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CENTER FOR REAL ESTATE

Quarterly Report

Volume 6, Number 3

Summer 2012

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SUMMARY AND EDITORIAL

ERIC FRUITS

Editor and Adjunct Professor, Portland State University

As noted in each of the issues over the past year, our economy continues its struggle to get out of recession. Among economic forecasters, cautious optimism has slipped to skeptical hope. The Wall Street Journal survey of economists now say there is a 1-in-5 chance that the U.S. will experience a recession in the next 12 months, which is up from the 1-in-6 chance reported in the last issue of this Report. Standard & Poor's also estimates a 1-in-5 chance of a double-dip recession in the U.S., although the company reports that a slow recovery remains their baseline forecast for the U.S. economy. Mark Zandi of Moody's Analytics puts the risk of a recession at 30 percent.

The Portland Business Journal reports that in a recent visit to Portland, Richard Davis, chairman and CEO of U.S. Bancorp thinks that the economy is slowing down. That is based on his review of same-store sales data and internal bank data showing that trucking companies are shipping less.

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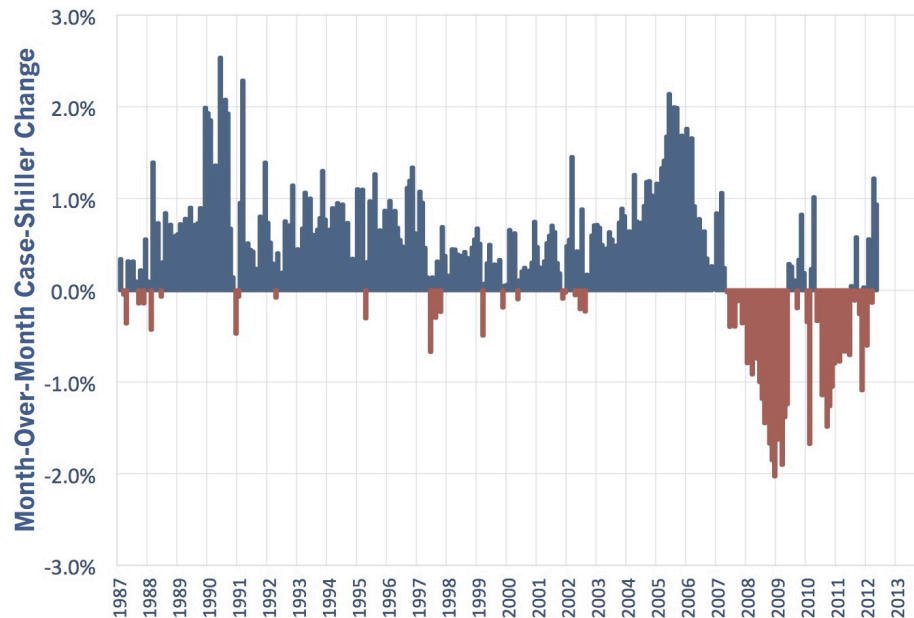
Household income has grown by about 2.5 percent since the end of last year. This is a marked improvement over the past two years, 2010 and 2011, in which income growth had been flat.

House prices and residential construction data suggest the housing sector is recovering slowly. The Case-Shiller Index of home prices for Portland has seen increases in four of the last six months (Figure 1). It's too early to tell whether these upticks are the beginning of an upward trend. The summer of 2009 saw a similar set of upticks, only turn around to more than a year of decreasing home prices.

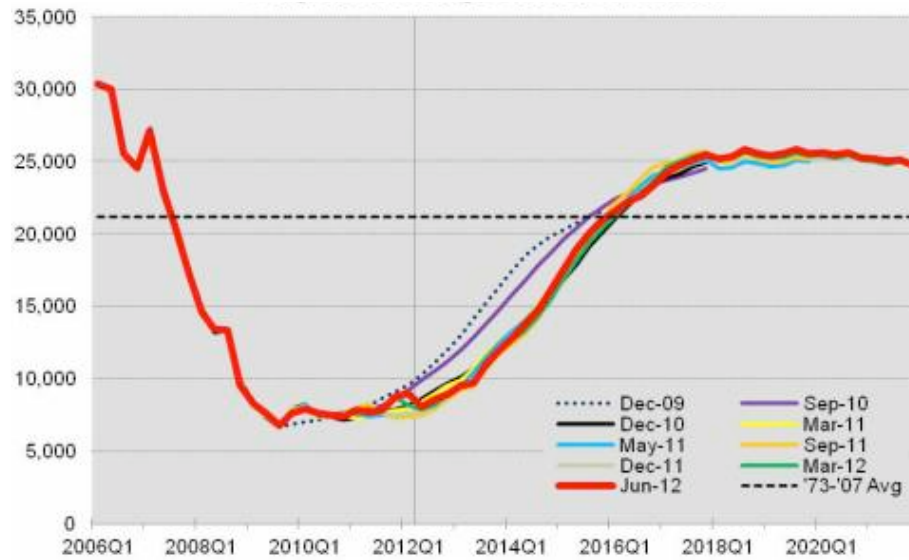
Oregon's Office of Economic Analysis reports that signs suggest that the state's housing market has hit bottom, at least in terms of housing starts, but prices may have further to fall. The agency's forecast of housing starts has remained relatively unchanged for the past two or three years. Looking forward, the state's economists project growth in starts to remain modest in 2012 and 2013 with a return to post-recession levels in 2014 and 2015 (Figure 2).

The Wall Street Journal reports that apartment projects now account for 28 percent of all new housing starts. By way of comparison, in the housing boom of the 2000s, the share was 17.4 percent and in the 1990s the share was 16.7 percent.

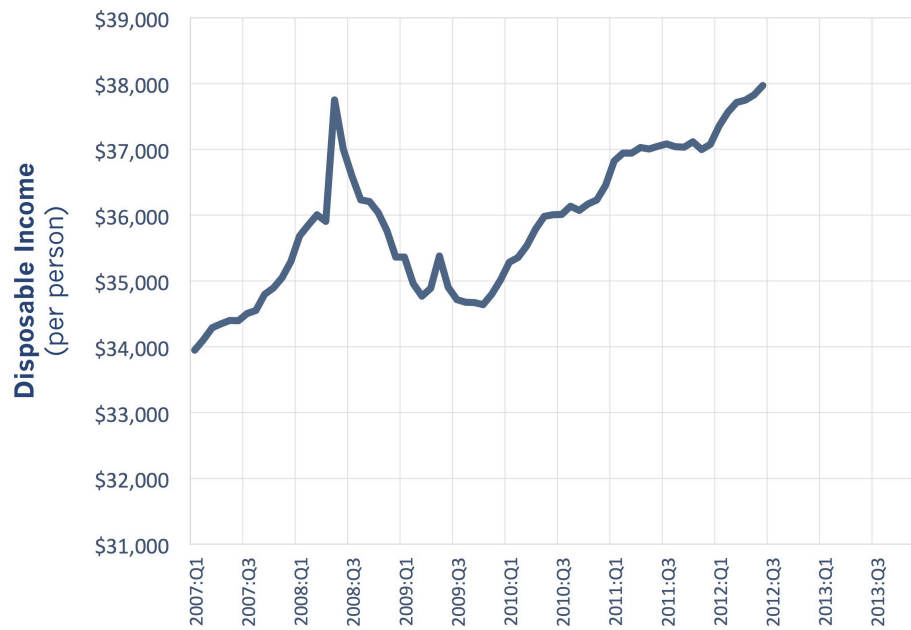
Figure 1: Portland home prices, Case-Shiller index, month-over-month percent change



Source: Author calculations from Standard & Poor's data

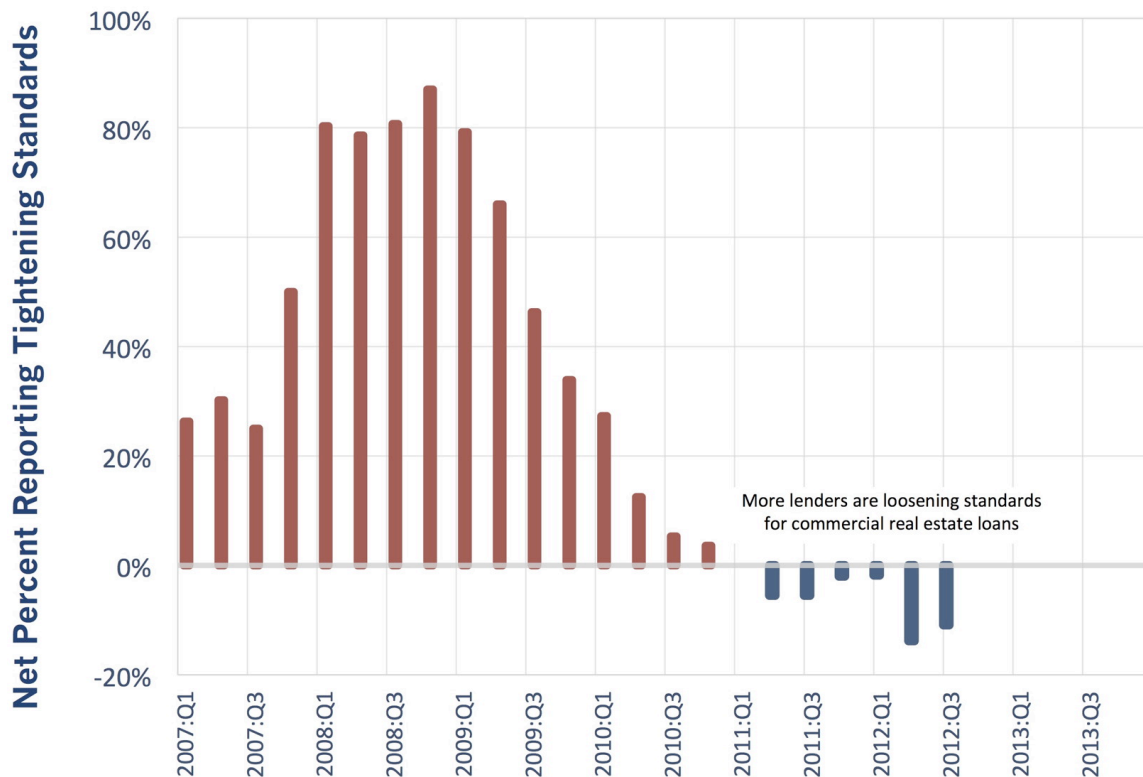
Figure 2: Oregon housing starts forecast

Source: Oregon Office of Economic Analysis

Figure 3: Disposable income, U.S.

Source: U.S. Bureau of Economic Analysis

Figure 4: Net percentage of domestic lenders reporting tightening standards for commercial real estate loans



Source: Federal Reserve Board

Consumer credit has recorded small monthly gains. Nevertheless, consumers have been unable to sustain the high rate of spending growth recorded in the first quarter. The household savings rate rose again in the second quarter, after dipping in the first. In June, consumers held on to their income gains, rather than spending them, help in part by lower motor fuel prices earlier in the summer (Figure 3). Nevertheless, the Economist Intelligence Unit reports that household balance sheets remain strained.

Commercial lending continues to ease, with more lenders reporting that they have loosened standards for commercial real estate loans (Figure 4). On the other hand, the Portland Business Journal reports that in a recent visit to Portland, Richard Davis, chairman and CEO of U.S. Bancorp, indicated his bank had concerns about oversupply in some multifamily markets and has pulled back on funding for apartment projects in Chicago and Boston.

In this issue of the Report, we welcome **George McCleary**, who will be reviewing the office, industrial, and retail sectors of the Oregon real estate market. Mr. 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. **Evan Abramowitz** continues to survey the residential and multifamily markets. He 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. ■

RESIDENTIAL MARKET ANALYSIS

EVAN ABRAMOWITZ

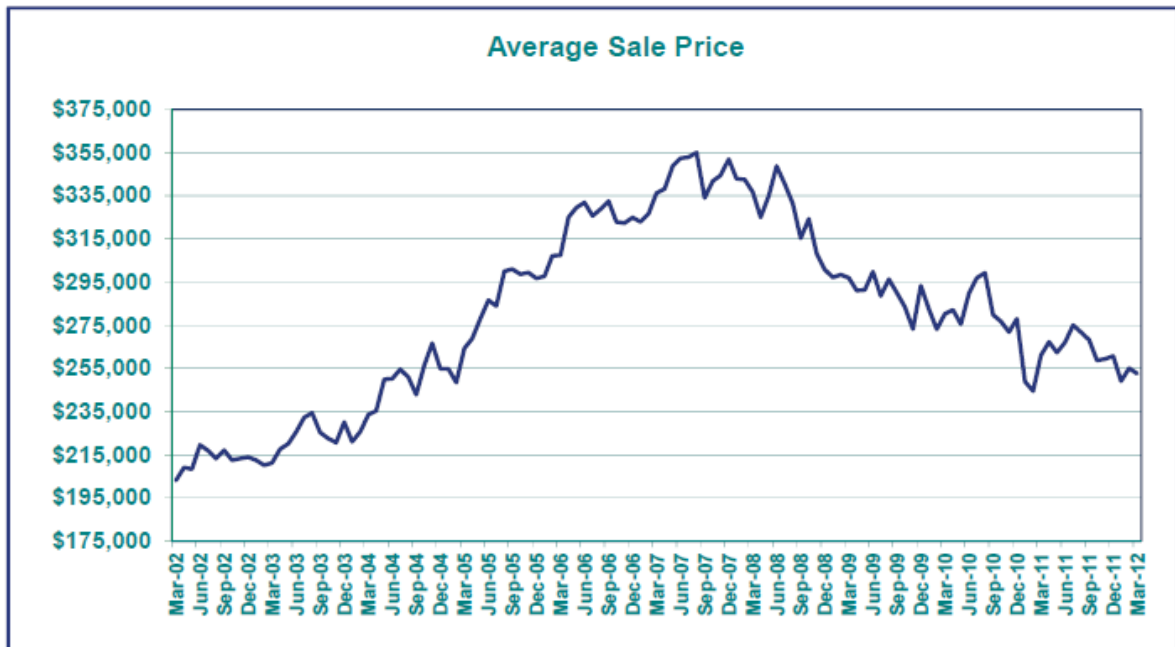
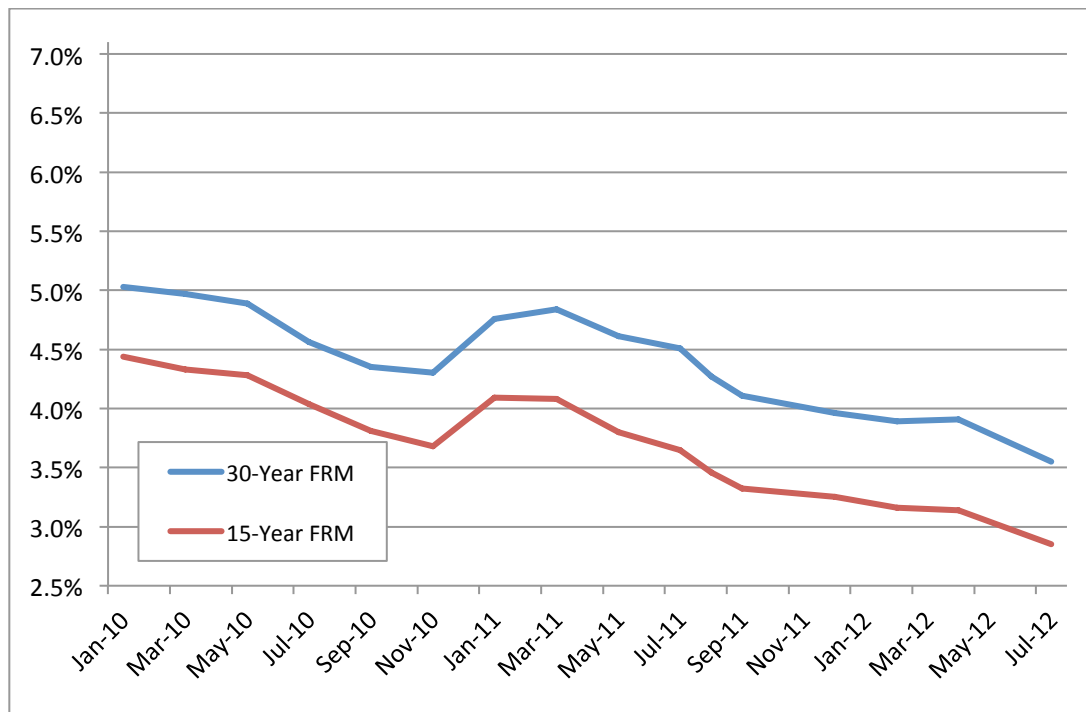
RMLS Student Fellow

Master of Real Estate Development Graduate Student

Existing-home prices continued to show gains but sales fell in June with tight supplies of affordable homes limiting first-time buyers, according to the National Association of Realtors. Lawrence Yum, NAR chief economist, said the bigger story is lower inventory and the recovery in home prices. "Despite the frictions related to obtaining mortgages, buyer interest remains solid. But inventory continues to shrink and that is limiting buying opportunities. This, in turn, is pushing up home prices in many markets," he said. "The price improvement also results from fewer distressed homes in the sales mix."

Median existing home price for all housing types over the past year was \$181,500 in June, up 7.3 percent annually from June 2011. Median prices in the western United States increased by 13.4 percent to \$234,000. Over the same period, the Portland metropolitan area experienced a decrease in median sales prices, but double-digit increase in sales volume. According to the National Association of Realtors, the median sales price in June 2012 was \$233,900, which was an increase of 6.3 percent over June 2011.

■ 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.

Figure 1: Average Sales Price in Portland, 2002-2012**Figure 2: Single Family Mortgage Interest Rate**

Source: Freddie Mac

The National Association of Realtors reports the number of existing home sales in June 2012 was a seasonally adjusted rate of 4.37 million homes sold nationally. This was a 5.4 percent decrease from May, which was seasonally adjusted to 4.62 million.

Mortgage interest rates have 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 3.55 percent in July, down from 3.68 percent in June; the rate was 4.55 percent in July 2011.

First time home buyers constituted 32 percent of homes in June, down from 34 percent in May, but up from 31 percent a year ago. Investors purchased 19 percent of homes in June, up from 17 percent in May.

Table 1: Median Home Values of Existing Detached Homes

	U.S.	West	Portland Metro Area
June 2011 Median Sales Price	\$169,100	\$206,300	\$220,100
June 2012 Median Sales Price	\$181,500	\$234,000	\$233,900
% Change in Median Sales Price	7.9%	13.3%	6.3%
% Change in Number of Sales June 2011- June 2012	4.5%	-3.6%	17.7%

Source: National Association of Realtors

Standard & Poor's Case-Shiller Index for Portland was 135.09 through May 2012. The represents an increase of 2.6 percent from April 2012, and a year-over-year increase of 0.4 percent. Case-Shiller's 20 city composite index is down 0.7 percent compared to the same time last year. The index data shows that in all 20 of the 20 major U.S. metropolitan cities, home prices increased from the previous month.

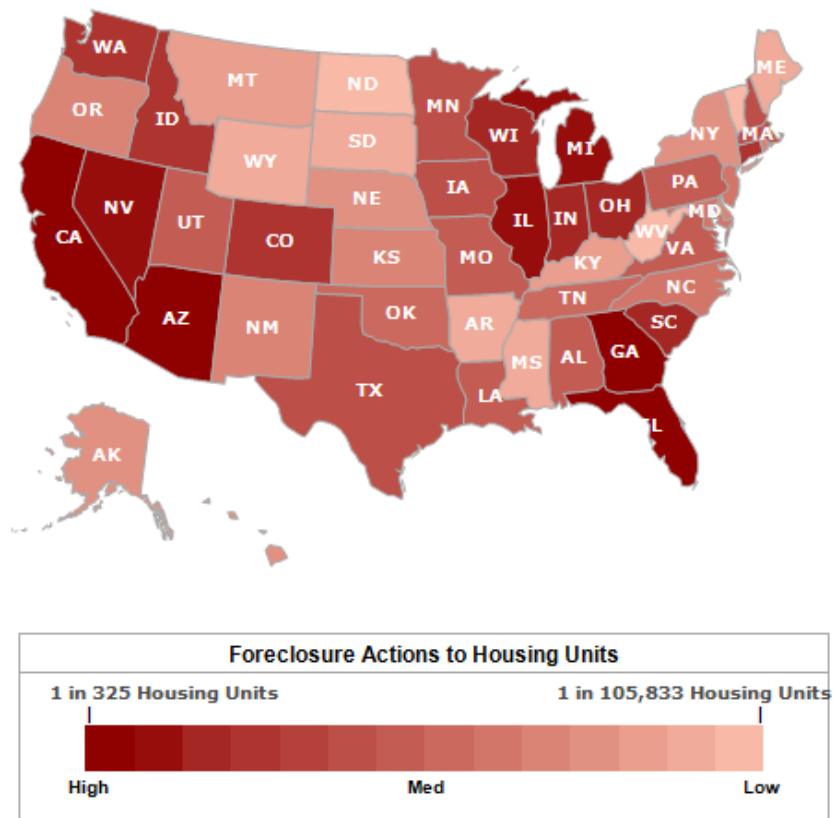
Foreclosure filings were reported on 191,925 U.S. properties in July, a 3 percent decrease from June and a 10 percent decrease from July 2011. The filing figures include default notices, schedule auctions and bank repossessions.

"U.S. foreclosure activity continued its uneven descent in July as the overall numbers declined on an annual basis for the 22nd straight month, but properties starting the foreclosure process increased on an annual basis for the third straight month," said Daren Blomquist, Vice President of RealtyTrac. "Recent foreclosure activity patterns vary significantly from state to state, often hinging on the level of dysfunction that exists in each state's foreclosure process. In states like Florida, Illinois and New Jersey, where processing and procedural issues slowed foreclosure activity to a crawl last year, foreclosure numbers continue to rebound off those artificially low levels. But in states like Texas, Arizona and Virginia, where the average time to foreclose is well below the national average of 378 days, foreclosure activity continues on a long-term downward trend.

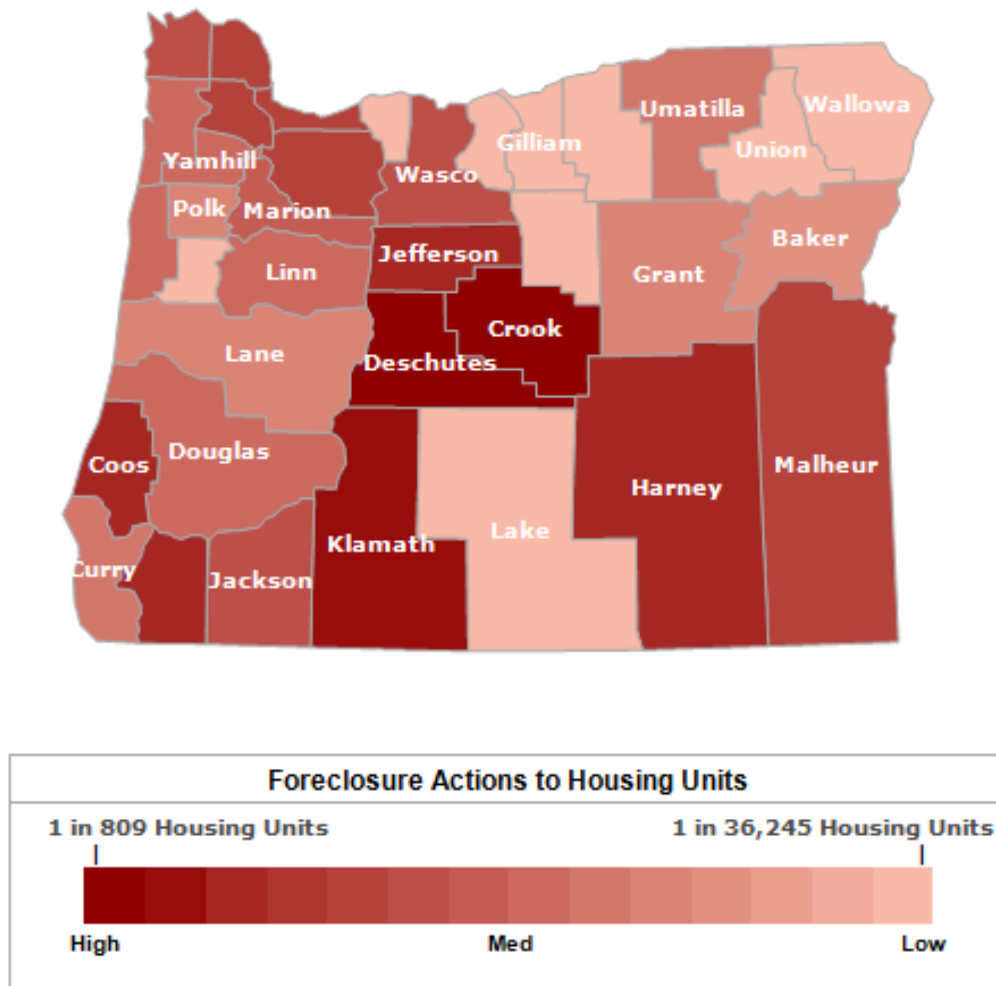
“Recent legislation and court rulings could lengthen the foreclosure process in some of the states with the shorter timelines, however, resulting in a temporary foreclosure lull and subsequent rebound in those states as well,” Blomquist continued. “Case in point is a new Oregon law that took effect in July and gives homeowners in default — or at risk of default — the right to request mediation to avoid foreclosure. Oregon foreclosure activity dropped 42 percent from June to July, hitting a five-year low, but we would expect the Oregon numbers to trend back higher sometime in the next several months based on the pattern we’ve seen in other states with similar legislation.”

During July 2012 Oregon reported 961 foreclosure filings, which is a 27.8 percent decrease from the previous year. Multnomah County had the state’s highest level of activity in July 2012 with 220 homes. In the U.S., one in every 686 homes received a foreclosure filing while one in every 1,744 homes in Oregon received a foreclosure filing during July 2012.

Figure 3: Foreclosure Rate Heat Map, July 2012



Source: RealtyTrac

Figure 4: Foreclosure Rate Heat Map-Oregon, July 2012

Source: RealtyTrac

According to RealtyTrac, the ten states that ranked the highest in foreclosure rates in July 2012 were Nevada, Arizona, California, Ohio, Georgia, Michigan, Florida, South Carolina, Indiana and Illinois. Of these states, California posted the nation's highest state foreclosure rate, with one in every 325 housing units receiving a foreclosure filing in July 2012, despite an 11 percent decrease from June and a 25 percent decrease from July 2011. In Arizona one in every 346 housing units and in Florida one in every 352 housing units filed for foreclosure during July 2012.

Table 2: Building Permits Issued, Year to Date, in thousands

	Single Family			Multi Family		
	June-12	June-11	% Change	June-12	June-11	% Change
United States	249.3	208.2	20%	132.0	87.6	51%
Oregon	3.24	2.53	28%	1.69	1.06	60%
Portland-Vancouver-Beaverton OR-WA	2.26	1.54	47%	1.28	0.66	93%
Salem OR	0.15	0.12	20%	0.07	0.10	-28%
Eugene-Springfield OR	0.18	0.20	-11%	0.13	0.09	41%
Bend OR	0.31	0.22	39%	0.05	0.00	2600%
Corvallis OR	0.03	0.01	167%	0.11	0.17	-34%
Medford OR	0.17	0.13	27%	0.03	0.07	-57%

Source: National Association of Home Builders

Single family building permits have increased sharply thus far in 2012 in the US and Oregon. The Portland, Bend, Corvallis, and Medford markets increased more than the US average for single-family with Corvallis increasing 167 percent over this time last year. Eugene was the only major market that decreased by 11 percent. Multifamily new construction has increased sharply in the US and even more in Oregon. Portland increased by 93 percent with over 1,280 units built in the metro area from January-June 2012. Multifamily development returned to Bend after almost zero building in 2011, and posted a 2,600 percent increase.

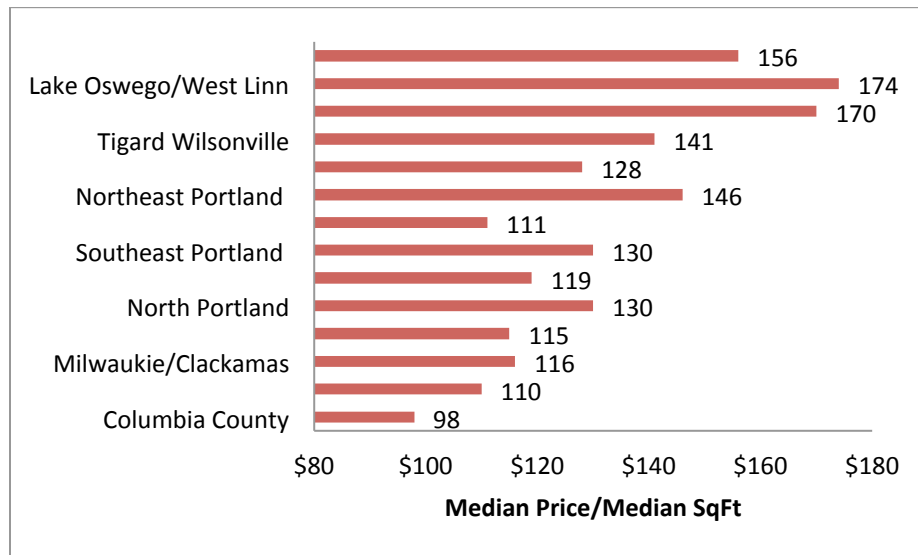
PORTLAND

Buyers closed on purchases of 5,363 homes. Second quarter 2012 increased 8.86 percent from last quarter and 17.69 percent year over year. Median prices for the first quarter were at \$273,620, which represents a year-over-year increase of 9.45 percent.

Sales price to original list price continue to come closer together, with average sales taking place at 98.76 percent of the original list price. This is a 2.49 percent increase annually from 96.36 percent. Sellers in the Portland area have had their homes on the market for an average of only 34 days before closing, reflecting a 47 day decrease from second quarter 2011 and a 24 day decrease from the previous quarter.

There were 392 new properties sold, which was almost unchanged at 391 in first quarter. The new properties sold at a median price of \$306,100 which was a 9.01 percent increase from first quarter. New home prices decreased slightly from second quarter 2011 by 0.69 percent, but there were 26 percent more transactions.

Figure 5: Single Family Price per Square Foot, New and Existing Detached Homes, Portland Sub Markets



Source: RMLS

Figure 6: Median Sales Price & Number of Transactions, Existing Detached Homes, Portland Metro (excluding Clark County, WA)

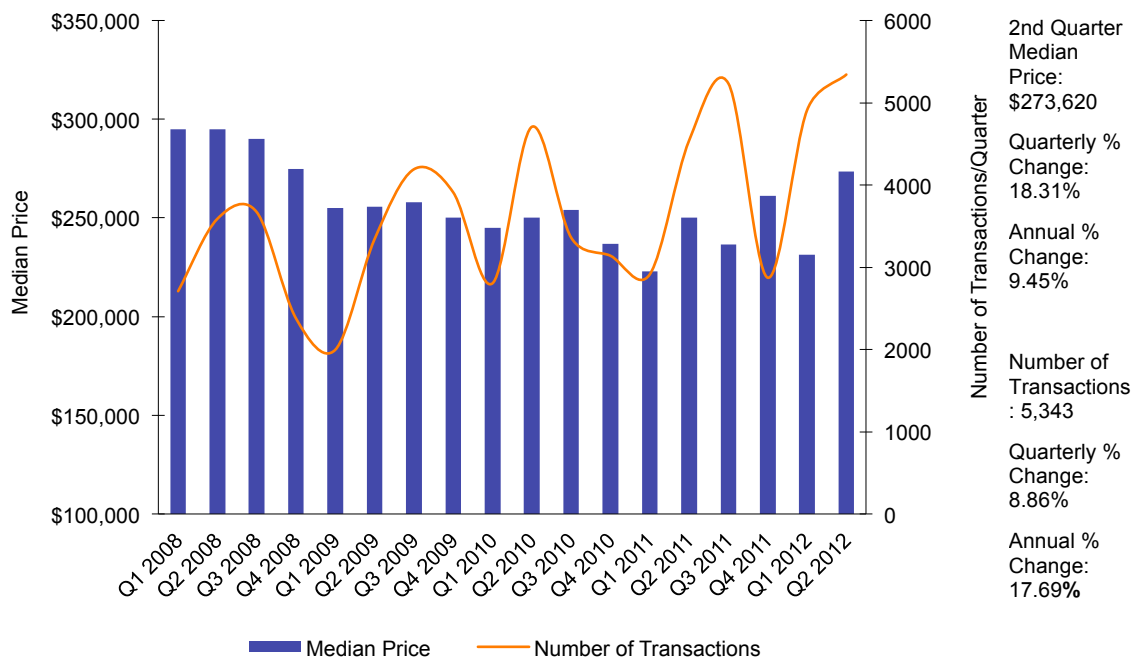


Figure 7: Sale Price/Original List Price& Average Days on Market, Existing Detached Homes, Portland Metro (excluding Clark County, WA)

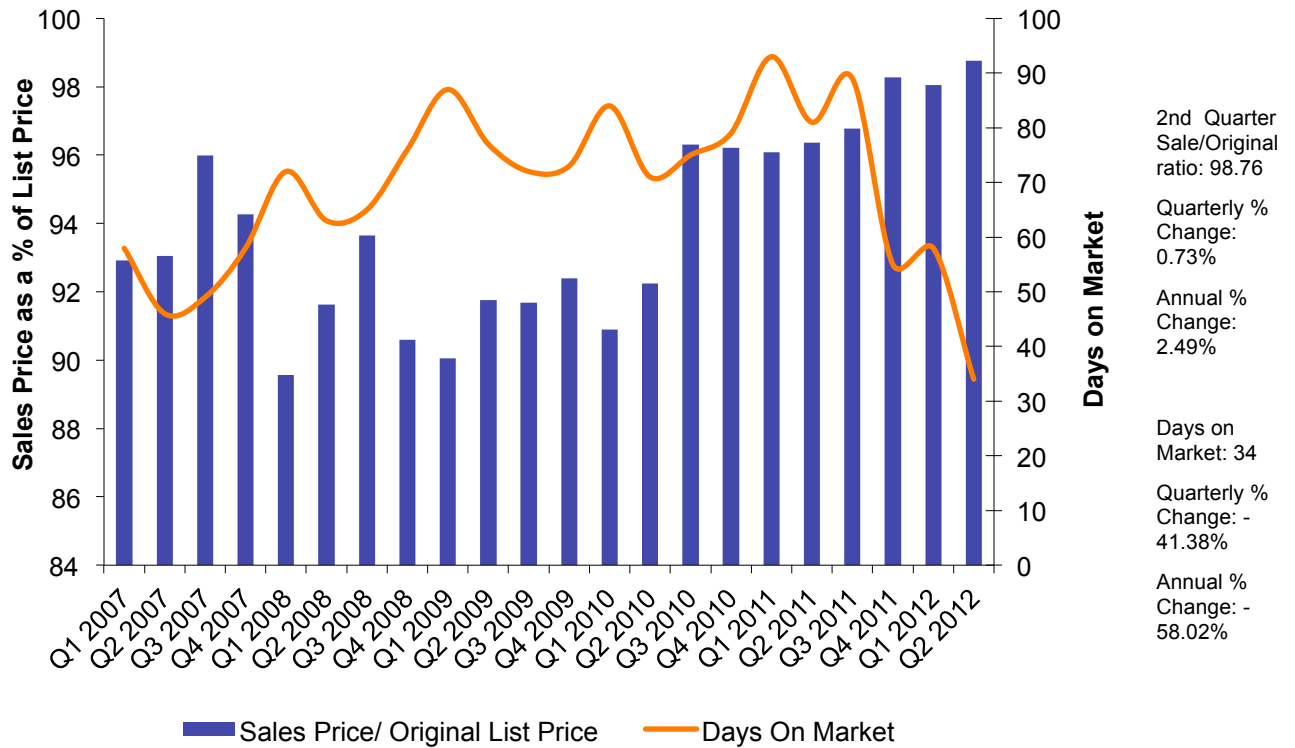


Figure 8: Median Sales Price & Number of Transactions, New Detached Homes, Portland Metro (excluding Clark County, WA)

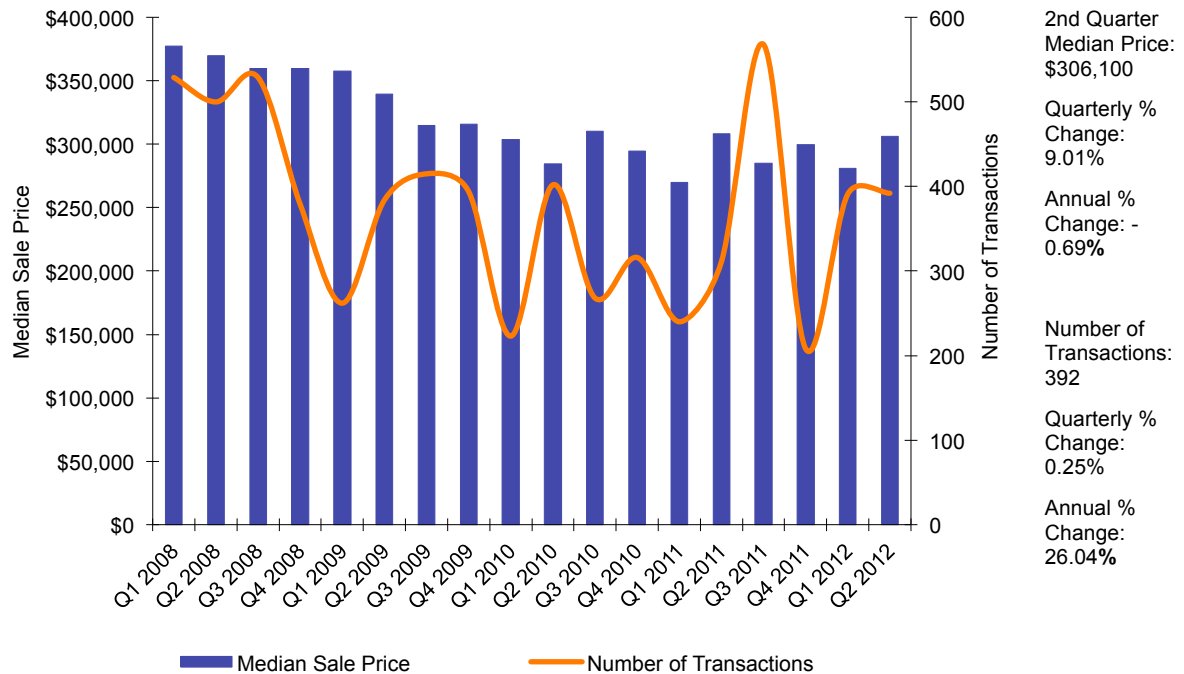
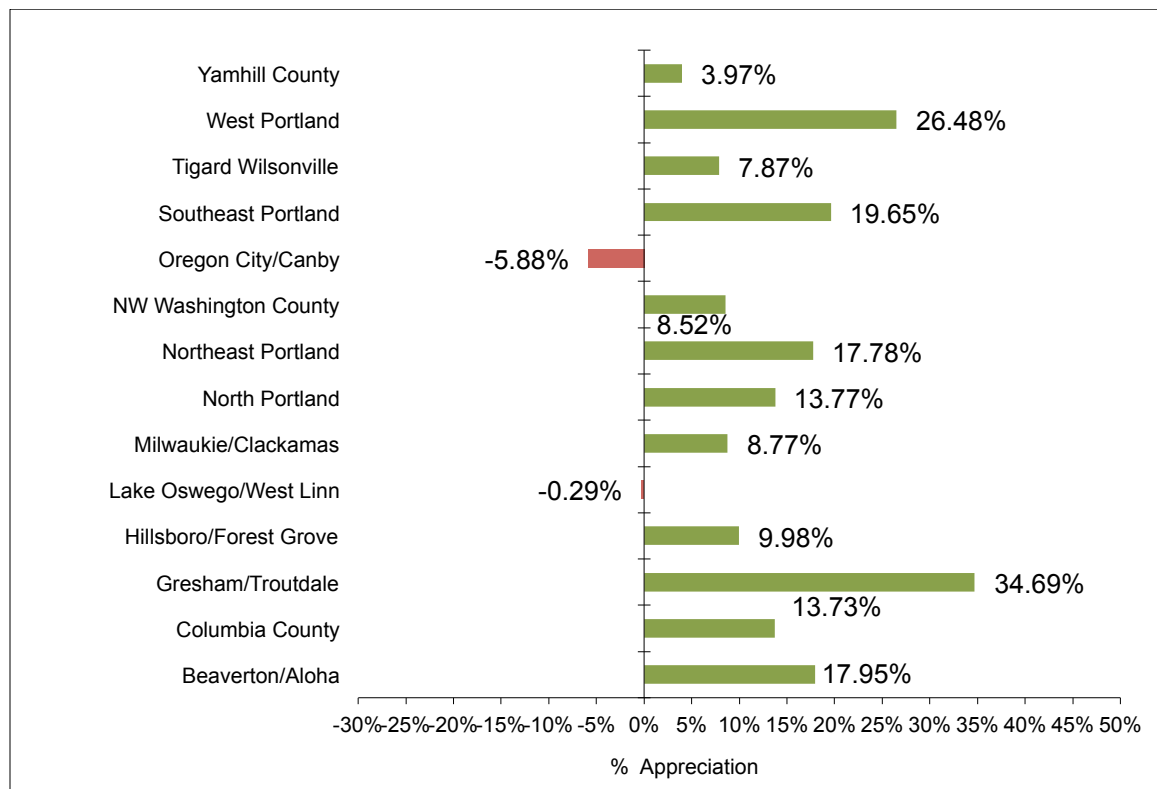


Figure 9: Appreciation Rates of Existing New Detached Homes from Q2 2011 to Q2 2012, Portland Sub-Markets



The Gresham / Troutdale submarket increased significantly at over 34 percent from second quarter 2011. West Portland also increased by 26 percent over the same period. The largest annual depreciation was experienced in Oregon City / Canby at 5.88 percent.

VANCOUVER

Vancouver's median home price during 2nd quarter 2012 was \$176,700, an 8.3 percent increase from 1st quarter 2012 when it was \$162,900. The number of homes sold in second quarter increased by over 27 percent to 931 from the first quarter of 2012, and a large increase of 39.1 percent year over year. In addition, the number of days on the market decreased to 50 from 58 in the previous quarter and 64 in second quarter 2011.

Figure 10: Median Price and Annual Appreciation Existing Detached Homes, Vancouver

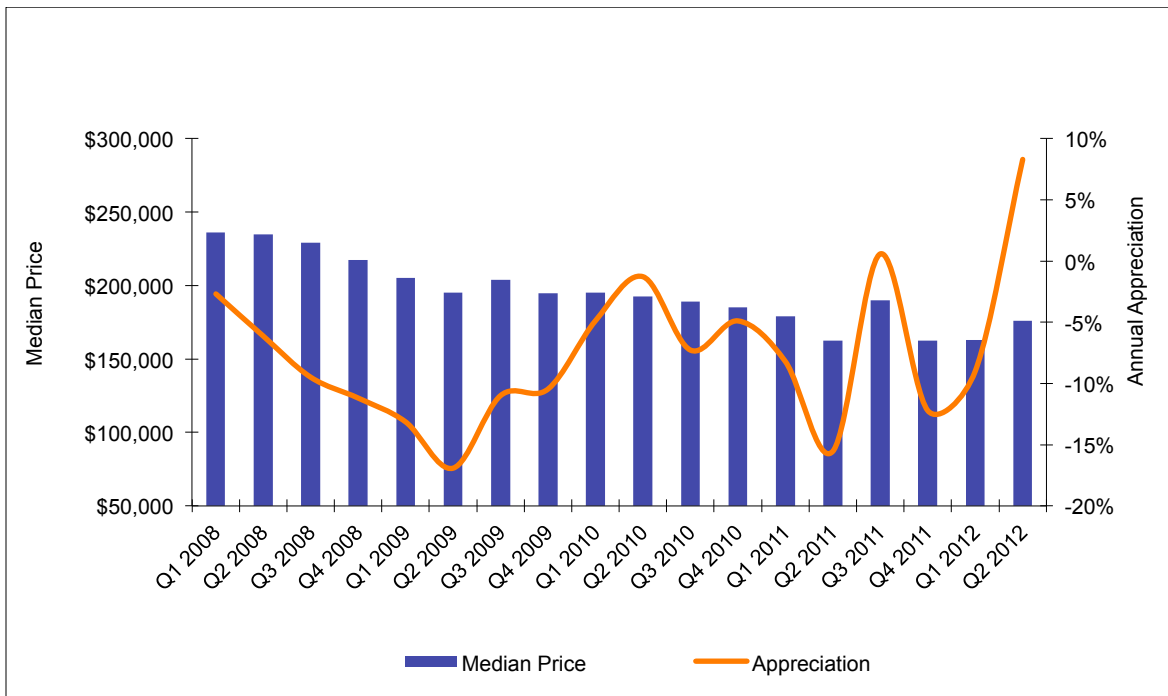
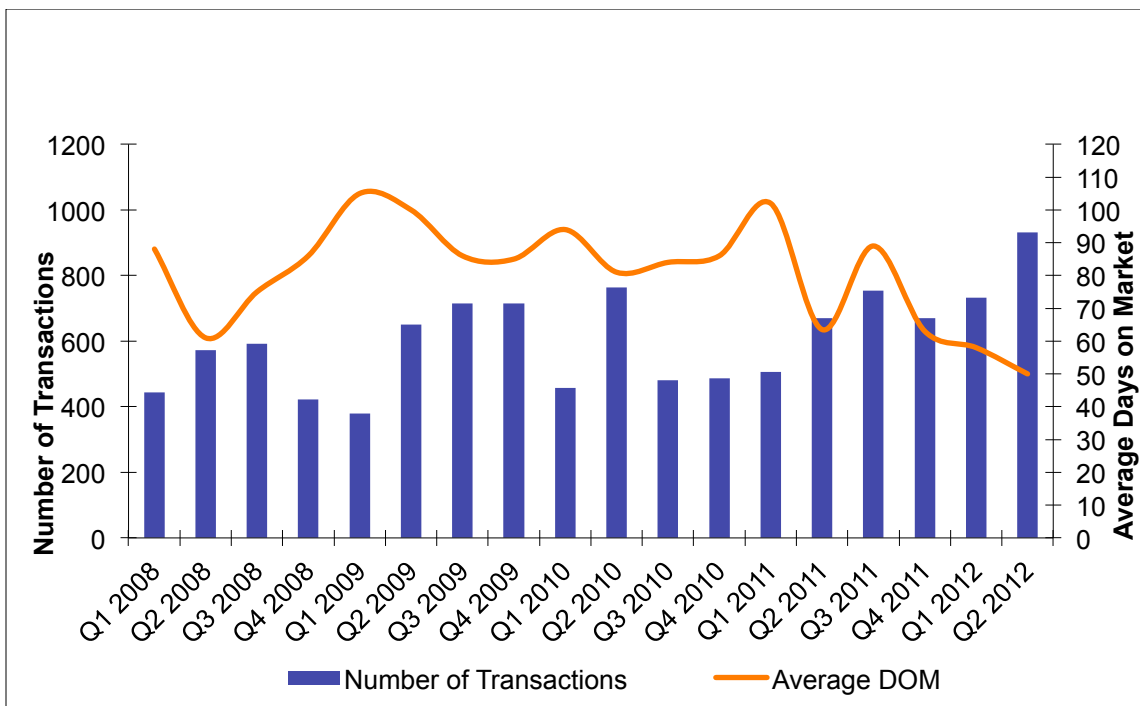


Figure 1: Average Days on Market and Number of Transactions Existing Detached Homes, Vancouver



In the Vancouver suburbs, the median home price was \$200,492, which was an 11 percent decrease from the first quarter of 2011, and a 3.8 percent decrease from the previous quarter. In the suburbs, as with the city, there was increase in the number of transactions and decrease in days on market in first quarter 2012. The number of transactions increased 21 percent from last quarter to 544 and increased 49 percent year over year. Properties were on the market an average of 73 days which was up slightly from last quarter when it was 67, but a sharp decrease from 120 in first quarter 2012.

Figure 12: Median Price and Annual Appreciation Existing Detached Homes, Clark County (excluding Vancouver)

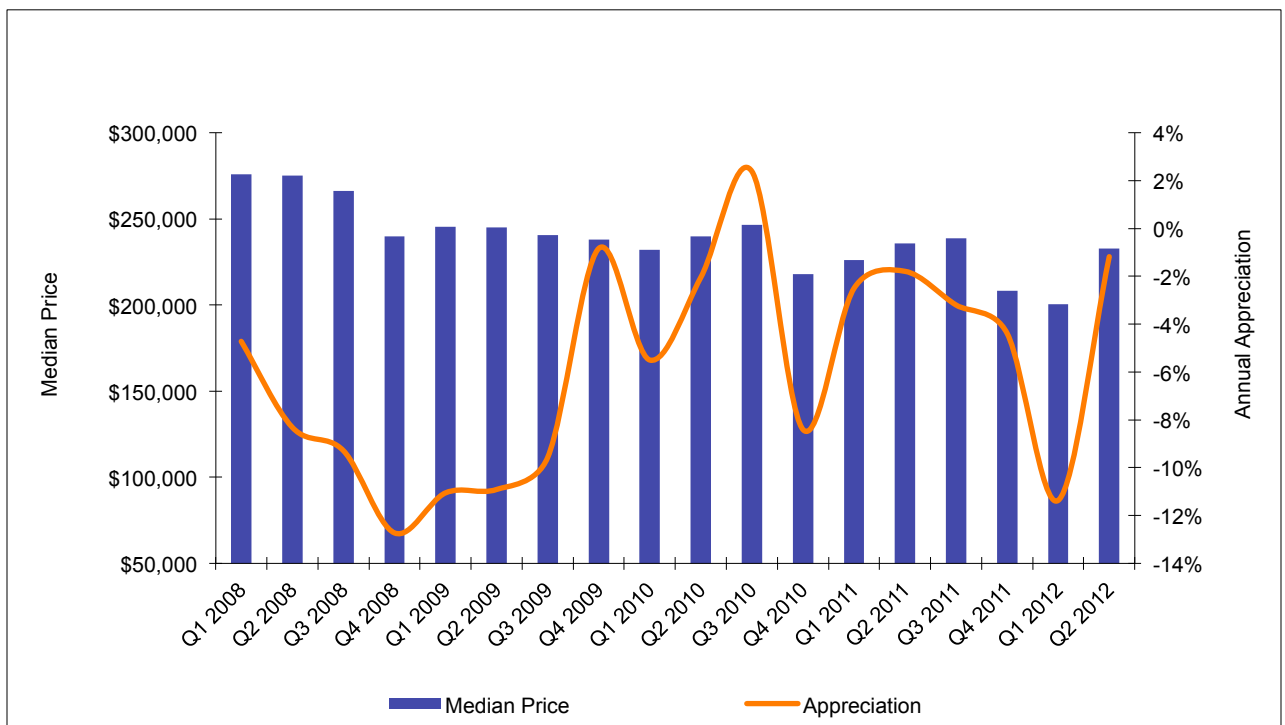
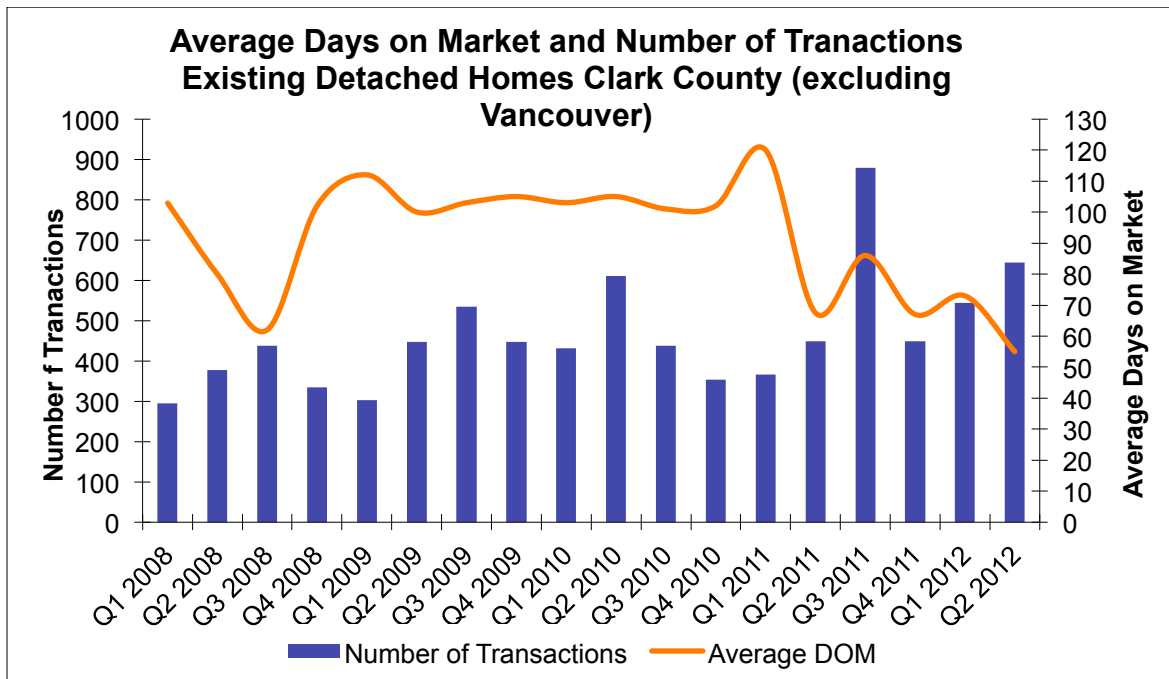


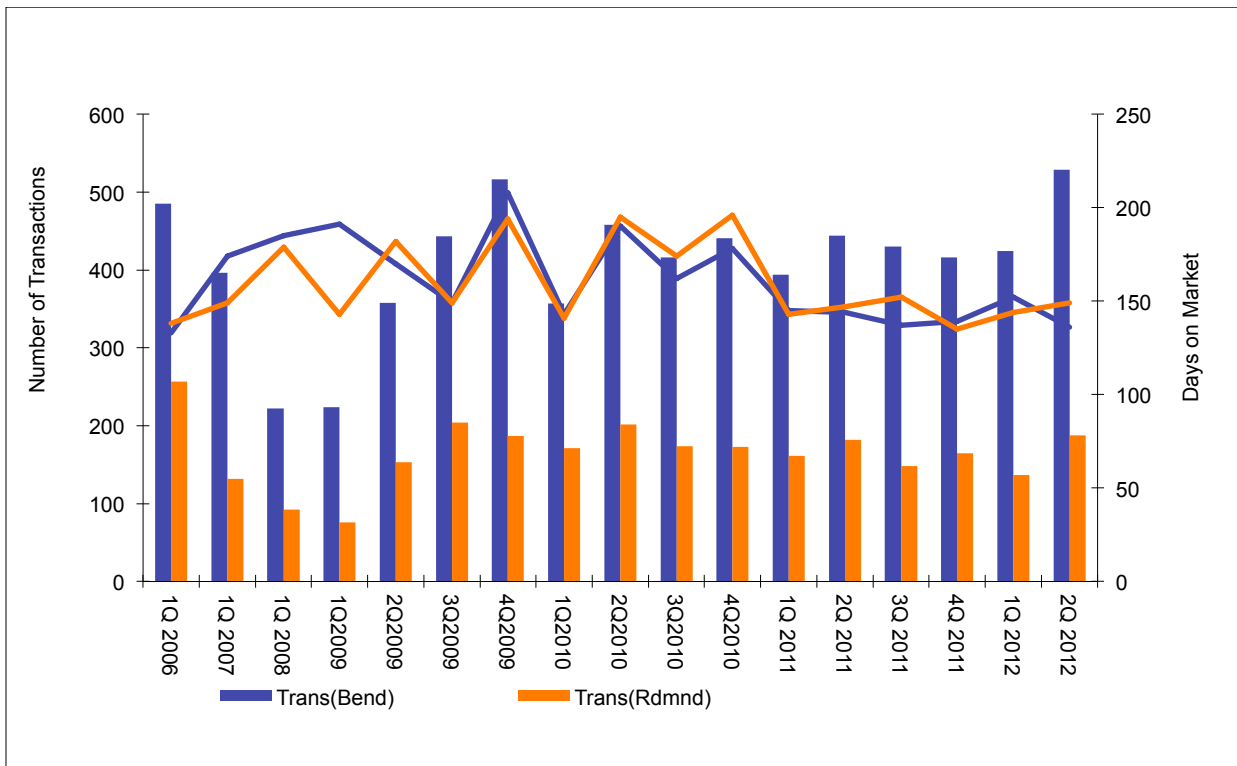
Figure 23: Average Days on Market and Number of Transactions Existing Detached Homes Clark County (excluding Vancouver)



CENTRAL OREGON

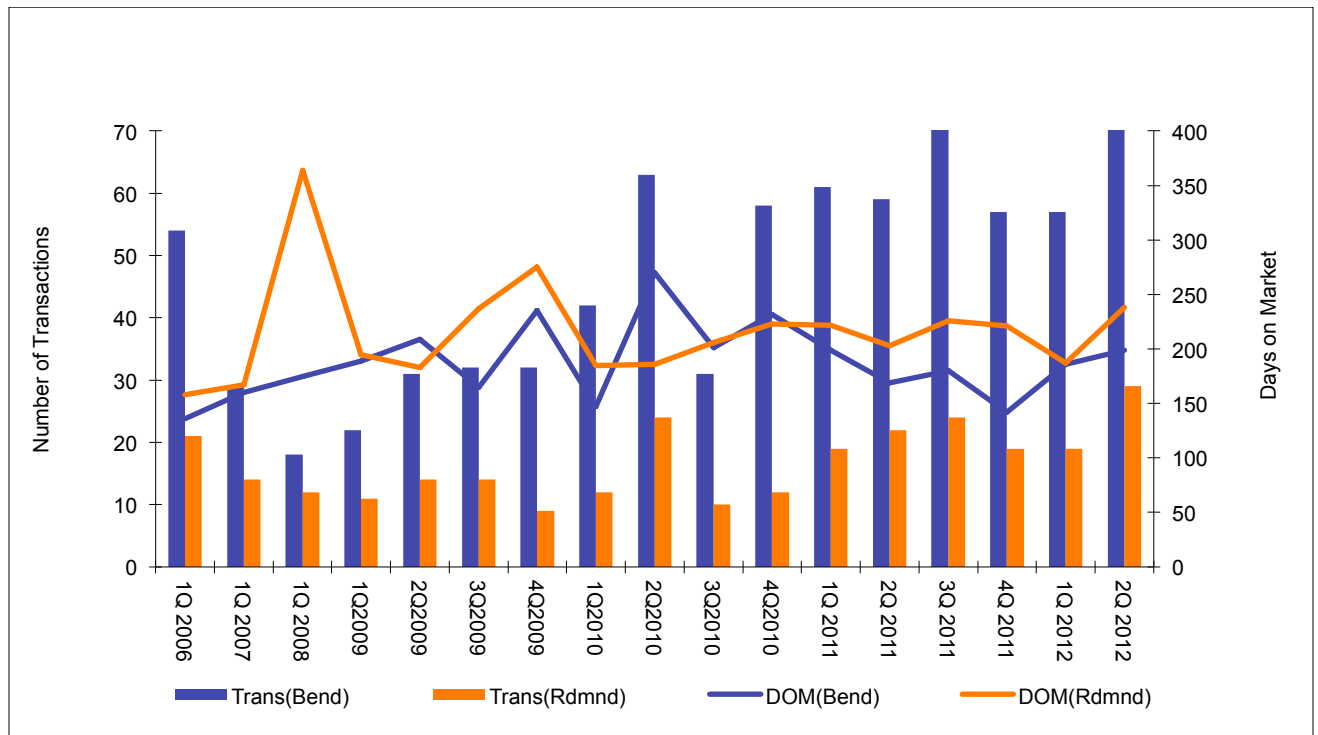
Bend home sales of less than one acre increased 1.9 percent to 424 while Redmond's decreased 17.0 percent to 137 in the fourth quarter on homes sold less than one acres. On the other hand, sales volume for homes on 1-5 acres remained the same in Bend and Redmond at 19 in Redmond and 57 transactions in Bend. For homes on less than one acre, the average number of days on market increased slightly from 139 (in the fourth quarter 2011) to 152 (in the first quarter 2012) in Bend and also increased from 133 to 144 in Redmond. In Central Oregon's reports, the housing stock is separated by lot size, properties under one acre and those between one and five acres. Price per square foot data is provided to control for lot size between both categories.

Figure14: Number of Transactions and Days on the Market, Single Family Under 1 Acre, Bend and Redmond



Source: Central Oregon Association of Realtors

Figure 15: Number of Transactions and Days on the Market, Single Family Over 1 Acre, Bend and Redmond



For sales under an acre, the median home prices for Bend increased while Redmond decreased slightly during the second quarter of 2012. The Bend market increased 10.4 percent to \$215,000, while Redmond decreased 3.7 percent to \$122,750 from the previous quarter. Both markets increased on homes over 1 acre as the Bend market increased 1.4 percent to \$296,000, and the Redmond market increased 35.7 percent to \$251,000. Over the past year the Bend market under and acre increased by 8.4 percent and the Redmond market increased 14.5 percent for home sales under an acre. For sales over one acre, Bend increased 18.6 percent while Redmond increased slightly by 0.5 percent since second quarter of 2011.

Figure 16: Median Single Family Price and \$/SqFt Under 1 Acre, Bend and Redmond

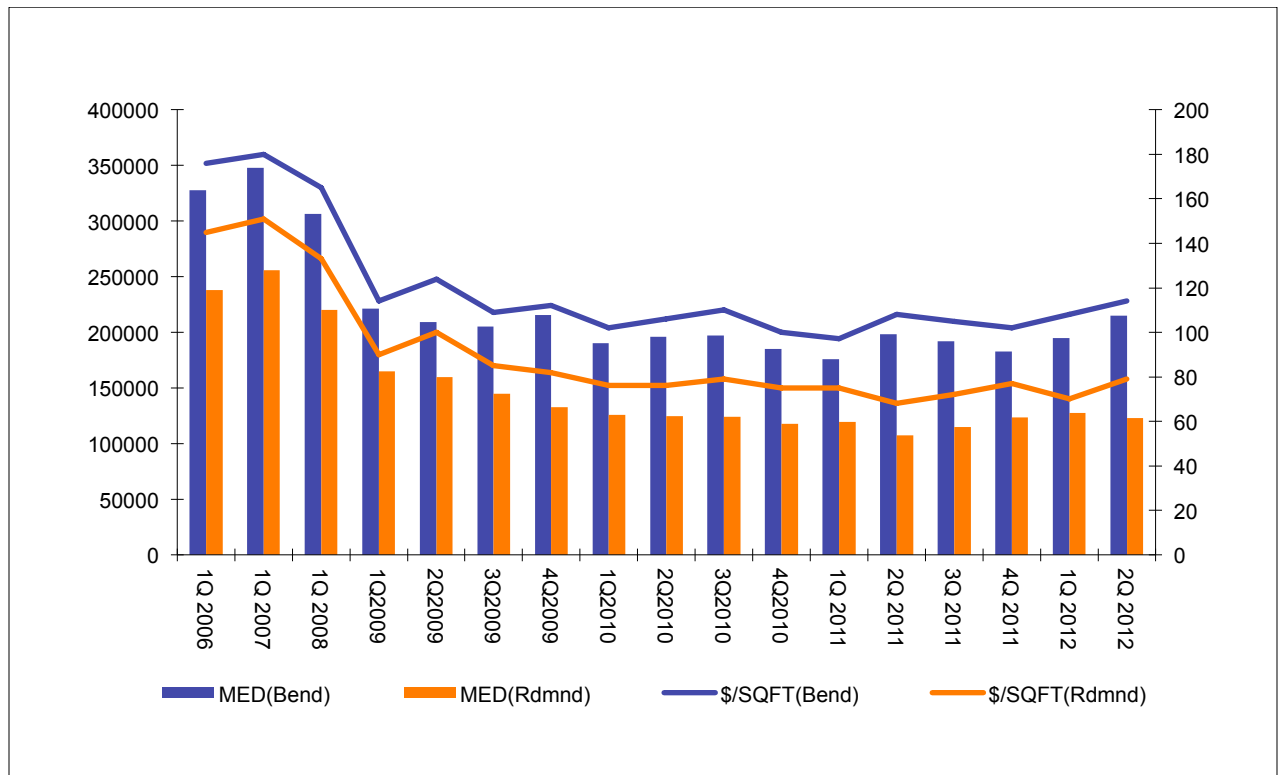
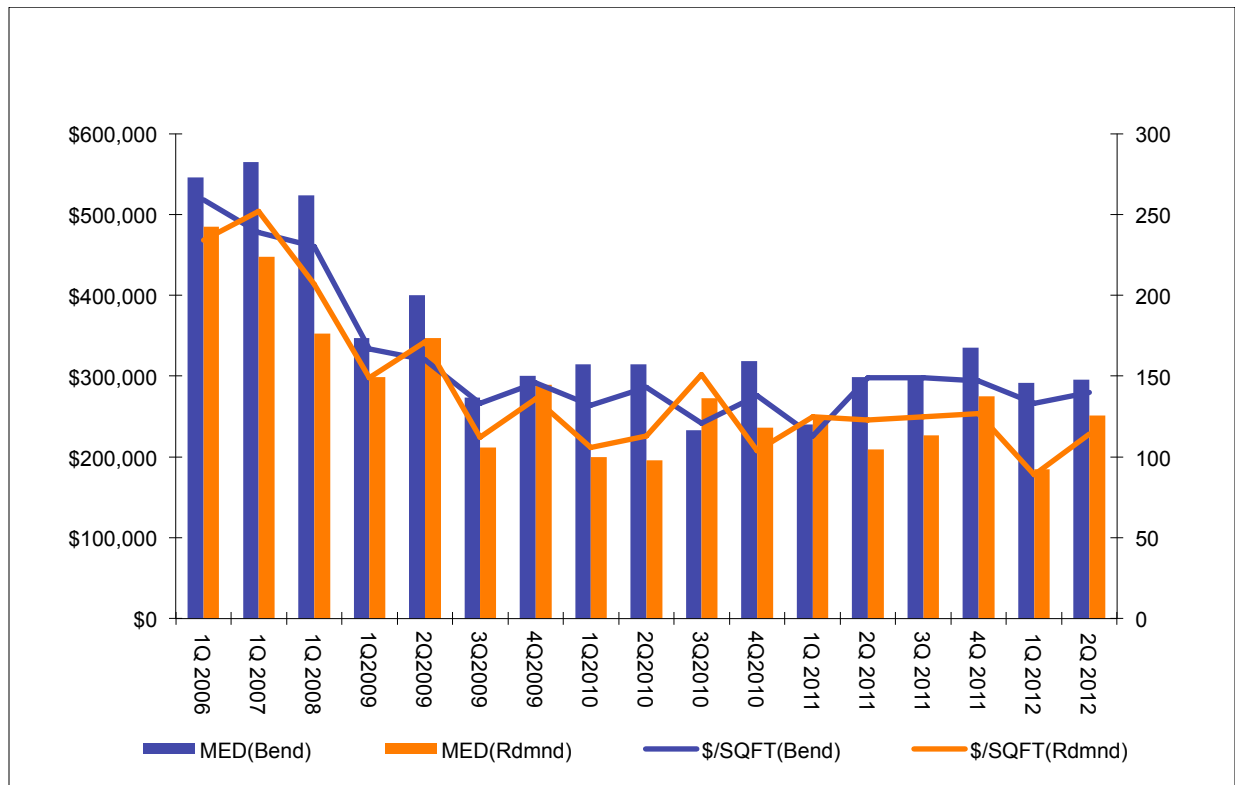


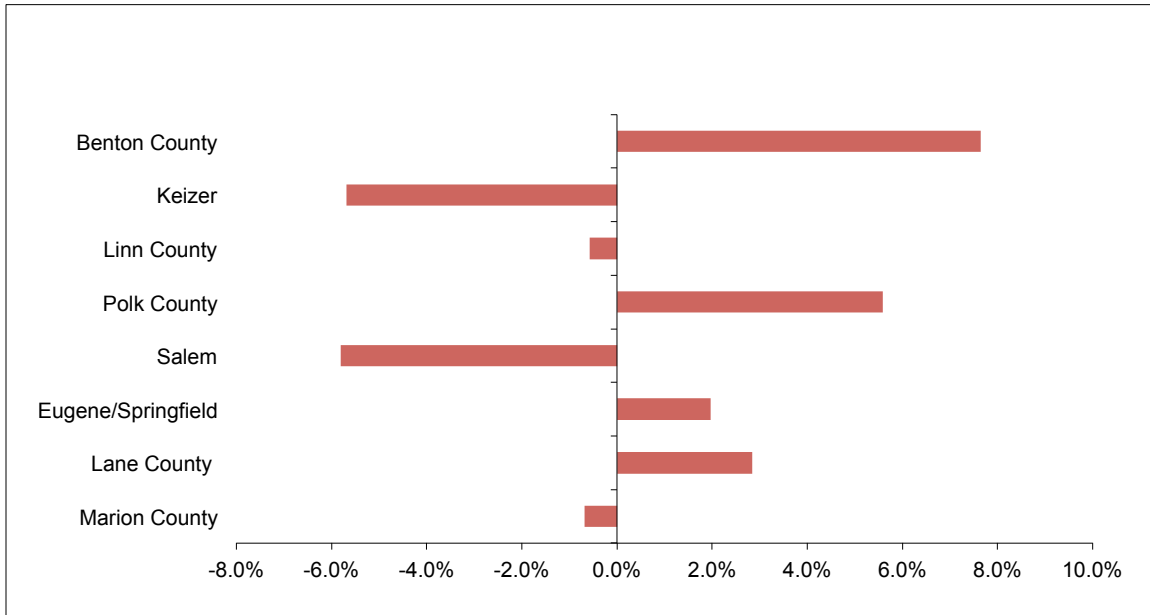
Figure 17: Median Single Family Price and \$/SqFt, Over 1 Acre, Bend and Redmond



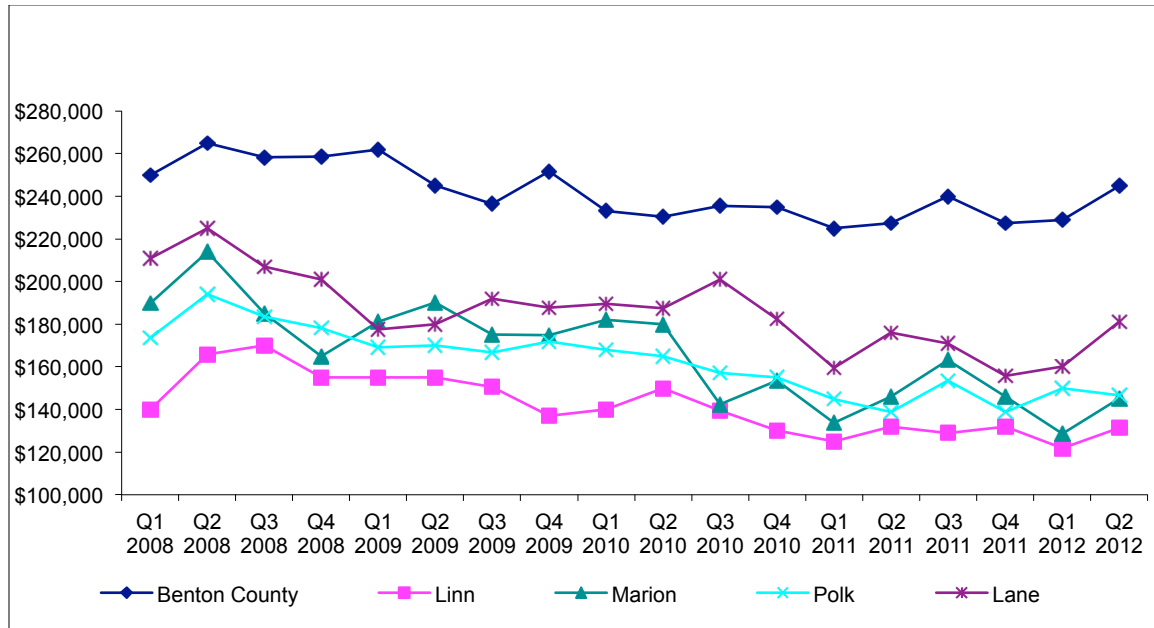
WILLAMETTE VALLEY

Marion County decreased 0.7 percent since the second quarter of 2011 to a median sold price of \$145,000. Salem and Keizer decreased year over year by 5.8 percent and 5.7 percent respectively. Benton County increased 7.6 percent over the past year to a median price of \$244,900.

Figure 18: Annual Appreciation Rates of Existing Detached Homes, Willamette Valley from Q2 2011 to Q2 2012



Source: Willamette Valley MLS

Figure 19: Median Sales Price Existing Detached Homes, Willamette Valley

Source: Willamette Valley MLS

SALEM

Salem's housing market again experienced annual depreciation of 5.8 percent year over year in the second quarter but the number of days on the market decreased. The median sale price decreased to \$145,900 but the number of transactions increased by over 11 percent from the second quarter of 2011. The average number of days on market decreased from 108 in the first quarter to 105 in the first quarter of 2012.

Figure 20: Median Sales Price and Annual Appreciation, Existing Homes, Salem

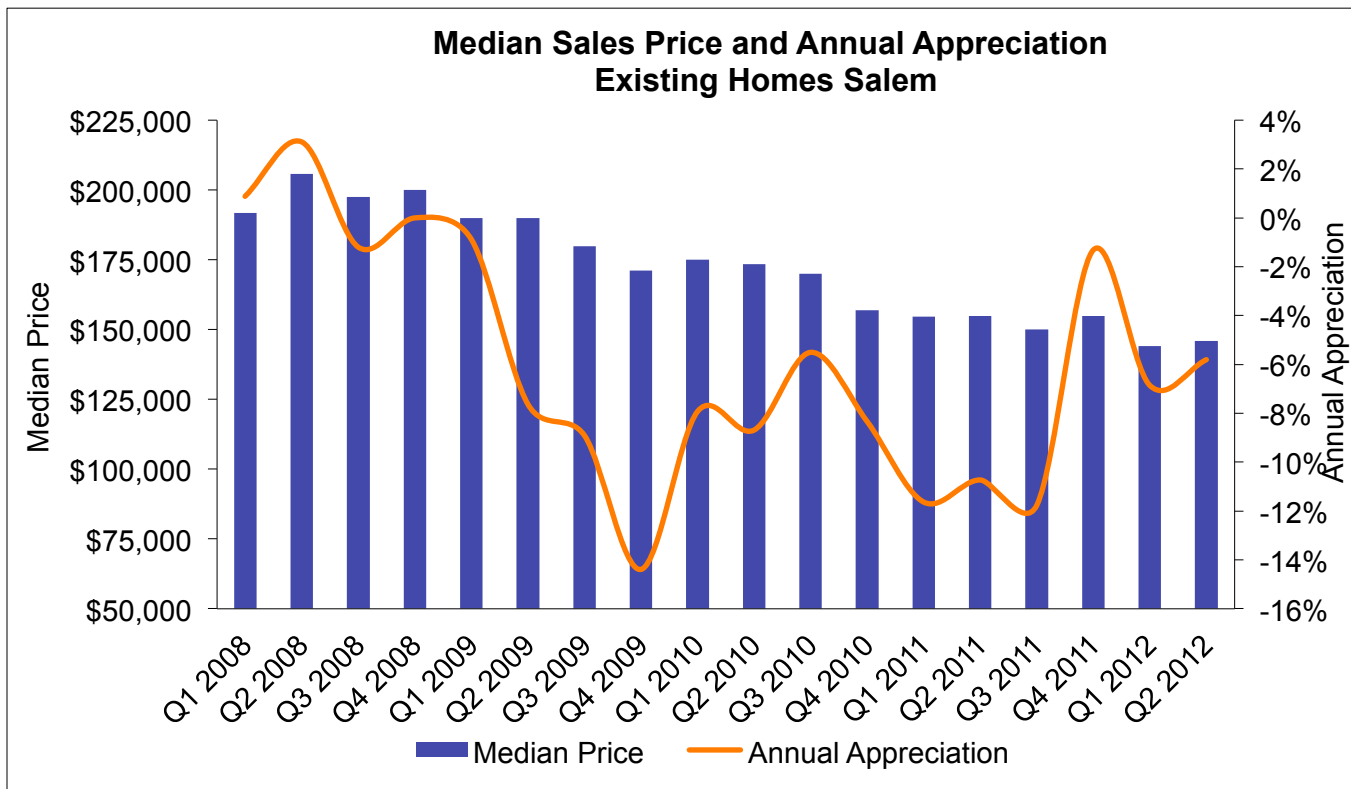
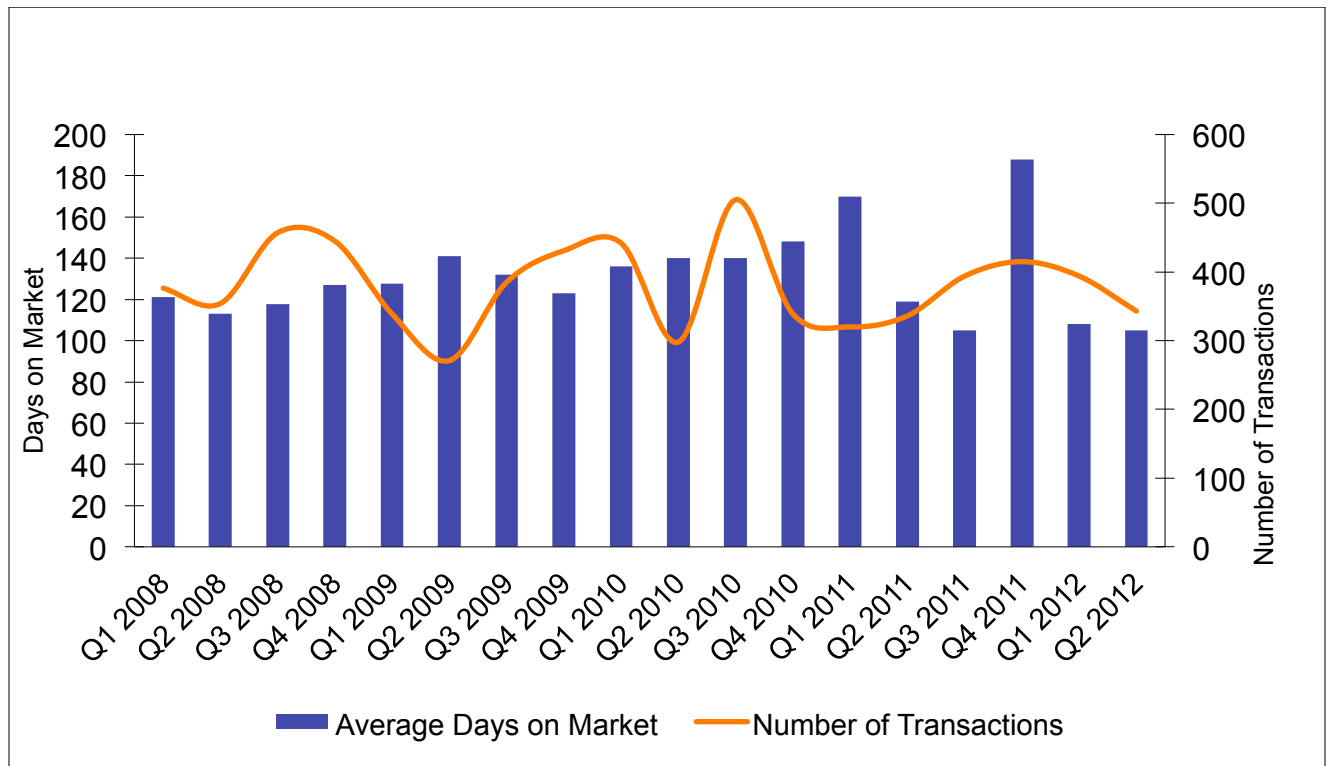


Figure 21: Average Days on Market and Number of Transactions, Existing Homes, Salem

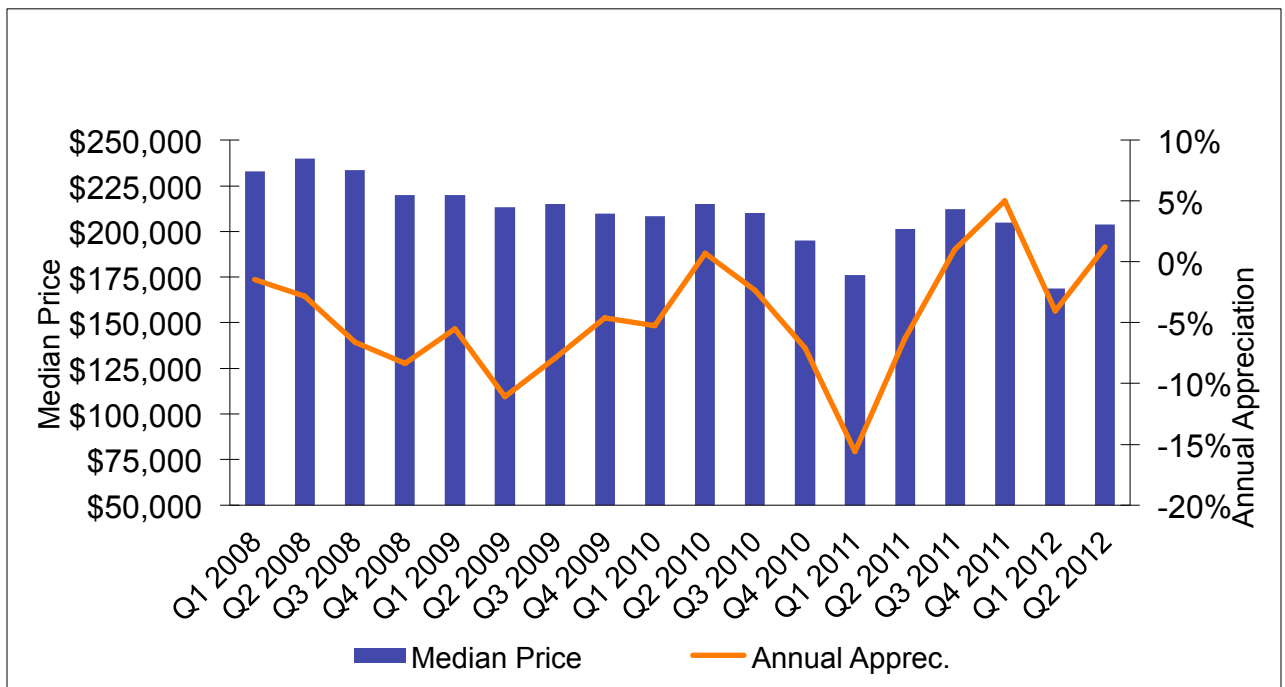


EUGENE/SPRINGFIELD

Home prices in the Eugene/Springfield area decreased 13.1 percent from the first quarter of 2012 to \$181,000. Values increased 2.84 percent since the second quarter of 2011.

Lane County prices increased 20.72 percent from the previous quarter to a median price of \$203,900. They increased slightly year over year by 1.23 percent from \$201,400 in second quarter of 2011.

Figure 22: Median Price and Annual Appreciation Existing Detached Homes, Eugene/Springfield



Source: RMLS

MULTIFAMILY MARKET ANALYSIS

EVAN ABRAMOWITZ

RMLS Student Fellow

Master of Real Estate Development Graduate Student

The apartment market in Portland remains strong as vacancies remain low, but many new projects are coming soon. Portland's vacancy rate increased to 3.4 percent according to MPF Research, a multifamily research firm, which remains among the lowest vacancy rates in the US. 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 entering a "two to four year sweet spot in the market and the real estate cycle."

■ 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.

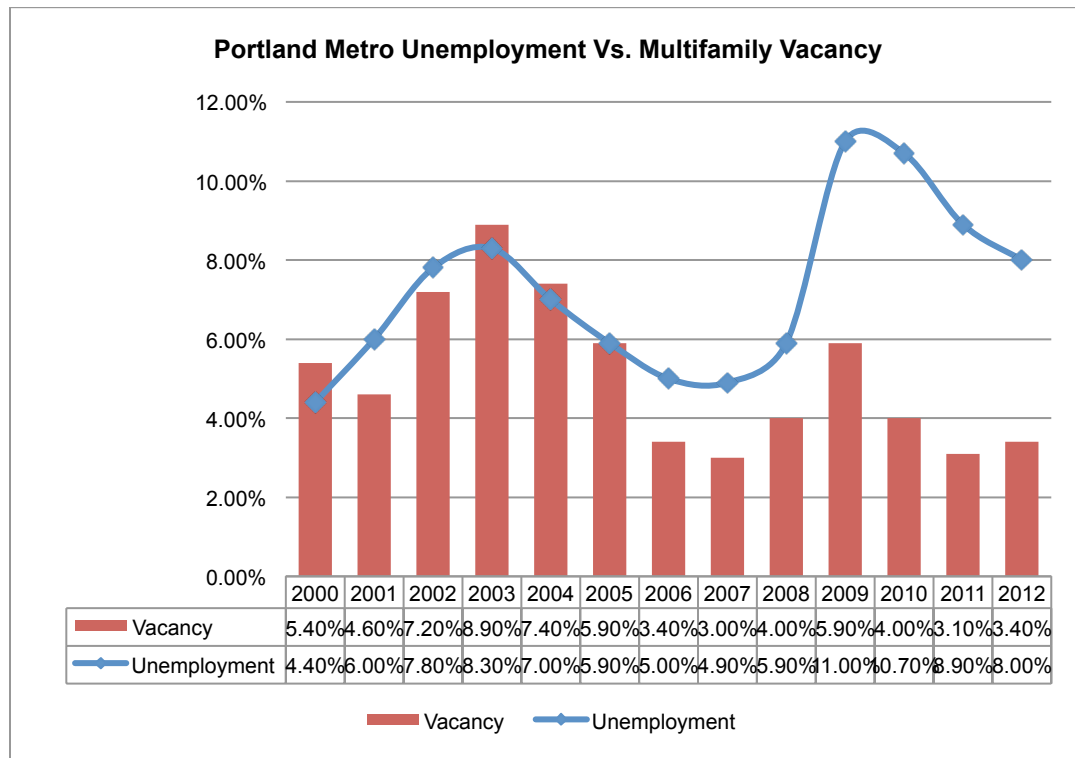
On the supply side, construction for multifamily in 2012 has increased significantly from 2011 and 2010, but is still below historical figures. From January-June 2012 there have been 1,696 units in the three county metro area, compared to 1,100 in 2010, according to the Barry Report. From 2004-2008 an average of 4,700 units came online annually. 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 three or four years, and vacancy rates are projected to remain low and market conditions should remain strong for property owners.

While demand for apartments in Portland was fairly mild at about 500 units during second quarter according to MPF, there really was not room for much absorption given the existing stock is essentially full at the same time that completions were held to a handful of unit. Effective rents for new leases in Portland climbed 1.8 percent during the April-June time frame. While that is a very healthy number, it fell short of the growth pace posted during the same months of 2011, so the annual level of increase slowed to 3.7 percent. Year-over-year rent growth had been running at about 5 percent or better for six consecutive quarters. The overall shift in pricing power for the most part reflected a slight dip in top-tier product in the urban core that had perhaps gotten too aggressive on rents.

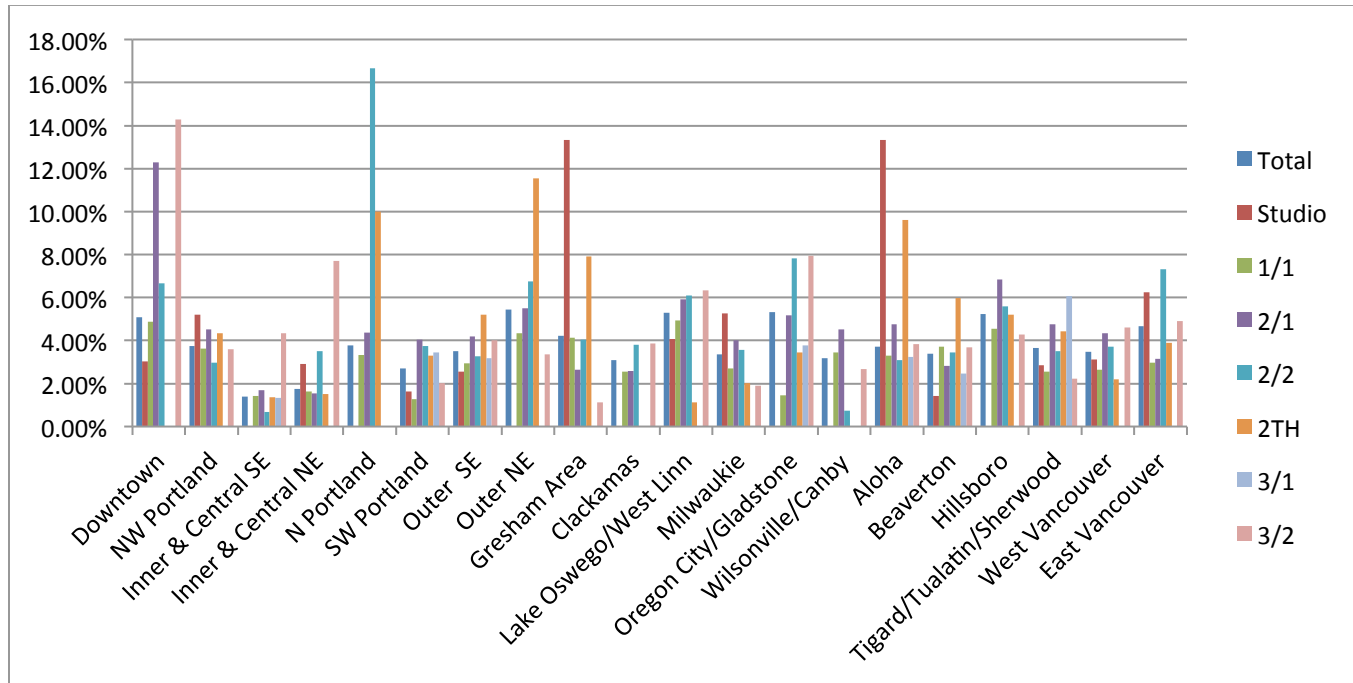
Although the current and future state of the local and national economy is uncertain, people need somewhere to live. With more and more potential single-family buyers opting to rent instead of own, the demand for apartments continues to be strong. Nationally effective rents increased 0.52 percent from May to June according to multifamily research firm Axiometrics. Year-to-date (YTD) growth remains strong with the national data set up 3.87 percent. The market is performing right in between the midpoint rates from 2010 (3.37 percent) and 2011 (4.14 percent). If the market performs as expected, this will be the third year in a row with greater than 4.0 percent annual growth at the national level. From 1996 to 2009, the market never had back-to-back years of growth greater than 4.0 percent, much less three years in a row.

Unemployment rates are positively correlated with vacancies as shown in the chart below. Portland currently has an unemployment rate of 8.0 percent which is lower than the state average of 8.5 percent and the national average of 8.3 percent. There were approximately 20,800 jobs added in the Portland area between January-June 2012, according to the Portland Business Journal.

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

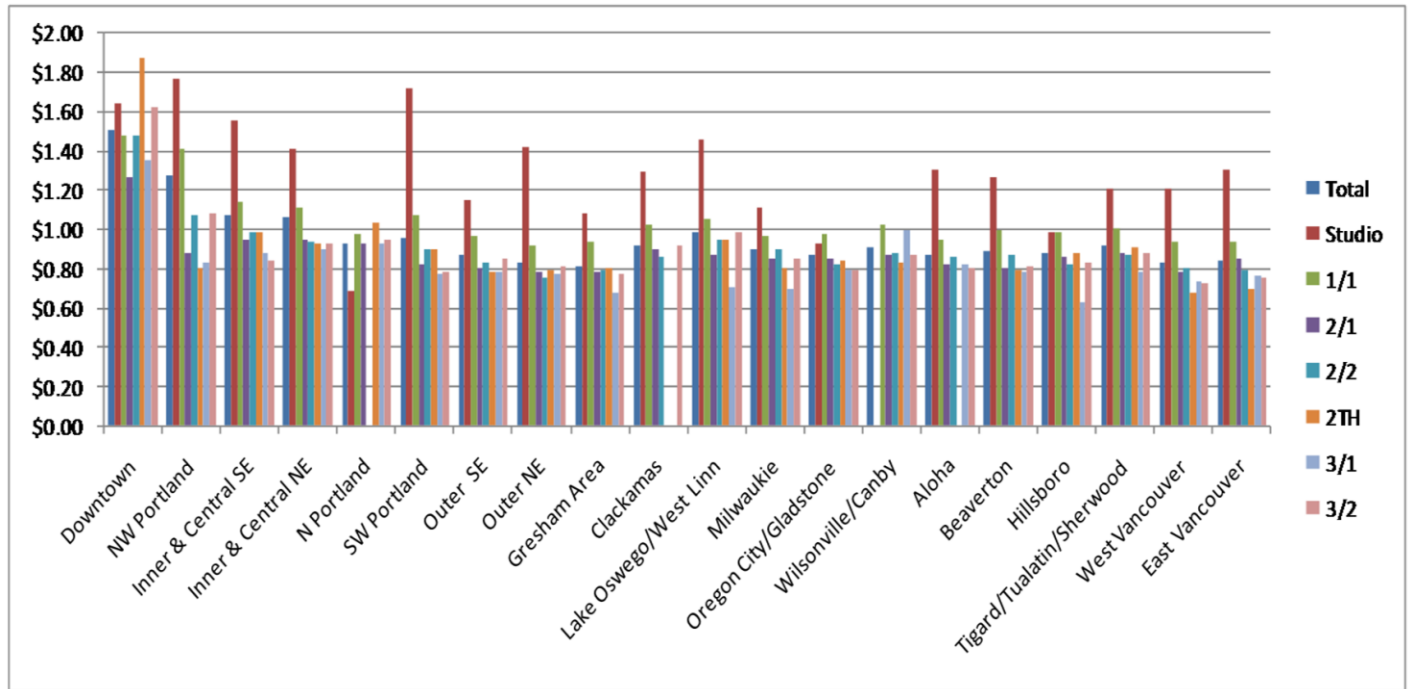


These market factors have driven vacancy rates in historically undersupplied Portland to among the lowest in the nation. The highest overall vacancy submarket was 5.44 percent in Outer Northeast and the lowest was Inner & Central SE at 1.4 percent. The highest vacancy rate among studios was Gresham Area and Aloha at 13.33 percent, while six submarkets reports 0 percent vacancy for studios. The highest vacancy rate for 1 BD, 1 BA was Lake Oswego / West Linn at 4.93 percent, while the lowest was SW Portland with 1.26 percent. For 2 BD, 1 BA the highest vacancy was Downtown Portland at 12.03 percent and the lowest was Inner & Central NE at 1.55 percent. Ten 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. North Portland reported 0 percent for 3 BD / 2 BA, while Downtown Portland had a 14.29 percent vacancy rate for 3 BD / 2 BA.

Figure 2: Vacancy Rates by Submarket 2012 Portland Metropolitan Area

Source: MMHA

The submarket with the highest overall rent/SF is downtown Portland with a \$1.66 average, followed by NW Portland at \$1.44. The lowest overall rent/SF is shared between Outer NE, Oregon City / Gladstone, and West Vancouver all at \$0.85 per square foot. The highest rent/SF for studios was NW Portland at \$2.04 and the lowest was Oregon City / Gladstone at \$0.68. The highest rent/SF for 1 BD, 1 BA was downtown at \$1.61 and the lowest were West Vancouver and Outer Northeast at \$0.93. The highest rent/SF for 2 BD, 1 BA was downtown at \$1.56 and the lowest was \$0.81 in Outer Northeast.

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

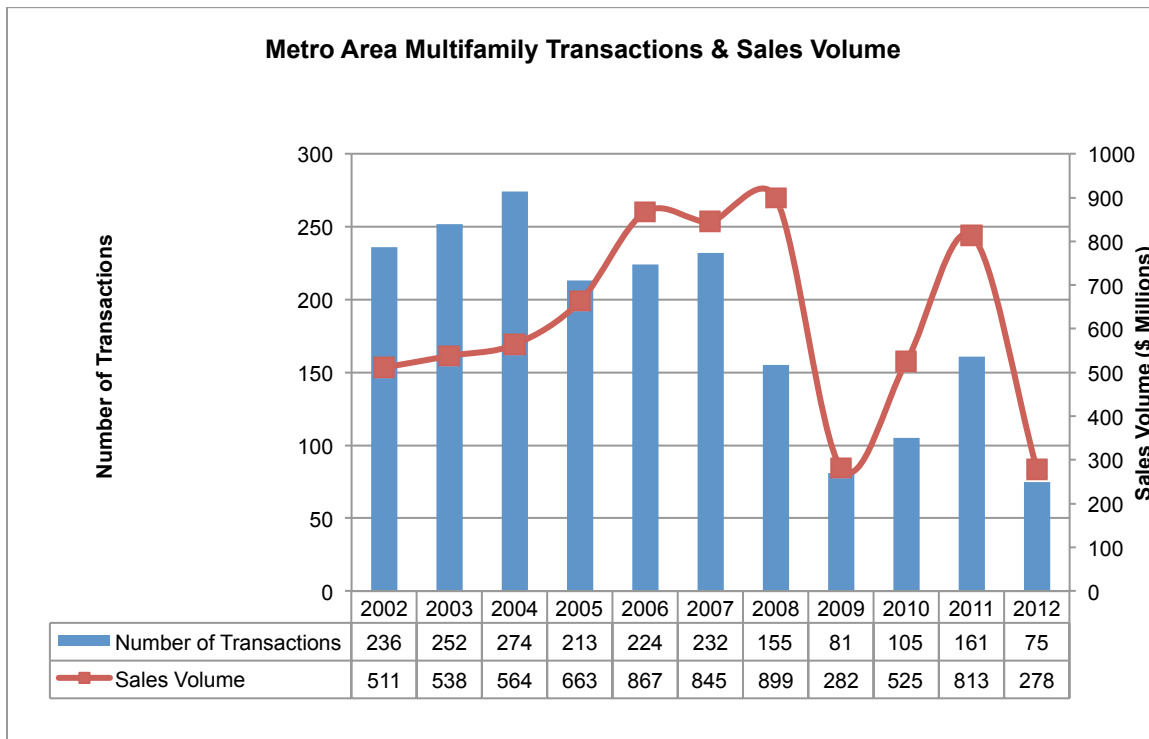
Source: MMHA

In this high demand market, investors are aggressively seeking quality, well-located properties. Apartments are viewed as a relatively safe investment to gain a higher return than bonds, or conventional Treasuries. Many large assets were traded within the past year and the second quarter of 2012 was relatively slow for large transactions. The only deal that sold this quarter over 50 units was Arbor Creek, a 100+ unit, Class A, institutional quality property traded for \$35.5 million.

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.

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 June 2012, there have been 75 deals that have closed. 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, June 2012 Year to Date



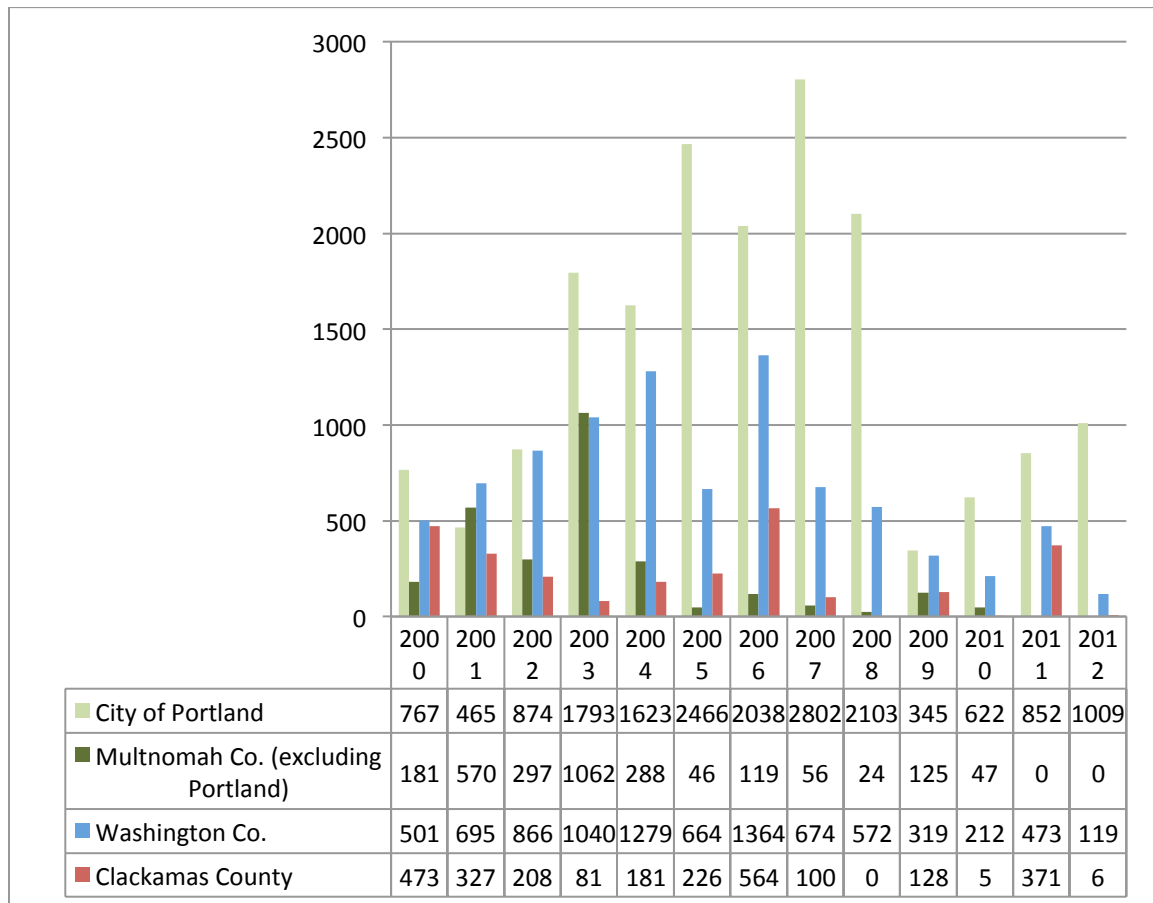
Source: Costar / Joseph Bernard Investment Real Estate

Through the first seven months of 2012, multifamily building permits have increased and within the City of Portland. Permits have been issued for 271 multifamily units built in the City, which is on pace to surpass the 2011 numbers for Portland. In 2012, there are 21 new apartment projects with 2,619 units slated to open. Many new developments are planned for close-in Portland including 20 Pettygrove (90 units), Prescott Apartments (156 units), and a 76-unit project at N Williams and Mason as these are the areas that have market rents that can support the high costs and risks associated with new construction. Developers are clearly favoring the core locations, as there have been zero permits issued in the rest of Multnomah County, Clackamas County, and only six units in Washington County. 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.

Factors contributing to the current lag in new construction include the weak economy, difficulty obtaining financing, and the current gap between replacement cost and market value. In light of the microscopic vacancy rate in the metropolitan region and lack of new construction, many real estate professionals would argue that the market is experiencing a shortage in apartments this year. 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. This

shortage will be felt first within the urban core and later in the suburbs, where there is slightly more inventory available.

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



Source: US Census

Experts predict a spike in number of transactions and sales volume as a result of owners and investors positioning their portfolios to capitalize on the further rent growth projected and persistent low vacancy in the market.

OFFICE MARKET ANALYSIS

GEORGE S. MCCLEARY

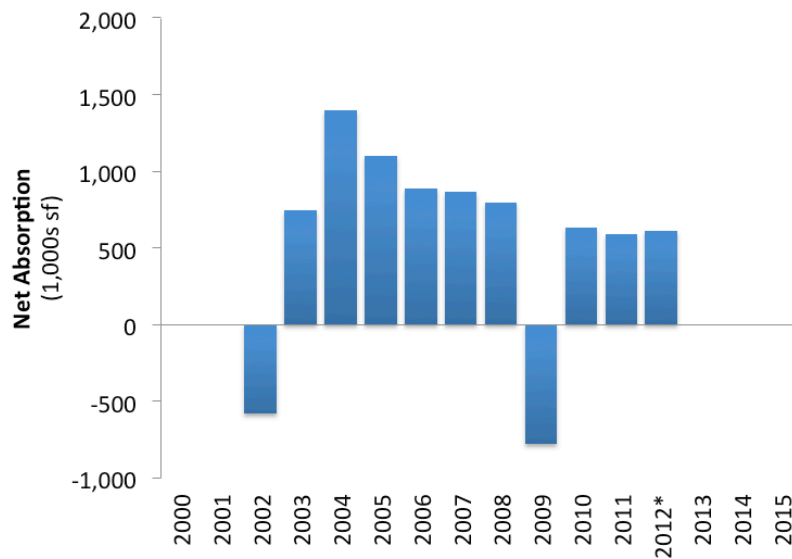
Owner, MRE Properties

RMLS Fellow, Master of Real Estate Development Candidate

Positive signs are emerging in Portland's office market as the metro area continues to recover from the recession. Portland's growing high-tech community continues to make headlines, as wind turbine manufacturer Vestas relocated to their new headquarters in the Pearl District. The FBI also relocated out of downtown, leaving two large vacancies in the CBD. At 9.8 percent, Portland's CBD vacancy rate is below the national average of 12 percent, but has increased from the first quarter of 2012. Moving forward, demand is expected to be driven by technology companies, business services and healthcare.

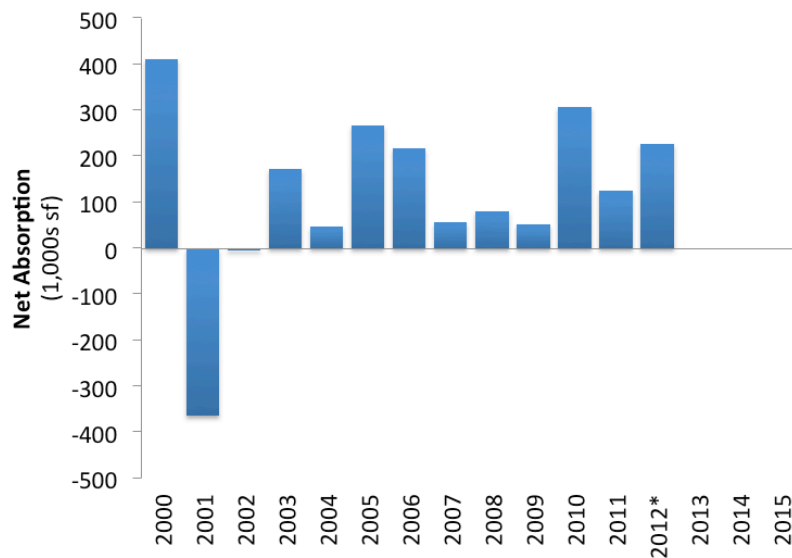
There are a number of indicators that Portland's economy is rebounding from the recession. The metro area has gained back 40 percent of employment lost during the downturn, with overall employment dipping to 7.9 percent. 20,000 jobs were added to the metro area, increasing the number of jobs by 2.1 percent. Oregon's economy grew by 4.7 percent in 2011, placing it second in the country for growth behind North Dakota. Portland recently ranked fourth in a study of leading high-tech metro areas based on the concentration of high-tech companies, patents per capita and patent growth. Despite these positive indicators, Oregon was late into the recession and lags behind other states recoveries by other metrics. The office market reflects this, as lease rates have yet to reach their pre-recession highs.

■ 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.

Figure 1: Overall net absorption, Portland office market

*Year-to-date

Source: Jones Lang LaSalle

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

*Year-to-date

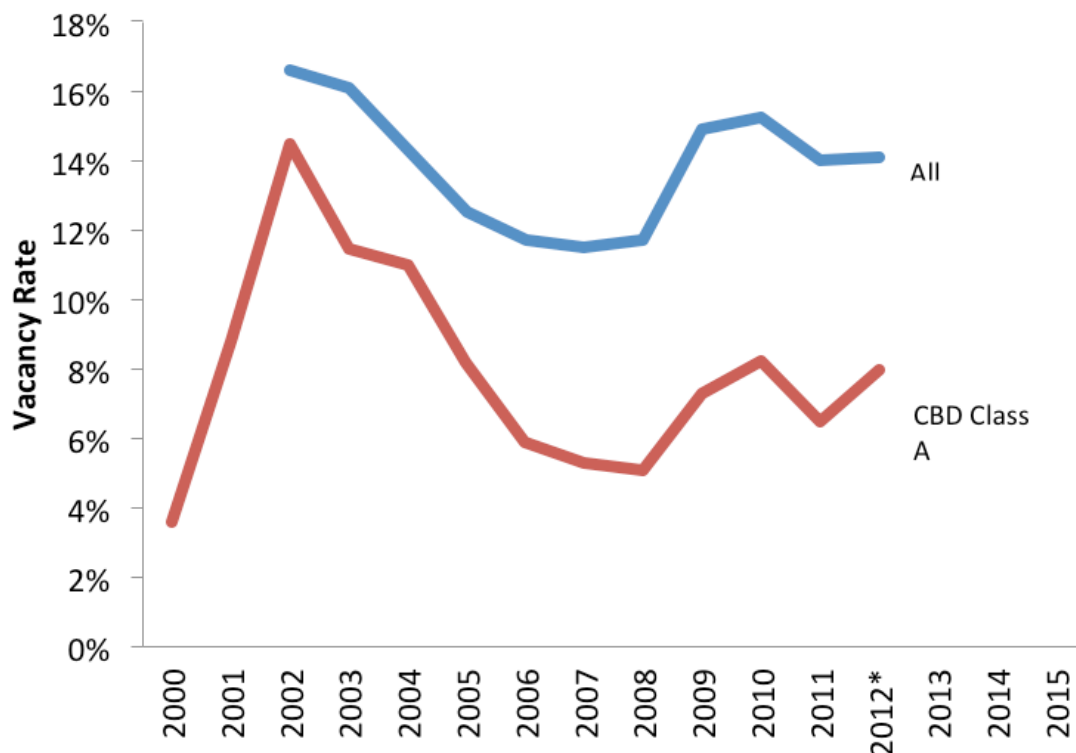
Sources: Jones, Lang & LaSalle, NAI Norris, Beggs & Simpson, CBRE

In the office market, Jones, Lang, LaSalle reports a 10 basis point increase in market-wide vacancy to 14.1 percent, up from 14 percent in the second quarter. While vacancy has remained relatively flat, absorption is up to a YTD 126,025 sf according to CB Richard Ellis, representing steady leasing activity over the past 12 months. While some larger leases have been signed, leases such as the Vestas and FBI were from vacated spaces in the CBD.

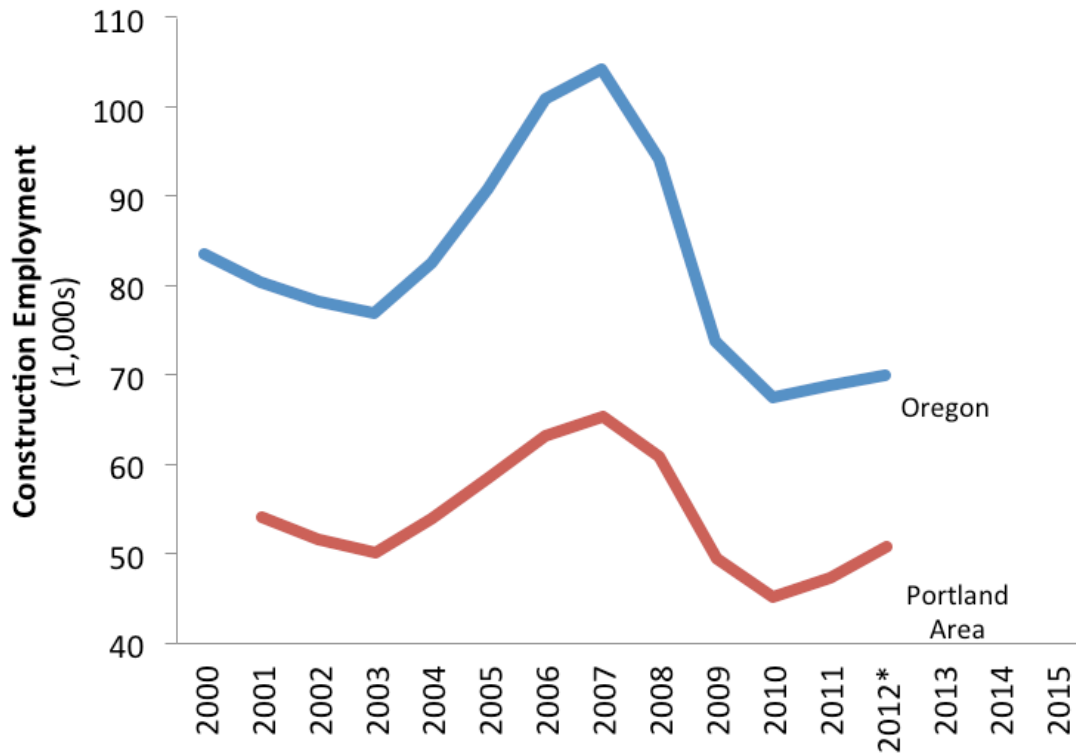
Overall vacancy rates in the CBD have been on the rise 2012 and have been increasing for the past 12 months. Adding to the Class A inventory will be the newly renovated Edith Green building, which will bring 323,000 of LEED Platinum Class A office space to the Portland market.

Vacancy rates for class A space in the CBD have risen as companies have relocated or vacated their spaces in favor of the suburbs or Pearl locations. Suburban office space was hard hit during the recession and currently has favorable rates and higher vacancy rates, leading to more affordable leases for companies. Despite a rise in vacancy rates in the CBD, the vacancy rate remains among the leaders within the metro area.

Figure 3: Vacancy rates, Portland office market

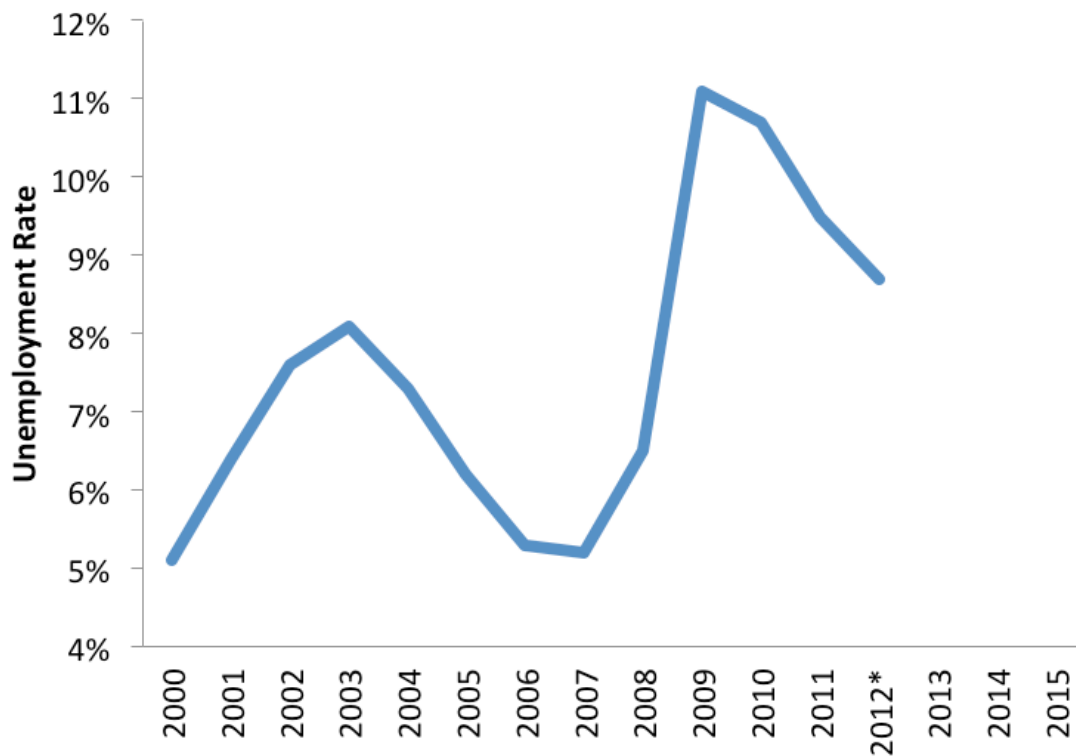


Source: Jones, Lang & LaSalle, NAI Norris, Beggs & Simpson, CBRE

Figure 4: Construction employment, Portland area and Oregon statewide

Source: Oregon Employment Department

Construction employment is currently at a seasonally adjusted 70,000, with Portland accounting for 50,800 of these positions in the Portland metro area. These numbers are up from 68,900 and 47,300, respectively, at the end of 2011. Current construction on the new transit bridge south of the Markham bridge is expected to continue into 2014 with substantial completion scheduled for that year. Private sector construction numbers are slowly rising as multifamily structures begin to rise.

Figure 5: Unemployment rate, Oregon

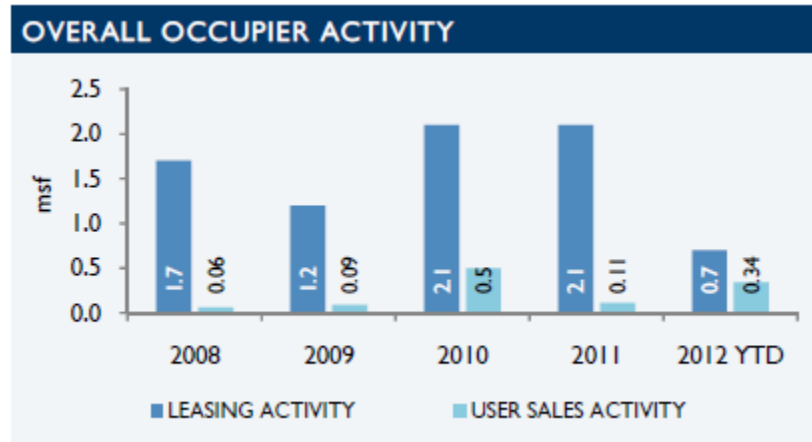
Source: Oregon Employment Department

Oregon's unemployment rate has slowly been dropping to levels that no longer distinguish it as one of the worst in the nation. At 8.7 percent it lags behind Portland, at 8 percent and the national unemployment rate at 8.2 percent. While these numbers are still historically high, this is the lowest unemployment in Oregon since the figure peaked in 2009 at an average 11.1 percent.

Sectors that are expected to see growth in employment are technology, business services and healthcare. EID Passport relocated to Hillsboro and added 100 jobs last year, and is expected to double that figure in 2012. Construction of data centers by Facebook and Apple in central Oregon, while not expected to add significantly to job growth, are positive signs that Oregon is on the map for technology companies.

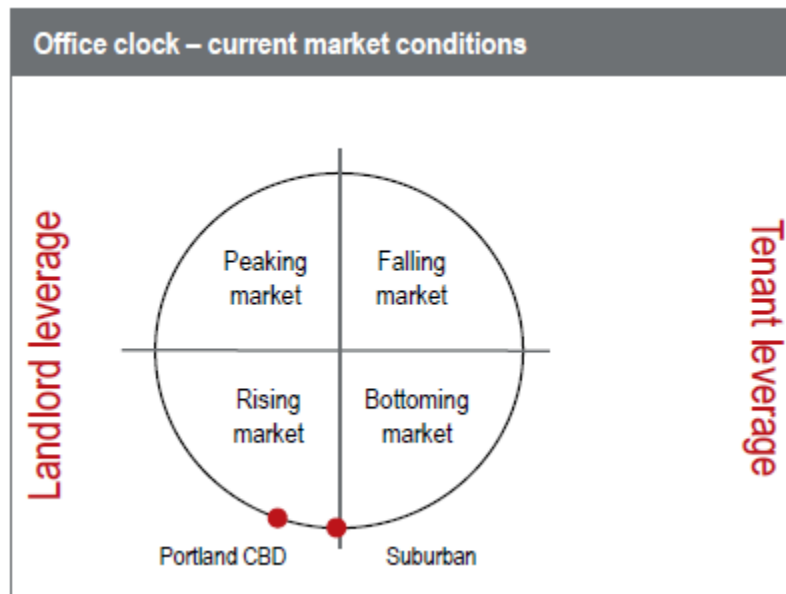
Additionally, three "new enterprise" zones were recently approved by the state which will allow businesses to earn tax breaks for investment in their respective neighborhoods. Any business that builds new operations or expands existing ones inside a designated zone can avoid paying property taxes for 3-5 years in return for creating jobs. These types of incentives are ideal for call centers and data centers, which have begun to spring up in central Oregon.

Figure 6

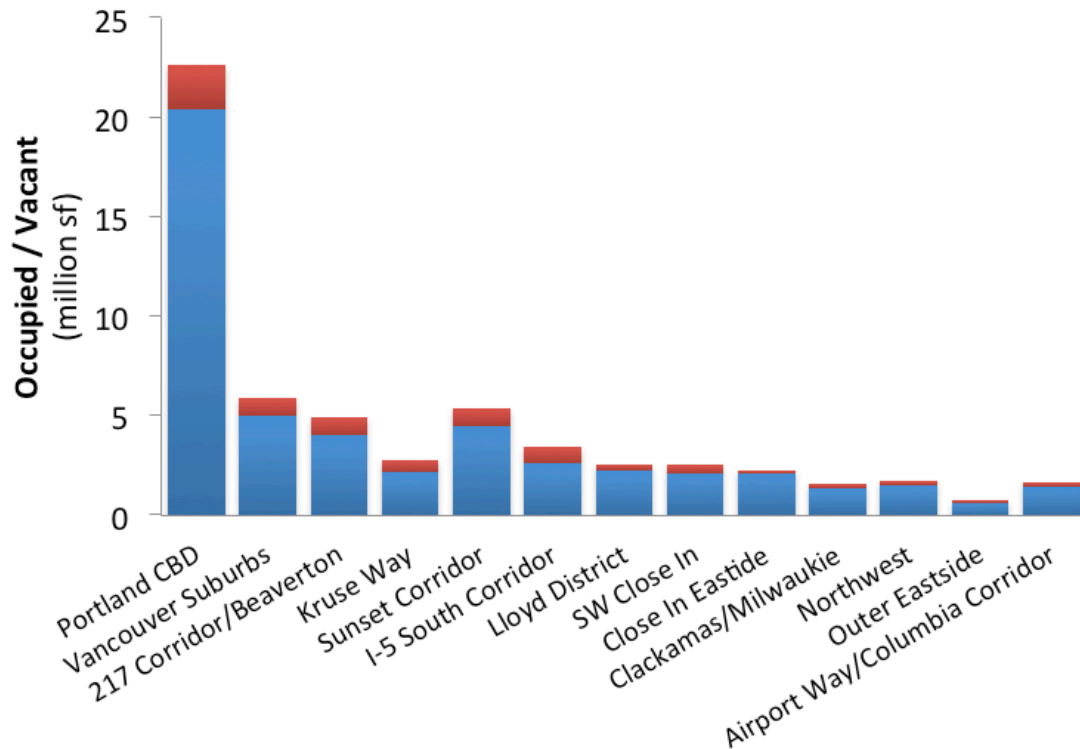


Source: Cushman & Wakefield

Figure 7

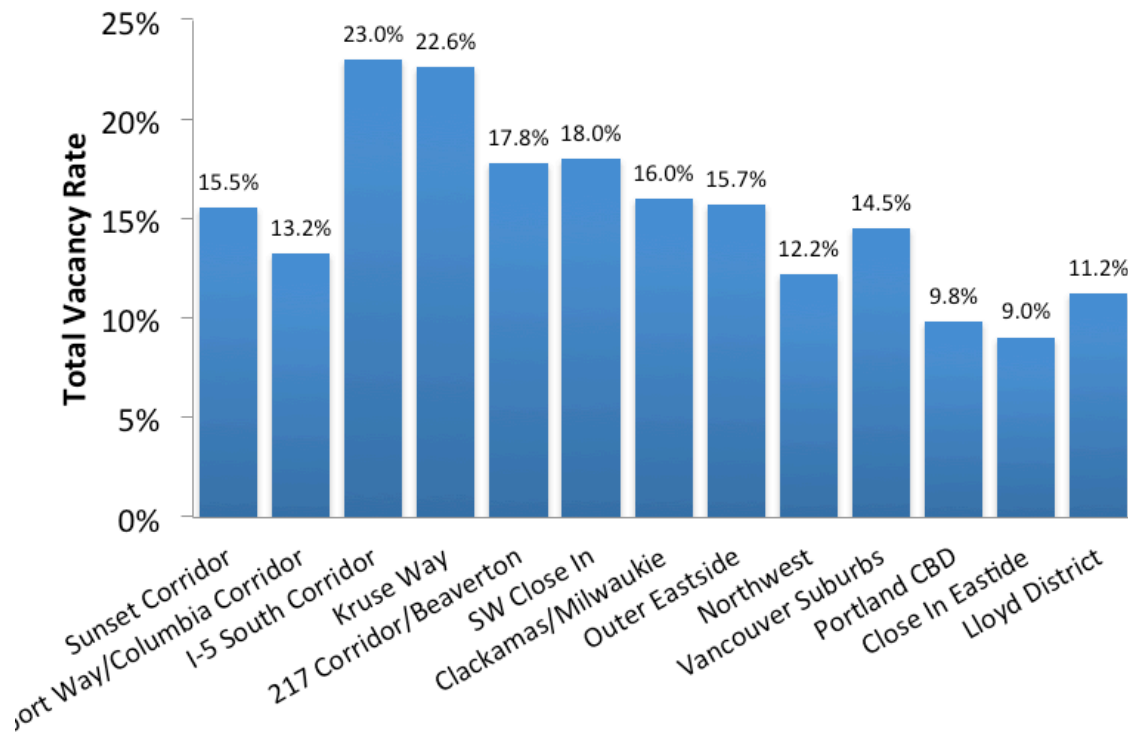


Source: Jones Land LaSalle

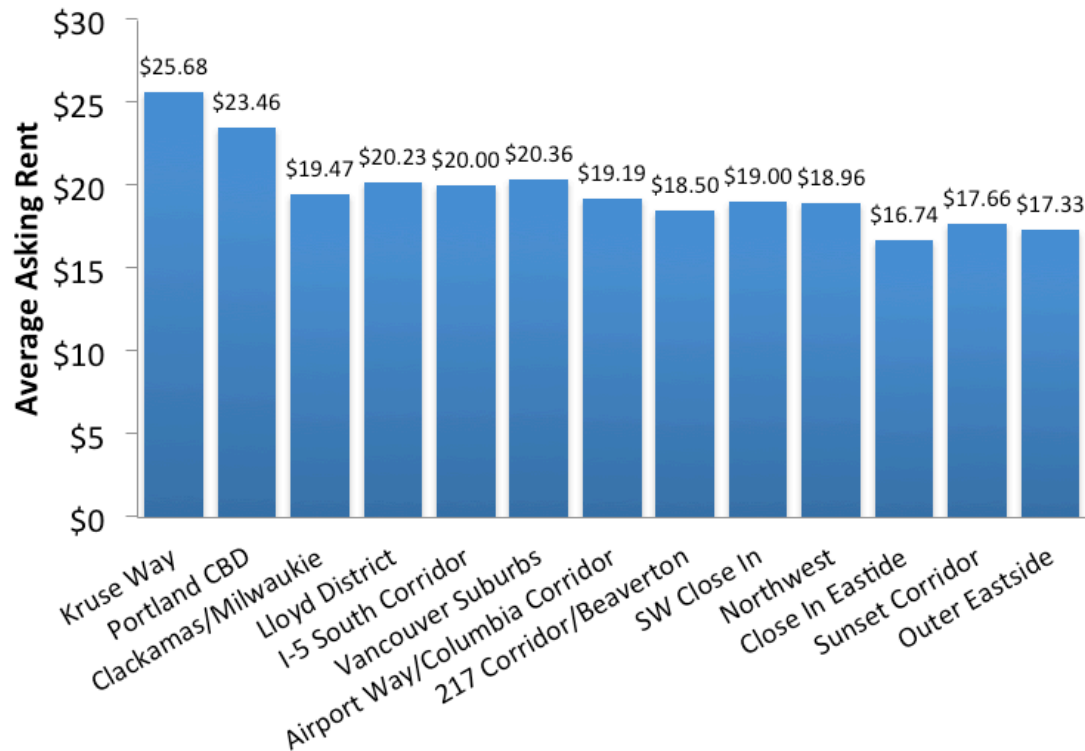
Figure 8: Submarket inventory, occupied and vacant

The CBD has seen higher vacancy rates the second quarter, while suburban submarkets have seen growth, especially in class A space. Despite this improvement in vacancy rates in suburban submarkets, the vacancy rates remain in the high teens or above 20 percent in Hillsboro, Kruse Way, Tualatin, Vancouver and Washington Square. The close-in east submarket continues to enjoy below-average vacancy rates, along with Northwest and the Pearl.

The lack of supply in the CBD of class A space is a problem that is likely to persist in the months to come, and continue until new class A space is constructed. Currently there is 315,000 square feet of new office space in the pipeline, per NAI Norris, Beggs & Simpson's report.

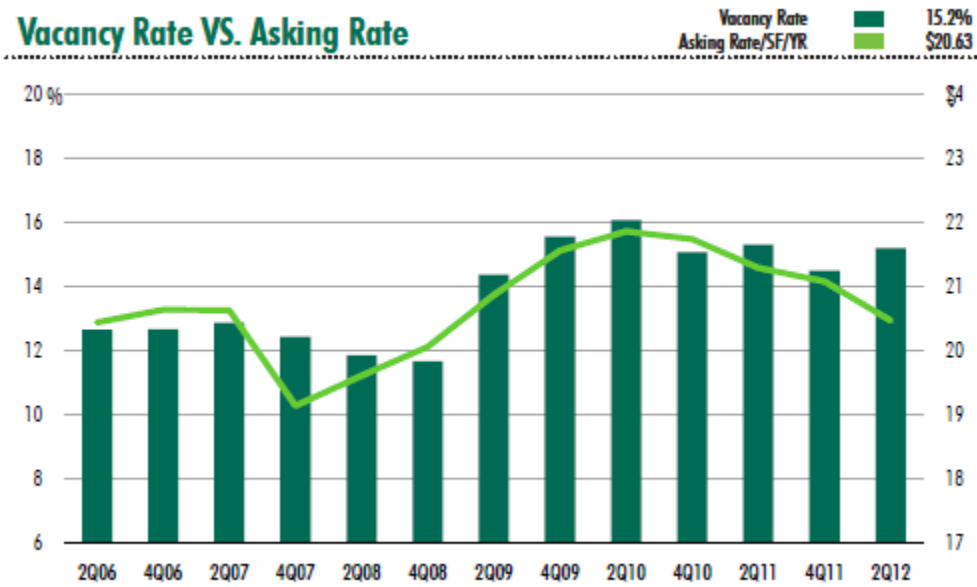
Figure 9: Submarket vacancy rates

With no new class A space available to the market in the near future, the trend of improving vacancy rates in the suburbs is likely to continue for the rest of the year.

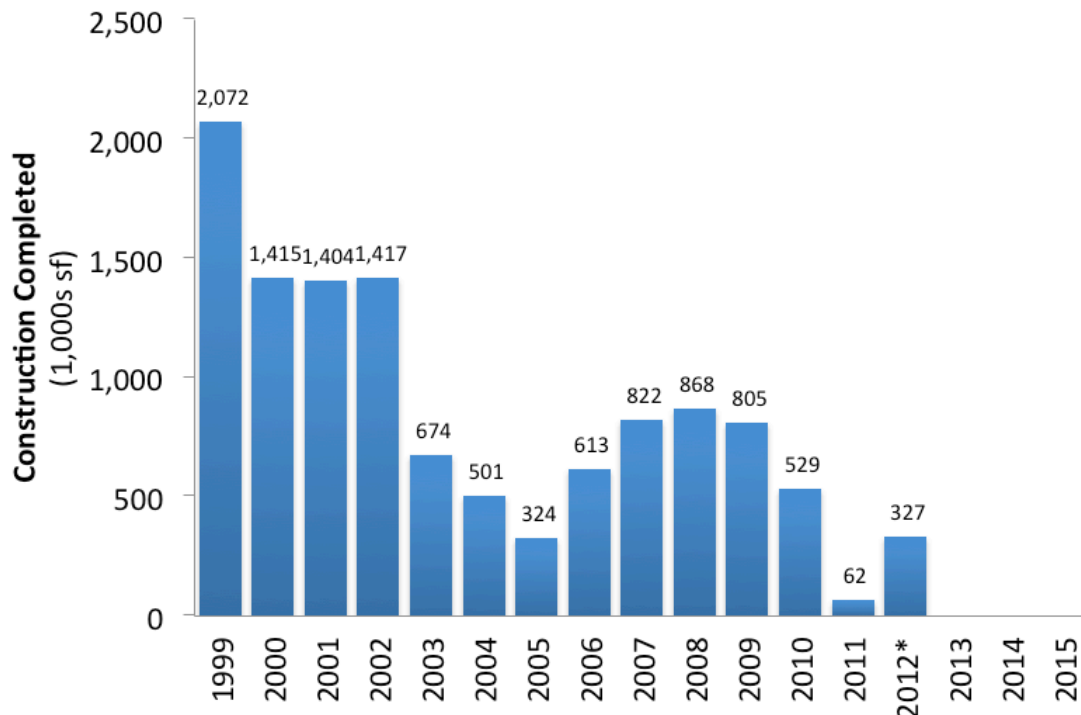
Figure 10: Submarket average asking rents

With the highest average asking rent and one of the highest vacancy rates, concessions are likely to continue in the suburbs as vacancy rates drop into the teens.

Figure 11



Source: CB Richard Ellis

Figure 12: Office construction completed, Portland

Colliers International reports 356,204 square feet of new supply constructed so far in 2012. While this is historically not a high number, it does show a positive trend of absorption of new space despite the timing being at the tail end of the recession.

Table 1: Major lease transactions, first quarter 2012

Lessee	Property	Submarket	Square Feet
EID Passport	5800 Pinefarm Place	Hillsboro, OR	72,000
Grass Valley	Tanasbourne Comm	Hillsboro, OR	52,000
GE Healthcare	Rock Creek 3600	Hillsboro, OR	41,385
Daimler	Montgomery Park	Portland, OR	38,489
The Clymb	Flying Rhino Bldg	Portland, OR	26,000

While there is uncertainty moving forward as we emerge from the recession, signs are pointing to modest upward pressure on absorption and lease rates through the end of 2012. At the current rate of absorption in 2012, we are only at 51 percent of the pre-recession absorption rate. Speculative construction remains minimal at the present time, as 1.6 million square feet of space will need to be occupied before the overall metro vacancy rate returns to the single-digits.

As employment continues to rise, there is likely to be a direct correlation with demand for commercial space. The Oregon Employment Department has predicted employment growth for the next quarter, and these jobs are predicted to be predominantly within the Portland metro area. With little speculative building during the recession, it is likely that demand will catch up to supply in 2013 and 2014, which will fuel the eventual recovery of the Portland office market. ■

RETAIL MARKET ANALYSIS

GEORGE S. MCCLEARY

Owner, MRE Properties

RMLS Fellow, Master of Real Estate Development Candidate

The retail market for the Portland metro area remains flat as CoStar reports a vacancy rate of 5.4 percent and a net absorption of negative 55,474 square feet. Rental rates have decreased slightly, to \$15.77 per square foot. Net absorption for 2012 is effectively zero, given the comparable amount of positive absorption in the first quarter. Construction has been slow, with 300,000 square feet currently under construction. This puts retail construction at its lowest level in decades. Most of this construction is build-to-suit and the vast majority is leased before completion.

Oregon's economy remains in a state of slow recovery. Shoppers are spending cautiously on news of moderate job creation and a slow turn-around in the housing industry. Consumer confidence is expected to rise for the remainder of 2012, which will spur leasing activity and retail occupancy. This stability in occupancy will allow rental rates to begin an upward swing by early 2013, predicts Cushman & Wakefield.

Lease rates have dropped to \$15.77 per square foot per year NNN, according to Cushman and Wakefield. This represents a 2.6 percent decrease

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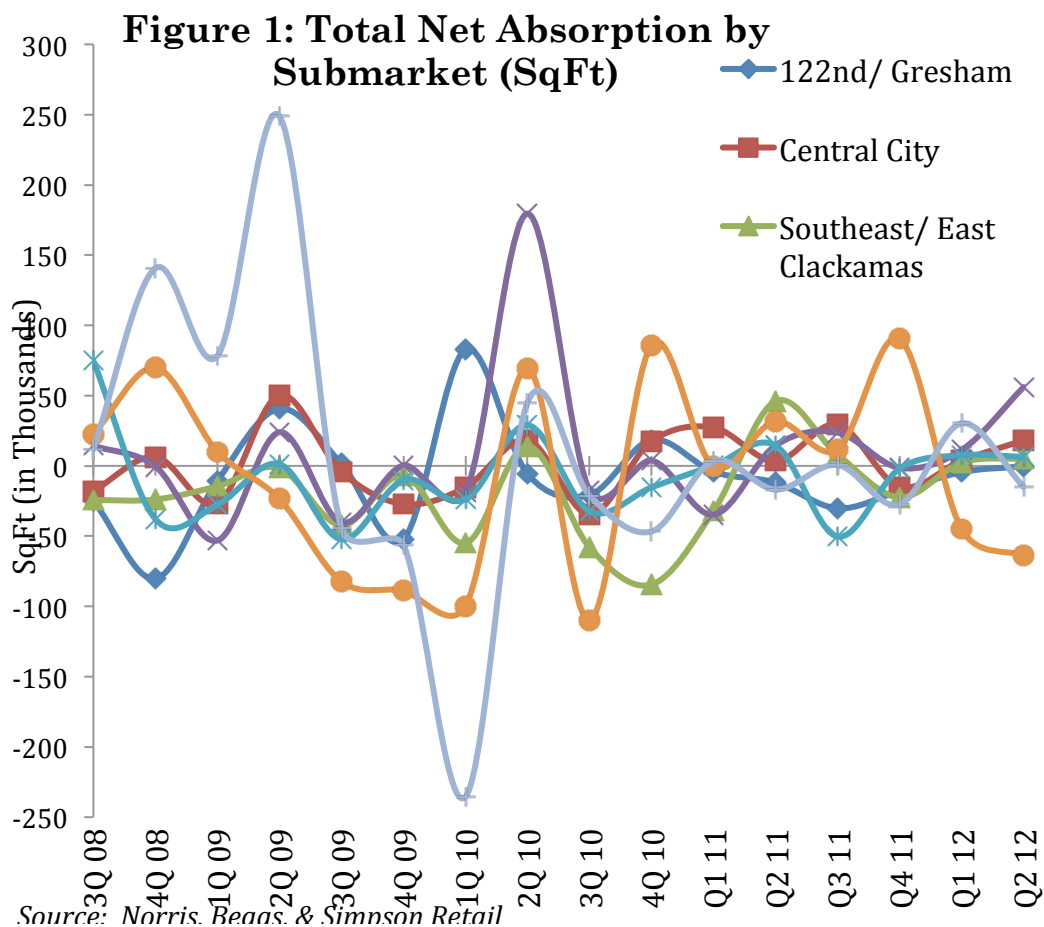
from last year. Lower lease rates are attracting retailers, however, as spaces in malls and shopping centers are being filled.

Major Lease Transactions			
Tenant:	Building:	Size (SF):	Submarket:
Punch Bowl Social	Pioneer Place	28,490	CBD
Jazzercise	Hillsboro Town Center	17,600	Sunset Corridor
Leer Truck Accessories	1301 SE Main Street, Oregon City	10,196	Southeast/East Clackamas

Source: CoStar, Oregonian, Portland Business Journal, Daily Journal of Commerce

Major Sale Transactions			
Buyer:	Building:	Price:	Submarket:
Wal-Mart	15600 SE McLoughlin Boulevard (former Joe's)	\$5,500,000	Southeast/East Clackamas
Guans USA Inc.	The Village on Scholls Ferry	\$4,350,000	Southwest
Anderson Hughes	2000 NE Burnside	\$3,295,000	122nd/Gresham

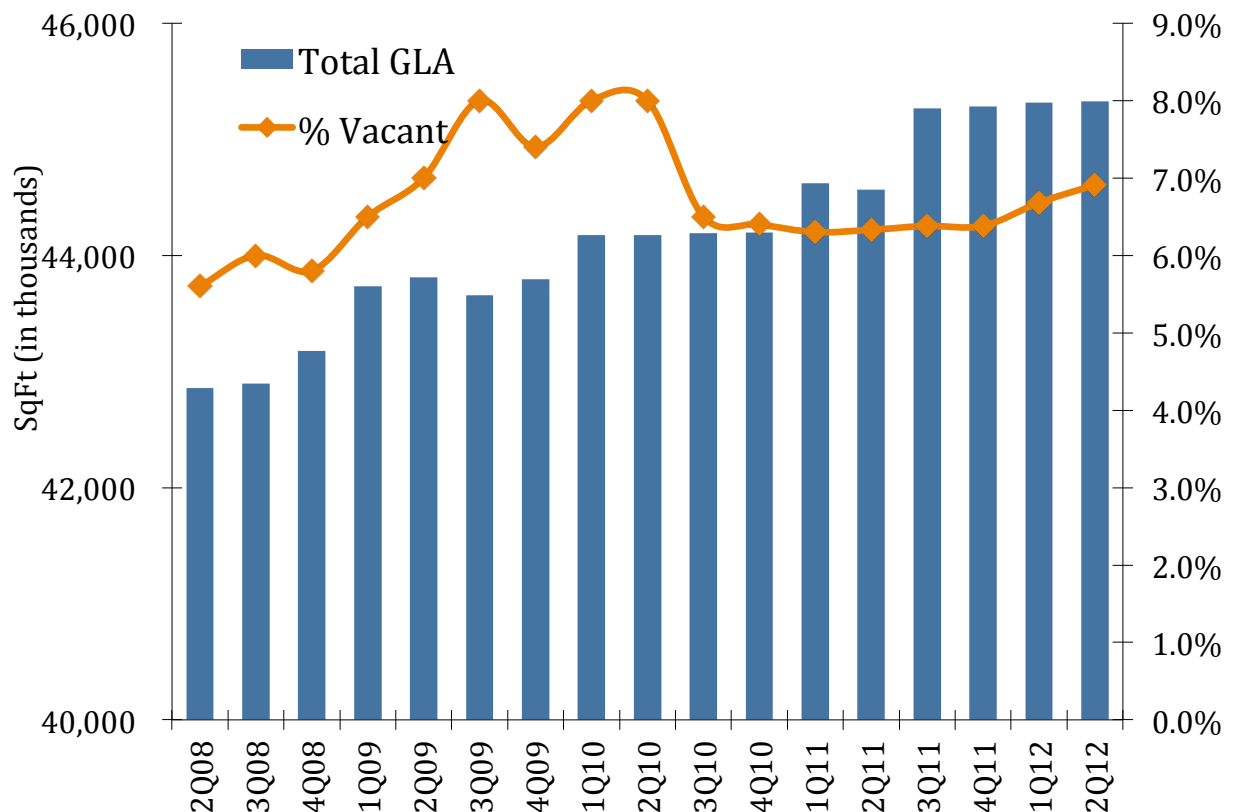
Source: CoStar



Norris, Beggs & Simpson reports a net negative net absorption for the second quarter in 2012 of .34,421 square feet. The CBD was hit the hardest, with a loss of 122,181 square feet in occupied space. Currently there is no new construction underway downtown, and retailers are anxious to get spaces filled as more spots open up at Pioneer Place. The Sunset Corridor and Gresham posted the biggest submarket gains at 40,413 and 54,985, respectively, but both are still in the negative for 2012 thus far. The eastside and Clackamas markets remained relatively flat with little net absorption gain or loss, while Southwest posted a loss of 24,410 square feet.

The Gresham submarket continued to carry a high level of available square feet, with 626,801 square feet of available space, second only to downtown. No new buildings are currently under construction in the area.

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

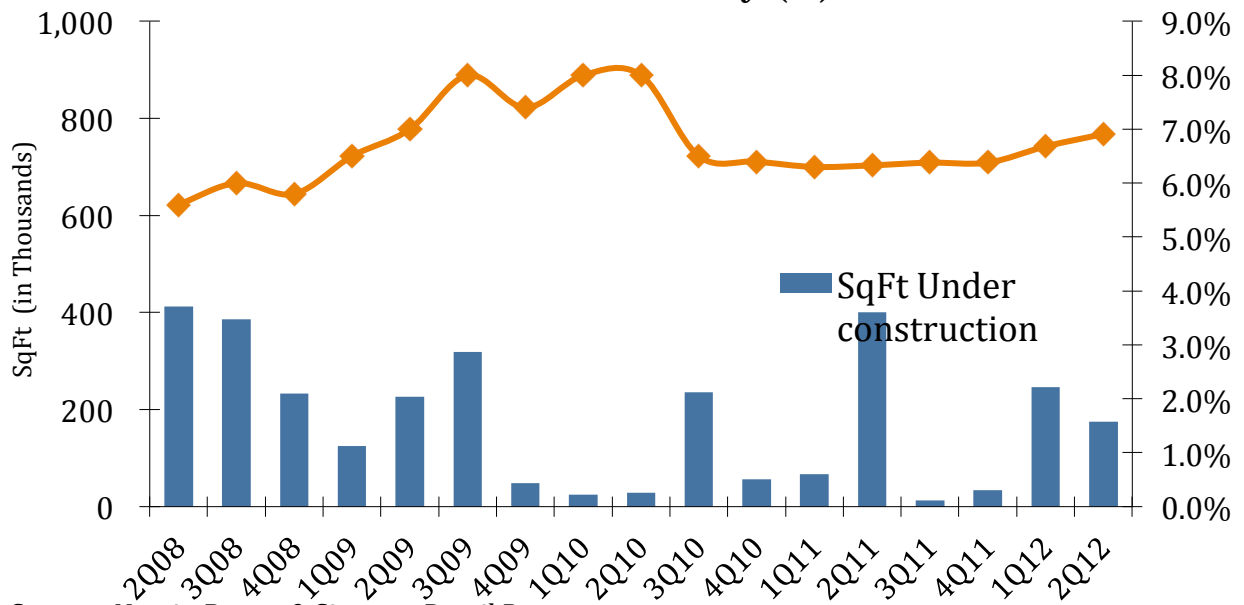


Source: Norris, Beggs, & Simpson Retail Reports

The total amount of gross leasable area (GLA) has remained relatively flat over the past four quarters, with little square footage delivered to the market. Vacancy rates have slowly been increasing, with several areas experiencing negative net absorption for the quarter and 2012 as a whole. Adding to downtown's woes, Bally Total Fitness at Yamhill marketplace closed its doors after being purchased by LA Fitness, vacating a space of 34,000 square feet.

Despite rising vacancy rates, grocery has been a bright spot in 2012. Wal-Mart has been active in the metro area with its grocery-centered neighborhood market stores. They recently leased a 60,000 square foot space at a Powell Valley Junction in Gresham and are expected to open their doors this month. The store will reportedly bring 80 jobs to the area. Zupan's Market has opened a location at the former Wizer's Lake Grove Market in Lake Oswego. Jantzen beach will see a new Target store complete with grocery section in October 2012. Currently the chain is demolishing and replacing the location, which will contain 138,000 square feet.

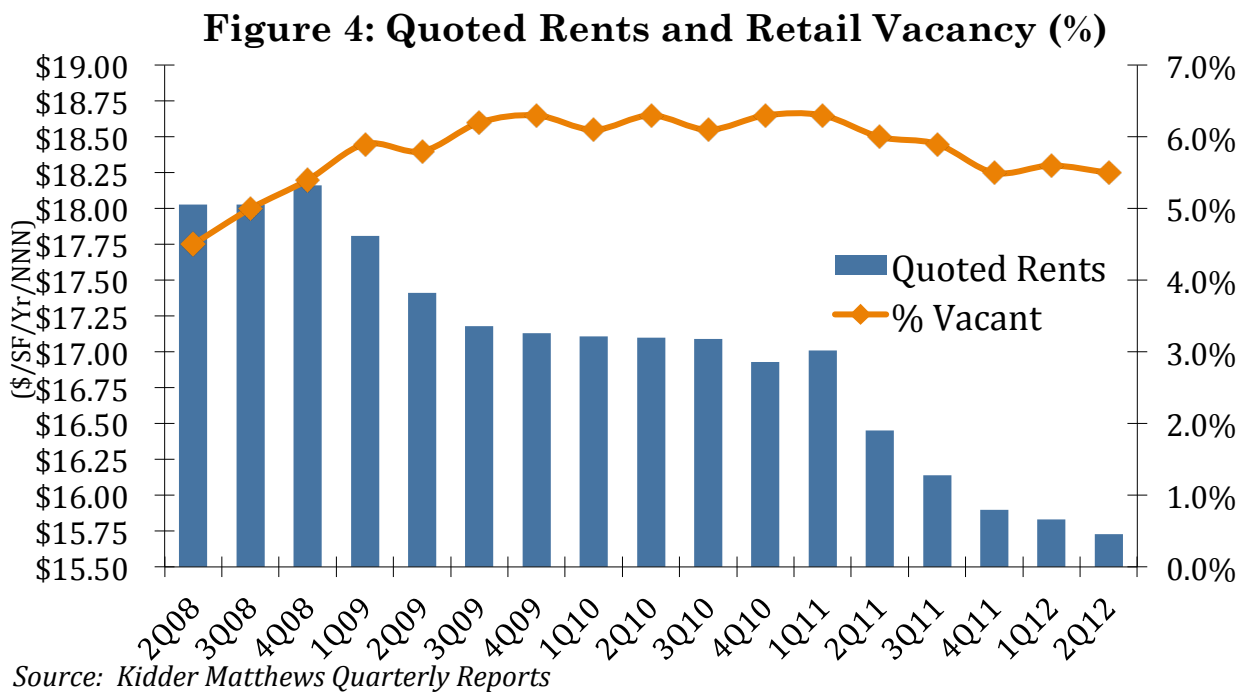
Figure 3: SqFt of Retail Space Under Construction and Vacancy (%)



2012 has showed an uptick in retail construction, but much of this construction is build-to-suit, with little speculative construction in the pipeline. Construction levels remain at historically low levels, despite the

slight uptick in 2009. It has been relatively unchanged for the past three years, despite some significant deliveries to the market. These deliveries has been offset by the demolition of older properties. The biggest upcoming delivery to the market will be the Target-anchored Jantzen Beach center, which will bring 30 new stores and as many as 500 jobs, reports Kidder Mathews.

Also in the construction pipeline is a \$12 million development project called D Street Village at SE 31st Avenue and Division Street. The mixed-used development will include business offices, retail spaces, and eventually apartments. Developers hope to break ground on the development in the Fall of this year.



Kidder Mathews reports vacancy holding at a relatively steady rate for the second quarter. There has been little change in vacancy, while lease rates have dropped steadily since the beginning of the recession. While most lease rates are dropping, rates continue to rise for restaurant and artisan/creative spaces. With little construction in the pipeline, it is likely that this trend will continue until new supply hits the market.

Oregon's economy has slowly gained strength and is expected to pick up speed by the end of this year. Retail sales are expected to benefit from the increase in consumer confidence, which is projected to lead to increased absorption and rates. News of job creation and a turnaround of the housing market are expected to spur increased confidence, which in turn should benefit landlords and retailers alike. ■

INDUSTRIAL MARKET ANALYSIS

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Owner, MRE Properties

RMLS Fellow, Master of Real Estate Development Candidate

2012 has brought the return of more robust user demand and strong export growth in the region. This has been spurred by a number of factors including Intel's \$4 billion D1X fab plant, which represents the largest single investment by any company in the state's history. Operations generating 1.1 million square feet will be completed in 2013. Build to suit development is moderate, and experts predict a return to speculative construction by the end of the year.

Demand for data centers has sprung up, especially in the sunset corridors and central Oregon. Oregon's durable goods manufacturing industry is currently dominated by tech and has driven this growth with a 16.3% increase in 2011. Sales volume of institutional grade industrial product is minimal due to soft market fundamentals, but this could change in the near future due to favorable market conditions for landlords. Lower vacancy rates are prevailing in nearly every sector, and Portland has enjoyed seven straight quarters of declining vacancy and growing tenant demand, in addition to nine straight quarters of positive absorption. Unemployment is down below the national average, which signals good things on the horizon for manufacturing.

Despite this uptick in activity, 3.9 million square feet of industrial/flex space still needs to be absorbed to equal the 6,870,000 square feet of inventory constructed since 2007. This new space, however, does not necessarily account for the majority

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of vacant space. Currently, class A space has sustained elevated leasing and absorption, while class B and C facilities are bearing more than their fair share of market vacancy.

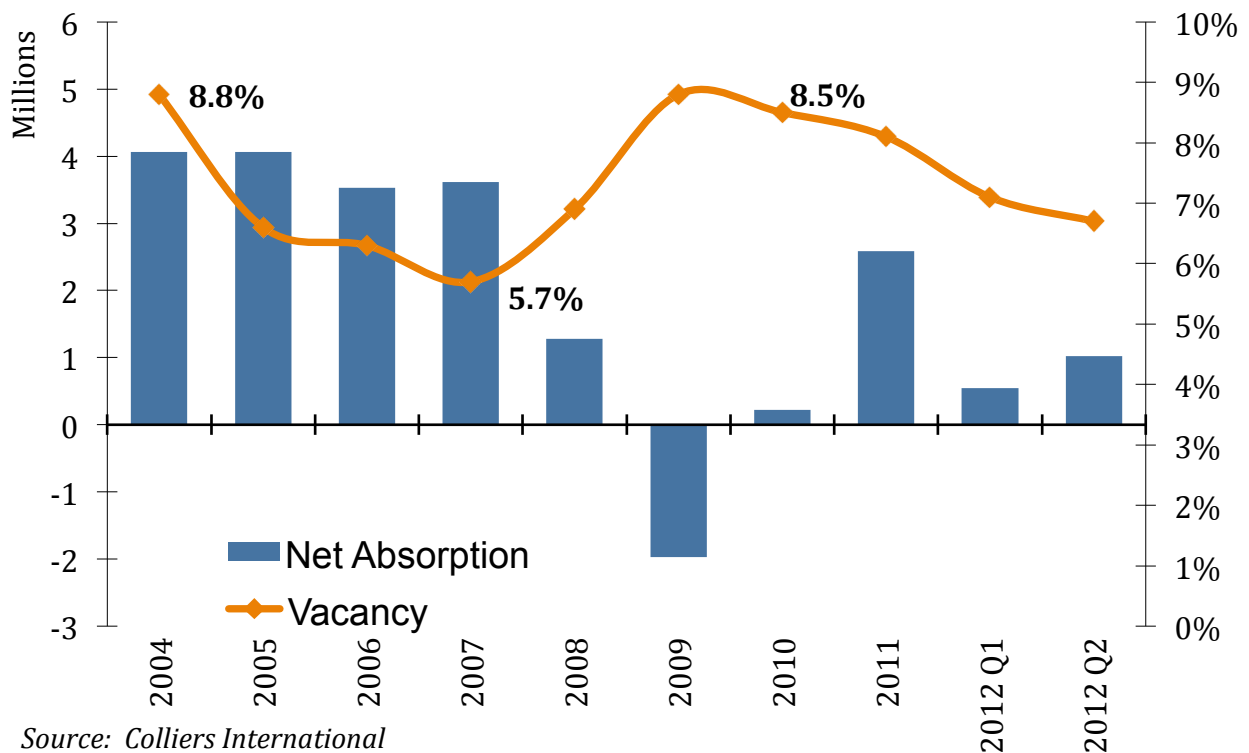
Table 1: Office Market Vacancies and Asking Rents, Q2, 2012

	CB Richard Ellis	Cushman & Wakefield	Kidder Matthews	Norris, Beggs & Simpson	Median
Market-Wide Vacancy	7.6%	7.4%	6.3%	14.2%	7.5%
Previous Quarter	14.9%	7.8%	6.8%	14.6%	11.2%
Second Quarter 2011	8.2%	6.8%	7.9%	16.1%	8.1%
Second Quarter 2010	8.2%	8.6%	8.2%	15.2%	8.4%
North/Northeast Market	8.1%	7.5%	5.5%	16.8%	7.8%
Previous Quarter	-	7.4%	5.6%	15.9%	7.4%
Second Quarter 2011	-	7.1%	40.1%	19.3%	19.3%
Second Quarter 2010	-	-	-	17.5%	17.5%
Northwest Market	6.7%	6.5%	5.1%	N/A	6.5%
Previous Quarter	-	7.1%	5.5%	8.6%	7.1%
Second Quarter 2011	-	2.9%	6.7%	11.9%	6.7%
Second Quarter 2010	-	-	-	10.3%	10.3%
Southeast Market	4.7%	5.1%	4.1%	N/A	4.7%
Previous Quarter	-	5.5%	4.5%	17.0%	5.5%
Second Quarter 2011	-	4.1%	5.2%	14.4%	5.2%
Second Quarter 2010	-	-	-	14.4%	14.4%
Southwest Market	9.5%	8.7%	16.9%	23.2%	13.2%
Previous Quarter	-	9.7%	15.1%	8.8%	9.7%
Second Quarter 2011	-	10.0%	14.9%	14.3%	14.3%
Second Quarter 2010	-	-	-	17.7%	17.7%
Vancouver/Clark County	6.7%	6.4%	5.5%	%	6.4%
Previous Quarter	-	7.2%	4.6%	13.1%	7.2%
Second Quarter 2011	-	4.7%	7.0%	14.1%	7.0%
Second Quarter 2010	-	-	-	15.4%	15.4%

Source: CB Richard Ellis, Cushman & Wakefield, Kidder Matthews, and Norris Beggs & Simpson Quarterly Reports

Overall, the median vacancy is down for the metro area for industrial space. The most consistent patterns are perhaps best measured from the reports of a particular brokerage, as each company uses different source data. This is especially true for NAI Norris, Beggs & Simpson, as their rates have varied greatly in similarly labeled geographic areas.

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



As we enter into the second half of 2012, we are currently on pace to exceed the net absorption of 2011 as vacancy continues to fall. While user demand has returned, experts point to the European debt crisis as a potential threat to the recovery. Europe accounts for over 20% of US exports, so a meltdown in consumer demand could derail progress out of the recession.

While net absorption is high in comparison with the past three years, there is 2,211,462 square feet of space currently under construction. As this space comes on

line, net absorption will need to continue to improve in order to absorb the new space.

Table 2: Major Industrial Transactions, 2nd Quarter, 2012

Tenant	Property	SqFt	Submarket
Vetris	Leveton Corporate Campus	140,000	Tualatin
OIA Global (renewal)	Rivergate Logistics	101,131	Portland
Fidelity Nat'l Title (renewal)	Kelley Point DC	65,099	Portland
TransPak Oregon LLC (renewal)	10675 SW Manhasset	60,087	Tualatin
Undisclosed	Southshore Corporate Park	60,000	Portland
Pacific Foods	Nike Distribution Center	300,000	Wilsonville

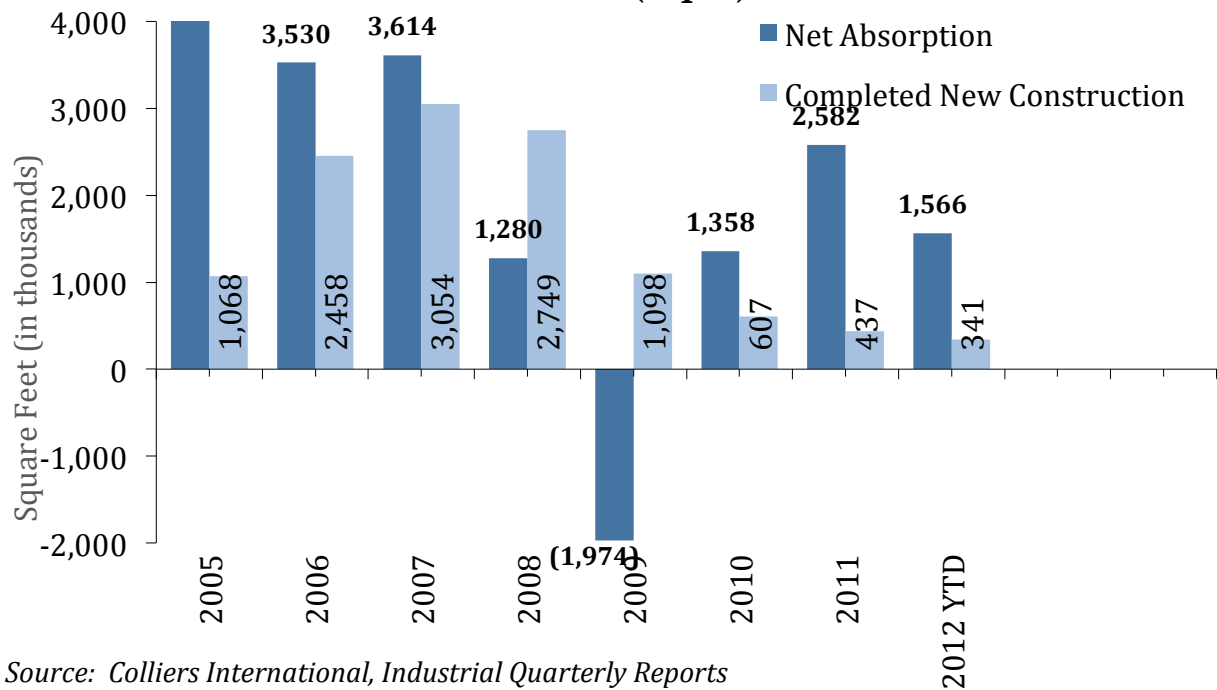
**Source: NAI Norris Beggs & Simpson, CB Richard Ellis, and Kidder Matthews Industrial Quarterly Reports*

Perhaps the most significant lease transaction was the absorption of 302,725 square feet of space in Willsonville at the former Nike distribution center. The Wilsonville submarket has struggled, and this space had sat largely vacant for the past three years.

Major Sale Transactions			
Buyer:	Building:	Price:	Submarket:
Kansas City Life Insurance	217 Distribution Center	\$23,350,000	Southwest 217
Industrial Income Trust, Inc.	11411-11603 SE Foster Road	\$17,385,000	Southeast
Tennant Investors	212 Corporate Center	\$9,500,000	Southeast

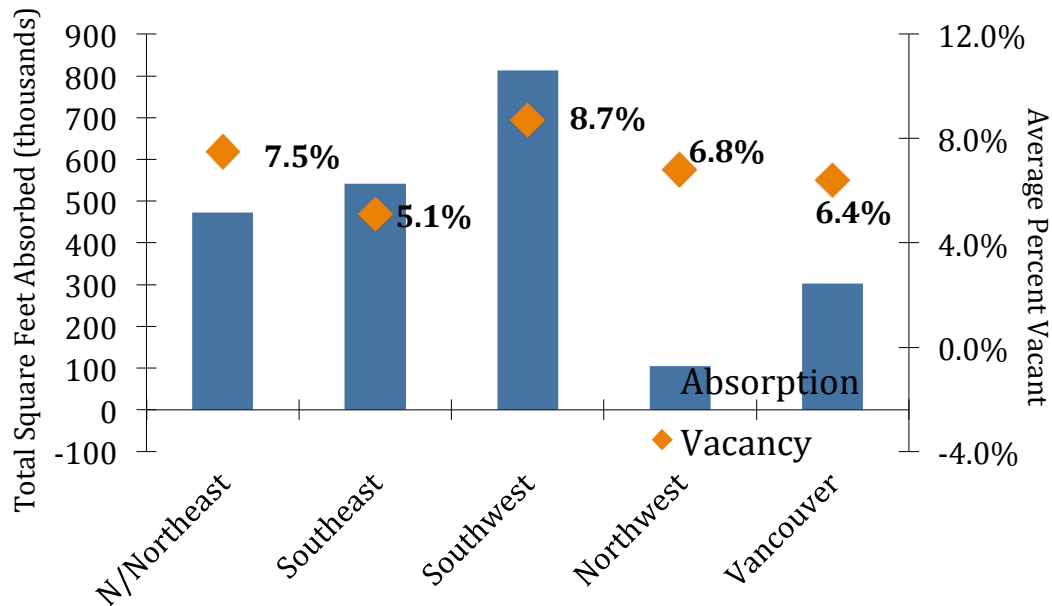
Source: CoStar

Figure 2: Industrial Absorption and New Construction (SqFt)



At current velocity, the market is trending toward a total new absorption of 3.3 million square feet in 2012. At this point in 2011, net absorption was only at 553,553 sq ft, according to Kidder Matthews. While this is would represent an improvement year over year, we are not yet at pre-recession levels, which averaged 5 million sq ft per year.

Figure 3: Submarket Vacancy and Overall Absorption, Q4 2011



Source: Cushman and Wakefield, Q2 2012 Industrial Quarterly Report

Rental rates for industrial space are ranging from \$.032 to \$.045 for a shell, with an office surcharge of \$.70/sf to \$.80/sf. Clackamas, Hillsboro and the I5 South Corridor are achieving the highest rates, while Airport Way, Rivergate and East Columbia submarkets achieve the lowest.

Most of the new construction in the pipeline is build to suit, with very little speculative construction. According to Kidder Matthews, the market has delivered 377,210 sf in 2012, with another 371,077 under construction. This is a total of around 748,287 for the year. While this is a higher number than in recession years, the market delivered an average of 2.4 million square feet to the market per year from 2003 through 2008. Construction is expected to remain low until lease rates are high enough to justify the construction of new units. ■