2015 hampton roads real estate market review

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General Overview

The large government presence that stabilized the local economy during recessions – even the Great Recession – was hit hard by spending caps and political inaction just as recovery in the nation’s private sector began to build steam. The Bureau of Labor Statistics reported that overall employment increased by only 1,600 jobs in 2014, and it remains 2.9% below the pre-recession peak in 2007.

The local economy grew much faster in 2014 than in 2013 (2.21% vs. 0.5%, according to the Old Dominion University Economic Forecasting Project), but the ongoing effects of 2013’s sluggish growth was felt in 2014’s office market statistics. Net overall absorption for the study set of Class A and Class B multitenant buildings of 20,000 or more square feet of rentable area; are office or, if flex, consist of all or mostly all office space; and, for market statistics, are multitenant. Because of this, market statistics published herein are not directly comparable to those published in previous years.

METHODOLOGY

The data used for this report are deemed reliable; however, neither Old Dominion University, the E. V. Williams Center for Real Estate and Economic Development, nor sponsoring companies and/or individuals makes any representation or warranty as to its accuracy. The information contained in this report was compiled from CoStar and contributions from commercial real estate professionals active in the Hampton Roads market. Additional information was obtained from the Old Dominion University’s Economic Forecast Project’s “2015 Regional Economic Forecast”, the Bureau of Labor Statistics, Moody’s Analytics November 2014-Precis Report on Hampton Roads, the “Workplace trends – office overview” report authored by JLL Research, and www.pilotonline.com.

This report surveys a select, representative inventory set of Class A and B office buildings across Hampton Roads. Buildings have 20,000 or more square feet of rentable area; are office or, if flex, consist of all or mostly all office space; and, for market statistics, are multitenant. Because of this, market statistics published herein are not directly comparable to those from other sources. Although the constancy of the building inventory set and parameters for selecting it provide a degree of consistency from year to year, significant corrections to this year’s inventory set mean that this year’s market statistics are not directly comparable to those of prior CREED market reports.

EMPLOYMENT AND ECONOMY

Sequestration stomped on the brakes of the Hampton Roads economy in 2013, when the Gross Regional Product (GRP) grew by only 0.5%, according to the 2015 Regional Economic Forecast authored by Old Dominion University’s Economic Forecasting Project. GRP growth increased to 2.2% in 2014, it remained 0.1 percentage points below growth in the national Gross Domestic Product, marking the fourth consecutive year in which the local economy grew more slowly than the national economy.

Local unemployment rates remained lower than national rates throughout both the Great Recession and the tepid recovery, holding steady at 5.0% in November and December. Total nonfarm employment in Hampton Roads averaged 754,300 during 2014, 0.2% higher than in 2013 but still 2.9% below peak years in 2007. For office-using industries (defined as the information, financial activities, professional and business services, education and health services, and government sectors), employment was 412,300 in 2014, up 1.5% from 2007 but 0.5% lower than last year. That gain has been concentrated in government (up 1.5% since 2007) and education and health services (up 19.3%), while the past seven years have seen employment declines of 3.1% in professional and business services, 8.9% in financial activities and 27.8% in information, resulting in a decline of 11,200 jobs across these three sectors. Those sectors more likely to drive office demand than more institutional education, health and government users, it is clear why recovery in this sector has lagged.

In November 2014 Moody’s Analytics ranked Hampton Roads 28th out of 392 metropolitan areas for economic risk through 2019 and 317th for projected employment growth through 2018 amid continuing concerns over the area’s dependence on defense spending at a time of federal belt-tightening. However, the budget request submitted to Congress by the Obama Administration in February 2015 includes defense spending levels $35 billion over current sequestration limits. If part or all of this spending increase is passed, this may stimulate employment growth among local defense contractors that would in turn stimulate office demand.
MARKET CONDITIONS

Modest improvements in the market during 2014 mirrored the sluggish growth in the Hampton Roads economy in 2013. Even more than in 2013, renewals drove leasing activity, and a combination of reduced demand and changes in the way tenants use office space led to more reductions in premises during either renewals or relocations. Direct vacancy rates improved by 1.0 percentage points, from 17.0% for the study set of buildings to 16.0%. Net absorption for buildings within the study set was positive at 24,551 square feet, but this was less than one-sixth of the 190,147 square feet absorbed over the previous year. Note that the study set of Class A and Class B buildings underwent some rationalization this year, with a net reduction of just under 350,000 square feet of inventory over last years, and some existing buildings moved to correct submarkets. This may distort absorption statistics, especially in smaller submarkets where changes in one building may have a disproportionate effect.)

The Peninsula saw more improvement than the Southside, with vacancy rates declining from 18.8% to 17.0%, and modest positive absorption of 50,770 square feet. In contrast, the Southside saw vacancy rates decline by only 0.8 percentage points, to 15.7%, and net absorption was negative 26,219 square feet.

Vacancy rates for Class A space were almost identical for the two clusters (13.6% Southside and 13.4% Peninsula, for 13.6% overall), but Class B vacancy was noticeably higher on the Peninsula at 20.2% versus 17.5% on the Southside, for a marketwide rate of 18.0%.

Class A large block availability remained low in 2014. There were still no large blocks available on the Peninsula, but the number of Southside large blocks of 25,000 to 50,000 square feet rose from seven in 2013 to eight in 2014, and there were three blocks of 50,000 to 100,000 square feet available at year’s end, versus only one twelve months prior.

Demand was limited in 2014, but the situation was not compounded by an increase in supply. Only two new multitenant buildings meeting study criteria (Class A or B with 20,000 or more square feet) delivered during the year – 4525 Main Street, which added 213,174 square feet of office inventory to the Pembroke / Central Business District submarket, and 5425 Discovery Park Boulevard, which added 21,200 square feet to Williamsburg/James City County. The only other completion that met criteria was Old Point National Bank’s new 42,774-square-foot building in Downtown Hampton. Projects in the pipeline will prove to be little threat this year, with only the 50,000-square-foot Convergence Center V and 25,000-square-foot Harbour View Health Center expected to deliver in 2015.
A TALE OF TWO SUBMARKETS

CONDITIONS IN TWO REPRESENTATIVE SUBMARKETS ILLUSTRATE SOME OF THE BROADER TRENDS IN THE CURRENT OFFICE MARKET.

DOWNTOWN DOLDRUMS

Even in a polycentric region such as Hampton Roads, the Downtown Norfolk CBD still carries clout, and clout comes with a price. At $25.03 per square foot, the weighted average asking rent for Class A space is second-highest among submarkets, exceeded only by Virginia Beach’s Pembrooke/Central Business District. Class B rents are also second-highest at $17.67 per square foot, behind only medical-heavy Hilltop/Oceanfront. Moreover, downtown parking costs are borne by tenants, their employees, or landlords offering parking as an incentive, whereas there is no additional cost to occupiers for parking at Town Center’s garages (and certainly not in suburban surface lots.)

Modest economic growth in Hampton Roads means tenants are more likely to be value-conscious than image-conscious. Downtown’s Class A vacancy rate rose by 1.8 percentage points to 18.2% during 2014 and, while Class B vacancy decreased 0.9 percentage points to 22.5%, this could be attributed to Downtown’s hottest trend – the conversion of older office buildings to apartments (multifamily conversion led to the removal of the 83,000-square-foot Madison Office Building from the study set this year.)

Downtown’s recovery is hampered by factors specific to the market – newer buildings, free parking and a location closer to many clients make Town Center an attractive option for those tenants looking for high-profile space – and broader trends among the kinds of occupiers that traditionally locate in the CBD. Recent research from JLL states that banks are reducing footprints by 10% when relocating, law firms are downsizing by 15% and consulting firms by 25%. Technology reduces the need for archive and library space, while working from home is both a perceived benefit for employees and a way for their employers to reduce real estate costs.

Downtown remains a desirable place to do business, and demand will improve as businesses become more confident and real growth counters pressures to reduce space. Its recovery will lag behind more value-oriented suburban submarkets, however.

LYNnhAVEN LEAPS FORWARD

If Lynnhaven lacks the status of either the traditional CBD in Downtown Norfolk or the new CBDs at Town Center and City Center at Oyster Point, it offers a proposition that’s attractive to the tenants looking for new space. The vacancy rate for Class A space is 9.7% for an identical set of buildings, down from 17.7% at the end of 2013. Class B vacancy rose from 14.2% to 15.4%, but this is due more to the allocation of two fully occupied buildings to the Little Neck submarket rather than movement out of the submarket. Reported vacant space for both classes declined by almost 60,000 square feet. And note that

Of the six largest new leases this year, four were in Lynnhaven, energizing a submarket that has had sluggish times in its past. What makes Lynnhaven attractive? Back-to-basics value, from reasonable asking rents ($18.19 per square foot for Class A space, the lowest among large Southside submarkets) to abundant free parking for staff-heavy tenants such as call centers.
OUTLOOK FOR 2015

We’re realistic this year. Changes in the economy and in the way in which occupiers use space will continue to keep improvements in the office market gradual. High-end office users will continue to want location and amenities but, with fewer employees and more of those employees working from home or at client sites, they simply will not require as much space. And despite a recovering national economy, businesses remain at best rationally exuberant and conservative about their real estate decisions. Much of the market demand in 2015 will be for lower-grade Class A or higher-grade Class B suburban space, with reasonable levels of amenities and even more reasonable rental rates.

Realistic does not mean negative, however. Although the Economic Forecasting Project does not anticipate a booming local economy this year, the changes that will occur are in the right direction. Real GRP growth is projected to be 1.96% and civilian employment is expected to increase by 0.9%. Although the sectors drive little direct office demand, rising port activity, hotel revenues and taxable sales should provide an indirect stimulus. Very slow economic growth in 2013 generated slow demand growth in 2014; increased economic growth last year should boost demand growth this year.

Businesses finally feel confident enough in a sustained and sustainable recovery to commit to expansion, and there’s substantial evidence of interest in suburban office space in that low-A to high-B band. As 2015 began, Farewell announced the addition of 170 jobs at its Claibome Building location, and several other call center users from both inside and outside the market have been looking at larger suburban spaces. In a recent meeting, a broker asked if others were seeing landlords reducing incentives and improvement allowances as the market became “tight” – and while he quickly backtracked from that specific term, the fact that a broker could even use such a term indicates that the market has moved and is moving in a direction that’s positive for landlords. There’s still a way to go, but a realistic view of 2015 incorporates an optimistic view as well.
Norfolk Commerce Park II, 5301 Robin Hood Road (Flex) ..........................126,926
OWNER OCCUPIED

Norfolk Commerce Center III, 5425 Robin Hood Road (Flex) ..................168,000
Norfolk Commerce Center I, 5505 Robin Hood Road (Flex) ....................73,000

DePaul Medical Building, 110 Kingsley Lane ..............................................39,054

TOTAL:

DePaul Health Park, 100 Kingsley Lane ..........................................................48,000
DePaul Medical Atrium, 160 Kingsley Lane ..................................................40,000

TOTAL:

Airport/Northampton

Crown Center, 580 East Main Street ..............................................................58,674

TOTAL:

Norfolk Southern Tower, 3 Commercial Place ............................................301,463
Wells Fargo Center, 440 Monticello Avenue ..................................................255,075

TOTAL Class A & B: ..................................................................................3,253,873

Atlantic Business Center, 1122 Executive Boulevard ...............................56,000

Total Class A & B: ...................................................................................583,750

Greenbrier Circle Corp Center, 825 Greenbrier Circle &
Greenbrier Tech Center II, 826 Greenbrier Circle (Flex) .........................82,340

Crossways Commerce Center, 1434 Crossways Boulevard .....................220,020

TOTAL:

Greenbrier Tower I, 860 Greenbrier Circle .......................................................87,900

TOTAL:

Independence Technology Center, 700 Independence Parkway ...............97,000

TOTAL:

QVC, 1553 North River Birch Run .................................................................50,000
Independence Technology Center, 700 Independence Parkway ..........97,000

TOTAL:

Wells Fargo Building, 225 West Brambleton Avenue ..................................38,000

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### COLISEUM CENTRAL

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### OYSTER POINT

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### SUBURBAN NEWPORT NEWS

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### OFFICE SUBMARKETS

**Southside**
- 1 Airport/ Northampton
- 2 Chesapeake Bank
- 3 Downtown Norfolk
- 4 Central Norfolk
- 5 Hilltop/Oceanfront
- 6 Corporate Landing
- 7 Kempsville

**Peninsula**
- 9 Newport News
- 10 Military Circle
- 11 Newport/Witchduck
- 12 North Suffolk
- 13 Pembroke
- 14 Portsmouth

**Virginia Beach**
- 15 Downtown Hampton
- 16 Hampton Roads \centerline{Coliseum Center}
- 17 Coliseum Center
- 18 Downtown Newport News
- 19 Newmarket
- 20 Oyster Point
- 21 Suburban Newport News
- 22 Williamsburg/James City Co.
Keith was a tough, hard-working firefighter — until he was stricken by a life-threatening, unknown illness. He arrived in critical condition. EVMS doctors worked until they achieved the impossible—a diagnosis, a successful treatment plan, and a man on the road to recovery.

You’re healthier because we’re here.