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# **CENTER FOR REAL ESTATE**

## Quarterly Report

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Volume 7, Number 1

Winter 2013

# CONTENTS

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|  |           |
|--|-----------|
| <b>Summary and Editorial</b>   | <b>2</b>  |
| <b>Central Oregon Commercial Real Estate:<br/>A Review of 2012 and Forecast for 2013</b><br>Ron Ross | <b>4</b>  |
| <b>Residential Market Analysis</b><br>Evan Abramowitz  | <b>8</b>  |
| <b>Multifamily Market Analysis</b><br>Evan Abramowitz  | <b>34</b> |
| <b>Office Market Analysis</b><br>George McCleary   | <b>41</b> |
| <b>Retail Market Analysis</b><br>George McCleary   | <b>55</b> |
| <b>Portland Industrial Market Analysis</b><br>George McCleary  | <b>62</b> |

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## SUMMARY AND EDITORIAL

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ERIC FRUITS

Editor and Adjunct Professor, Portland State University

**Ron Ross**, from Compass Commercial Real Estate Services, provides a review and forecast for Central Oregon's commercial real estate markets. He says in 2013, the industrial market should expect to see a drop in industrial vacancy rates and a slight rise in rental rates. He forecasts that retail occupancy will rise and rates will be expected to climb a bit. In the Central Oregon office market, Mr. Ross expects a one to two percent drop in vacancy and for lease rates to remain stable.

In our single family housing report, RMLS student fellow **Evan Abramowitz** reports that the market recovery continues, with improving home sales, and increasing upward pressure on prices. In the Portland metropolitan area, the median sales price continues to sputter upward to \$315,320 for new homes and \$287,000 for existing homes. Central Oregon is seeing signs of improvement, but wild swings in sales and prices from quarter-to-quarter provided little confidence in knowing how strong any recovery will be. The Willamette Valley and I-5 corridor continue to be challenged by stagnant or slightly declining prices.

In the multi-family housing report, Abramowitz finds a market that "has everything going for it." He reports that rents have increased in the U.S. by just under four percent. At 2.1 percent, Portland vacancies are among the lowest in the country.

■ Eric Fruits, Ph.D. is editor of the Center for Real Estate Quarterly Report and an adjunct professor at Portland State University. He is a managing economist with Nathan Associates Inc., a consulting firm specializing in economics, finance and statistics, [www.nathaninc.com](http://www.nathaninc.com). Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

The region continues to attract young migrants who seem hesitant to commit to homeownership. He finds that new construction continues to lag behind demand, but several new projects in the pipeline are expected in the next year.

In our commercial market report, OAR Student Fellow **George McCleary** finds a market that has improved modestly in 2012, with general economic conditions continuing a slow upward climb. Fundamentals have improved, and unemployment has dropped almost a full percent, to 7.8 percent. Vacancy is down and 100,000 square feet of space was delivered to the market, although speculative construction is still nearly nonexistent. He concludes that new space is unlikely to be developed before demand increases, forcing lease rates higher.

McCleary's retail report finds overall retail vacancy rate of 5.7 percent, up three tenths of a percentage from the same period last year. Absorption totaled 141,586 square feet for the year, and rents are up by 0.4 percent to \$15.83 per square foot. He predicts that measures are expected to improve in 2013. Mixed-use projects drove much of the retail development in 2012, and that most development was build-to-suit or owner-user oriented. Speculative retail construction remains mostly absent, save for smaller infill projects, or ground floors of apartment buildings.

In the industrial report, McCleary that fourth quarter of 2012 was the tenth straight quarter of positive absorption in the Portland industrial/flex market. It also, however, saw the lowest number of leasing deals since the third quarter of 2003. Although there is a lack of space in certain classes, lease rates are generally still not supportive of speculative construction, as has been in the case for the past four years. Developers have constructed facilities, but nearly all development has been built-to-suit. This is expected to continue in the months to come, with market fundamentals eventually arriving at levels that support speculative development.

I hope you enjoy this latest issue of the Center for Real Estate Quarterly Report and find it useful. The Report is grateful to the Oregon Association of Realtors (OAR) for their continued support. ■

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# CENTRAL OREGON COMMERCIAL REAL ESTATE: A REVIEW OF 2012 AND FORECAST FOR 2013

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RON ROSS

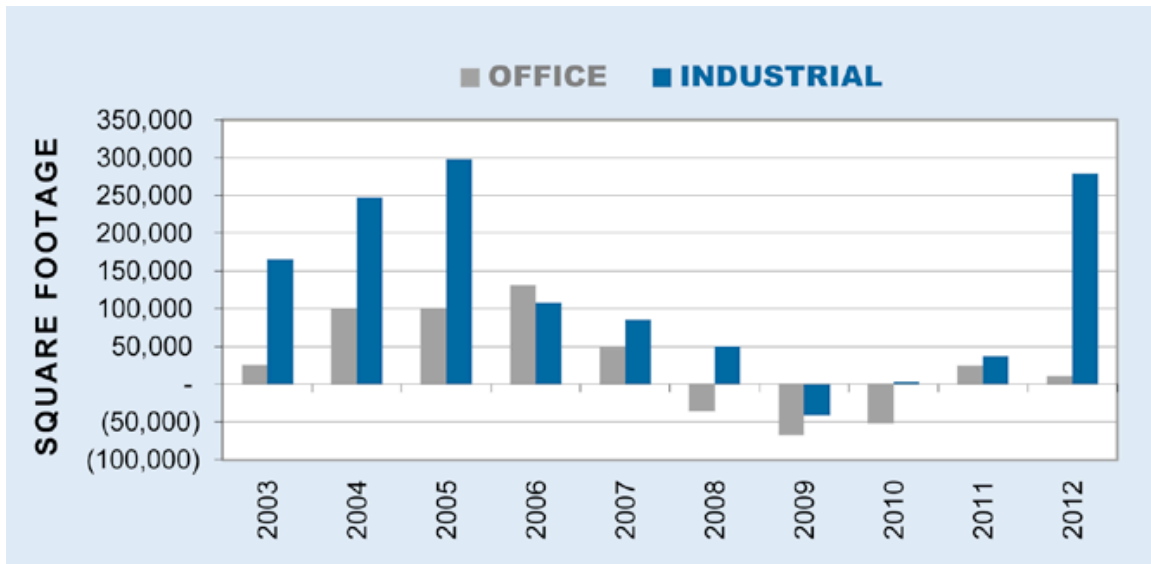
Compass Commercial Real Estate Services

For the second straight year, Central Oregon's vacancy rates in the industrial, retail and office markets all saw a drop, indicating a slow but steady recovery from the recent recession. Rental rates in the retail market held steady and in the industrial market we actually saw a slight uptick, but unfortunately our office rates are still stuck in first gear, and will probably continue in that slow mode for 2013.

The City of Bend recently announced plans for several new industrial and commercial endeavors, and we foresee at least the industrial projects commencing this year. Finally, with no change at the top in Washington D.C., we expect a sluggish, but upward regional economic rise.

The latest reports from the U.S. Commerce Department show that residential housing starts were up nationally in 2012 to the highest levels since 2008. Locally, we are also experiencing that trend. It's not hard to see this in action as you drive around Bend, particularly in NorthWest Crossing and other planned developments, where walls are going up and builders are getting busier.

■ Ron Ross, CCIM, is a principal broker at Compass Commercial Real Estate Services, and was named Realtor of the Year by the Central Oregon Association of Realtors for 2011. He can be reached at [rross@compasscommercial.com](mailto:rross@compasscommercial.com) or (541) 322-1230. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

**Figure 1: Bend office and industrial absorption by year**

Historically, commercial real estate activity follows residential movement by about a year. We are optimistic that by the end of this year, there will be less inventory and thus, more construction in the commercial sector, which was already evidenced by the lack of residential development land, REO (bank “Real Estate Owned”) properties, and quality investment grade opportunities for commercial buyers in 2012. The last year or two appeared to be the latest great land rush, with investors and solvent builders snapping up residential land developments for a fraction of the cost of the infrastructure, sometimes as low as \$10,000 – \$15,000 per finished buildable lot, when it can cost upwards of \$25,000 per lot to get to that stage.

For 2012, 11,354 square feet of office space was absorbed in Bend, compared to almost 68,000 square feet in 2011. Prior to our two years of growth we experienced three years of negative absorption in the Bend office market, so we are continuing a slow but steady upward climb. The west side submarket was the only losing submarket, recording a negative 14,646, sq. ft. while the downtown area gained 10,433 sq. ft. and the Highway 97/3rd Street submarket gained 15,567 sq. ft. of new net occupancy.

The Bend industrial market also showed positive absorption for the year with a whopping 278,477 sq. ft. in 2012. Vacancy rates for the industrial sector dropped from 16.7 percent at the end of 2011 to 9.6 percent at the end of 2012. This followed a positive year in 2011 that saw over 37,000 sq. ft. absorbed after a two year period of negative absorption and greatly surpasses the 10-year average that has typically recorded over 100,000 sq. ft. of annual positive absorption. At this rate, with just under 389,000 sq. ft. of available industrial space on the market, there is only a 17-month supply of rental space available.

Will this hot leasing activity continue in 2013? It will likely not remain as brisk, but with all indicators pointing to improved housing starts, window makers, cabinet manufacturers, plumbers and electricians may be looking for more industrial square footage to expand their businesses.

The southeast and northeast submarkets recorded the majority of the net positive absorption of nearly 235,000 sq. ft., while the central area showed a gain of over 44,000 sq. ft. and the and west side again recorded slight negative absorption of 218 sq. ft.

Redmond's industrial market finally recorded a gain in 2012, after two years of negative net absorption, recording 36,489 sq. ft. of positive absorption, which is above Redmond's 10-year average of 29,000 sq. ft. of positive absorption. But putting that in terms of supply, there is a nearly 10-year inventory of available industrial space in Redmond, not a pleasant outlook for landlords.

## **OFFICE MARKET REVIEW**

Again in 2012, and for the fifth year in a row in Bend, no significant new construction of office buildings was added to the inventory available for rent. For those of you keeping score, however, the additional 116,985 sq. ft. on our survey in 2012 was mainly the result of investor purchases from owner/users (or banks) that now qualify for inclusion, and an adjustment of some of the data obtained by our survey collectors. Our 2012 prediction of new office projects popping up in the next year or two will most likely be the latter time frame, even though there were some significant commercial land purchases this past year, as those buyers were mainly speculators sitting on cash and finding great bargains. We doubt any of those savvy developers would start an office project in 2013 with a 21 percent vacancy rate except those who procure tenants prior to starting construction. Our wish of a reduction in inventory with resulting vacancy rate decreases and rising rental rates did not materialize, but we hope to have better news at the end of this coming year.

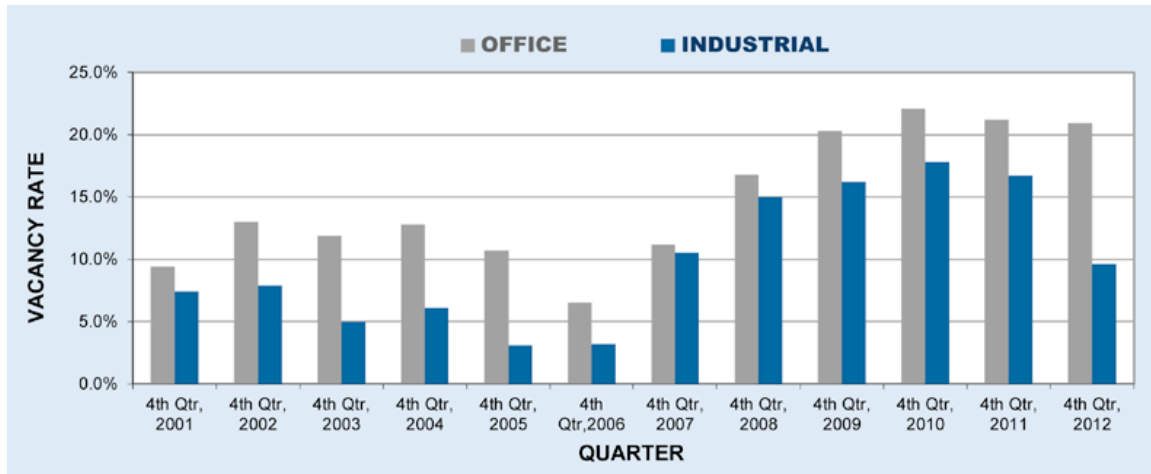
Look for another year of low office rental rates and enticing landlord incentives until the vacancy rate improves.

## **INDUSTRIAL MARKET REVIEW**

At the end of 2011 we predicted that "there will again be improvement in the vacancy rates, possibly down to 15 percent, as little or no construction is slated for the year, and evidence of job creation is afoot, with falling unemployment rates and talk of new industry popping up in the area. Lease rates should stay level for the year."

Happily, we erred on the side of conservatism, as our end of year industrial vacancy rate of 9.6 percent dropped precipitously from the previous end of year 2011 rate of 16.7 percent. Lease rates did stay steady in 2012 but should be on the rise, and several new industrial projects are on the books for 2013.



**Figure 2: Bend office and industrial vacancy by year**

## RETAIL MARKET REVIEW

The retail sector in Bend continues to shine. Our tourist based industry remains a model for other mid-sized MSAs (Metropolitan Statistical Areas), with recreation, sporting goods, restaurants and brew pubs the shining industries. Rents are on the upswing after several years of landlord concessions. The vacancy rate of 8.0 percent is the lowest since the second quarter of 2008 when we recorded a 6.8 percent figure. Since then, retail rates have been as high as 13.2 percent, recorded at the end of Q1 2009, and have fallen steadily since.

Several vacant downtown restaurant locations are backfilling, with rising rents and good stable operators moving into the previously dark spaces.

## OUR PREDICTION FOR 2013

In 2013, expect to see a continued drop in industrial vacancy rates, two or three new buildings on the survey, and a slight rise in rental rates of between \$0.40 and \$0.45 per sq. ft.

The retail occupancy will also rise as consumer confidence gets stronger and tourism remains good. Retail rates should also continue to climb a bit.

We do expect a better office market, but that will depend on businesses feeling confident enough to expand, hire and absorb larger office spaces. We look for a one to two percent drop in vacancy and lease rates remaining stable. ■

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## RESIDENTIAL MARKET ANALYSIS

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EVAN ABRAMOWITZ

RMLS Student Fellow

Master of Real Estate Development Graduate Student

Existing-home sales continued to improve in November with low inventory supply pressuring home prices, according to the National Association of Realtors.

Total existing homes sales, which are completed transactions that include single-family homes, townhomes, condominiums and co-ops, rose 5.9 percent to a seasonally adjusted annual rate of 5.04 million in November from a downwardly revised 4.76 million in October, and are 14.5 percent higher than the 4.40 million-unit pace in November 2011. Sales are at the highest level since November 2009 when the annual pace spiked at 5.44 million.

Lawrence Yun, NAR chief economist, said there is healthy market demand. “Momentum continues to build in the housing market from growing jobs and a bursting out of household formation,” he said. “With lower rental vacancy rates and rising rents, combined with still historically favorable affordability conditions, more people are buying homes. Areas impacted by Hurricane Sandy show storm-related disruptions but overall activity in the Northeast is up, offset by gains in unaffected areas.”

■ Evan Abramowitz is a multifamily investment specialist with Joseph Bernard LLC Investment Real Estate. He is currently working towards the Master of Real Estate Development degree through Portland State University’s School of Business where he is an RMLS Student Fellow. Any errors or omissions are the author’s responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

The national median existing-home price for all housing types was \$180,600 in November, up 10.1 percent from November 2011. This is the ninth consecutive monthly year-over-year price gain, which last occurred from September 2005 to May 2006.

Single-family home sales increased 5.5 percent to a seasonally adjusted annual rate of 4.44 million in November

from 4.21 million in October, and are 12.4 percent higher than the 3.95 million-unit level in November 2011. The median existing single-family home price was \$180,600 in November, up 10.1 percent from a year ago.

Existing condominium and co-op sales increased 9.1 percent to a seasonally adjusted annual rate of 600,000 in November, and are 33.3 percent above the 450,000-unit pace a year ago. The median existing condo price was \$181,000 in November, which is 10.6 percent higher than November 2011.

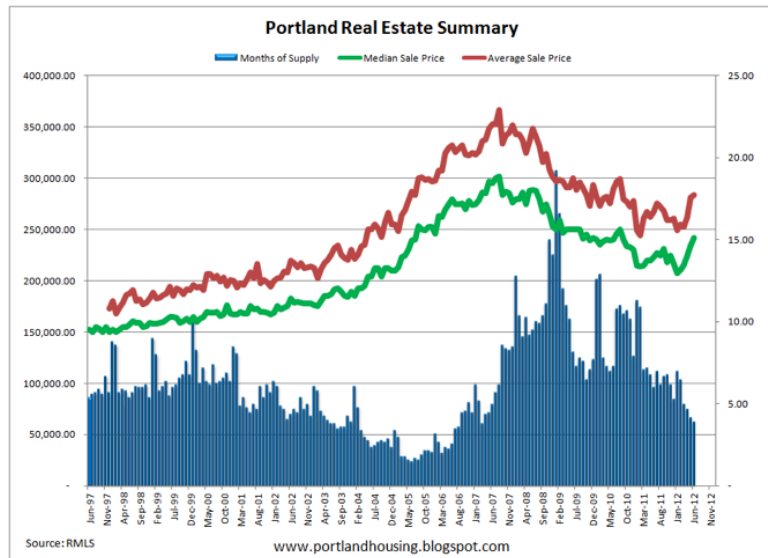
Regionally, existing-home sales in the Northeast increased 6.9 percent to an annual level of 620,000 in November and are 14.8 percent above November 2011. The median price in the Northeast was \$232,900, down 2.0 percent from a year ago.

Existing-home sales in the Midwest increased 7.2 percent in November to a pace of 1.19 million but are 21.4 percent higher than a year ago. The median price in the Midwest was \$141,600, up 7.0 percent from November 2011.

In the South, existing-home sales increased 7.9 percent to an annual level of 2.04 million in September and are 17.2 percent above November 2011. The median price in the region was \$157,400, up 10.5 percent from a year ago.

Existing-home sales in the West rose 0.8 percent to an annual pace of 1.19 million in November and are 4.4 percent above a year ago. With continuing inventory shortages in the region, the median price in the West was \$248,300, which is 23.9 percent higher than November 2011.

Mortgage interest rates had been steadily decreasing since the first quarter of 2011 and are now at nearly 60-year lows. The national average commitment rate for a 30-year conventional, fixed-rate mortgage was 3.34 percent in January, down from 3.68 percent in June; the rate was 4.55 percent in July 2011.



First time homebuyers constituted 30 percent of homes in November, down from 31 percent in October. They were 35 percent in November 2011. Investors purchased 19 percent of homes in November, which was unchanged from November 2011.

### Median Home Values of Existing Detached Homes

|  | U.S.      | West      | Portland<br>Metro Area |
|--|-----------|-----------|------------------------|
| November 2011 Median Sales Price               | \$164,000 | \$200,400 | \$223,900              |
| November 2012 Median Sales Price               | \$180,600 | \$248,300 | \$241,000              |
| % Change in Median Sales Price                 | 10.1%     | 23.9%     | 7.1%                   |
| % Change in Number of Sales Nov 2011- Nov 2012 | 14.5%     | 4.4%      | 13.9%                  |

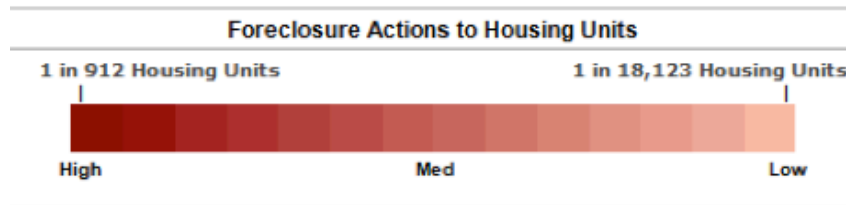
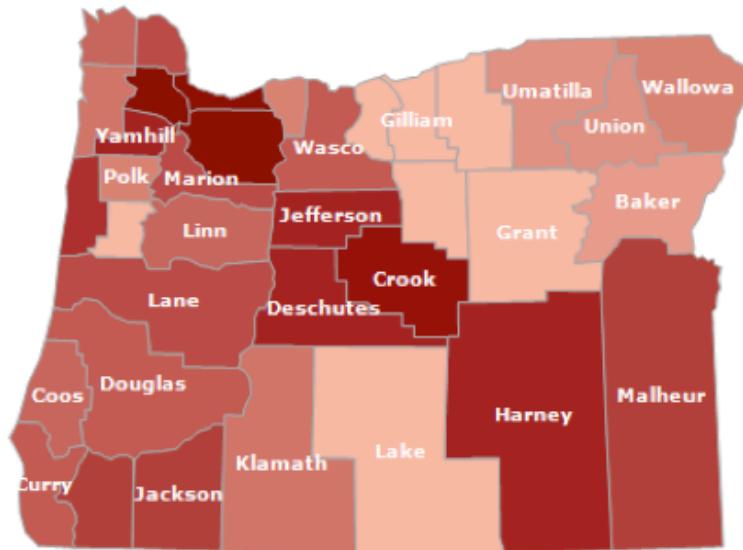
Standard & Poor's Case-Shiller Index for was 146.08 through October 2012. The represents a decrease of 0.1 percent from September 2012, and a year-over-year increase of 4.30 percent. Portland was at 142.44 in October, which is an 0.9 percent increase from September, and up 5.2 percent compared to the same time last year. The index data shows that in October 12 of the 20 major U.S. metropolitan cities, home prices declined from the previous month, 7 including Portland increased, and Denver remained unchanged.

Foreclosure filings were reported on 531,576 U.S. properties during the quarter, a decrease of 5 percent from the second quarter and a decrease of 13 percent from the third quarter of 2011—the ninth consecutive quarter with an annual decrease in foreclosure activity. This was the lowest total since 2007. The report also shows one in every 248 U.S. housing units with a foreclosure filing during the quarter.

“We’ve been waiting for the other foreclosure shoe to drop since late 2010, when questionable foreclosure practices slowed activity to a crawl in many areas, but that other shoe is instead being carefully lowered to the floor and therefore making little noise in the housing market—at least at a national level,” said Daren Blomquist, vice president at RealtyTrac. “Make no mistake, however, the other shoe is dropping quite loudly in certain states, primarily those where foreclosure activity was held back the most last year.

“Meanwhile, several states where the foreclosure flow was not so dammed up last year could see a roller-coaster pattern in foreclosure activity going forward because of recent legislation or court rulings that substantively change the rules to properly foreclose,” Blomquist added. “A backlog of delayed foreclosures will likely build up in those states as lenders adjust to the new rules, with many of those delayed foreclosures eventually hitting down the road.”

During September 2012 Oregon reported 969 foreclosure filings. Multnomah County had the state’s highest level of activity in September 2012 with 275 homes. In the U.S., one in every 730 homes received a foreclosure filing while one in every 1,729 homes in Oregon received a foreclosure filing during September 2012.



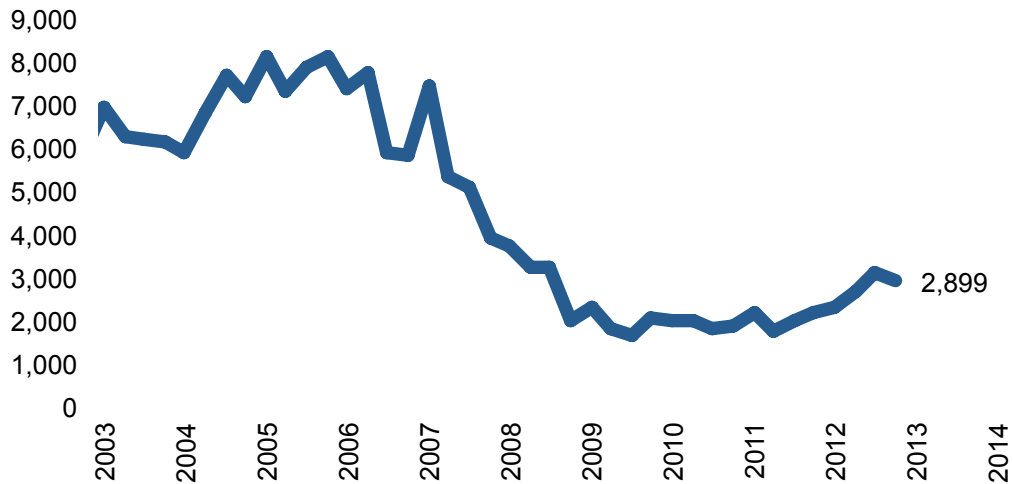
Source: RealtyTrac

According to RealtyTrac, the ten states that ranked the highest in foreclosure rates in September 2012 were Florida, Arizona, California, Illinois, Georgia, Nevada, Ohio, Michigan, South Carolina, and Colorado. Of these states, Florida posted the nation’s highest state foreclosure rate, with one in every 117 housing units receiving a foreclosure filing in September 2012, more than twice the national average and the first time Florida has lead the rankings since April 2005. In Arizona one in every 125 housing units and in California one in every 125 housing units filed for foreclosure during September 2012.

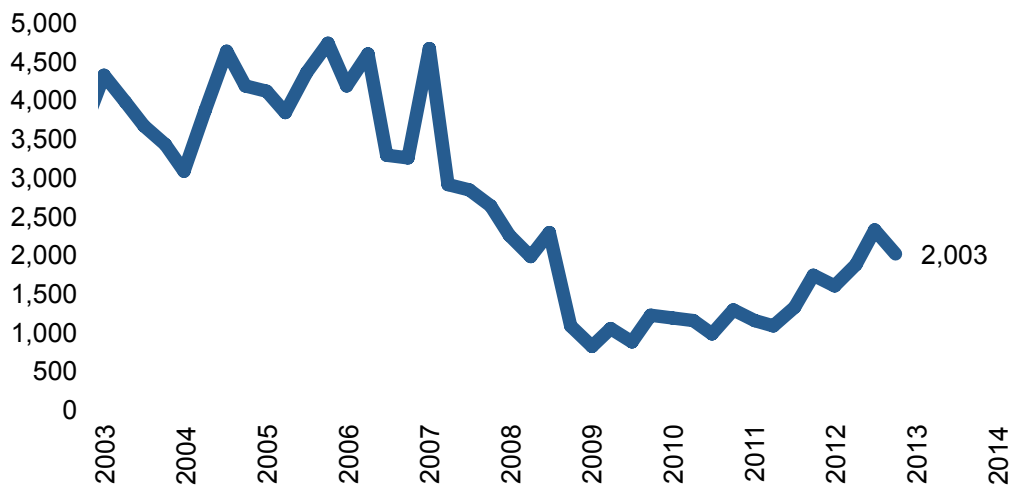
Single family building permits have increased sharply thus far in 2012 in the US and Oregon. With the exception of Eugene, the state and all major Oregon markets increased more than the US average for single-family with Corvallis increasing 70 percent over this time last year. Portland had over 136,000 more permits than

the same time last year and all major Oregon markets increasing. Multifamily new construction has increased sharply in the US and even more in Oregon. Portland increased by 69 percent with over 3,000 units built in the metro area from January-November 2012. Multifamily development returned to Bend after almost zero building in 2011, and posted a 2,900 percent increase.

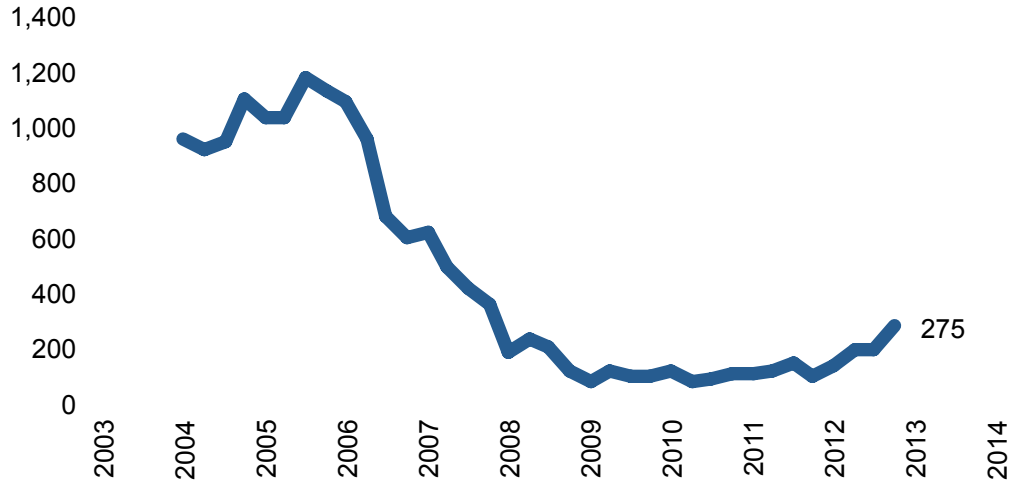
**Building permits for new private housing  
Oregon, statewide**



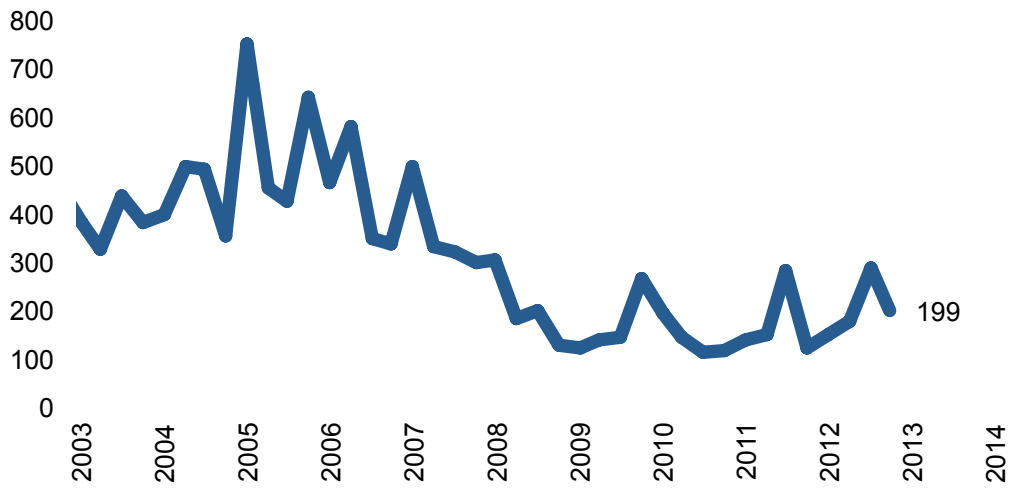
**Building permits for new private housing  
Portland-Vancouver-Beaverton MSA**



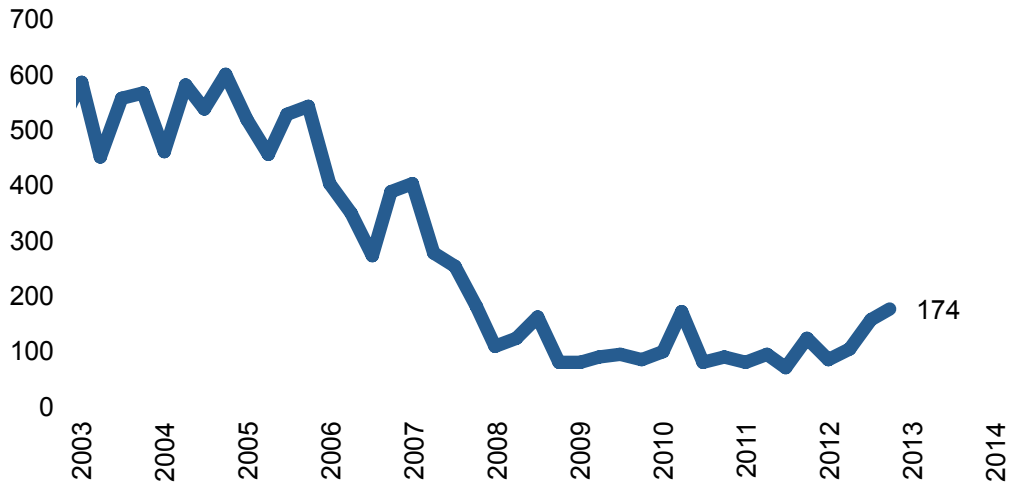
### Building permits for new private housing Bend



### Building permits for new private housing Eugene-Springfield



### Building permits for new private housing Medford



## PORTLAND

Buyers closed on purchases of 4,279 homes. The number of transactions in fourth quarter 2012 decreased 3.34 percent from last quarter, but increased 48.94 percent annually. Median prices for the first quarter were at \$287,000 which represents an 7.1 percent increase over the previous quarter and a 9.9 percent increase annually.

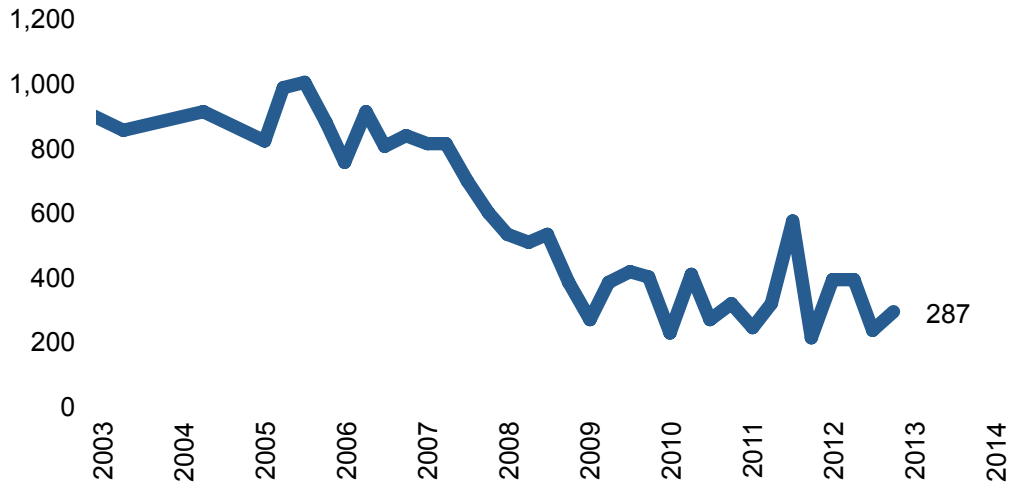
The data comparing sales price to list price cooled a bit from its red hot performance last quarter and number of days on the market increased slightly as well. Properties sold at an average price of 98.3 percent of the original list price. Sellers in the Portland area have had their homes on the market for an average of 40 days before closing, which is 21 percent longer than the previous quarter but 27 percent shorter than fourth quarter 2011.

There were 287 new properties sold, compared to 231 in third quarter, and a 38 percent increase from fourth quarter 2011. The new properties sold at a median price of \$315,320 which was a 3.3 percent increase from third quarter. New home prices increased from fourth quarter 2011 by 5.3 percent.

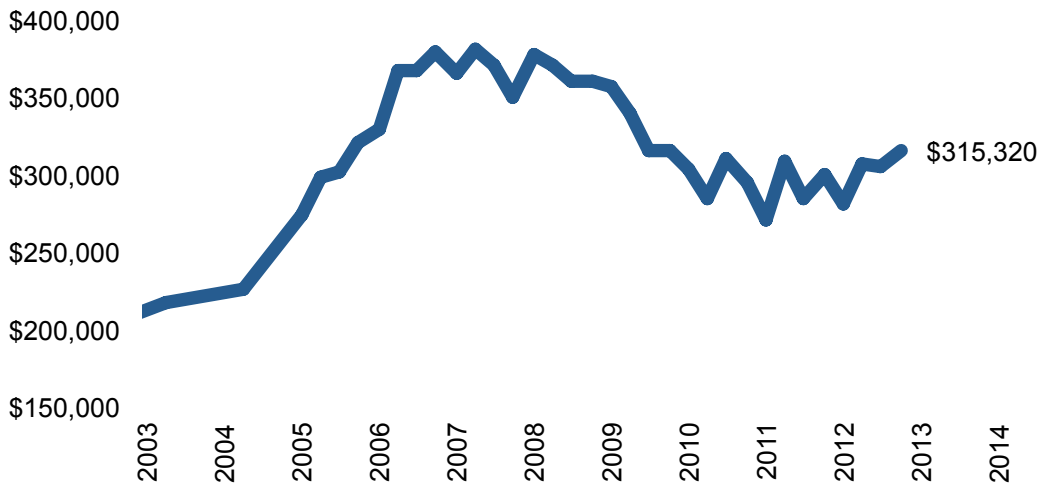
Tigard / Wilsonville submarket had the largest annual increase of 18 percent from fourth quarter 2011. NE Portland also increased by 17.6 percent over the same period. NW Washington was the only submarket that experienced annual depreciation at -3.88 percent.



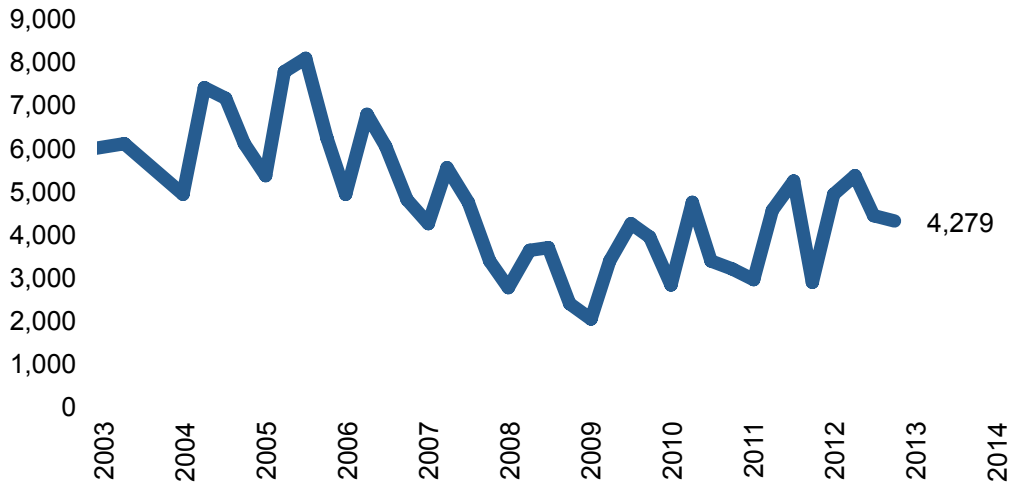
**Number of transactions**  
**Portland metro, new detached homes**



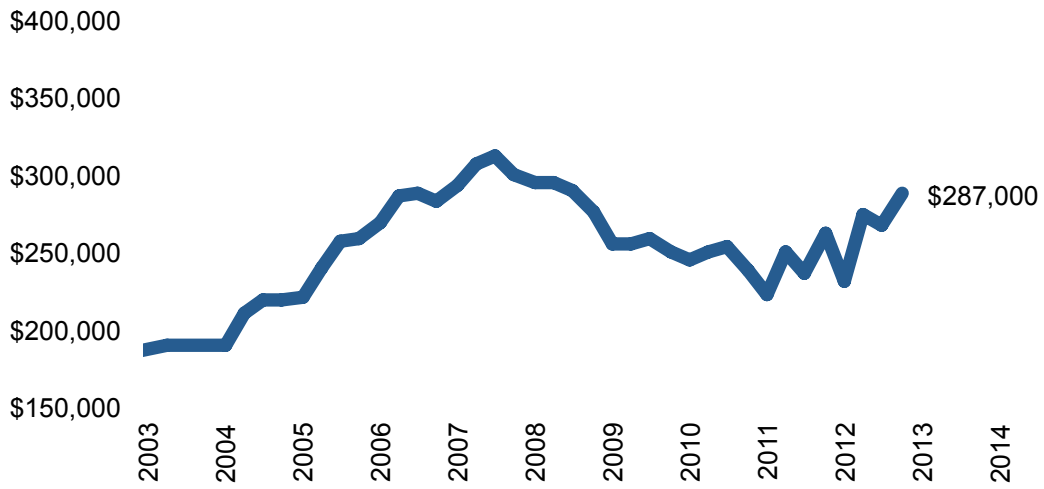
**Median sales price**  
**Portland metro, new homes**



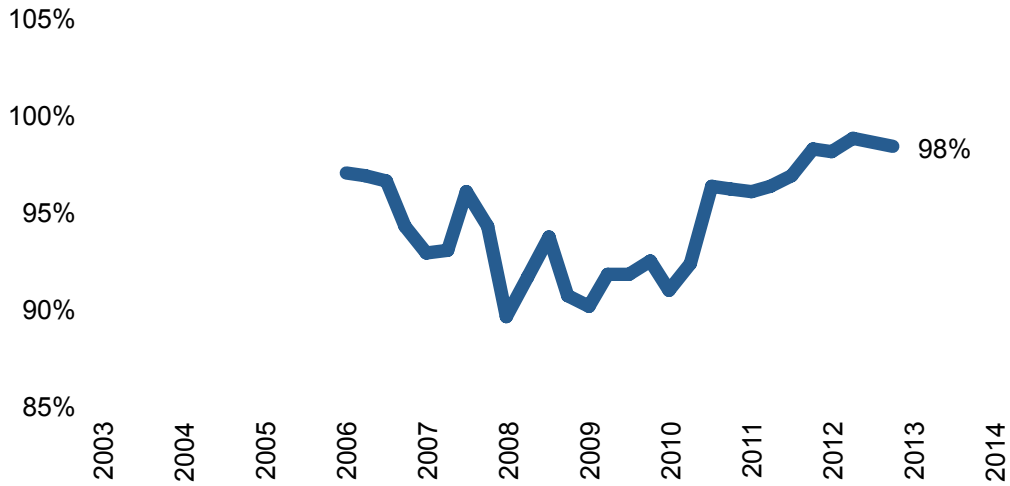
**Number of transactions**  
**Portland metro, existing homes**



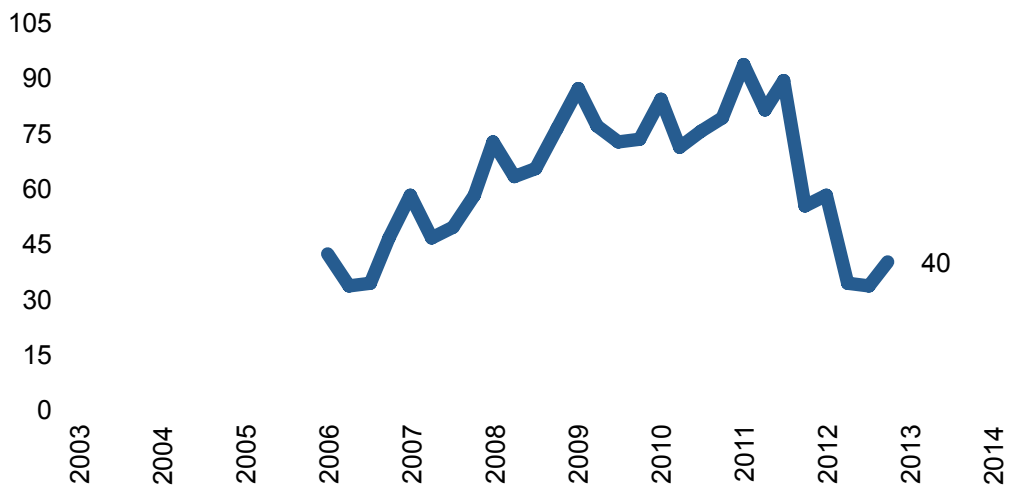
**Median sales price**  
**Portland metro, existing homes**



**Ratio of sales price to list price  
Portland metro, existing homes**



**Days on market  
Portland metro, existing homes**



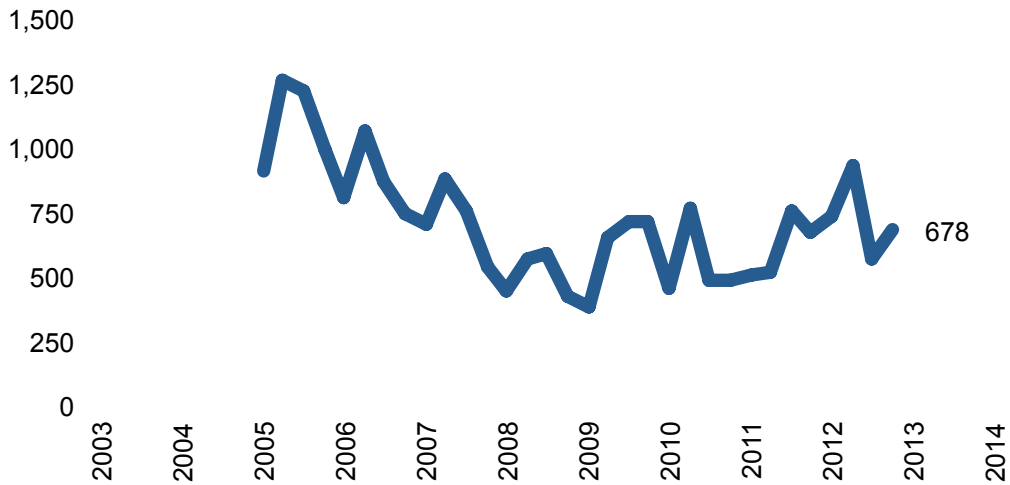
**VANCOUVER**

Vancouver’s median home price during fourth quarter 2012 was \$206,000, a 7 percent increase from third quarter 2012 when it was \$192,500. The number of homes sold in fourth quarter was relatively unchanged from the third quarter of

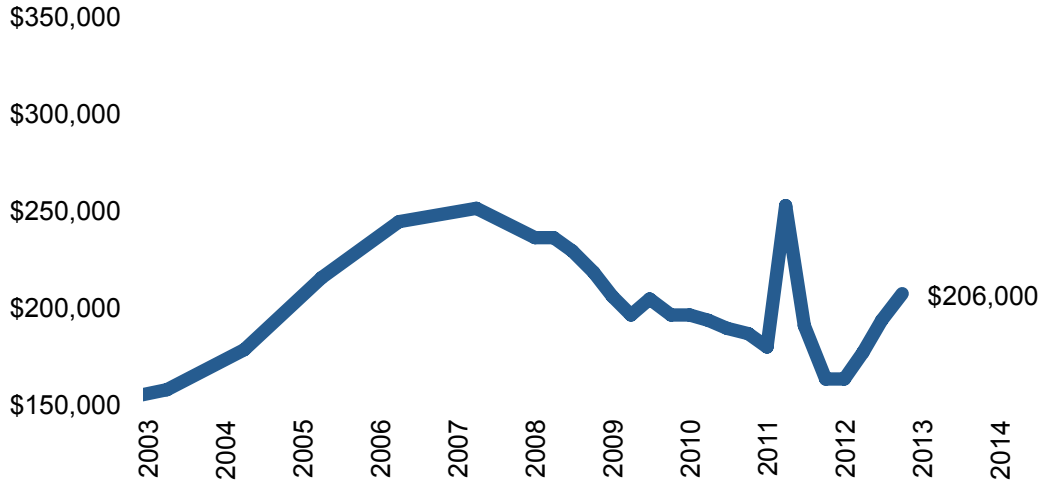
2012 at 515, but it increased by 14 percent year over year. However, the number of days on the market increased to 62 from 56 in the previous quarter and 67 in fourth quarter 2011.

In the Vancouver suburbs, the median home price in fourth quarter 2012 was \$252,600, which increased 21 percent year over year. This was a 3.7 percent increase from the previous quarter. The number of homes sold in fourth quarter increased by over 20 percent from the previous quarter to 678, and by one percent annually. The number of days on market increased by 17.5 percent from the previous quarter to 47 but this was down from 63 last year at this time.

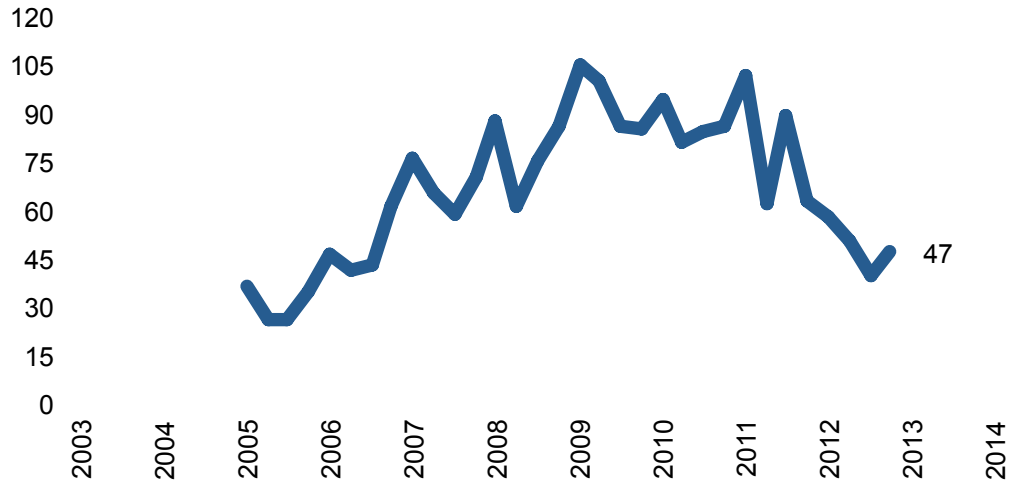
**Number of transactions  
Vancouver, existing homes**



**Median sales price  
Vancouver, existing homes**



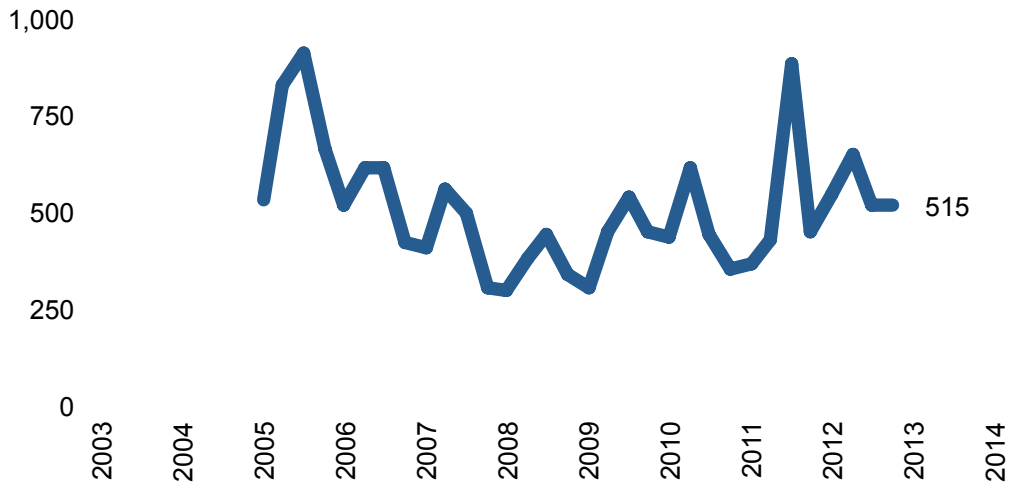
**Days on market  
Vancouver, existing homes**



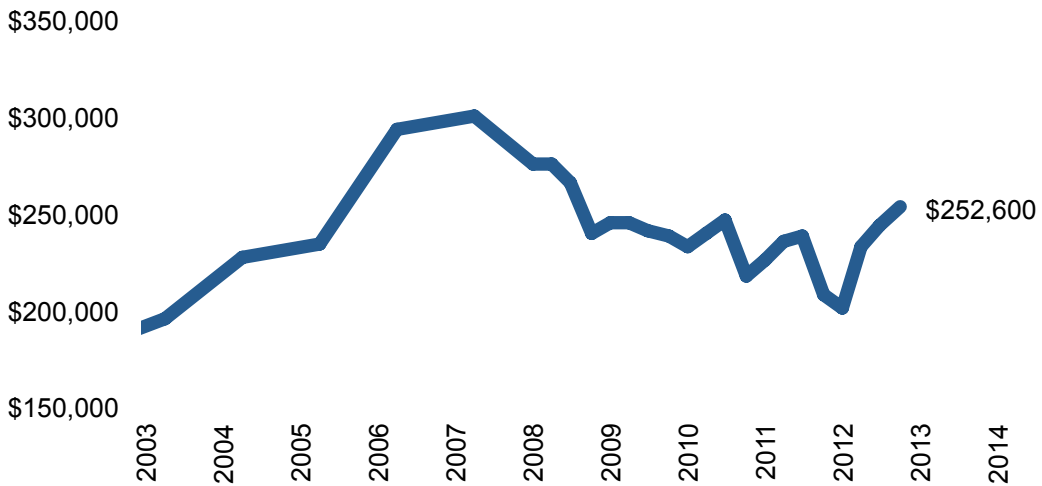
In the Vancouver suburbs, the median home price was \$243,430, which was a 2 percent increase from the third quarter of 2011, and a 4.5 percent increase from the previous quarter. The number of transactions decreased 20 percent from last quarter to 518. Properties were on the market an average of 56 days which was up

slightly from last quarter when it was 55, but a sharp decrease from 86 in third quarter 2011.

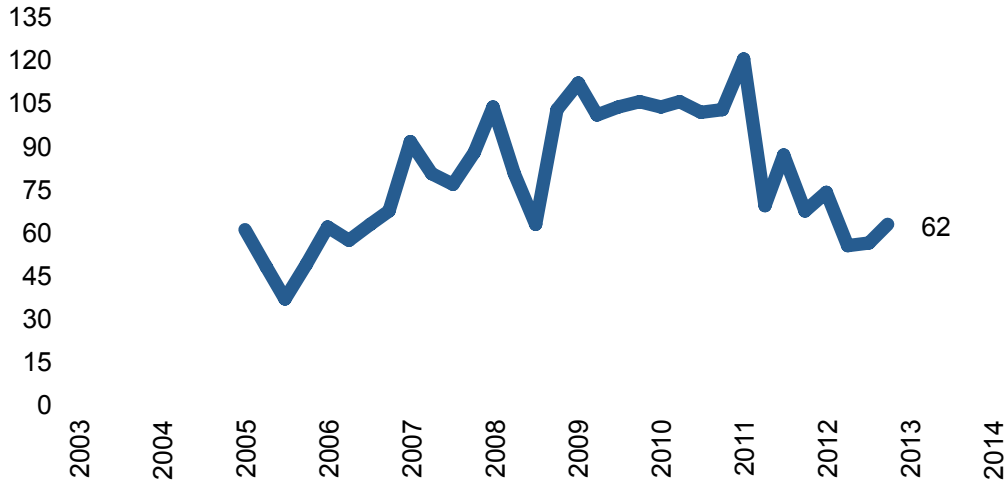
**Number of transactions**  
**Clark County, excluding Vancouver, existing homes**



**Median sales price**  
**Clark County, excluding Vancouver, existing homes**



**Days on market**  
**Clark County, excluding Vancouver, existing homes**



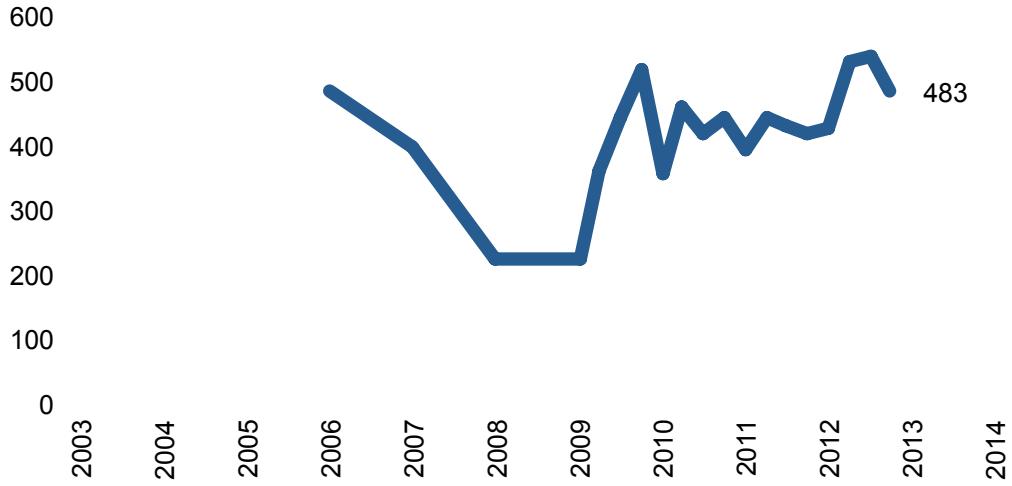
**CENTRAL OREGON**

At 438 transactions, fourth quarter Bend home sales of less than one acre are up 16 percent since the same period last year. At 170 transactions of less than one acre, Redmond is up 3 percent over last year. For larger properties—homes on 1-5 acres—transactions are up 11 percent in Bend and up 53 percent in Redmond.

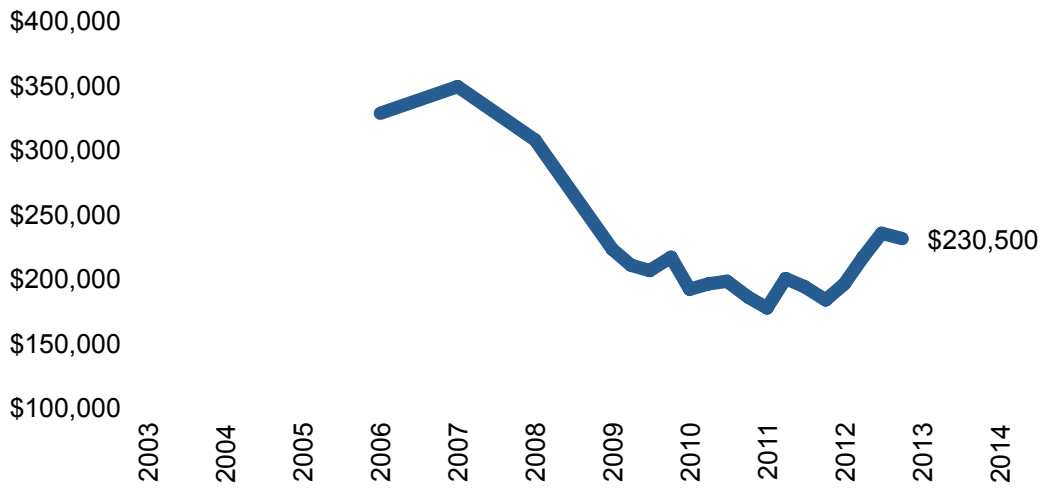
Although transaction volume is up, so is the number of days on the market for every market in Central Oregon. Properties of on less than an acre spend nearly five months on the market before sale. Larger properties average seven months in Bend and eight month in Redmond.

For sales under an acre, the median home prices for Bend and Redmond both since the fourth quarter of the previous year. The median price in Bend market increased 26 percent to \$230,500, while Redmond increased 12 percent to \$138,680. Results are mixed in the market for larger properties: the median price in Bend is up 19 percent, but the median price is down 4 percent in Redmond. Measured on a price-per-square-foot basis, the median price of properties of 1-5 acres is up 5 percent in Bend, but down 17 percent in Redmond.

**Number of transactions  
Bend, under 1 acre**

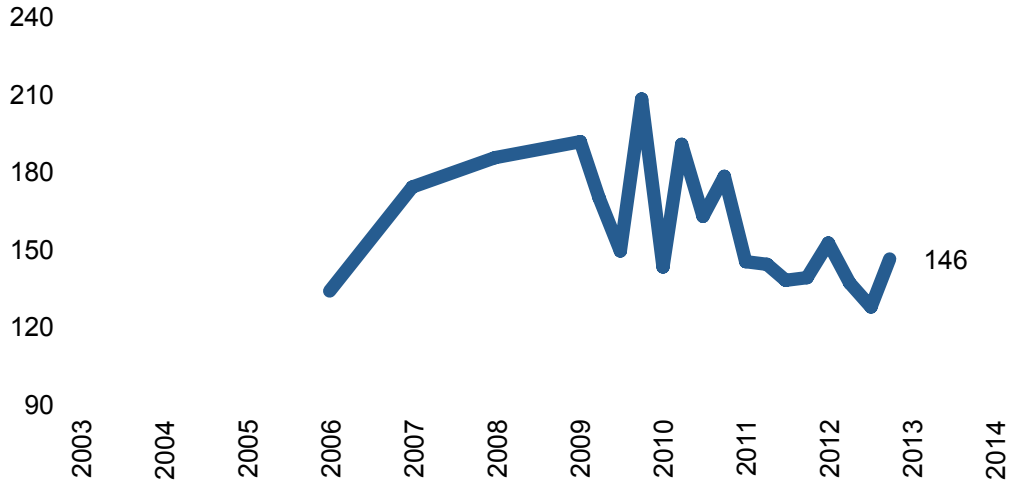


**Median sales price  
Bend, under 1 acre**

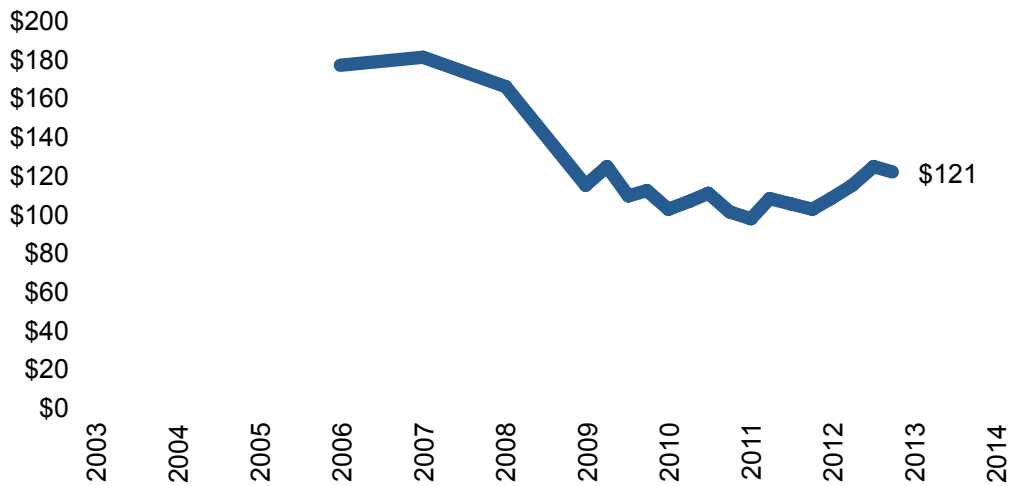




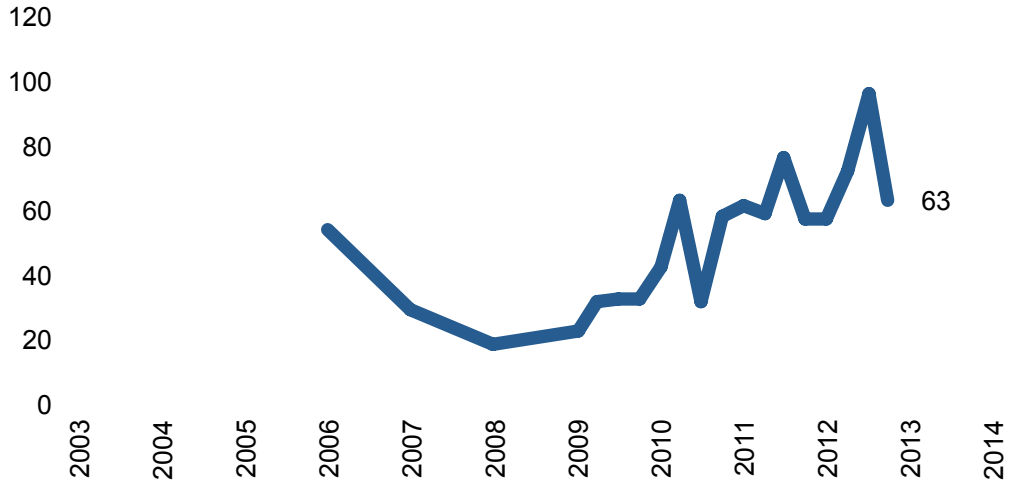
**Days on market**  
**Bend, under 1 acre**



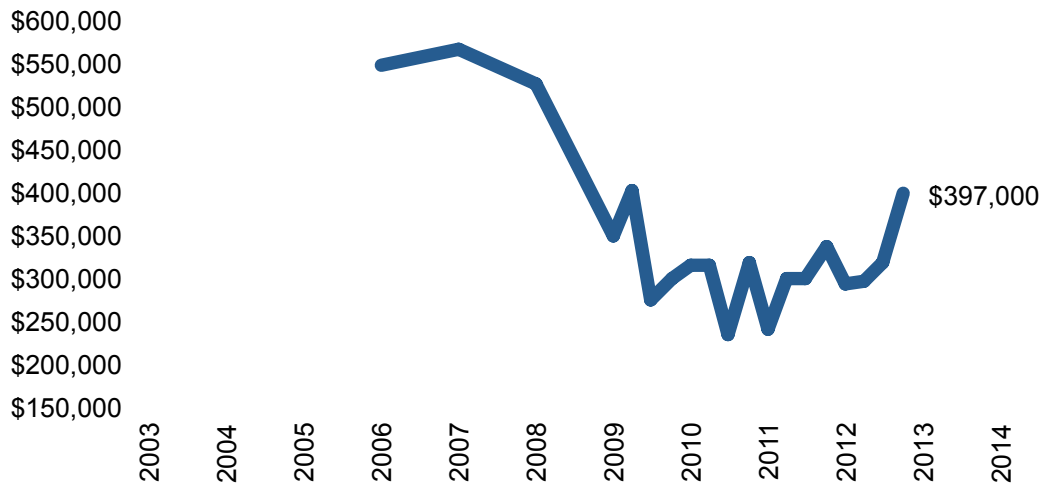
**Median sales price, \$ per square foot**  
**Bend, under 1 acre**



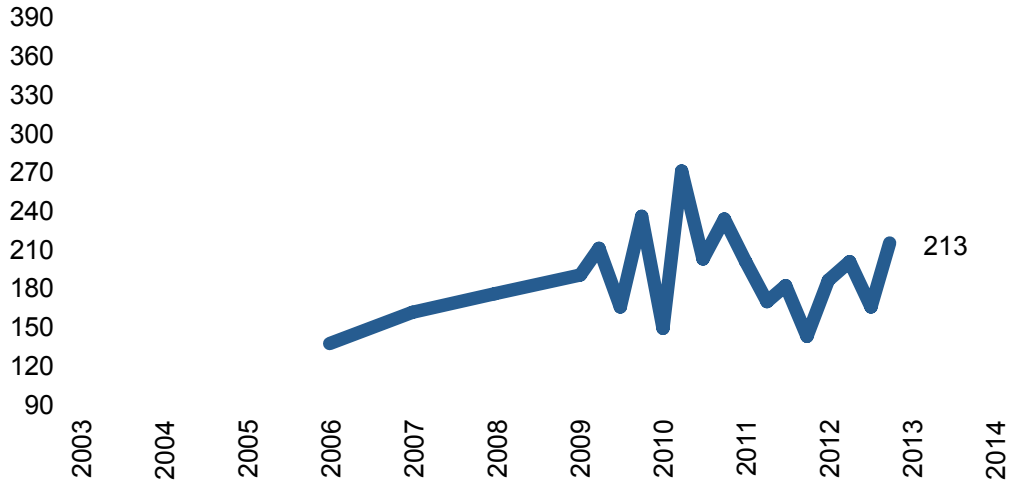
**Number of transactions  
Bend, 1-5 acres**



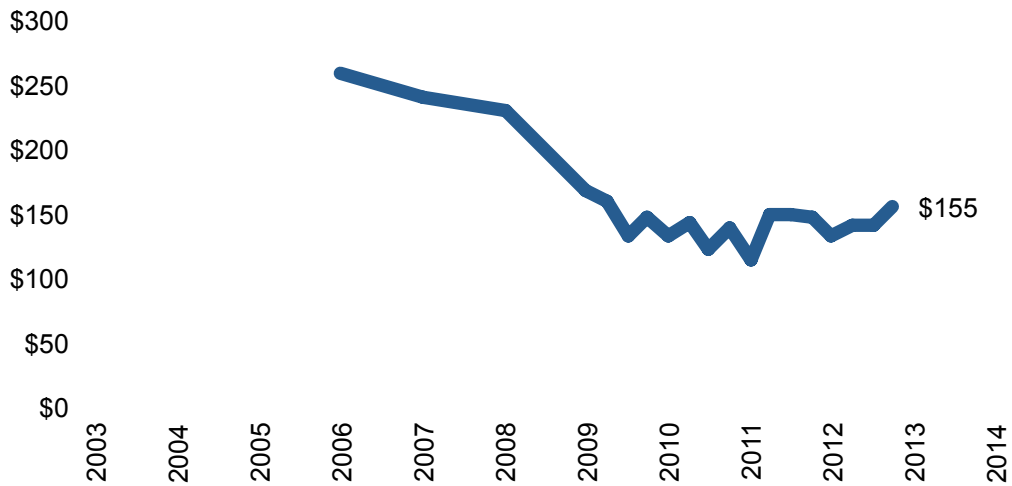
**Median sales price  
Bend, 1-5 acres**



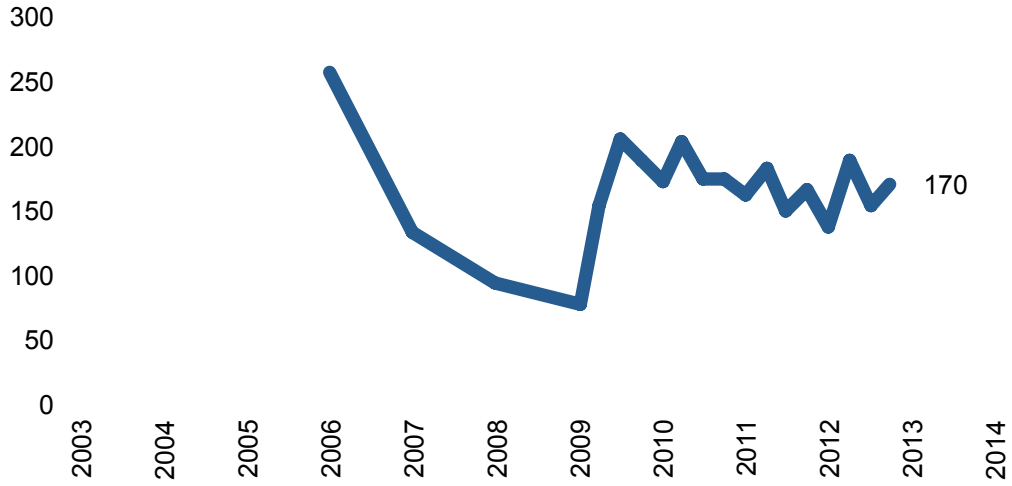
**Days on market  
Bend, 1-5 acres**



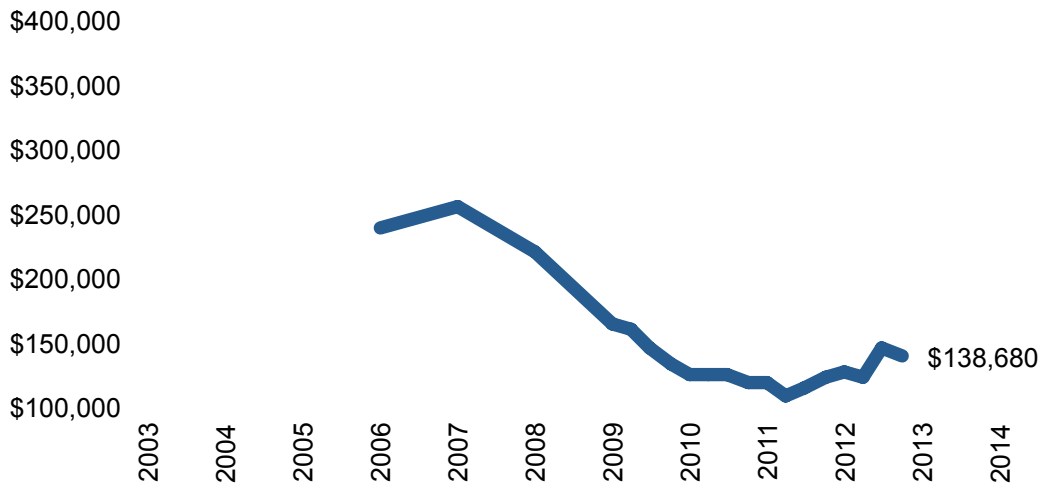
**Median sales price, \$ per square foot  
Bend, 1-5 acres**



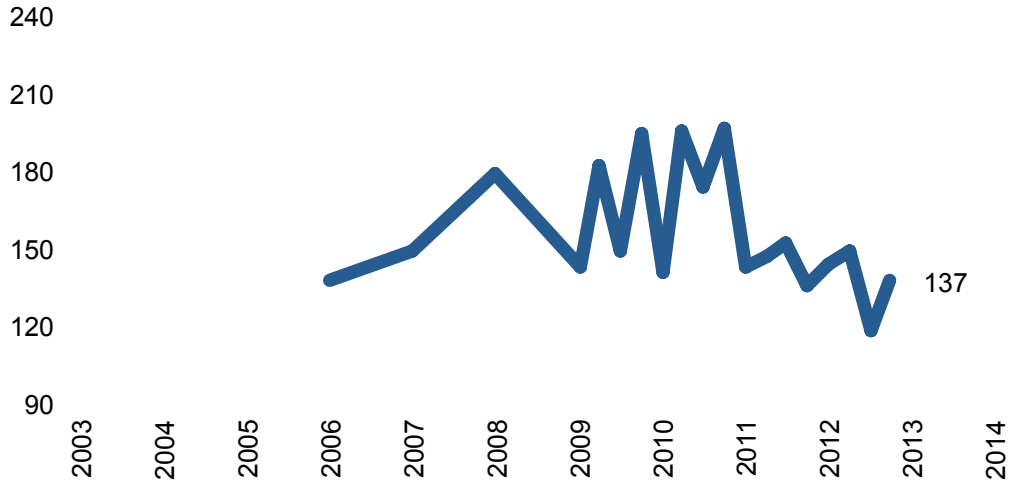
**Number of transactions  
Redmond, under 1 acre**



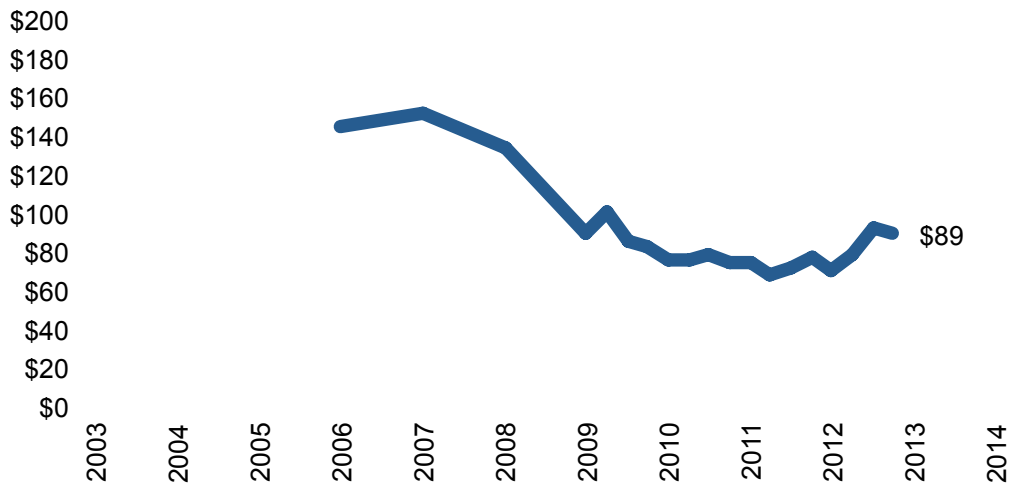
**Median sales price  
Redmond, under 1 acre**



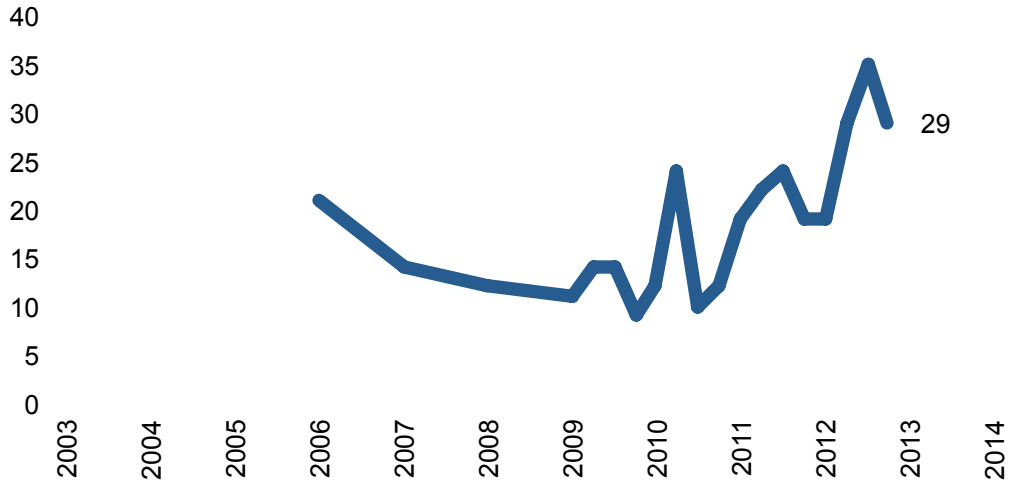
**Days on market**  
**Redmond, under 1 acre**



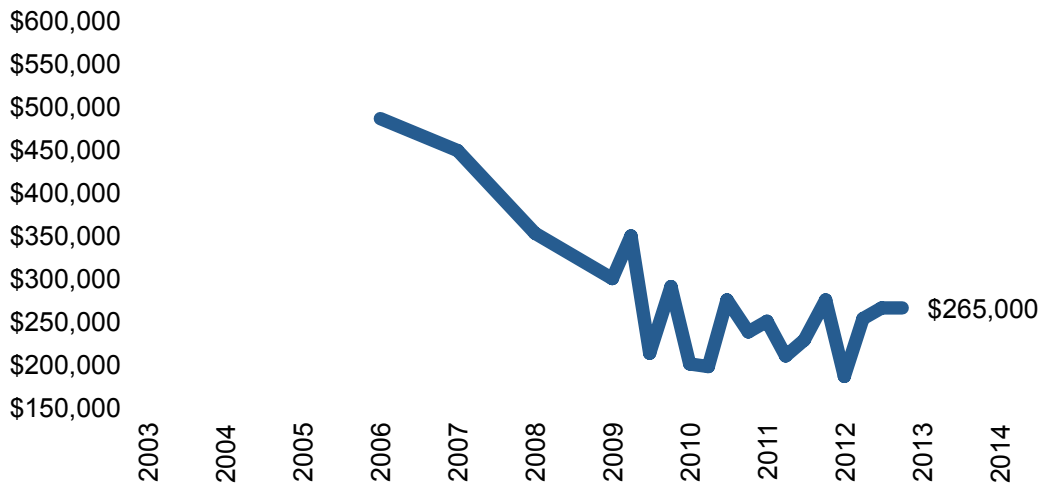
**Median sales price, \$ per square foot**  
**Redmond, under 1 acre**



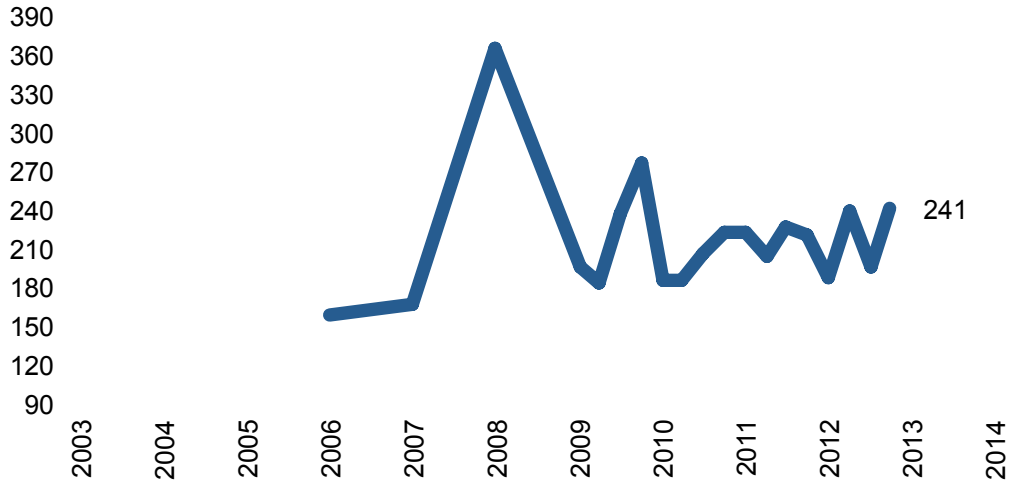
**Number of transactions  
Redmond, 1-5 acres**



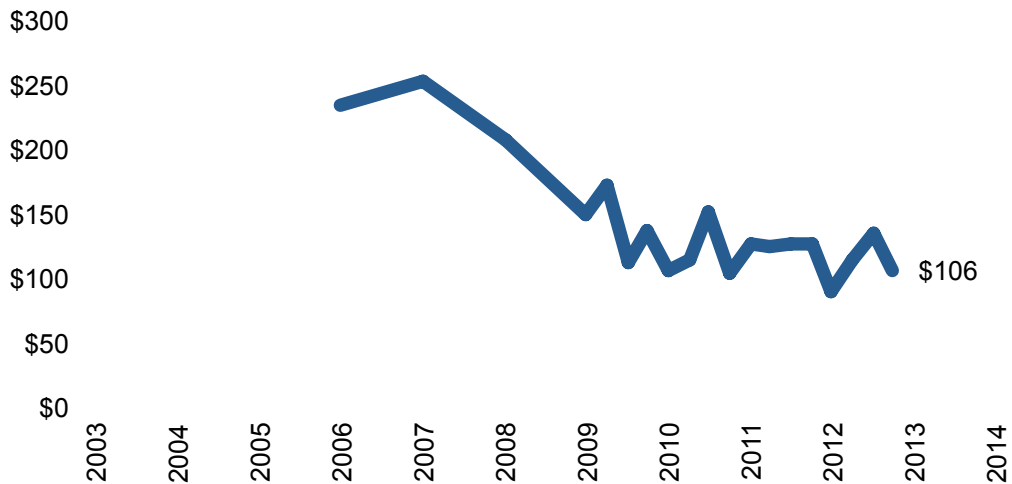
**Median sales price  
Redmond, 1-5 acres**



**Days on market  
Redmond, 1-5 acres**



**Median sales price, \$ per square foot  
Redmond, 1-5 acres**

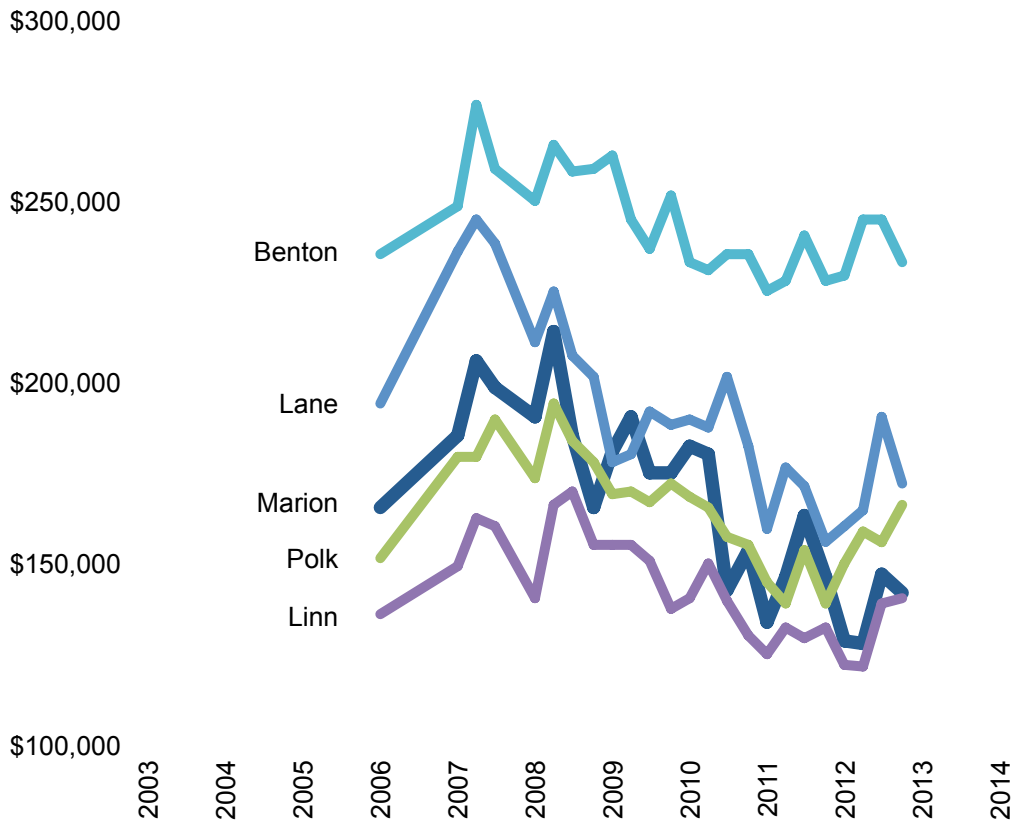


**WILLAMETTE VALLEY**

Marion County decreased 9.9 percent since the third quarter of 2011 to a median sold price of \$147,000. Salem and Keizer increased year over year by 7.7 percent

and 2.2 percent respectively. Benton County increased 2.1 percent over the past year to a median price of \$245,000.

**Median sales price  
Willamette Valley, existing detached homes**

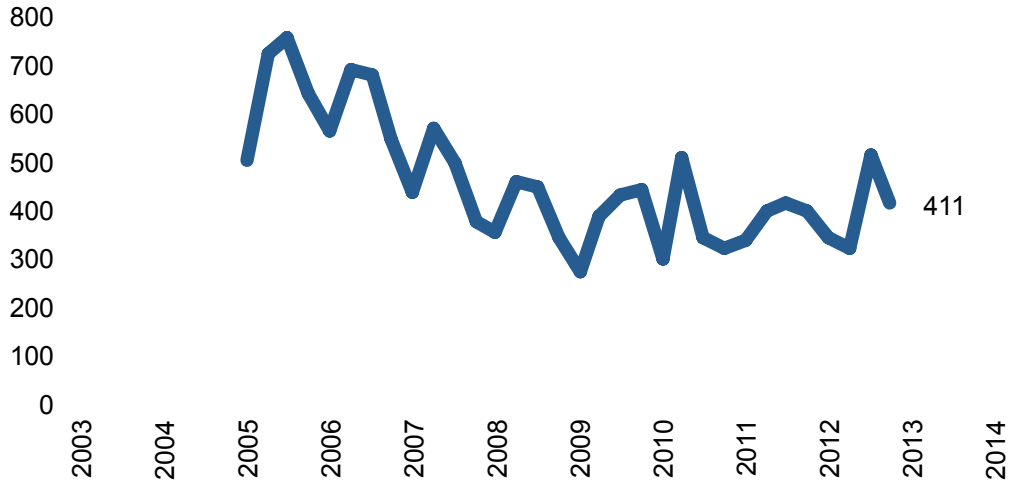


**SALEM**

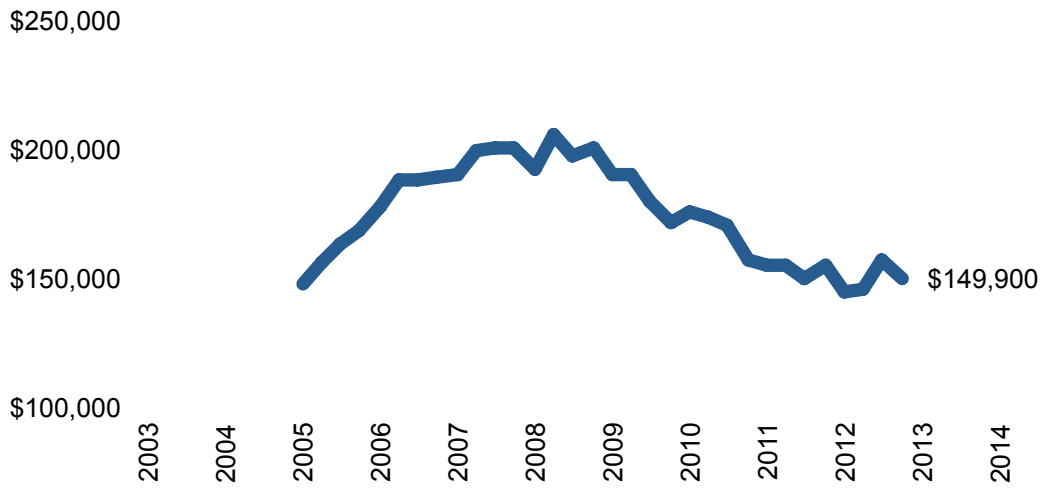
Salem’s housing market again experienced annual depreciation of 3 percent since the fourth quarter of the previous year. At the same time, the number of transactions are up 4 percent, and the number of days on the market has dropped by 38 percent from 188 days in the fourth quarter of 2011 to 116 in the fourth quarter of 2012.



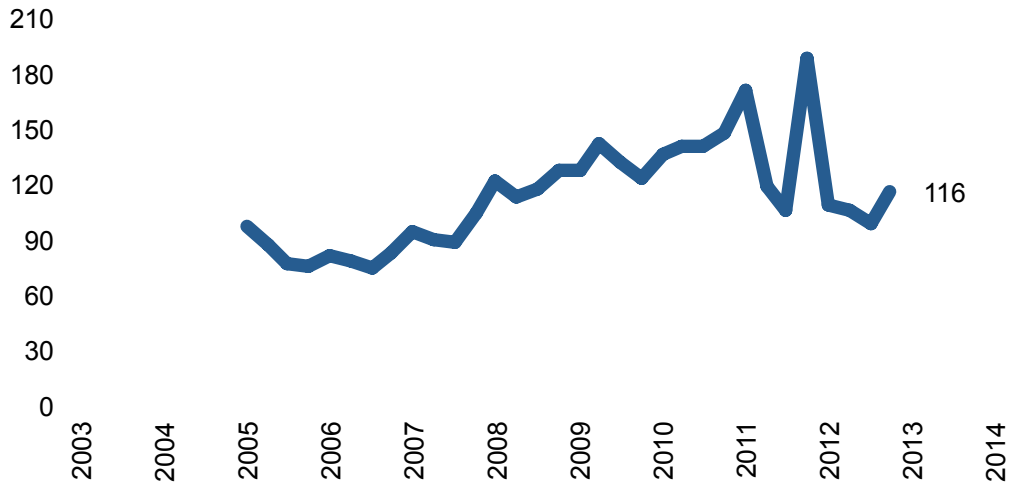
**Number of transactions**  
**Salem, existing homes**



**Median sales price**  
**Salem, existing homes**



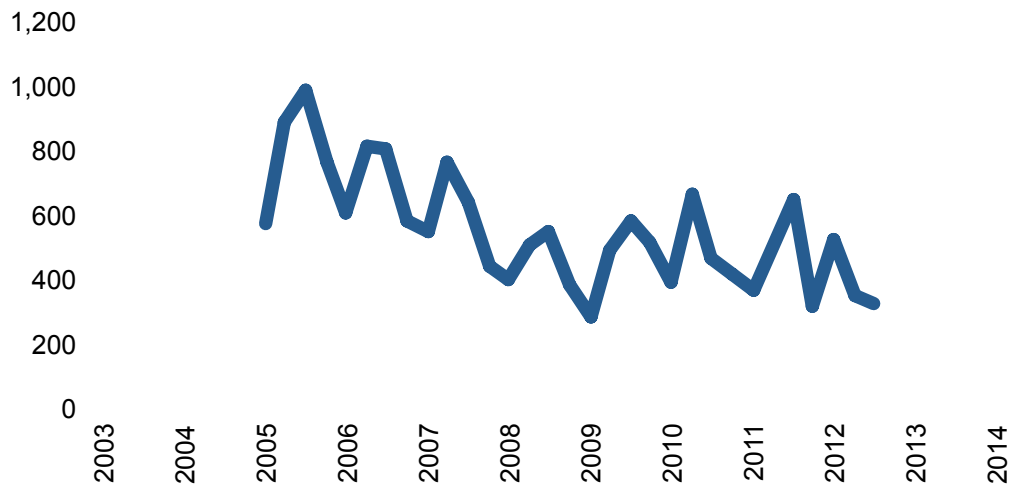
**Days on market  
Salem, existing homes**



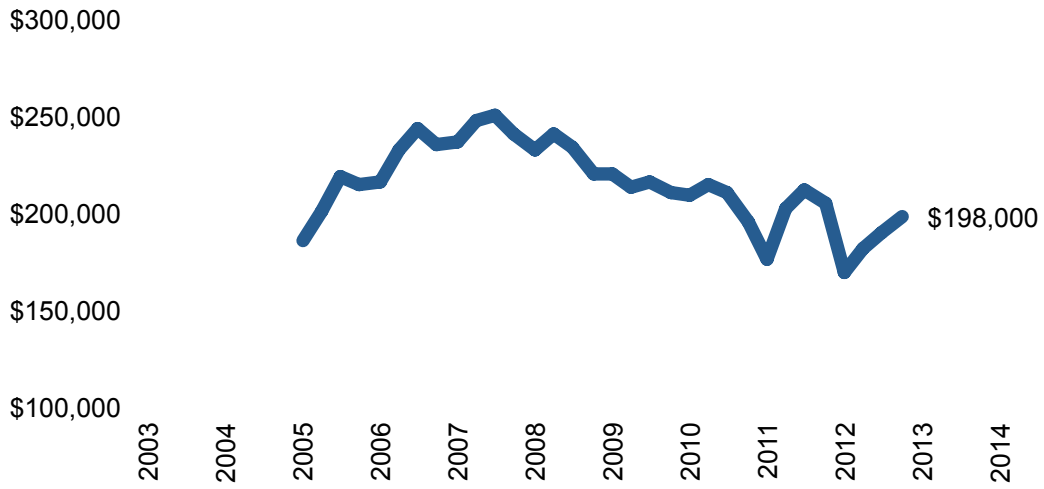
**EUGENE/SPRINGFIELD**

Home prices in the Eugene/Springfield area up 4 percent since the previous quarter. However, at a median price of \$198,000, the year-over-year median price is down 3 percent. At a median price of \$172,000, Lane County prices are up 10 percent over the previous year.

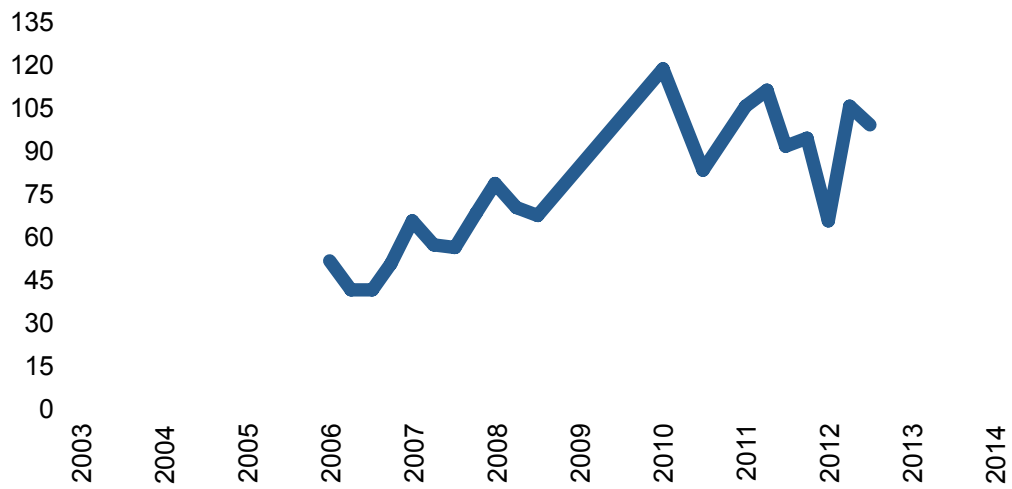
**Number of transactions  
Eugene-Springfield, existing homes**



**Median sales price  
Eugene-Springfield, existing homes**



**Days on market  
Eugene-Springfield, existing homes**



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## MULTIFAMILY MARKET ANALYSIS

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EVAN ABRAMOWITZ

RMLS Student Fellow

Master of Real Estate Development Graduate Student

In late November, the National Association of Realtors indicated that Portland had the lowest multifamily vacancy rate in the nation at 2.1 percent. Strong rental demand has persisted as fewer buyers are drawn to the single family market. According to the 2012 Barry Report: “The apartment market has everything going for it, with increasing rents, increasing income, low vacancies, financing which is readily available, relatively slow apartment construction, and good investor demand.” The report projects stronger performance in the market in 2012 and 2013 and forecasts that we are in the midst of a “two to four year sweet spot in the market and the real estate cycle.”

On the supply side, construction for multifamily in 2012 increased significantly from 2011 and 2010, but is still below historical figures. From January-November 2012 there have been multifamily building permits issued for 2,677 units in the tri-county area. In 2011 permits were issued for 1,696 units in the three county metro area, compared to 1,100 in 2010, according to the Barry Report. From 2004-2008 an average of 4,700 units came online annually.

■ Evan Abramowitz is a multifamily investment specialist with Joseph Bernard LLC Investment Real Estate. He is currently working towards the Master of Real Estate Development degree through Portland State University’s School of Business where he is an RMLS Student Fellow. Any errors or omissions are the author’s responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

Half of the units being built are in the close-in areas where vacancy is lowest. The high demand for rentals is expected to persist over the next several years and absorb the new construction projects. New construction has begun to ramp up as more projects are approved in the coming year. The market is projected to have remained in balance absorbing approximately 2,000 units annually over the next 3-4 years, and vacancy rates are projected to remain low and market conditions should remain strong for property owners.

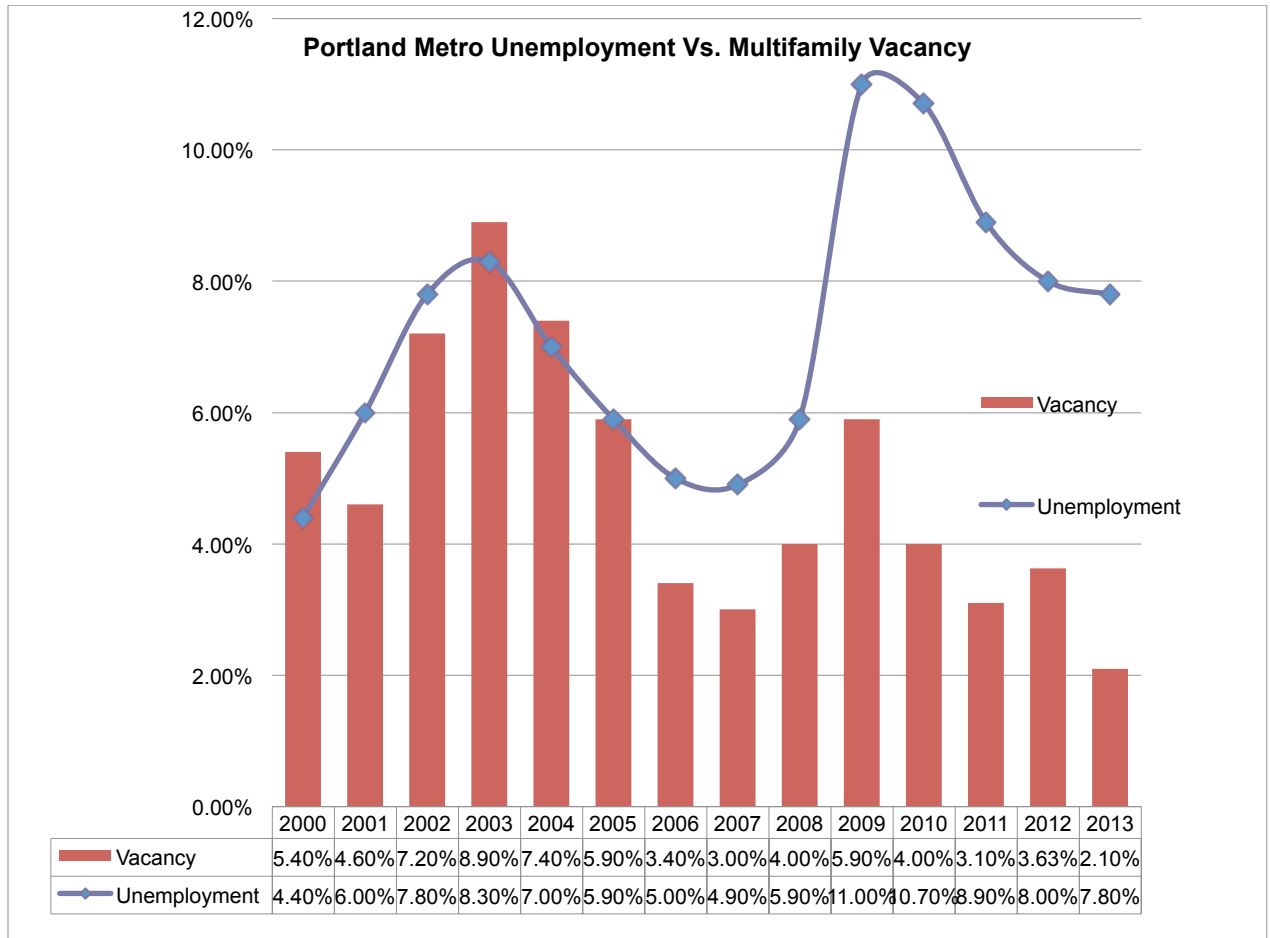
Countering the typical seasonal trend, annual effective rent growth for the apartment market increased from 3.60 percent in October to 3.72 percent in November according to the latest data from Axiometrics Inc., the leading provider of apartment data and market research. Annual occupancy growth also increased by 48 basis points (bps), making November the sixth consecutive month with an increase, though on a sequential basis there was a decline in the occupancy rate from October to November.

Axiometrics also notes that the average square footage for new apartment construction is decreasing, reversing a trend that reached its peak at an average of 1,008 square feet for properties built in the 2001-2005 timeframe. Still, while the current average of 982 square foot for properties in lease-up is lower than in recent years, it still has a way to go before dropping to the 834 square foot average for properties built from 1981-1985, according to Axiometrics.

“As we believed would be the case at the beginning of the year, Class C properties have led the way in both effective rent and occupancy growth throughout the year, and helped lead a turnaround in momentum since August,” said Ron Johnsey, president of Axiometrics. “In addition, while many coastal areas and the top Texas markets continue to lead the nation in effective rent growth, it is interesting to note that for the first time in four years Las Vegas posted positive annual growth during November.”

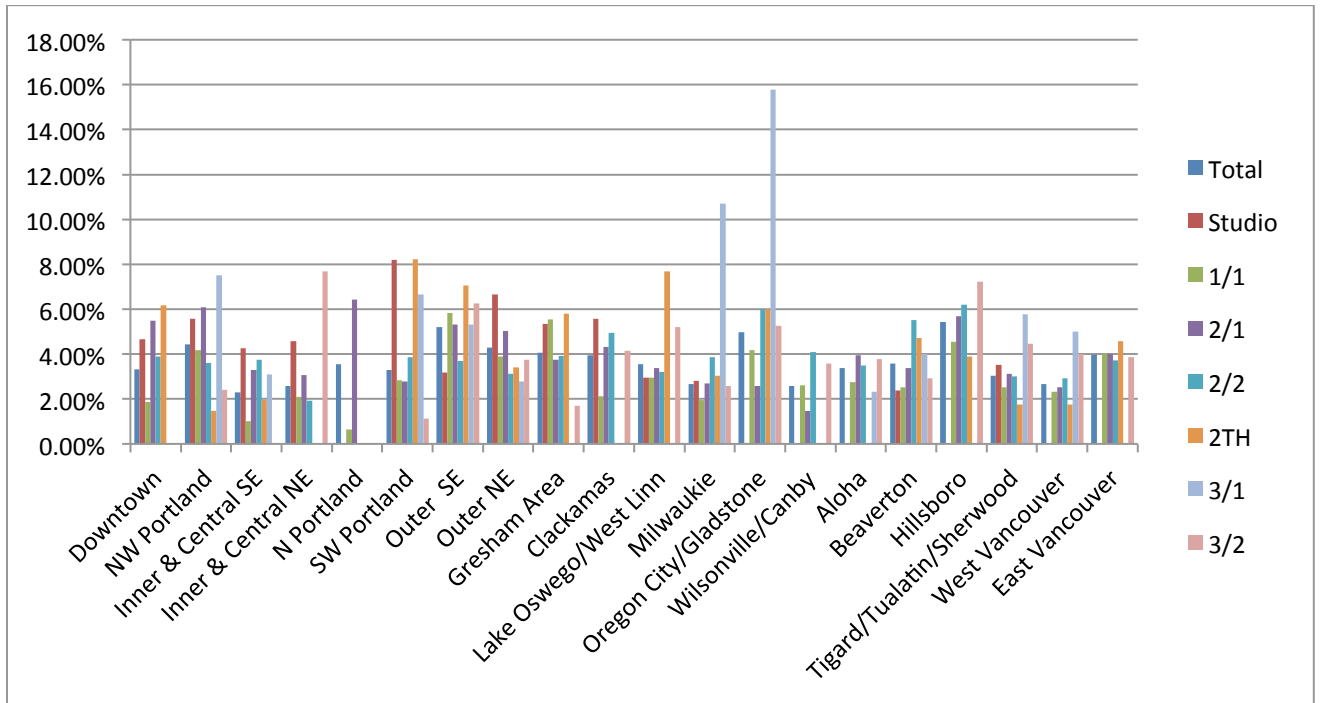
Unemployment rates are positively correlated with vacancies as shown in the chart below. Portland currently has an unemployment rate of 7.8 percent, which is lower than the state average of 8.4 percent on par with the national average of 7.8 percent.

**Figure 1: Unemployment and Multifamily Vacancy, Portland Metropolitan Area**



These market factors have driven vacancy rates in historically undersupplied Portland to among the lowest in the nation. The highest overall vacancy submarket was 5.42 percent in Hillsboro and the lowest was Inner & Central SE at 2.29 percent. The highest vacancy rate among studios was SW Portland at 8.2 percent, while four submarkets reports 0 percent vacancy for studios. The highest vacancy rate for 1 BD, 1 BA was Outer SE at 5.83 percent, while the lowest was N Portland with 0.65 percent. For 2 BD, 1 BA the highest vacancy was N Portland at 6.44 percent and the lowest was Wilsonville / Canby at 1.48 percent. Six submarkets had a 0 percent vacancy rate among 3 BD, 1 BA, but many of these were based on less than 100 units surveyed, as 3 BD / 1 BA units are relatively unusual. Downtown, N Portland, and Inner NE reported 0 percent for 3 BD / 2 BA, while Inner NE had a 7.69 percent vacancy rate for 3 BD / 2 BA.

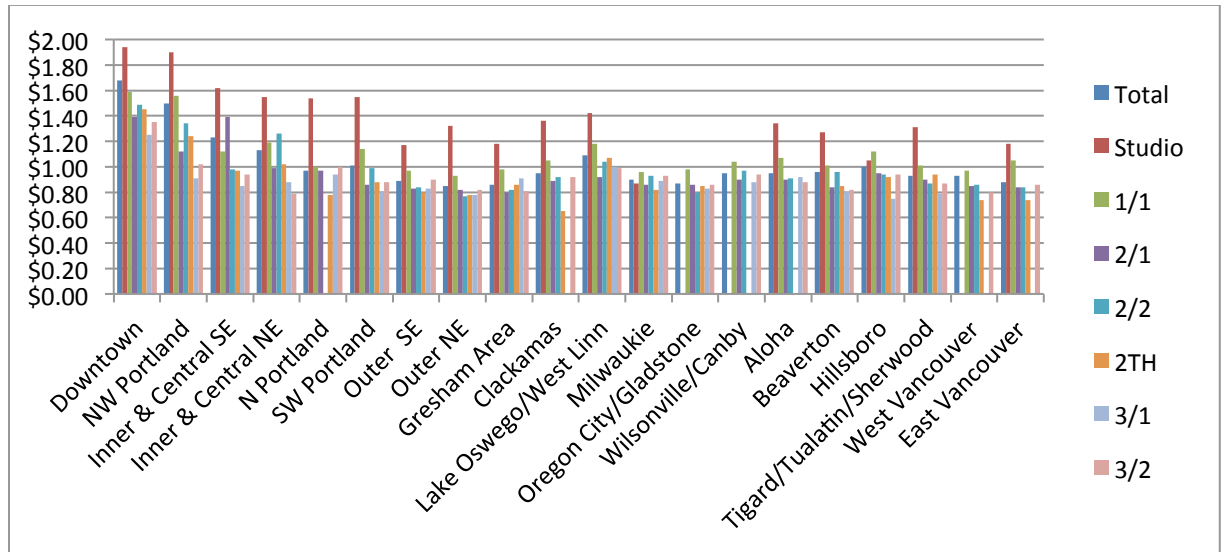
**Figure 2: Vacancy Rates by Submarket Fall 2012 Portland Metropolitan Area**



Source: MMHA

The submarket with the highest overall rent/SF is downtown Portland with a \$1.68 average, followed by NW Portland at \$1.50. The lowest overall rent/SF is shared between Outer NE at \$0.85 per square foot. The highest rent/SF for studios was Downtown at \$1.94 and the lowest was Milwaukie at \$0.87. The highest rent/SF for 1 BD, 1 BA was Downtown at \$1.59 and the lowest was Outer Northeast at \$0.93. The highest rent/SF for 2 BD, 1 BA was downtown at \$1.39 and the lowest was \$0.80 in the Gresham area.

**Figure 3: Rent / SF by Submarket Fall 2012 Portland Metropolitan Area**



Source: MMHA

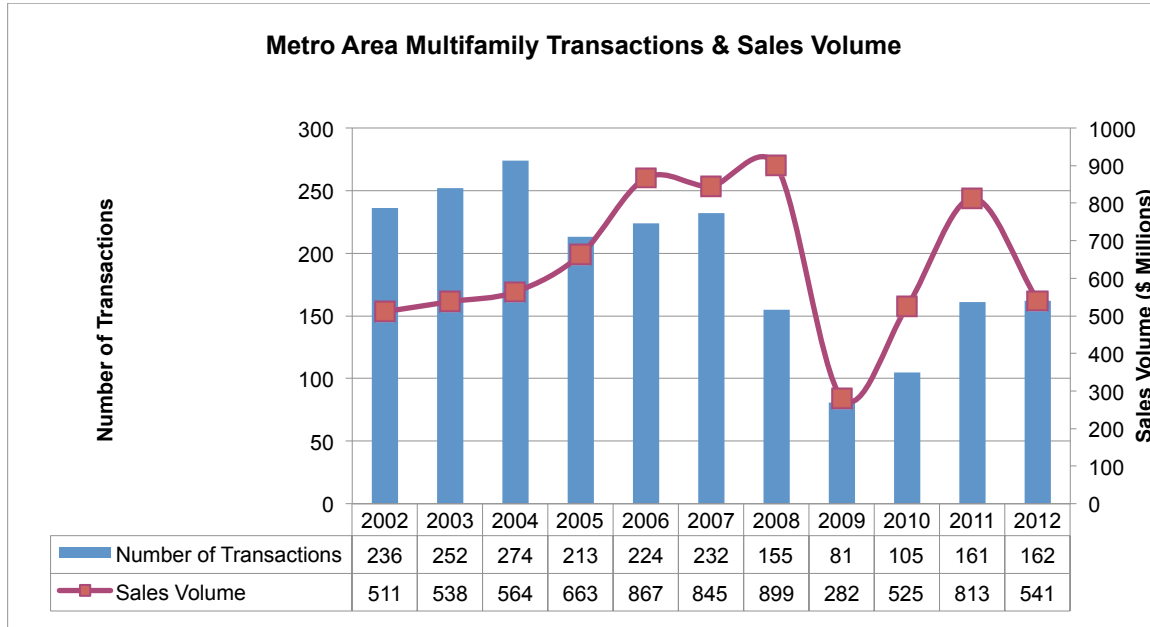
In 2011 there were 26 institutional transactions, which was the highest total in ten years according to MMHA. This trend is not projected to continue as the majority of the product in Portland is Class B and C quality properties based on location and condition of the building. In Portland, approximately 70 percent of the apartments were built in the 1970s. These properties are often in the 8-60 unit range, have varying levels of deferred maintenance, and many sell in the \$50,000-\$80,000 per unit range depending on rents, location, condition, and other factors. In the third quarter the sold price per unit was \$71,400. The average number of units sold per property was 28 in second quarter 2012 and 32 in the third quarter.

There have been ten deals thus far in 2012. In the third quarter the Alexan Villedois in Wilsonville (275 units) sold for 30.4 million, Forest Rim in Tualatin (300 units) sold for \$42.1 million, Access 15 (202 units) in NE Portland sold for \$48.6 million, and Forest Creek (160 units) in NW Portland sold for \$25.7 million.

The number of transactions and sales volume has rebounded nicely since 2009. In 2011 there were 161 transactions and \$813 million in sales volume compared with 105 transactions and \$525 million in 2010. This is 65 percent more transactions and 64 percent increase in sales volume. Through the end of September 2012, there have been 162 deals that have closed and \$541 million in volume, which already exceeds the volume transacted in 2010. Experts are projecting that the increases in sales volume and transactions will continue to be strong in 2012 and over the next several years.



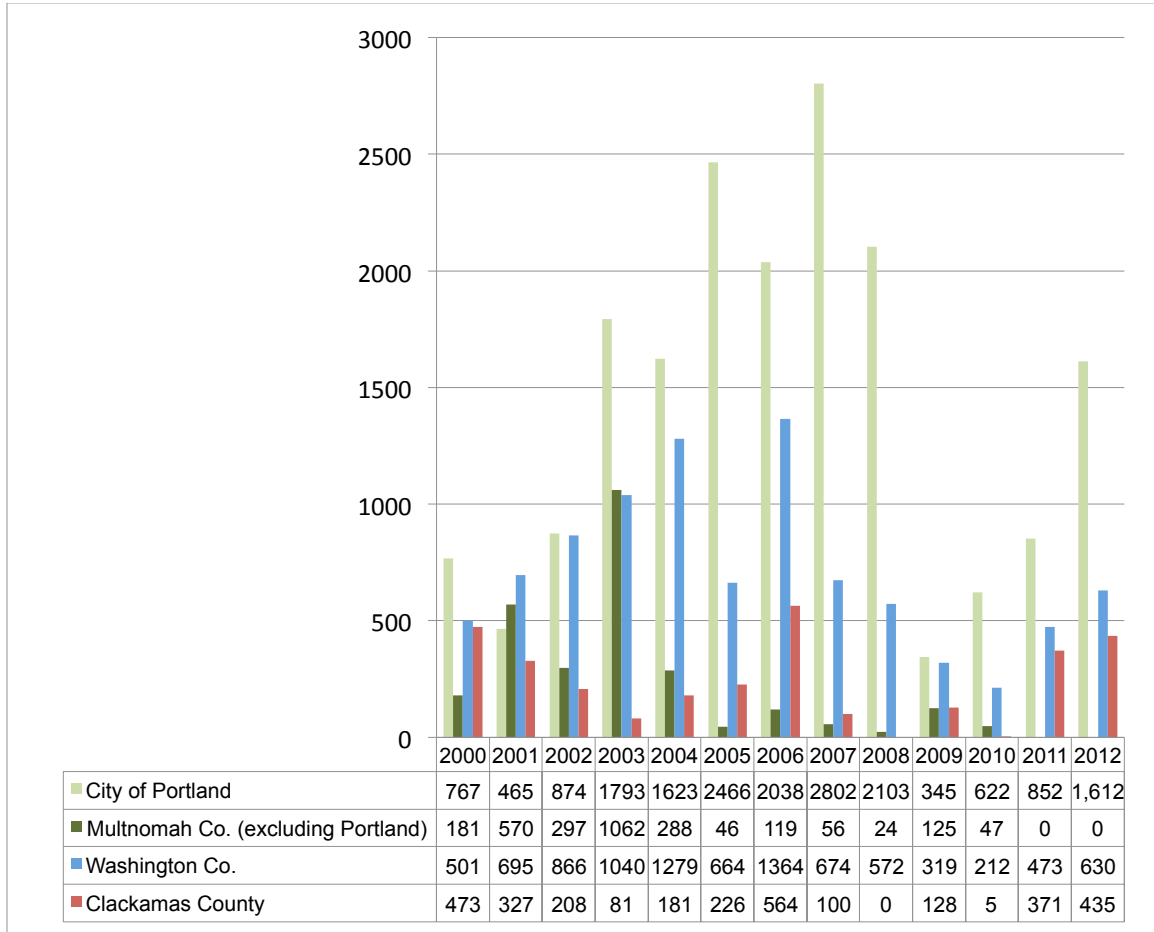
**Figure 4: Multifamily Transactions and Sales Volume, Portland Metropolitan Area, November 2012 Year to Date**



Source: Costar / Joseph Bernard Investment Real Estate

Through November 2012, multifamily building permits have increased within the City of Portland. Permits have been issued for 1,612 multifamily units built in the City, which is already the highest total since 2008. In 2012, there are 21 new apartment projects with 2,619 units slated to open. There are approximately 2,924 market rate apartment units in 26 different complexes that are currently leasing up or under construction now and into 2013. The majority of projects are in the suburban west side and close-in eastside markets. These are the areas that have market rents that can support the high costs and risks associated with new construction. New development for multifamily rebounded in 2011 with a total of 1,696 units built. However this number is still significantly lower than 2003-2008. In order to get back in balance the market needs 5,000-7,000 apartment units, and it will take developers three years to produce this supply, according to the Barry Report.

**Figure 5: Multifamily Building Permits Issued, November 2012 Year to Date**



Source: US Census

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## OFFICE MARKET ANALYSIS

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GEORGE S. McCLEARY

Owner, MRE Properties

RMLS Fellow, Master of Real Estate Development Candidate

The fourth quarter of 2012 was relatively stable for Portland's office market and the economy at large, despite a stir of national activity. The presidential race, Hurricane Sandy and the fiscal cliff all jolted the economy as investors feared the potential worst-case scenario. A double-dip recession was not to be, and markets remained relatively stable. However, most Americans will see smaller paychecks in 2013 as a result of the fiscal cliff compromises, and Hurricane Sandy is estimated to have caused nearly \$60 billion in damages. With office construction and absorption driven by economic activity, these are important factors to consider as Portland's office market emerges from the recession.

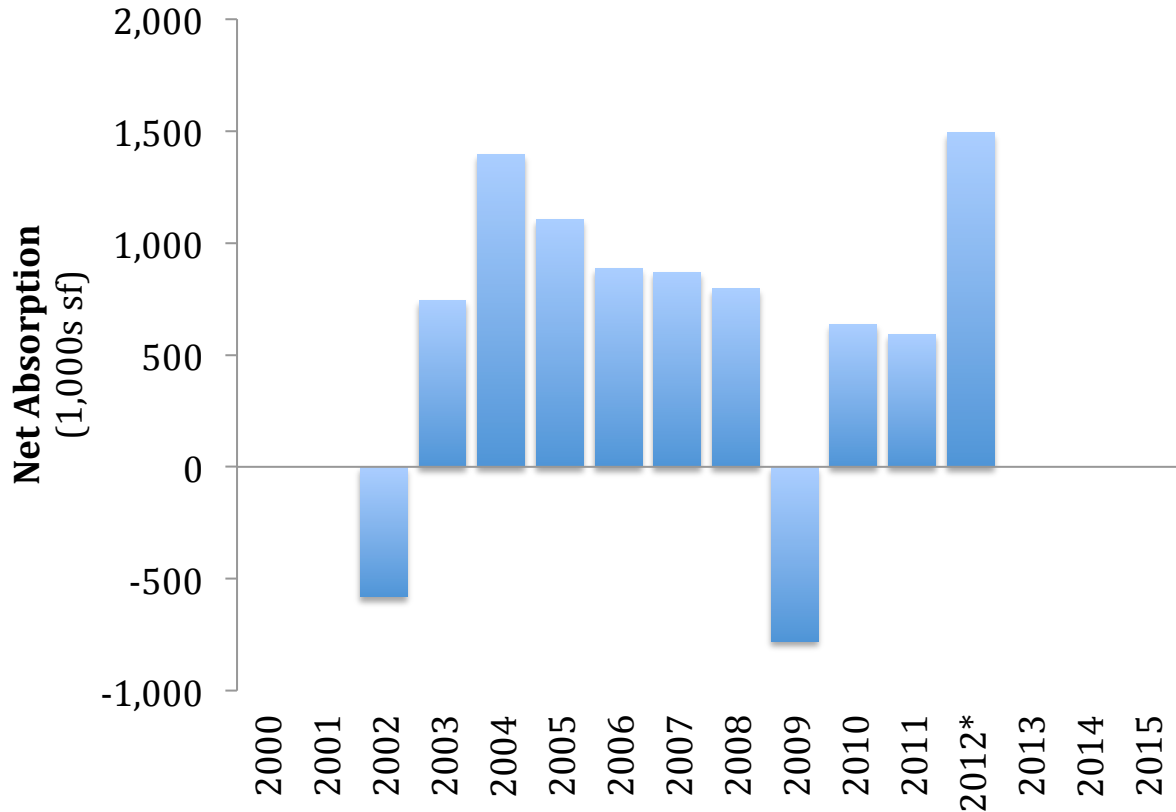
The Portland office market improved modestly in 2012, with general economic conditions continuing a slow upward grind. Fundamentals have improved, and unemployment has dropped almost a full percent, to 7.8 percent. Vacancy is down and 100,000 square feet of space was delivered to the market, although speculative construction is still nearly nonexistent. New space is unlikely to be developed before demand increases, forcing lease rates higher.

Nike and Intel have announced major expansions in the area, which will provide additional jobs to the area. Intel's D1X fabrication facility is expected to cost \$6 billion, and Nike has indicated that they will invest \$150 million in a capital project that is expected to add 500 jobs.

■ George S. McCleary is the owner of MRE properties specializing in commercial real estate investment and development of urban infill properties. He is enrolled in the Master of Real Estate Development program at Portland State University and is an RMLS Fellow in the program. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

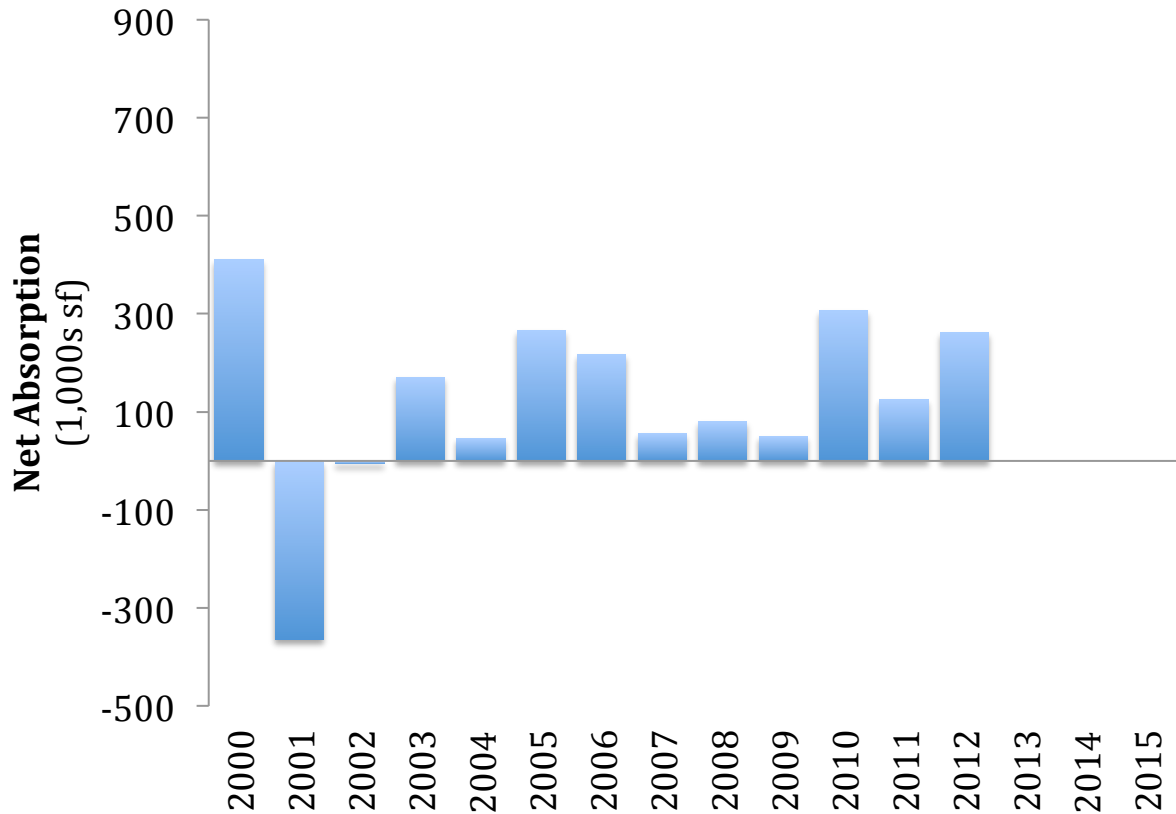
The office market and overall Portland economy is expected to improve throughout 2013. With the election and fiscal cliff resolved, businesses will have more certainty as they make their plans for the coming years.

**Figure 1: Overall net absorption, Portland office market**



\*Year-to-date  
 Source: Jones Lang LaSalle

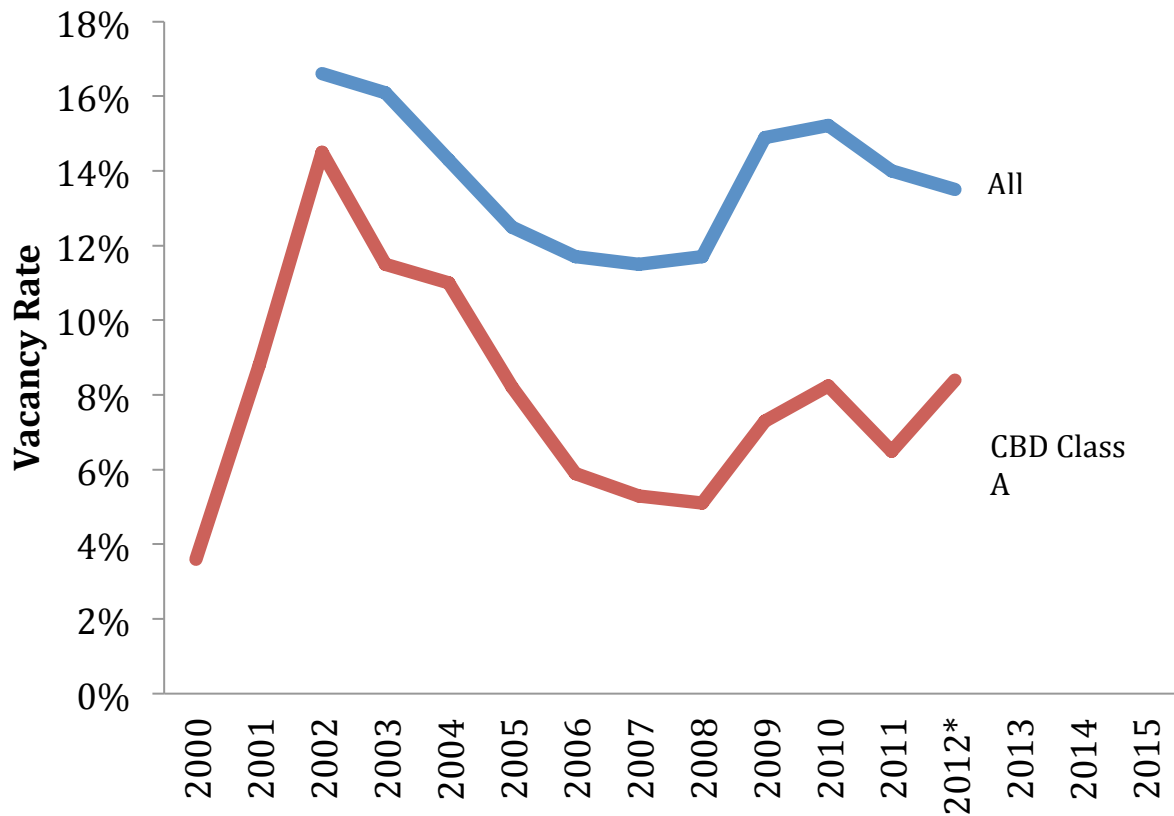
In the office market, Jones, Lang, LaSalle reports a 6 basis point decrease in market-wide vacancy to 12.7 percent, down from 13.5 percent in the third quarter. Year to date net absorption reached 1,492,011 square feet, which surpasses the highest net absorption rate since 2004. The suburbs have been responsible for the bulk of this activity, with vacancy rates that began the year much higher than those in the CBD. As vacancy rates stabilize, it is expected that rates will increase in suburban markets and spur new construction in years to come.

**Figure 2: Class A overall net absorption, Portland office market**

Sources: Jones, Lang LaSalle, NAI Norris, Beggs & Simpson

Class A citywide direct net absorption is 262,843 square feet according to Jones Lang LaSalle. This represents a significant change from previous years. Over half of the overall net absorption was realized in the west suburbs, which had previously experienced very high vacancy rates and negative net absorption.

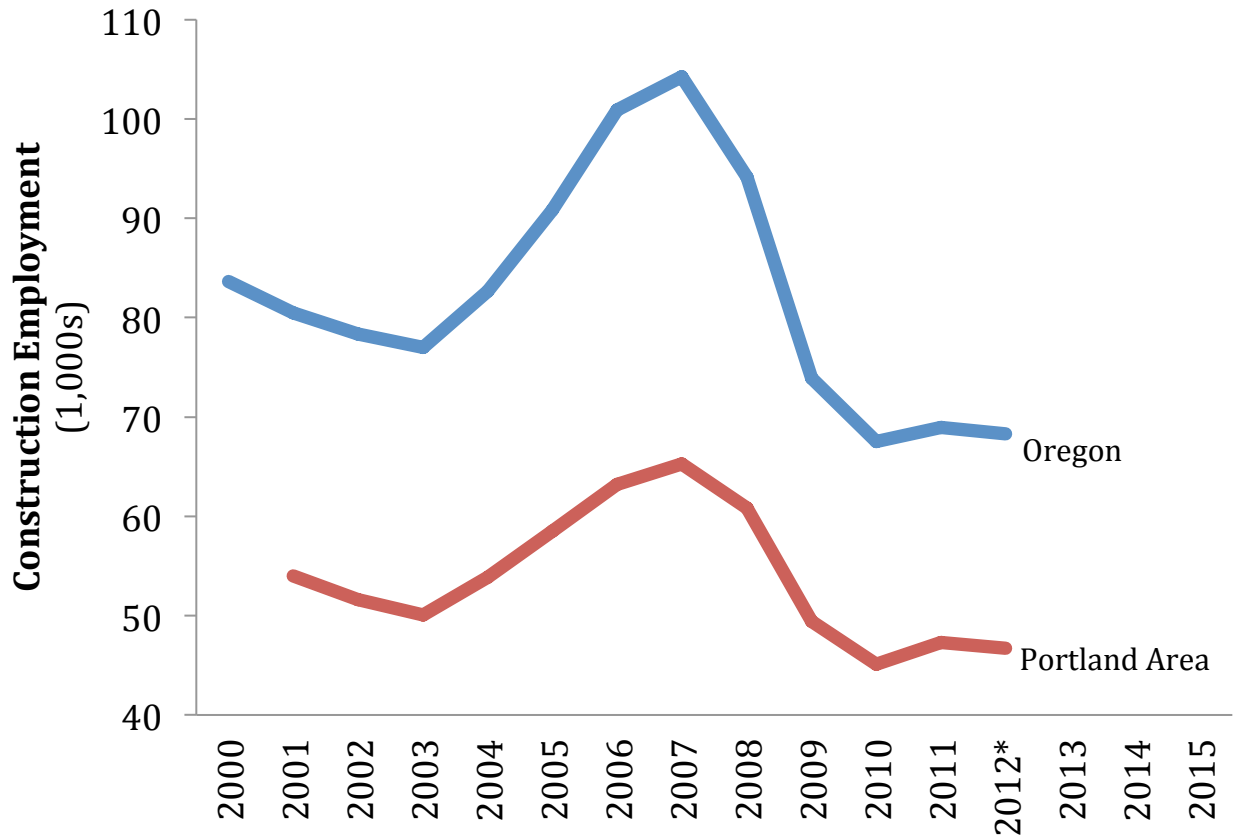
Overall vacancy rates in the CBD have been on the rise 2012 and increased throughout 2012, owing partly to attractive lease rates in the suburbs. Adding to the Class A inventory will be the newly renovated Edith Green building, which will bring 323,000 of LEED Platinum Class A office space to the Portland market. 2012 ended with class A vacancy in the CBD at 7.7 percent, according to Jones, Lang & LaSalle.

**Figure 3: Vacancy rates, Portland office market**

Source: Jones, Lang & LaSalle, NAI Norris, Beggs & Simpson, CBRE

CBD vacancy rates had been slowly rising while submarket vacancy rates have been falling. Vacancy rates for class A space in the CBD had risen throughout 2012, with companies relocating or vacating their spaces in favor of the suburbs or Pearl District locations. The fourth quarter may have signaled the end of this trend, with vacancy dropping to 7.7 percent, down from 8.4 percent in Q3.

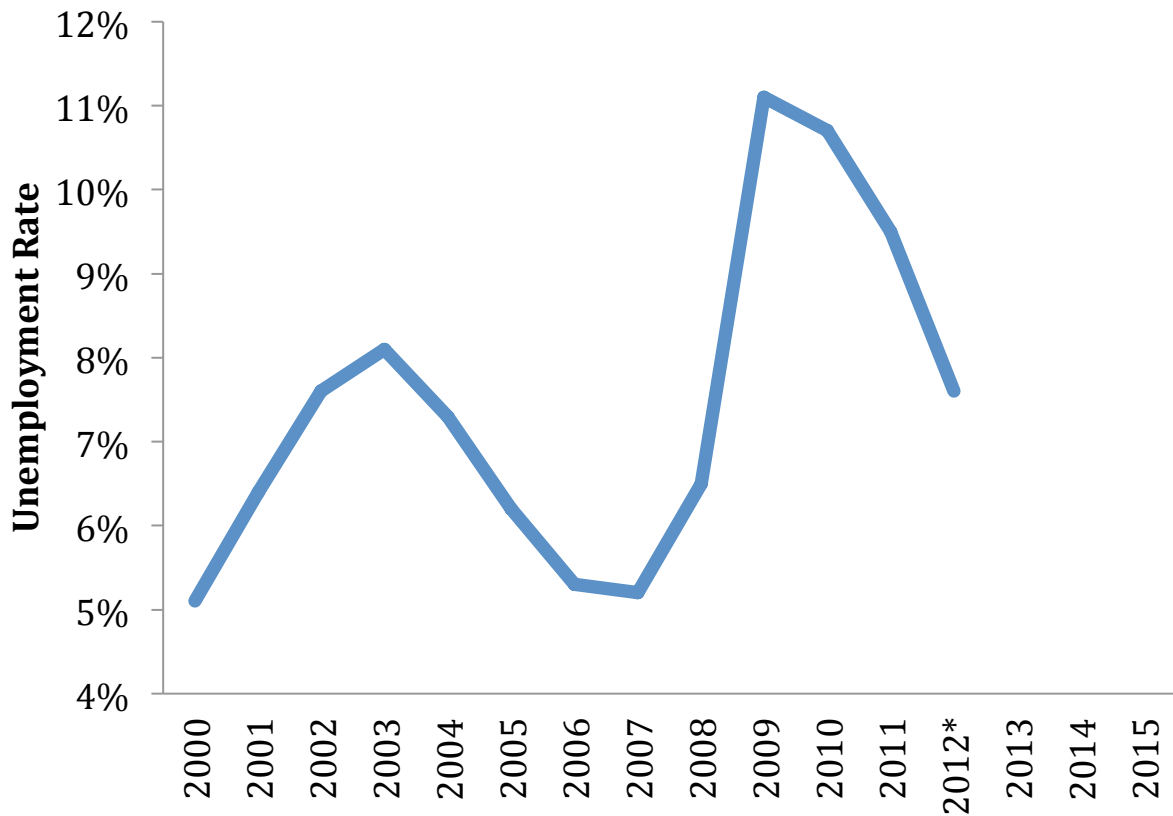
Suburban office spaces continue to hold the highest vacancies and most attractive rates. Vacancy rates are expected to remain steady or rise in the CBD with the impending completion of the Edith Green building.

**Figure 4: Construction employment, Portland area and Oregon statewide**

Source: Oregon Employment Department

Construction employment is currently at a seasonally adjusted 68,300, with the Portland metro area accounting for 46,700 of these positions. Construction employment was overall mostly flat during 2012, with a slight dip downwards toward the end of the year. This owes partly to the uncertainty of the fiscal cliff and presidential election.

Construction on the new transit bridge south of the Marquam Bridge is expected to continue into 2014 with substantial completion scheduled for that year. Several large multifamily projects conceived during 2012 are expected to break ground in 2013, which should help bolster construction numbers in the area.

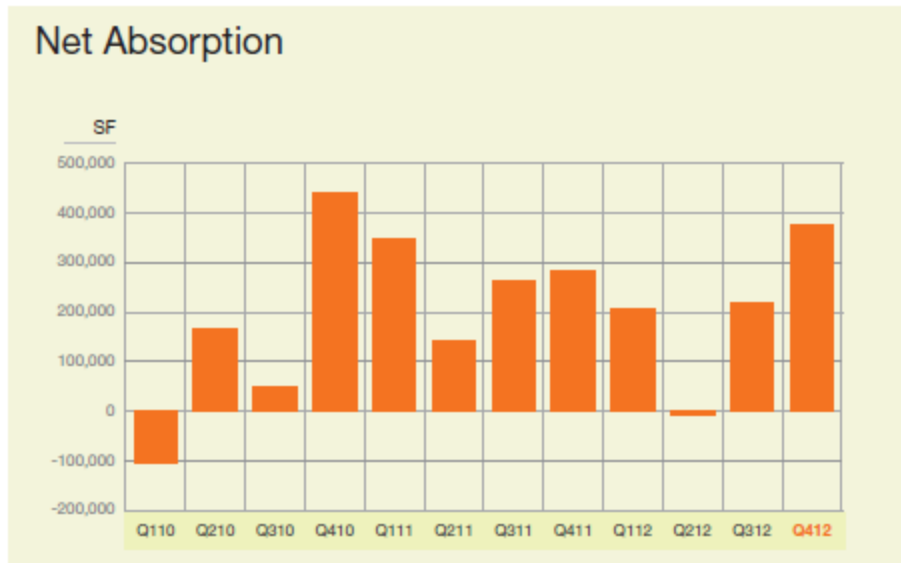
**Figure 5: Unemployment rate, Oregon**

Source: Oregon Employment Department

Oregon's unemployment rate dropped to 8.4 percent by the conclusion of 2012. Oregon continues to lag behind the rest of the nation employment-wise, but there are reasons to believe that these numbers will improve. This is the lowest year-end unemployment in Oregon since the figure peaked in 2009 at an average 11.1 percent. National unemployment remains at a seasonally adjusted 8.1 percent, rising up from 7.2 percent in the third quarter.

Employment numbers are expected to improve following the fiscal cliff compromise and presidential election, in addition to more robust market fundamentals.



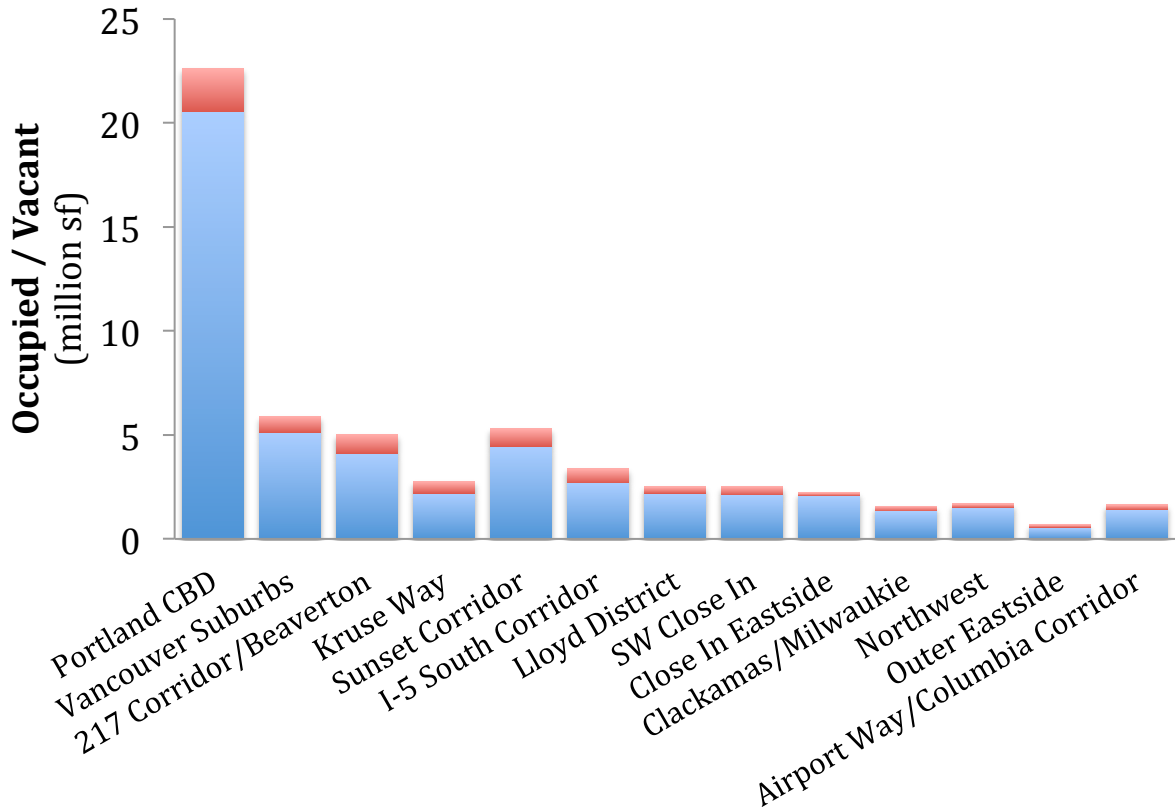


Source: Kidder Mathews

| Key market indicators |                                  | 12-month forecast |
|-----------------------|----------------------------------|-------------------|
| Supply                | Supply                           | ➡ 57,894,035 sf   |
|                       | Direct vacancy rate              | ⬇️ 11.9%          |
|                       | Total vacancy rate               | ⬇️ 12.7%          |
|                       | Under construction (% preleased) | ➡ 292,690 (34%)   |
| Demand                | Leasing activity 12 mo. % change | ⬇️ -37.0%         |
|                       | YTD net absorption               | ⬆️ 1,492,011 sf   |
| Pricing               | 12-month overall rent % change   | ⬆️ +0.9%          |
|                       | Class A overall asking rent      | ⬆️ \$24.10 sf     |

Source: Jones, Lang & LaSalle

**Figure 6: Submarket inventory, occupied and vacant**



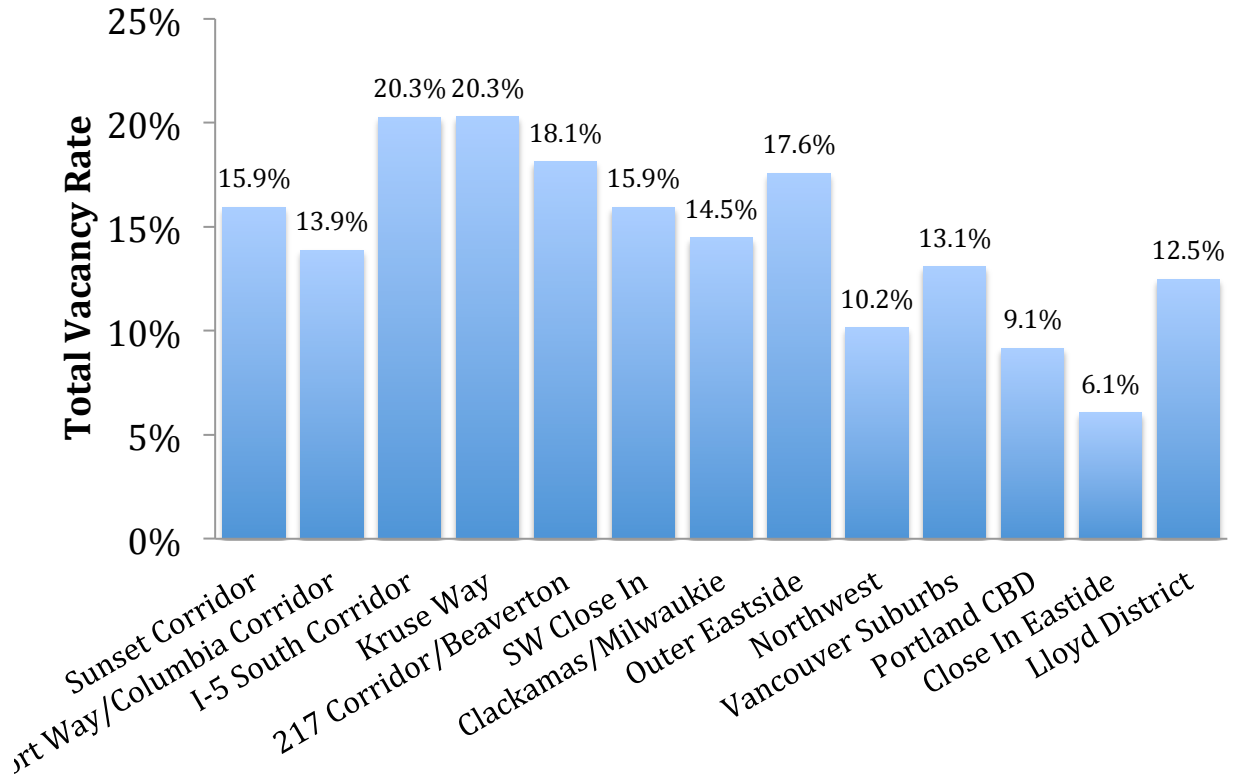
Source: Jones Lang LaSalle

Nearly every submarket in the metro area saw a small increase in lease rates in Q4. With vacancy rates dropping slowly and space slowly being absorbed, rents are expected to climb in submarkets such as the central east side, Northwest, Clackamas/Milwaukie, the Vancouver Suburbs and the CBD, all boasting vacancy rates below 15 percent.

Suburban submarkets such as Kruse Way appear to have bottomed out, with the high vacancy rates being absorbed as rents have remained stable. Growth is expected in fundamentals of these class A spaces, although their vacancy rates remain stubbornly high. Vacancy rates remain in the high teens or above 20 percent in Hillsboro, Kruse Way, Tualatin, I5 South Corridor and the 217 Corridor. The close-in east side, Lloyd and CBD submarkets and continue to enjoy vacancy rates that are below those of the other dominant submarkets. These trends are expected to continue as rents rise and supply remains constant. Currently there is only 98,424

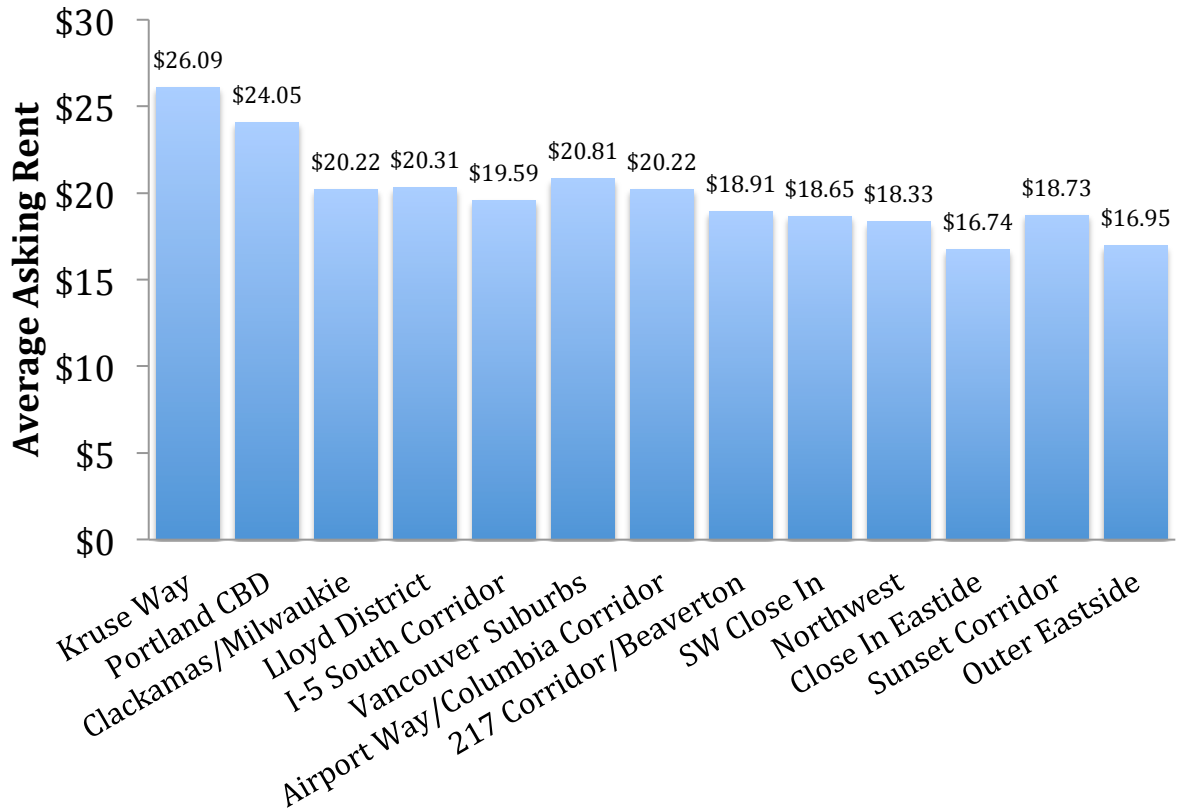
square feet of new office space in the pipeline for all suburban submarkets, according to NAI Norris, Beggs & Simpson.

**Figure 7: Submarket vacancy rates**



With a year of slow and steady improvement in the suburban submarkets, it is likely that these trends will continue through 2013. Low vacancy such as the 6.1 percent rate in the Central Eastside is unlikely to be remedied with ground-up development, but rather the repurposing of existing spaces. This usually represents a lower cost of development, and creates edgy, green spaces such as the Leftbank project on N Broadway.

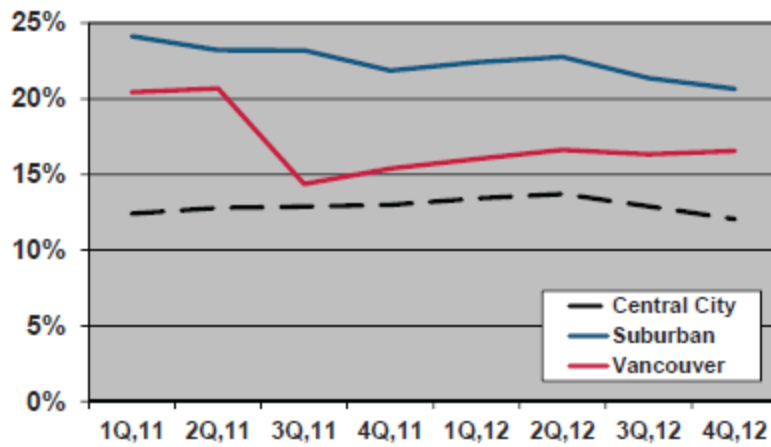
**Figure 8: Submarket average asking rents**



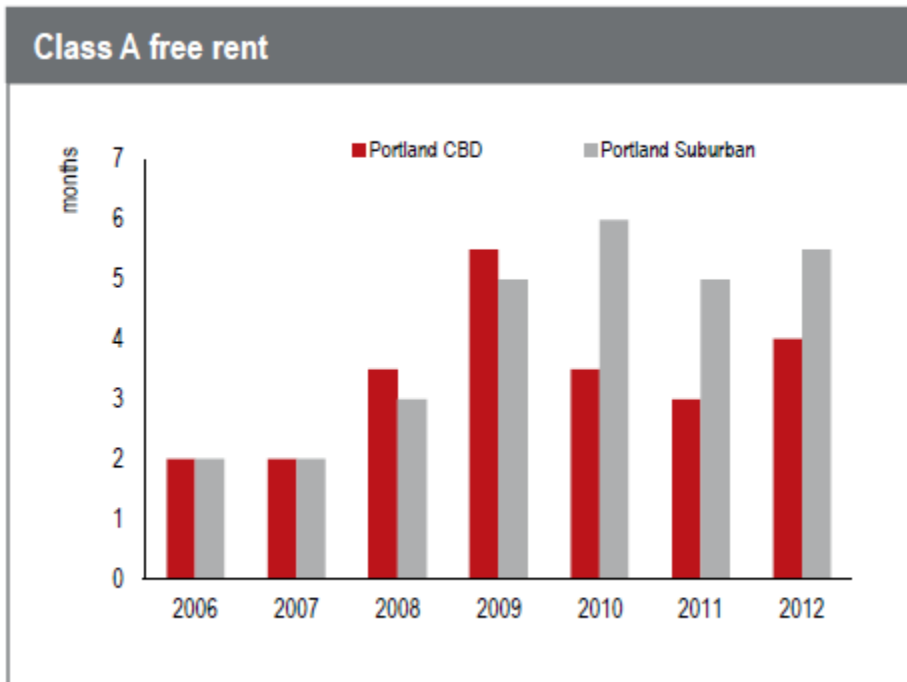
Kruse Way saw an uptick in the average lease rate despite having one of the highest vacancy rates in the metro area. This is likely caused by a higher demand for true class A space, of which the market appears to be running short. This is likely to last until the completion of the Edith Green building in the CBD, which will add approximately 315,000 square feet of new space.

Rents in suburban markets posted small gains in Q4, and these are likely to continue rising through 2013. Landlords are hopeful that this is the signal that the bottom has hit in 2012. Concessions are likely to continue in the suburbs until vacancy rates drop and the market regains balance.

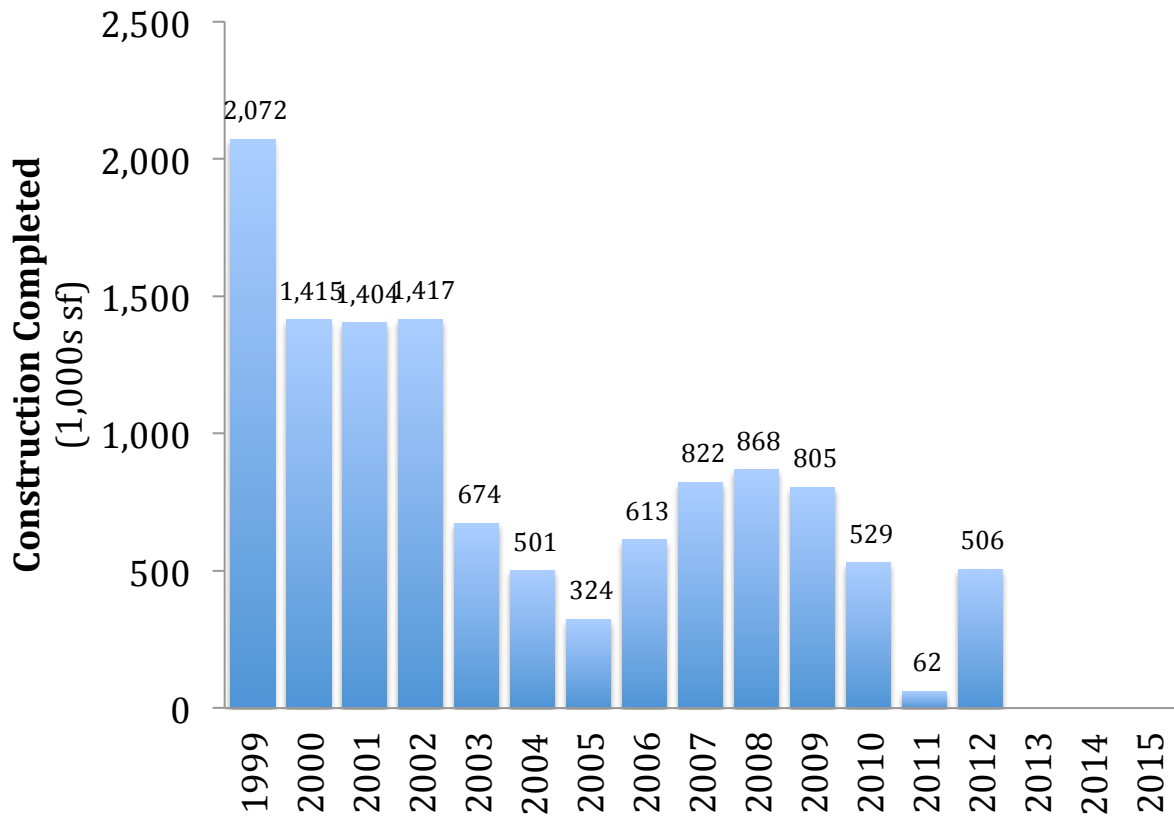
### Vacancy Comparison (%)



Source: NAI Norris, Beggs & Simpson



Source: Jones Lang LaSalle

**Figure 9: Office construction completed, Portland**

Source: Colliers International

Colliers International reports 506,025 square feet of space constructed in 2012. This represents a significant improvement from 2011, but is lower than the previous 5 years. This number should climb in future quarters, but most studies agree that speculative construction is still further down the road. With the current supply on hand it is unlikely that speculative building will reach the levels of the early 2000's anytime soon, but as supply is absorbed it is likely that developers will reenter the market.

It has been said that Portland developers tend to wait until vacancy is very low before beginning a new speculative building cycle. Other markets, such as those in Texas, have a much lower threshold to develop on speculation and therefore carry higher vacancy rates year over year.

With the success of redevelopments such as the Spaulding-Hamilton, Yeon and Loyalty buildings in the CBD, it is likely that the trend of refurbishing existing spaces will continue until a new construction cycle begins.

**Table 1: Major lease transactions, fourth quarter 2012**

| Completed lease transactions |                                  |                    |        |               |
|------------------------------|----------------------------------|--------------------|--------|---------------|
| Tenant                       | Building/Address                 | Submarket          | SF     | Type          |
| M Financial                  | Brewery Block 4                  | CBD                | 70,000 | Renewal       |
| DW Fritz Automation          | Wilsonville I-5 Corporate Center | I-5 South Corridor | 70,000 | New           |
| Jive Software                | Federal Reserve                  | CBD                | 51,000 | Renewal       |
| Daimler                      | Montgomery Park                  | Northwest          | 41,000 | Expansion     |
| New Relic                    | US Bancorp Tower                 | CBD                | 38,702 | New/Expansion |
| Thetus                       | Historic US National Bank Block  | CBD                | 32,000 | New           |
| University Medical Group     | Con-way Crossings NW             | Northwest          | 25,640 | New           |
| ESCO Corporation             | Montgomery Park                  | Northwest          | 23,000 | Expansion     |
| Phoseon Technology           | Evergreen Business Park          | Sunset Corridor    | 20,000 | Renewal       |
| PriceWaterhouseCoopers       | Fox Tower                        | CBD                | 19,290 | New           |
| Survey Monkey                | US Bancorp Tower                 | CBD                | 18,973 | New           |
| R.V. Kuhns & Associates      | Pacwest Center                   | CBD                | 18,000 | New           |
| M-Six                        | 1 <sup>st</sup> & Ash            | CBD                | 16,000 | New           |

Source: Jones Lang LaSalle

**Table 2: Major sale transactions, fourth quarter 2012**

| SALES ACTIVITY                    |           |            |             |          |                  |
|-----------------------------------|-----------|------------|-------------|----------|------------------|
| PROJECT                           | CITY      | SALE DATE  | SALES PRICE | PRICE/SF | TRANSACTION TYPE |
| Fleischner-Mayer Bldg.            | Portland  | 10/22/2012 | \$6,000,000 | \$158    | Investment       |
| AmberGlen Corporate Center        | Beaverton | 10/09/2012 | \$4,500,000 | \$60     | Owner/User       |
| Johnson Street Professional Bldg. | Portland  | 11/16/2012 | \$4,075,000 | \$272    | Investment       |
| HDJ Building, Bldg. B             | Vancouver | 12/07/2012 | \$3,600,000 | \$154    | Owner/User       |

The fourth quarter saw a handful of sizable lease transactions, ranging from M Financial renewing their lease in the Brewery Blocks to Daimler expanding into Montgomery Park in Northwest. The suburbs saw less activity and leases of smaller magnitude. With the economic uncertainty of the election and fiscal cliff behind us, it is likely that 2013 will bring renewed energy to the leasing and transaction market as investors capitalize upon opportunities in a growing market.

It is believed that Portland reached a cyclical bottom in 2012, and that the office market will continue slow, steady upward progress through 2013. There are several large lease turnovers expected this year, which will bring short-term vacancy rates temporary higher. This is expected to pass, along with diminishing tenant conces-

sions and allowances. With unemployment down in 2012 and the single family home market up year over year, a number of signs are pointing to a stronger Portland office market for the next several quarters. ■



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## RETAIL MARKET ANALYSIS

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The combination of Hurricane Sandy and the fiscal cliff did not bode well for retailers, as the Conference Board's index of consumer confidence fell to 65.1 in December, its lowest level since August. However, buyers came out in full force for the holidays, with retailers enjoying a 4 percent overall increase in sales from 2011. Retail property owners and retailers alike move into 2013 with tempered expectations for slow, continual growth while the economy strengthens.

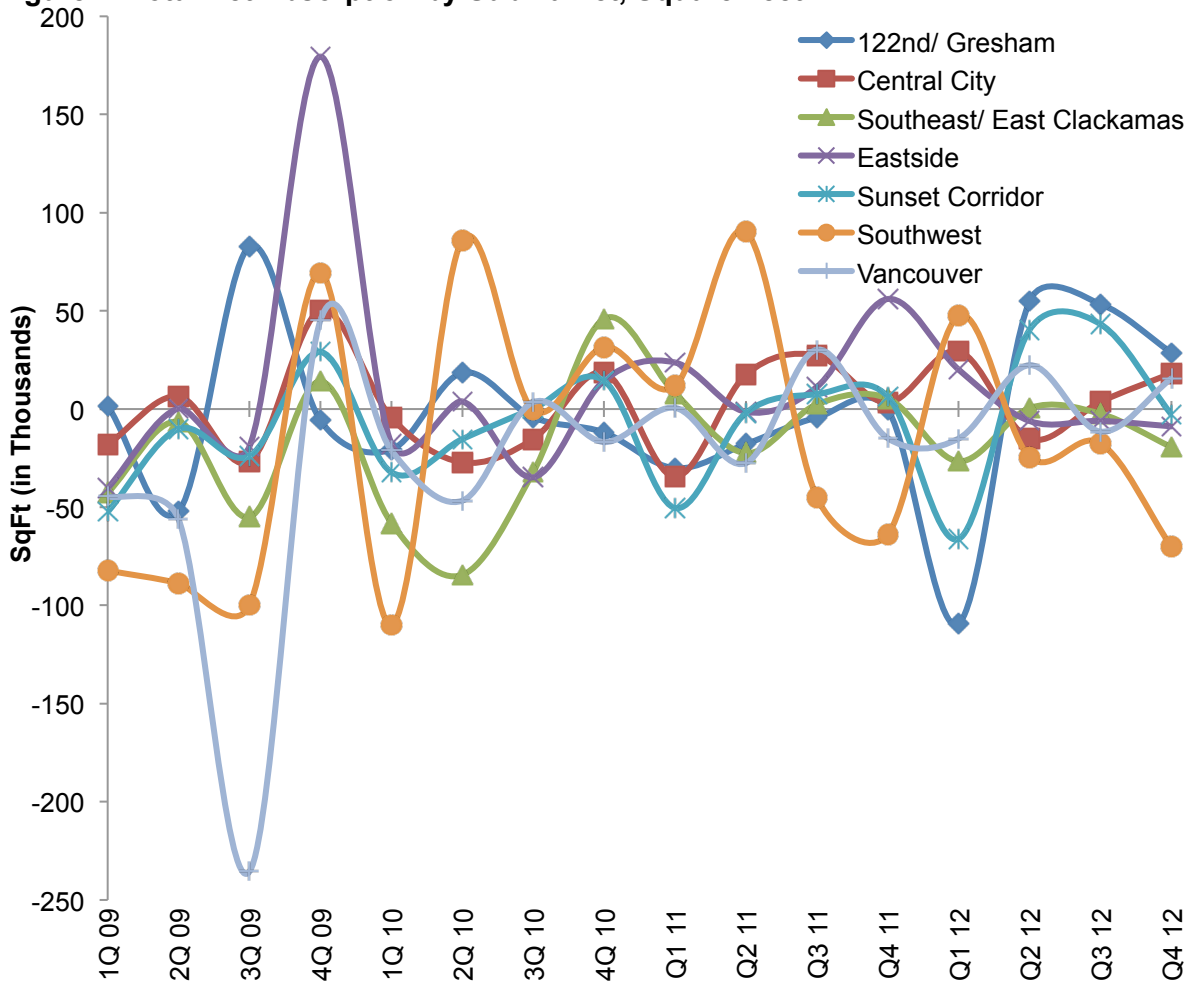
Cushman & Wakefield reports an overall retail vacancy rate of 5.7 percent, up three tenths of a percentage from the same period last year. Absorption totaled 141,586 square feet for the year, and rents are up by 0.4 percent to 15.83 per square foot. These metrics are expected to improve in 2013, which will lead to higher rental rates.

Mixed-use projects drove much of the retail development in 2012, with developers taking advantage of pedestrian traffic around new department development, reports Kidder Mathews. Cushman & Wakefield report that 469,684 square feet of retail space were delivered to the market in 2012. Most development was build-to-suit or owner-user oriented. Speculative retail construction remains mostly absent, save for smaller infill projects, or ground floors of apartment buildings.

■ George S. McCleary is the owner of MRE properties specializing in commercial real estate investment and development of urban infill properties. He is enrolled in the Master of Real Estate Development program at Portland State University and is an RMLS Fellow in the program. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

Oregon’s economy continues to steadily recover, with activity expected to pick up in 2013. As job growth continues on an upward trend, the retail sector should see increased demand as consumers return to the market. Consumers have been spooked by the election and natural disasters, but have been encouraged by a slow turn-around in the housing market. Consumer confidence is expected to rise alongside news of job creation and a residential housing market turnaround. Retailers continue to lose money to online sellers, and have made efforts to level the playing field. Legislation has been proposed that charges a sales tax for online purchases.

**Figure 1: Total Net Absorption by Submarket, Square Feet**

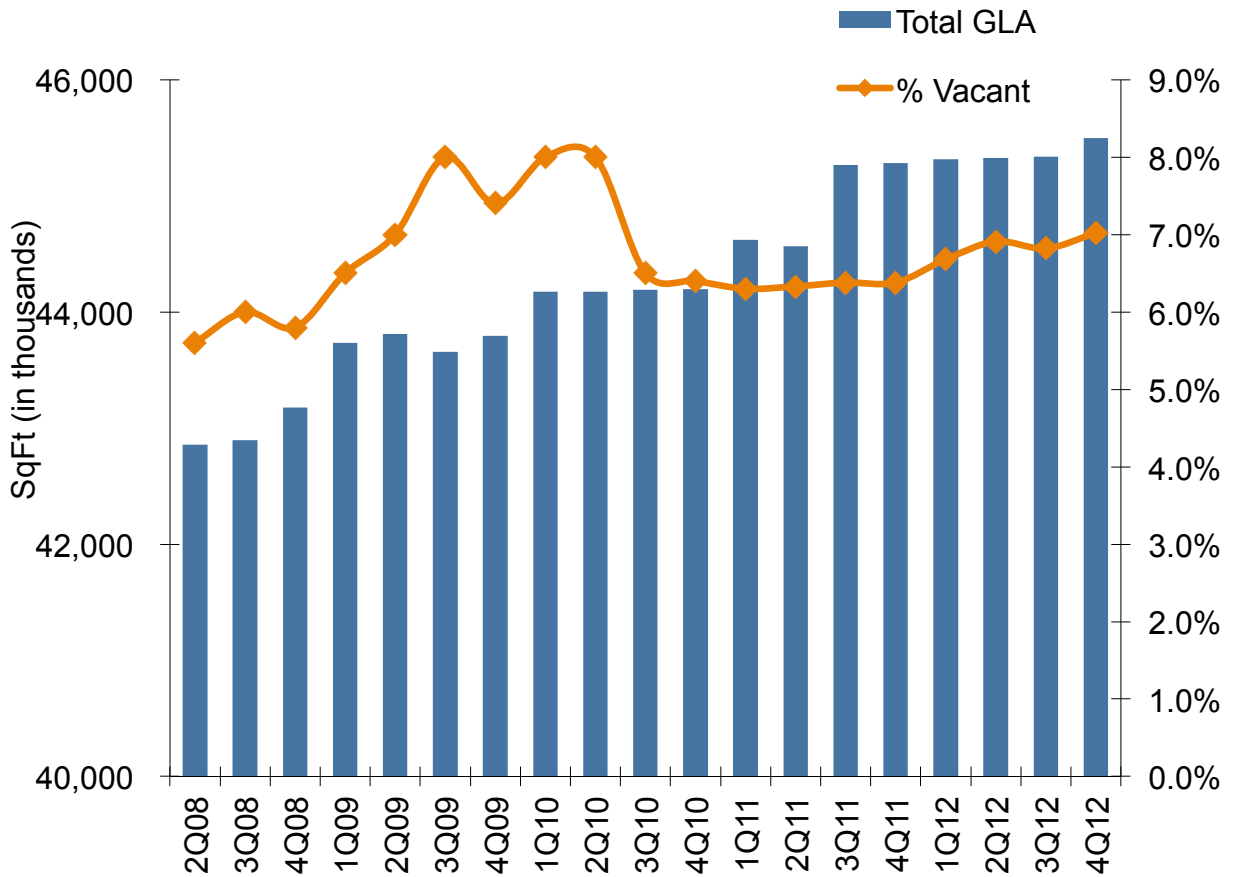


Source: Norris, Beggs, & Simpson Retail Reports

Norris, Beggs & Simpson reports negative net absorption in four of the seven major submarkets. The Southwest district lost the most, reporting a negative 70,201 square feet. 122<sup>nd</sup>/Gresham led all submarkets with a gain of 28,713 square feet of positive net absorption. Vancouver was a distant second, with a net 15,571 square feet absorbed. The Eastside, Central City, Clackamas, and Sunset Corridor all experienced losses of 8806, 10,840, 19,379, and 2,809 square feet, respectively.

In contrast, Kidder Mathews reports a positive net absorption for the quarter of 212,380 square feet, but a negative 83,458 square feet for the year, along with a vacancy rate of 5.9 percent. The Central City appears to be the only submarket with continuous improvement each quarter in terms of net absorption, with other markets subject to more stark fluctuations.

**Figure 2: Total Gross Leasable Area (GLA) and Vacancy (%)**

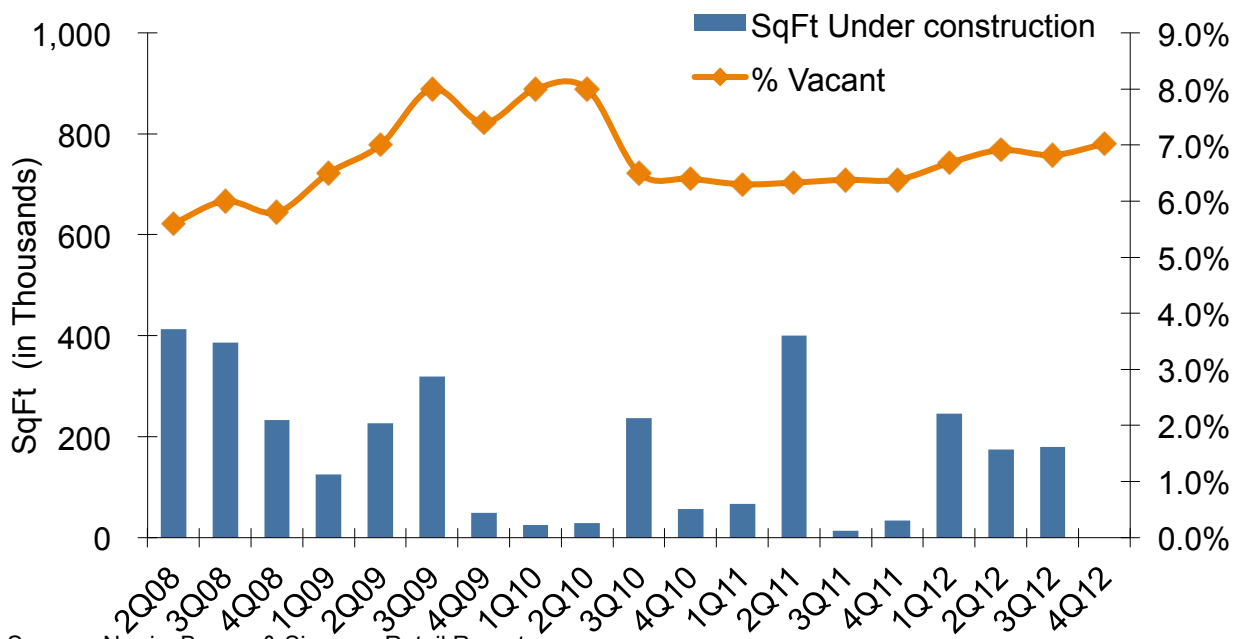


Source: Norris, Beggs, & Simpson Retail Reports

The total amount of gross leasable area (GLA) has remained relatively flat over the past six quarters, with little square footage delivered to the market. This past quarter saw 47,243 square feet delivered to the market with a 5.9 percent vacancy rate, according to Kidder Mathews. Vacancy rates have remained relatively flat for over two years, but have had a slight uptick in 2012. Negative absorption, tenant concessions, internet sales and weak market fundamentals have inhibited recovery.

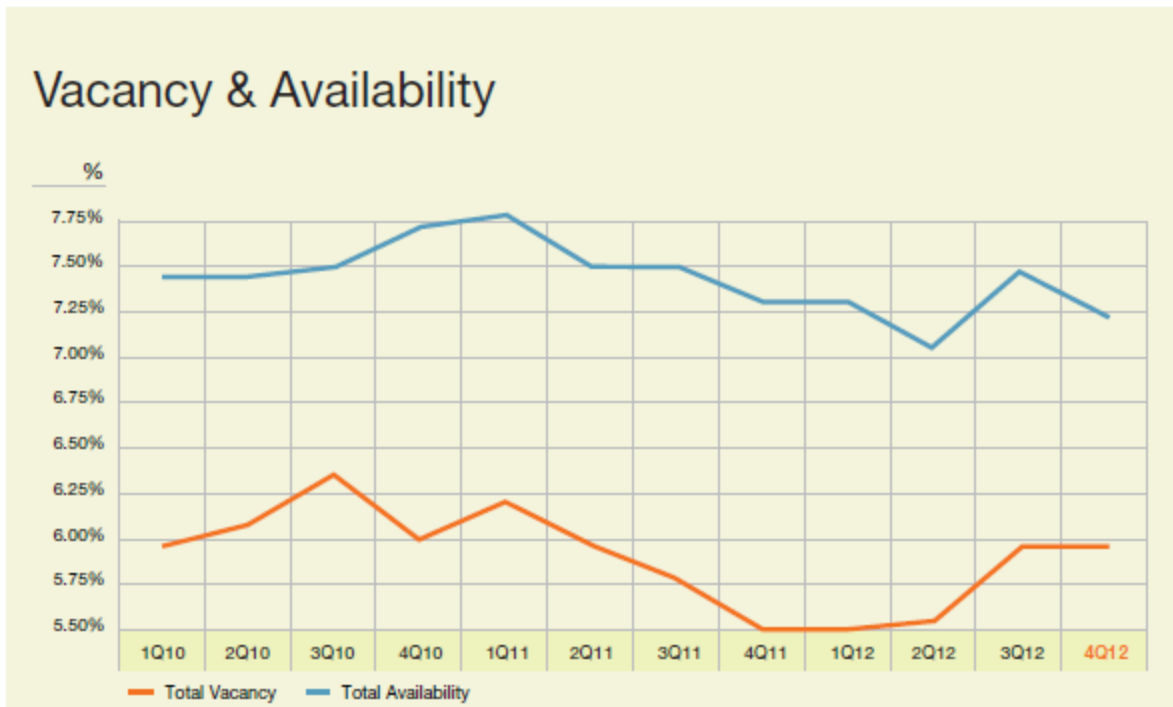
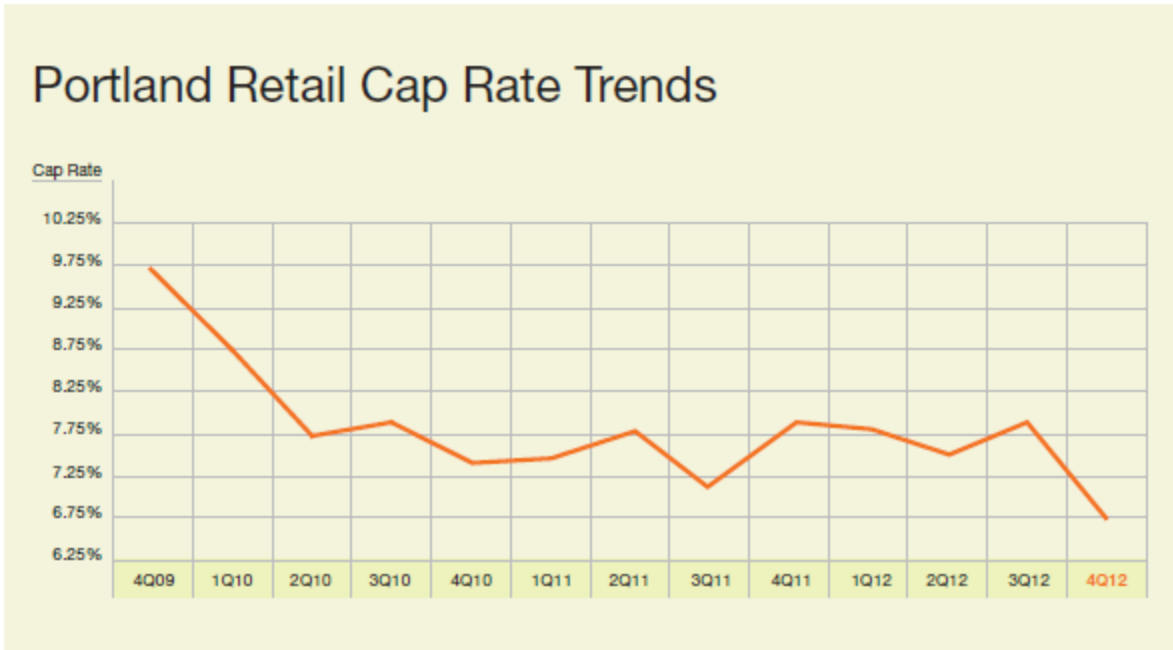
The fourth quarter saw two large deliveries to the market in the 137,000 target store in the Jantzen Beach SuperCenter and the 95,000 square foot Stafford Hills Tennis Club.

**Figure 3: SqFt of Retail Space Under Construction and Vacancy (%)**



Norris, Beggs & Simpson report zero space under construction, and Kidder Mathews reports a scant 47,240. Developers appear to be sidelined by a difficult market, and retailers have been constrained by weak economic fundamentals and uncertainty. Despite this, vacancy has remained between 6-7 percent for the past ten quarters.

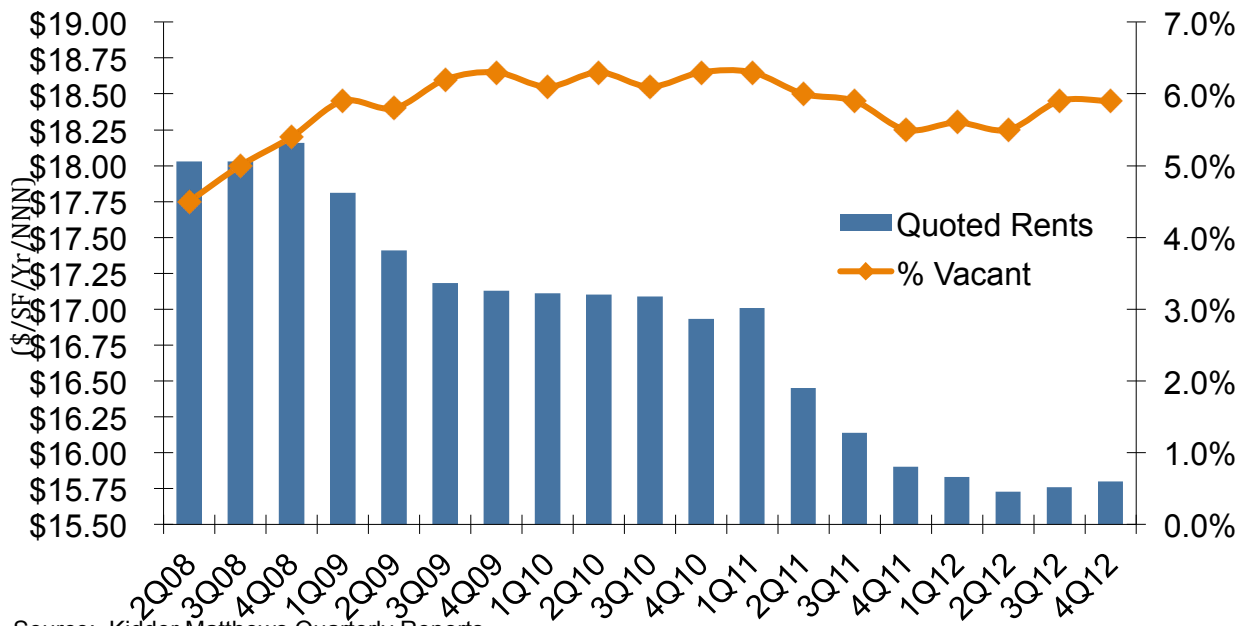
Construction numbers have been low for several quarters. Historically, the numbers being delivered to the market have been very low for some time and has led to a contraction in vacancy rates. This, along with the destruction of existing obsolete buildings will contribute to this eventual turnaround in the market.



Source: Kidder Mathews Retail Reports

Overall, capitalization rates have been headed downwards, which is good news for owners who are looking to sell. Not a lot of selling has been happening, owing mostly to the depressed state of many retail projects, along with the positive economic outlook for the future.

Figure 4: Quoted Rents and Retail Vacancy (%)



Kidder Matthews reports a small uptick in vacancy in the third quarter, coupled with a very slight increase in rents. For the most part, the market remained flat. While this is not ideal, it must be considered that this was during a period of great economic uncertainty. It is expected that 2013 will bring changes in retail market fundamentals, along with general economic prosperity. This should lead to lease rates reaching their 2008 high water mark within a year or two.

## 2012 Sale Activity of Note

| Property Name                       | Location         | Size (SF) | Vacancy | Date of Sale | Sale Price   | Price Per SF | Cap Rate |
|-------------------------------------|------------------|-----------|---------|--------------|--------------|--------------|----------|
| Wood Village Town Center            | Wood Village, OR | 149,806   | 4%      | Oct-12       | \$27,600,000 | \$184        | 6.40%    |
| Tigard Marketplace                  | Tigard, OR       | 136,879   | 0%      | Aug-12       | \$16,000,000 | \$117        | N/A      |
| Riverstone Marketplace              | Vancouver, WA    | 13,837    | 0%      | Jun-12       | \$27,977,000 | \$246        | N/A      |
| Fisher's Mercantile Center          | Vancouver, WA    | 36,014    | 36%     | Jul-12       | \$4,000,000  | \$111        | 8.50%    |
| Salmon Creek Square                 | Vancouver, WA    | 21,816    | 7%      | Sep-12       | \$8,000,000  | \$367        | 7.42%    |
| Tanasbourne Town Center             | Hillsboro, OR    | 12,000    | 0%      | Mar-12       | \$4,473,500  | \$373        | 6.80%    |
| Aaron's Furniture                   | Portland, OR     | 11,429    | 0%      | Oct-12       | \$1,900,000  | \$166        | 7.10%    |
| Hansen's Corner Retail Strip Center | Lake Oswego, OR  | 10,905    | 0%      | Nov-12       | \$2,650,000  | \$243        | 7.25%    |

The largest retail transaction of Q4 was the sale of the Wood Village Town Center in Wood Village, OR. This transaction carried a low cap rate (6.4 percent) for a Gresham area project. Cap rates are expected to rise in the coming years as inventory is added and competition heats up for prime space. Fisher's Mercantile Center sold at a higher 8.5 percent cap rate, but has a vacancy factor of 64 percent. Investors seeking to rehabilitate or restore existing product have ample supply from which to choose, so long as new construction remains infeasible on spec.

The Portland area retail market has improved by some measures and declined in others, but most agree that it has done well given the circumstances in 2012. Other property types such as multifamily have rebounded impressively in recent quarters. While this type of hot market is not expected for the retail sector, retail remains a key component of many of these projects. The ground floor retail element of many apartment projects should add new, class A space to the market and prove to developers that there is room in the market for more retail product.

Nationally, a portion of the success of the retail market will be determined by pending legislation regarding mandated sales tax in online transactions. This could help bolster retail sales across the board. This, along with little construction, improving market fundamentals, and increased consumer confidence is likely to spur an uptick in demand in 2013. ■

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# INDUSTRIAL MARKET ANALYSIS

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The fourth quarter of 2012 was the tenth straight quarter of positive absorption in the Portland industrial/flex market. It also, however, had the lowest number of leasing deals since the third quarter of 2003. This represents just 38 percent of the average quarterly leasing volume over the past 10 years. Overall economic progress in the area helped spur positive absorption, but a lack of class A warehouse and distribution space is placing limitations on institutional tenants seeking this type of space.

Economic growth has been affected on a national level by fiscal cliff tax code restructuring, natural disasters, and the presidential election. The Federal Reserve has kept interest rates low, and has promised to do so for at least two years. The shrinking of China's economy and the continuing European debt crisis are likely to reduce US exports and affect the national markets as a result. The duration and severity of these issues will have a measurable effect on how markets perform in 2013.

Locally, the economy appears to be improving. Oregon's unemployment rate dropped to 8.4 percent by the end of 2012, and is inching ever closer to the national average. 8.4 percent is the lowest year-end unemployment percentage since its peak in 2009 at 11.1 percent. National unemployment rose in the fourth quarter, while Oregon's continued to drop.

■ George S. McCleary is the owner of MRE properties specializing in commercial real estate investment and development of urban infill properties. He is enrolled in the Master of Real Estate Development program at Portland State University and is an RMLS Fellow in the program. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

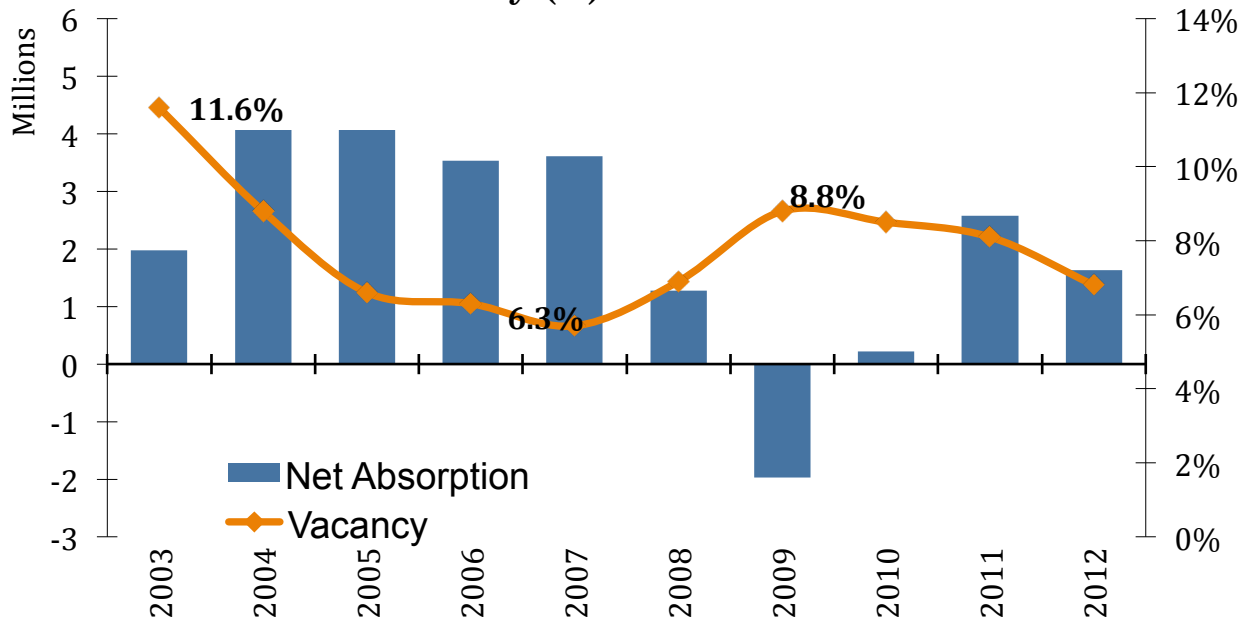


Although there is a lack of space in certain classes, lease rates are generally still not supportive of speculative construction, as has been in the case for the past four years. Developers have constructed facilities, but nearly all development has been built-to-suit. This is expected to continue in the months to come, with market fundamentals eventually arriving at levels that support speculative development.

Colliers Reports that 2012 had a total net absorption of 1,629,782 square feet and ended with a vacancy rate of 6.8 percent. This is the lowest post-recession vacancy rate the market has seen, although net absorption failed to meet expectations from 2011. This positive net absorption occurred despite negative net absorption in three of the five major submarkets. Northeast Portland accounted for 37 percent of all vacant space and posted 308,375 square feet of negative net absorption. This is partly due to the fact that class A space continues to drive current leasing activity. Current vacancy is disproportionately weighted towards class B and C space, presenting challenges in the quarters to come. Much of the inventory in NE Portland is class B and C space.

This subdued activity in these market sectors is expected to improve in 2013, as fundamentals remain upwardly mobile. The improvement or refurbishment of class B and C spaces could lead to a lower supply, and lower vacancy factor in these submarkets.

**Figure 1: Overall Industrial Net Absorption (SqFt) and Vacancy (%) for Portland Market**



Source: Colliers International

Bybee Lake Logistics received both a new tenant and large lease renewal in Q4. All told, there were no significant lease transactions that significantly impacted net absorption in the fourth quarter. Sales volume declined significantly quarter by quarter in 2012, with the peak reached in Q3 and Q4 of 2011.

Inventory levels have remained relatively consistent over the past three years, with slight increased at the end of 2010 and beginning of 2011.

No significant sale transactions were recorded in Q4, although there were several deals in the \$10 million+ category, reports Kidder Mathews.

| UPDATE: SIGNIFICANT LEASES & SALES |                        |                                  |         |            |                  |
|------------------------------------|------------------------|----------------------------------|---------|------------|------------------|
| LEASE ACTIVITY                     |                        |                                  |         |            |                  |
| PROJECT                            | SUBMARKET              | TENANT                           | SIZE SF | DATE       | TRANSACTION TYPE |
| Bybee Lake Logistics, Phase II     | Rivergate              | OIA Global Logistics SCM, Inc.   | 167,305 | 12/12/2012 | Renewal          |
| Bybee Lake Logistics, Phase I      | Rivergate              | Exel Inc.                        | 130,255 | 10/25/2012 | New Deal         |
| Birtcher Center at Townsend Way    | East Columbia Corridor | Communications Test Design, Inc. | 124,154 | 11/01/2012 | New Deal         |
| PDX Corporate Center East          | East Columbia Corridor | CEVA Freight, LLC                | 64,977  | 11/05/2012 | New Deal         |

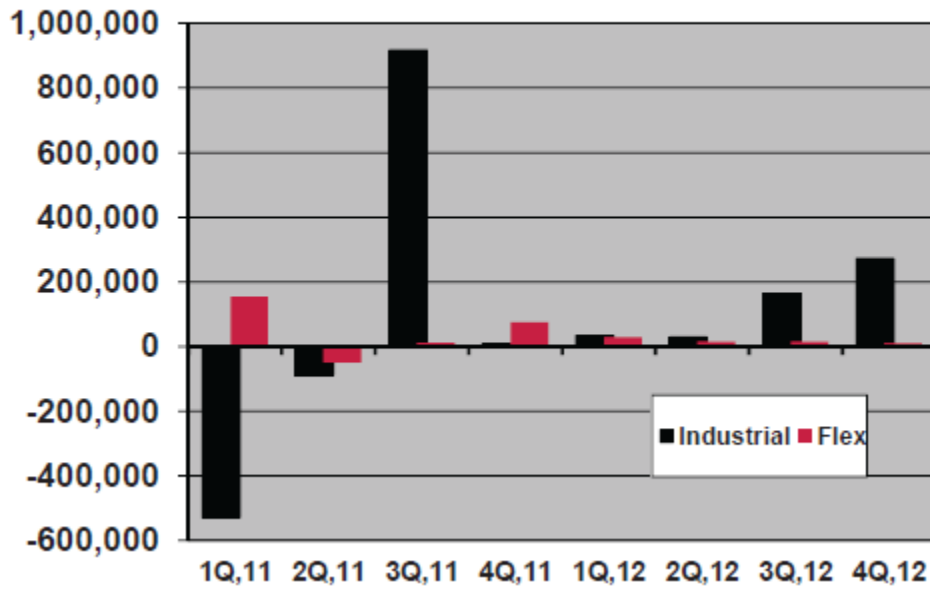
### 2012 Sale Activity of Note

| Property Name  | Location  | Size (SF) | Vacancy | Date of Sale | Sale Price   | Price Per SF |
|--|-----------|-----------|---------|--------------|--------------|--------------|
| 217 Distribution Center                              | Beaverton | 449,245   | 3%      | May 2012     | \$23,350,000 | \$52         |
| Prologis Park Southshore & Northgate Industry Center | Portland  | 676,608   | 5%      | Feb 2012     | \$40,350,000 | \$60         |
| Integrated Device Technology Fabrication Facility    | Hillsboro | 245,000   | 0%      | Mar 2012     | \$25,500,000 | \$104        |
| Foster 205 Commerce Center                           | Portland  | 272,146   | 0%      | Jun 2012     | \$17,385,000 | \$64         |
| 212 Corporate Center                                 | Clackamas | 223,175   | 70%     | Apr 2012     | \$9,500,000  | \$43         |

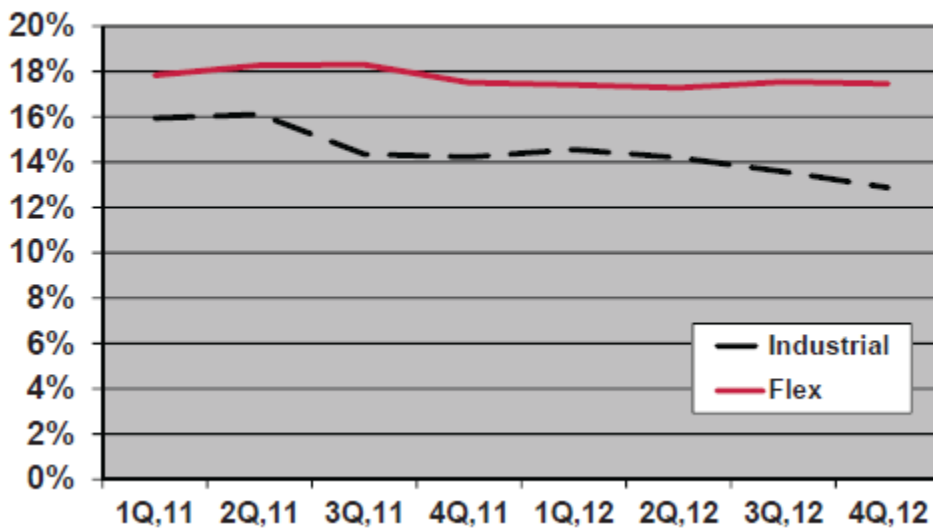
| Major Sale Transactions     |                                |             |            |
|-----------------------------|--------------------------------|-------------|------------|
| Buyer:                      | Building:                      | Price:      | Submarket: |
| Killian Pacific             | 1010 SE 11th Avenue            | \$2,850,000 | Southeast  |
| J & S Ventures LLC          | 1212 W. Fourth Plain Boulevard | \$2,600,000 | Vancouver  |
| JV Property Investments LLC | 802 SE 199th Avenue            | \$2,600,000 | Southeast  |

Source: CoStar

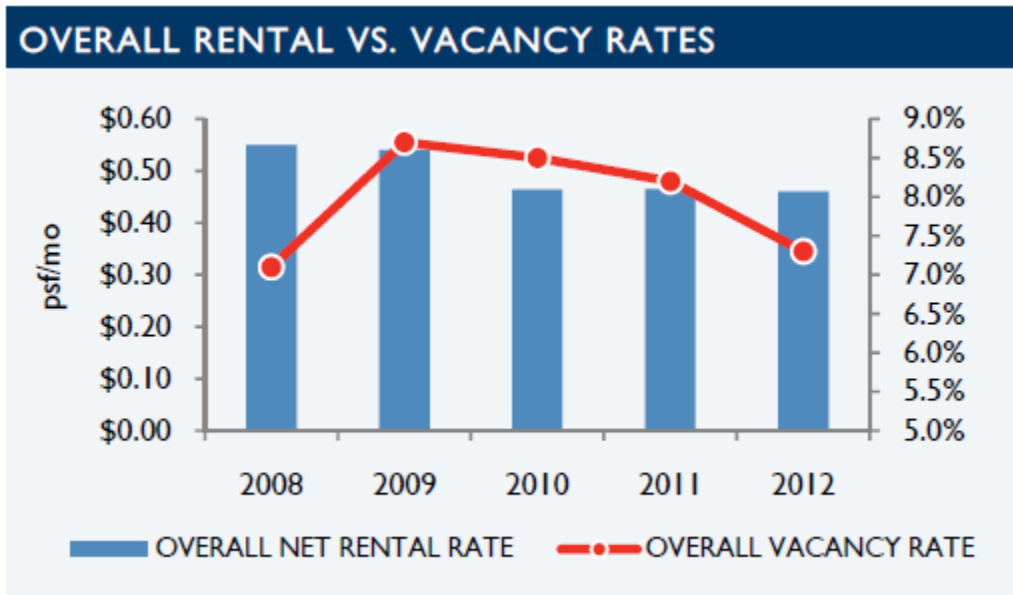
### Absorption Comparison (SF)



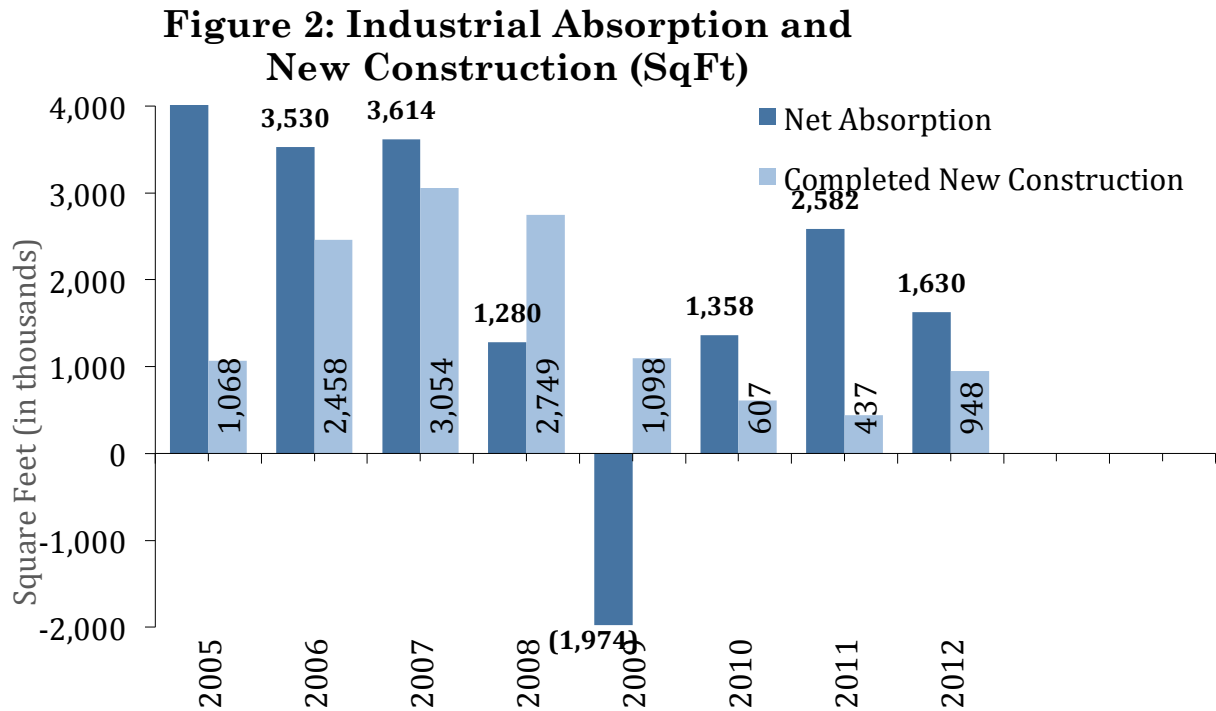
### Vacancy Comparison (%)



Source: Norris, Beggs & Simpson



Source: Cushman & Wakefield

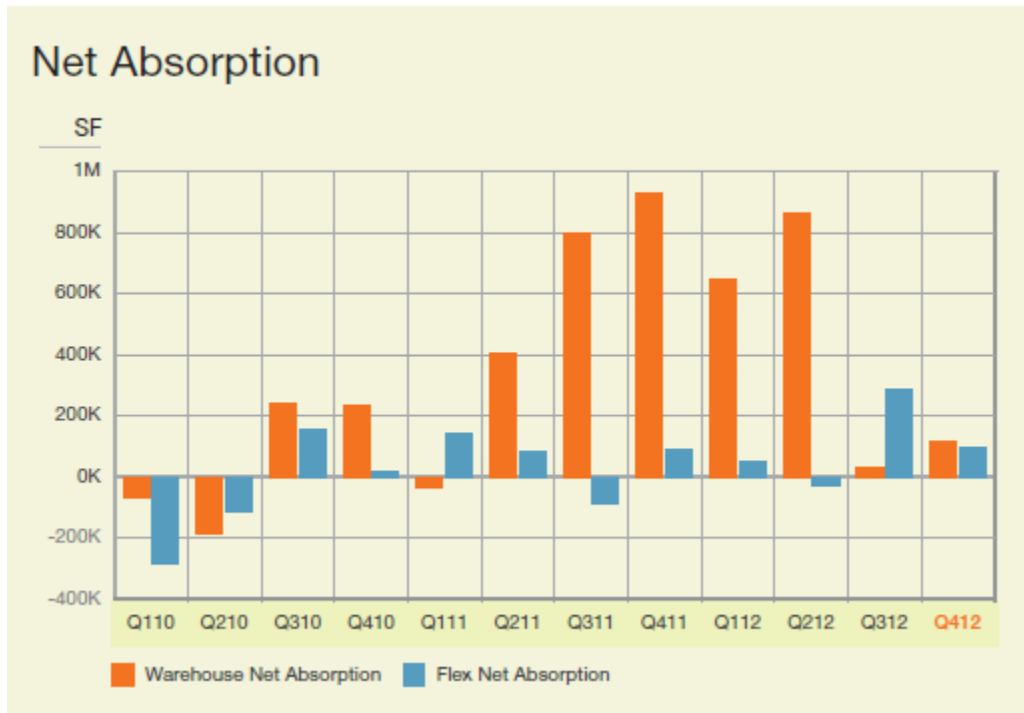


Source: Colliers International Quarterly Reports

Portland has enjoyed its tenth consecutive quarter of positive net absorption since Q3 2010. Although not as strong as 2011 in terms of overall net absorption, 2012 made a strong showing despite difficult external factors such as the election and natural disasters.

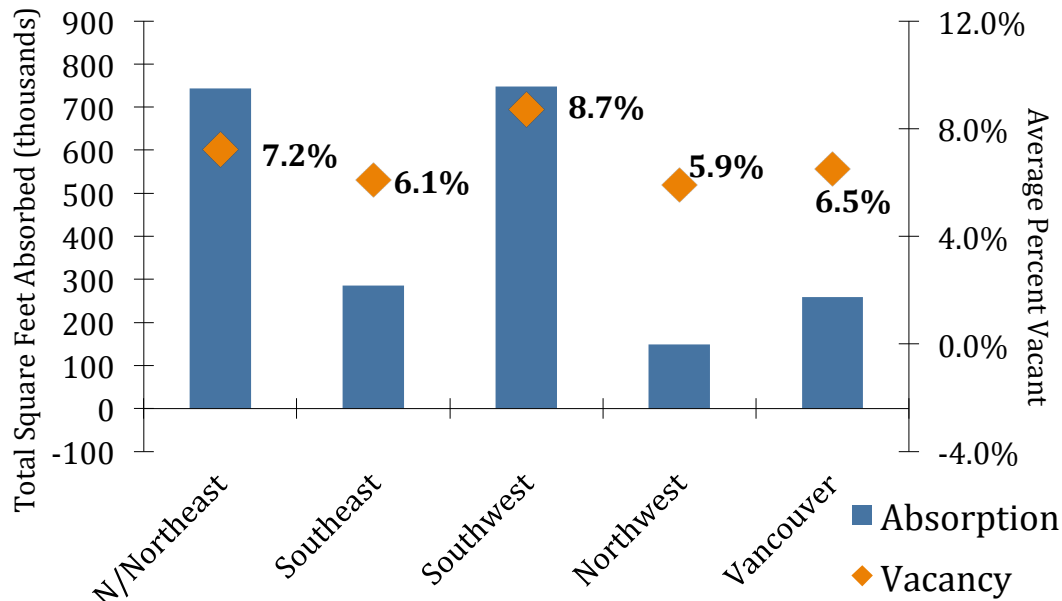
Construction has picked up to the highest level since 2009, although it is safe to assume that most of the projects completed in 2009 were initiated pre-recession. The tightening supply of large, quality warehouse and distribution space should have positive implications for increasing rates and renewed construction activity, reports Colliers International. Additionally, there is a shortage of developable land for industrial projects. Expect refurbishment, repurposing or demolition of existing spaces in 2013.

Redevelopment of existing properties, combined with the urban growth boundary and the robust demand for class A space should lead to a transfer between the ample supply of class B and C spaces and the short supply of class A spaces. This should occur as fundamentals improve and the market tightens.



Source: Kidder Mathews

**Figure 3: Submarket Vacancy and Overall Absorption, Q4 2012**



Source: Cushman and Wakefield, Q4 2012 Industrial Quarterly Report

Vacancy has been decreasing in all submarkets over the past three years, but has held steady at about 6.5 percent for the past three quarters, reports Cushman and Wakefield. The market was decidedly more active during the second half of 2011 and the first half of 2012, which lead to an overall less robust year for 2012 in terms of absorption.

Rental rates have stabilized in Q4. The blended (including shell and office surcharge) average asking rental rate in the market was \$0.45 per square foot per month, NNN, up from \$0.43 per square foot during the first three quarters, reports Kidder Mathews. Kidder Mathews reports that Hillsboro has seen a rise in rents as a result of demand from contractors for warehouse space near the Intel Ronler Acres expansion project.

One of the hardest hit markets has been spaces offering less than 10,000 square feet, which are commonly found in business parks. These spaces charge a larger amount per square foot, and have had higher vacancy rates in recent quarters.

Overall, very little improvement was shown in the last half of 2012, but indicators have remained on the plus side despite a flurry of shaky economic news. Rental rates for flex space have been unstable, while shell/warehouse rates have trended steadily upwards, which is overall good news for the market as a whole. With speculative construction remaining largely out of the picture, it is likely that renovations will be filling the void for class A space in the months to come. For 2013, it is expected that these trends will continue a slow, upward grind. ■