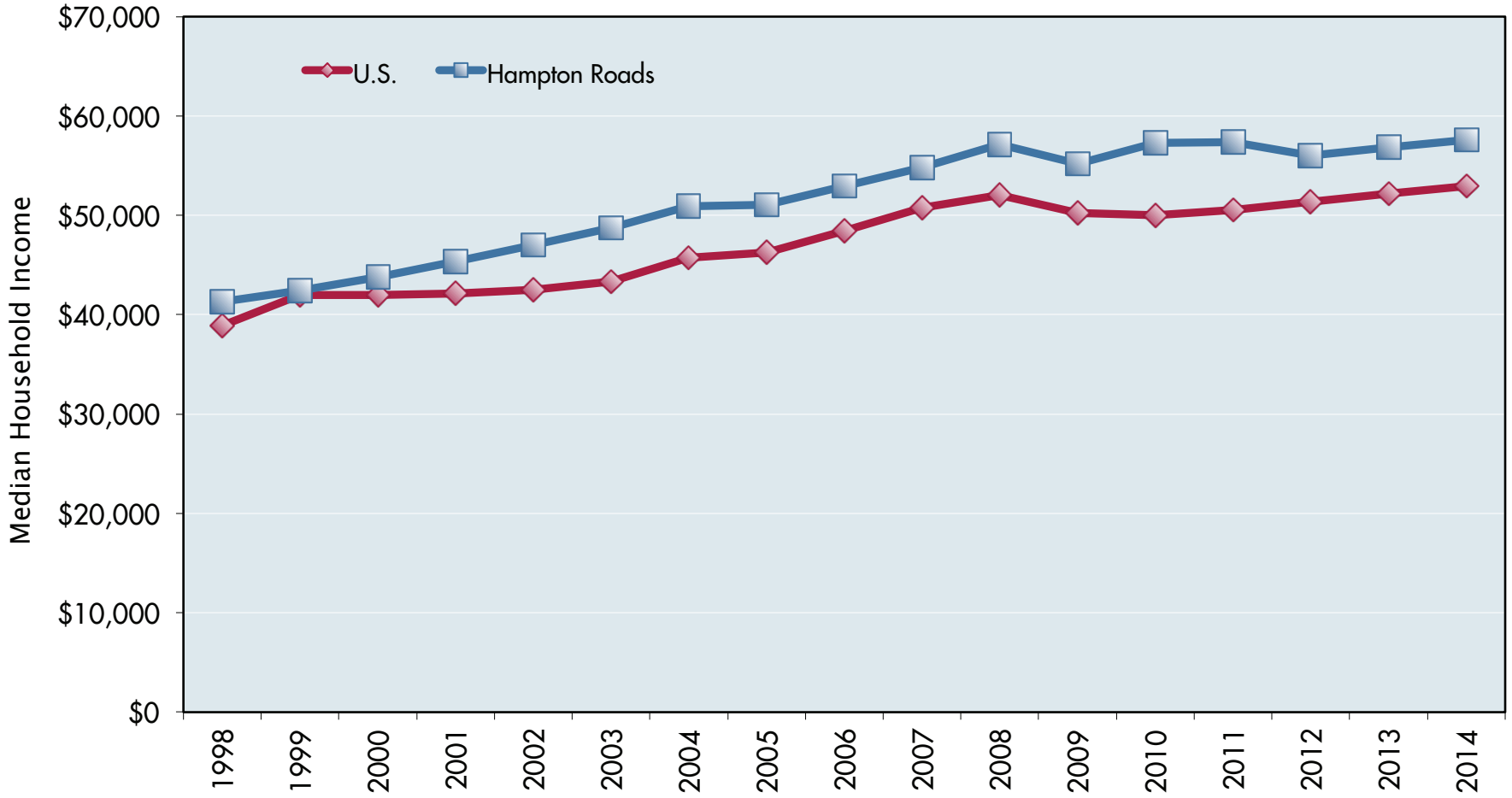
CAPS ON DEPARTMENT OF DEFENSE DISCRETIONARY SPENDING, FY 2012 TO FY 2021



Sources: Budget Control Act 2011, budget requests for FY14, Congressional Budget Office Sequestration Update Report and the Old Dominion University Economic Forecasting Project

GRAPH 6

COMPARISON OF MEDIAN HOUSEHOLD INCOME, HAMPTON ROADS AND THE U.S., 1998-2014



Sources: U.S. Census Bureau and the Old Dominion University Economic Forecasting Project

Employment And Job Markets In Hampton Roads

Even though we have yet to recover all of the jobs we lost in the Great Recession, some sectors of our economy have done rather well. Graph 7 reports sectoral winners and losers in Hampton Roads in 2013 in terms of jobs gained and lost. Continuing a long-term trend that was not altered by recession (see Graph 8), the health care and social assistance sector exhibited a strong increase in employment. Reflecting economic recovery, professional and business services, retail and wholesale trade, and even manufacturing, recorded significant increases in jobs.

At the other end of the spectrum, government jobs declined across the board – federal, state and local – within Hampton Roads. This is indicative both of disappointing tax collections and citizen resistance to expanded governmental activity. Governments collectively shed approximately 1,600 jobs in our region in 2013.

Hampton Roads, however, is not a high-wage oasis. Table 3 reports average weekly wages in various economic sectors at the end of 2003 and at the end of 2013. Our largest growth in jobs has been occurring in health care and social assistance, but average weekly wages in this sector grew only 27.4 percent in Hampton Roads over the 2003-2013 period. Unfortunately, during the same years, the CPI-U (consumer price index for all urban consumers) grew 26.5 percent. Thus, these workers experienced only a scant 1 percent increase in their real incomes. Following national trends, the big winners regionally in terms of increased real incomes over this decade were finance and insurance workers, whose real incomes increased by almost 16 percent. The big losers were retail trade workers (many of whom are salespeople) – their real incomes fell by 13.6 percent during this decade.

TABLE 3

AVERAGE PRIVATE-SECTOR WEEKLY WAGES IN SELECTED INDUSTRIES IN HAMPTON ROADS, 2003 AND 2013

Industry	4th Quarter 2003	4th Quarter 2013	Changes
Construction	$709	$938	$246 (34.7%)
Manufacturing	$908	$1,120	$212 (23.3%)
Wholesale Trade	$947	$1,176	$229 (24.2%)
Retail Trade	**$405**	**$457**	**$52 (12.8%)**
Transportation and Warehousing	$790*	$1,066	$276 (34.9%)
Information	$795*	$1,044	$249 (31.3%)
Finance and Insurance	$867	$1,234	$367 (42.3%)
Professional and Business Services	$1,075	$1,430	$355 (33.0%)
Health Care and Social Assistance	**$696***	**$887**	**$191 (27.4%)**
Accommodation and Food Services	**$242**	**$303**	**$61 (27.4%)**

Sources: U.S. Department of Labor Quarterly Census of Employment and Wages in Private Sector and the Old Dominion University Economic Forecasting Project. *Wage data shown for Transportation and Warehousing and Information industry are for second quarter 2005. Data for Health Care and Social Assistance are for first quarter 2007.

Hence, in Hampton Roads, we find ourselves in a good news/bad news situation with respect to jobs and labor markets.

The good:

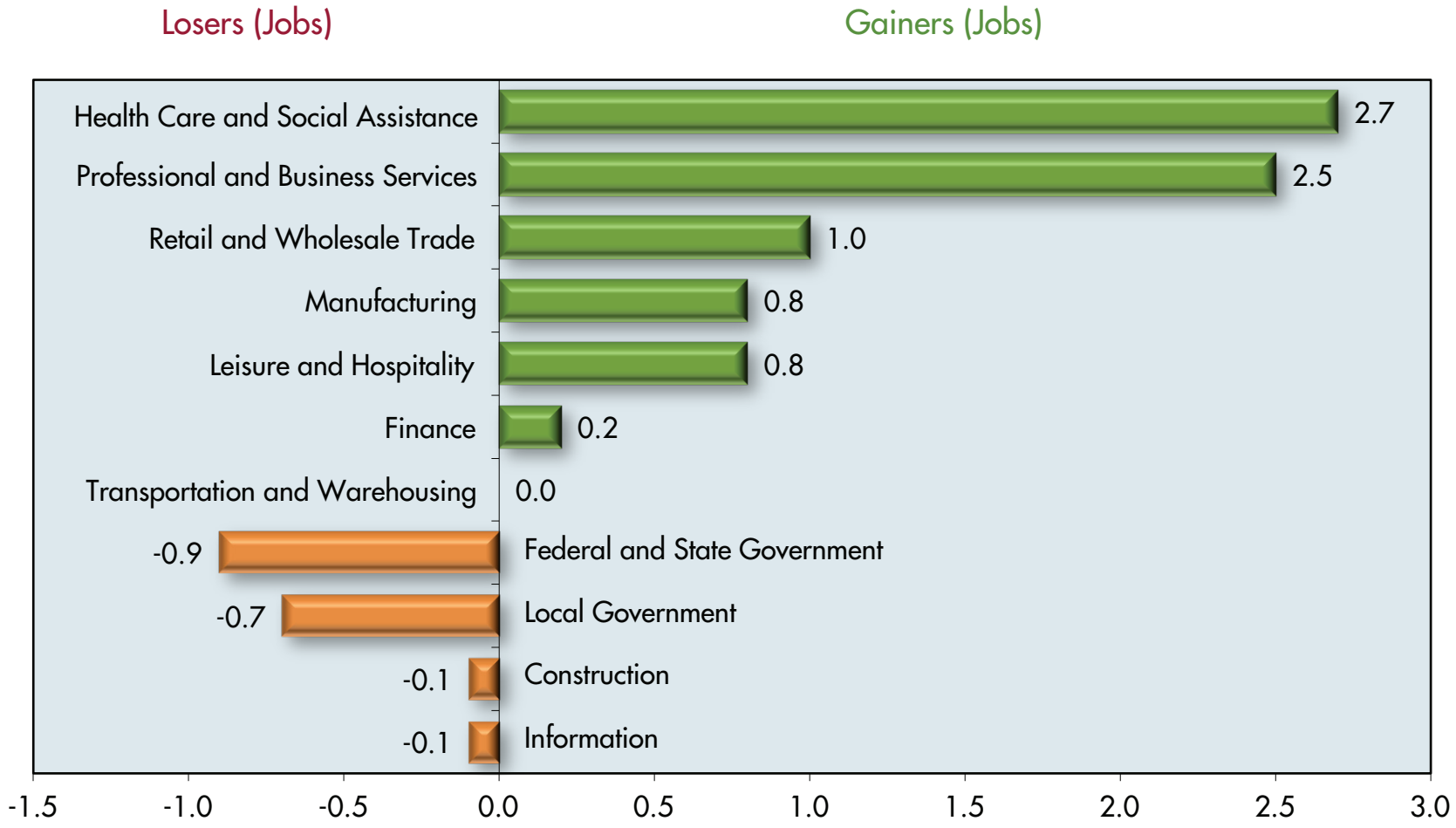
- Our regional rate of unemployment (5.8 percent in July 2014) continues to hover well below the U.S. unemployment rate (6.5 percent in July 2014).
- As Graph 9 reveals, the number of people seeking unemployment insurance in Hampton Roads continues to decline.
- All things considered, the private-sector economy in our region has not performed too badly. There is private-sector economic growth and there has been some job creation.

The bad:

- We simply aren't creating enough new jobs; we have yet to replace all of the jobs we lost in the Great Recession.
- Labor force participation in Hampton Roads (and in the U.S.) continues to decline, reflecting the reality that an increasing number of people of working age are not seeking work. Hence, they are not counted as unemployed.
- Growth in real, inflation-adjusted incomes has been minimal overall and in many job sectors income growth has not kept up with the rise in the Consumer Price Index over the past decade.
- While we are doing better than the U.S., our July 2014 unemployment rate (5.8 percent) was higher than Virginia's (5.4 percent) and Richmond's (5.7 percent).

GRAPH 7

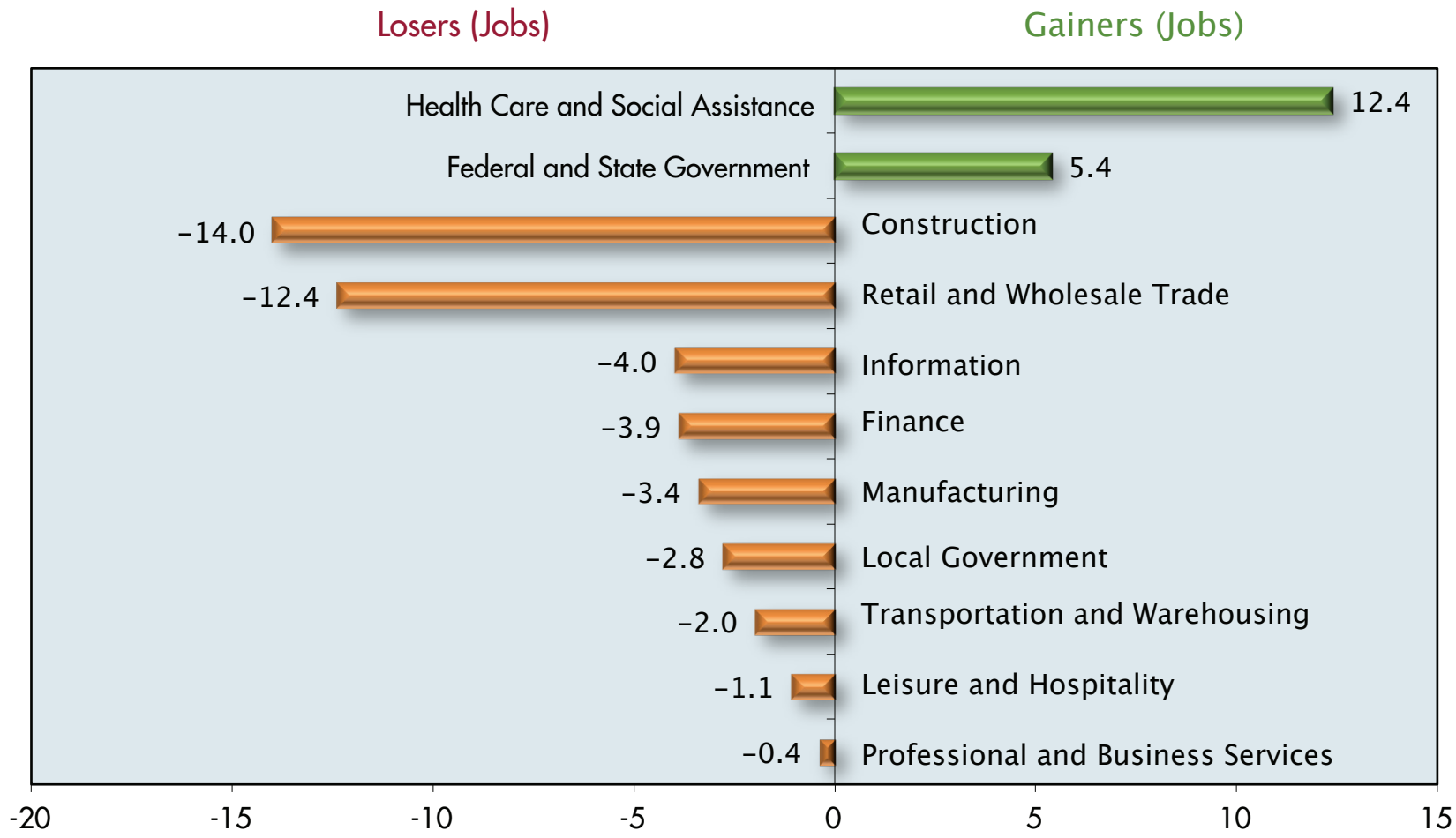
JOBS GAINS AND LOSSES IN HAMPTON ROADS, 2013



Sources: U.S. Census Bureau and the Old Dominion University Economic Forecasting Project

GRAPH 8

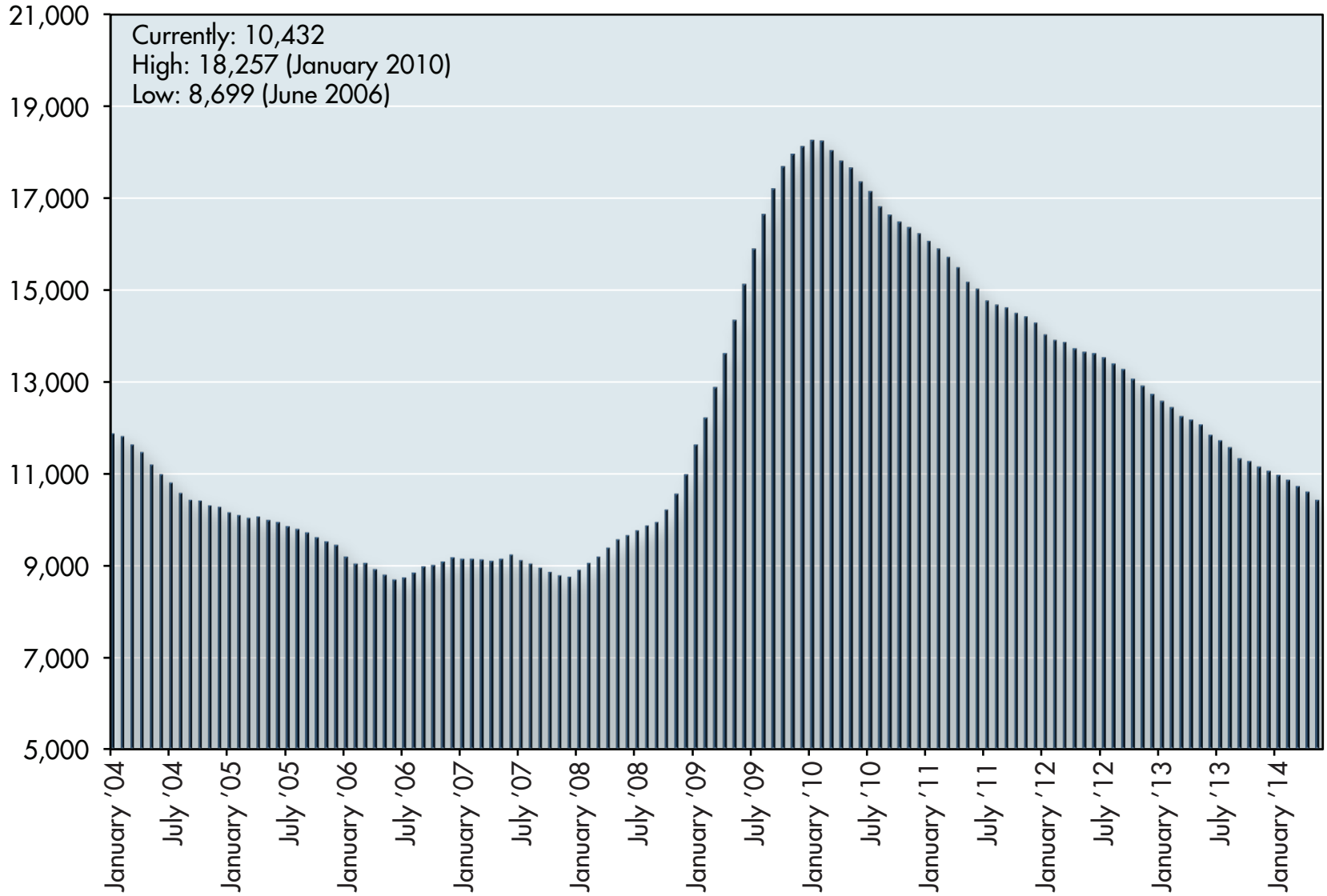
JOB GAINS AND LOSSES IN HAMPTON ROADS, 2007-2013 (IN THOUSANDS)



Sources: U.S. Department of Labor CES data and the Old Dominion University Economic Forecasting Project. Not seasonally adjusted. Revised data March 17, 2014.

GRAPH 9

TOTAL MONTHLY UNEMPLOYMENT CLAIMS FOR HAMPTON ROADS, JANUARY 2004 THROUGH MAY 2014 (12-MONTH MOVING AVERAGE)



Sources: Virginia Employment Commission and the Old Dominion University Economic Forecasting Project

The Port

"If you want to know who the players are, you'd better buy a program." This baseball park bromide also applies to the Port of Virginia, where both the Port's management and the membership of the Virginia Port Authority board have changed several times in recent years.

Politically, governors Bob McDonnell and Terry McAuliffe are far apart, but both have gone on the record expressing dissatisfaction with various aspects of the operation of the Port. During his term, McDonnell considered privatizing the management of the Port, but this proposal succumbed to a flurry of objections. More recently, McAuliffe has been vocal in his criticisms of financial losses sustained by the Port and his administration also appears to be dissatisfied with the Port's lease arrangements with APM Maersk in Portsmouth.

Meanwhile, the Port is more active than ever. It recorded an all-time high in cargo tonnage handled in 2013 and is on track to set another record in 2014 (see Graph 10). The Port also set a record in handling the ubiquitous 20-foot equivalent (TEU) containers in 2013 and likely also will exceed that number in 2014 (see Graph 11). Further, the Port has been grabbing market share away from its major East Coast competitors – New York/New Jersey, Savannah and Charleston. Graph 12 demonstrates that the Port has decisively reversed the decline in East Coast market share that it suffered 2007 through 2011 and, counting 2014, will have increased its market share three years in a row.

One indicator of the Port's recent success is the increase in the proportion of containers that have been moving out of the Port by means of rail rather than trucks (see Graph 13). A significant proportion of truck cargo leaving the Port is "captive," that is, it is cargo that is most likely to be carried by truck from the Port because we are closest to the customers and have a cost advantage in this method of delivery. One can draw a radius around the Port of Virginia extending as much as 250 miles in some directions, and high proportions of the cargo delivered within that radius are captive because we enjoy a delivery cost advantage compared to more distant ports such as New York/New Jersey or Savannah.

The same cannot be said for prospective customers located in metropolitan areas such as Columbus, Detroit, St. Louis, Chicago, Cincinnati and Cleveland. Multiple ports can and do compete for this cargo, which typically is delivered via rail. It is a good sign that the Port of Virginia's market share is increasing in this highly competitive arena. We are competing and winning in a very tough environment for "discretionary" cargo.

The good news does not stop there. Because the Port of Virginia is the largest deepwater port on the East Coast (and will remain so for several years), we can handle larger ships than most of our competitors. **Graph 14 reports that there has been a general upward trend in the average number of TEUs handled by the Port of Virginia per single vessel call.** Not only is this good for business, but also it enables the Port to realize economies of scale and potentially to exert control on its costs and prices as we continue to invest in Port infrastructure.

In addition, the Port of Virginia is realizing dividends from Norfolk Southern Corp.'s Heartland Rail Corridor, which, among other things, allows double stacking of TEUs headed to the Midwest; from CSX Corp.'s on-dock rail services at Portsmouth's APM Terminals; and from more "first-in, last-out" service by ships coming and going to and from Hampton Roads.

Why, then, the current angst over the Port's performance? Why did The Virginian-Pilot's editorial board choose to label the recent past a "legacy of chaos?" (June 1, 2014). First, the Port (as outlined in previous State of the Region reports) has been losing money, if one accepts the precepts of accountants and economists. Indeed, the Port recently has been in the unenviable position of losing money on some of the record number of TEUs that it has been handling, in some cases because it sometimes has offered "sale" prices for its services. Second, there is growing recognition that there was some validity to the assertions of those who were competing to manage the Port privately that they could in fact manage it more efficiently by reorganizing its operations and instituting new cost controls. Third, and related to reason No. 2, there is agreement that the previous management structure of the Virginia Port Authority (VPA) and its operating arm, the Virginia International Terminals (VIT), resulted in overlapping responsibilities, excessive managerial expenditures and sometimes-laggard reactions to changing circumstances. Fourth, the Port has

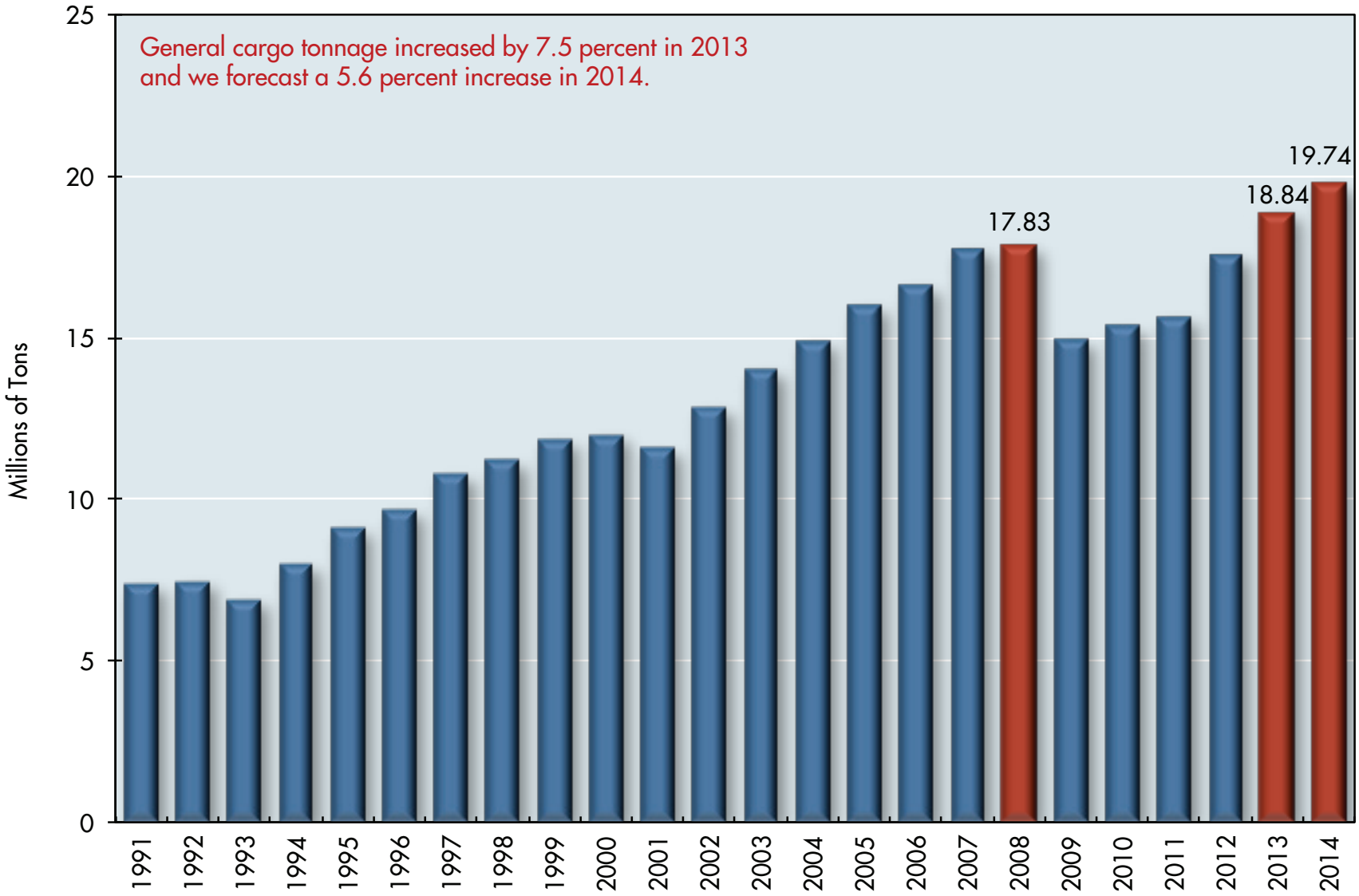
suffered from instability; its operational and board leadership has turned over several times in just a few years.

Since late February 2014, the Port has been led by an experienced and respected hand, John Reinhart, who knows the industry well and understands the range of tasks in front of him. Visible changes have occurred in cargo handling, and various efficiency-oriented, cost-containing activities are in process. The basic outlook for the Port of Virginia is favorable. Port activity likely will grow much more rapidly than gross regional product; our Port is well situated geographically; we are a deepwater port; we benefit from excellent rail connections; we have the ability to expand; and our labor relations have generally been good.

The Port of Virginia has been a bright spot, economically speaking, over the past few years despite the challenges noted above. At a time when defense spending and tourism are stagnant, we have a special need for the Port to surmount the challenges facing it and augment its regional leadership role.

GRAPH 10

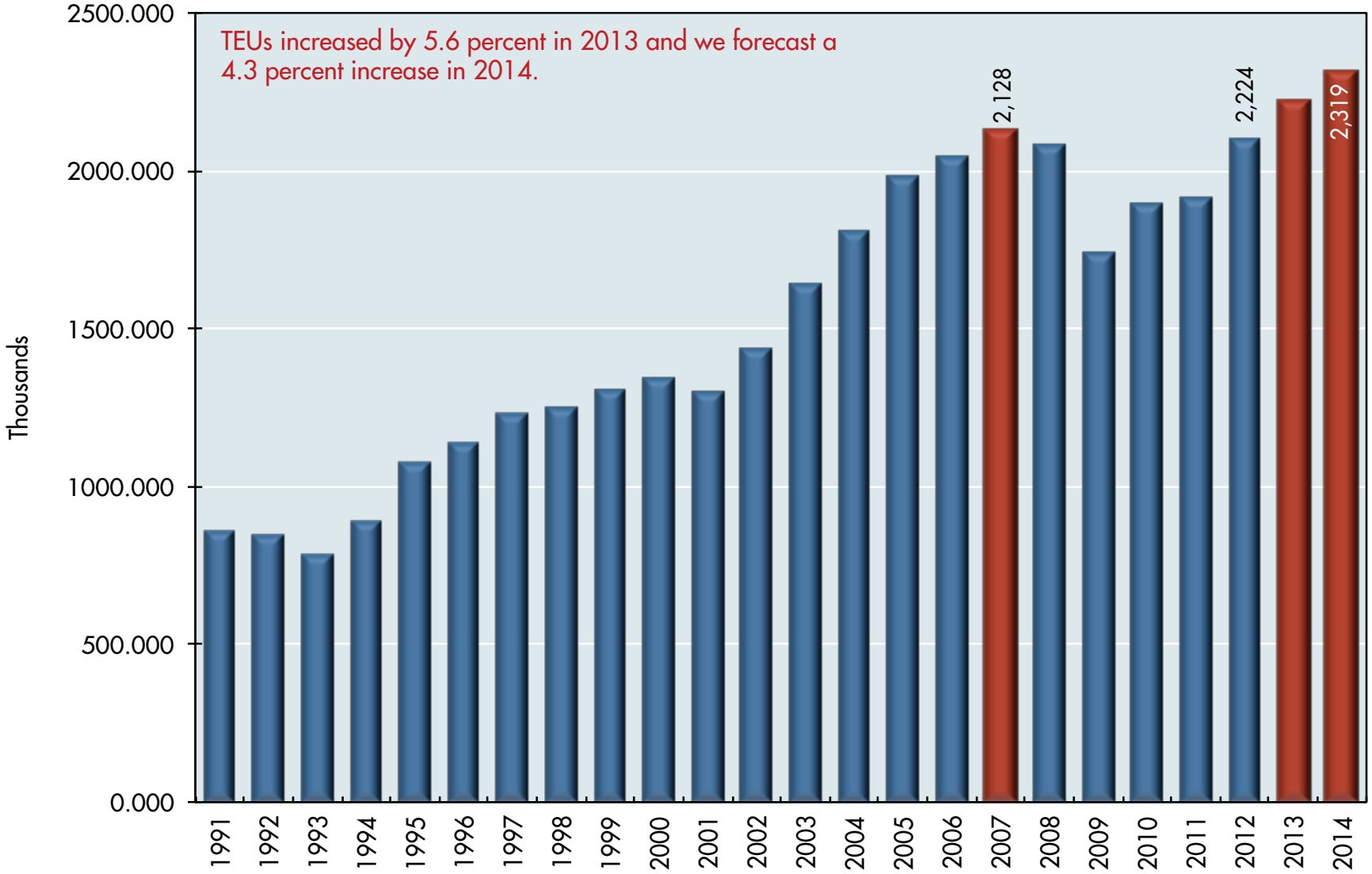
GENERAL CARGO TONNAGE AT THE PORT OF HAMPTON ROADS, 1991-2014



Sources: Virginia Port Authority and the Old Dominion University Economic Forecasting Project

GRAPH 11

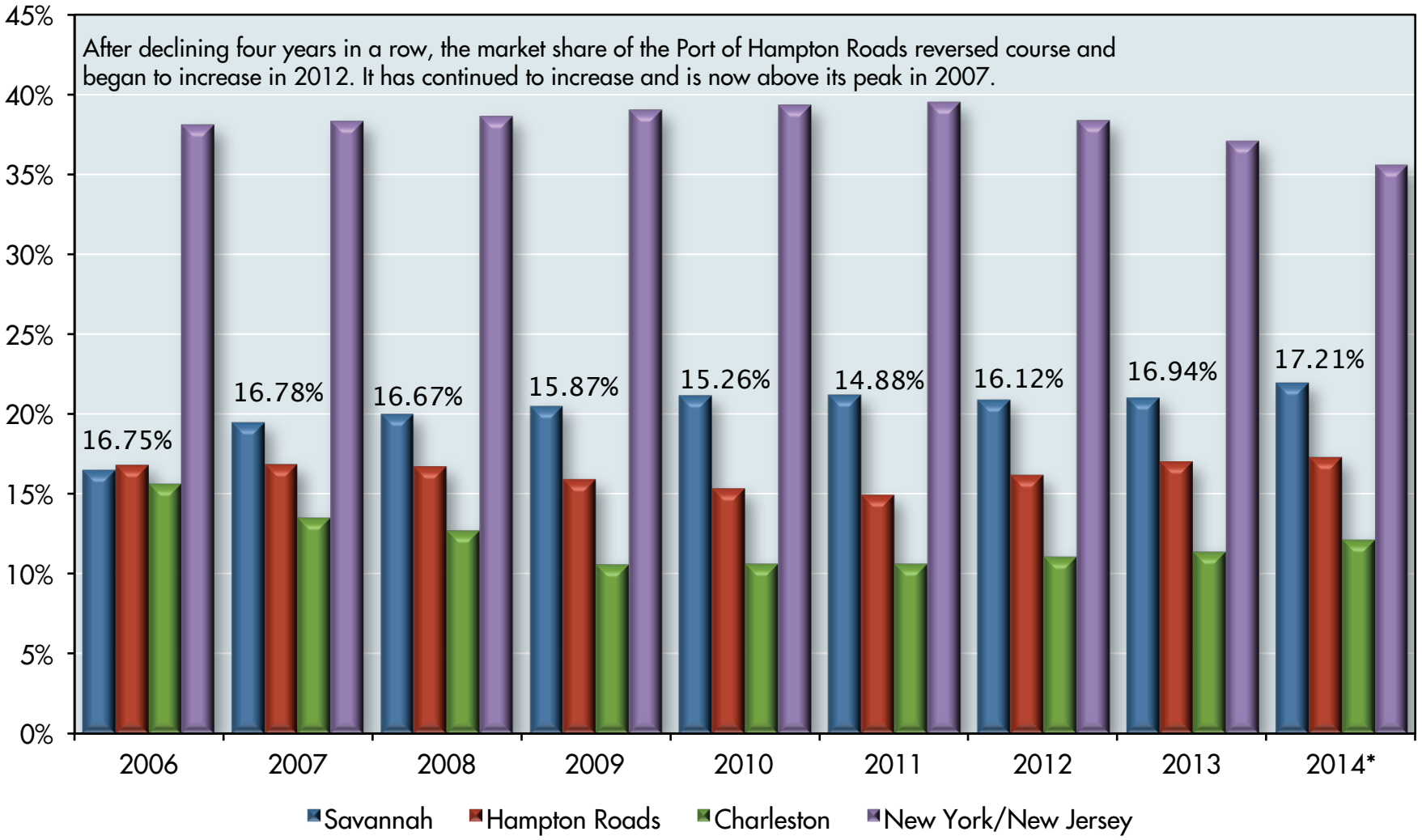
TWENTY-FOOT EQUIVALENT CONTAINER UNITS (TEUS) IN THE PORT OF HAMPTON ROADS, 1991-2014



Source: Virginia Port Authority and the Old Dominion University Economic Forecasting Project

GRAPH 12

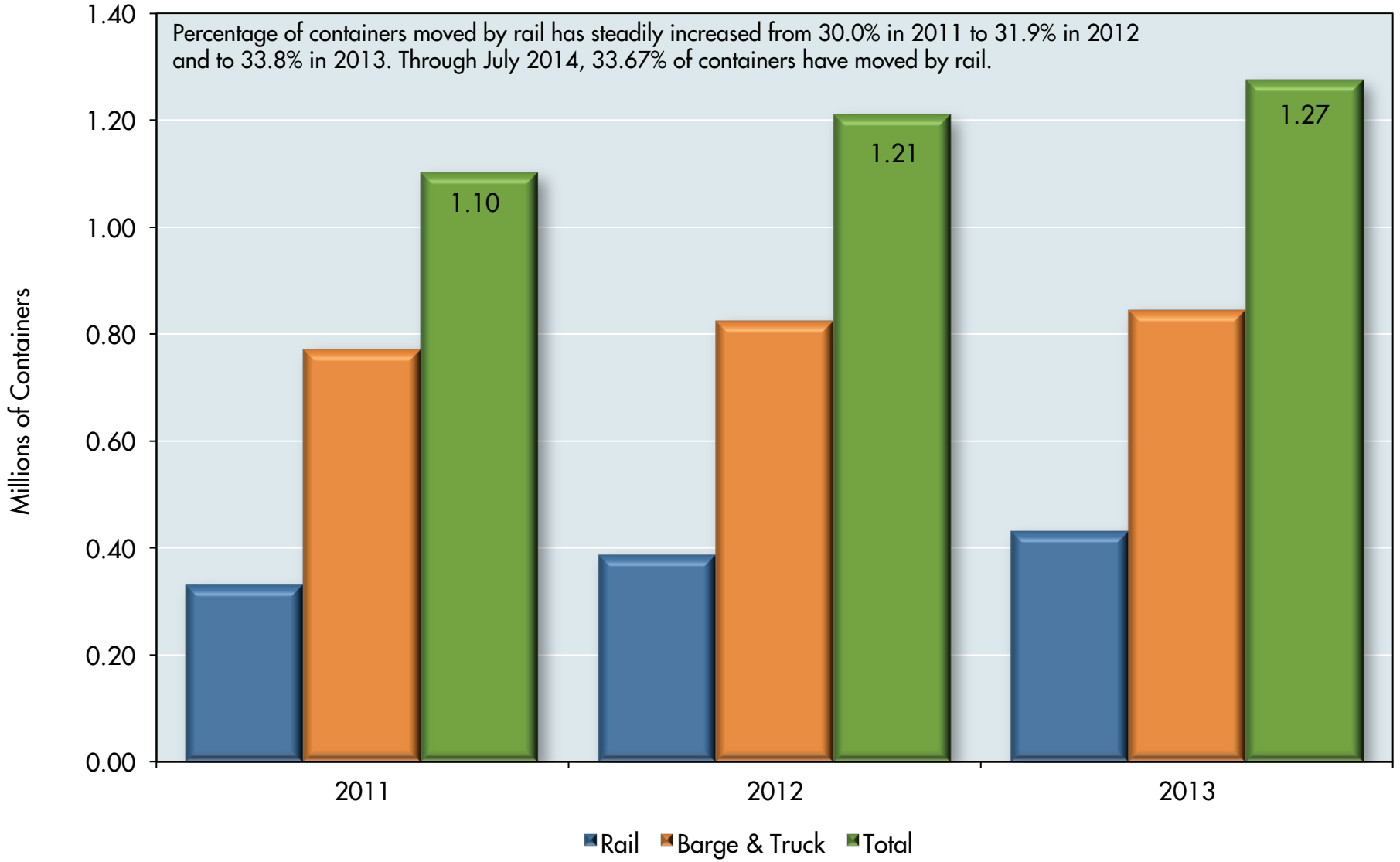
SHARES OF TOTAL LOADED TEU CONTAINERS FOR SELECTED PORTS ON THE EAST COAST, 2006-2014*



Sources: American Association of Port Authorities and the Old Dominion University Economic Forecasting Project. Market shares exclude TEUs for Philadelphia, Miami, Palm Beach and Port Everglades. *Data for 2014 are through April.

GRAPH 13

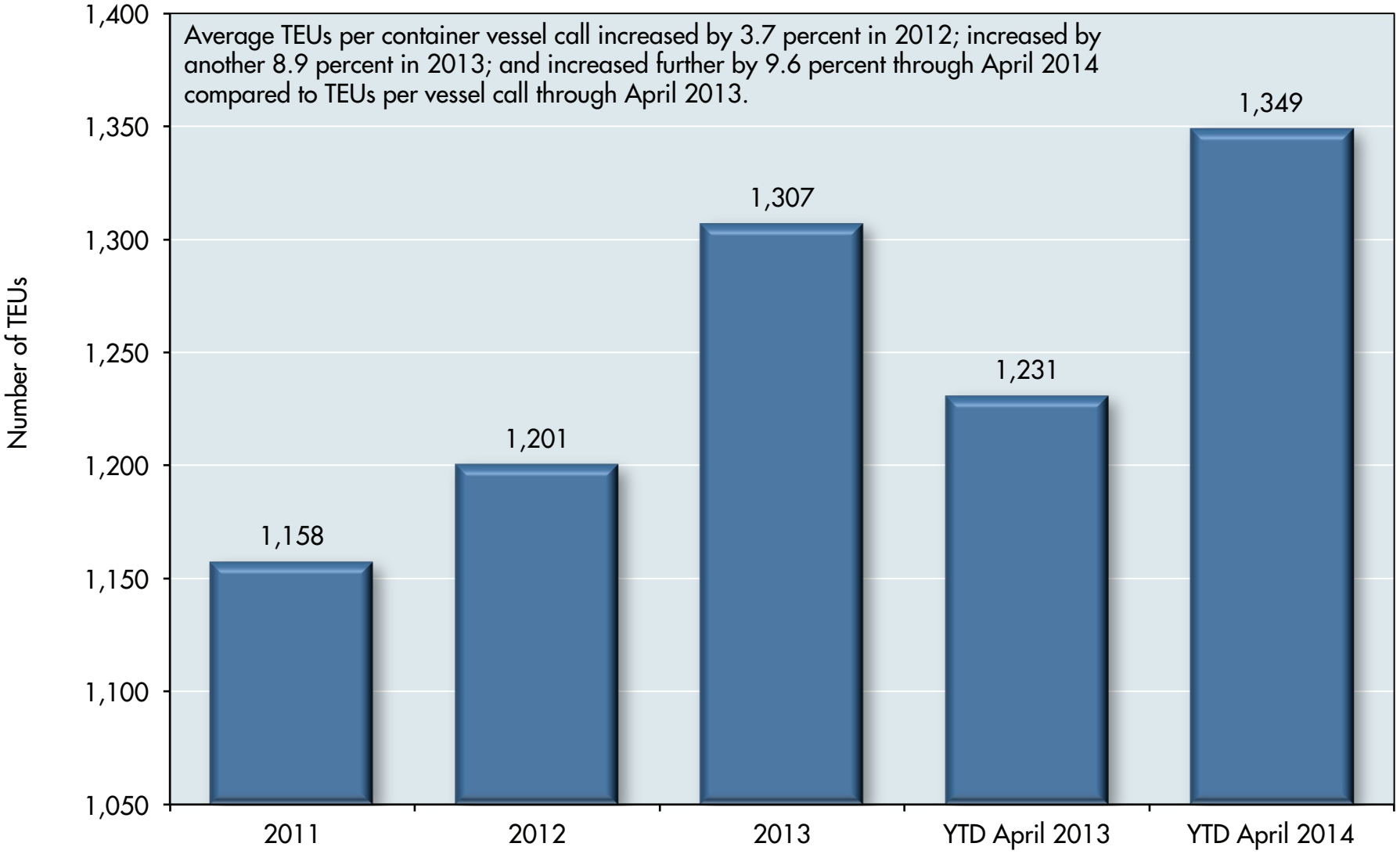
MOVEMENT OF CONTAINERS AT THE PORT OF HAMPTON ROADS BY TYPE OF TRANSPORTATION, 2011-2013



Sources: Virginia Port Authority and the Old Dominion University Economic Forecasting Project

GRAPH 14

AVERAGE TEUs PER CONTAINER VESSEL CALL, 2011-2014*



Sources: Virginia Port Authority and the Old Dominion University Economic Forecasting Project. *Data for 2013 and 2014 are through April.

Tourism

The sluggish recovery of our tourism industry epitomizes the slow recovery of our regional economy. As one can see in Graph 15, total hotel revenues peaked in Hampton Roads in 2007 and by 2013 were still $48.6 million (or 6.8 percent) below the record 2007 level. In real, inflation-adjusted terms, 2013 revenues were 18.6 percent below those of 2007.

Much the same story holds true for REVPAR – revenue received per available room. This is the single best indicator of how well a hotel or motel operator is doing because it is a measure that takes into account both supply and demand (see Table 4). REVPAR in Hampton Roads fell by 10.7 percent between 2007 and 2013 – and almost 25 percent in inflation-adjusted terms. Virginia Beach, which performed the best in our region, suffered a 0.1 percent decline in REVPAR in nominal terms over this period, but a more than 14 percent decline once price inflation is taken into account.

The long-term shift in tourists away from the Historic Triangle (Williamsburg, Jamestown, Yorktown) moderated in 2013, but the continuing reality is that the Historic Triangle's share of regional tourism revenues declined from 31.5 percent in 1999 to 18.3 percent in 2013 (see Graph 16). The winner in the market share derby was Virginia Beach, whose share increased from 33.2 percent in 1999 to 40.8 percent in 2013. While the Historic Triangle has been reducing its supply of rooms (see Graph 17, which shows a decline in available room nights from 3.45 million in 2005 to 3.11 million in 2013), this also has been accompanied by a slow attrition in the number of actual hotel nights it has sold. Counteracting this long-term trend – which appears to reflect a change in the tastes of the public – represents a major challenge for the Historic Triangle, which is one of our region's treasures.

We will give considerable additional attention to the evolution of the hotel/motel market in a succeeding chapter, titled "The Answer Is Always Yes," which considers the hotel/motel market in conjunction with the construction of new convention centers and arenas.

TABLE 4

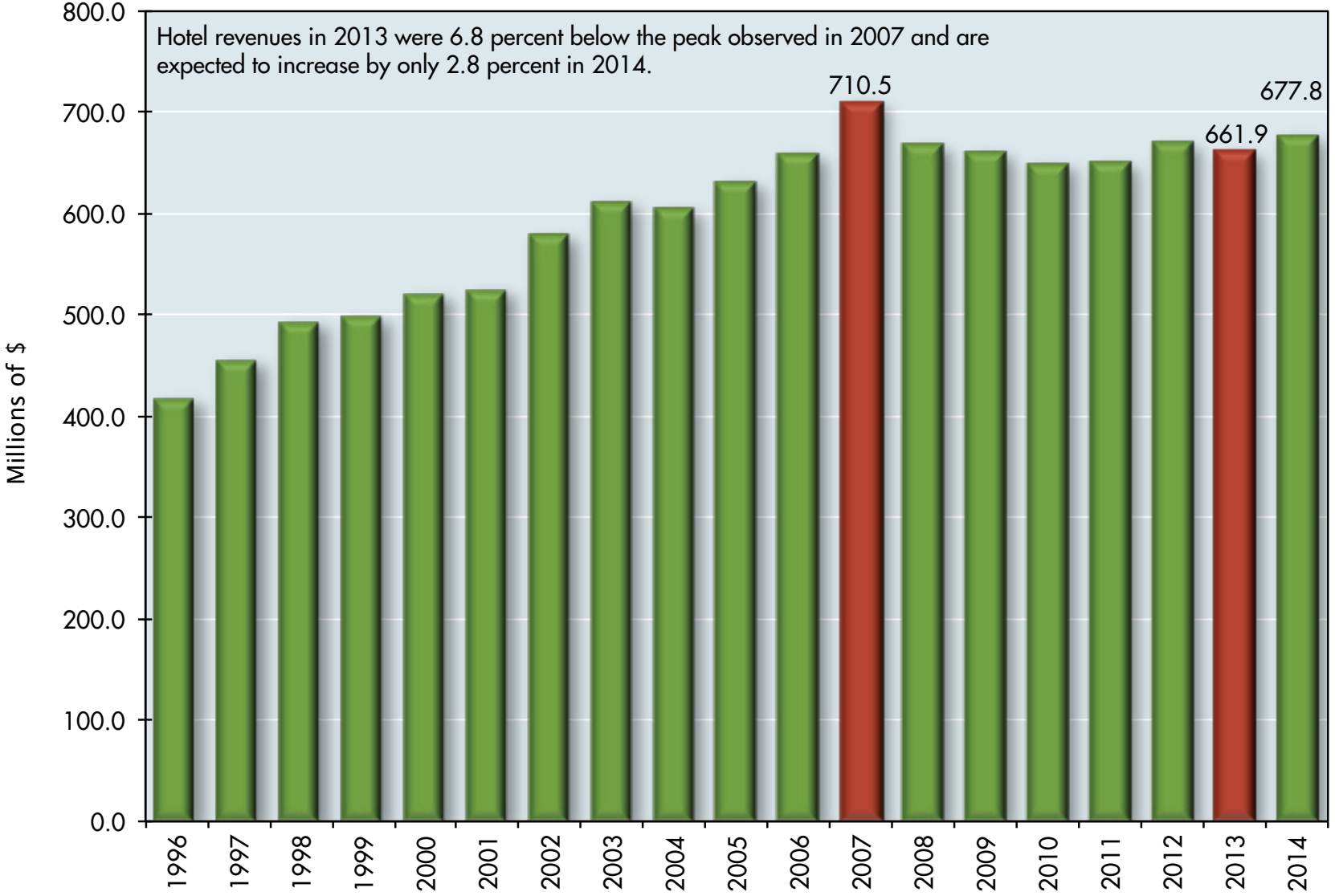
REVPAR IN SELECTED MARKETS, 2007 AND 2013

	2007	2013	Percentage Change
U.S.	**$65.58**	**$68.69**	**+4.7%**
Virginia	$61.95	$55.69	-10.1%
Hampton Roads	**$52.90**	**$47.25**	**-10.7%**
Myrtle Beach	$54.03	$56.40	+ 4.4%
Coastal Carolina	$55.83	$56.26	+ 0.8%
Ocean City	$71.74	$68.81	- 4.1%
Virginia Beach	**$64.73**	**$64.64**	**- 0.1%**
Hampton	$41.71	$37.45	-10.2%
Newport News	$39.69	$34.29	-13.6%
Norfolk/ Portsmouth	$54.05	$45.35	-16.1%
Norfolk	$54.14	$45.95	-15.1%
Williamsburg	$47.48	$39.08	-17.7%
Chesapeake/ Suffolk	$52.90	$41.11	- 22.3%
Chesapeake	$53.60	$41.18	- 23.2%

Sources: Smith Travel Research Trend Report, Feb. 17, 2014, and the Old Dominion University Economic Forecasting Project

GRAPH 15

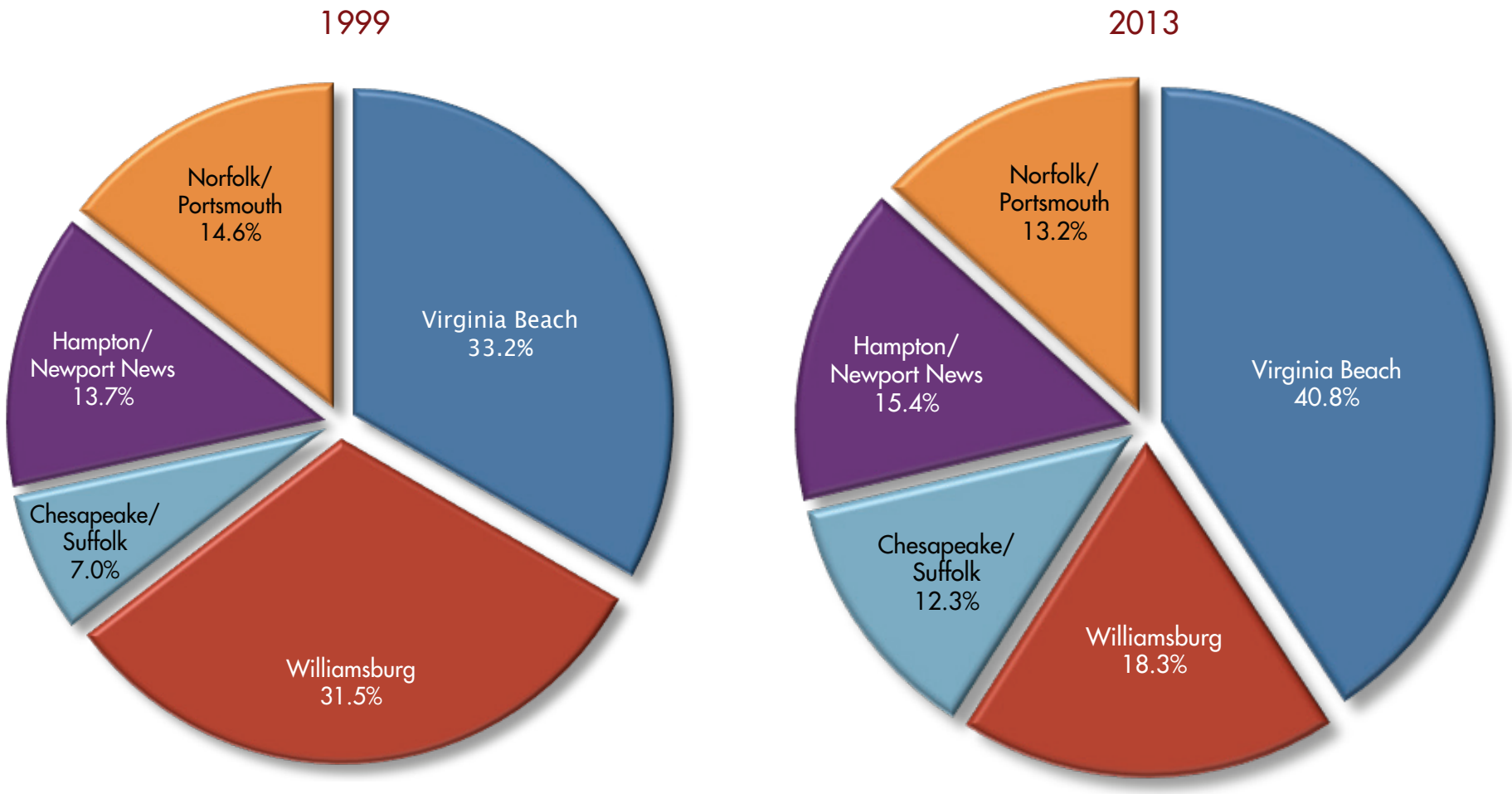
HOTEL REVENUE IN HAMPTON ROADS, 1996-2014



Sources: Smith Travel Research Trend Report, Jan. 7, 2014, and the Old Dominion University Economic Forecasting Project

GRAPH 16

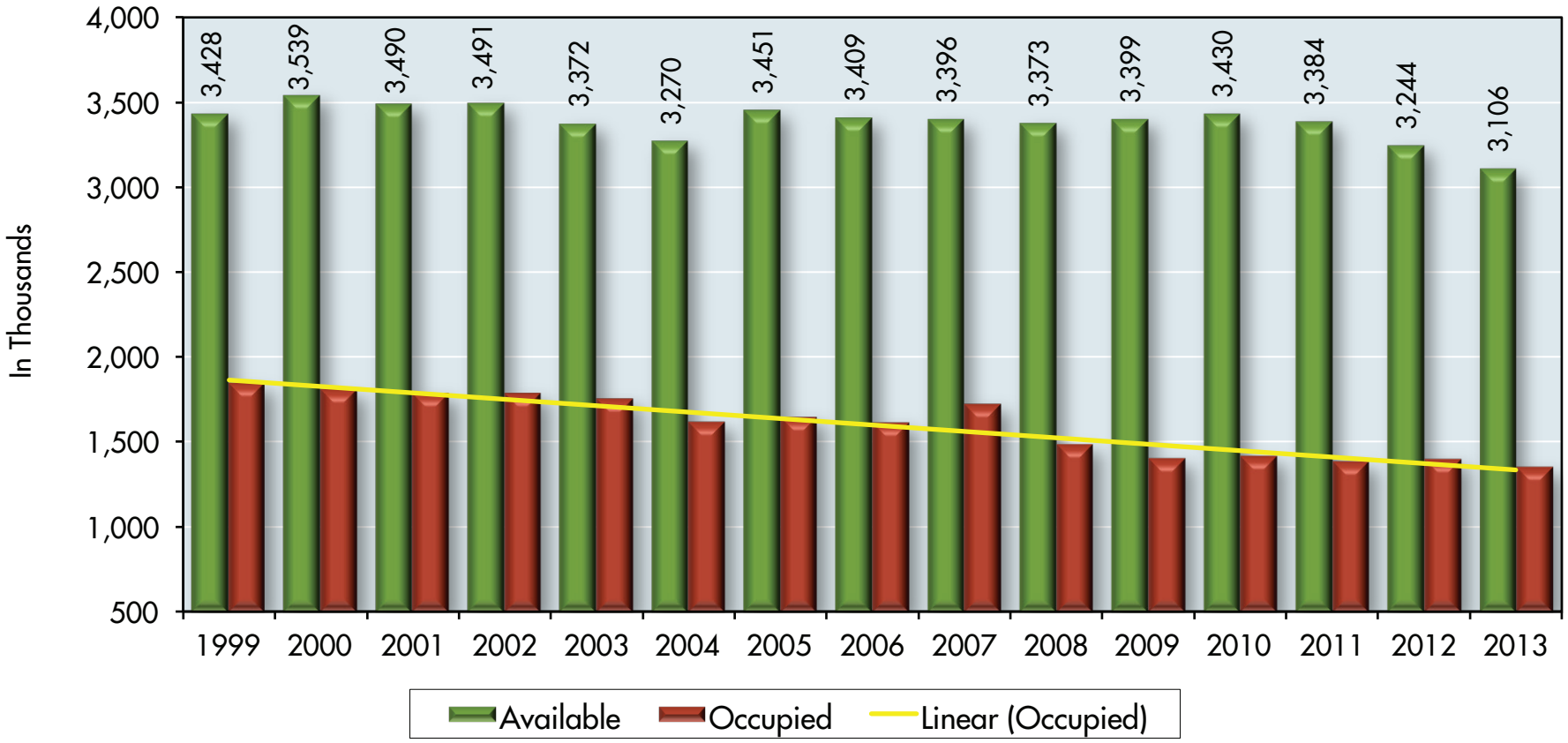
ESTIMATED CITY HOTEL MARKET SHARES IN HAMPTON ROADS AS INDICATED BY INDUSTRY REVENUES, 1999 AND 2013



Sources: Smith Travel Research Trend Report, Jan. 7, 2014, and the Old Dominion University Economic Forecasting Project

GRAPH 17

HOTEL ROOM NIGHTS IN THE HISTORIC TRIANGLE (WILLIAMSBURG) MARKET, 1999-2013



Sources: Smith Travel Research Trend Report, Jan. 7, 2014, and the Old Dominion University Economic Forecasting Project

Housing

From the standpoint of sellers, the market for existing residential homes in Hampton Roads continued to improve. As Graph 18 confirms, the average number of days that an existing home was on the market before selling declined for the second year in a row and the total number of existing homes sold increased for the third consecutive year. While the inventory of such homes increased slightly, it remains very close to our historical average level (see Graph 19). Meanwhile, as Table 5 suggests, 2014 should be the third consecutive year that the median sale price of existing residential homes has increased, albeit modestly.

An important reason why the market for existing homes has changed is that the number of distressed homes on the market has declined. Graph 20 shows that the absolute number of residential foreclosure filings in Hampton Roads is continuing to move toward pre-recession levels, while Graph 21 tells us that the number of active listings of distressed homes (REO bank-owned homes and properties up for bid in a short sale) has fallen almost continuously since peaking at 3,224 in November 2010. In 2014, such sales are expected to account for roughly one-quarter of all homes sold. This is vitally important to sellers because, as Table 6 notes, **in 2014 sales prices of REO bank-owned properties have been only 55.7 percent of non-distressed sales prices, while short sale prices have been only 72.3 percent of non-distressed sales prices. Plainly put, sales of distressed homes depress sales prices, and not just by a little bit.**

More stringent loan requirements imposed by lenders and our plodding economic recovery have made it difficult for many prospective homeowners to obtain financing and actually make a home purchase. At the same time, the Great Recession put a crimp in the construction of new apartments and condominiums. The combination of these factors has driven up rents within Hampton Roads. Relatively speaking, it now is much more attractive for individuals to purchase a home (instead of renting) than it was five years ago. Table 7 underlines this point by comparing the median monthly rent for a three-bedroom house to the average monthly principal, interest and taxes required to purchase a home in our region. The ratio of that rent-to-house payment increased from 0.73 in 2007 to 1.45 in 2013.

At the same time, the average monthly mortgage principal, interest and tax payment just mentioned now is only 19.4 percent of median household monthly income (see Graph 22). Thus, if you are employed and can obtain mortgage financing, this is a splendid time for you to purchase a home.

TABLE 5

MEDIAN SALE PRICE OF EXISTING RESIDENTIAL HOMES IN HAMPTON ROADS, 2001-2014*

Year	Median Price	Annual Percent Change
2001	$109,000	9.1%
2002	$116,900	7.3%
2003	$130,000	**11.2%**
2004	$156,500	**20.4%**
2005	$192,000	**22.7%**
2006	$214,900	**11.9%**
2007	**$223,000**	3.8%
2008	$219,000	**-1.8%**
2009	$207,000	**-5.5%**
2010	$203,900	**-1.5%**
2011	$180,000	**-11.7%**
2012	$185,000	**+2.78%**
2013	$190,000	**+2.70%**
2014*	$183,000	**+0.55%**

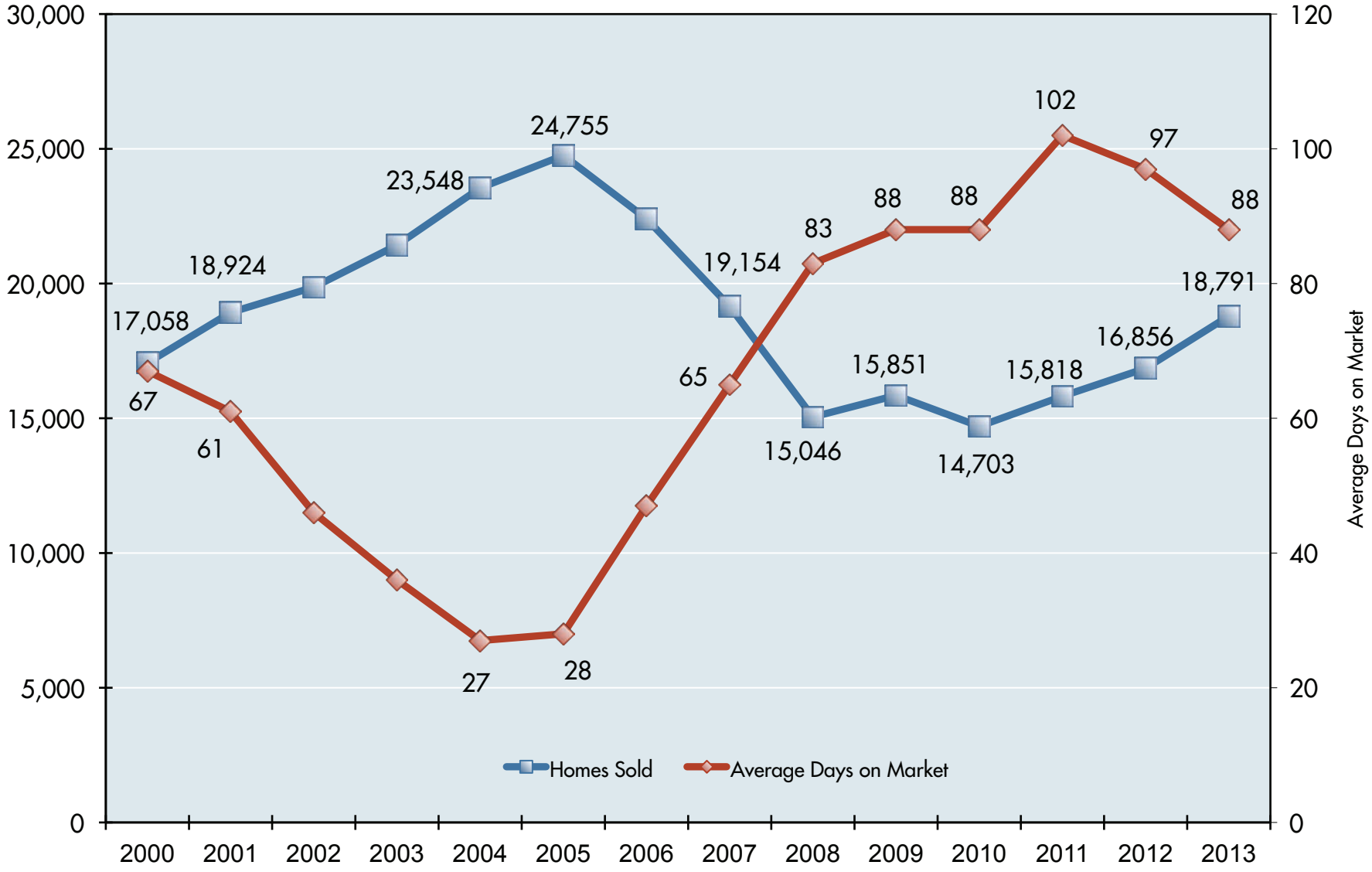
90% Increase from 2002-07

19% Decrease from 2007-11

Sources: Real Estate Information Network Inc. and the Old Dominion University Economic Forecasting Project.
*YTD May 2013 median price was $182,000 and YTD May 2014 median price is $183,000.

GRAPH 18

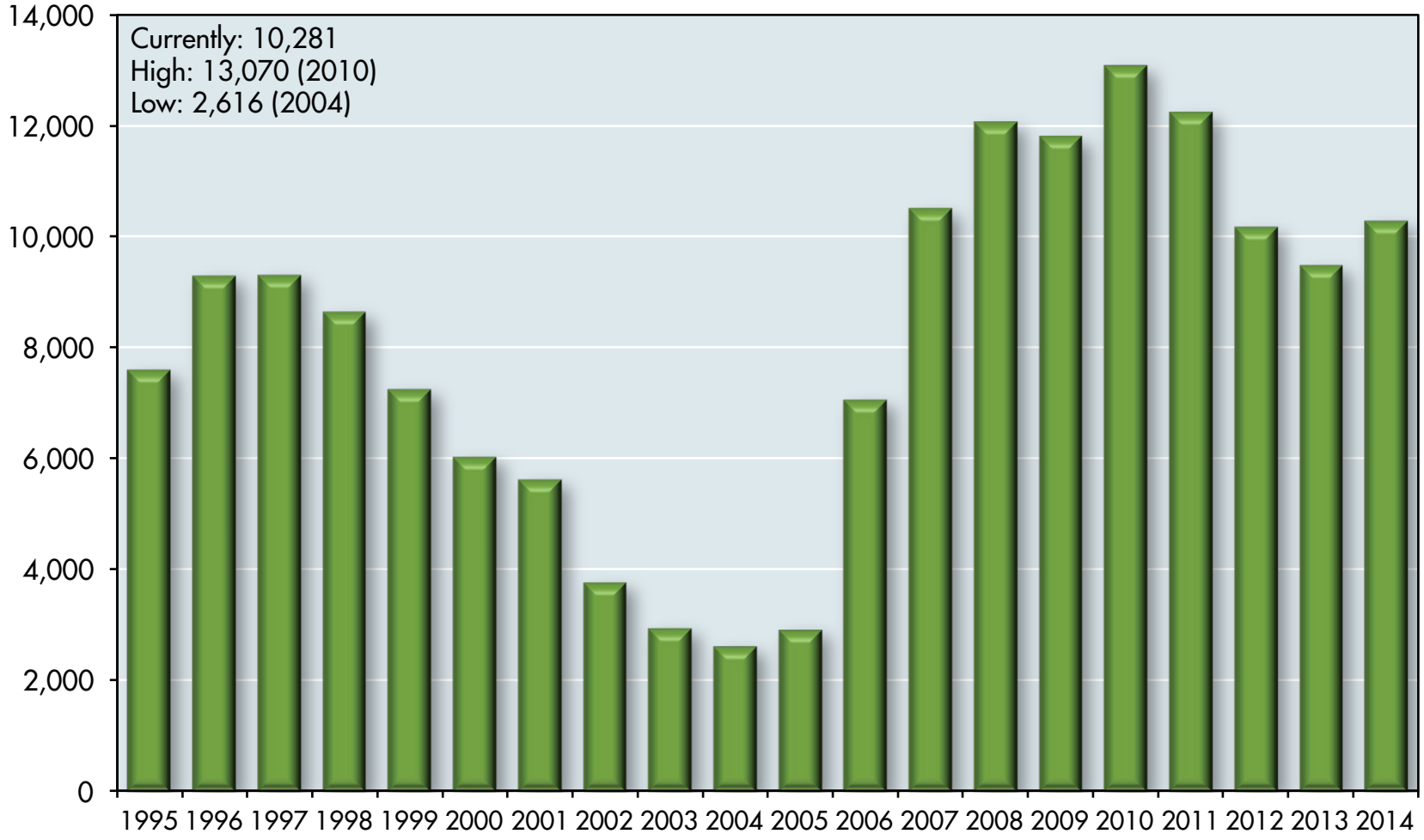
EXISTING RESIDENTIAL HOMES SOLD AND AVERAGE DAYS ON THE MARKET IN HAMPTON ROADS, 2000-2013



Sources: Real Estate Information Network Inc. and the Old Dominion University Economic Forecasting Project. Information deemed reliable but not guaranteed. Days on market is calculated from the date listed to the date under contract for existing homes sold.

GRAPH 19

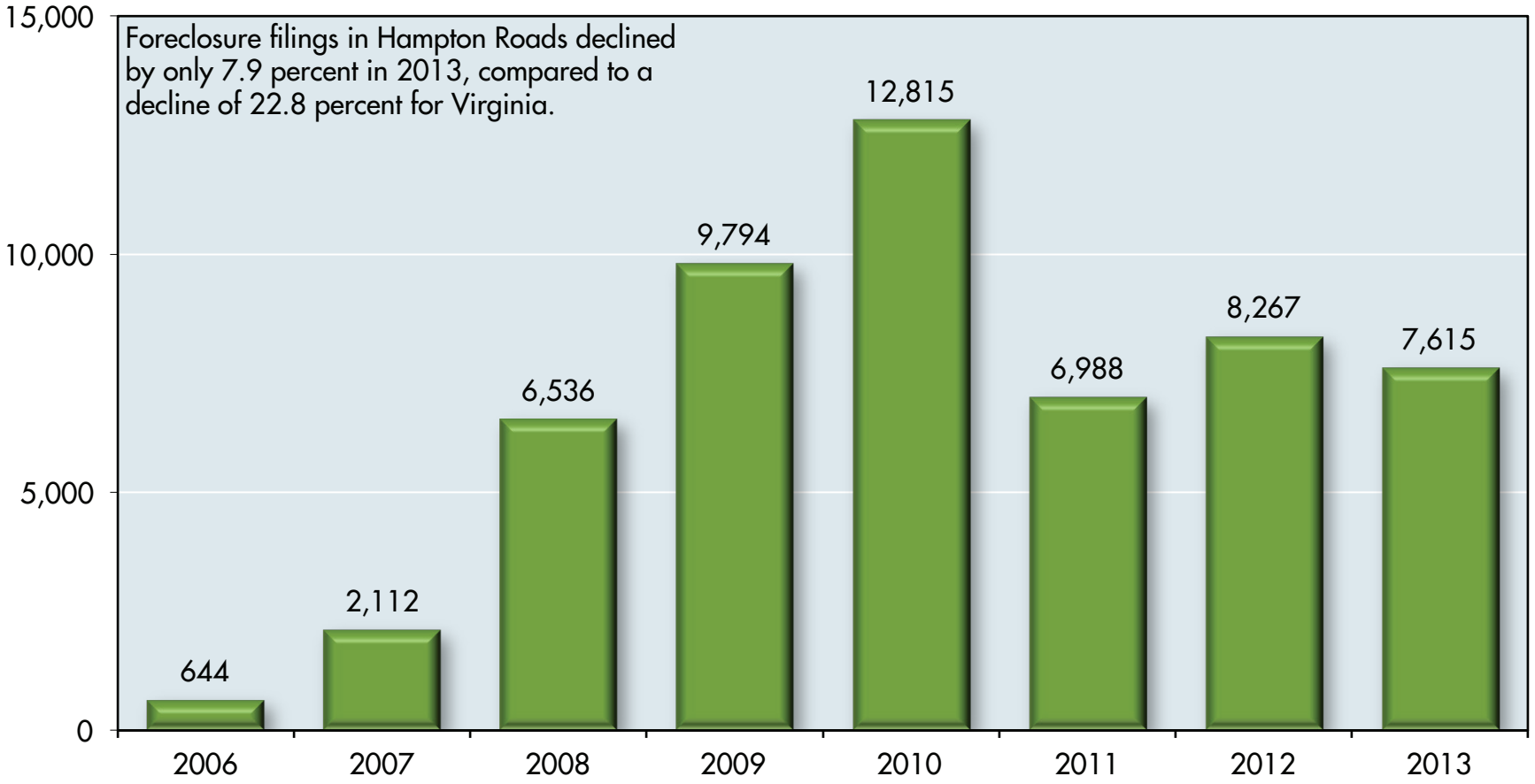
ESTIMATED INVENTORY OF EXISTING RESIDENTIAL HOMES AS MEASURED BY ACTIVE LISTINGS ON MAY 31 OF EACH YEAR



Sources: Real Estate Information Network Inc. and the Old Dominion University Economic Forecasting Project. Information deemed reliable but not guaranteed.

GRAPH 20

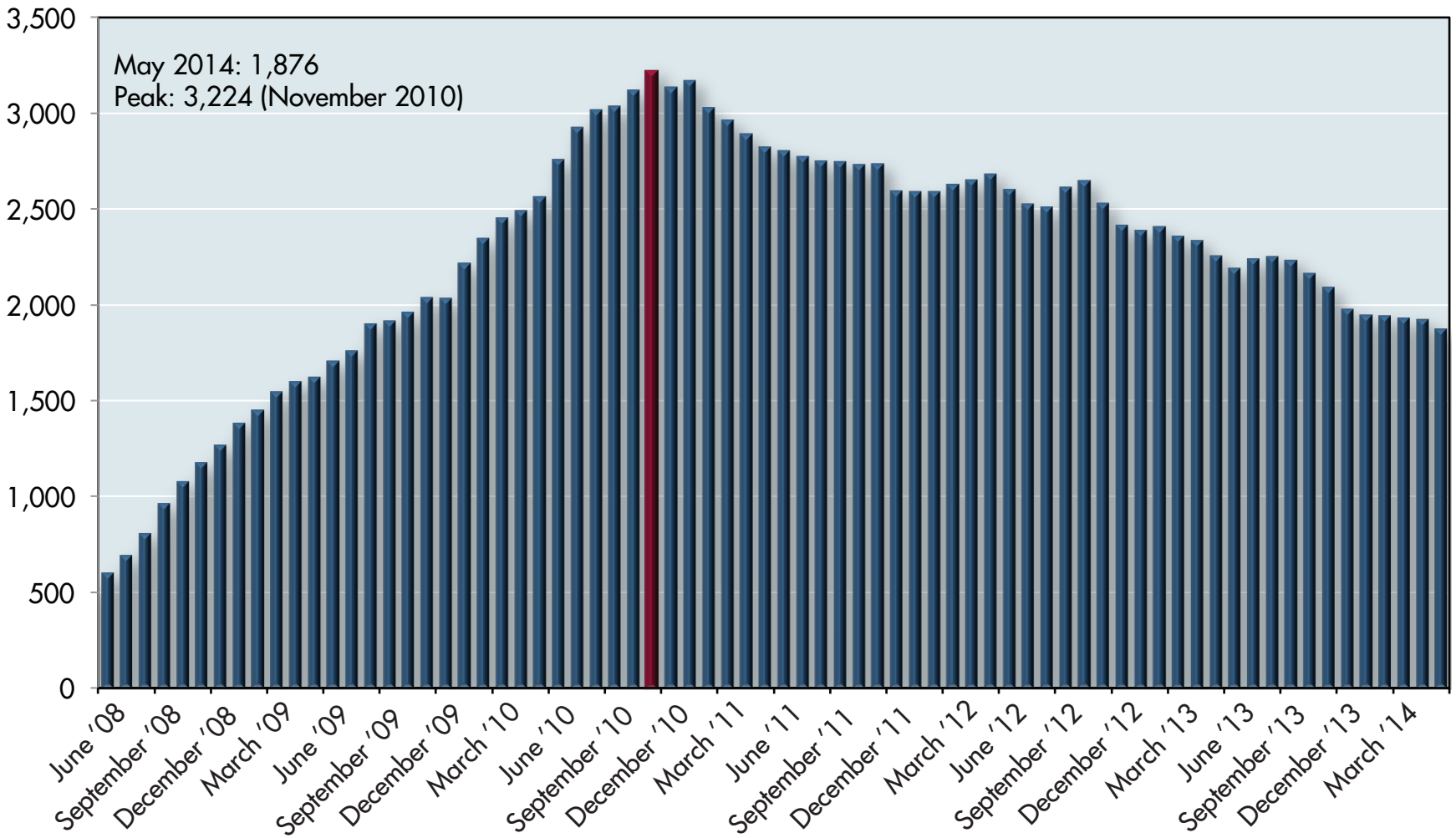
HAMPTON ROADS RESIDENTIAL FORECLOSURE FILINGS, 2006-2013



Sources: RealtyTrac and the Old Dominion University Economic Forecasting Project

GRAPH 21

NUMBER OF ACTIVE LISTINGS OF DISTRESSED HOMES (REO AND SHORT SALES) IN HAMPTON ROADS, JUNE 2008 – MAY 2014



Sources: Real Estate Information Network Inc. and the Old Dominion University Economic Forecasting Project

TABLE 6

AVERAGE PRICE OF EXISTING SHORT SALE, REOS AND NON-DISTRESSED RESIDENTIAL HOMES SOLD IN HAMPTON ROADS, JANUARY 2006 - MAY 2014

Year	Non-distressed Sales	Short Sales	Short Sales Price% Non-distressed Price	REO Sales	REO Price% Non-distressed Sales
2006	$250,254	$241,666	96.6	$120,817	48.3
2007	$261,723	$237,897	90.9	$163,421	62.4
2008	$255,852	$239,110	93.5	$184,462	72.1
2009	$243,902	$239,913	98.4	$164,229	67.3
2010	$251,572	$231,211	91.9	$151,612	60.3
2011	$236,358	$212,967	90.1	$135,304	57.3
2012	$237,215	$187,527	79.1	$134,535	56.7
2013	$245,344	$180,001	73.4	$131,644	53.7
2014*	$235,755	$170,504	72.3	$131,361	55.7

Sources: Real Estate Information Network Inc. and the Old Dominion University Economic Forecasting Project. Information deemed reliable but not guaranteed. REOs represent bank-owned homes.
*Data for 2014 are through May 2014.

TABLE 7

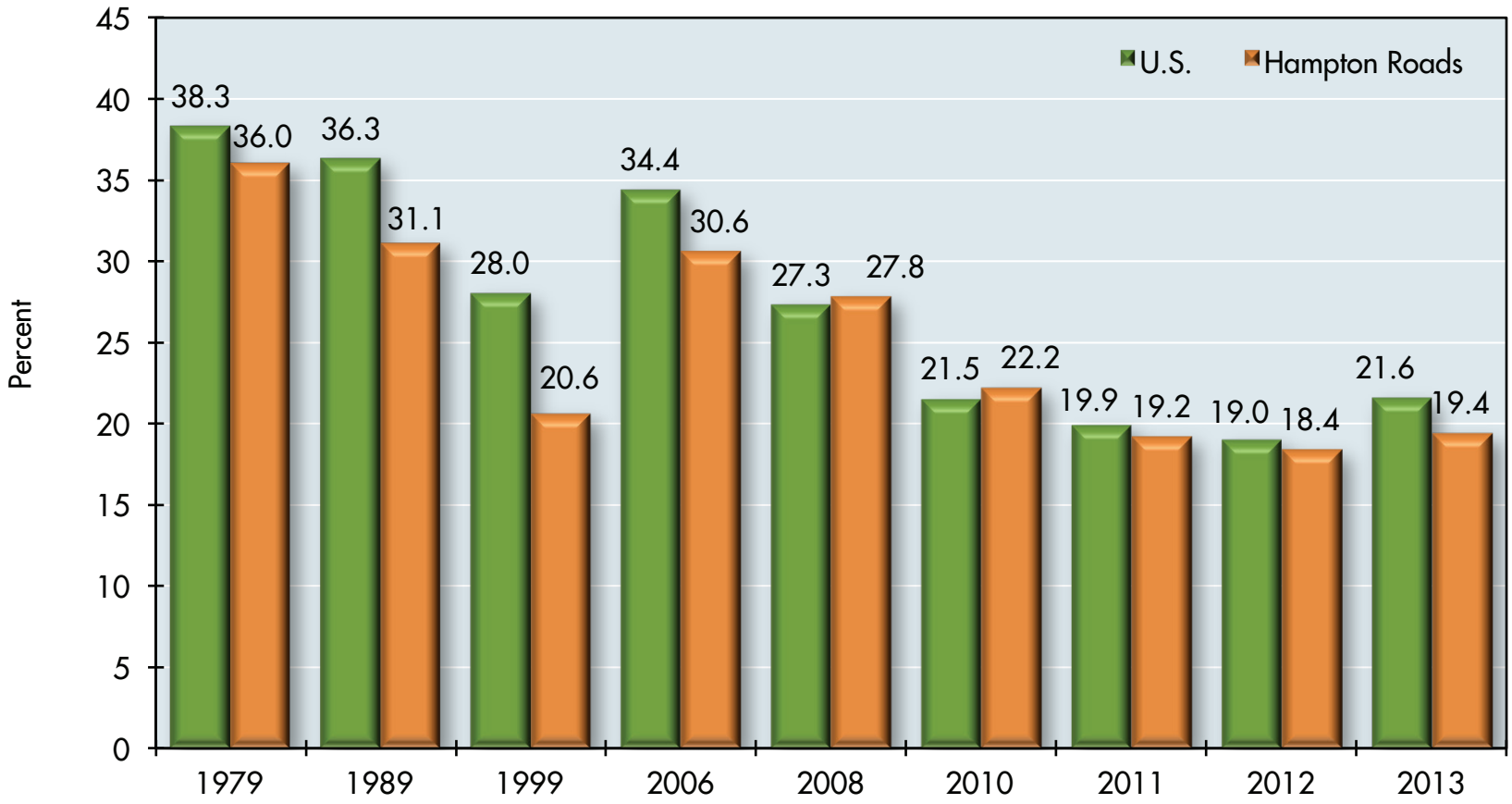
ESTIMATED HOUSE RENTAL AND PRINCIPAL, INTEREST AND TAXES FOR A HOUSE PAYMENT IN HAMPTON ROADS, 2001-2013

Year	Median Monthly Rent for a Three-bedroom House	PI&T Monthly for a Median-priced Existing House	Ratio of Monthly Rent to Principal, Interest and Taxes
2001	$882	$836	1.19
2002	$911	$861	1.20
2003	$1,037	$890	1.33
2004	$1,044	$1,073	1.11
2005	$1,087	$1,315	0.83
2006	$1,118	$1,533	0.73
2007	$1,164	$1,598	0.73
2008	$1,247	$1,507	0.83
2009	$1,236	$1,307	0.95
2010	**$1,277**	**$1,233**	**1.04**
2011	**$1,319**	**$1,071**	**1.23**
2012	**$1,454**	**$1,015**	**1.43**
2013	**$1,570**	**$1,080**	**1.45**

Sources: HUD and the Old Dominion University Economic Forecasting Project. Monthly payments are calculated assuming that the buyer has a 30-year mortgage. It is assumed that real estate tax rate is 1 percent and the tax reduction received by homeowners would compensate for homeowners insurance and maintenance expenditures.

GRAPH 22

HOUSING AFFORDABILITY: MONTHLY PAYMENT FOR A MEDIAN PRICE RESALE HOUSE AS A PERCENTAGE OF MEDIAN HOUSEHOLD MONTHLY INCOME IN HAMPTON ROADS AND THE U.S., 1979-2013



Source: Old Dominion University Economic Forecasting Project. Monthly payments are calculated assuming that the buyer has a 30-year mortgage. The 30-year mortgage rate was 3.98 percent for 2013, for example.

Summing It Up And A Quick Look At The Future

We have reasons to be pleased that our regional economy is growing modestly despite DOD spending within Hampton Roads remaining slightly below its 2012 peak. Overall, our tourism industry has grown at a modest pace since the end of the Great Recession. Continued growth in the national economy will help accelerate the recovery of our hotels and motels, but experience demonstrates that their prosperity is rather sensitive to federal spending levels, including DOD spending. Until federal spending recovers, our hotels and motels, as a group, are not likely to prosper as they did pre-recession.

Despite some turmoil and issues, the Port has been expanding both in size and market share and has become an increasingly important economic engine for Hampton Roads.

Our regional housing market turned the corner at least a year ago, but it is not likely to do extremely well until federal spending in general and DOD spending in particular turn upward.

All of this adds up to an outlook of modest growth that is below our recent historical norms. **Table 8 documents that Hampton Roads grew at the rate of 1.89 percent in 2013 (after removing price inflation), but we estimate only a 1.54 percent real rate of growth in 2014.** The 2015 outlook is for more of the same, but international crises that push DOD spending upward and/or inflate oil prices could easily alter this projection.

Graph 23 illustrates where we've been and where we believe we are going in terms of real, inflation-adjusted economic growth. **Our predicted 1.54 percent regional economic growth rate for 2014 will find us trailing both Virginia (predicted 1.76 percent) and the U.S. (predicted 1.94 percent).** Unfortunately, the Commonwealth now faces its own economic challenges, as slumping state tax collections reveal. Three Northern Virginia counties rank among the top 10 in the U.S. in terms of their total loss of jobs in 2014. At the same time, the coal industry in Southwest Virginia is under environmental siege. Hence, we cannot anticipate much economic stimulus (for example, that coming from tourists) from the rest of the Commonwealth.

In the 2013 State of the Region report, we observed that "It could have been worse." While hardly satisfying, this assessment remains on target.

TABLE 8

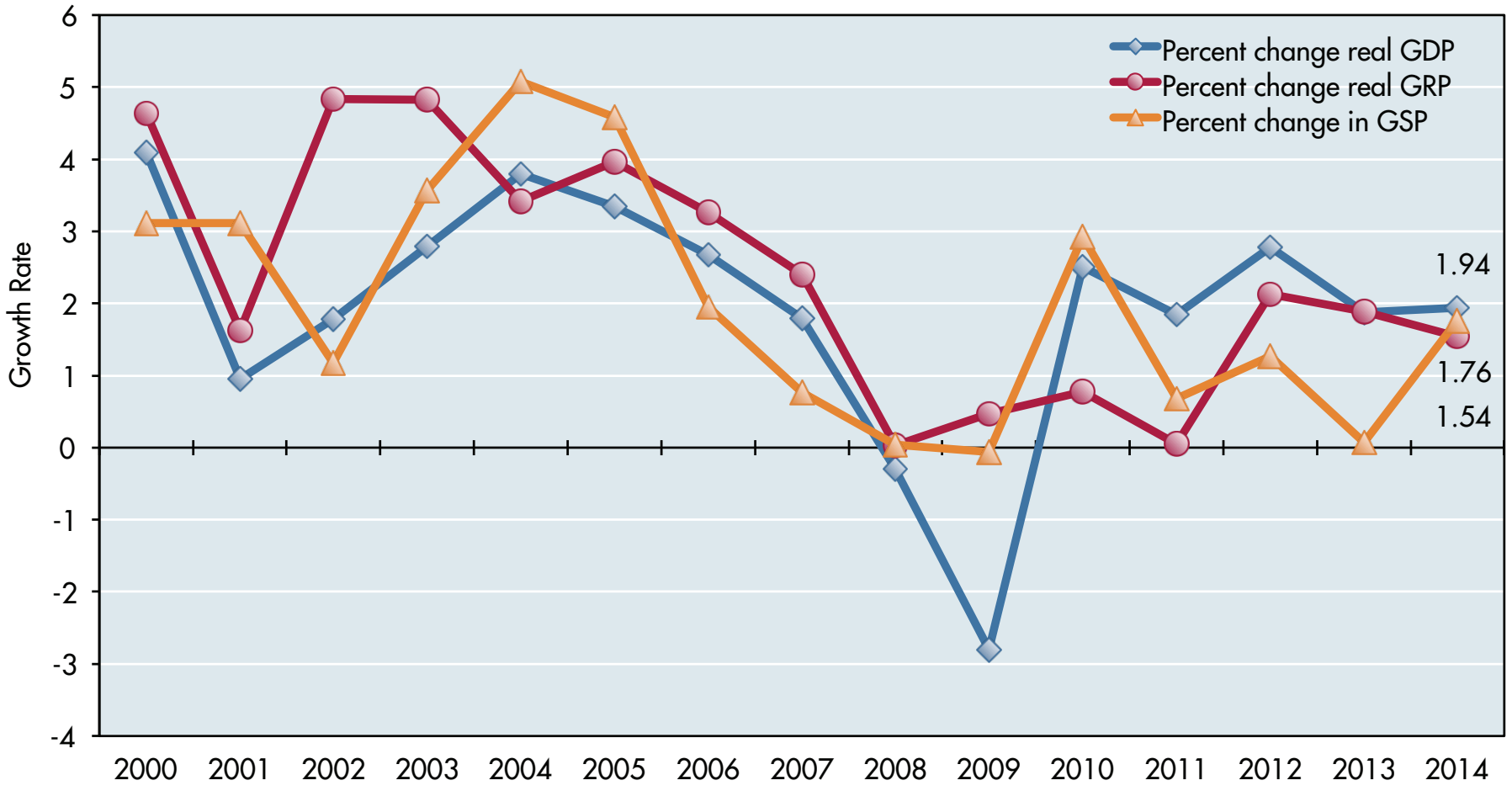
ESTIMATED HAMPTON ROADS GROSS REGIONAL PRODUCT (GRP), NOMINAL AND REAL (PRICE ADJUSTED), 2000-2014

Year	Nominal GRP Billions of $	Real GRP (2009=100) Billions of $	Real GRP Growth Rate Percent
2000	50.35	61.49	4.64
2001	52.34	62.49	1.62
2002	55.72	65.51	4.84
2003	59.58	68.67	4.83
2004	63.31	71.02	3.42
2005	67.93	73.84	3.97
2006	72.29	76.25	3.26
2007	75.99	78.07	2.40
2008	77.50	78.10	0.03
2009	78.46	78.46	0.47
2010	80.03	79.07	0.77
2011	81.64	79.11	0.05
2012	84.84	80.79	2.13
2013	87.71	82.31	1.89
2014	90.27	83.58	1.54

Source: Old Dominion University Economic Forecasting Project. Data incorporate U.S. Department of Commerce personal income revisions through November 2013. Base year is 2009.

GRAPH 23

RATE OF GROWTH OF GDP (U.S.), GSP (VIRGINIA) AND GRP (HAMPTON ROADS)



Sources: Bureau of Economic Analysis and the Old Dominion University Economic Forecasting Project. Data on GDP incorporate latest BEA revisions through June 11, 2014.


Sep
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