Gathering Steam: The Regional Economy Recovers (Slowly)

GATHERING STEAM: THE REGIONAL ECONOMY RECOVERS (SLOWLY)

Ah, can you remember the good old days – the first half of the last decade when our real (inflation-adjusted) regional economic growth averaged slightly more than 3.8 percent annually? The years 2000 to 2006 were among the best in our modern economic history. Since then, however, it has been a different story. As Table 1 reveals, after 2006, the Hampton Roads economy began to grow much more slowly and, including our anticipated 2012 growth, has averaged only .9 percent annually since 2007.

TABLE 1

ESTIMATED HAMPTON ROADS GROSS REGIONAL PRODUCT (GRP), NOMINAL AND REAL (PRICE ADJUSTED), 2000-2012

Year	Nominal GRP Billions$	Real GRP (2005=100) Billions$	Real GRP Growth Rate Percent
2000	50.33	56.81	4.80
2001	52.49	57.94	1.99
2002	55.73	60.44	4.32
2003	59.27	62.99	4.21
2004	63.80	65.91	4.64
2005	67.59	67.59	2.55
2006	72.71	70.45	4.23
2007	76.32	71.78	1.88
2008	78.00	71.82	0.07
2009	78.10	71.20	-0.87
2010	79.84	71.93	1.03
2011	82.36	72.88	1.32
2012	84.72	74.32	1.97

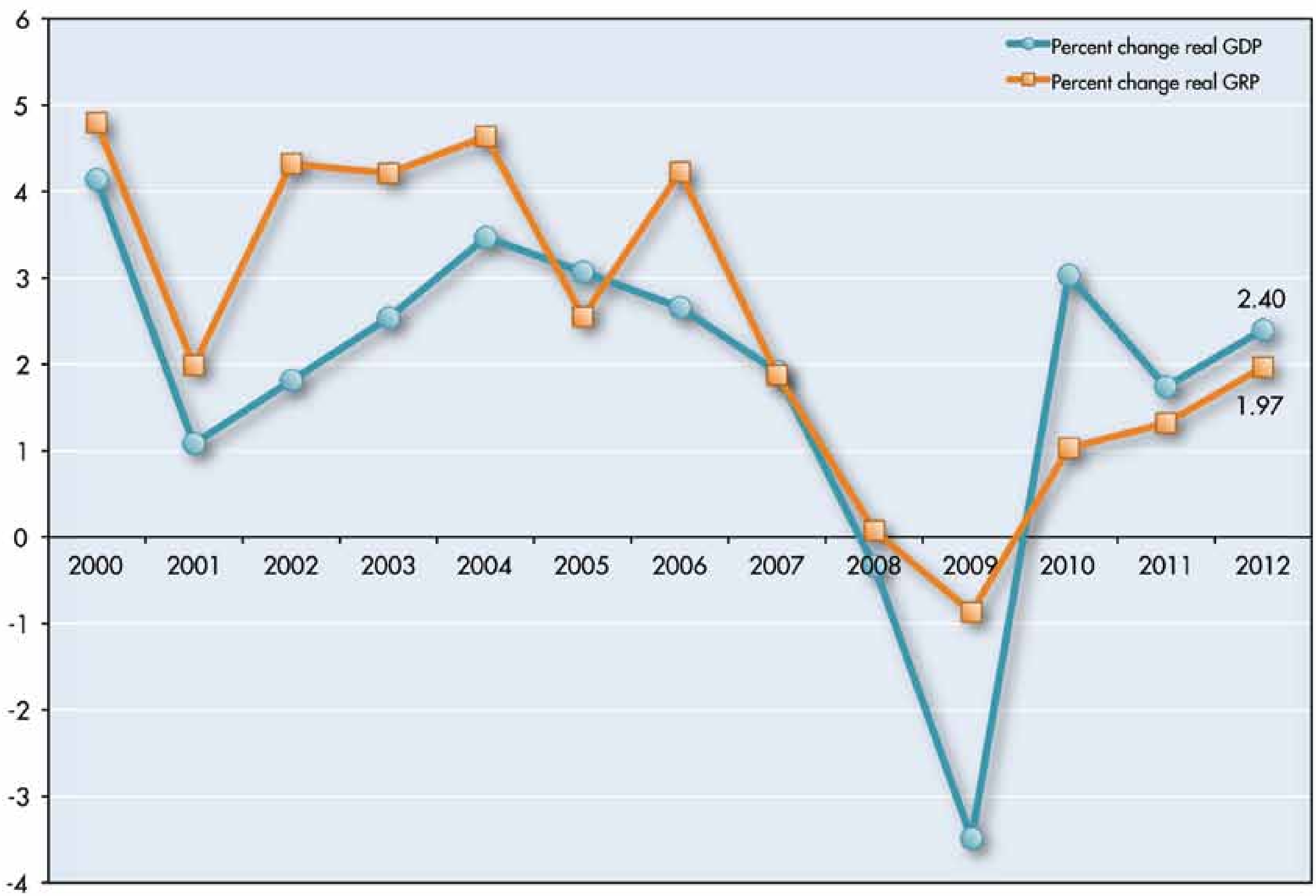
Source: Old Dominion University Economic Forecasting Project. Data incorporate U.S. Department of Commerce personal income revisions through May 2012.

The good news is that our anticipated 2012 real economic growth rate of 1.97 percent is the highest we will have experienced since 2006, and we are seeing a modest acceleration in our economic activity. Despite having to overcome several major economic setbacks, such as the closing of the Joint Forces Command and actual or planned cuts in defense spending, the economy shows signs of emerging from its economic funk. Per capita income is growing, there are indications that the regional housing market finally has bottomed out, and national economic recovery is providing the impetus for increased consumer spending and business investment in Hampton Roads.

To be sure, several ominous storm clouds remain on the horizon and, as Graph 1 illustrates, our anticipated 2012 real economic growth rate of 1.97 percent still will trail the U.S. growth rate (2.4 percent) by .43 percent. Reality is that most of the previously scheduled cuts in defense spending in our region have yet to be implemented and they will hit us primarily throughout the rest of this decade. Unless Congress is able reach agreement on major budget deficit issues, across-the-board budget cuts ("sequestration") will be invoked automatically and defense spending nationally will decline more than $500 billion in addition to the $487 billion in cuts already scheduled for this decade. This is a potentially disastrous scenario for the Hampton Roads economy, but a possible solution is on the horizon. Timely action by Congress after the November 2012 election to deal meaningfully with the nation's chronic budget deficits will avert as much as three-quarters or more of the sequestration reduction and dramatically reduce the negative impact of declining defense spending on Hampton Roads. We will have more to say about the size of this potential problem in a section below.

GRAPH 1

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



Source: Old Dominion University Economic Forecasting Project

Perhaps the greatest uncertainty facing us immediately, however, is the slowdown of the world economy, heavily influenced by economic and financial problems in Europe. There are those who believe that what happens in countries such as Greece and Spain has little impact on us in Hampton Roads, but they are misguided. In 2011, the United States exported $2.66 trillion of goods and services to other countries. Approximately one of every six dollars of economic activity in the American economy is directly tied to our international trade activities.

Here in Hampton Roads, the Port of Virginia reports that the dollar value of its exports in 2011 was $23.98 billion. While much of this traffic was simply being handled in our port and "passing through," the moral to the story is obvious – if the economies of other countries contract, then those countries will stop buying as much from us and we will feel the impact immediately in the way of reduced export sales and diminished activity at the Port of Virginia.

Further, faced with uncertain economic prospects and possible bank failures, many people around the globe have decided that the United States is the equivalent of the least sick person in the world economic hospital and therefore have been transferring large sums of money into our country, often to purchase U.S. government securities. The United States has become a safe haven for many world savers and investors. This sounds good, but is one of the reasons why the value of the U.S. dollar has climbed relative to other currencies, such as the euro. The net effect of a rising dollar has been to make the prices of our exported goods and services more expensive to any foreigners who might become our customers. If world economic problems continue, then it is likely that the value of the dollar will resume its upward climb and this will make it more difficult for U.S. businesses to export goods and services. (On the other hand, the strengthening dollar will make their exports to us less expensive, and that is a good thing.)

One more possible adverse impact of European economic problems is worthy of mention. If our financial institutions have loaned European entities money that will not be paid back, then we could feel serious ripples from these overseas problems in our own financial system. The balance sheets of our financial institutions will deteriorate and they will have to scramble to meet their own obligations; they will be less likely to have loanable funds available for businesses and consumers. The specter of another "too big to fail" bankruptcy similar to that of Lehman Brothers in 2008 cannot be ruled out in such a scenario.

A Closer Look At Our Regional Economic Situation

In this section, we will look at what's been happening to income and jobs in Hampton Roads and what the future portends. We'll then focus our attention on the "Big Three" in our regional economy: defense, the Port of Virginia and tourism/hotels. We'll finish by examining the regional housing market.

INCOMES AND JOBS

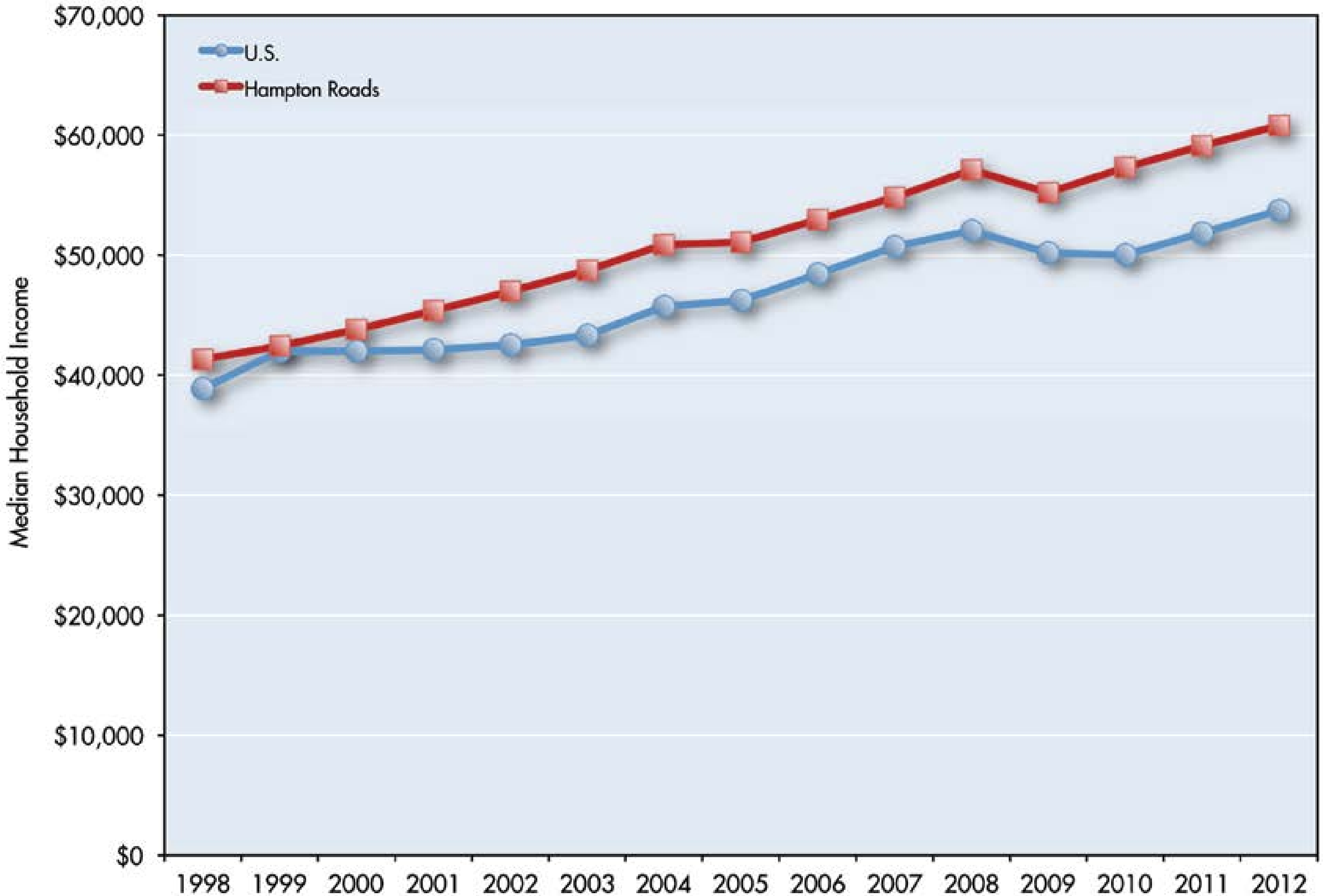
Graph 2 reveals that median (50th percentile) household income in Hampton Roads continues to be higher than that of the nation as a whole. Interestingly, the Great Recession widened the gap between Hampton Roads and the United States because we did not experience as deep an economic slowdown as the rest of the country. We have defense spending to thank for this.

Nevertheless, as Graph 3 demonstrates, increased household income has not always translated into increased jobs. In 2007, 775,300 people in our region were employed; even with economic recovery, we anticipate that this number will be only 743,400 in 2012. Thus, we still will be short approximately 32,000 jobs. This is a sobering reflection of our "jobless recovery" in Hampton Roads.

There is disagreement among economic analysts as to the reason why this economic recovery has not created as many new jobs as hoped. Some argue that "aggregate demand" is too small; that is, households and businesses simply don't have enough spending power. Their solution is to introduce additional economic stimulus in the form of increased federal spending and more tax cuts.

GRAPH 2

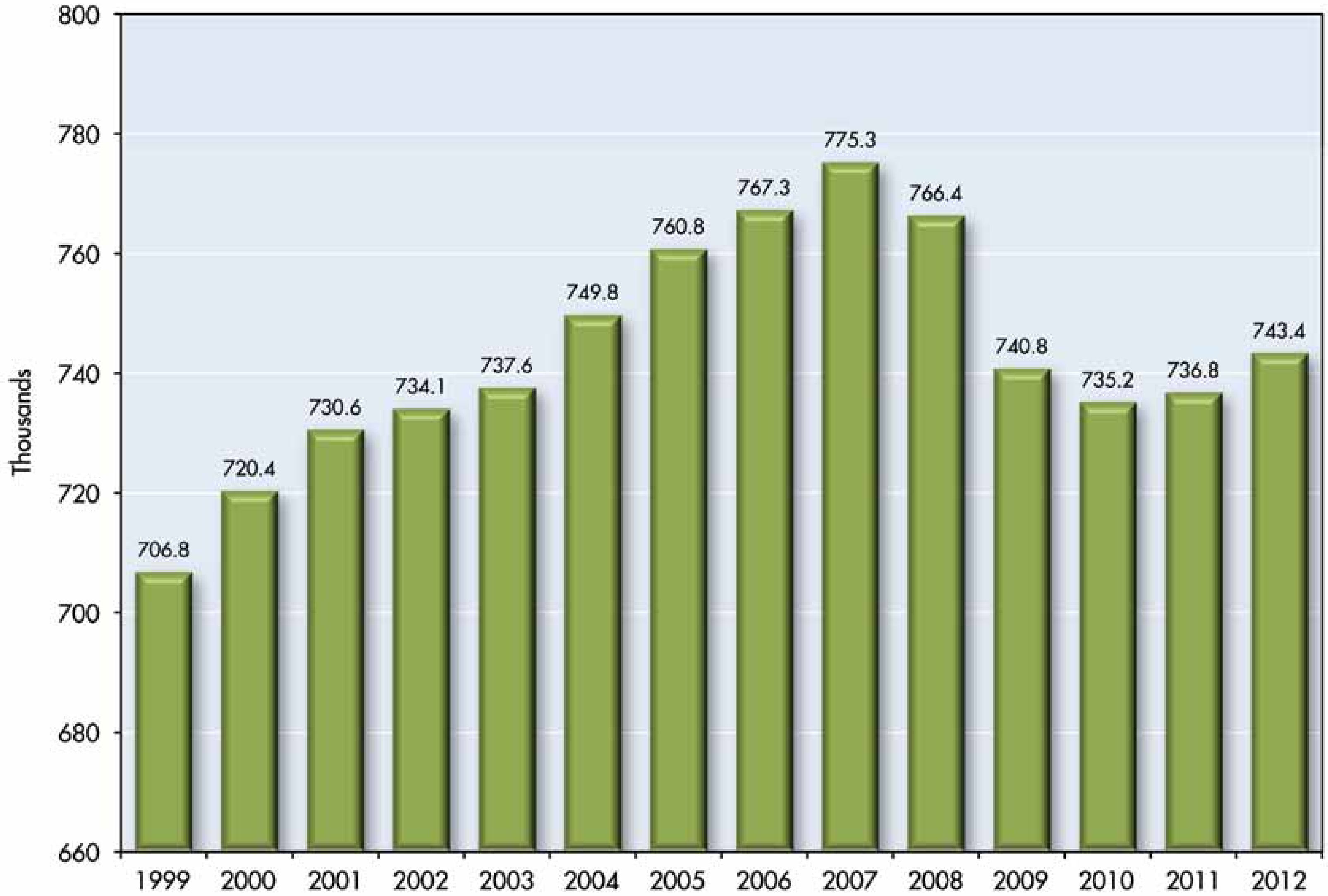
COMPARISON OF MEDIAN HOUSEHOLD INCOME: HAMPTON ROADS AND THE U.S., 1998-2012



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

GRAPH 3

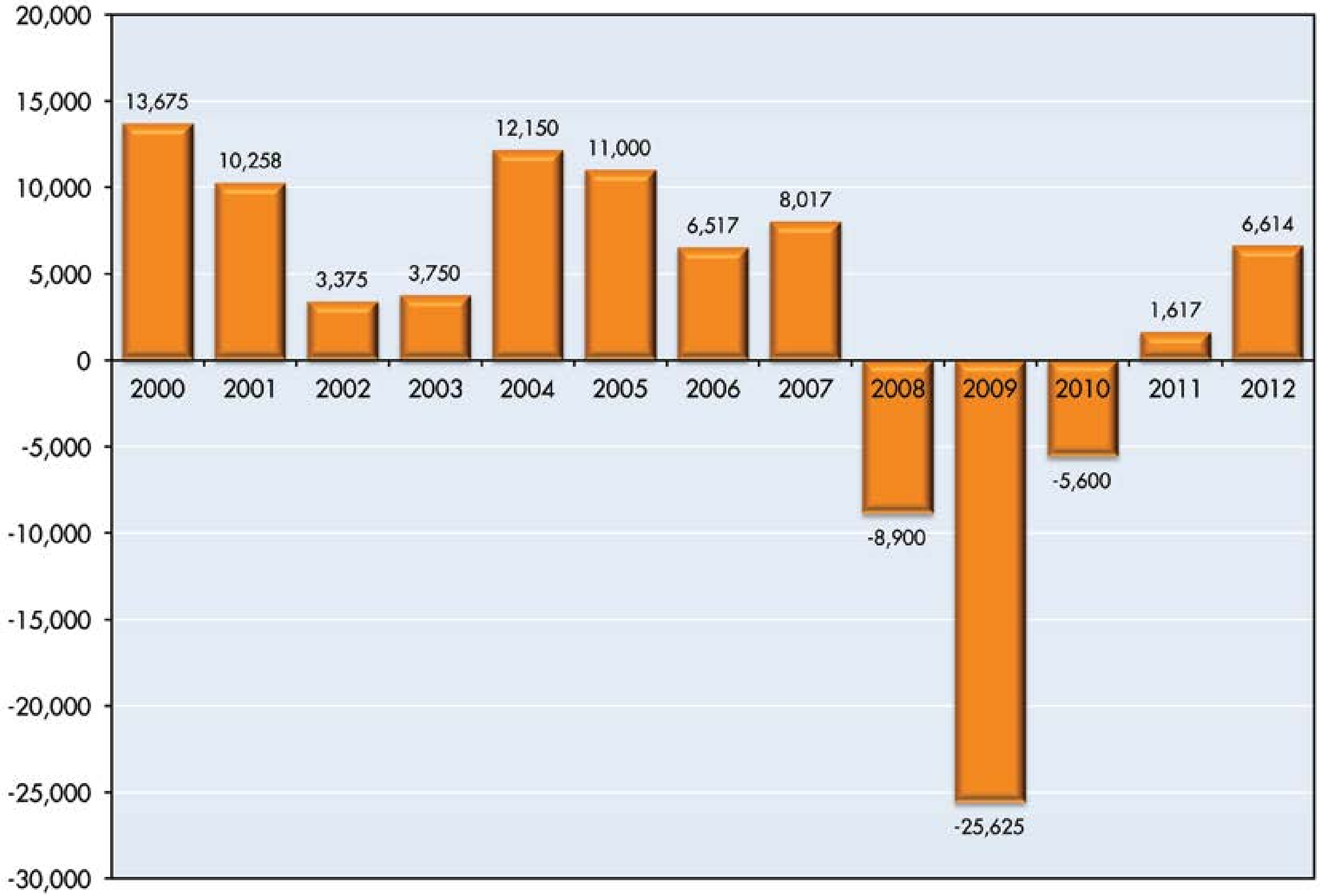
CIVILIAN EMPLOYMENT (JOBS) IN HAMPTON ROADS: 1999-2012



Sources: U.S. Department of Labor CES data and the Old Dominion University Economic Forecasting Project

GRAPH 4

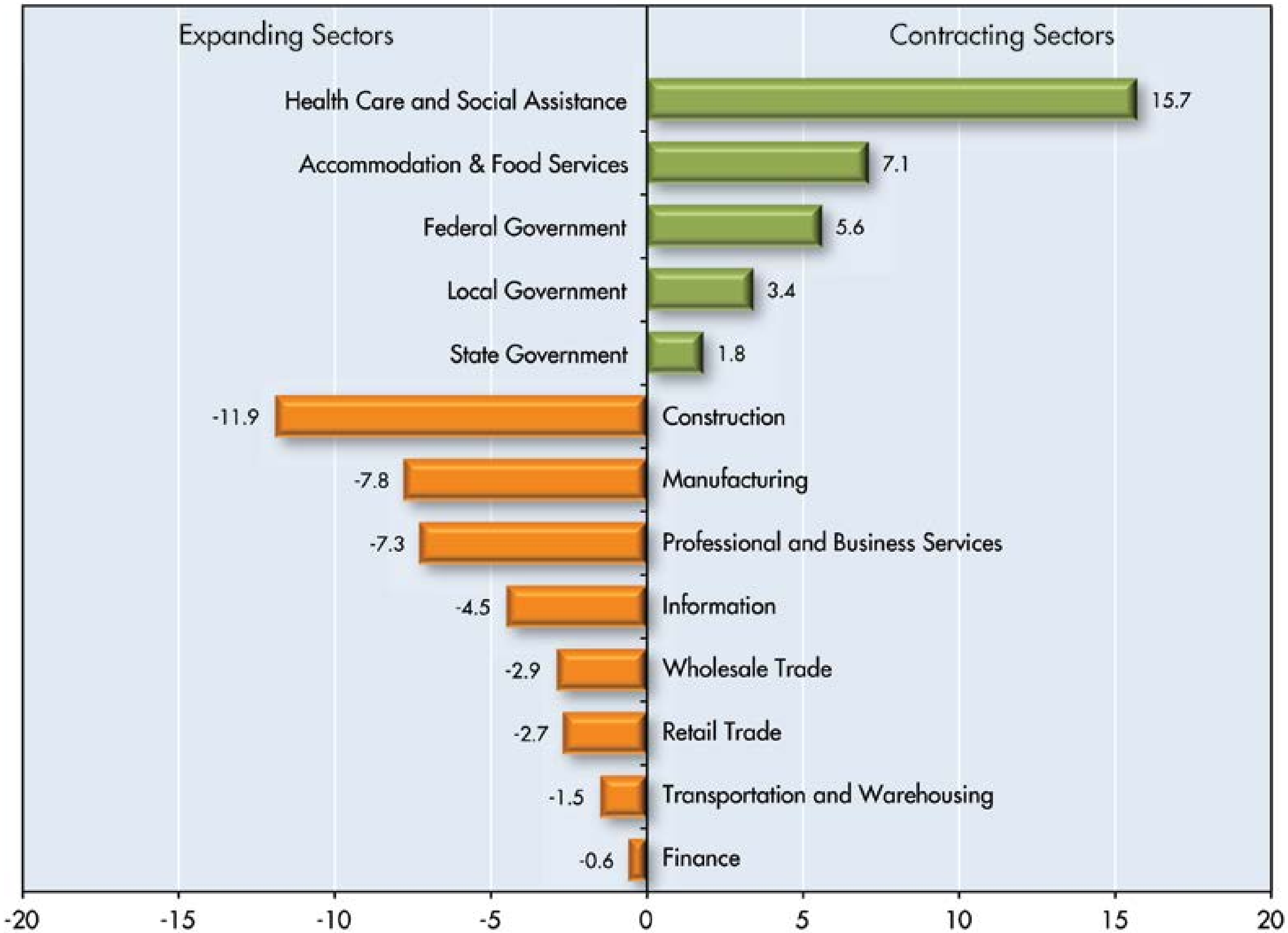
NET NEW CIVILIAN WAGE AND SALARY JOBS CREATED IN HAMPTON ROADS (2000-2012)



Sources: U.S. Department of Labor and the Old Dominion University Economic Forecasting Project

GRAPH 5

JOB GAINS AND LOSSES (THOUSANDS) IN HAMPTON ROADS, 2003-2011



Sources: U.S. Department of Labor CES data and the Old Dominion University Economic Forecasting Project (not seasonally adjusted)

Other analysts assert that the economic impact of the federal stimulus thus far has been disappointingly small and that the huge U.S. government deficits that have accompanied the stimulus and anti-business rhetoric have created damaging uncertainty in the minds of businesses. Hence, they are reluctant to hire new employees. The Wall Street Journal reported that S&P 500 firms' cash holdings in mid-2012 exceeded $1 trillion, up from $600 billion in 2006 ("Blame Fear, Not Greed, as Firms Hoard Cash," July 29, 2012). This, the WSJ reporter argued, was due to the great uncertainty they have about future economic developments.

Another explanation of the jobless nature of our recovery focuses on "structural unemployment" – the notion that there are jobs available, but either the unemployed aren't qualified to fill those positions, or they aren't located where the jobs are. Exponents of this view cite complaints by manufacturers that they cannot find skilled workers capable of operating complex equipment. Structural unemployment advocates also note that the rate of unemployment in energy-booming North Dakota was only 3 percent in May 2012, while it was 11.6 percent in Nevada and 8.2 percent in the United States. They believe that some state and federal policies, in addition to the difficulties in housing markets, have served to anchor prospective workers in locations where there are few jobs, and that a way to change this is to produce financial incentives for prospective workers to move where the jobs actually are.

It's beyond the scope of the State of the Region report to decide this issue. What we can point out is that job creation in Hampton Roads has been slow (see Graph 4) and that between 2003 and 2011, many different sectors of our regional economy lost jobs (see Graph 5). In general, health care and government added jobs, while construction, manufacturing, and wholesale and retail trade lost jobs.

How has Hampton Roads performed in job creation compared to other metropolitan regions? Our record is mixed, as Table 2 indicates. **Between 2003 and 2010, we lost jobs, even though Charlotte, N.C., Jacksonville, Fla., Raleigh-Durham, N.C., Richmond and the Commonwealth of Virginia all gained jobs. Over this time period, we performed slightly worse than the United States as a whole. We lost .33 percent of our total jobs, while the country lost .10 percent of its total jobs.**

TABLE 2

COMPARING JOB GAINS AND LOSSES IN HAMPTON ROADS TO OTHER REGIONS AND THE U.S., 2003-2010

AREA	2003-07	2007-10	2003-2010
Hampton Roads	37.7 (+5.11%)	-40.1 (-5.17%)	-2.4 (-0.33%)
Charlotte	96.0 (+12.55%)	-53.7 (-6.24%)	42.3 (+5.53%)
Jacksonville	70.7 (+12.55%)	-50.8 (-8.01%)	19.9 (+3.53%)
Raleigh-Durham	116.1 (+16.68%)	-43.0 (-5.29%)	73.1 (+10.50%)
Richmond	45.4 (+7.72%	-30.9 (-4.88%)	14.5 (+2.47%)
U.S.	7,599.0 (+5.85%)	-7,724.0 (-5.61%)	-125.0 (-0.10%)
Virginia	263.9 (+7.55%)	-123.3 (-3.28%)	140.6 (+4.02%)

Sources: U.S. Department of Labor CES seasonally unadjusted data and the Old Dominion University Economic Forecasting Project

On the other hand, if we focus on 2007 to 2010, although we did not perform as well as Virginia in job retention, we did better than most of the other metropolitan regions. Thus, our employment expanded more modestly in the first part of the previous decade than most of the other metropolitan regions, but then in the latter part of the decade we also contracted more modestly than they did after the Great Recession.

Despite the loss of jobs in our region over the past decade, as Table 3 discloses, average weekly wages in Hampton Roads rose in every occupational segment between 2003 and 2011. This was true even in occupations that lost many jobs. To wit, one of the heaviest job-losing occupations was construction,

TABLE 3

AVERAGE PRIVATE-SECTOR WEEKLY WAGES IN SELECTED INDUSTRIES IN HAMPTON ROADS: 2003 AND 2011

INDUSTRY	4th Quarter 2003	4th Quarter 2011	Change
Construction	$709	$930	$221 (+31.2%)
Manufacturing	$908	$1,093	$185 (+20.4%)
Wholesale Trade	$947	$1,129	$182 (+19.2%)
Retail Trade	$405	$452	$47 (+11.6%)
Transportation and Warehousing	$790*	$1,012	$222 (+28.1%)
Information	$795*	$1,001	$206 (+25.9%)
Finance and Insurance	$867	$1,210	$343 (+39.6%)
Professional and Business Services	$1,075	$1,374	$299 (+27.8%)
Health Care and Social Assistance	$696*	$841	$145 +(20.8%)
Accommodation and Food Services	$242	$294	$52 (+21.4%)

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 for the Transportation and Warehousing and Information industries are second quarter 2005. Data for Health Care and Social Assistance are first quarter 2007.

but average weekly wages climbed 31.2 percent during this time period and this was 9 percent faster than the consumer price index, or about 1 percent per year. While the major influence on construction employment clearly is overall economic prosperity, this generous increase in wage rates could not have helped the employment of construction workers.

One of the keys to the economic prosperity of Hampton Roads is defense spending, which generates attractive jobs both for active-duty military and civilians. **Table 4 reports that between 2001 and 2010, the**

TABLE 4 ESTIMATED AVERAGE TOTAL COMPENSATION (WAGES, SALARIES AND FRINGE BENEFITS) SELECTED CATEGORIES (2001 TO 2010)			
	Earnings in 2001	**Earnings in 2010**	**Percent Increase**
Hampton Roads Military	$56,811	$109,766	93.2%
Hampton Roads Federal Civilian Govt. Employees	$70,742	$101,018	42.8%
Hampton Roads State and Local Govt. Employees	$38,730	$52,924	36.7%
Hampton Roads Private Sector	$32,988	$41,917	27.1%
U.S. Private Sector	$41,103	$49,626	20.7%

Sources: U.S. Bureau of Economic Analysis (BEA) and the Old Dominion University Economic Forecasting Project. * BEA refers to compensation as earnings.

average total compensation (including fringe benefits) of military personnel in Hampton Roads rose 93.2 percent – well above the 42.8 percent growth in the compensation of federal government civilian employees, the 36.7 percent growth for state and local government employees, and the 27.1 percent growth for private-sector employees.

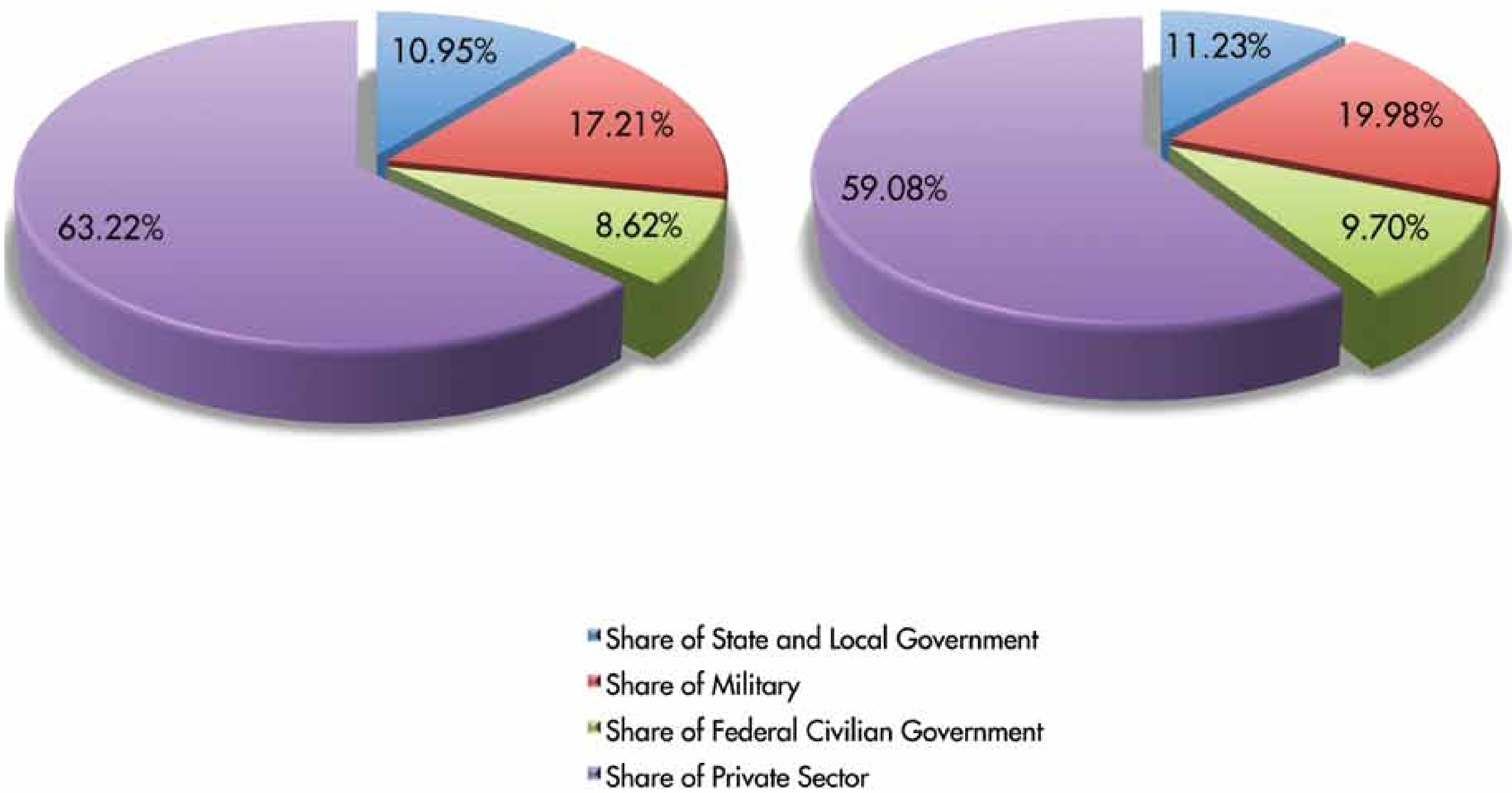
The United States does not have a military draft and therefore the Department of Defense (DOD) must offer compensation packages sufficient to attract and retain the personnel it requires, both military and civilian. Increased compensation levels over the past decade have made the DOD and military service much more attractive economic options than previously, though there are strong signs now that large annual increases in DOD-related compensation are over. In fact, the DOD will be shedding personnel in coming years and thus its need for additional compensation incentives likely will decline.

It is important to note that even while military compensation rose more than 93 percent over the past decade, the actual number of active-duty military personnel in the region fell by about 10 percent. Thus, we have witnessed a smaller number of people being compensated at much higher levels. The net effect has been to provide a powerful economic stimulus to our region, so much so that the share of compensation paid to private-sector employees in Hampton Roads fell from 63.22 percent to 59.08 percent over the decade (see Graph 6). There is no way to sugarcoat this finding – the private sector became proportionately less important, economically speaking, in Hampton Roads over the past decade. That is, our economy became less diversified between 2001 and 2010.

One of the ironies connected to the relatively slow job creation in the region has been that almost paradoxically, our rate of unemployment has been below that of the entire country for many years. Graph 7 illustrates this for 2000 to 2012. On occasion, we've also enjoyed an unemployment rate below that of Virginia. Currently, however, our regional unemployment rate is 6.7 percent versus 6.0 percent for the Commonwealth (June 2012 data). Regardless, as Graph 8 reveals, our regional employment trend is positive. The number of monthly initial unemployment claims has been falling steadily since topping out in May 2010.

GRAPH 6

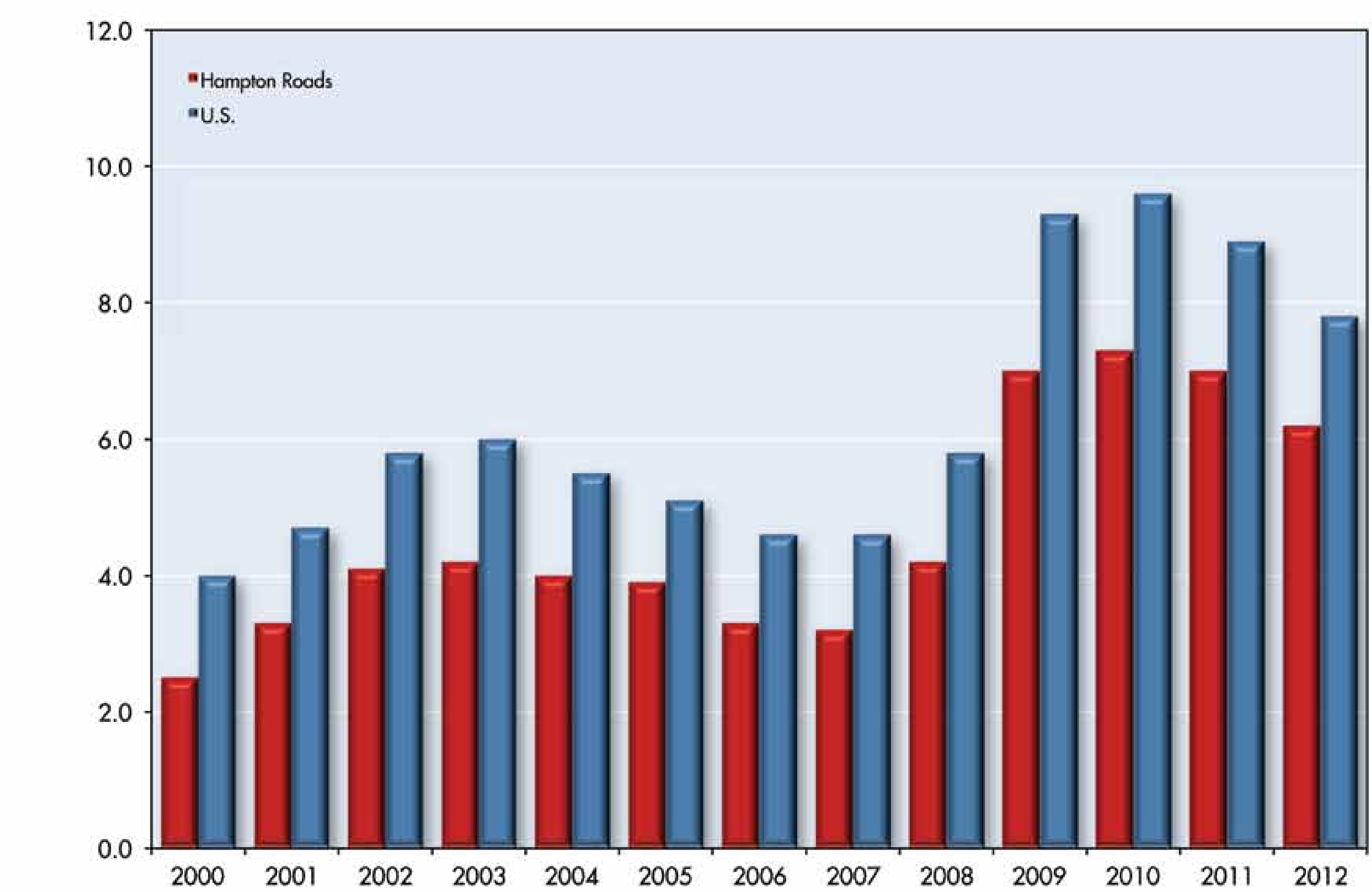
SHARES OF SELECTED SECTORS MEASURED BY TOTAL COMPENSATION IN HAMPTON ROADS: 2001 AND 2010



Sources: U.S. Bureau of Economic Analysis (BEA) and the Old Dominion University Economic Forecasting Project. *BEA refers to compensation as earnings.

GRAPH 7

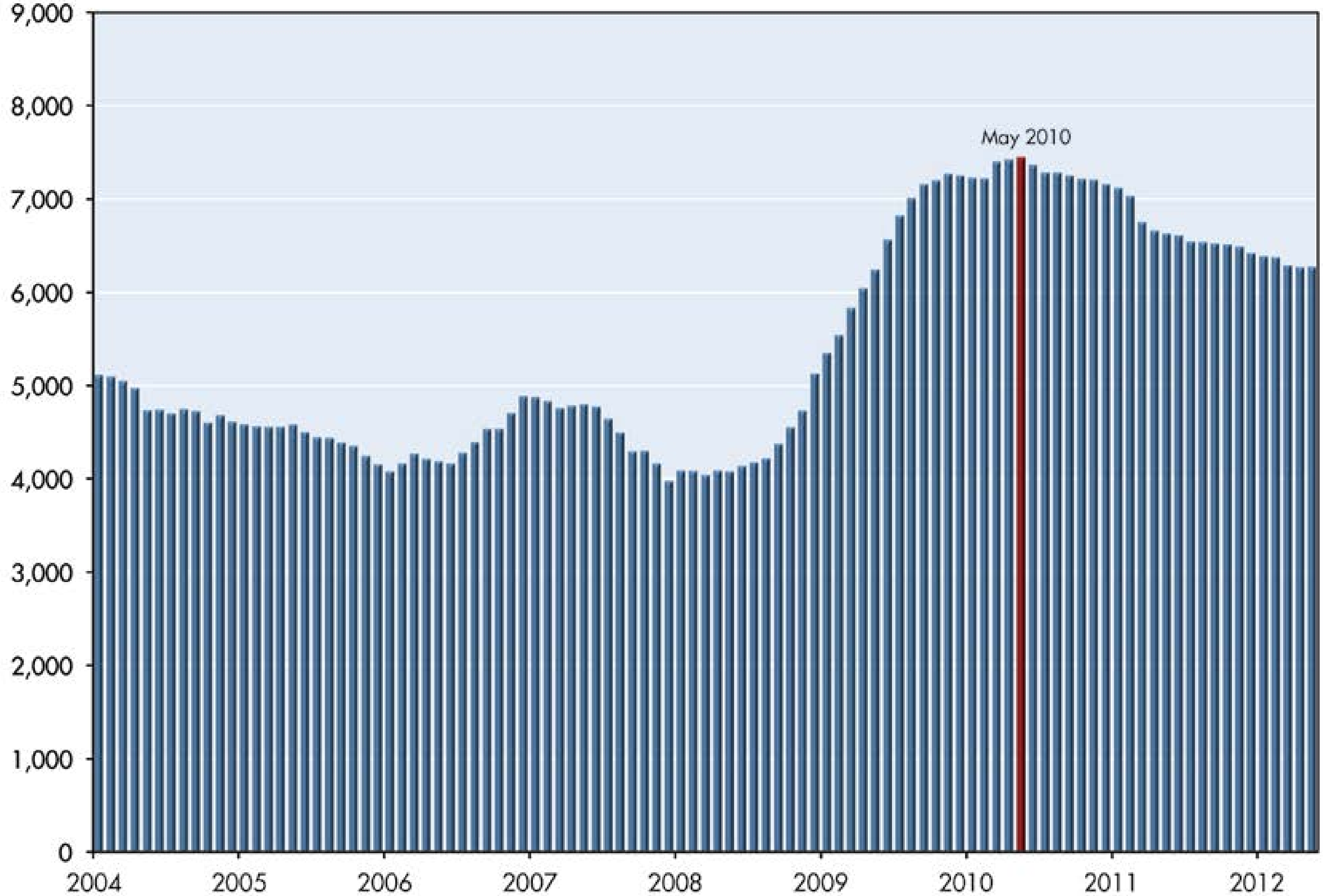
HAMPTON ROADS AND U.S. ANNUAL UNEMPLOYMENT RATE: 2000-2012



Sources: U.S. Department of Labor and the Old Dominion University Economic Forecasting Project (not seasonally adjusted)

GRAPH 8

MONTHLY INITIAL UNEMPLOYMENT CLAIMS FOR HAMPTON ROADS: JANUARY 2004 THROUGH JUNE 2012 (12-MONTH MOVING AVERAGE)



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

DEFENSE SPENDING

For many years, our primary regional economic engine has been defense spending, which as Graph 9 illustrates, will total about $20.75 billion in 2012. Note that this is a "universal" estimate for Hampton Roads that includes DOD civilian employees and all defense procurement activities; and further note that defense spending has stagnated in recent years.

As mentioned above, our regional economy has become increasingly dependent upon defense spending over the past decade and DOD spending now accounts for 45.6 percent of all regional economic activity, a number not seen since the early 1990s (see Graph 10). Despite auspicious attempts to diversify the regional economic base, reality is that we have not succeeded in doing so.

Since DOD spending is so critical to our regional economic well-being, what are our prospects in this regard? First, Congress already has agreed to $487 billion of DOD spending cuts over the next 10 years. While the precise character of these cuts has yet to be determined, one would be astonished if they did not result in a smaller number of active-duty military stationed in our region, a reduction in the number of ships ported here, and a slowdown in ship construction, repair and maintenance.

We should anticipate as a part of these reductions that the significant increases in military compensation that propelled this region during the last decade will come to an end. Rather than the 93 percent increase we benefited from during the 2001 to 2010 time period, the 27 percent increase experienced by the private sector during the same period seems more likely.

Second, as noted above, because the "Super Committee" in Congress was unable to agree upon a long-term solution to persistent federal budget deficits, automatic, across-the-board budget cuts will be imposed in January 2013 and they will extract more than $500 billion from defense spending. From a political standpoint, it seems unlikely that Congress will allow such to occur. Yet, the solution (increased tax revenues accompanied by reduced spending that includes controlling the growth of entitlements) thus far has been elusive, even though it appeared as if the bipartisan Simpson-Bowles Commission report had provided political cover for both Congress and the president.

What does this translate to in terms of income and jobs in Hampton Roads? Table 5 reports the estimates of the Old Dominion University Economic Forecasting Project in this regard. The first and least onerous outcome for our region is based on a Congressional Budget Office forecast of the size of any fund "sequestration" (the term used by Congress for the largely across-the-board cuts). Even this scenario would cost Hampton Roads an estimated 26,900 jobs and 3.19 percent loss in annual gross regional product. To place this in context, the Ford Motor Co. plant closing ultimately cost the region only about one-tenth of this number of jobs.

The "worst of all worlds" estimate of cuts in defense spending (No. 2 in Table 5) emanates from the Center for Strategic and Budgetary Assessment and would cost our region 39,694 jobs, plus $3.89 billion of our annual gross regional product. This would constitute 4.70 percent of the value of our annual economic activity. While we do not expect this to happen, honesty requires us to predict

TABLE 5

ESTIMATED EFFECT OF POTENTIAL ADDITIONAL REDUCTIONS IN DOD SPENDING IN HAMPTON ROADS, BEGINNING IN JANUARY 2013

	Reduction in DOD Spending	GRP Loss	Job Loss	Jobs as a Percent of MSA Total	Percent GRP Loss
One: CBO Estimate (7 percent)	$1.45 billion	$2.64 billion	26,900	2.69%	3.19%
Two: Center for Strategic and Budgetary Assessment (10.3 percent)	$2.14 billion	$3.89 billion	39,694	3.97%	4.70%

Notes: Nominal GRP in 2011 is estimated to be $82.36 billion and DOD spending is estimated to be $20.75 billion.
All of the regional reductions and losses are estimates of the Old Dominion University Economic Forecasting Project based upon the overall percentage cuts in national defense spending estimated by the CBO or CSBA.

that by 2020, DOD spending probably will have declined more than the $487 billion in cuts already agreed to and under way for this decade.

It's important to note that the reductions in spending outlined in Table 5 represent subtractions from a projected upward sloping trend line for future defense spending. Thus, the $487 billion in cuts are reductions from a constant, never changing amount of defense spending because a variety of virtually automatic increases and enhanced weapon systems spending has been projected into the future for defense spending. Some increases in certain types of defense spending are, in the words of a U.S. Navy admiral, "already cooked into the stew." Excluding overseas contingency operations such as Afghanistan and emergency relief operations, base budget defense spending was projected to increase from approximately $510 billion in FY 2011 to approximately $610 billion in FY 2017. Hence, rather than absolute reductions in defense spending, what we are talking now are severe reductions in the accustomed rates of increase in many types of defense spending. (As a reminder, defense spending increased more than 7 percent per year in Hampton Roads during the past decade. Those days are over.)

> Already agreed upon reductions in defense spending of $487 billion in this decade will reduce the size of the U.S. Army from 547,000 to 490,000 and shave about 20,000 troops from the roster of the U.S. Marine Corps. Six U.S. Air Force squadrons of 18 to 24 aircraft will be eliminated. Seven U.S. Navy cruisers will be decommissioned and 10 new ships, such as the highly regarded littoral combat ships, will not be constructed. Another Base Realignment and Closure Commission (BRAC) process involving base closures will ensue.

Our regional vulnerability to alterations in defense spending actually goes well beyond potential declines in the absolute size of the DOD budget. Hampton Roads also could be jolted by the movement of an aircraft carrier group to the Pacific. Secretary of Defense Leon Panetta has placed himself on the record by expressing his intention to change the distribution of naval assets from 50/50 (Atlantic vs. Pacific) to 40/60 (Jane Perlez, "Panetta Outlines New Weaponry for Pacific," The New York Times, June 1, 2012). This increases the probability that an additional aircraft carrier group will be moved to the Pacific.

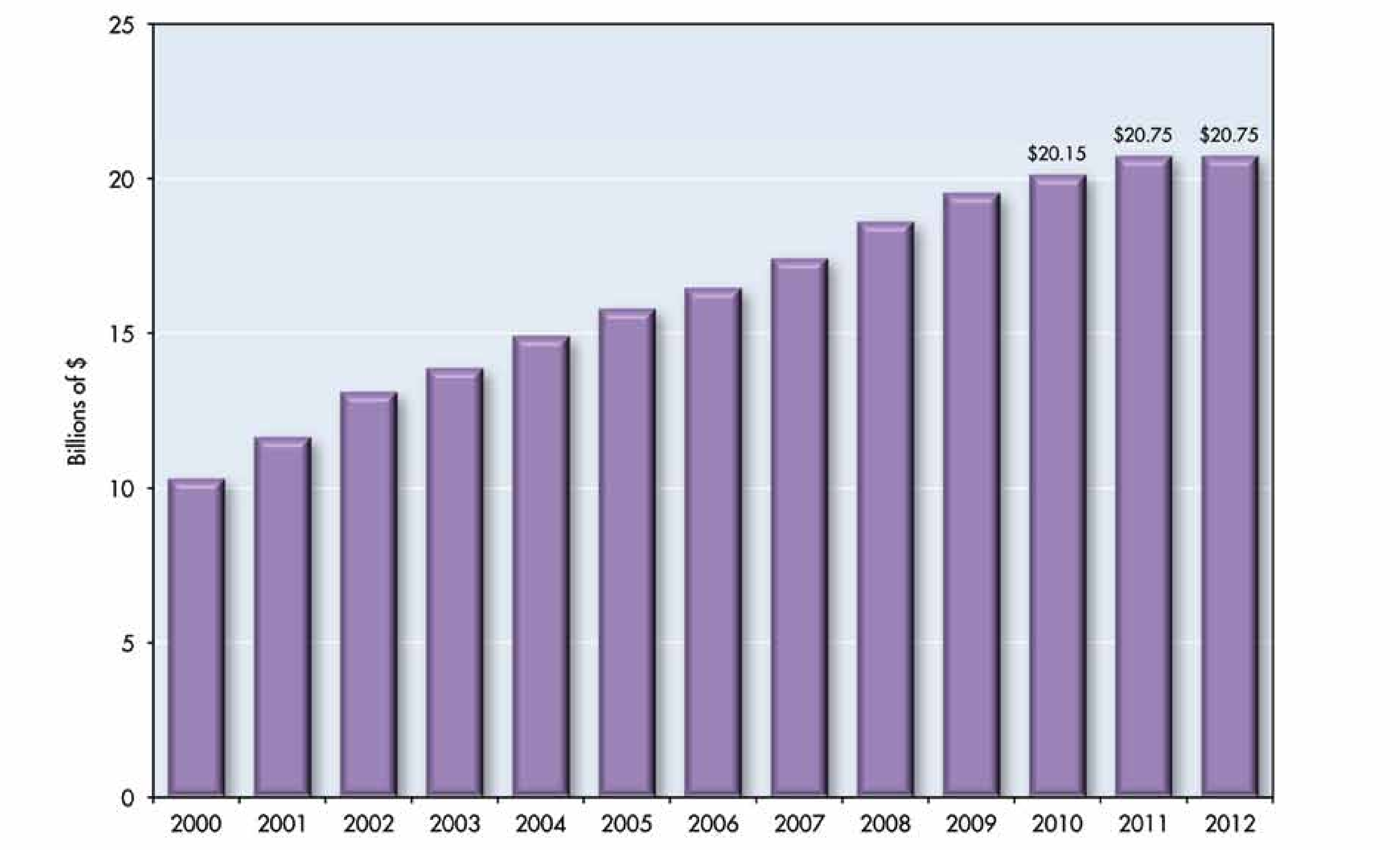
It also seems likely in the future that Oceana Naval Air Station will not host as many aircraft as it does currently. Two factors might move the U.S. Navy in this direction. First, the cost of building and maintaining individual aircraft has risen so dramatically that the Navy simply will not be able to afford as many aircraft, and Oceana could well feel some of this reduction. Second, the inability of Oceana to pin down an alternate, auxiliary airfield somewhere within our region continues to disappoint the Navy. Classic NIMBY behavior by potentially affected citizens has frustrated the Navy's ability to move ahead in this sphere.

Threats to DOD Spending in Hampton Roads

- General Defense Spending: Cuts already are in place that total $487 billion over the next 10 years ($259 billion over the first five years).
- Sequestration: In addition, because the Super Committee failed to act, $1.2 trillion in automatic cuts will be imposed — apparently including a $500+ billion reduction in DOD spending, effective January 2013. These automatic cuts are labeled "sequestration" by the Congress.
- Base Realignment and Closure Commission (BRAC): We could be headed for an additional round of BRAC reductions as a means to deal with the cuts described above.
- Movement of Assets: Our region currently hosts five aircraft carrier groups. It's possible that we will have only three by the end of this decade because one will be moved to the Pacific and another will have been eliminated by U.S. Navy downsizing. When in port, each aircraft carrier generates about $300 million in annual income for the region. It's also not clear that Oceana Naval Air Station (with about 10,000 employees) will continue to host as many fighter aircraft in future years.

GRAPH 9

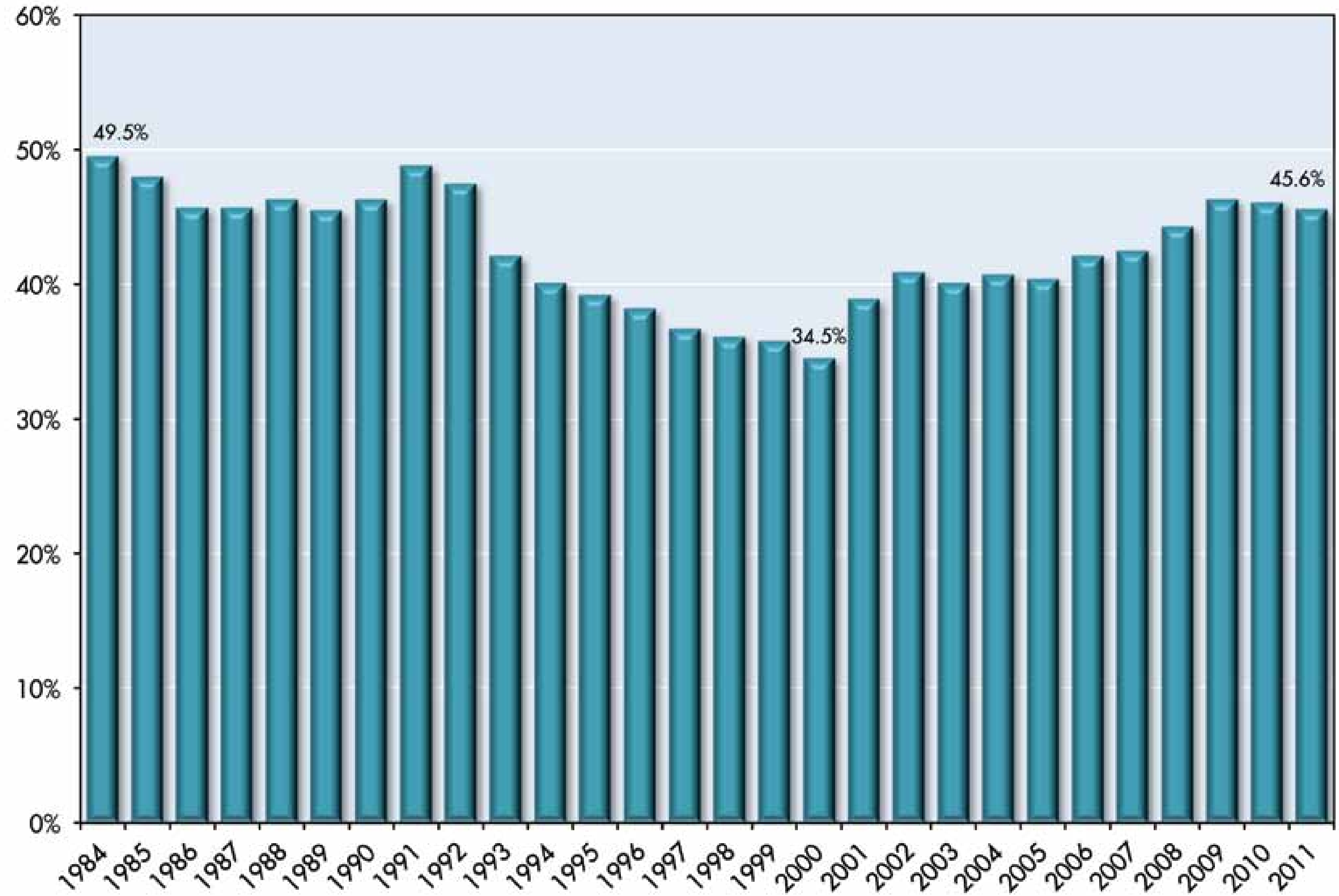
ESTIMATED DIRECT DOD SPENDING IN HAMPTON ROADS* (2000-2012)



Source: Old Dominion University Economic Forecasting Project
*Includes federal civilian and military personnel and procurement

GRAPH 10

HAMPTON ROADS GROSS REGIONAL PRODUCT ATTRIBUTABLE TO DOD SPENDING IN HAMPTON ROADS (1984-2011)



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

THE PORT OF VIRGINIA

The prosperity of the Port of Virginia and the prosperity of Hampton Roads are intertwined, even though many do not believe this to be true. For example, many citizens view U.S. trade with the People's Republic of China (PRC) as an unprofitable one-way street. Hence, Table 6 may come as a surprise to them. The PRC actually is the most lucrative trade partner of the Port of Virginia in terms of the value of exports going from our port to China.

Note that four of the top 10 countries in Table 6 are European. The lesson is this – if European economies tumble, then we in Hampton Roads will get hurt. For that matter, if economic growth in countries such as the PRC, Brazil and India decelerates, then we also will feel this locally.

TABLE 6

VALUE OF PORT OF VIRGINIA EXPORT CARGO BY DESTINATION, 2011

1. China	$2,460 million
2. Germany	$2,090 million
3. Brazil	$1,592 million
4. Netherlands	$1,363 million
5. United Kingdom	$1,225 million
6. Belgium	$1,090 million
7. Japan	$ 893 million
8. Saudi Arabia	$ 764 million
9. India	$ 737 million
10. Egypt	$ 609 million

Source: Port of Virginia, http://www.portofvirginia.com/media/38503/2011_vpa_kpi.pdf

In 2011, Gov. Bob McDonnell replaced nearly the entire membership of the board of the Virginia Port Authority, and it was widely speculated that among the reasons was his dissatisfaction with the port's performance (Robert McCabe, "McDonnell Guts Board of Virginia Port Authority," The Virginian-Pilot, July 23, 2011). Total cargo tonnage handled by the Port of Virginia in 2011 was still 13.5 percent below the 17.83 million tons it handled in its record year of 2008 (see Graph 11). While our port moves bulk cargo (such as grain and coal), break-bulk cargo that is individually handled, and roll-on, roll-off cargo (such as automobiles), its forte is the 20-foot equivalent (TEU) containers that are ubiquitous on some Hampton Roads expressways and streets. Graph 12 records TEU traffic at the port between 1991 and 2012. One can see that the port's TEU traffic reached an all-time high in 2007. However, the port has yet to recover from the impact of the Great Recession. Through last year, TEU traffic remained more than 13.7 percent below the record volume in 2007.

In 2011, the Port of Virginia exported 15,615,938 tons of cargo, down 13.5 percent from its all-time high of 17,726,251 tons in 2007. In May 2012, the Port of Virginia exported 833,781 tons of 20-foot equivalent units (TEUs), but only 4,607 tons of break-bulk (individually loaded) cargo. Improving its break-bulk performance is one of several challenges the port faces. Counting the activity of Norfolk Southern Corp., our region's best performance has been in the area of bulk cargo (such as coal), where Hampton Roads has surged forward and become the largest coal-exporting site in the United States.

Graph 13 shows that in recent years, it is the ports of New York/New Jersey and Savannah that have maintained or increased their market shares of fully loaded TEUs at the expense of the Port of Virginia. Savannah in particular, driven by economic expansion in the Southeast, superbly targeted state of Georgia investments in incentives and critical infrastructure, and its marketing emphasis on large distributors such as Wal-Mart rather than shipping lines, has steadily increased its share of East Coast port activity in recent years. Savannah's dynamic cargo growth is especially evident when one eliminates New York/New Jersey from the equation. Graph 14 does so and it is apparent that Savannah's growing TEU market share has been accompanied by a decline in the TEU share of the Port of Virginia.

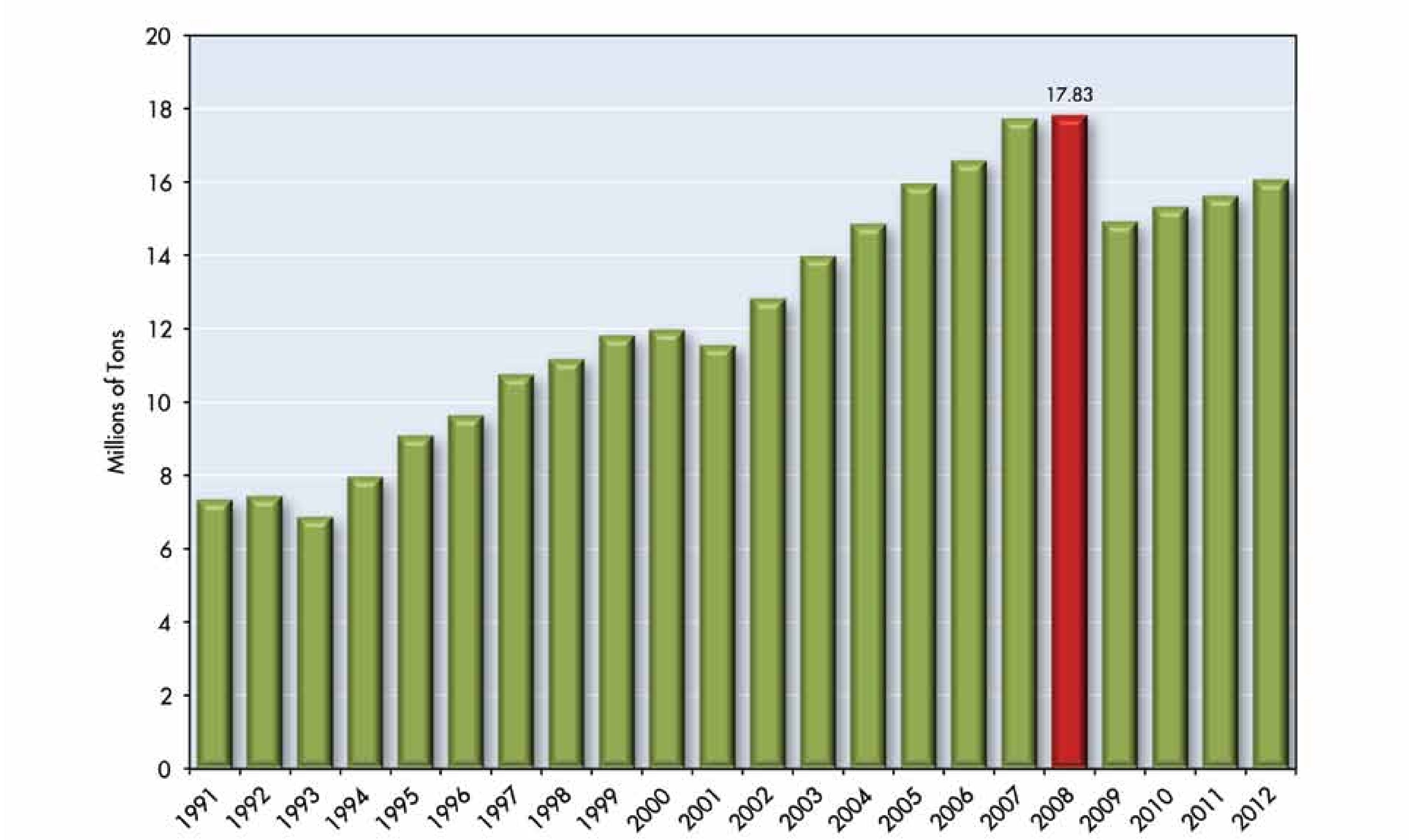
Nevertheless, our port is not without advantages and its future potentially is bright. The Heartland Corridor rail connection to the Midwest, which opened in September 2010, enables Norfolk Southern to send double-stacked TEUs to Chicago on a route that is one day and 250 miles shorter than previous routings. Additionally, the Port of Virginia is the only legitimate 50-foot deep-draft port on the East Coast, and in March 2012 notably loaded a huge, new-generation, 48.5-foot draft ship that no other East Coast port could handle. Our major competitors (New York/New Jersey and Savannah) do not have this capability, though both have plans to improve their situations.

The depth of our shipping channels is critically important because the Panama Canal is being widened and deepened. In 2014, the canal will be able to handle the new generations of much larger, deep-draft ships that are increasingly attractive because of the significant economies of scale they provide shippers. The vision of our port is that many ships coming to the United States no longer will stop on the West Coast in locations such as Long Beach and Los Angeles and unload for railroad transit across the continent to the East Coast, but instead will come through the canal and proceed directly to the Port of Virginia. Of course, Savannah and Charleston are closer to the canal than we are, and if Savannah in particular is able to dredge its shipping channels and obtain greater draft, then it will be a very tough competitor for many large, deep-draft ships coming through the canal. Nevertheless, it is unlikely that this could occur before 2018 at the earliest. New York/New Jersey, in turn, is disadvantaged by the low-clearance Bayonne Bridge, under which most of the large ships serving this port must transit. New York/New Jersey plans to spend more than $1 billion to raise the bridge 65 feet, but again, this will take several years to complete.

All things considered, there is a window of opportunity for the Port of Virginia to excel during this decade. If it is able to do so, then this will help counteract other less favorable economic developments, such those relating to defense spending that now loom on our regional horizon.

GRAPH 11

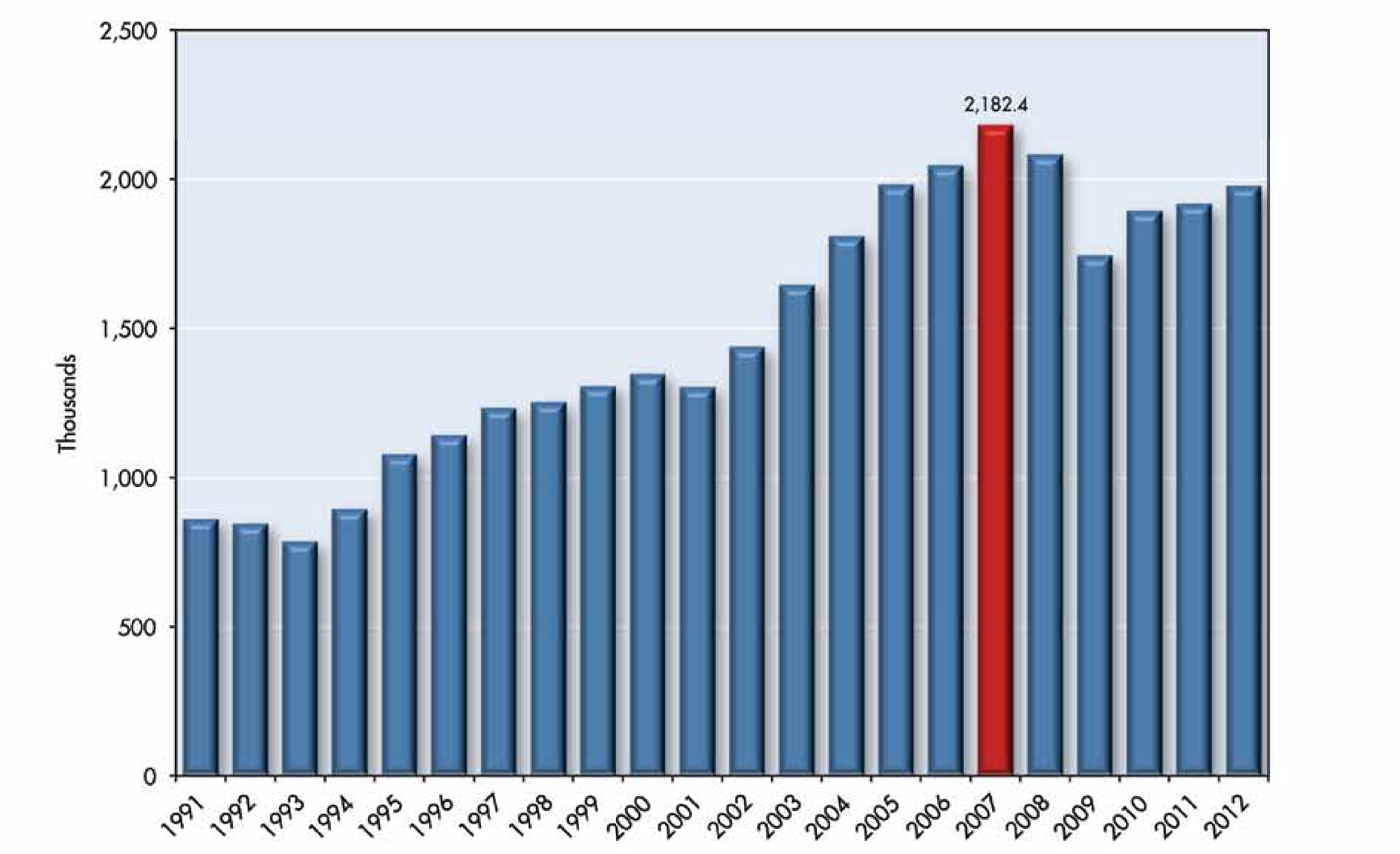
CARGO TONNAGE AT THE PORT OF HAMPTON ROADS: 1991-2012



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

GRAPH 12

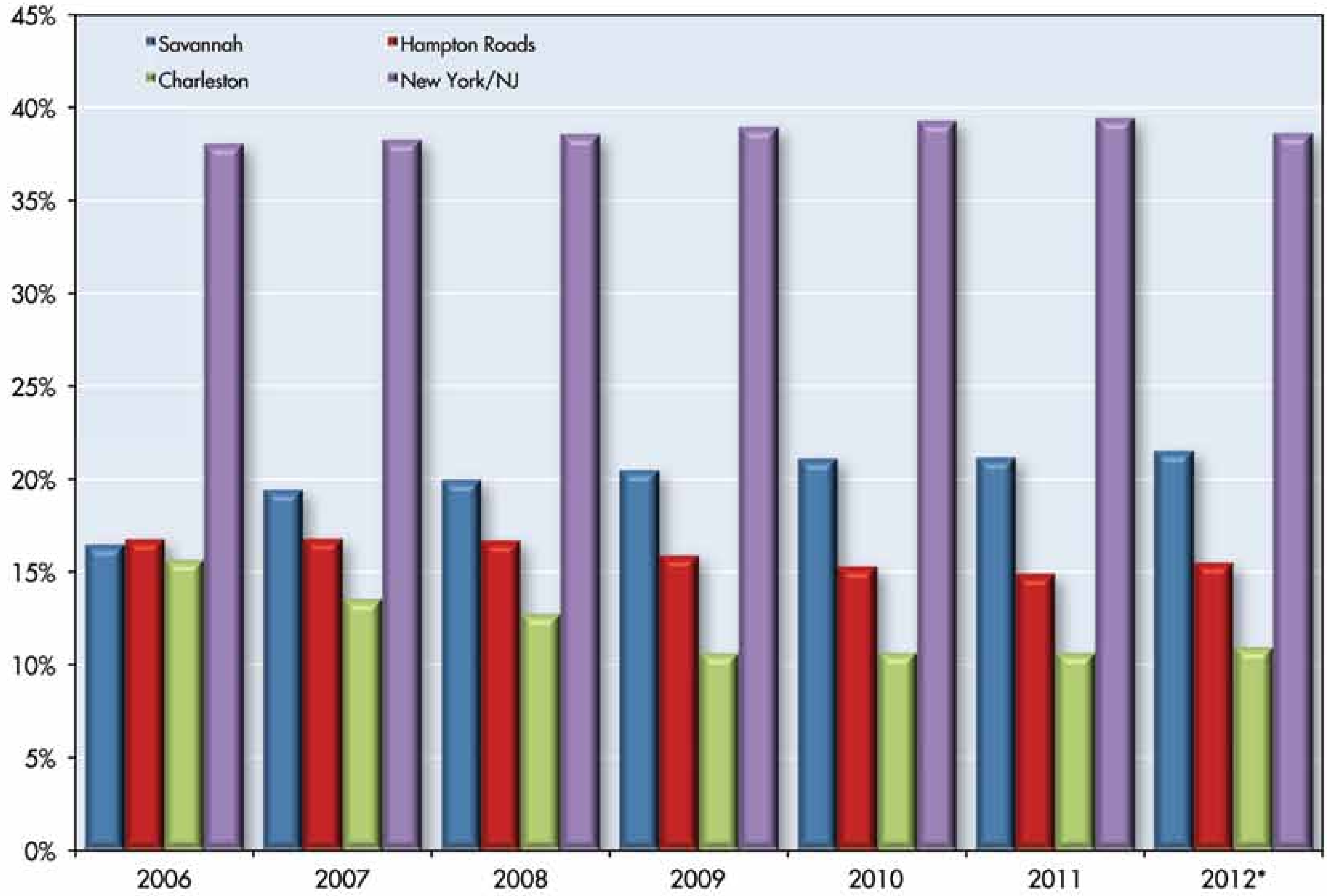
TWENTY-FOOT EQUIVALENT CONTAINER UNITS, PORT OF HAMPTON ROADS: 1991 TO 2012



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

GRAPH 13

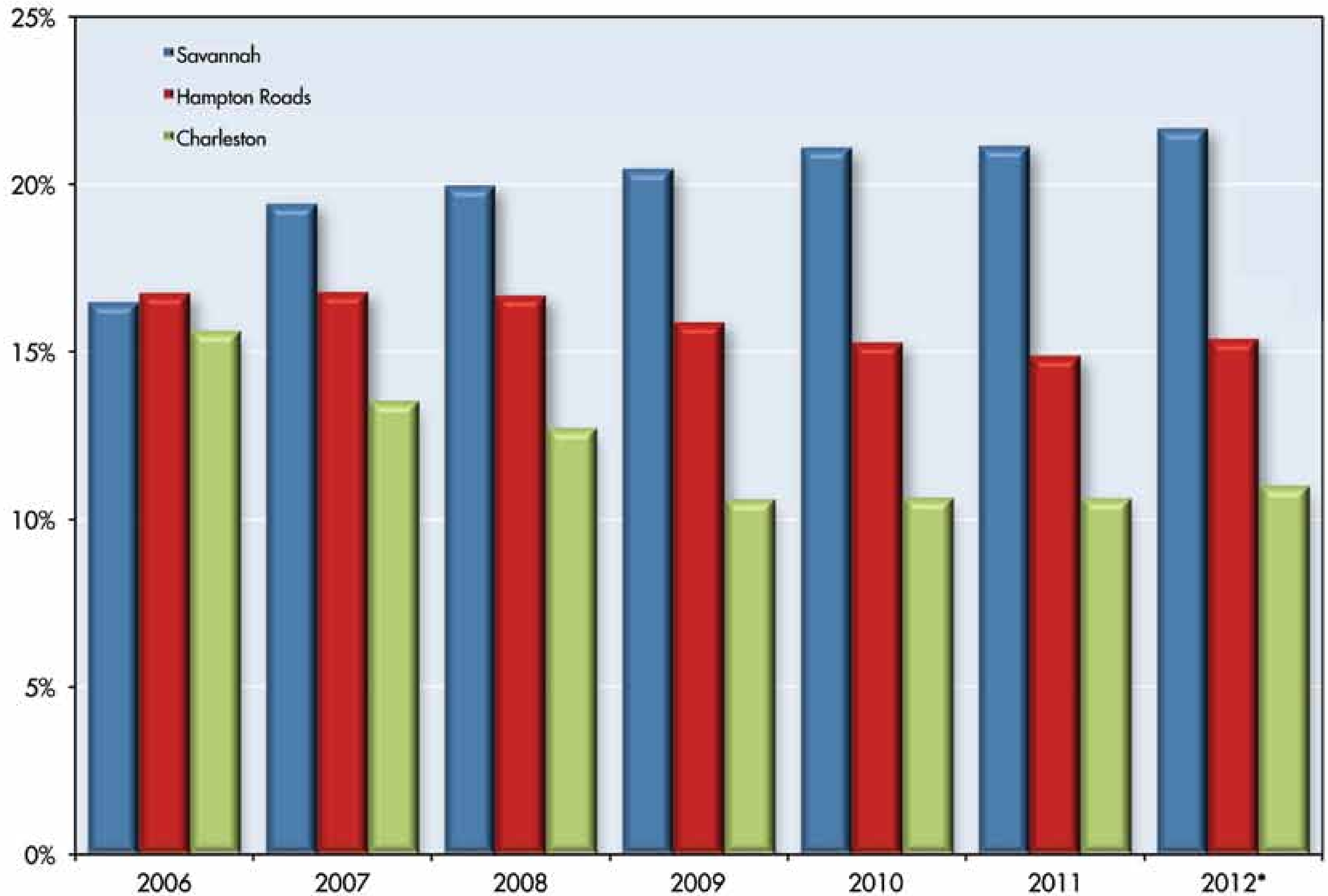
SHARES OF TOTAL LOADED TEU CONTAINERS FOR SELECTED PORTS ON THE EAST COAST, 2006-2012*



Sources: American Association of Port Authorities and the Old Dominion University Economic Forecasting Project. * Data for 2012 are through June 2012.

GRAPH 14

SHARES OF TOTAL LOADED TEU CONTAINERS FOR SELECTED PORTS ON THE EAST COAST, 2006-2012*



Sources: American Association of Port Authorities and the Old Dominion University Economic Forecasting Project. * Data for 2012 are through June 2012.

TOURISM AND HOTELS

In recent State of the Region reports, we have noted a major trend in the nature and location of tourism and hotel traffic in Hampton Roads, namely, that Virginia's Historic Triangle (Williamsburg, Jamestown, Yorktown) has experienced a significant decline in its share of regional tourism and hotel traffic. Graph 15 illustrates the import of this trend, which has seen the Historic Triangle's share of regional hotel revenues decline from 30.6 percent in 1999 to only 17.9 percent in 2011.

The coin of the realm, economically speaking, in hotel economics is REVPAR – revenue per available room. One can see in Table 7 that REVPAR in the Historic Triangle fell 26.3 percent between 2007 and 2011; this is despite the fact that there was very little growth in the number of hotel rooms available in the Williamsburg area (see Graph 16). The problem was inadequate demand for those hotel rooms. Contrast this with the Chesapeake/Suffolk market, where REVPAR declined 20.3 percent. This, however, was primarily a function of the over-building of hotel rooms there (see Graph 17). The region's star performer in terms of REVPAR is Virginia Beach, which was the only regional hotel market to enjoy an increase between 2007 and 2011.

If one takes a more Olympian view of the hotel market in our region (which is highly attuned to tourism), then it is fair to conclude that some hotel operators are struggling. One can see in Graph 18 that hotel revenue in Hampton Roads in 2011 was still $31 million below what it was at its apogee in 2007. Like the Port of Virginia, the regional hotel industry has yet to recover from the Great Recession.

TABLE 7

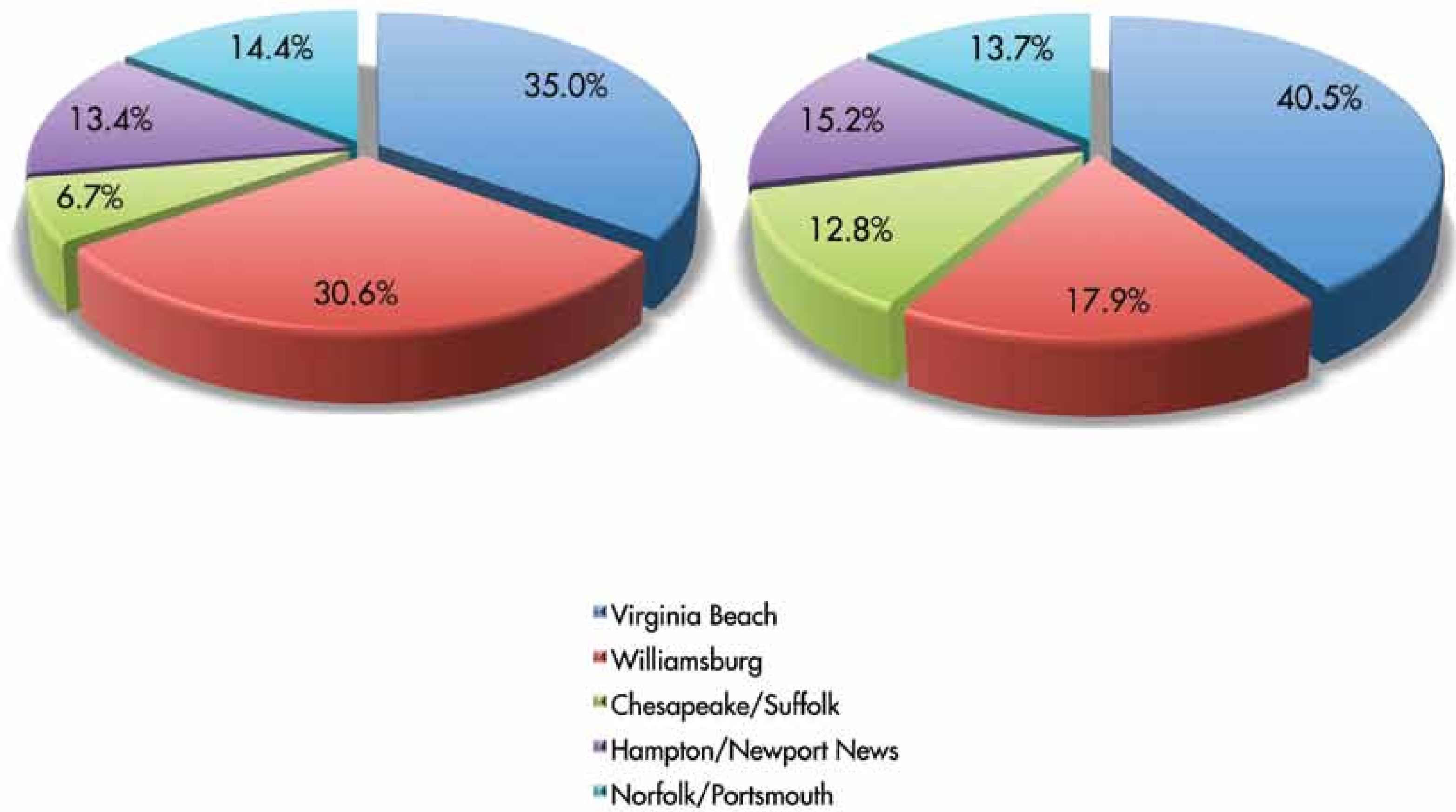
REVPAR IN SELECTED MARKETS: 2007 AND 2011

	2007	2011	Percentage Change
U.S.	$65.52	$61.06	- 6.8%
Virginia	$61.95	$55.67	- 10.2%
Hampton Roads	$52.90	$46.10	- 12.8%
Myrtle Beach	$53.92	$49.24	- 8.7%
Ocean City	$71.12	$65.68	- 7.7%
Coastal Carolina	$55.84	$54.73	- 2.0%
Virginia Beach	$64.75	$65.33	+0.9%
Norfolk/ Portsmouth	$54.05	$45.66	- 15.5%
Newport News/ Hampton	$41.49	$34.84	- 16.0%
Chesapeake/ Suffolk	$52.90	$42.16	- 20.3%
Williamsburg	$47.48	$35.00	- 26.3%

Sources: Smith Travel Research Trend Report (Feb. 7, 2012) and the Old Dominion University Economic Forecasting Project

GRAPH 15

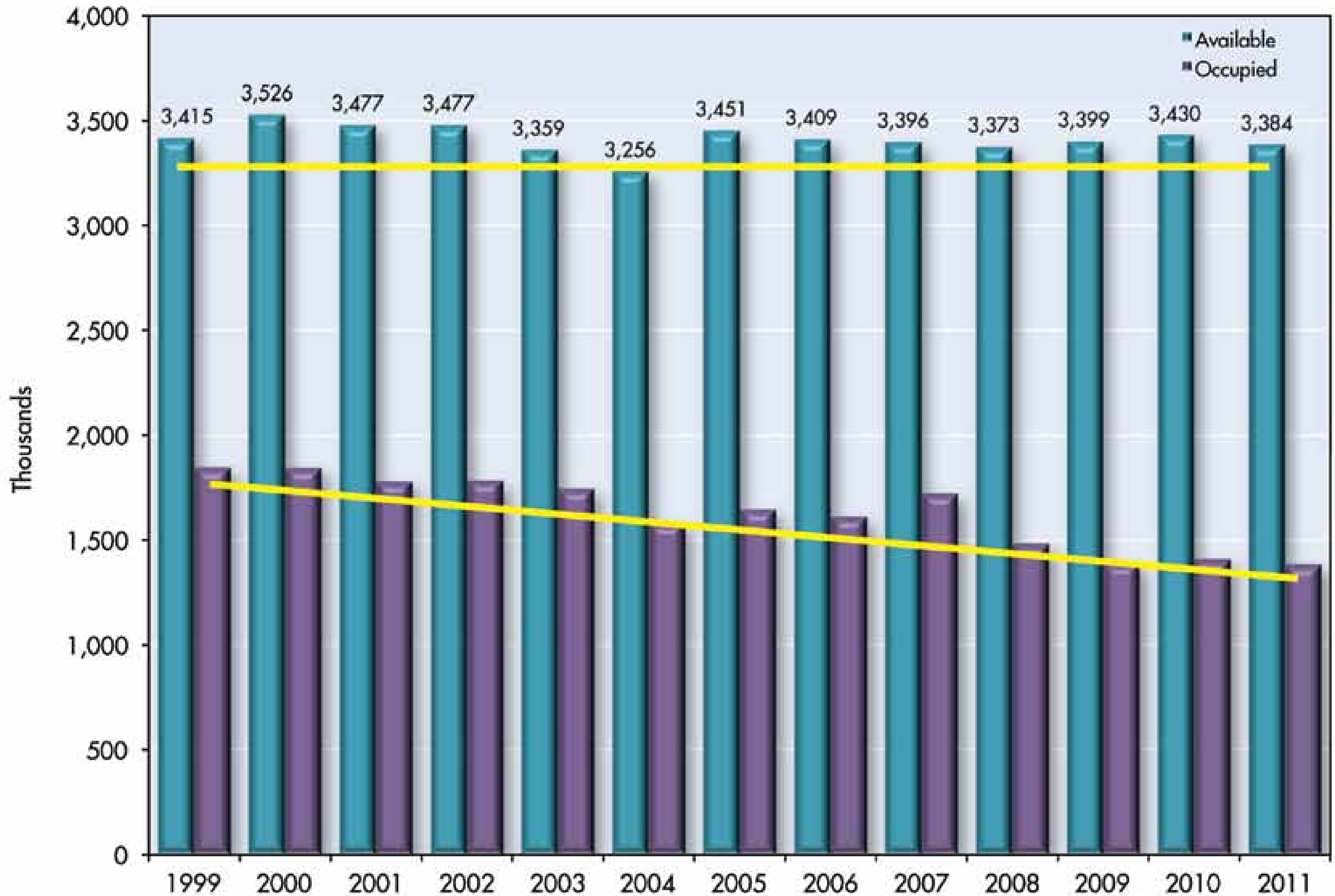
ESTIMATED MARKET SHARES OF THE HAMPTON ROADS HOTEL INDUSTRY BASED UPON HOTEL REVENUES



Sources: Smith Travel Research Trend Reports (Dec. 27, 2007, Dec. 23, 2009, and Feb. 7, 2012) and the Old Dominion University Economic Forecasting Project

GRAPH 16

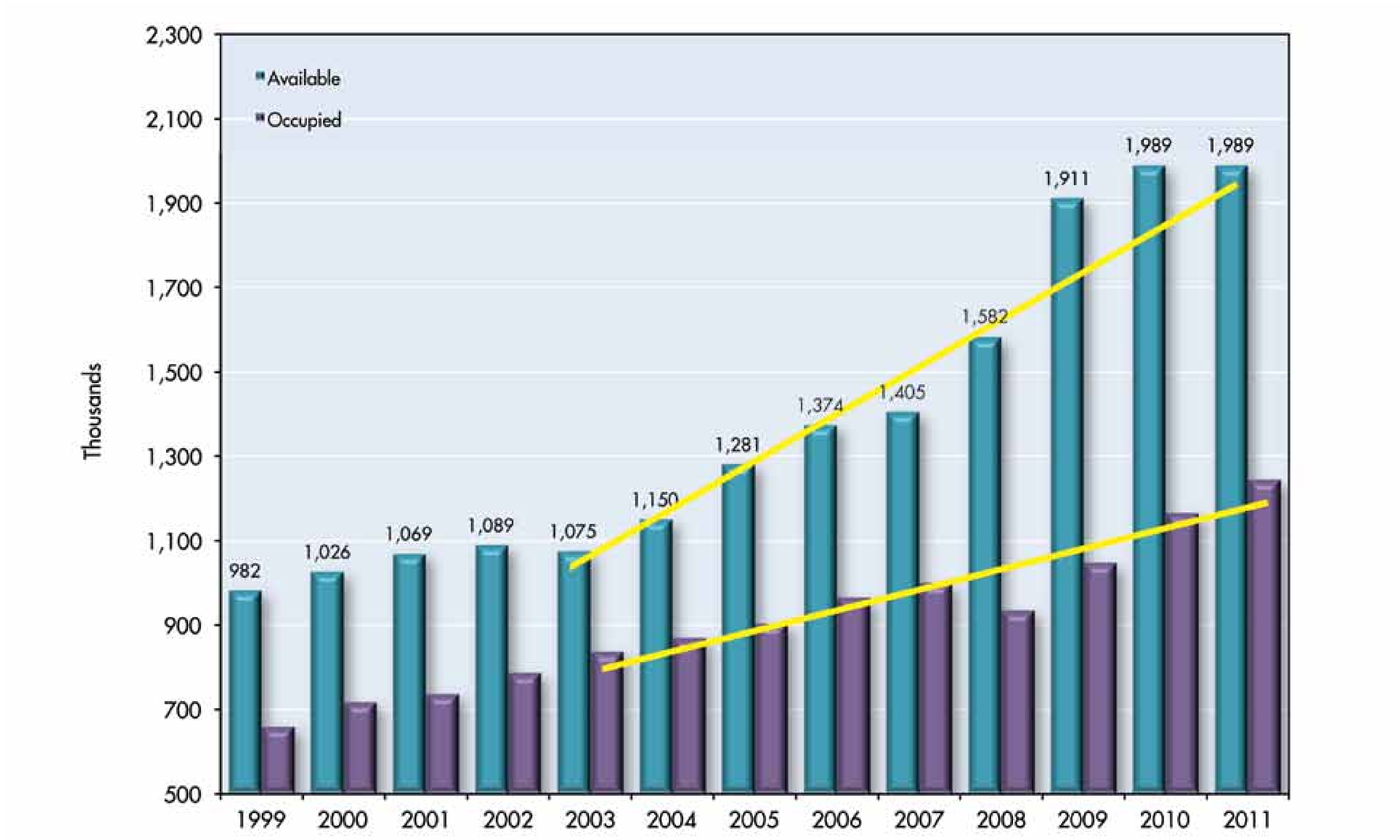
HOTEL ROOM NIGHTS IN WILLIAMSBURG MARKET: 1999-2011



Sources: Smith Travel Research Trend Reports (Dec. 27, 2007, Feb. 7, 2012) and the Old Dominion University Economic Forecasting Project

GRAPH 17

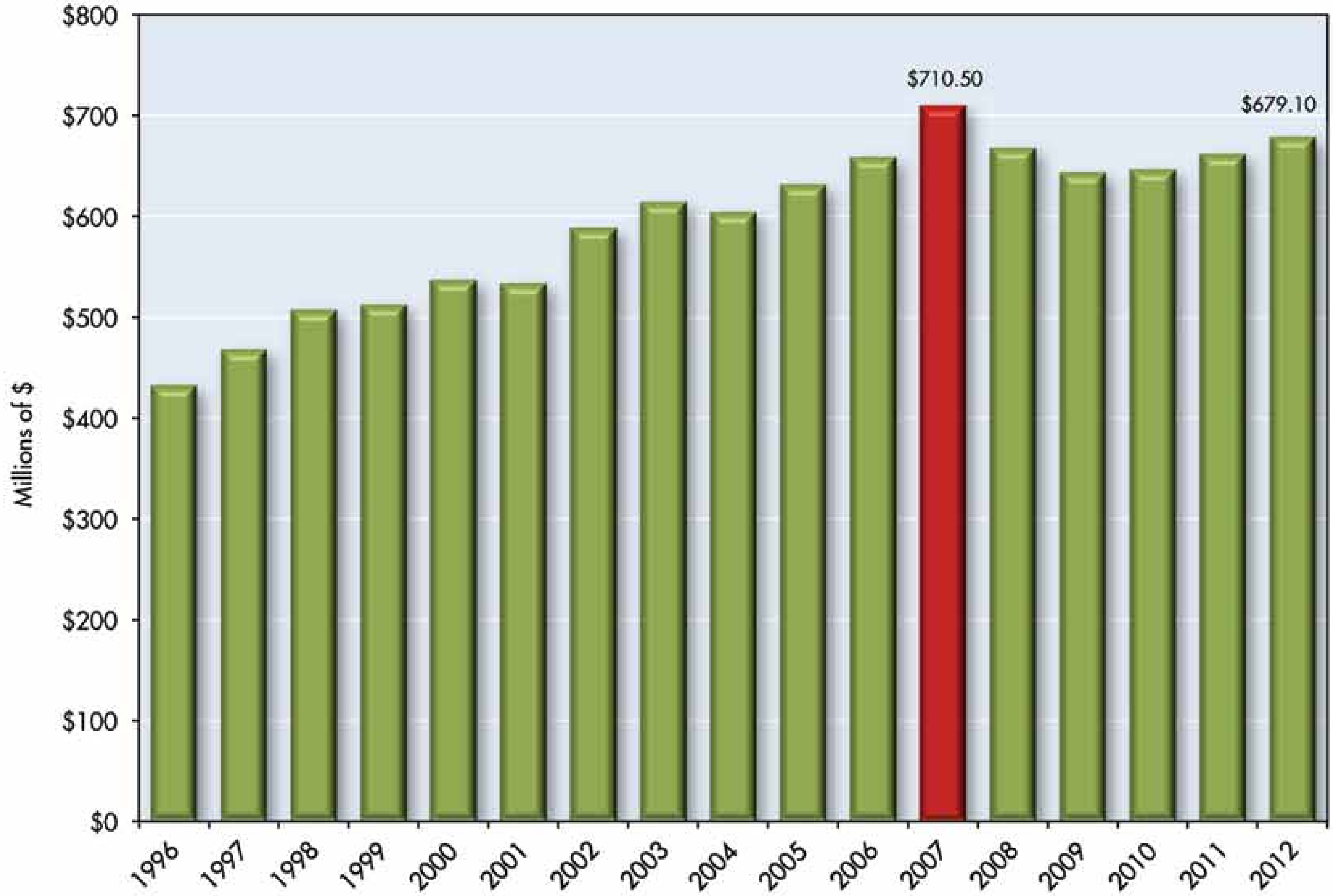
HOTEL ROOM NIGHTS IN CHESAPEAKE/SUFFOLK MARKET: 1999-2011



Sources: Smith Travel Research Trend Reports (Dec. 23, 2009, and Feb. 7, 2012) and the Old Dominion University Economic Forecasting Project

GRAPH 18

HOTEL REVENUE IN HAMPTON ROADS: 1996-2012



Sources: Smith Travel Research Trend Reports, (Dec. 27, 2007, and Feb. 7, 2012) and the Old Dominion University Economic Forecasting Project

RESIDENTIAL HOUSING

The Hampton Roads housing market – in fact our entire regional economy – historically has lagged national economic developments and usually has experienced less variability. Housing prices in Hampton Roads did not fall as quickly (or as far) as housing prices nationally after the housing market bust in 2008. Graph 19 demonstrates that relative to the peak average price in each market, housing prices have fallen 30.5 percent in the United States, but only 28 percent in Hampton Roads. Indeed, the Case-Shiller Composite Home Price Index for the 20 largest metropolitan areas in the U.S. fell almost 35 percent from its high, which occurred eight years ago in 2004 (http://www.standardandpoors.com/indices/sp-case-shiller-home-price-indices).

At long last, however, it appears that housing prices in Hampton Roads are bottoming out. Table 8 reports the median (50th percentile) sale price of existing residential homes between 2000 and 2012. We have experienced four straight years of declining prices and 2012 may add another, though of very modest size. Even so, there are indications that we are at, or near, the bottom of this pricing cycle. One indication is that there has been a gradual, though perceptible, decline in the percentage of "distressed" homes for sale in our region (see Graph 20). A distressed home is one that has been foreclosed upon, and/or is bank owned, or is subject to a financial institution doing a short sale ("Let's get the best price we can and get rid of this property and this owner.") that usually results in a sale price less than the value of the outstanding mortgage. Graph 21 reveals that distressed properties now account for a much smaller percentage of existing home sales than just a few years ago. At one of the worst points in the reeling housing market, 42.8 percent of all sales of existing residential homes in Hampton Roads involved distressed properties; however, this had fallen to 28.81 percent by mid-summer 2012. This is still a relatively high level, but the trend is positive.

Table 9, however, reveals that short sales and REOs (sales of houses that a financial institution has taken ownership of) have become increasingly important in the Hampton Roads residential housing market. Together, in 2012, we estimate that they will account for about one-third of all sales of existing homes. This may make it seem as if the housing market continues to have severe problems, but it actually is a sign of progress and an indication that the regional housing market is beginning to clear. Though short sales and REO sales are painful to those doing the selling, they represent an important way to reduce the excess housing inventory that depresses housing prices.

TABLE 8

MEDIAN SALE PRICE OF EXISTING RESIDENTIAL HOMES IN HAMPTON ROADS: 2000-2012*

Year	Median Price	Percent Change Year to Year
2000	$99,900	
2001	$109,000	9.1%
2002	$116,900	7.2%
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*	$180,000	+0.06%
2002-06		**83.8%**

Sources: Real Estate Information Network (REIN) and the Old Dominion University Economic Forecasting Project
*Information provided here is for YTD June 2012.

Measured unsold housing inventory is declining and this is one of the reasons we believe the Hampton Roads housing market is approaching its bottom. Graph 22 presents estimates of the months of supply of short sale homes and REO homes in Hampton Roads, 2007 to 2012. It's apparent that REO homes in particular are declining in number. A word of caution is merited – perhaps there still remains a good deal of "hidden inventory" held by homeowners and organizations that have not put up their properties for sale because they

TABLE 9

NUMBER OF EXISTING SHORT SALES AND REOS FOR RESIDENTIAL HOMES SOLD IN HAMPTON ROADS: 2006-2012*

Year	All Sales	Short Sales	REO Sales	Percent Short Sales	Percent REO Sales
2006	22,405	3	56	<1%	<1%
2007	19,152	40	223	<1%	1.2
2008	15,047	217	833	1.4	5.5
2009	15,849	598	2,271	3.8	14.3
2010	14,696	784	3,021	5.3	20.6
2011	15,817	1,127	4,213	7.1	26.6
2012*	8,147	791	1,773	9.7	21.8

Sources: Real Estate Information Network (REIN) and the Old Dominion University Economic Forecasting Project
*Information provided here is for YTD June 2012.
*REOs represent bank-owned homes.

have had little confidence they could sell these properties at attractive prices. This remains to be seen; however, the trend is clearly positive and is provided legitimacy by Graph 23, which estimates the inventory of all unsold residential homes in Hampton Roads (whether or not distressed) between 1996 and 2012. By our calculations, only seven-plus months of unsold residential housing inventory exists now in Hampton Roads and this is the smallest supply of unsold homes we have recorded since March 2008 (see Graph 24).

Yet another positive factor in regional housing markets is the increasing affordability of the typical home that is for sale. Table 10 presents estimates of the ratio of the monthly principal and interest on a median-priced home to the median monthly rent on a three-bedroom home. When this ratio is greater than 1.00, owning a house is relatively expensive and renting is more attractive; when it is less than 1.00, owning a house (instead of renting) is relatively inexpensive. We estimate that this "affordability ratio" has plunged to only 0.56 in 2012, suggesting that buying a home is, *ceteris paribus*, a better deal for most households than renting. In fact, owning a home is more affordable in Hampton Roads than it has been for many decades.

TABLE 10

ESTIMATED HOUSE RENTAL AND PRINCIPAL AND INTEREST FOR A HOUSE PAYMENT IN HAMPTON ROADS, 2000-2012

	Median Monthly Rent for a Three-Bedroom House	P&I Monthly for a Median House	Ratio of Monthly P&I to Rent
2000	$822	$854	0.97
2001	911	809	0.89
2002	1,037	827	0.89
2003	1,044	799	0.75
2004	1,087	971	0.89
2005	1,118	1,202	1.08
2006	1,164	1,459	1.25
2007	1,247	1,495	1.19
2008	1,236	1,447	1.17
2009	1,277	1,190	0.93
2010	1,319	1,062	0.81
2011	1,454	922	0.63
2012	1,541	868	0.56

Sources: HUD and the Old Dominion University Economic Forecasting Project

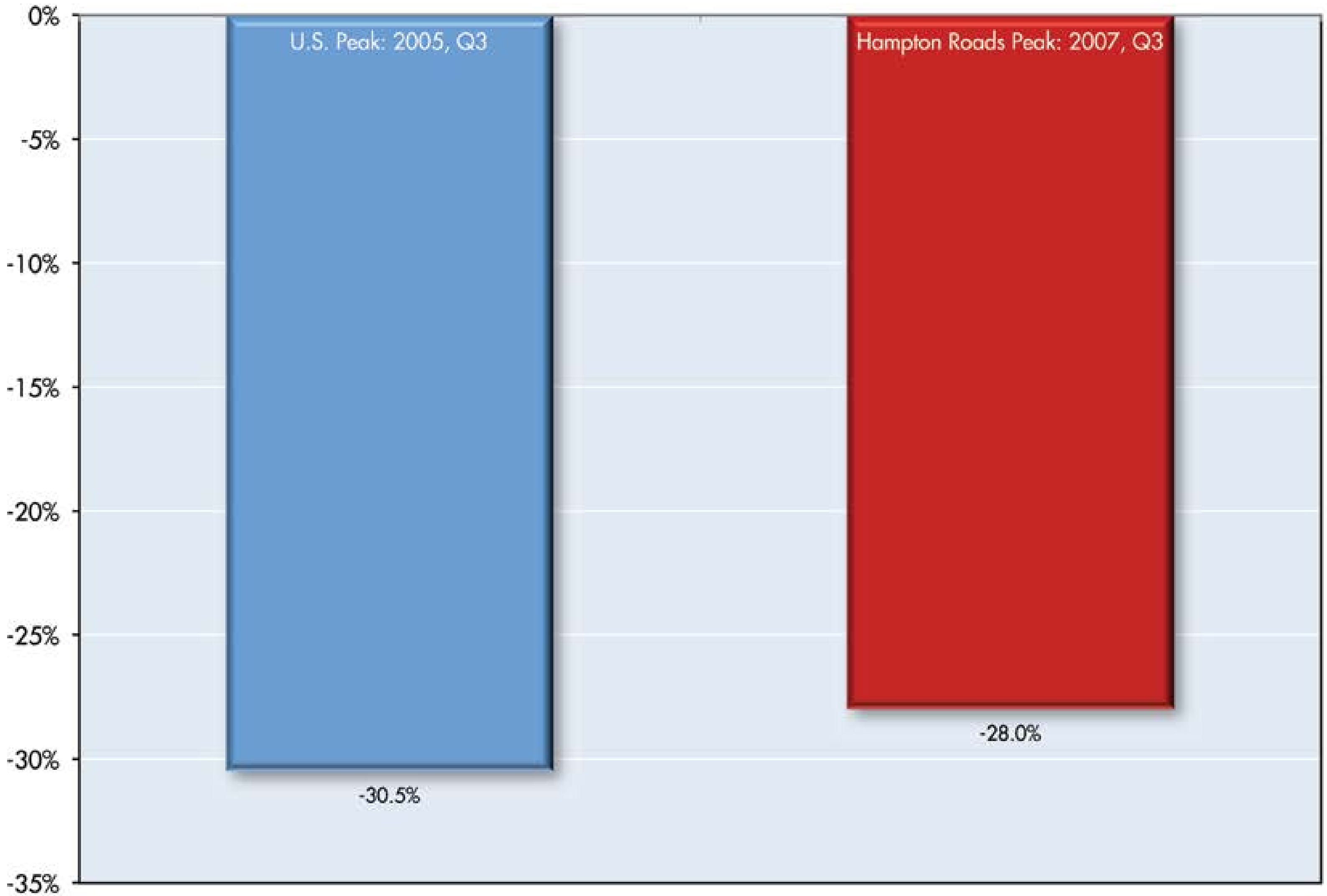
Graph 25 illustrates the increased affordability of housing in a different way by examining the monthly payment required to service a mortgage on a median-price existing home as a percentage of median household income. In Hampton Roads, in 2012, we estimate that only 17.1 percent of the median household's income now is required to service a mortgage on our median-price existing home for sale. Hence, by this measure, housing is more affordable in our region than it has been for at least 30 years. Note that lower mortgage rates are an important factor in this analysis.

If there is a problem associated with the affordability numbers, then it is that ordinarily one must have a reliable job, good credit and the consequent ability to obtain a mortgage in order to take advantage of the affordability. Financial institutions have (for good reason) increased their standards with respect to granting mortgages, and the halcyon days (for borrowers, anyway), when lenders would require minimal or even zero down payments from borrowers and did not need to see firm evidence of steady employment, have disappeared. Taking a more detached view, we are prepared to say that this is a good thing because lax lending standards led to a variety of problems and abuses that generated a housing price bubble and predictable, self-inflicted grief for financial institutions.

As a consequence, there has been a decline in the rate of homeownership nationally (see Graph 26) and also in Hampton Roads, yet nearly all economists regard the upward surge in homeownership that occurred during the past decade as unsustainable for many households, based upon their income and employment status. Thus, it was only a matter of time before reality intruded. Perhaps we now are approaching the end of a long and bitter process of coming to terms with these economic facts.

GRAPH 19

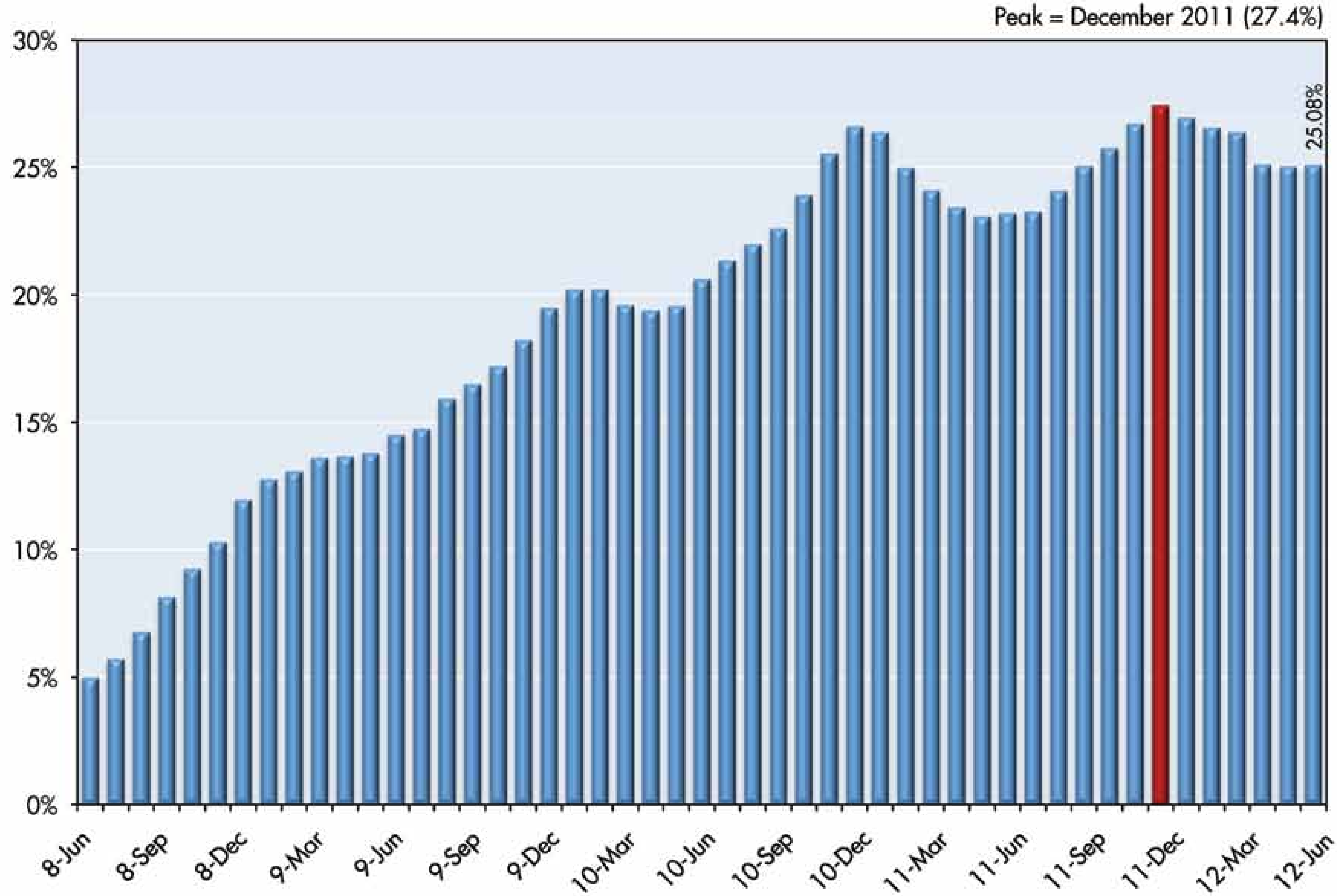
**CUMULATIVE DECLINE IN MEDIAN SINGLE-FAMILY HOUSE PRICES
QUARTER PEAK* TO 1ST QUARTER 2012 FOR EXISTING HOMES, EXCLUDING CONDOMINIUMS**



Sources: National Association of Realtors (NAR), REIN and the Old Dominion University Economic Forecasting Project
*U.S. house prices peaked in Q3 2005 (NAR); Hampton Roads in Q3 2007 (REIN).

GRAPH 20

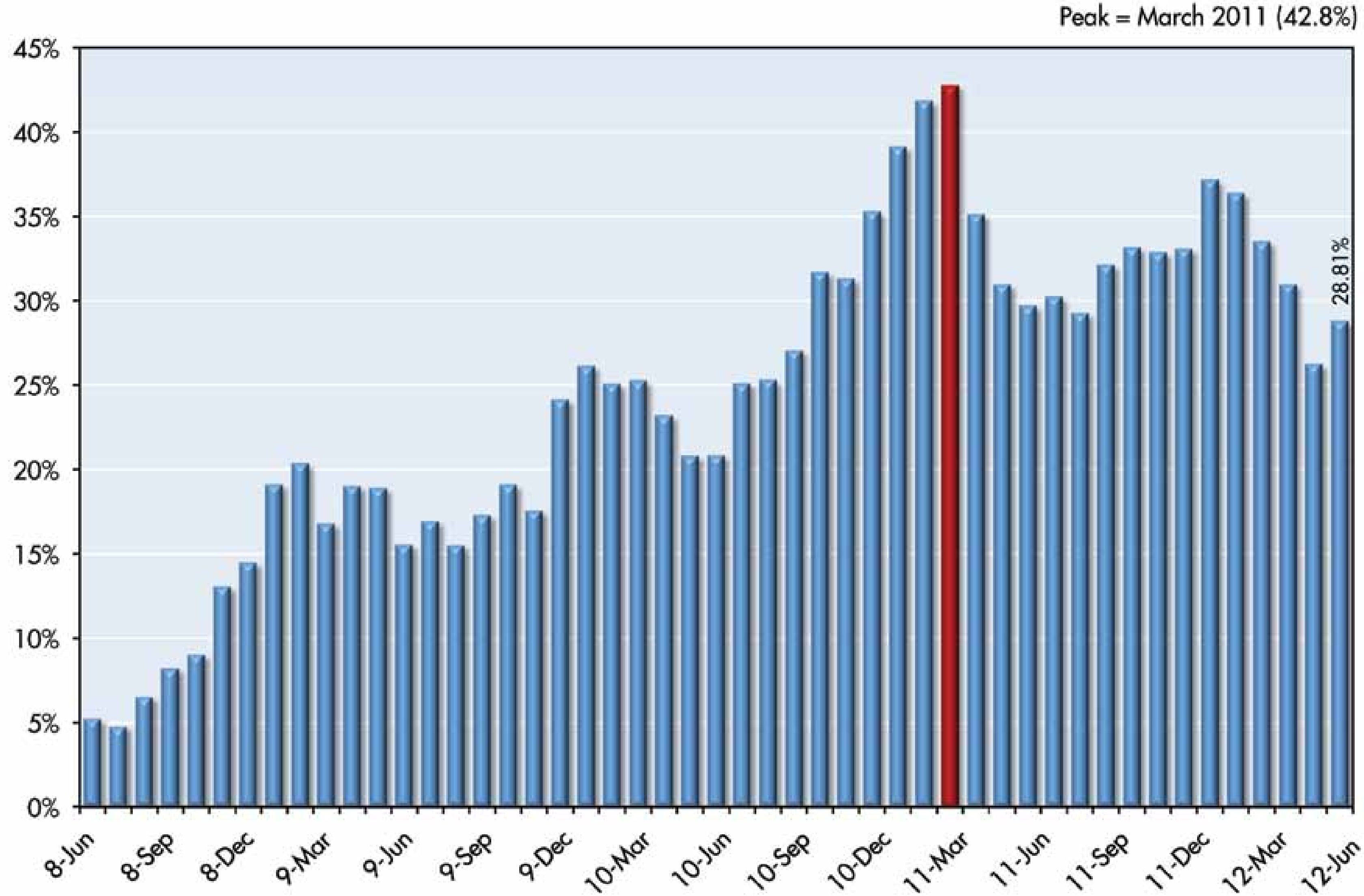
ACTIVE LISTING OF DISTRESSED HOMES (REO AND SHORT SALES) AS A PERCENTAGE OF TOTAL EXISTING RESIDENTIAL HOMES LISTINGS IN HAMPTON ROADS



Sources: Real Estate Information Network (REIN) and the Old Dominion University Economic Forecasting Project

GRAPH 21

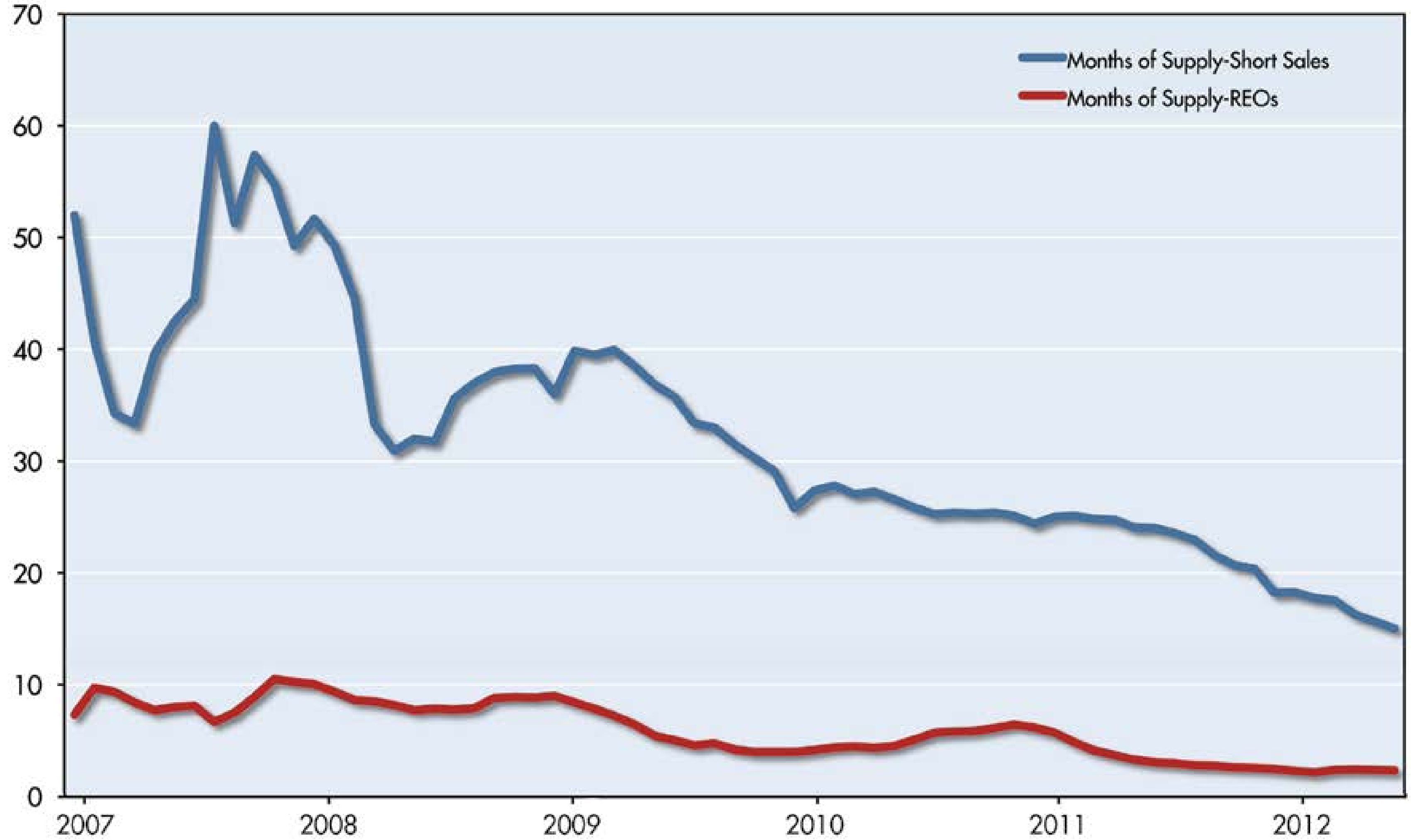
**SALE OF DISTRESSED HOMES (REO AND SHORT SALES)
AS A PERCENTAGE OF TOTAL EXISTING RESIDENTIAL HOMES SOLD IN HAMPTON ROADS**



Sources: Real Estate Information Network (REIN) and the Old Dominion University Economic Forecasting Project

GRAPH 22

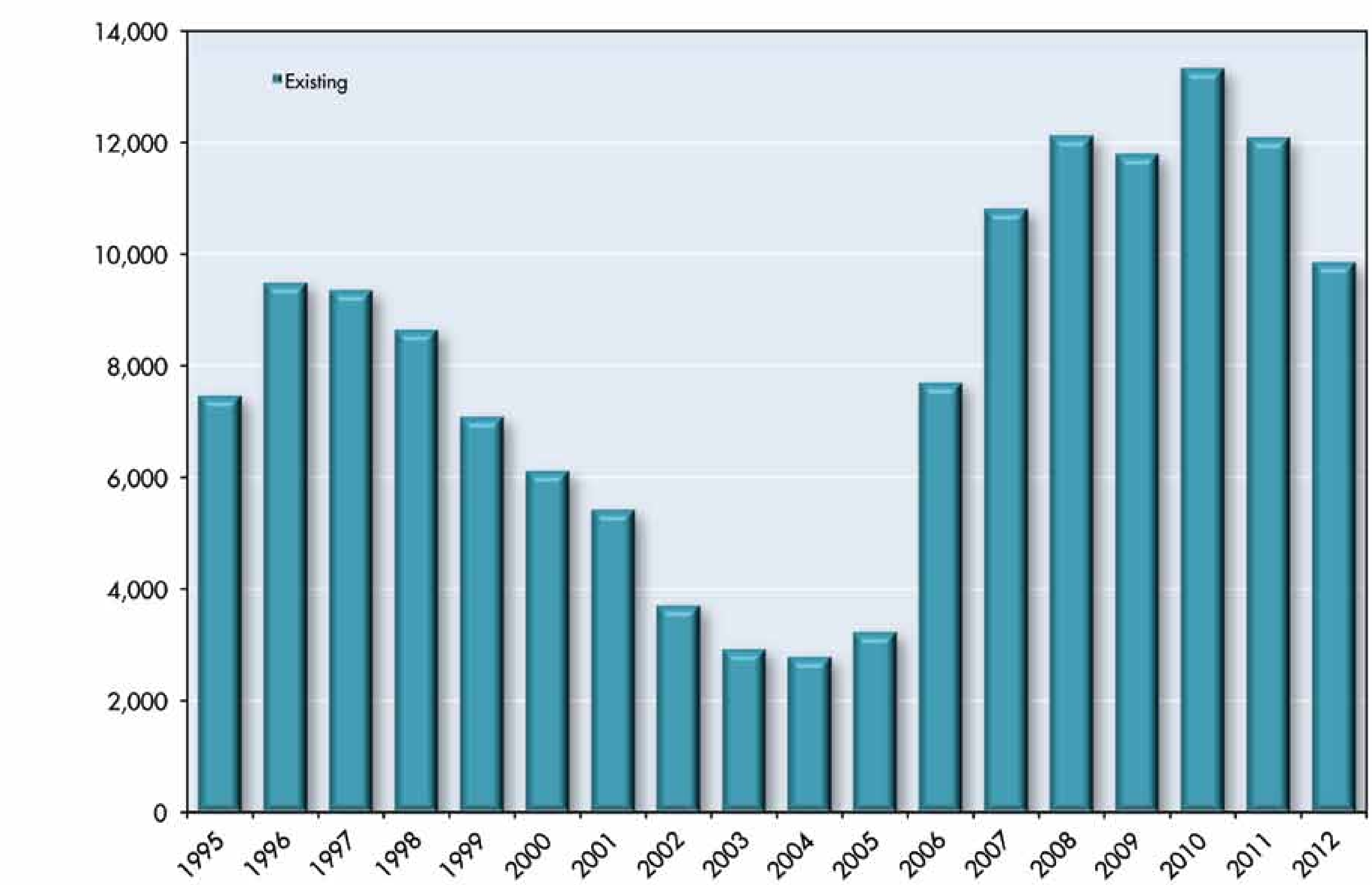
ESTIMATED MONTHS OF SUPPLY OF SHORT SALES AND REOs FOR EXISTING HOMES IN HAMPTON ROADS BASED ON AVERAGE SALES IN THE LAST 12 MONTHS: 2007-2012*



Sources: Real Estate Information Network (REIN) and the Old Dominion University Economic Forecasting Project.
*Data are through June 2012.

GRAPH 23

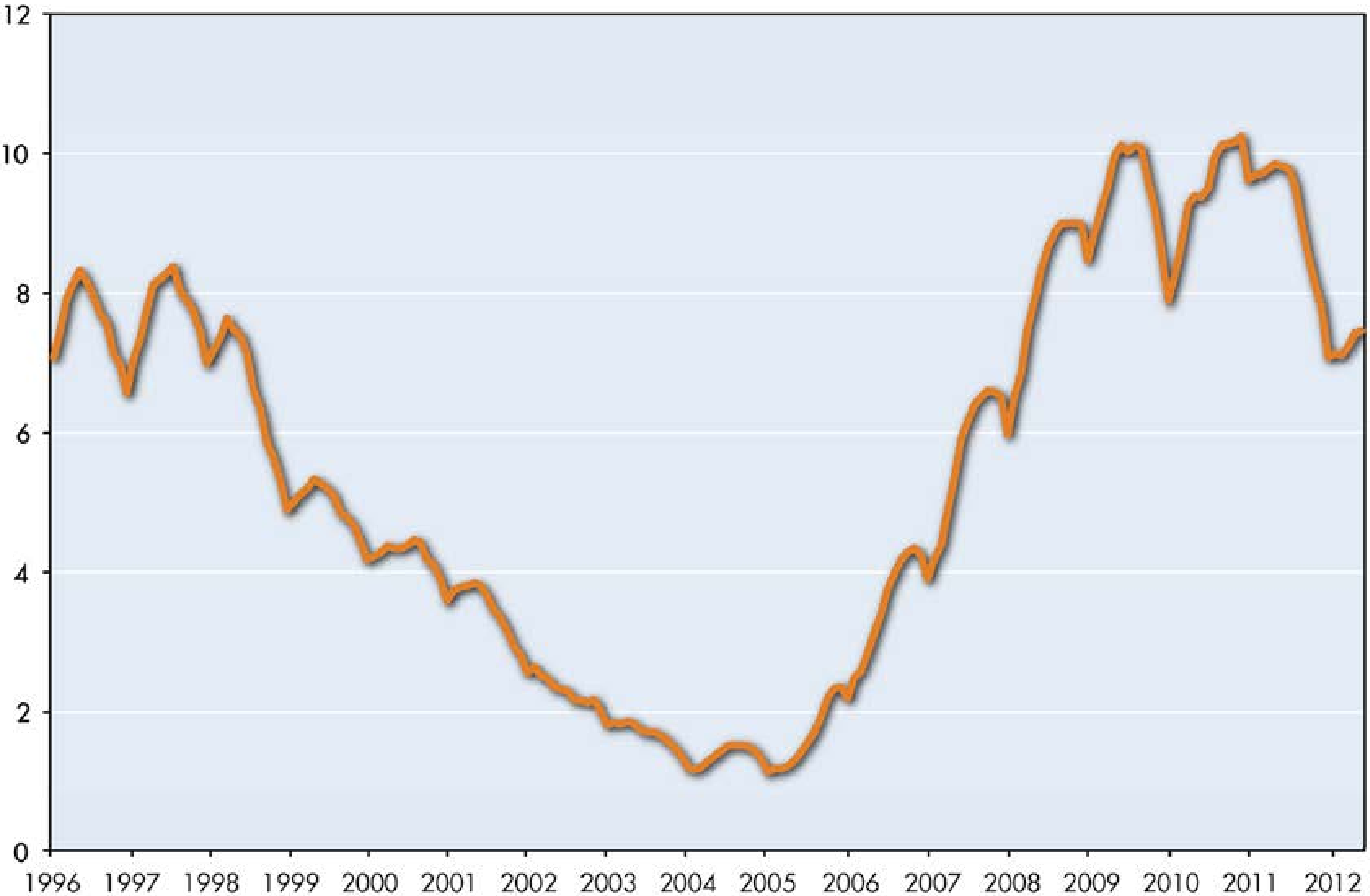
ESTIMATED INVENTORY OF EXISTING RESIDENTIAL HOMES IN HAMPTON ROADS AS MEASURED BY ACTIVE LISTINGS ON JUNE 30 OF EACH YEAR



Sources: Real Estate Information Network (REIN) and the Old Dominion University Economic Forecasting Project

GRAPH 24

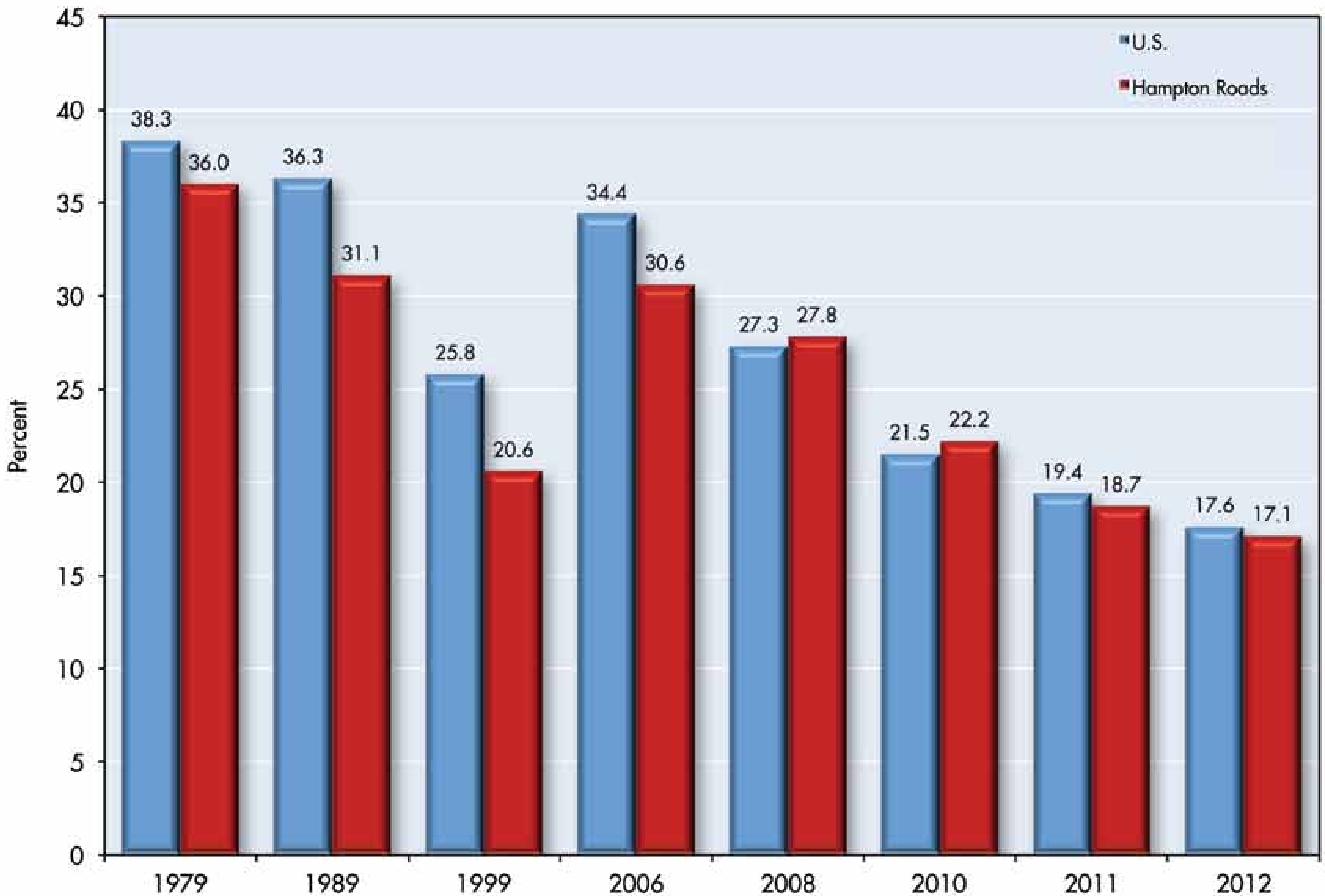
ESTIMATED MONTHS OF SUPPLY OF ALL EXISTING HOMES IN HAMPTON ROADS BASED ON AVERAGE SALES IN THE LAST 12 MONTHS: 1996-2012*



Sources: Real Estate Information Network (REIN) and the Old Dominion University Economic Forecasting Project
*Data are through June 2012.

GRAPH 25

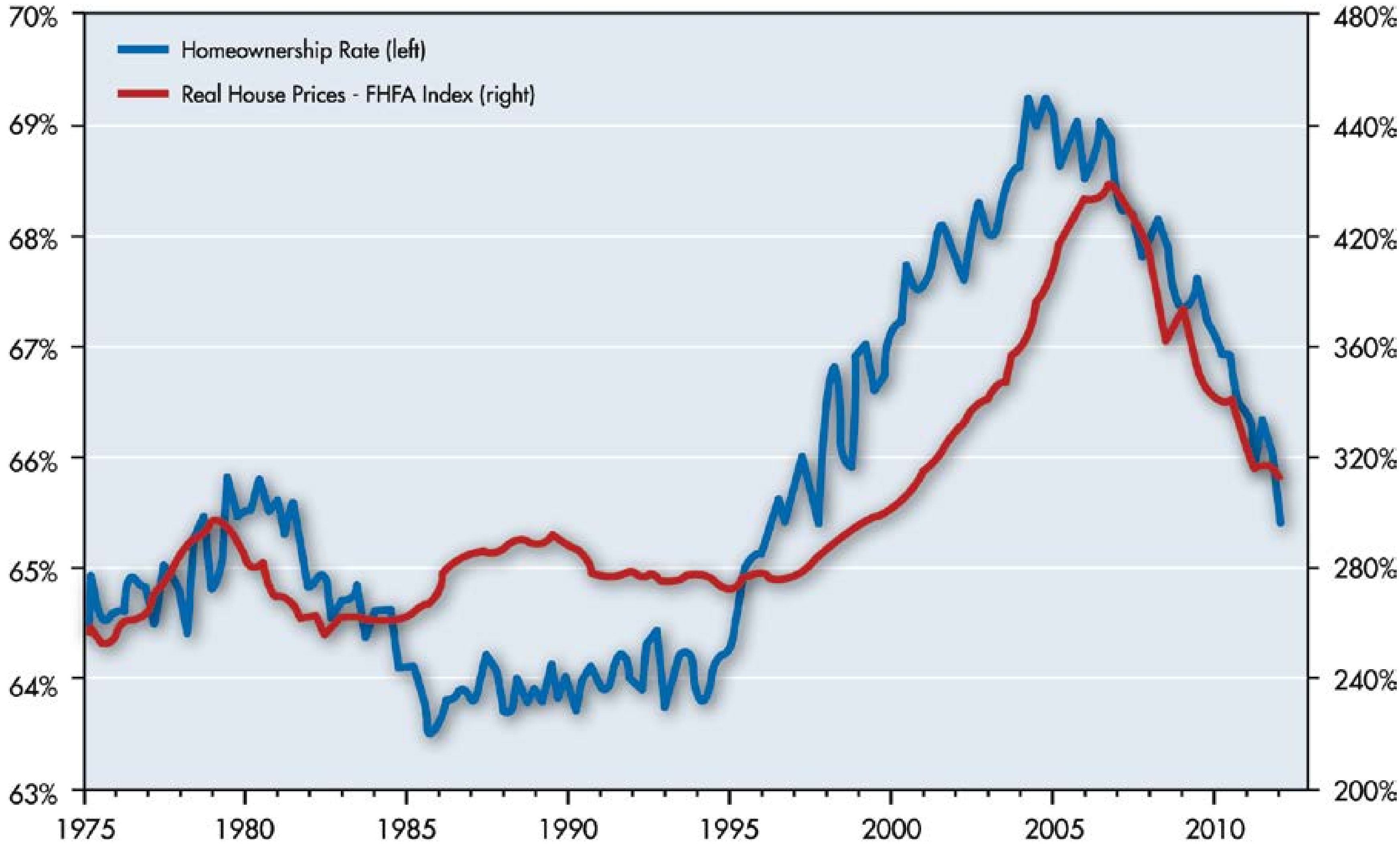
HOUSING AFFORDABILITY: MONTHLY PAYMENT FOR A MEDIAN-PRICE RESALE HOUSE AS A PERCENTAGE OF MEDIAN HOUSEHOLD MONTHLY INCOME IN HAMPTON ROADS AND THE U.S. (1979-2012)



Source: Old Dominion University Economic Forecasting Project
*Assumes 3.95 percent mean mortgage rate in 2012

GRAPH 26

HOMEOWNERSHIP RATE VS. FHFA HOUSE PRICE INDEX 1975:Q1 TO 2012:Q1



Sources: Census, FHFA, BLS
Mark Perry, Carpe Diem Blog, www.mjperry.blogspot.com, June 23, 2012

FINAL OBSERVATIONS

In 2009, 2010 and 2011, the economic analyses presented in the State of the Region report were largely pessimistic. While not all agreed with them, in retrospect, these judgments were accurate assessments of the Hampton Roads economic environment. In truth, our region has suffered visibly from the Great Recession and related developments.

Economic recovery now is visible in our region, though the conditions supporting that recovery are fragile. Stagnant or declining defense spending (a real possibility), or a European or world economic collapse, or renewed recession could derail our economic recovery.

Traditionally, the three legs on our regional economic stool have been defense spending, the port and tourism. In a nutshell, defense spending is quite likely to decelerate and this is problematic because more than 46 percent of our regional economic activity now can be attributed to defense spending. We are less diversified today in an economic sense than we have been for almost 20 years and hence we are very dependent upon defense spending for our regional economic prosperity.

The Port of Virginia has not performed nearly as well as many observers (apparently, including the governor) have expected, and Savannah has emerged as a very strong competitor. Still, at least for several years, the port will reap the benefits of the Heartland Corridor and the advantage of its own deep-draft status, and these are among several reasons why it now has an opportunity to excel.

Tourism has rebounded from its recession lows, but still lags its previous highs. Some hotel markets within the region (for example, Chesapeake/Suffolk) suffer from over-capacity of rooms, while others (the Historic Triangle) battle what appears to be a long-term decline in demand.

In the short run, most of the factors that influence our economic prosperity are beyond our own control. In the long run, the story is very different, and our region, by wisely investing in education, research and development, and transportation, can alter its economic fate. Whether we will choose to do so may be the question of this decade.