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CONTENTS

SUMMARY AND EDITORIAL

The economy is facing the turbulence of turnaround. Each new piece of economic data invites the question, "Is this a blip or a trend." Many signs point to a recovering economy. Even so, several other signs suggest it will not be an easy recovery.

The most recent employment figures are the biggest piece of good news. Private sector employment increased by 268,000 and the U.S. saw the seventh straight month of employment gains. Even the increase in the unemployment rate may be viewed as a positive sign. It may be a sign that "discouraged" workers are becoming encouraged enough to re-enter the workforce. Despite the positive employment news, it should be kept in mind that U.S. employment is about 7.0 million below the relatively full employment we saw just before the recession.

Business performance is another bright spot. Corporate profits are healthy and small business incomes are seeing slight increases. At the same the time, the stifled employment environment has worked its way through many sectors of the economy. For example, retail sales have provided mixed news. On the one hand, retail sales were up for the tenth month in a row. On the other hand, much of the recent increase was because of rising gasoline prices. Sales at general merchandise stores, a category that covers both department stores and big retailers such as Wal-Mart, edged up a modest 0.1 percent. And department store sales actually fell 0.2 percent. Sales at furniture stores fell 1.1 percent in April, which is likely a reflection of continued weakness in home sales.

Residential real estate has been blamed for being the first sector to enter the financial crisis (and drag the rest of the economy with it), and it looks like it may be

one of the last to get out. Home prices have seen a slight dip from what was hoped to be the first signs of a recovery. The Portland market has been listed as one of the markets with the steepest drop in home prices since the beginning of the year. Research from Zillow show that more than one-third of Portland area homes are now underwater.

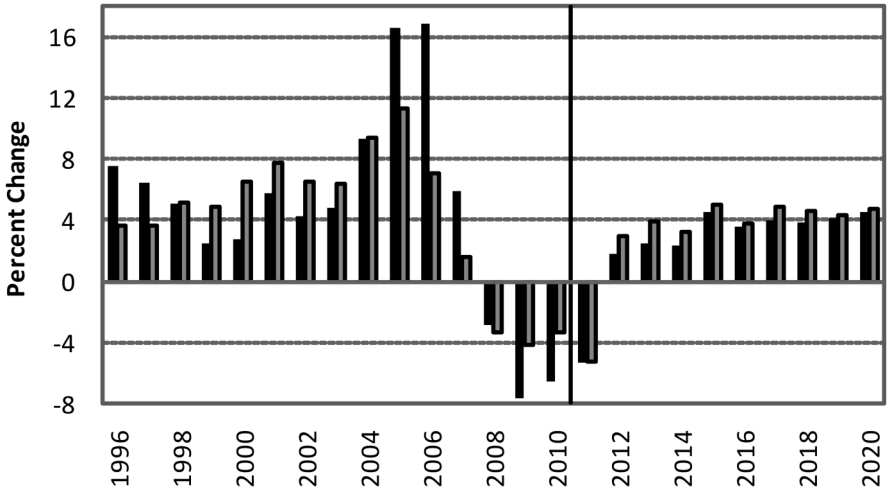
Oregon's Office of Economic Analysis warns that the housing market may be the biggest threat to a sustained economic recovery in Oregon. The state identifies several factors inhibiting recovery in the housing market:

- **An oversupply of houses** on the market, driven by income uncertainty and the a backlog of foreclosures. This oversupply is reflected in new construction activity. The state's economists find that, relative to last year, single family home permits are down 21.4 percent in the first quarter. At the same time, multi-family markets appear to be improving with permits up by more than 250 percent since the same time last year.

- **Further declines in home prices**. Figure 1 shows that the state predicts home prices will decline by another five percent this year.

- **Foreclosures and delinquency rates** are still relatively high. According to RealtyTrac, Oregon is now one of the top 10 states for foreclosure filings. While foreclosure activity seems to have slowed in the past few months, RealtyTrac cautions that the slowdown is largely the result of massive delays in processing foreclosures rather than the result of a housing recovery that is lifting people out of foreclosure.

Figure 1: House price forecast, U.S. and Oregon, through 2020



Source: Oregon Office of Economic Analysis; light bar represents Oregon, dark bar represents U.S.

In contrast to residential real estate, commercial real estate may be one of the first real estate areas to emerge from the recession. **Chris Lee** is one of the keynote speakers at the Portland State University Center for Real Estate's Annual Conference. Mr. Lee is also the editor of *Strategic Advantage*, a monthly electronic newsletter that has a futurist perspective of the real estate industry. In this issue of the *Quarterly*, Mr. Lee describes the existence of real estate cycles and the extent to which they can be predicted. Also in this issue, **Bill Conerly** predicts a coming "mini-boom" in commercial real estate. He argues that the small pipeline of new projects will meet an expanding economy. The result will be decreasing vacancy rates and increasing rents. Dr. Conerly cautions, however, that a true boom requires easy money and the return of easy money is still a long way away.

Brian Owendoff explains the potential impacts of FASB 13 changes on the commercial real estate participants. He expects the proposed changes will impact landlord, tenants, as well as commercial real estate brokers who will have to deal with more complex lease agreements and pressure from tenants to execute shorter term leases.

As part of a discussion of the role real estate development may play in potential climate change **Todd Littman** describes some research on the impacts of "smart growth" policies. He concludes that such policies can provide various economic, social and environmental benefits.

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REAL ESTATE CYCLES: THEY EXIST… AND ARE PREDICTABLE

CHRISTOPHER LEE

CEL & Associates, Inc.

We are bombarded daily with sound bytes about cycles. Today we have the "economic cycle," "business cycle," "recovery cycle," "stock market cycle" and recently the "climate cycle." We have "natural cycles," "energy cycles," "commodities cycles" and "currencies cycles." Cycles can be short-, intermediate- or long-term, as well as seasonal. A Foundation for the Study of Cycles was started in 1941 by Edward Dewey. Wall Street analysts, governmental agencies and talking heads assign the term "cycle" to all that can't be quantifiably explained or that which needs a catchy phrase to be explained. We have "vicious cycles" and "theoretical cycles." We have notable business consulting gurus who use phrases such as "cycle time" or the "customer cycle." Very sophisticated computer models at many universities and colleges seek to "quantify" business cycle theory (with the hope of a prediction), and one can blog and/or communicate with others 24/7 regarding economic cycles.

The issue with the term "cycle" is that it mandates an acknowledged beginning and an end, thus creating the endless challenging dilemma of knowing when to "get out" or when to "get in." A cycle is generally defined as "an interval of time during which characteristics, or often regularly repeated events or a sequence of events occur." However, regardless of what cycle you are in, no two cycles have the same start or finish date, and no two cycles have precisely similar characteristics. Cycles are both business and human multi-dimensional mosaics of varying duration. Predicting a precise date or time for a cycle to begin or end is next to impossible. With cycles, there is only one certainty—they exist, and they ultimately will have a significant impact on success or failure. The key is to not try to control but to take advantage of the cycles.

A BRIEF HISTORY OF BUSINESS CYCLE THEORY

While we may not be certain when the study of "economic" or "business" cycles began, we can look to the early and mid-19th century when fluctuations, patterns or cycles were first recognized, analyzed and explained. As shown in the table below, the study of economic or business cycles began around 1860.

Table 1: Cycles 101—A Brief Chronology

Year/Period	Corresponding Event
1860	French economist and physician Clement Juglar identified the presence of economic cycles to be 8-11 years in length. The Juglar fixed investment cycle (often called the true "business cycle") was 7-11 years in length.
1923	Joseph Kitchin addressed movements of economic factors by introducing: ♦ Minor Cycles averaging 3.5 years in length. ♦ Major Cycles, which are merely aggregates of Minor Cycles.
1925	Research by Russian economist Nikolai Kondratiev brought the now-familiar "K wave" to the dialogue of cycles. He observed cycles would last 45-60 years, and that people act differently over time in a continuing repetitive pattern. The "K wave" has four distinct phases.
1920–1936	John Maynard Keynes studied and developed theories of income determination. Unemployment crises inspired his two main works: *A Treatise on Money* and *General Theory of Employment, Interest and Money*.
1946	American economists Arthur Burns and Wesley Mitchell wrote and published *Measuring Success Cycles*.
1961	John Muth and Robert Lucas explore Real Business Cycle Theory. This is the assumption that business cycles are driven entirely by technology shocks rather than by monetary shocks or changes in expectations.
Late 1970s	Martin Armstrong constructed the "Pi Cycle Economic Confidence Model" that revealed a panic every 8.6 years between 1683 and 1907. The significance of 8.6 years, Martin later discovered, was exactly 3,141 days…the number of pi times 1,000.

Whatever the "natural" life cycle of business or economic cycles might be, on occasion they have been interrupted by government intervention as policy makers seek to lessen, correct, enhance, extend or reduce the impact or eventual outcome of cycles. Unfortunately this intervention (regardless whether political or well-intentioned) inevitably results in a deferral of a cycle's natural course or the creation of a new economic bubble that inevitably creates its own set of consequences. This further highlights the fact that cycle theory is often the historic offspring of technical analysis and modeling, based not on "natural" cycles, but emanating from monetary and fiscal policy decisions.

Today one of the more common explanations of business cycles is found in Keynesian economics, which argues for government intervention in the form of fiscal and monetary policy to "smooth out" fluctuations in the business cycle. The alternative to Keynesian economics is the Real Business Cycle Theory ("RBC Theory") which argues that business cycles are real and recessions merely respond

to changes in the economic environment and that markets, not government, should be the agents of "self-clearing" or "self-correction."

In recent years economists have begun to look at "economic fluctuations" rather than business cycles. It has been reported that noted economist and Keynesian opponent Milton Friedman believed it is a misnomer to refer to a business cycle as a "cycle." For every change in business activity, a cycle theory undoubtedly will be applied. The Internet has also spawned a number of "cycle bloggers" and "economic theorists," adding to the seemingly instant need for real-time explanations to very complex factors and trending information. For most real estate leaders, explaining and/or understanding cycle theory is like having a wisdom tooth extracted without Novocain. However, the real estate industry is clearly defined and measured by cycles, regardless of the definition or title/name applied.

So what does all this mean to the real estate industry?

REAL ESTATE CYCLES EXPLAINED

My research, experience and exposure to approximately 500 real estate firms over the past 30-plus years has revealed that real estate cycles tend to follow a fairly consistent 10-year pattern. Obviously it is not a precise 10-year period—one cannot pick specific beginning or ending dates; and real estate cycles vary by asset type, market factors and location. However, real estate cycles are comprised of four Periods of Opportunity, as highlighted in Table 2.

As you can see, the length of time within a period is typically uniform. However, the "Plateau" and "Crisis" periods can be shorter in duration. It appears that, as the real estate industry nears its peak during the Growth Period, the level of denial, misguided expectations, blind optimism and "one more day" mindset appears to creep into the C-suite. How many times have we heard, "I know it is probably time to get out, but I just need to get this deal done," or "I'm not sure I believe these numbers, but debt is cheap, I am using OPM and this opportunity is just too good to pass up." A good time to exit is probably 6–12 months before or 6 months after the peak of the Plateau Period. A good time to enter is in the Transition Period. A good time to be very cautious is near the end of the Growth Period.

Because real estate cycles tend to work on 10-year cycles, it is important to note that all asset classes or markets do not begin or end a cycle at the same time. The impact of global, state and regional economic and government activity does affect the length and severity of a real estate cycle. For example, the Tax Reform Act of 1986 eliminated/removed many tax shelter-based investments and probably contributed to the savings and loan crisis that sent the real estate industry into a rapid downturn by the late 1980s/early 1990s. The aftermath of 9/11 delayed the economic recovery for 12–18 months. The current financial stimulus and bailout programs may contribute to a slower recovery of the non-residential real estate market.

Table 2: Periods of Opportunity in the Real Estate Cycle

Period I	**Growth Phase**	
	♦ Accelerated development activity	♦ Growth in "start ups"
	♦ Increasing leasing activity	♦ Geographic expansion
	♦ Access to inexpensive credit	♦ Rising GDP
	♦ Rising rents and asset values	♦ Rapid job growth
	♦ Expanding risk profile	♦ New competitors entering the market
Period II	**Plateau Phase**	
	♦ Overly optimistic underwriting	♦ Supply/demand out of balance
	♦ Increase in capital raising	♦ Protracted closing period
	♦ Aggressive compensation for talent	♦ Increase in "guarantees"
	♦ Blind entrepreneurism	♦ High investment sales activity
	♦ Low cap rates	♦ Generous TIs and lease terms
Period III	**Crisis Phase**	
	♦ Declining asset values	♦ Workouts/restructurings
	♦ Entity downsizing	♦ Little to no development activity
	♦ Declining rents and occupancy	♦ Leasing concessions
	♦ Discounted asset/loan sales	♦ Limited access to credit
	♦ Cash is king	♦ Government intervention
Period IV	**Transition Phase**	
	♦ Focus on fundamentals	♦ Government incentives
	♦ Recapitalization	♦ Commitment to CRM
	♦ Industry consolidation	♦ Realistic underwriting
	♦ New business models emerge	♦ Diversification of risk
	♦ Reduced/restructured compensation	♦ Next-generation leaders emerge

Note: It is important to understand that the attributes highlighted within each Period of Opportunity are not intended to represent an all-encompassing list. There are, obviously, many more attributes. Readers are encouraged to share their recommendations by sending them to cel@celassociates.com.

Interestingly REITs tend to cover two "normal" real estate cycles. Bob Case, NAREIT's economist, recently stated that REIT real estate cycles tend to last 18 years with two-year transition periods. This closely parallels the findings of CEL & Associates, Inc. regarding the 10-year "normal" real estate cycle.

Most real estate cycles have begun around the third year of a decade (1973, 1983, 1993, 2003) and usually end by the eighth year of that same decade (1978, 1988, 1998, 2008). Between the finish and start of a new cycle, a period of transition occurs (1989–1992, 1999–2002, 2009–2012). We are in a period of transition now (two years of bottoming out and two years of recovery) that will end around 2011–2012, depending on which asset class or market you are watching.

While there are many "fundamental" drivers of real estate cycles, no single factor determines a real estate cycle. CEL & Associates, Inc. has identified nearly 50 "cycle drivers;" however, 20 "core" or "fundamental" drivers tend to dominate a real estate cycle. Since all drivers are not created equal or their weighted impact the same, they can be divided into the two groupings shown in Table 3.

Table 3: Fundamental Drivers of Real Estate Cycles

Primary Drivers	
♦ Federal Policy & Priorities	♦ Consumer Confidence/Spending
♦ Access To/Cost Of Capital	♦ Labor Force Productivity
♦ Job Growth (Quantity & Type)	♦ Supply/Demand Ratios
♦ Commodity Prices	♦ Infrastructure Investments
♦ Demographic Shifts	♦ Economic Growth
Secondary Drivers	
♦ International Trade	♦ Business Start-Ups
♦ State/Local Regulations	♦ Advancements In Technology
♦ Population Migration	♦ Competitor/Industry Factors
♦ Small Business Performance	♦ Household Formation/Characteristics
♦ Consumer Credit/Savings	♦ Household Income/Net Worth

Source: CEL & Associates, Inc.

Note: There are other indicators of demand (e.g. housing, savings rates, money supply, cap rates, cost of capital, asset sales volume, migration, etc.); however, most, if not all of these are the net result of a core driver, and not the basis for creating business demand.

PAST, PRESENT & FUTURE CYCLES

Since 1983, real estate cycles can be characterized by these primary business drivers, as highlighted in Table 4.

Table 4: Primary Drivers of Past Real Estate Cycles

Cycle Growth Period	Primary Drivers Of The Real Estate Cycle
1983–1988	Growth from an abundance of capital, financial engineering and tax incentives.
1993–1998	Growth from industry consolidation, securitization, and the digital economy.
2003–2008	Growth from an abundance of inexpensive debt, unprecedented consumer spending and a “bull” stock market.

The business drivers’ characteristics of the next two real estate cycles will likely be those shown in Table 5.

Table 5: Likely Primary Drivers of the Next Real Estate Cycles

Cycle Growth Period	Primary Drivers Of The Real Estate Cycle
2013–2018	Growth from recapitalization, generational shifts, global restructuring, "green" technologies, education, public infrastructure, knowledge-centered industries, energy, data storage and healthcare.
2023–2028	Growth from life sciences, bio-technology, Gen Y shifts, scarcity, artificial intelligence, alternative energy, fusion, oceanography, robotics, research, micro-farming and water reclamation.

The wild card in these next two real estate cycles will be the role and/or impact of government intervention/policies, taxes, regulations, 2010 and 2012 election outcomes, terrorism, global unrest, U.S. Federal and State debt levels and availability of capital. The speed of available information and role of the Internet is having an impact on the cycle length. However, the U.S. population is projected to increase by 49.2 million between 2010 and 2030, and the aging real estate asset stock will need to be replaced, renovated and/or redeveloped. Increasing demand for real estate assets will be driven by the fundamental drivers that have guided the real estate industry for over 100 years. My good friend, Arthur Nelson, who directs the Metropolitan Research Center at the University of Utah, estimates between 2000 and 2040 the U.S. will need over 112 billion square feet of non-residential space. The issue going forward will not be trying to figure out supply/demand or cap rate fluctuations; it will be understanding real estate cycles to know when and where to invest.

It is also important to note that the next global credit crisis could occur in the 2012–2013 period, followed by a recession that could last into 2015. Based on U.S. real estate cycles, I believe 2010–2013 is the time to buy domestically, and 2015–2018 will be the time to buy internationally. The U.S. real estate cycle generally occurs two to three years before the international real estate cycle, which can vary widely by market and product. But real estate cycles are predictable.

CONCLUSION

The study of real estate cycles will never be complete. The unexpected and predictable outcomes of national and global events will impact the start, end and duration of a cycle. In the years ahead, the continuing study and understanding of real estate cycles will be important in setting strategic priorities and direction. However, one fact is very clear, real estate cycles exist … and are predictable. How will you take advantage in the current and next real estate cycle? ■

Christopher Lee is President and CEO of the Los Angeles-based CEL & Associates, Inc., one of the nation's leading consulting organizations specializing in strategic planning, compensation, benchmarking, opinion surveys and performance improvement in the real estate industry. Mr. Lee is an acknowledged leading futurist, has his Ph.D. in Management and Organizational Development and, for over 30 years, been an advisor to real estate companies nationwide. Mr. Lee is also the editor of *Strategic Advantage*, a monthly electronic newsletter that has a futurist perspective of the real estate industry. Chris' opinions and forecasts regularly appear in trade publications, and he is a frequent speaker at industry conferences. For over 20 years his firm has conducted the nation's largest compensation survey in the real estate industry, and in 2010 Chris' firm conducted approximately 2,000,000 customer opinion surveys. CEL & Associates, Inc.'s 500 clients read like a Who's Who in the real estate industry. Readers are encouraged to sign up to receive a complimentary subscription to *Strategic Advantage* and/or to address any questions by emailing Mr. Lee at cel@celassociates.com.

THE COMING MINI-BOOM IN COMMERCIAL REAL ESTATE

BILL CONERLY, PH.D.

Conerly Consulting LLC

We are currently under-building commercial real estate, which will lead to a mini-boom. The pipeline of new buildings is thin, so as the economy improves, there will be very little additional space coming to market. Occupancy rates and rents will rise. The resulting increases in operating earnings will cause the mini-boom. However, a true boom requires easy money, which is not part of our future, at least over the course of the upcoming cycle.

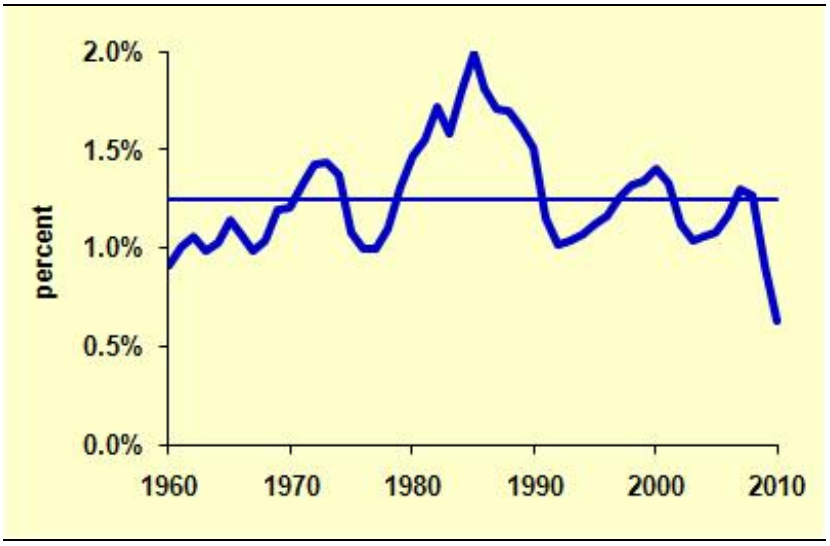
As a good rule of thumb, we spend about one-and-a-quarter percent of gross domestic product on commercial and health care buildings. That figure was steady through most of the 1960s and 1970s, until the Savings and Loan industry diversified into financing commercial real estate. At the peak in 1985, two percent of GDP was devoted to commercial construction. That overbuilding as well as tighter lending rules associated with the FIRREA legislation in 1989, led to below-normal construction in the early 1990s. The 2001 recession cut development levels again.

The recent economic boom and housing boom was not a commercial construction boom. The best years of the last decade were below the long-run average. In other words, the American economy entered the recession without an excess supply of commercial structures.

The recession certainly clobbered commercial real estate, pushing occupancy rates down, which triggered rent cuts. The long lead times of many projects kept pushing more floor space onto the market even as the recession was reducing demand. Commercial real estate is not healthy at this time, but there is a vital

distinction between commercial and residential real estate. We overbuilt residential, and then the recession lowered demand. In the commercial sector, we had not overbuilt—and then the recession lowered demand.

Figure 1: Commercial construction, as a share of GDP, 1960–2010



Last year commercial construction amounted to just 0.6 percent of GDP, less than half its long-run average. One might argue about whether the long run average is drifting up or down over time. However, there's absolutely no way that the current construction pace constitutes the new normal.

I scanned a few market reports from around the country and found the pattern remarkably similar. Washington DC is one of the strongest economies in the country. Office vacancy rate dropped a little in the fourth quarter of 2010, but at 14.9 percent it is still too high. Grubb & Ellis reports that last year net absorption was 4.5 million square feet, but there was only 0.7 million square feet of space under construction. That pace of new building activity is appropriate for an overbuilt market, but it will not be appropriate forever.

Phoenix has a middling unemployment rate—9.3 percent, which is about average—and its industrial market is very soft, with a high vacancy rate that is gradually dropping. CBRE reports that net absorption last year was over six times greater than space under construction.

One of the worst economies of the large metropolitan areas is Tampa, where the unemployment rate is 12.4 percent. The retail sector has a fairly high vacancy rate, but in the fourth quarter net absorption was 323,000 square feet, according to Cushman and Wakefield. Completed retail space: a mere 18,500.

The economy is gradually expanding. The pace of growth is disappointing, but it is definitely positive, triggering increased occupancy of all types of properties, in

almost all parts of the country. Net operating income will improve, initially because of rising occupancy, and eventually from rising rents.

Improvement in the economy does not always trigger improvement in net operating income, because developers often anticipate the economic growth and build new space in anticipation of greater demand. That increase in floor space can sink rents even in a growing economy.

Today, however, there is hardly any speculative new construction. Banks and other lenders have tightened credit standards. They are skeptical of new projects given today's high vacancy, and they are demanding very high equity positions before lending to developers. The lower loan-to-value ratios make it harder for a developer to earn the return that covers the risk. In addition, some developers who are convinced that their ideas are worthy projects even at a low loan-to-value simply do not have access to the equity capital needed to satisfy banks. The result: no one is building today in anticipation of tomorrow's demand.

This improvement in commercial real estate will not become a full-blown boom, however. A real boom requires easy money, and plenty of it. Credit standards will remain high throughout the next cycle, and long-term interest rates will gradually rise as the global economic expansion fuels demand for credit. Call it a mini-boom, but it would be great deal better than what we are experiencing now.

What does this coming mini-boom mean for people in the commercial real estate business? Developers will need to start planning their new projects, which may involve more development of equity sources than development of dirt. Timing is crucial and will vary from market to market. Too early and developers will have a few bad years as they put property into still-weak markets. The greater risk, however, is too late, in which case others have already filled the need.

Tenants should consider extending their leases now, while the market is still soft. In a couple of years most markets will have shifted to favor landlords.

Landlords should be cautious about lease extensions. Those who need the cash flow may sign new leases at current rates, but those who can wait a couple of years will be well rewarded for their patience.

When the real estate market turns, we will surely look back and say, "We should have seen it coming." You can see it coming right now, even though the turn is a few years away. ■

Bill Conerly, Ph.D. is a Lake Oswego economist with a national following. He is the principal of Conerly Consulting LLC, advising business leaders on strategy and economics. He holds a Ph.D. in economics from Duke University, was formerly senior vice president at First Interstate Bank, and is chairman of the board of Cascade Policy Institute. He is also the author of *Businomics*, a book that connects the dots between the economy and business decisions. His website is www.ConerlyConsulting.com.

CHANGES IN FASB 13 RULES TO CHANGE COMMERCIAL REAL ESTATE INDUSTRY

BRIAN OWENDOFF

BMO Commercial Real Estate L.L.C.

As a child growing up to the late 1970s, I remember the push for the metric system in the United States to have the same standard of measurement as the rest of the world.

President Gerald Ford signed the Metric Conversion Act on December 23, 1975, strongly suggesting the use of metric, but just stopping it short of being the "law of the land".

The 1975 Act didn't last very long. American scientists, who had long been using metric units to describe their work to others in the international scientific community, were excited about the conversion. I remember the PSAs and jingles about metric measurements (recall "Take 10 America" similar to the Schoolhouse Rock series?). Public opposition to the process of officially converting to the metric system (called metrication) was strong. The result was a law passed in 1982 that repealed the metrication.

Unlike the failed attempt to bring the US to an international standard with the metric system, dramatic changes will occur over the next 24 months that will forever change how accounting standards are made for handling leases on a company's balance sheet. It would also replace rent payment expense reporting with interest and depreciation expense reporting. The Financial Accounting Standards Board ("FASB") will implement legislation that will effectively eliminate all operating leases, and have U.S. accounting standards consistent with those of companies on an international basis.

New lease accounting standards are currently being developed in a joint project between the International Accounting Standards Board ("IASB") and FASB that could result in a complete overhaul of the way in which leases are reported in financial statements.

According to the Securities and Exchange Commission, industry projections estimate over $1.3 trillion would be transferred to U.S. corporate balance sheets, with roughly 70 percent being in real estate leases.

DEFINITION OF CAPITAL AND OPERATING LEASES

The basic concept of real estate accounting is that some leases are simply rentals, whereas others are effectively purchases. For example, if a company rents office space for a year, the space is worth nearly as much at the end of the year as when the lease started; the company is simply using it for a short period of time, and this is an example of an operating lease.

For example, if a company leases a printer for five years, at the end of the lease the printer is nearly worthless. The lessor (the company who receives the lease payments) anticipates this, and charges the lessee (the company who uses the asset) a lease payment that will recover all of the lease's costs, including a profit. This transaction is called a capital lease. In this case, it is essentially a purchase with a loan, as such an asset and liability must be recorded on the lessee's financial statements. Essentially, the capital lease payments are considered repayments of a loan; depreciation and interest expense, rather than lease expense, are then recorded on the income statement.

Operating leases do not typically impact a company's balance sheet. There is, however, one exception. If a lease has scheduled changes in the lease payment (for instance, a planned increase for inflation, perhaps tied to Consumer Price Index), the rent expense is to be recognized on an equal basis over the life of the lease. The difference between the lease expense recognized and the lease actually paid is considered a deferred liability (for the lessee, if the leases are increasing) or asset (if decreasing).

A lease is capital if any one of the following four tests is met:

1. The lease conveys ownership to the lessee at the end of the lease term;
2. The lessee has an option to purchase the asset at a bargain price at the end of the lease term
3. The term of the lease is 75 percent or more of the economic life of the asset.
4. The present value of the rents, using the lessee's incremental borrowing rate, is 90 percent or more of the fair market value of the asset.

INTRODUCTION TO FASB 13 CHANGES

On August, 17, 2010, FASB released their "exposure draft" requiring companies to record nearly all leases on their balance sheets as a "right to use" asset, and a corresponding "future lease payment – liability." What does this change mean to owners and tenants of commercial real estate in simple terms?

This proposal does away with operating leases; all leases would be capitalized using the present value of the minimum rental obligations under a lease. Businesses who in the past had off-balance sheet lease obligations, will now record these obligations on their balance sheet.

A key point to consider with regards to the proposed accounting changes is that, in all likelihood, existing operating leases, signed prior to the implementation of the new rules, will require reclassification as capital leases that must be accounted for on the balance sheet. This means that real estate professionals must immediately consider the effect that existing and planned leases will have on financial statements once the proposed rules are implemented. Since operating lease obligations can represent a larger liability than all balance sheet assets combined, this reclassification could significantly alter the business's balance sheet.

The impact of recording these rent obligations on the balance sheet can have multiple impacts, including: businesses needing to notify their lenders of potential non-compliance with their loan covenants, negotiating new loan covenants with the lenders due to the restated financial statements, ratios used to evaluate a business's potential of credit will be adversely impacted and the restatement of a lessee's financial statement once the change takes effect may result in a lower equity balance, and changes to various accounting ratios

The conceptual basis for lease accounting would change from determining when "substantially all the benefits and risks of ownership" have been transferred, to recognizing "right to use" as an asset and apportioning assets (and obligations) between the tenant and the landlord

As part of FASB's announcement, the Board stated that in their view "the current accounting in this area does not clearly portray the resources and obligations arising from lease transactions." This suggests that the final result will likely require more leasing activity to be reflected on the balance sheet than is currently the case. In other words, many, perhaps all, leases now considered operating are likely to be considered capital under the new standards. Thus, many companies with large operating lease portfolios are likely to see a material change on their corporate financial statements.

Part of the purpose for this is to coordinate lease accounting standards with IASB, which sets accounting standards for Europe and many other countries. IASB and FASB currently have substantial differences in their treatment of leases; particularly notable is that the "bright line" tests of FAS 13 (whether the lease term is 75 percent or more of the economic life, and whether the present value of the rents

is 90 percent or more of the fair value) are not used by the IASB, which prefers a "facts and circumstances" approach that entails more judgment calls. Both, however, have the concept of capital (or finance) and operating leases, however the dividing line is drawn between such leases.

FASB will accept public comments on this proposed change through December 15, 2010. If FASB makes a final decision in 2011 regarding this proposed change to lease accounting, the new rules will go into effect in 2013.

IMPACT ON COMMERCIAL REAL ESTATE

The impact of the FASB 13 changes on the commercial real estate market will be substantial and will have material impact on commercial tenants and landlords. The proposed changes not only impact landlord and tenants, but will affect commercial real estate brokers as it increases the complexity of lease agreements and provides an impetus for tenants to execute shorter term leases to mitigate the liability on their balance sheet.

The shorter term leases create financing issues for property owners as lenders and investors prefer longer term leases to secure their investment. Therefore, landlords should secure financing for purchase or refinance prior to the implementation of this regulation, as financing will be considerably more difficult the future. This will most dramatically impact new construction. In today's environment, it takes three things to secure financing for new construction: (1) an investment grade tenant; (2) a lease term of at least 12 years; and (3) a building that is not overly specialized and is "market accepted" in both layout and location.

This accounting change will increase the administrative burden on companies and the leasing premium for single tenant buildings will effectively be eliminated. The impact of this proposed change will have a profound impact on leasing behavior of tenants. Companies that are the single tenant in a building may find it advantageous to simply own the building since a lease of the property will be of record on its financials due to the FASB 13 changes.

Under the proposed rules, tenants would have to capitalize the present value of virtually all "likely" lease obligations on the corporate balance sheets. "Likely" includes renewal options, even if they are not firm obligations but simply an option that is exercised solely by tenant's election. FASB views leasing essentially as a form of financing in which the landlord is letting a tenant use a capital asset, in exchange for a rent payments that includes the principal and interest, similar to a mortgage.

Unfortunately regulators have missed the point of why most businesses lease and that is for flexibility as their workforce expands and contracts, as location needs change, and businesses would rather invest their cash in producing revenue growth, rather than owning real estate.

In my experience, companies achieve a better return on investment in their core business or service than return on ownership of bricks and mortar. A lease provides greater flexibility to meet unknown future space needs, and can be a lower cost "exit" strategy for many companies.

The proposed accounting changes will also impact landlords, especially business that are publicly traded or have public debt with audited financial statements. Retail owners and some Real Estate Investment Trusts ("REITs") may be required to perform analysis for each tenant located in their buildings or malls, analyzing the terms of occupancy and contingent lease rates.

Proactive landlords, tenants and brokers need to familiarize themselves with the proposed standards that could take effect in 2013 and begin to negotiate leases accordingly.

CONCLUSION

The end result of this proposed lease accounting change is a greater compliance burden for the tenants as all leases will have a deferred tax component, will be carried on the balance sheet, will require periodic reassessment and could require more detailed financial disclosure.

Therefore, landlords will need to know how to structure leases and sale transactions that will be desirable to Tenants in the future. Many tenants will realize that the new rules take away the off balance sheet benefits FASB 13 afforded them in the past, and will determine leasing to be a less beneficial option. They may also see the new standards as being more cumbersome and complicated to account for and disclose. Finally, it will become a challenge for every landlord and commercial real estate broker to find a new approach for marketing commercial real estate leases that make them more attractive than owning.

However, this proposed accounting change to FAS 13 could potentially stimulate a lack luster commercial real estate market in 2011 and 2012 as businesses decided to purchase property rather than deal with the administrative issues of leasing in 2013 and beyond.

I am not an accountant, and I do not play one on TV. I recommend that landlords and tenants begin preparing for this changes by reviewing their leases with their commercial real estate broker and discussing the financial ramifications with their chief financial officer or outside accountants to avoid potential financial surprises when the accounting changes are adopted. For the most up to date information on FASB change, visit http://www.fasb.org/home.

While the metric system never became the law of the land in the US, our global economy will cause the FASB changes that will result in the US being consistent with the rest of the world. With change comes opportunity, and those that address this reality sooner rather than later can benefit than those that wait and respond after the fact. ■

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CAN SMART GROWTH POLICIES CONSERVE ENERGY AND REDUCE EMISSIONS?

TODD LITMAN

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This article examines the role that smart growth can play in achieving planning objectives, including energy conservation and emission reductions. Smart growth policies include zoning code changes to allow more compact, diverse and mixed development (e.g., higher buildings, attached and multi-family housing, commercial within residential neighborhoods); reduced and more flexible parking requirements; improvements to alternative modes (more sidewalks and paths, and better public transit service); more public investments in existing developed areas (brownfield cleanups, more redevelopment of urban schools and parks); regulations and incentives that discourage urban expansion; and financial incentives that reward compact, infill development (lower development fees and utility rates for infill to reflect public cost savings, and location-efficient mortgages which reflect the transport savings in such locations).[1, 2, 3, 4]

[1] Blais, P. (2010). *Perverse Cities: Hidden Subsidies, Wonky Policy, and Urban Sprawl.* University of British Columbia Press.

[2] Institute of Transportation Engineers (2010). *Smart Growth Transportation Guidelines: An ITE Recommended Practice*. Institute of Transportation Engineers.

[3] Smart Growth Network (2002). Getting to smart growth: 100 policies for implementation. Smart Growth Network and International City/County Management Association.

[4] Nelson, K., Doll, A., Schroeer, W., Charlier, J., Dover, V., Flippen, M., Duerksen, C., Einsweiler, L., Farr, D., Oberholtzer, L., and Williams, R. (2009). Essential smart growth fixes for urban and suburban zoning codes. Environmental Protection Agency.

This is an important and timely issue. Many existing land use development policies tend to favor sprawl and automobile dependency.[5] Smart growth policy reforms can help create more accessible, multi-modal communities where residents tend to drive less and rely more on alternative modes. However, such reforms tend to face institutional inertia and political opposition. It is therefore important to have accurate information on their potential impacts and benefits.

This article summarizes existing literature on land use impacts on travel activity, energy consumption and pollution emissions. It discusses the overall economic, social and environmental benefits of smart growth. It examines claims that smart growth policies are ineffective and harmful.

DO LAND USE POLICIES AFFECT TRAVEL, ENERGY CONSUMPTION AND EMISSIONS?

There is extensive research showing that *land use* (also called *built environment*) factors affect travel activity, energy consumption and pollution emissions.[6, 7] This implies that smart growth land use policies can help achieve various planning objectives including energy conservation and emission reductions.

Some critics claim there is little evidence of these impacts and benefits,[8] and that smart growth policies harm consumers.[9] I disagree. I believe that there is abundant evidence that smart growth land use policies can provide substantial reductions in per capita vehicle travel, energy use and pollution emissions; that these can provide numerous economic, social and environmental benefits; and that there is growing consumer demand for smart growth communities.[10]

It is true, as critics argue, that compact development (i.e., higher density) alone has only modest impacts, and these effects partly reflect self-selection (people who, for any reason cannot drive tend to choose smart growth locations).[11] However, plenty of good research indicates that land use factors (regional accessibility,

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[5] Levine, J. (2006). Zoned out: Regulation, markets, and choices in transportation and metropolitan land-use. Resources for the Future.

[6] Bartholomew, K. and Ewing, R. (2009). Land use-transportation scenarios and future vehicle travel and land consumption: A meta-analysis. *Journal of the American Planning Association*, 75(1):13–27.

[7] Frank, L. D., Greenwald, M. J., Kavage, S., and Devlin, A. (2011). An assessment of urban form and pedestrian and transit improvements as an integrated GHG reduction strategy. Washington State Department of Transportation.

[8] Fruits, E. (2011). Compact development and greenhouse gas emissions: A review of recent research. *Center for Real Estate Quarterly Journal*, 5(1):2–7.

[9] Pisarski, A. (2009), ULI *Moving Cooler* report: Greenhouse gases, exaggerations and misdirections. Retrieved May 6, 2011, from http://www.newgeography.com/content/00932-uli-moving-cooler-report-greenhouse-gases-exaggerations-and-misdirections.

[10] Litman, T. (2011). Evaluating smart growth savings. Victoria Transport Policy Institute.

[11] Ewing, R. and Cervero, R. (2010). Travel and the built environment: A meta-analysis. *Journal of the American Planning Association*, 76(3):265–294.

density, mix, street connectivity, walkability, public transit proximity, and efficient parking management) do significantly affect vehicle travel, fuel use and emissions.[12] Table 1 summarizes these impacts based on my review of this literature.[13]

Academics tend to be cautious so generally report lower-bound estimates of impacts and benefits. For example, one National Academy of Sciences report concluded that smart growth policies can be counted on to provide only modest emission reductions.[14] It used lower-bound estimates of impacts and assumed little change in future housing preferences, ignoring demographic and economic trends (aging population, rising fuel prices, increasing traffic congestion, increasing health and environmental concerns, etc.) that are increasing demand for smart growth locations.[15] If these factors are considered, the predicted impacts and benefits of smart growth significantly increase.[16]

That land use factors besides density significantly affect vehicle travel can be considered good news because it expands the menu of policies that can help achieve planning objectives. For example, smart growth can be applied in rural and suburban locations where high densities are inappropriate by improving land use mix, roadway connectivity, and walkability to create walkable villages.

CUMULATIVE IMPACTS

Smart growth can provide large cumulative impacts. In automobile-dependent, sprawled locations virtually every adult resident owns an automobile and uses it for most travel, and average trip lengths are relatively long. In multi-modal, smart growth locations residents tend to own fewer vehicles, drive fewer annual miles, and rely more on alternative modes. Even larger vehicle travel reductions occur where smart growth is implemented with efficient road, parking and fuel pricing; such pricing reforms tend to be more effective (price elasticities increase) at reducing vehicle travel if travelers have viable alternatives.

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[12] Brandes, U., MacCleery, R., Peterson, S. J., and Johnston, M. (2010). Land use and driving: The role compact development can play in reducing greenhouse gas emissions: Evidence from three studies. Urban Land Institute.

[13] Litman, T. (2005), Land use impacts on transport. Victoria Transport Policy Institute.

[14] Transportation Research Board (2009). *Driving and the Built Environment: The Effects of Compact Development on Motorized Travel, Energy Use, and CO_2 Emissions*. Special Report No. 298. National Academy of Sciences, 2009.

[15] Nelson, A. C. (2006). Leadership in a new era: Comment on "Planning leadership in a new era." *Journal of the American Planning Association*, 72(4):393–409.

[16] Calthorpe Associates (2010). The role of land use in reducing VMT and GHG emissions: A critique of TRB Special Report 298.

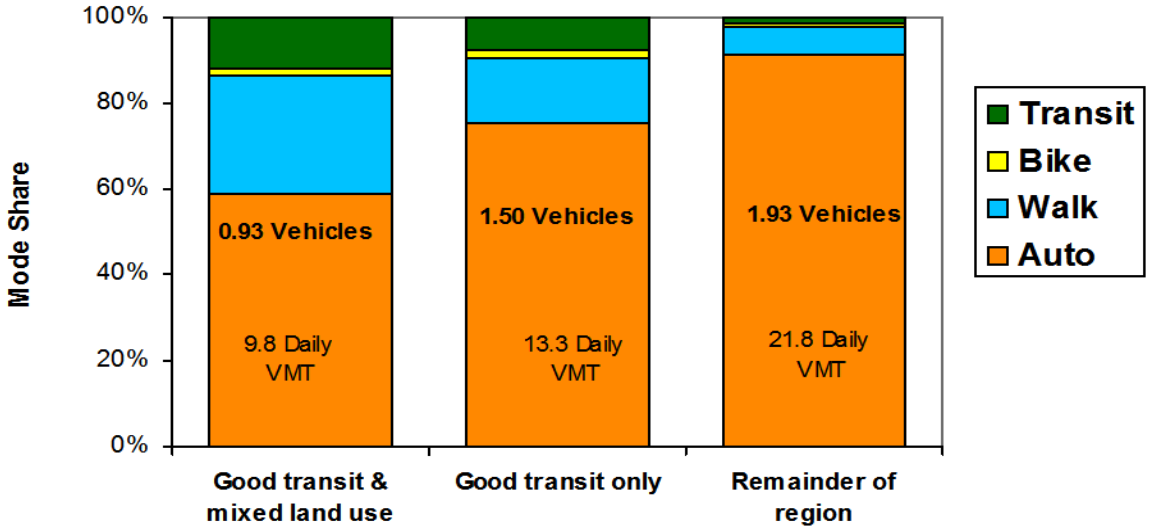
Table 1: Land Use Impacts on Travel

Factor	Definition	Travel Impacts
Density	People or jobs per unit of land area (acre or hectare).	Increased density tends to reduce per capita vehicle travel. Each 10% increase in urban densities typically reduces per capita VMT by 2-3%.
Mix	Degree that related land uses (housing, commercial, institutional) are mixed	Increased land use mix tends to reduce per capita vehicle travel, and increases use of alternative modes, particularly walking for errands. Neighborhoods with good land use mix typically have 5-15% lower vehicle-miles.
Regional Accessibility	Location of development relative to regional urban center.	Improved accessibility reduces per capita vehicle mileage. Residents of more central neighborhoods typically drive 10-30% fewer vehicle-miles than residents of more dispersed, urban fringe locations.
Centeredness	Portion of commercial, employment, and other activities in major activity centers.	Increased centeredness increases use of alternative commute modes. Typically 20-50% of commuters to major commercial centers drive alone, compared with 80-90% of commuters to dispersed locations.
Connectivity	Degree that walkways and roads are connected and allow direct travel between destinations.	Improved roadway connectivity can reduce vehicle mileage, and improved walkway connectivity tends to increase walking and cycling.
Roadway design and management	Scale, design and management of streets.	More multi-modal street design and management increases use of alternative modes. Traffic calming tends to reduce driving and increase walking and cycling.
Walking and Cycling conditions	Quantity and quality of sidewalks, crosswalks, paths and bike lanes, and the level of pedestrian security.	Improved walking and cycling conditions increases nonmotorized travel and can reduce automobile travel, particularly if implemented with land use mix, transit improvements, and incentives to reduce driving.
Transit quality and accessibility	Quality of transit service and degree to which destinations are transit accessible.	Improved transit service quality increases transit ridership and can reduce automobile trips, particularly for urban commuting.
Parking supply and management	Number of parking spaces per building unit or acre, and how parking is managed.	Reduced parking supply, increased parking pricing and other parking management strategies can significantly reduce per capita vehicle travel. Cost-recovery parking pricing (users pay directly for parking facilities) typically reduces automobile trips by 10-30%.
Site design	The layout and design of buildings and parking facilities.	More multi-modal site design can reduce automobile trips, particularly if implemented with improved transit services.
Efficient transport pricing	More marginal-cost pricing for congestion, roads, parking facilities and vehicle insurance.	Affected travel typically declines 10-30%, depending on circumstances.

Figure 1 shows how location factors affect vehicle ownership, daily mileage and mode share in the Portland, Oregon region. Transit-oriented neighborhoods, with

good transit and mixed land use, have far lower vehicle ownership and use, and more walking, cycling and public transit use than other areas. Residents of areas with high quality transit drive 23 percent less, and residents of areas with high quality public transit *and* mixed land use drive 43 percent less than elsewhere in the region, indicating that land use and transportation factors have about the equal impacts on travel activity.

Figure 1: TOD Impacts On Per Capita Vehicle Ownership and Use



A U.S. Environmental Protection Agency (EPA) study identified substantial energy conservation and emission reductions if development shifts from the urban fringe to infill.[17] The study found that individual households that shift from urban fringe to infill locations typically reduce VMT and emissions by 30-60 percent, and in typical U.S. cities, shifting 7-22 percent of residential and employment growth into existing urban areas could reduce total regional VMT, congestion and pollution emissions by 2-7 percent.

Another EPA study calculated both transportation and building energy savings from smart growth land use policies.[18] Travel to a building often uses as much energy as is consumed in the building.[19] Residents reduce total building and transportation energy consumption 64 percent by living in an attached energy efficient (green) home in an urban location, and by 75 percent by living in a multifamily energy efficient home, compared with the same household living in a

[17] Environmental Protection Agency (2007). Measuring the air quality and transportation impacts of infill development.

[18] Hernandez, D., Lister, M., and Suarez, C. (2011). Location efficiency and housing type: Boiling it down to BTUs. Environmental Protection Agency.

[19] Wilson, A. and Navaro, R. (2007). Driving to green buildings: The transportation energy intensity of buildings. *Environmental Building News*, 16(9).

typical detached single-family house in an auto-dependent suburb,[20] as indicated in Figure 2. Housing location and type have greater impacts on total energy use than do vehicle or home energy efficiency,[21] as indicated in Figure 3.

Figure 2: Residents Transport and Home Energy Consumption

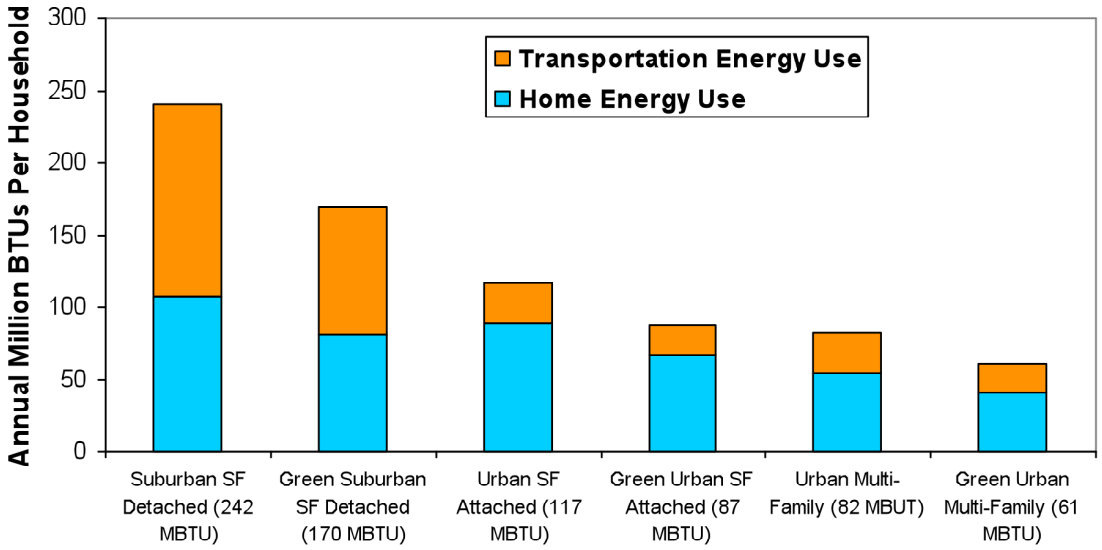
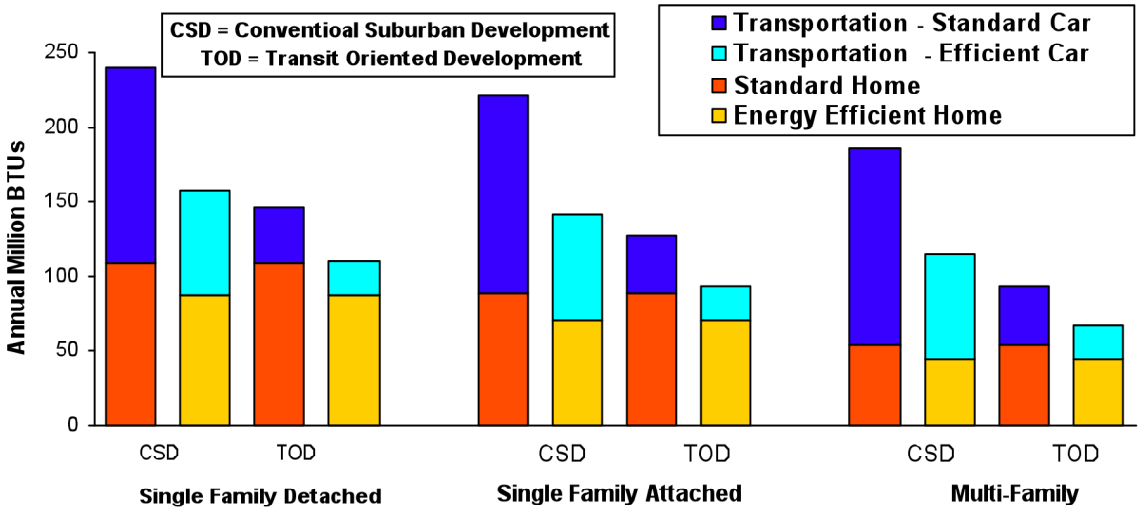


Figure 3: Residents Transport and Home Energy Consumption



[20] Jonathan Rose Companies (2009). Charts and slides. Retrieved on May 6, 2011 from http://www.rose-network.com/resources/charts-and-slides.

[21] Hernandez, D., Lister, M., and Suarez, C. (2011).

COMPREHENSIVE BENEFIT ANALYSIS

Smart growth tends to provide various economic, social and environmental benefits,[22, 23] as summarized in Table 2.

Table 2: Smart Growth Benefits

Economic	Social	Environmental
Reduced development costs	Improved transport options and mobility, particularly for non-drivers	Greenspace & habitat preservation
Reduced public service costs	Improved housing options	Energy savings
Reduced transportation costs	Community cohesion	Air pollution reductions
Economies of agglomeration	Preserves unique cultural resources (historic sites, older neighborhoods, etc.)	Water pollution reductions
Supports industries that depend on high quality environments (tourism, farming, etc.)	Increased physical exercise and health	Reduced "heat island" effect.

As a result, smart growth policies that create more accessible, multi-modal communities (better walking, cycling and public transit service) tends to provide more total benefits than most other energy conservation and emission reduction strategies,[24] as illustrated in Table 3.

Current demographic and economic trends are increasing demand for smart growth location.[25] Although market surveys indicate that most North American households prefer single-family homes, they also indicate growing consumer preference for smart growth features such as accessibility and modal options (reflected as short commutes and convenient walkability to local services).[26] Twenty years ago less than a third of households preferred smart growth home locations, but this is projected to increase to two thirds of households within two decades.[27]

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[22] Litman, T. (2009), Land use impact costs of transportation. *World Transport Policy & Practice*, (1)4:9–16.

[23] Burchell, R. W. and Mukherji, S. (2003). Conventional development versus managed growth: The costs of sprawl. *American Journal of Public Health*, 93(9):1534–1540.

[24] Todd Litman (2009), Win-win transportation emission reduction strategies. Victoria Transport Policy Institute

[25] Litman, T. (2009). Where we want to be: Home location preferences and their implications for smart growth. Victoria Transport Policy Institute.

[26] Belden Russonello & Stewart (2011). The 2011 Community Preference Survey: What Americans are looking for when deciding where to live. National Association of Realtors.

[27] Nelson, A. C. (2009). The new urbanity: The rise of a new America. The Annals of the American Academy of Political and Social Science, 626(1):192–208.

Table 3: Smart Growth Benefits

Planning Objective	Energy Efficient Buildings	Fuel Efficient Vehicles	Smart Growth
Congestion reduction			✓
Road and parking cost savings			✓
Consumer cost savings			✓/×
Improved traffic safety			✓
Improved mobility options			✓
Energy conservation	✓	✓	✓
Pollution reduction	✓	✓	✓
Land use objectives			✓
Physical fitness & health			✓

(✓ = supports objective × = contradicts objectives)

This is not to suggest that suburban living and automobile travel will end. Even with aggressive smart growth policies most North Americans will continue to live in single-family homes and rely primarily on automobile travel. However, the current stock of large-lot, single-family, suburban houses is predicted to satisfy market demand for the foreseeable future, while the market for smaller-lot and attached housing in accessible, multi-modal communities will grow. It therefore makes sense to implement smart growth policy reforms that help satisfy these demands, such as allowing more compact and mixed development, reducing zoning code parking requirements, and improving walking and cycling conditions and public transit service quality.

EVALUATING CRITICISMS

Some critics claim that research on smart growth's ability to reduce vehicle travel and emissions is ambiguous, and that smart growth policies have little impact on travel activity.[28] For example, Fruits (2011) claims that "At a theoretical level there is no obvious connection between compact development and mode choice." However, there are theoretical reasons to conclude that smart growth policies in general, and increased density in particular, reduce automobile travel and encourage use of alternative modes. Increased land use density increases the portion of destinations within walking and cycling distances, and increases the cost efficiency of alternative mode improvements (sidewalks and transit services) by increasing potential users per area. Potential impacts on mode choice are even greater when other smart

[28] Litman, T. (2011). Evaluating criticism of smart growth. Victoria Transport Policy Institute.

growth policies are considered, such as increased land use mix, improved road and pathway connectivity, and complete streets roadway policies.[29], [30]

Fruits (2011) claims that "some studies have found that more compact development is associated with greater vehicle-miles traveled" citing Crane (1996).[31] This is untrue. Crane presented theoretical analysis indicating that grid street systems may under some conditions increase vehicle travel compared with hierarchical street systems; previous research he cites indicates that higher densities do reduce vehicle travel. Fruits (2011) cites other studies which he claims indicate that density has little impact on vehicle travel and emissions, and therefore concludes, "Such insignificant results indicate that compact development policies should not be based on expectations of reduced motor vehicle usage." This conclusion is unjustified:

- There is little doubt that policies that increase density tend to reduce vehicle travel and emissions. Compact neighborhoods typically generate 20-40 percent less vehicle travel per capita than conventional, lower-density neighborhoods. These reductions partly result from density itself and partly from associated factors such as increased regional accessibility, land use mix and transport diversity (better walking and public transit options). To the degree they are interrelated, policies that increase density will reduce vehicle travel and emissions. For example, encouraging more compact, urban infill instead of lower-density urban-fringe development will almost certainly reduce per capita vehicle travel because it increases density, accessibility, mix and transport diversity.
- Density is just one of several land use factors that affect travel activity. Integrated smart growth policies can significantly reduce vehicle travel, energy use and emissions.
- Most studies do show a statistically significant relationship between density (isolated from other factors) and vehicle travel, only a few do not.
- Energy conservation and emission reductions are just two of many smart growth benefits. Other benefits include reduced costs of providing public services, household transportation cost savings, improved accessibility for non-drivers, reduced traffic fatality rates, improved public fitness and health, openspace preservation, and reduced stormwater management costs.

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[29] Institute of Transportation Engineers (2010). *Designing Walkable Urban Thoroughfares: A Context Sensitive Approach, an ITE Recommended Practice*. Institute of Transportation Engineers

[30] Sacramento Area Council of Governments (2011). Complete streets resource toolkit. Retrieved on May 6, 2011 from http://www.sacog.org/complete-streets/toolkit/START.html.

[31] Crane, R. (1996). Cars and drivers in the new suburbs: Linking access to travel in neotraditional planning. *Journal of the American Planning Association*, 62(1):51–65.

Pisarski claims that, "most people, excepting a small but often very loud minority, opt for lower density living," implying that smart growth policies harm consumers.[32] Yet, the market research discussed previously in this article indicates growing demand for more compact development, particularly if public policies provide support and incentives, such as more flexible zoning regulations, increased investment in alternative modes, and financial rewards for more compact infill development that reflect public service cost savings.[33]

CONCLUSIONS

Land use policies can significantly affect transportation options and costs, and therefore travel activity. People who live and work in automobile-dependent locations tend to drive more annual miles, consume more fuel and produce more pollution than they would in more accessible, multi-modal communities. As a result, smart growth reforms can provide various economic, social and environmental benefits.

Some critics claim that these impacts are small and not cost effective but their analysis tends to misrepresent key issues. The only consider land use density, ignoring the effects of other land use factors such as regional accessibility, land use mix, road and path connectivity, transport system diversity, and parking management. They overlook additional benefits, and growing consumer demand for more accessible, multi-modal home locations. As a result, they underestimate smart growth impacts and benefits.

This is important because existing land use development policies and planning practices tend to favor sprawl and automobile dependency. Smart growth requires policy reforms that allow more compact and mixed development, support alternative modes, and reduce existing subsidies to automobile such as generous minimum parking requirements. These reforms tend to face institutional inertia and political opposition. It is therefore important to have accurate information on the full potential impacts and benefits of smart growth policy reforms. When all impacts are considered, smart growth policies are often a cost effective way to achieve planning objectives. ■

Todd Litman is founder and executive director of the Victoria Transport Policy Institute, an independent research organization dedicated to developing innovative solutions to transport problems. His research is used worldwide in transport planning and policy analysis. Mr. Litman authored the *Online TDM Encyclopedia*, a comprehensive Internet resource for identifying and evaluating mobility management strategies, and *Parking Management Best Practices*, the most comprehensive book available on management solutions to parking problems.

[32] Pisarski (2009).
[33] Blais (2010).

RESIDENTIAL MARKET ANALYSIS

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Oregon's Office of Economic Analysis warns that the housing market appears to be the biggest threat to a sustained economic recovery in Oregon. Among major markets, Portland has seen one of steepest drops in home prices since the beginning of the year. Research from Zillow shows that more than one-third of Portland area homes are now underwater.

National housing market statistics reflect decreasing median-existing home prices for all housing types, down 6.9 percent from March 2010. Median prices in the western United States have decreased by 6.70 percent. Portland reports mixed news. Information from RMLS showing no change in median sales prices and an increase in sales volume. The median sales price $245,000 and the number of transactions in the metropolitan area increased by 11.73 percent. At the same time, the Case-Shiller Index shows that Portland is now underperforming much of the U.S.

As reported by the Wall Street Journal, the U.S. housing market's first quarter 2011 decline was the steepest in three years. Home values fell 3 percent in the first quarter from the previous quarter and 1.1 percent in March from the previous month. Housing market improvements last year were spurred by federal programs that gave buyers up to $8,000 in tax credit. However, when the credits expired last summer, the prices continued to fall. A fall that was exacerbated by the abundance of foreclosed homes on the market. According to the Wall Street Journal, 94,000 foreclosed homes were sold by Fannie Mae and Freddie Mac during the first quarter, a 23 percent increase from the previous quarter. Fannie and Freddie still held

another 218,000 properties at the end of March, a 33 percent increase from the prior year.

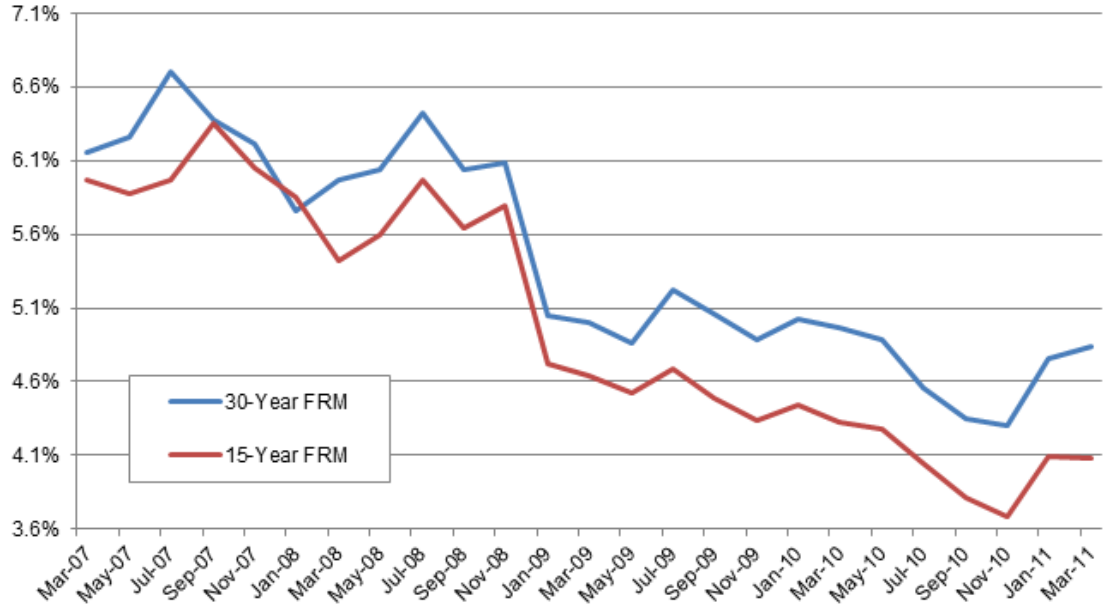
Steep declines in home prices combined with mortgage rates near their lowest levels in decades have helped make housing more affordable than at any time in the past 30 years, according to Zillow. Even so, tight credit poses another challenge for the housing market. While many unqualified buyers received loans during the boom, many potential borrowers are having difficulty obtaining loans. For example, the average credit score on loans backed by Fannie Mae stood at 762 in the first quarter, up from an average of 718 for the 2001-2004 period.[1]

While home values decreased, The National Association of Realtors reports that the number of existing home sales showed a strong increases in December 2010 and continued through the first quarter of 2011. NAR reports an increase of 3.7 percent to a sales volume of 5.10 million in March from the 4.92 million in February. Despite the increases, sales remain 6.3 percent below the 5.44 million in March 2010.

The HousingPulse Distressed Property Index (DPI) is an indicator of the health of the housing market. The index rose to 48.6 percent in March, the second highest level seen in the past 12 months. This indicates that nearly half of all housing in the survey involves distressed properties. This trend is likely continue as the backlog of foreclosures and mortgage defaults make their way through the housing pipeline. According to HousingPulse, January was flat with activity and inventory as both investors and first time home buyers were fearful of what was happening nationally and waited to act. February saw more buyers coming out and March has seen a sharp increase of new listings, approximately double that in February.

[1] Timiraos, Nick and Wotapka, Dawn. "Home Market Takes A Tumble." Wall Street Journal - Real Estate. May 9, 2011.

Figure 1: Single Family Mortgage Interest Rate



Source: Freddie Mac

Mortgage interest rates have been steadily decreasing since the first quarter of 2010, but started rising in the fourth quarter and continued through the first quarter. The national average commitment rate for a 30-year conventional, fixed-rate mortgage was 4.84 in March, down from 4.95 percent in February; the rate was 4.97 percent in March 2010. As this issue goes to press, the rate is 4.71 percent.

First time home buyers constituted 33 percent of homes in March, compared with 34 percent of homes in February and 37.7 percent of all transactions tracked in December 2010. They were 44 percent in March 2010.

Table 1: Median Home Values of Existing Detached Homes

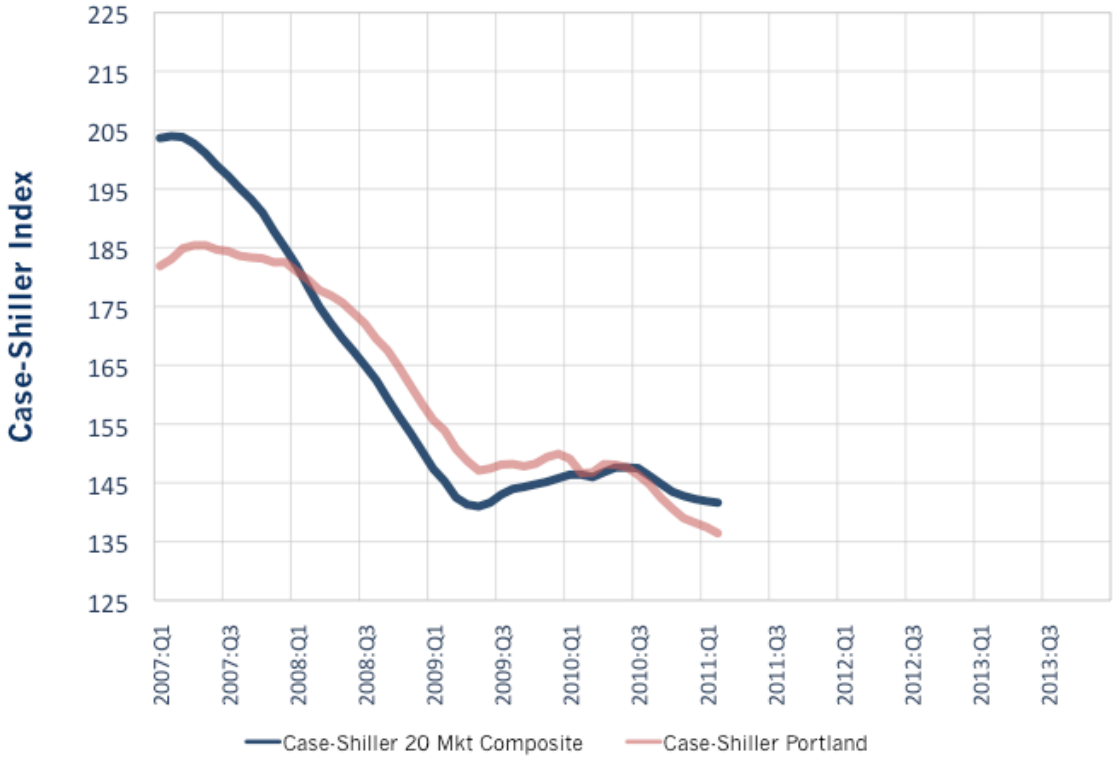
	U.S.	West	Portland Metro Area
March 2010 Median Sales Price	$169,500	$216,300	$238,700
March 2011 Median Sales Price	$160,500	$192,100	$211,500
% Change in Median Sales Price	-5.30%	-11.20%	-11.40%
% Change in Number of Sales Sept. 2009-Sept. 2010	-6.90%	-3.10%	-12.7%

Source: National Association of Realtors and RMLS

Standard & Poor's Case-Shiller Index for Portland was 133.66 through February 2011. The represents a decrease of 1.60 percent from January 2011, a 1.80 percent decrease between December 2011/January 2011 and a year-over-year decrease of

7 percent. Case-Shiller's 20 city composite index is down 3.2 percent compared to the same time last year. The index data shows that in the major U.S. metropolitan cities, home prices slowed in the first quarter compared to the previous quarter.

Figure 2: Standard & Poor's Case-Shiller Index for Portland and Composite-20.



The Case-Shiller Home Price Indices are the leading measures for the U.S. residential housing market, tracking changes in the value of residential real estate both nationally as well as in 20 metropolitan regions. The indices show prices for the 10- and 20-city composites are lower than a year ago but still slightly above their April 2009 bottom. Both the composites fell, 2.60 percent for the 10-city composite and 3.30 percent for the 20-city composite as compared to February 2010.

Of the 20 cities tracked, Washington D.C. was the only market to post a year over year gain at growth rate of 2.7 percent. January 2011 recorded new lows for 11 cities, 10 of which saw new lows again in February 2011. The 20-composite index was 141.62 in February 2011, and Portland was 136.42.

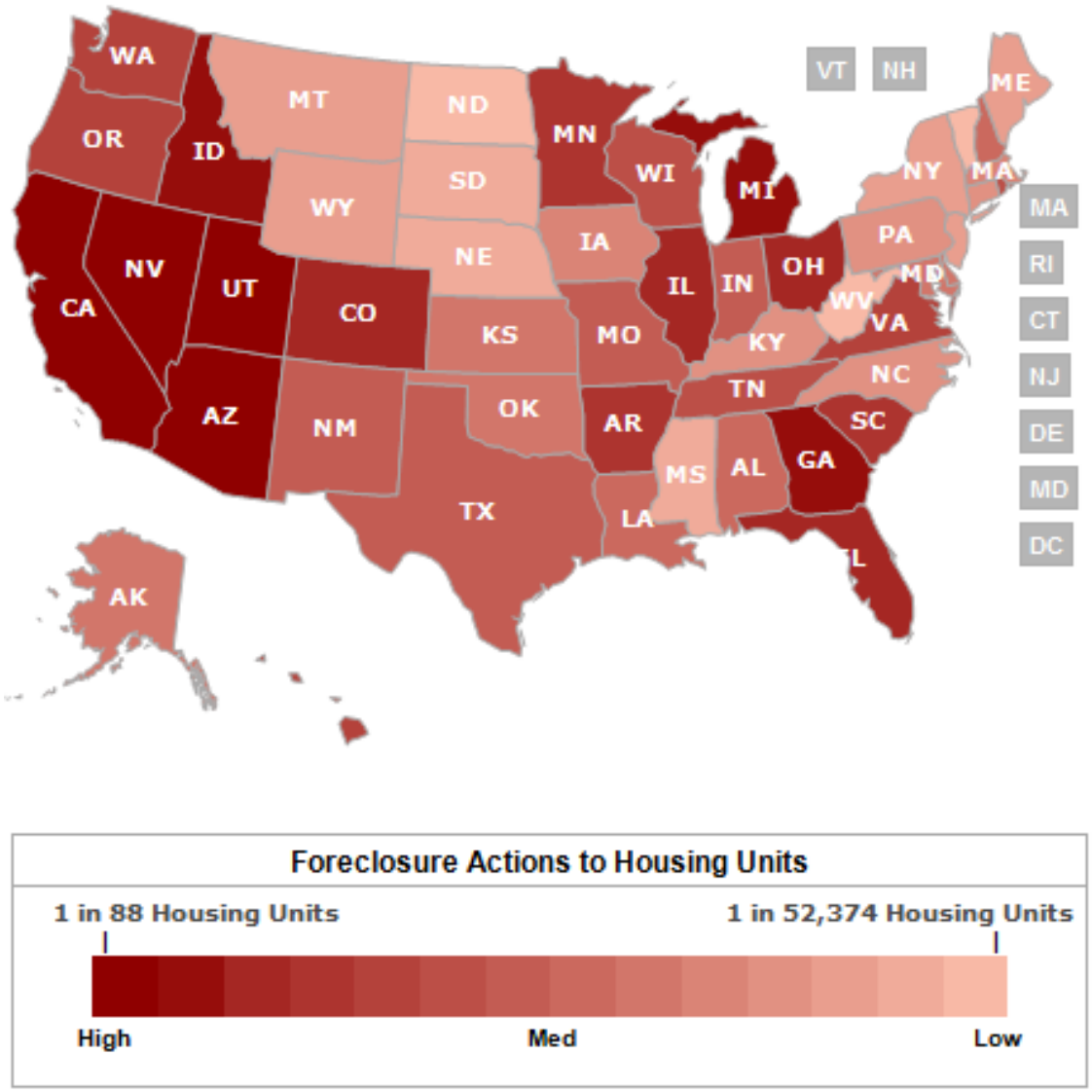
Foreclosures and delinquency rates are still relatively high. According to RealtyTrac, Oregon is now one of the top 10 states for foreclosure filings. Foreclosure fillings hit its three year low during the first quarter of 2011 triggered primarily by the continuing controversy surrounding foreclosure documentation and procedures that prompted many major lenders to temporarily halt some foreclosure

proceedings. While foreclosure activity seems to have slowed in the past few months, RealtyTrac cautions that the slowdown is largely the result of massive delays in processing foreclosures rather than the result of a housing recovery that is lifting people out of foreclosure. The company warns that foreclosure activity will begin to increase again as lenders and servicers gradually work their way through the backlog of thousands of foreclosures that have been delayed due to improperly processed paperwork.

For the first quarter of 2011, Oregon reported 7,058 foreclosure fillings, a 20.75 percent decrease from the previous quarter and a 41.55 percent decrease from the previous year. In the U.S. 1 in every 542 homes received a foreclosure filling while 1 in every 830 homes in Oregon received a foreclosure filling during quarter 1 2011.

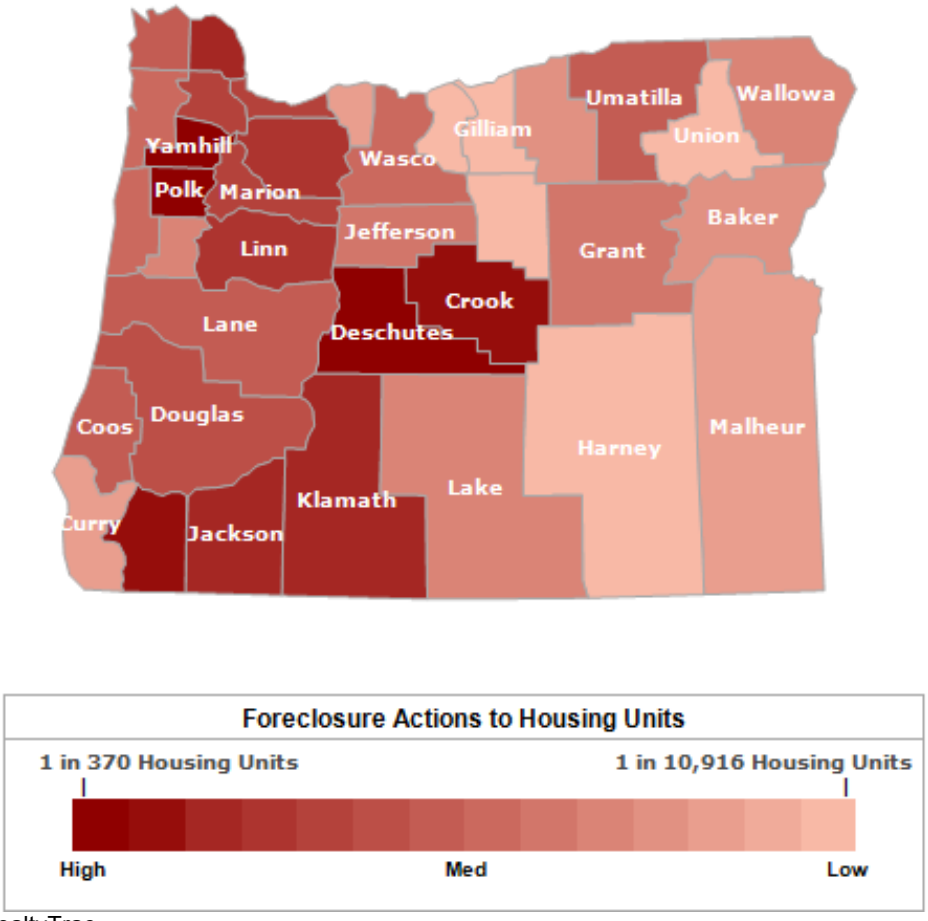
According to RealtyTrac, the ten states that ranked the highest in foreclosure rates in the first quarter were Nevada, Arizona, California, Utah, Idaho, Georgia, Michigan, Florida, Colorado and Illinois. Of these states, Nevada posted the nation's highest state foreclosure rate, with one in every 35 housing units receiving a foreclosure filing. Arizona at one in every 60 housing units and California at one in every 80 housing units with a foreclosure filing during the quarter.

Figure 3: Foreclosure Rate Heat Map, March 2011



Source: RealtyTrac

Figure 4: Foreclosure Rate Heat Map-Oregon, March 2011



Source: RealtyTrac

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

	Single Family			Multi Family		
	Mar-11	Mar-10	% Change	Mar-11	Mar-10	% Change
United States	90.4	115.7	-22%	36.9	30.0	23%
Oregon	1.25	1.59	21 %	0.61	0.17	270%
Portland-Vancouver-Beaverton OR-WA	0.74	1.01	-27%	0.30	0.09	220%
Salem OR	0.06	0.11	-42%	0.06	0.02	150%
Eugene-Springfield OR	0.08	0.15	-44%	0.02	0.01	92%
Bend OR	0.10	0.11	-3%	-	0	-100%
Corvallis OR	0.01	0.01	-43%	0.08	-	-
Medford OR	0.05	0.07	-21%	0.01	0.02	150%

Source: National Association of Home Builders

PORTLAND

The number of Portland metropolitan area home sales decreased by 7.23 percent during the first quarter compared to the fourth quarter of 2010, and buyers closed on purchases of 2,913 existing homes. This is a 3.85 percent increase from the first quarter of 2010 when there were 2805 transactions in the metropolitan area.

Median prices for the first quarter were at $223,000, which represents a 5.91 percent decrease over the previous quarter and an 8.89 percent reduction annually. Sales price to original list price are coming closer together, with average sales taking place at 96.08 percent of the original list price. This is a 0.15 percent point decrease from the previous quarter which was 96.22 percent, and a 5.71 percent increase annually from 90.89 percent. Sellers in the Portland area have had their homes on the market for an average of 93 days before closing, reflecting a nine day increase from 2009 and a 14 day increase from the previous quarter.

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

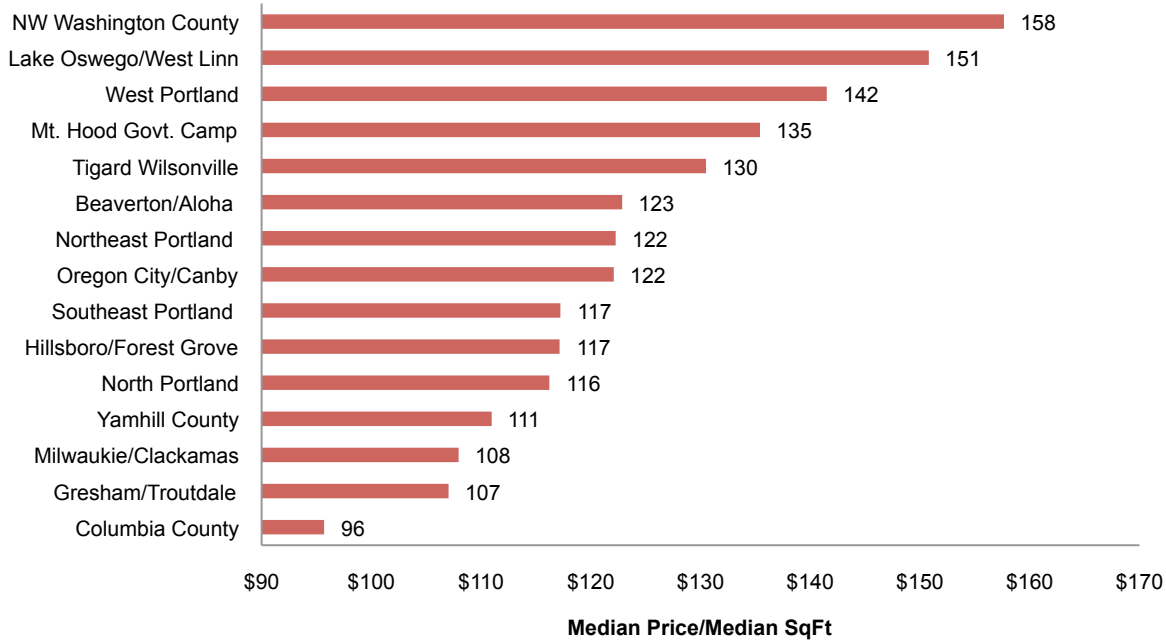


Figure 6: Median Sales Price & Number of Transactions, Existing Detached Homes, Portland Metro (excluding Clark County, WA)

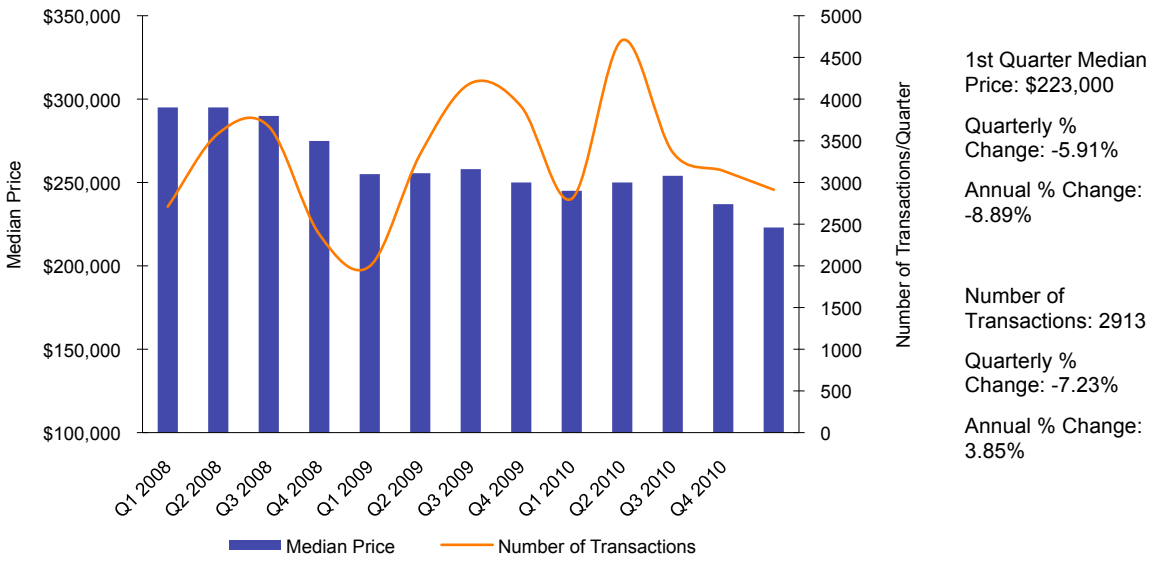


Figure 7: Sale Price/Original List Price& Average Days on Market, Existing Detached Homes, Portland Metro (excluding Clark County, WA)

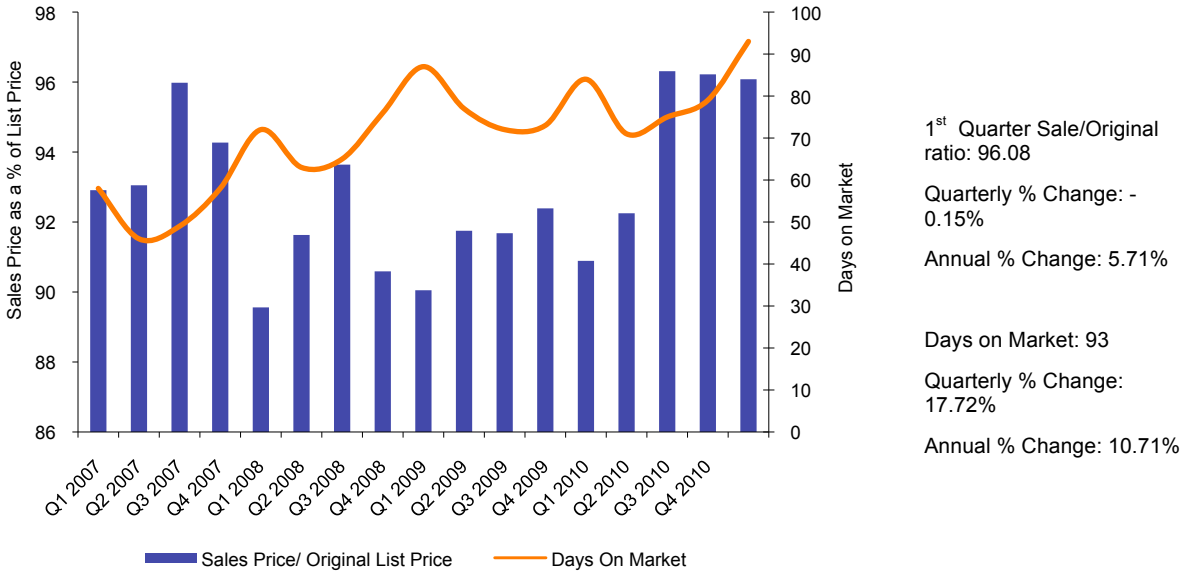


Figure 8: Median Sales Price & Number of Transactions, New Detached Homes, Portland Metro (excluding Clark County, WA)

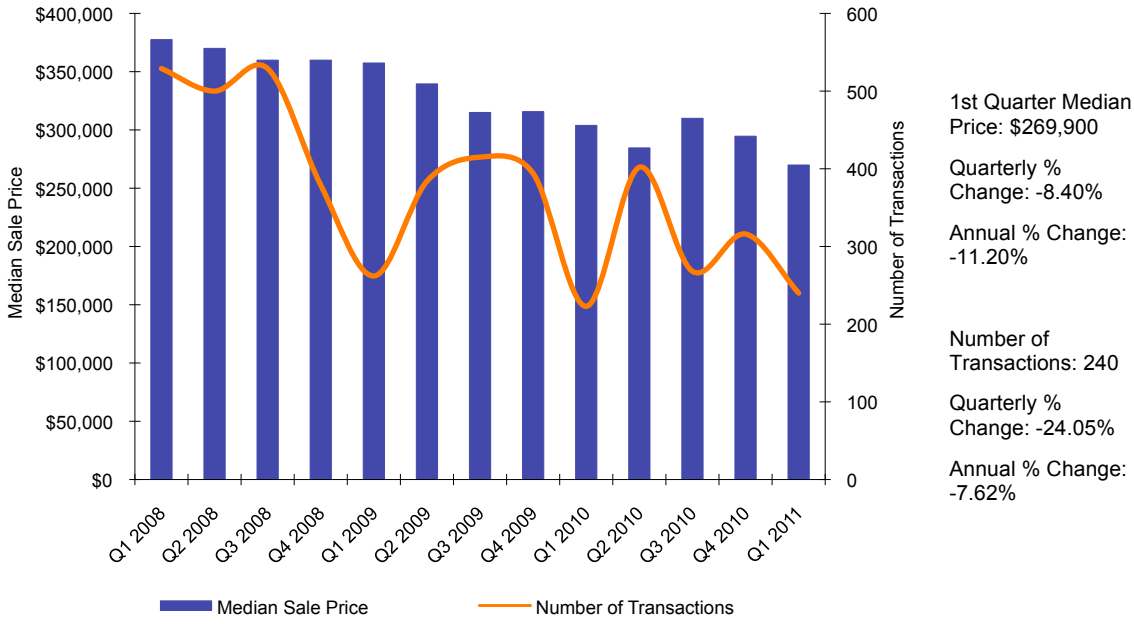
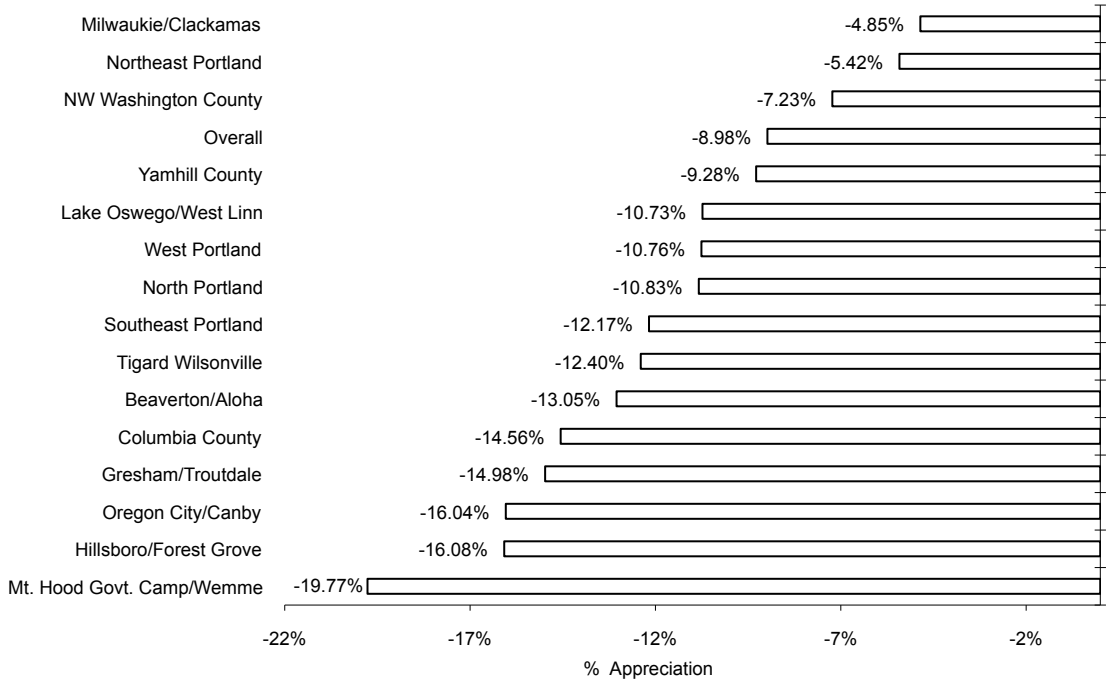


Figure 9: Appreciation Rates of Existing Detached Homes from Q1 2010 to Q1 2011, Portland Sub-Markets



Annual median sale price depreciated for all Portland submarkets. The largest annual depreciation was experienced in Mt. Hood Govt. Camp with a 17.99 percent, Columbia County at 16.08 percent and Oregon City/Canby at 16.04 percent.

Map courtesy of RMLS

VANCOUVER

Vancouver's median home price was $179,000 resulting in a quarterly decrease of 8.20 percent and an annual decrease of 3.36 percent in home values. The number of homes sold throughout the first quarter increased by 4.11 percent to 507 from the fourth quarter of 2010, and up 10.94 percent annually. The average number of days on the market is up to 102 days. Fourth quarter 2010 average number of days on the market was 86, while it was 94 during the first quarter of 2010.

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

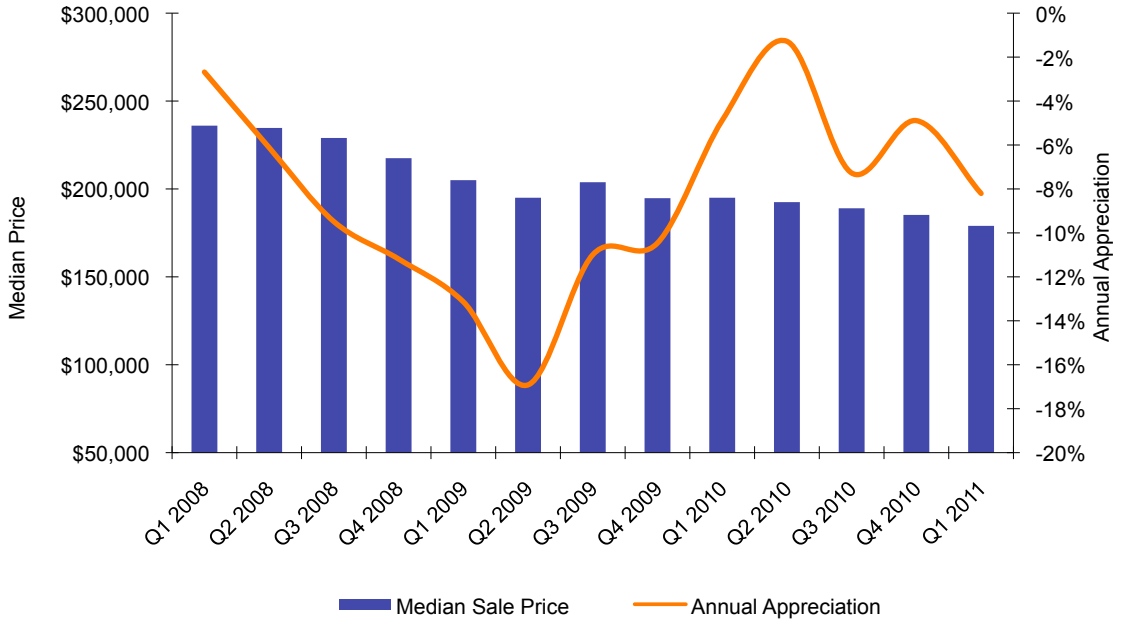


Figure 1: Average Days on Market and Number of Transactions Existing Detached Homes, Vancouver

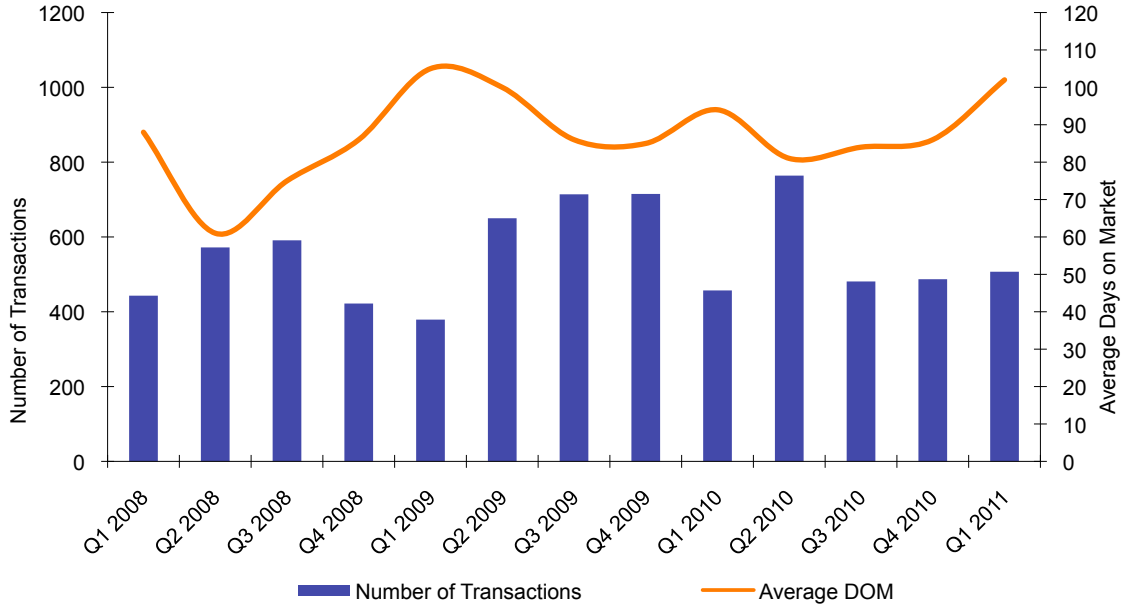
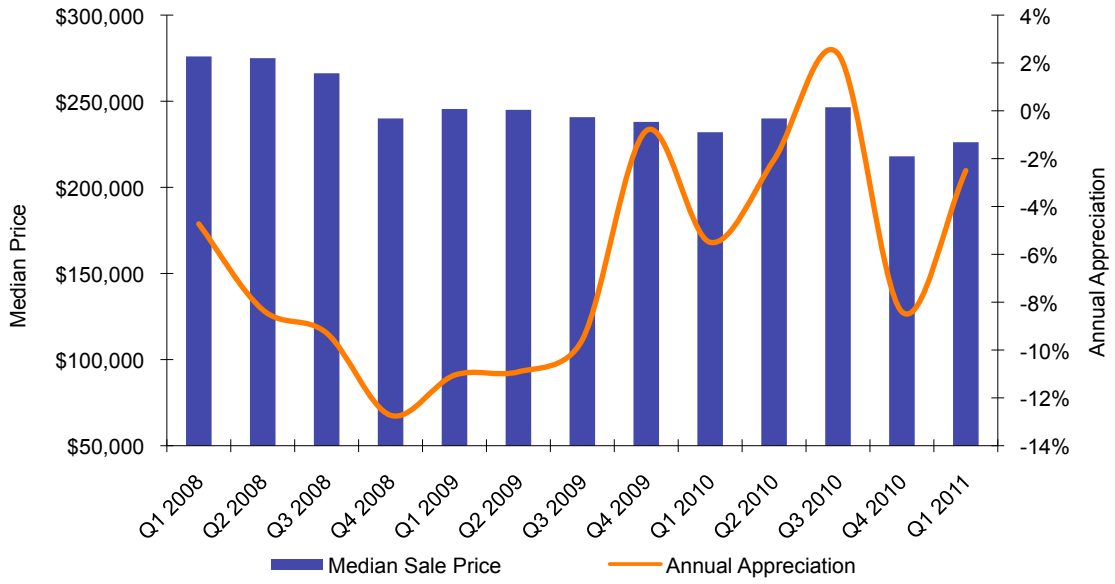


Figure 12: Median Price and Annual Appreciation Existing Detached Homes, Clark County (excluding Vancouver)



In the Clark County suburbs home prices have increased to $226,000. This is a 3.76 percent increase from the previous quarter's median price, and 2.40 percent decrease annually.

The number of home transactions in Clark County's suburbs is up 3.39 percent from the fourth quarter and down 15.28 percent annually. There were 366 transactions during the first quarter. The average number of day on the market is up from 102 to 120. During the first quarter of 2010 homes averaged 103 days on the market.

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

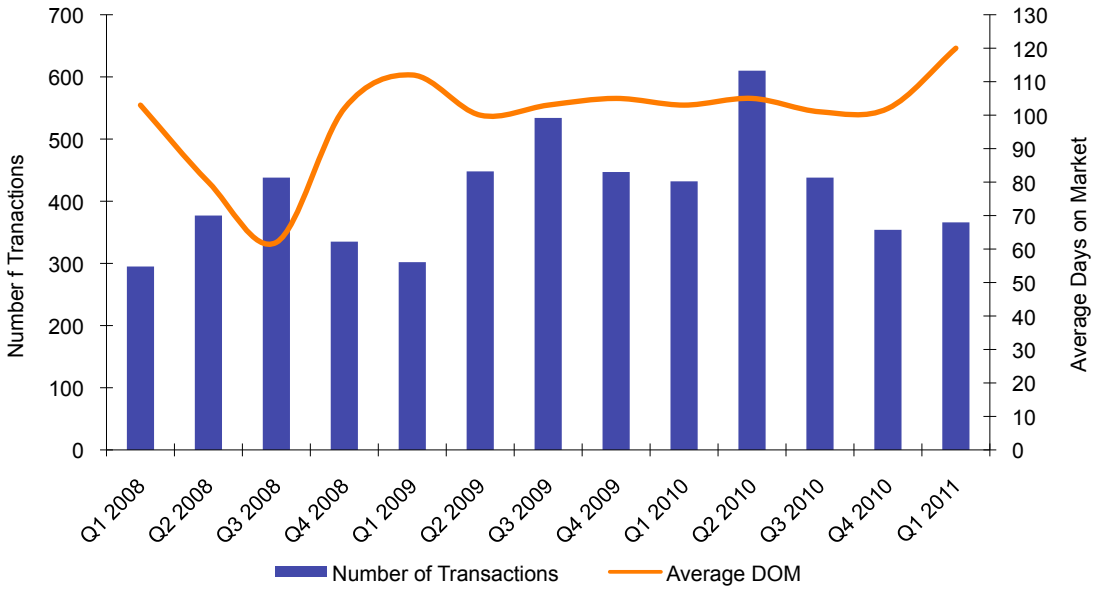
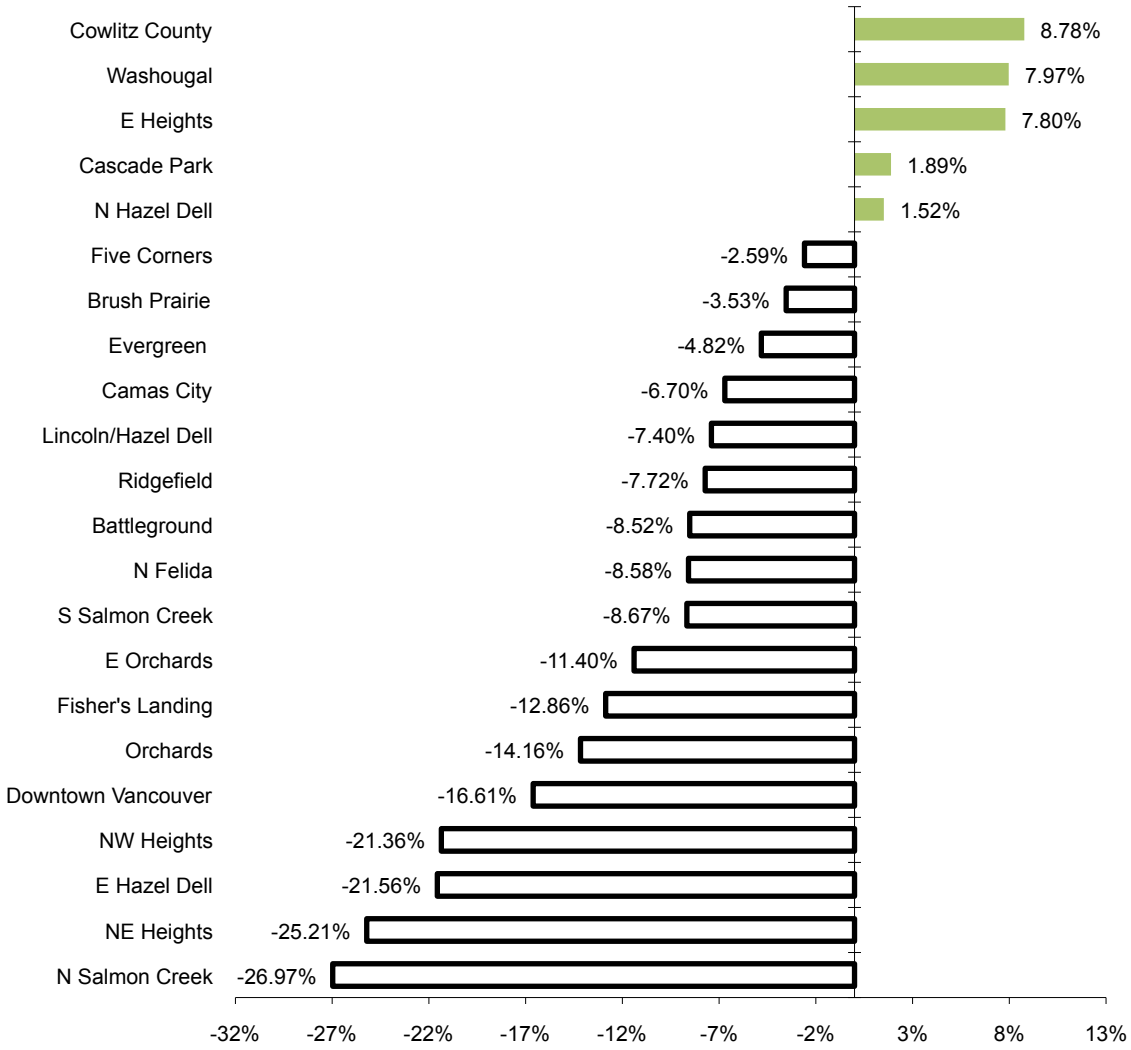


Figure 14: Appreciation Rates of Existing Detached Homes, Vancouver and Clark County Sub Market from Q1 2010 to Q1 2011



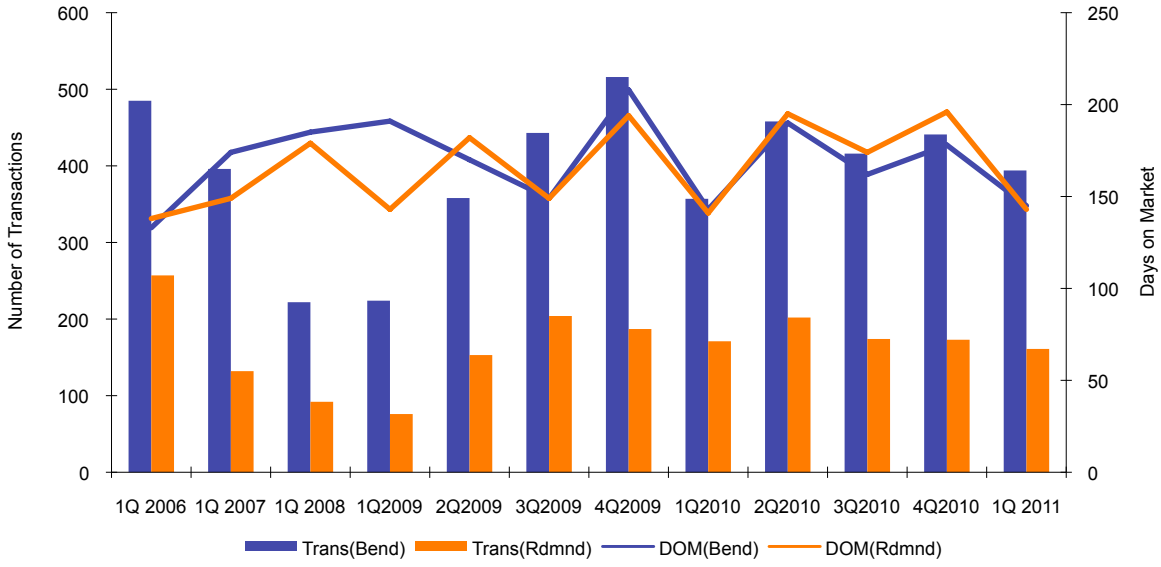
Of the submarkets where there were more than 15 transactions to make appreciation numbers informative, five Vancouver/Clark County submarkets experienced price appreciation for the year. The Cowlitz submarket posted the highest gains with an appreciation rate of 8.78 percent (based on 41 transactions) followed by Washougal at 7.97 percent (46 transactions) and E. Heights at 7.80 percent (in 21 transactions).

Conversely seventeen submarkets had price depreciation. The N Salmon Creek submarket had the highest quarterly depreciation rate at 26.97 percent (30 transactions) followed by NE Heights submarket at 25.21 percent (21 transactions) and E Hazel Dell at 21.56 percent (43 transactions).

CENTRAL OREGON

Both Bend and Redmond are experiencing decreases from the previous year with respect to the number of homes sold less than one acres. Bend home sales less than one acre are down 14 percent to 394 while Redmond's decreased 20.3 percent to 161. More significant transaction decrease were seen with homes on 1-5 acres where volumes decreased 20.8 percent from 12 to 19 in Redmond and from 42 transactions in the first quarter of 2010 to 61 transactions during the first quarter of 2011 in Bend. The average number of days on market increased from 143 (in the first quarter 2010) to 145 (in the first quarter 2011) in Bend and from 141 to 143 in Redmond for homes on less than one acre. 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.

Figure15: Number of Transactions and Days on the Market, Single Family Under 1 Acre, Bend and Redmond



The median home prices for both Central Oregon submarkets remained fairly stable during the fourth quarter after the significant decline during the first quarter of 2010 and are down 5.1 percent from the fourth quarter of 2010. However, annually they are down 10.4 percent in Bend and down 4 percent in Redmond for homes less than 1 acre. The declines grow larger once current median home sale prices are compared to their peak during the first quarter of 2007. The median price for homes under one acre in Bend were $347,750 (first quarter 2007) and are now $175,600. The median price for Bend homes with 1-5 acres was $565,000 in 2007

and now is $240,500. The Redmond submarket experienced similar changes in median sale price during this time frame with homes under one acre dropping from $125,730 to $119,500. Homes with 1-5 acres increased from $200,000 to $236,250 in Redmond (from the first quarter of 2010 to first quarter of 2011). Price-per-square-foot numbers decreased for Bend from the fourth quarter to the first quarter from $100/sq.ft to $97/sq.ft for homes under one acre and from $138/sq.ft to $113/sq.ft for homes with 1-5 acres (from the fourth quarter of 2010 to the first quarter of 2011). In Redmond, homes under one acre was unchanged at $75/sq. ft. Price-per-square-foot on homes with 1-5 acres was up 20.2 percent quarterly in Redmond to $125.

Figure 16: Number of Transactions and Days on the Market, Single Family 1-5 Acres, Bend and Redmond

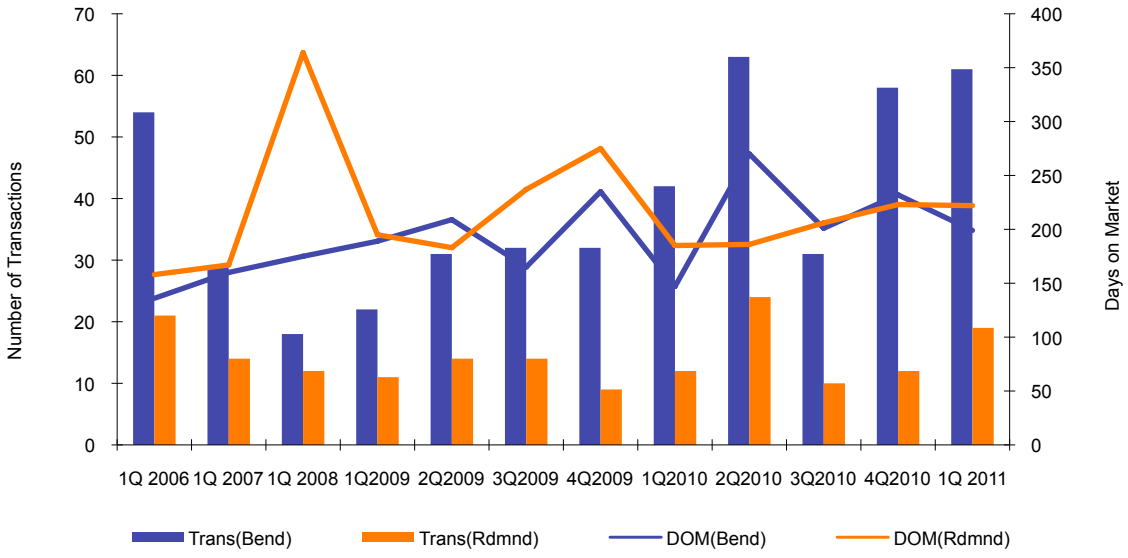


Figure 17: Median Single Family Price and $/SqFt Under 1 Acre, Bend and Redmond

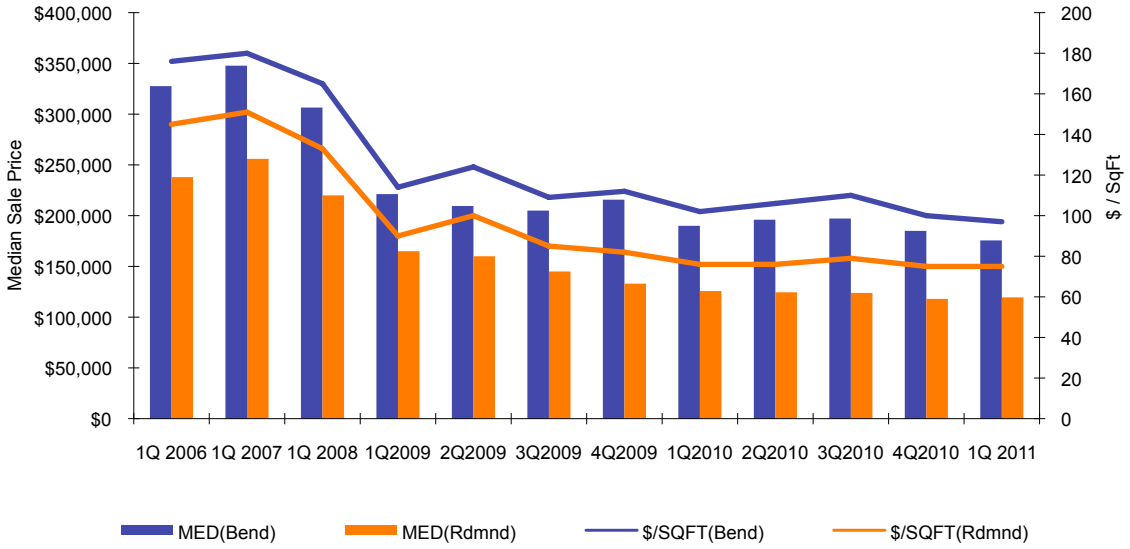
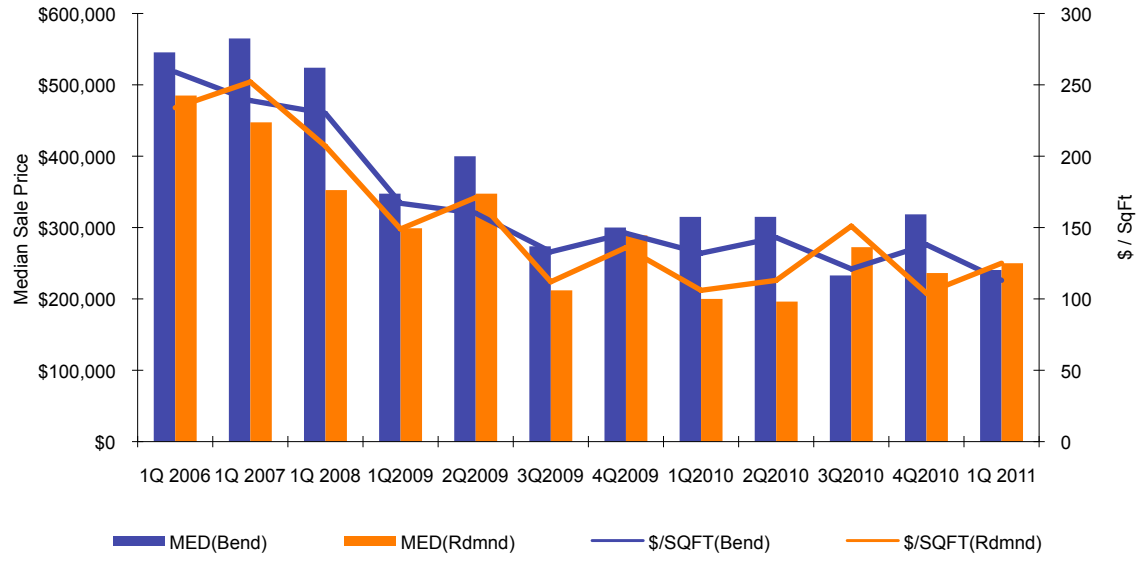


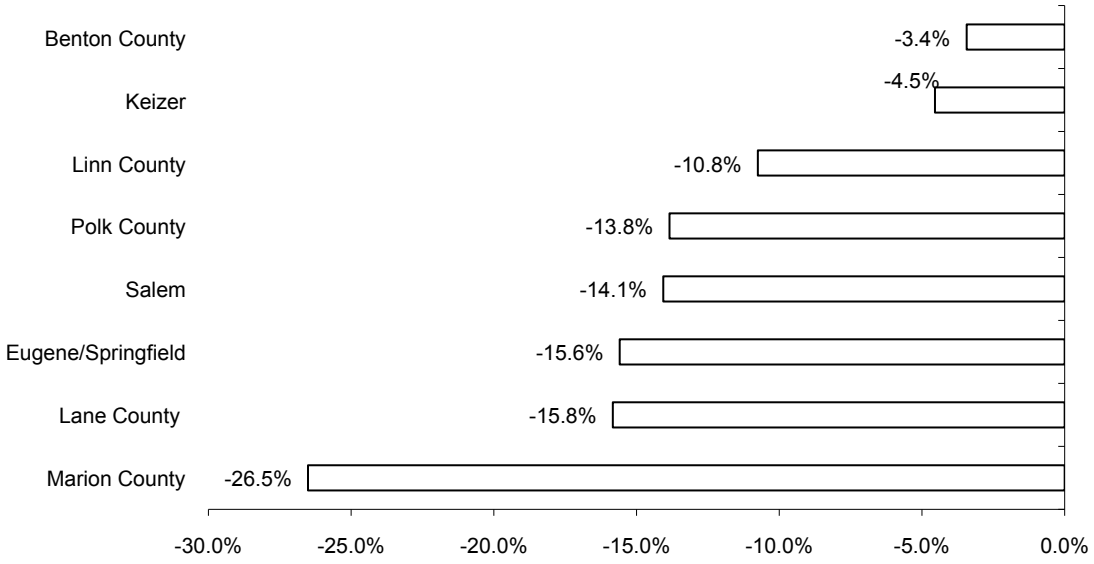
Figure 18: Median Single Family Price and $/SqFt, 1-5 Acres, Bend and Redmond



WILLAMETTE VALLEY

All Willamette Valley submarkets experienced annual depreciation on existing home prices. Marion County had the highest depreciation of 26.5 percent followed by Lane County with a 15.8 percent decrease.

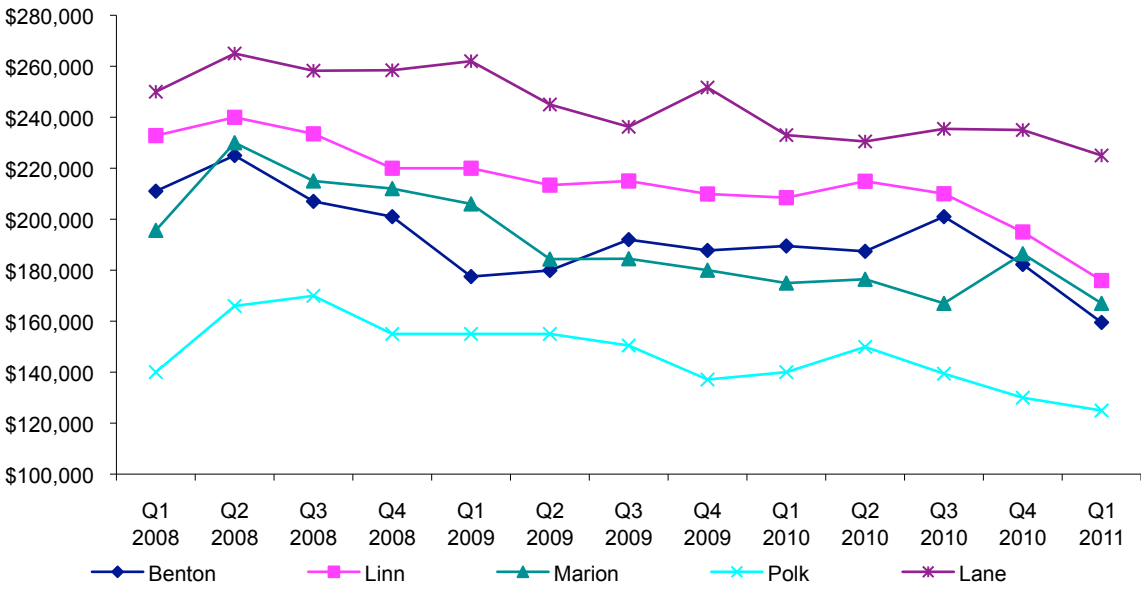
Figure 19: Annual Appreciation Rates of Existing Detached Homes, Willamette Valley from Q1 2010 to Q1 2011



The number of transactions over the past year decreased annually for all of these submarkets except Benton and Marion County where the number of transactions during the first quarter of 2011 increased 0.90 percent and 26.00 percent, respectively. The number of transactions in Benton County was 107, up from 106 the previous year. Linn County had 213 transactions, up from 169 during the first quarter of 2010.

The number of days on the market increased annually for all of these submarkets except Keizer and Linn County. The average days on the market for Keizer decreased from 143 days to 116 days. The average days on the market for Linn County decreased from 152 days to 144 days. The largest increase in average days on market from the first quarter of 2010 was Salem which increased from 136 days to 170 during the first quarter of 2011. This is followed by Lane County which increased from 118 days in first quarter of 2010 to 138 days during the fourth quarter of 2011.

Figure 20: Median Sales Price Existing Detached Homes, Willamette Valley



SALEM

Salem's housing market again experienced annual depreciation while the number of days on the market increased. The median sale price decreased while the number of transactions increased from the fourth quarter of 2010.

Prices declined 11.63 percent from the previous year to $156,600. Meanwhile, the average number of days on market increased to 136 from 170 in the first quarter of 2010. There was increase in the average days on market from the fourth quarter of 2010.

The number of transactions increased from the previous year from 298 to 336, as well as a decreased from the fourth quarter of 2010 from 320.

Figure 21: Median Sales Price and Annual Appreciation, Existing Homes, Salem

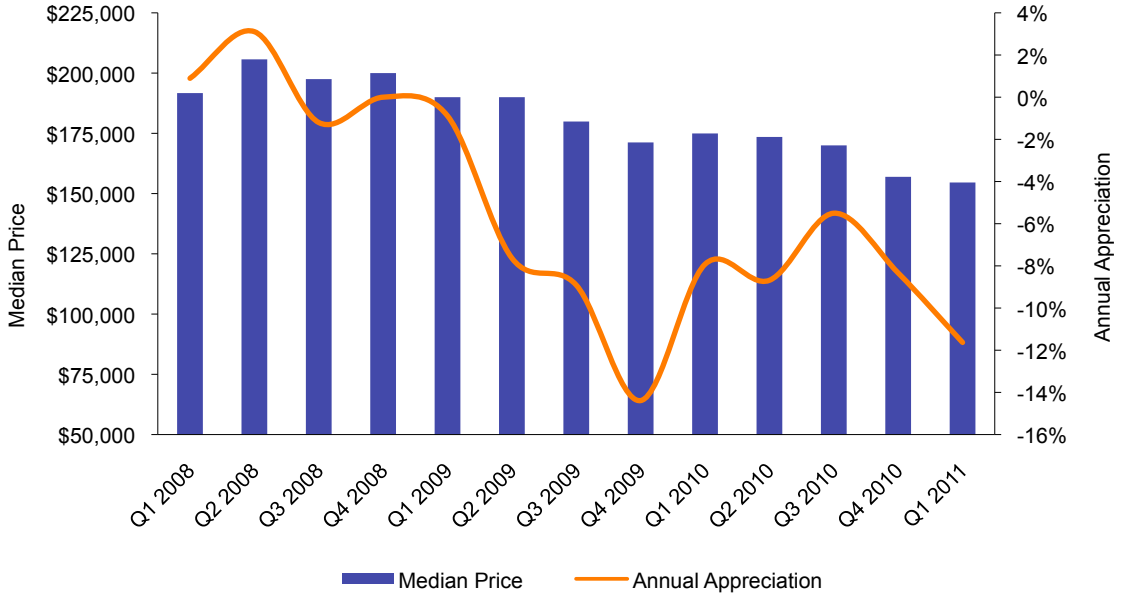
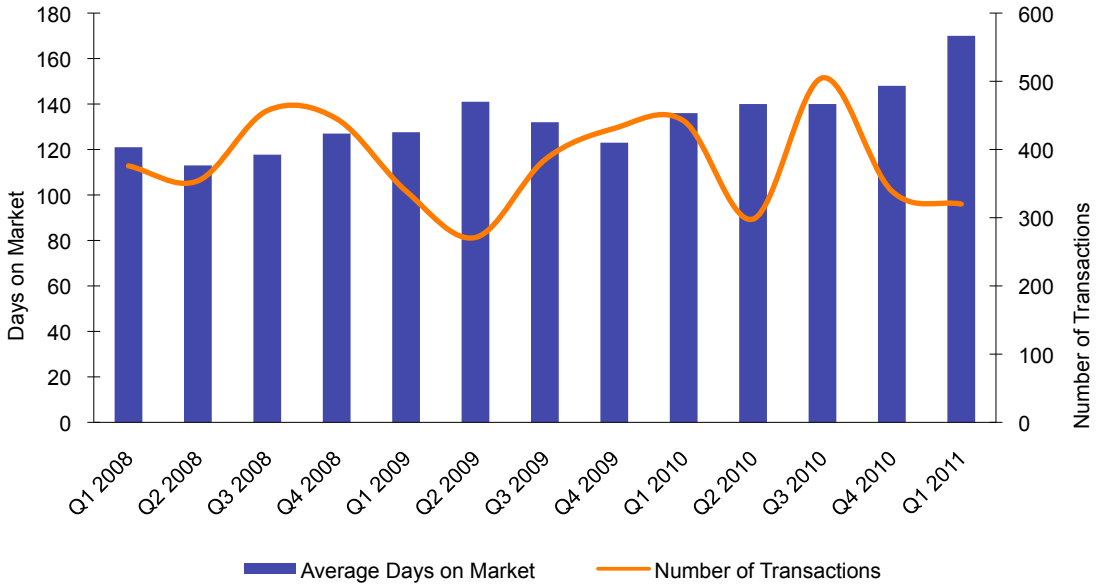


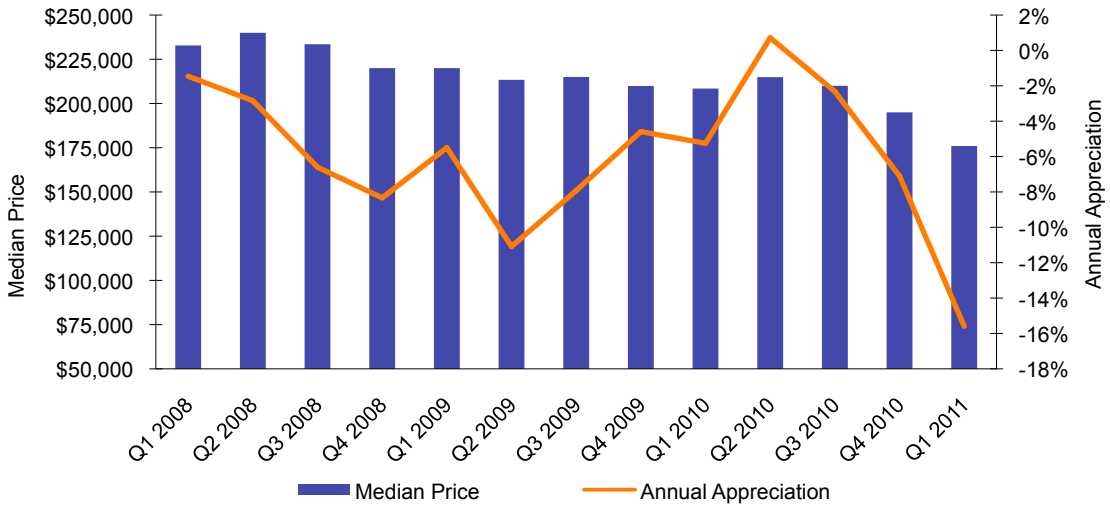
Figure 22: Average Days on Market and Number of Transactions, Existing Homes, Salem



EUGENE/SPRINGFIELD

The Eugene/Springfield area experienced decreasing home prices relative to the first quarter of 2010 and the number of transactions decreased 8.00 percent annually to 360. The number of transactions year over year have been increasing since the second quarter of 2009 but has decreased from the second quarter of 2010 to the first quarter of 2011. The median price decreased annually by 15.59 percent to $175,950.

Figure 23: Median Price and Annual Appreciation Existing Detached Homes, Eugene/Springfield



MULTIFAMILY MARKET ANALYSIS

NGAN NGUYEN

Oregon Association of Realtors Student Fellow
& Certificate of Real Estate Development Graduate Student

Norris, Beggs & Simpson reported that, in the first quarter of 2010, multifamily vacancy has dropped to 2.69 percent in the metropolitan Portland market, down from 3.09 percent from the previous quarter and down from last year's 5.45 percent. For new downtown units, vacancy fell nearly three percentage points to 3.14 percent as occupancy of newer buildings in the last two years stabilize. The average vacancy rate for 2010 was 4.05 percent. The multifamily market is gaining strength and rent is growing in all Portland submarkets. Several major sales transactions closed during the first quarter including Russelville Commons ($31.6 million) in Southeast Portland and 1700 SW Marlow Avenue ($10 million) in Southwest Portland.

The average rents for the first quarter of 2011 were $834 ($0.96/Sq.Ft) up from $825 ($0.95/Sq.Ft) in the fourth quarter for overall average. For a 2BR/2BA, rent increased from $950 ($0.91/Sq.Ft) in the fourth quarter to $964 ($0.92/Sq.Ft). Rent increased from $1,002 to $1,010 for a 3 BR/2BA, and the price/ Sq.Ft increased from $0.95 to $0.96.

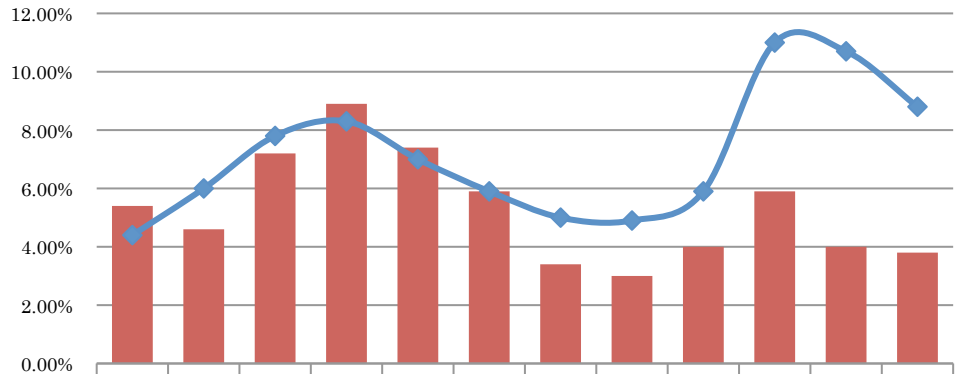
Norris & Stevens reported similar trends in the spring 2011 Newsletter. It was found that rents increases occurred in the majority of markets since the last survey, and vacancy rates have dropped further. It was reported that while some buildings are offering concessions, especially larger communities, these are in the minority.

Decreased vacancy rates and increased rent have stirred new interest in multifamily investment although the apartment market is still catching up to this increased demand which is driving rent rates. Reis, Inc. predicts apartment rents will jump 4.3 percent this year, marking the biggest annual increase in four years.

MPF Research, which also monitors apartment rents, expects them to rise more than 5 percent this year.

Apartment investment has seen positive trends in recent months where a few projects in under-built, close in submarkets were leased up and stabilized relatively quickly. These projects include Tupelo Alley and ecoFLATS in North Portland, The 20 on Hawthorne and 2121 Belmont in Southeast Portland. Financing for properties is becoming easier as Fannie Mae and Freddie Mac join with major banks, regional banks and life insurance companies as a good source for development financing. In recent months, long proposed that have been postponed by the recession have broken ground or have plans to. These projects include The Albert on N. Williams, and a 90-unit project by Phase Two Development on NW Pettygrove, and Block 49 at South Waterfront by Reach Community Development Corporation.

Figure 1: Unemployment and multifamily vacancy, Portland metropolitan area



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Mar-11
Vacancy	5.40%	4.60%	7.20%	8.90%	7.40%	5.90%	3.40%	3.00%	4.00%	5.90%	4.00%	3.80%
Unemployment	4.40%	6.00%	7.80%	8.30%	7.00%	5.90%	5.00%	4.90%	5.90%	11.00%	10.70%	8.80%

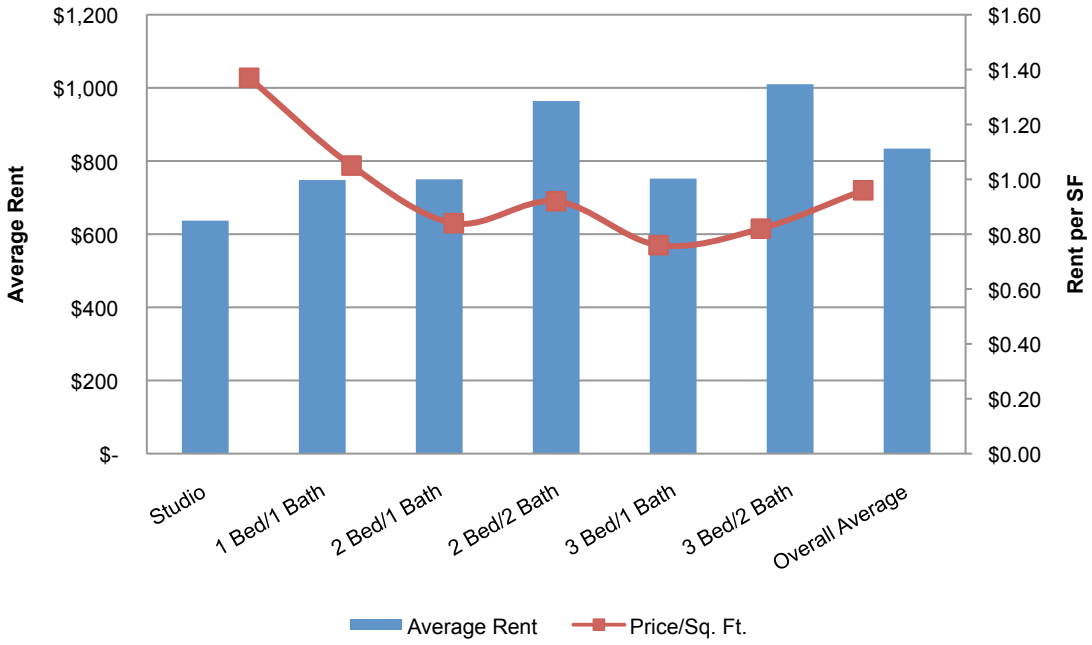
Source: Norris, Beggs & Simpson

Unemployment rates are positively correlated with vacancies as shown in the chart below, and dramatically rose from 5.9 percent in 2008 to 11 percent in 2009, but have declined from 10.70 percent in 2010 to 8.80 percent in March 2011. This is also reflected in the vacancy rates.

The drop in the local vacancy rate reflects similar conditions in the national apartment market. Data released by Reis Inc., a New York real estate research firm, showed that the U.S. apartment vacancy rate fell 1.8 percent to 6.2 percent in the first quarter of 2011. Nationwide rent rose almost 2 percent from the first quarter of 2010. They attributed this rise in apartment rent to the limited number of new apartment units with only 40,000 new apartment units expected to be added to the

U.S. supply this year, down from the 130,000 new units each year for much of the past decade.

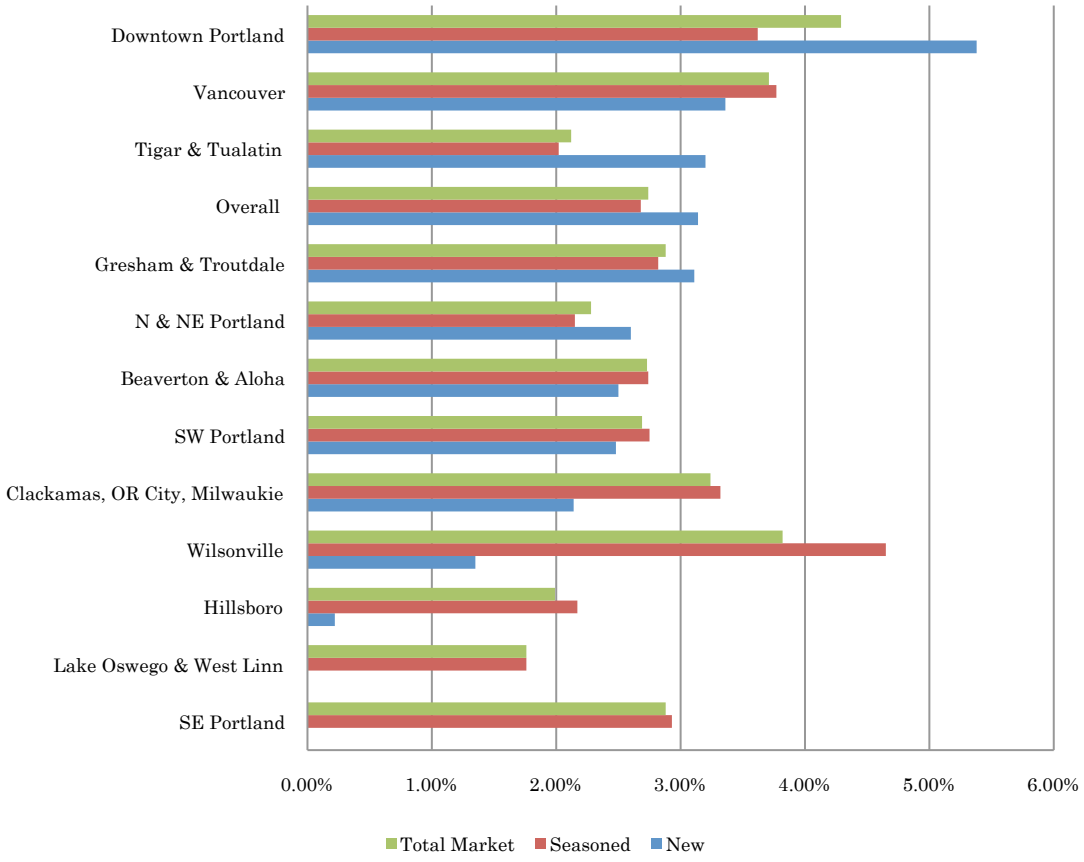
Figure 2: Average rent and Price/Sq.Ft, 1st Quarter, 2011, Portland metropolitan area



Source: Norris, Beggs & Simpson

In the first quarter of 2011, the downtown Portland submarket showed the highest overall vacancy rate at 4.29 percent, while Lake Oswego & West Linn had the lowest submarket vacancy at 1.76 percent. Downtown Portland hand the highest new unit vacancy at 5.38 percent (an increase from 16.7 percent in the fourth quarter) while Lake Oswego/West Linn had virtually no vacancy. Wilsonville has the highest vacancy rate for seasoned units at 4.65 percent followed by Vancouver at 3.77 percent, while Downtown Portland had 3.62 percent. Rent rates increased by $14 overall to $964 from last quarter, or $0.92/Sq.Ft.

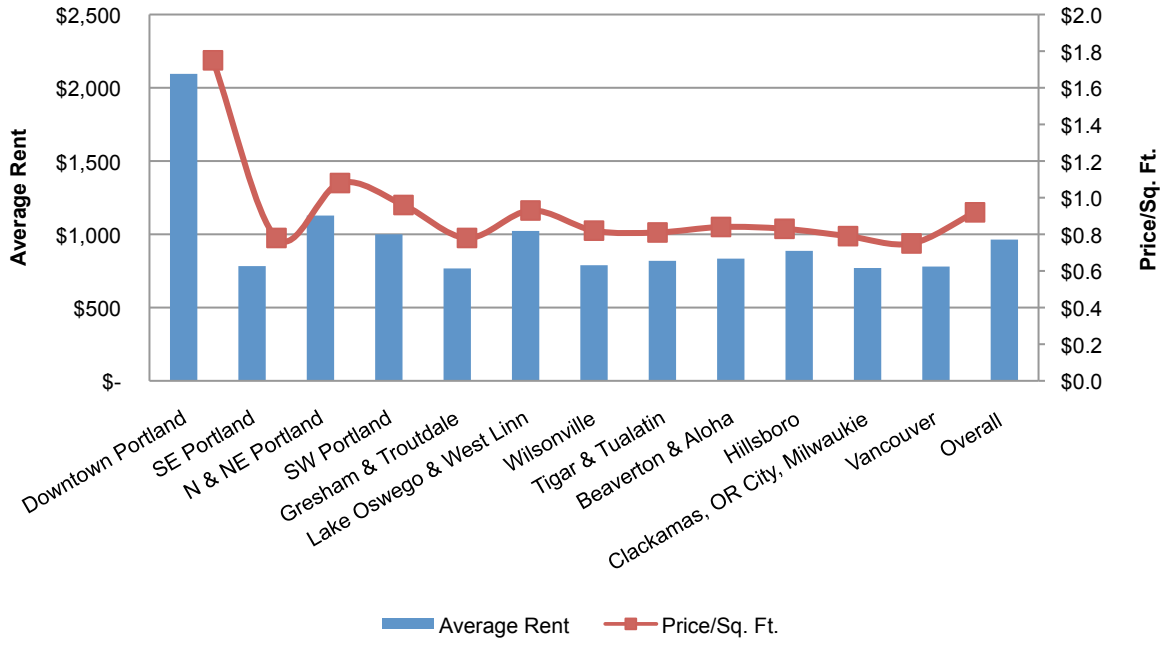
Figure 3: Vacancy rates, 4th Quarter, 2010, Portland metropolitan area, by submarket



Source: Norris, Beggs & Simpson

The recent Norris, Beggs & Simpson survey shows asking rents for two-bedroom/two-bath are highest in the Downtown Portland area at $2,095 at $1.75/Sq.Ft up from the $1.75/Sq.Ft from fourth quarter 2010, followed by Lake Oswego and West Linn at $1,023 at $0.93/Sq.Ft and N & NE Portland at $1128 at $1.08/Sq.Ft. The lowest rent average for two-bedrooms/two-baths is in Gresham & Troutdale for $767 at $0.78/Sq.Ft. Rent prices and $/Sq.Ft increased for every submarket in Portland from the fourth quarter of 2010 to the first quarter of 2011.

Figure 4: Average rents and Price/Sq.Ft, 1st Quarter, 2011, Portland metropolitan area, by submarket



Source: Norris, Beggs & Simpson

Major apartment sale transactions for the first quarter of 2011 include five transactions for 100 units. These include the Russelville Commons (283 units) in Southeast Portland for $30.62 million, Thunderbird Village Apartments (182 units) in Vancouver for $9.07 million, The Village Apartments (124 units) in Gresham/Troutdale for $6.2 million, 1700 SW Marlow Avenue (100 units) in Southwest Portland for $10.0 million, and Gardenbrook Apartments (120 units) in Beaverton/Aloha for $5.50 million.

Table 1: Major sales transactions, 1st Quarter, 2011, Portland metropolitan area

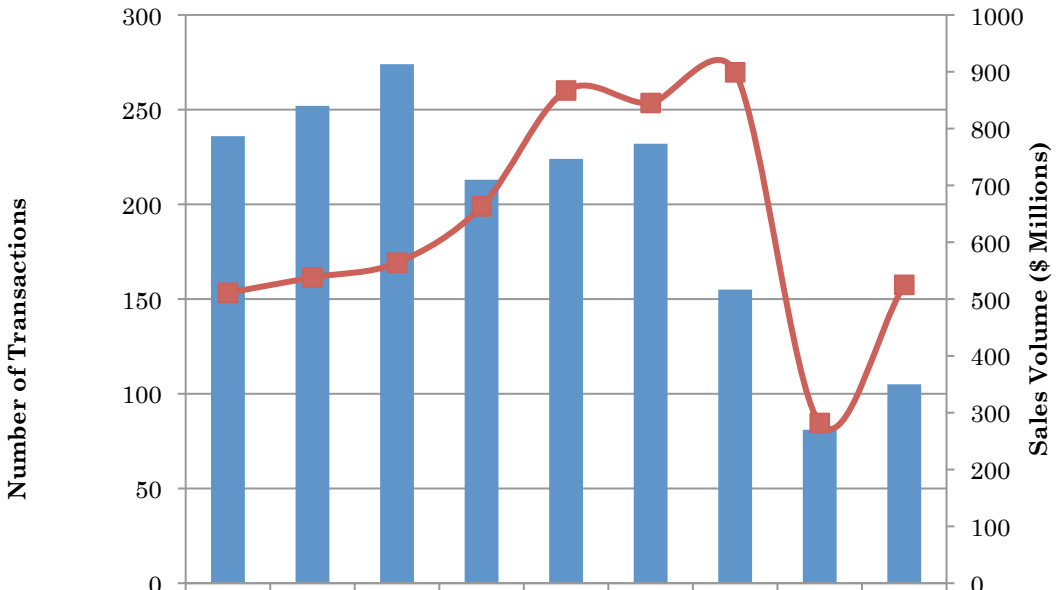
Major Sale Transactions

Buyer:	Building:	Price:	Units:	Submarket:
The Reliant Group	Russelville Commons	$31,625,000	283	Southeast Portland
Pacific Insurance Investment Company	1700 SW Marlow Avenue	$10,000,000	100	Southwest Portland
Thunderbird Investments LLC	Thunderbird Village Apartments	$9,075,000	182	Vancouver
K & F Development LLC	The Village Apartments	$6,200,000	124	Gresham/Troutdale
Santa Barbara Capital	Gardenbrook Apartments	$5,500,000	120	Beaverton/Aloha
Santa Barbara Capital	Meridian Village Apartments	$4,646,000	59	Tigard/Tualatin
Graeme Rael	Woodland Park Apartments	$4,390,000	74	North/Northeast Portland

Source: Norris, Beggs & Simpson

Despite the recent large multifamily sales, apartment sales volumes volume were down significantly in 2010 relative to the prior six years as well as the number of transactions within the current market is still down significantly from levels seen in 2002 through 2008. The graph below shows the sharp drop-off in transactions and total dollar value through 2009 that picked up in 2010.

Figure 5: Multifamily transactions and sales volume, Portland metropolitan area

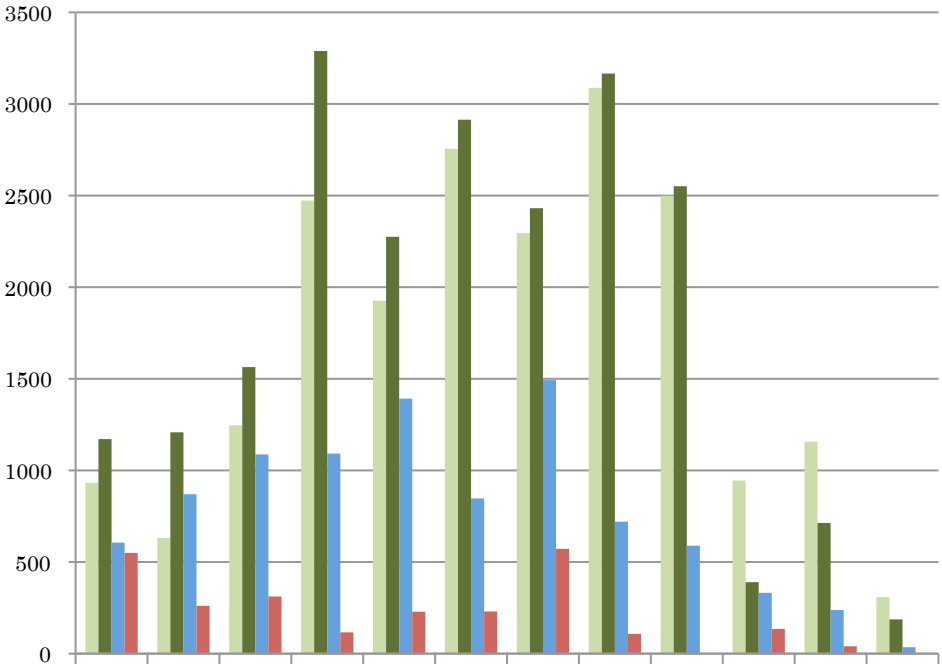


	2002	2003	2004	2005	2006	2007	2008	2009	2010
Number of Transactions	236	252	274	213	224	232	155	81	105
Sales Volume	511	538	564	663	867	845	899	282	525

Source: The Barry Apartment Report

As shown by the graph below, multifamily permits experienced a strong drop-off in 2009 when only 945 multifamily units were permitted within the city. This was well below the yearly average of 1,982 permits issued between 2000 and 2008. Through the first three months of 2011, only 187 multifamily units have been permitted in Multnomah County, with 35 units in Washington County and no units permitted in Clackamas County. For the 2011 year to date, a total of 308 building permits have been issued. 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 current low 2.69 percent vacancy rate in the metropolitan region and lack of new construction, many knowledgeable multifamily brokers and investors are predicting a shortage in apartments by 2012. This shortage will be felt first within the urban core and later in the suburbs, where there is slightly more inventory.

Figure 6: Multifamily residential permits issued



	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011 YTD
Portland - Metro	932	632	1246	2473	1926	2755	2295	3088	2499	945	1157	308
Portland - Multnomah Co.	1171	1208	1564	3289	2275	2914	2431	3166	2551	390	713	187
Washington Co.	606	870	1087	1092	1392	847	1493	720	589	332	238	35
Clackamas County	550	261	312	116	229	230	572	108	0	135	40	0

OFFICE MARKET ANALYSIS:

DAVID WEST

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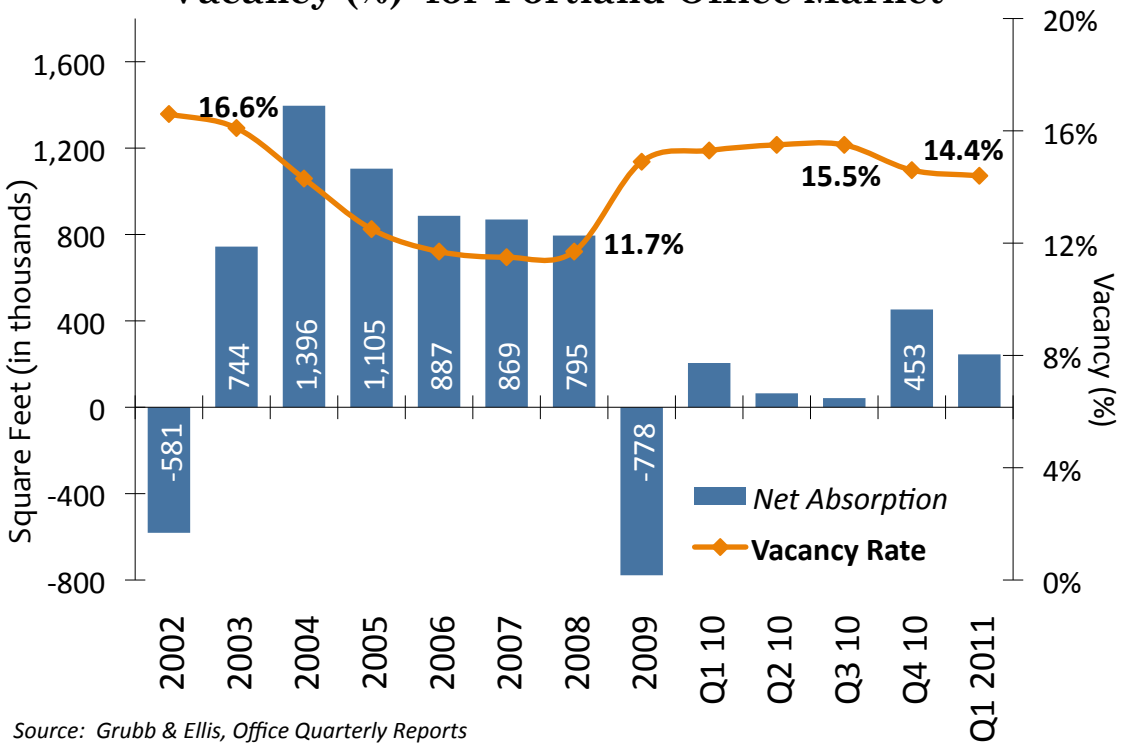
While the Portland office market continues the slow recovery begun in mid-2010, most major indicators point to a somewhat slower pace of growth in the first quarter. Local indices show steady vacancy and modest absorption numbers, with suburban markets outperforming CBD despite continued high demand for Class A space, most prevalent in the CBD. Nationally, REIS reported the first drop in office vacancy across classes in over three years and the second consecutive quarter of positive net absorption.

With metropolitan unemployment nudging down to 9.6 percent from the previous quarter and down 1.3 percentage points since last year, the job recovery has held steady, but progressed slower than many forecasts. Positive signs continue at the national level including strong consumer spending and consumer confidence, but several major risk factors are in place for the coming quarters. Most notably, political unrest in Northern Africa and the Middle East have led to considerable uncertainty in the oil markets, with per barrel crude prices jumping from the $70 to $90 range per barrel in the first quarter with spikes over $100 since. While rising fuel prices are a sign of a growing economy, the recovery could suffer if gasoline prices for consumers continue their rise over $4/gallon.

Despite these concerns, strong corporate profits through the first quarter have sustained growth in private sector demand for office space. Employment growth was relatively well distributed across sectors, with business services and manufacturing standing out at annualized first quarter growth rates above 3 percent.

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



Source: Grubb & Ellis, Office Quarterly Reports

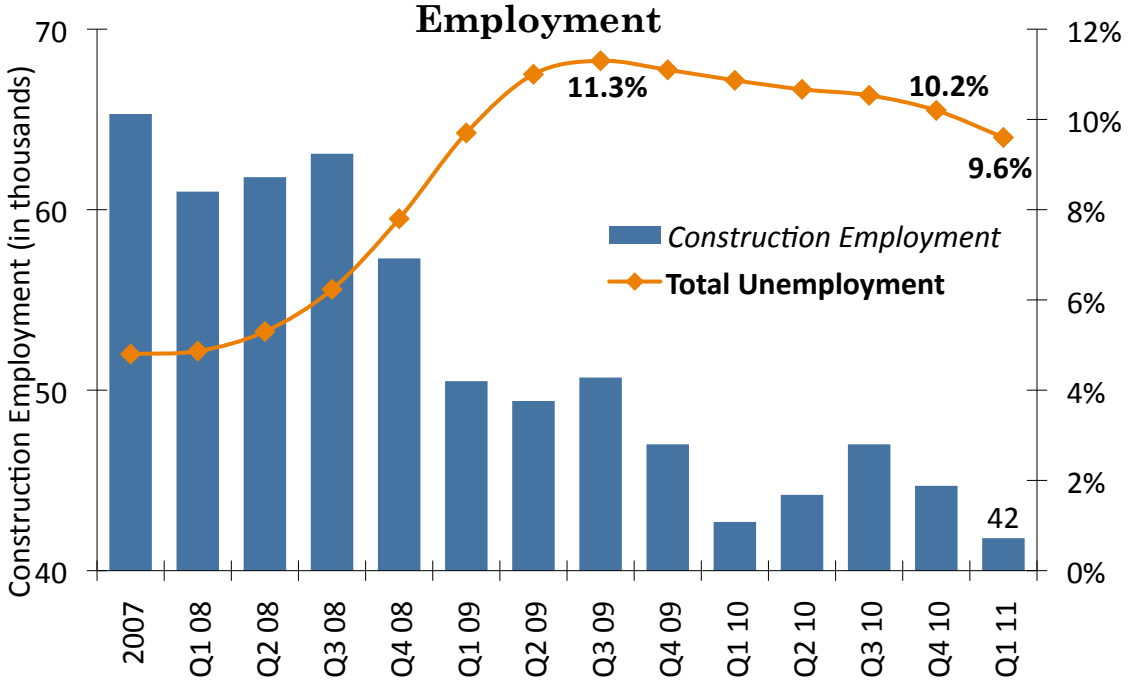
Counteracting the moderate growth in private jobs, however, were widespread legislative initiatives to reduce budgets and staffing at all levels of government. As government employment retracts, concerns of softening public sector demand grow in many regional markets. Thus far, this trend has played out most dramatically in government-dependent markets like Washington DC, [1] but as tight budgets persist in future years, nationally as well as in Oregon, it may be an key component to consider in office market projections.

METRO PORTLAND TRENDS

Grubb & Ellis reports a slight drop in market-wide vacancy to 14.4 percent in the first quarter, led by a drop in Central Business District (CBD) Class A vacancy to 6.3 percent, exceeding forecasted rates of just below 7 percent. Grubb & Ellis continue to call the Portland downtown a "national standout" which will be competitive for the foreseeable future due in part to a lack of sizable projects under construction. Strong demand for downtown Class A space continues to drive these low vacancy averages. At 6.3 percent CBD Class A vacancy to 14.4 percent class and market-wide, the gap between these two numbers (8.1 percent) is , by far, the greatest seen in 10 years, and continues to widen each quarter. (See Figure 4).

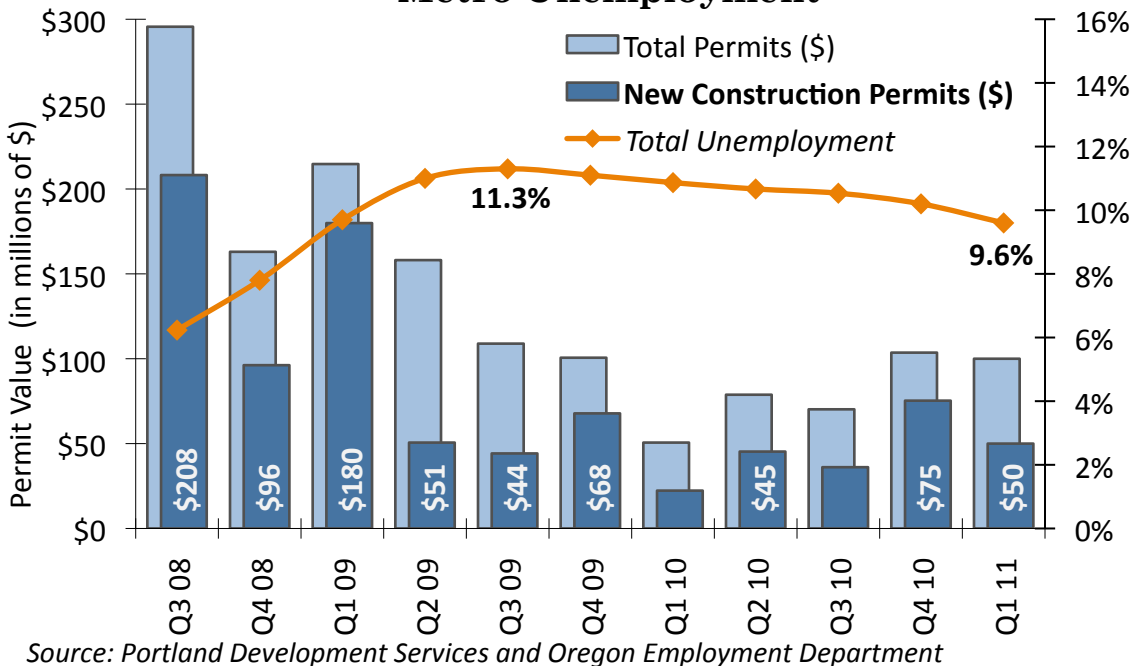
[1] Troianovski, Anton. "Government Cuts Clip Office Market" Wall Street Journal, March 23, 2011.

Figure 2: Unemployment & Construction Employment



Source: Oregon Employment Department

Figure 3: Portland Construction Permits & Metro Unemployment

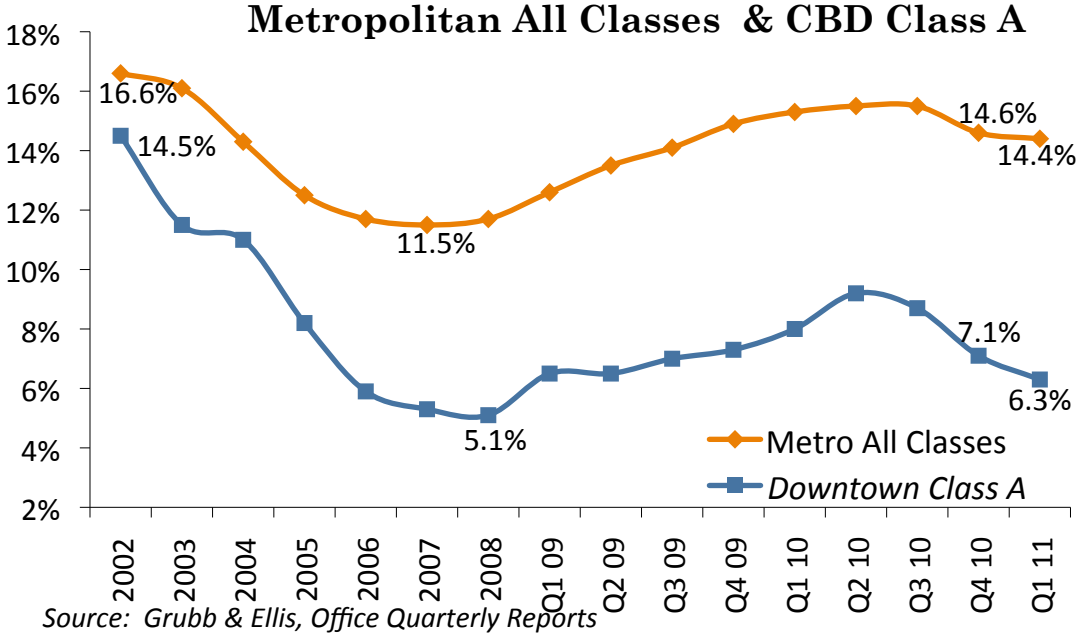


Source: Portland Development Services and Oregon Employment Department

Cushman & Wakefield also reports tightening market-wide vacancies in the fourth quarter while Norris, Beggs & Simpson report a 50 basis point market-wide vacancy rise with CBD Class A vacancies remaining stable at 8.5 percent. Cross brokerage vacancy numbers for the first quarter varied significantly in magnitude, but showed relatively consistent direction with suburban vacancy dropping a median value of 130 basis points across reports. Notably, Grubb & Ellis reports a rise in suburban Class A vacancy of 20 basis points to 23.1 percent, despite a 60 basis point drop across all suburban classes.

While improvements in the employment picture have led to some positive shifts in the office market, a total lack of newly constructed office product has led to some strange trends across submarkets. In line with no newly completed construction in the first quarter (Figure 7) and very little in 2010, construction employment remains at historically low levels in the metropolitan area, as indicated in Figure 2. City of Portland new construction permits in Figure 3 remain steady with a small dropoff from the previous quarter, with continued low levels of investment in new development ($50 million) which remains at a fraction of the levels seen in 2008. While not specifically an office property, nearly $17 million of this total is represented by a more than 400,000 square foot Subaru facility to be constructed at 14510 N Lombard St on land leased from the Port of Portland, which will include significant office space along with warehouse space and a distribution facility.

Figure 4: Office Vacancy (%)
Metropolitan All Classes & CBD Class A



Source: Grubb & Ellis, Office Quarterly Reports

Table 1: Office Market Vacancies and Asking Rents, Q1, 2011

	CB Richard Ellis	Cushman & Wakefield	Grubb & Ellis	Norris, Beggs & Simpson	Median
Market-Wide Vacancy	15.1%	13.9%	14.4%	18.0%	14.8%
Previous Quarter	15.1%	15.4%	14.6%	17.5%	15.3%
First Quarter 2010	15.8%	-	15.3%	18.0%	15.8%
First Quarter 2009	12.8%	13.5%	12.6%	14.7%	13.2%
CBD & Downtown Vacancy	9.5%	9.7%	9.6%	12.4%	9.7%
Previous Quarter	8.9%	10.5%	9.4%	11.8%	10.0%
First Quarter 2010	10.5%	-	10.4%	12.0%	10.5%
First Quarter 2009	8.0%	10.2%	8.3%	10.5%	9.3%
CBD Class A Vacancy	-	-	6.3%	8.5%	7.4%
Previous Quarter	-	7.9%	7.1%	8.4%	7.9%
First Quarter 2010	-	-	8.0%	7.9%	8.0%
First Quarter 2009	5.5%	8.3%	6.5%	6.2%	6.3%
CBD Class A Asking Rents	-	$25.22	$26.04	N/A	$25.63
Previous Quarter	-	$24.86	$26.11	N/A	$25.49
First Quarter 2010	-	-	$25.88	N/A	$25.88
First Quarter 2009	$26.89	$27.62	$27.02	N/A	$27.02
Suburban Vacancy	20.3%	18.1%	17.2%	24.1%	19.2%
Previous Quarter	20.8%	20.2%	17.8%	23.9%	20.5%
First Quarter 2010	20.8%	-	18.9%	21.9%	20.8%
First Quarter 2009	17.2%	16.7%	15.7%	17.1%	16.9%
Suburban Class A Vacancy	N/A	-	23.1%	-	23.1%
Previous Quarter	N/A	-	22.9%	-	22.9%
First Quarter 2010	N/A	-	24.4%	24.2%	24.3%
First Quarter 2009	N/A	18.3%	17.3%	17.5%	17.5%
Suburb Class A Asking Rent	N/A	$22.90	$22.33	N/A	$22.62
Previous Quarter	N/A	$22.56	$22.40	N/A	$22.48
First Quarter 2010	N/A	-	$22.98	N/A	$22.98
First Quarter 2009	N/A	$22.95	$23.20	N/A	$23.08

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

Table 2: Total Vacancy for Select Suburban Submarkets

Submarket	Market Size (SqFt)	1Q 10 Vacancy	2Q 10 Vacancy	3Q 10 Vacancy	4Q 10 Vacancy	1Q 11 Vacancy
Wash. Square/Kruse Way	6,189,173	21.9%	21.7%	21.2%	19.7%	19.2%
Sunset Corridor	4,321,964	28.1%	27.6%	29.3%	25.5%	24.5%
SW/Beaverton/Slyvan	3,530,939	16.6%	17.3%	17.0%	17.0%	16.3%
Eastside	2,855,826	7.8%	7.6%	8.2%	8.6%	10.6%
Johns Landing/ Barber Blvd.	1,759,396	14.3%	14.4%	16.8%	17.7%	15.7%
Tualatin/Wilsonville	1,676,855	29.2%	36.1%	34.0%	32.0%	32.5%

Source: Grubb & Ellis, First Quarter 2011 Statistics

Suburban submarkets showed absorption numbers not seen since before the recession at 244,842 square feet with net absorption for the CBD barely breaking even at 399 square feet according to Grubb & Ellis. Norris, Beggs & Simpsons numbers lined up with this as suburban markets posting only the third quarter of positive absorption since 2007.

Rankings of vacancy by submarket from Grubb and Ellis numbers (Table 3) show few dramatic shifts from the fourth quarter. Tualatin/Wilsonville replaces the small Camas market at the top of the list with a 32.6 percent vacancy, up 60 basis points from the fourth quarter. Next is Sunset Corridor at 24.5 percent and Columbia Corridor at 23.9 percent. Vancouver Mall currently carries the lowest suburban vacancy rate at 8.6 percent followed by Northwest at 9.5 percent and St. John's/Vancouver at 10.3 percent. Hazel Dell saw a large rise in vacancy from 7.7 percent to 11.0 percent.

Table 3: Suburban Office Submarkets, Ranked by Vacancy Rate

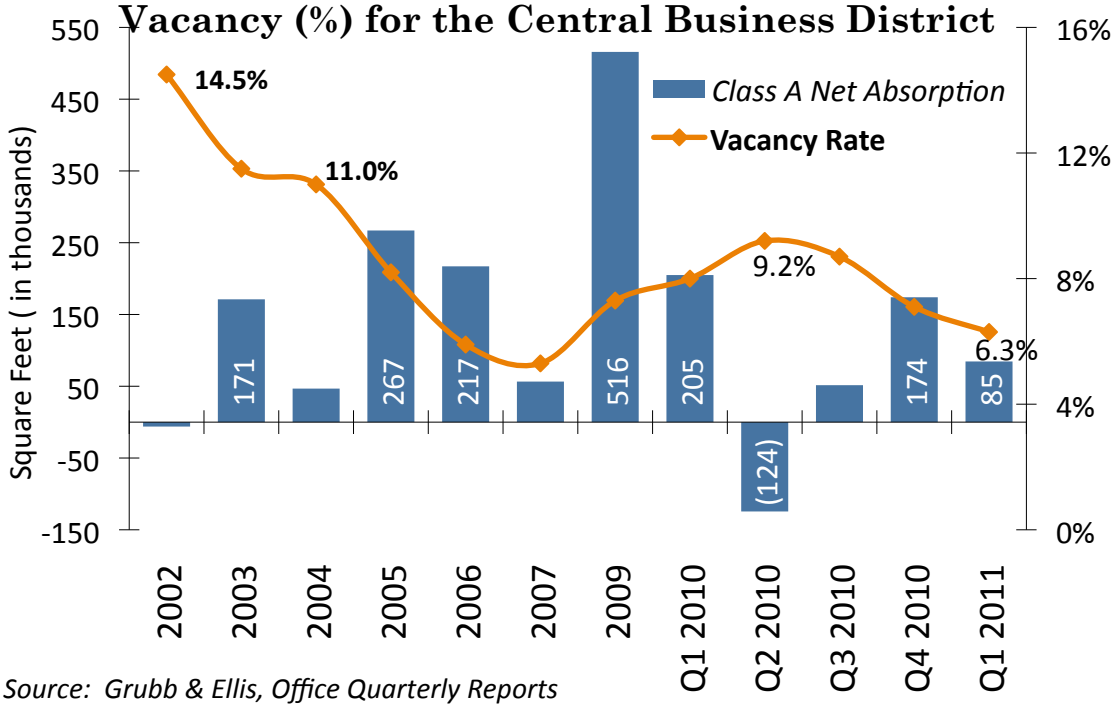
Submarket	1Q 11 Vacancy
Tualatin/Wilsonville	32.5%
Sunset Corridor	24.5%
Columbia Corridor	23.9%
Camas	21.6%
Orchards	21.0%
Cascade Park	19.3%
Wash. Sq/Kruse Wy	19.2%
Clackamas Sunnyside	18.0%
SW/Beaverton/Sylvan	16.3%
Johns Landing/Barbur Blvd	15.7%
Vancouver	13.6%
Hazel Dell/Salmon Creek	11.0%
Eastside	10.6%
St. Johns/Cent.Vanc.	10.3%
Northwest	9.5%
Vancouver Mall	8.6%

Source: Grubb & Ellis Office Report, Q1 2011

One likely explanation for the improvement in suburban markets is the high demand for Class A and Class A+ space while the supply of such properties in the CBD has been dwindled, forcing tenants which might otherwise have located in a downtown location to consider a peripheral location. Grubb & Ellis forecasts this trend to continue through 2011, particularly if CBD Class A vacancies approach the 5 percent mark. At this point, very little new supply is imminent. As of April, only one Class A+ vacancy above 30,000 feet exists in the CBD, with little guaranteed new supply in the construction pipeline.

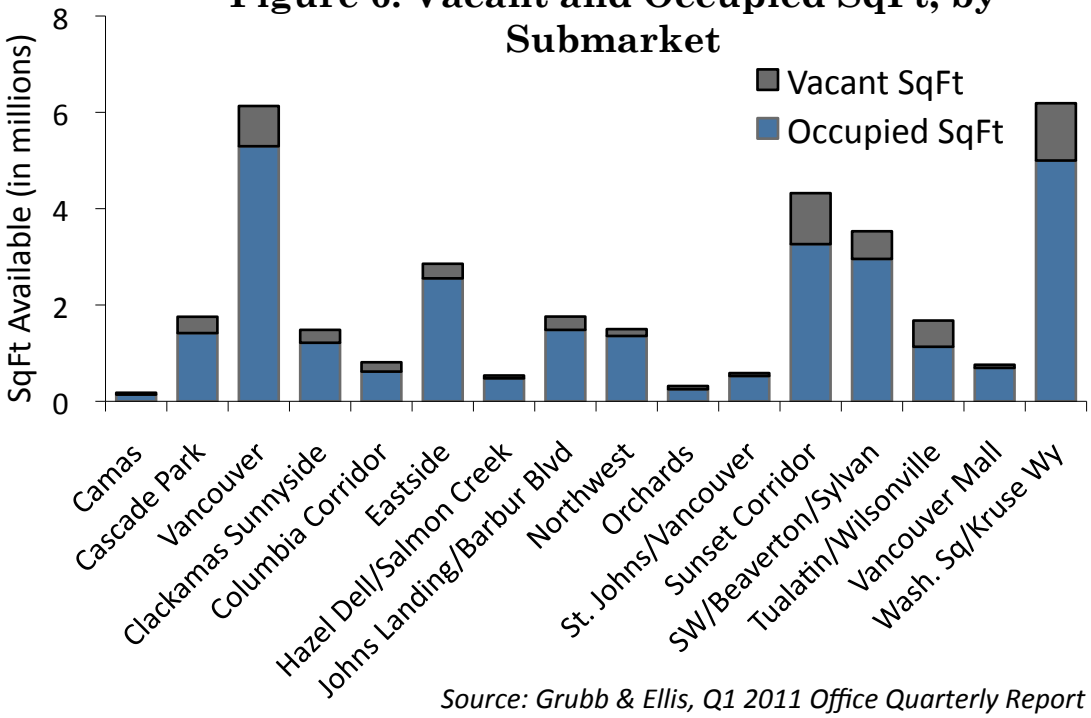
Financing remains tight for developers and while many projects are currently being pitched to fill this niche, few have been able to move forward. Park Avenue West serves as the most visible example of constrained lending. It is still sitting vacant nearly two years from the day that work was halted due to its construction loan falling through. Despite the apparent demand for Class A space, Grub & Ellis reported drops in Class A asking rents in both the CBD and suburban market, continuing a multi-year trend. However, brokerage data was split as Cushman Wakefield reported healthy increases in Class A asking rents for both CBD and suburbs, both in the +$.50 range. This split represents the first compelling signs of a stabilization in rents since the recession.

Figure 5: Class A Net Absorption (SqFt) & Vacancy (%) for the Central Business District



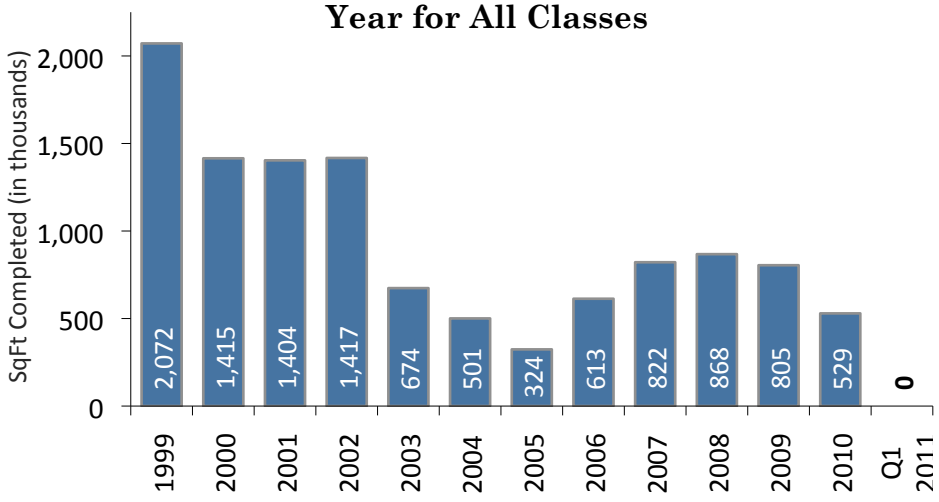
Source: Grubb & Ellis, Office Quarterly Reports

Figure 6: Vacant and Occupied SqFt, by Submarket



Source: Grubb & Ellis, Q1 2011 Office Quarterly Report

Figure 7: Office Construction Completed by Year for All Classes



Source: Grubb & Ellis, Office Quarterly Reports

Table 4: Major Lease Transactions, 1st Quarter, 2011

Lessee	Property	Submarket	Size (SqFt)
Hewlett Packard	Columbia Tech Center	Vancouver	142,850
High-Tech Institute, Inc	The Round	Beaverton	33,257
Wells Fargo Advisors	KOIN Center	Portland	25,917
OHSU	The Bancroft Building	Portland	20,315
Albertina Kerr Centers	Cascade Station	Portland	19,480
Northwestern Mutual	200 Market Place	Portland	19,353

Source: CB Richard Ellis, Cushman & Wakefield, Grubb & Ellis, and Norris Beggs & Simpson Q1 2011

Notable lease transactions (see Table 4) include only one new lease greater than 100,000 square feet, as Hewlett Packard moves into a 164,000 square foot space in the Columbia Tech Center. The Wells Fargo consolidation and relocation to the top floors of the KOIN Center represents 25,000 square feet within the CBD..

CONCLUSION

While indicators continue to paint a mixed picture moving forward, the first quarter of 2011 presents some encouraging signs of a recovery that continues, albeit tentatively. In particular, big net absorption numbers and drops in vacancy for suburban markets suggest that constraints on new supply across submarkets have had metro-wide effects. While asking rent data is inconsistent across brokerages, mixed results show the first hints of a halt to the steady decreases in rent of the past two years. Along with the sustained strong performance for the Class A market, these indicators will be important to watch in order to gauge demand in a market that appears to be led by tenants who desire high quality space in the Central City. Moving forward, there may be opportunities in place for developers who are able secure credit.

RETAIL MARKET ANALYSIS:

DAVID WEST

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The Portland retail real estate market was relatively quiet in the first quarter. With the metropolitan unemployment rate down to 9.6 percent and retail sales up for 10 consecutive months according to Census Bureau, there are some encouraging notes, but none seem strong or stable enough to entice investors back to the market. Several important cautionary notes exist. Following a 3.1 percent growth rate in the fourth quarter of 2010, US GDP grew only 1.8 percent in the first quarter of 2011 according to the Commerce Department.[1] Inflation concerns are growing in a climate where commodity prices appear on a steady upward march with the price of oil threatening to derail the country's cautious recovery.

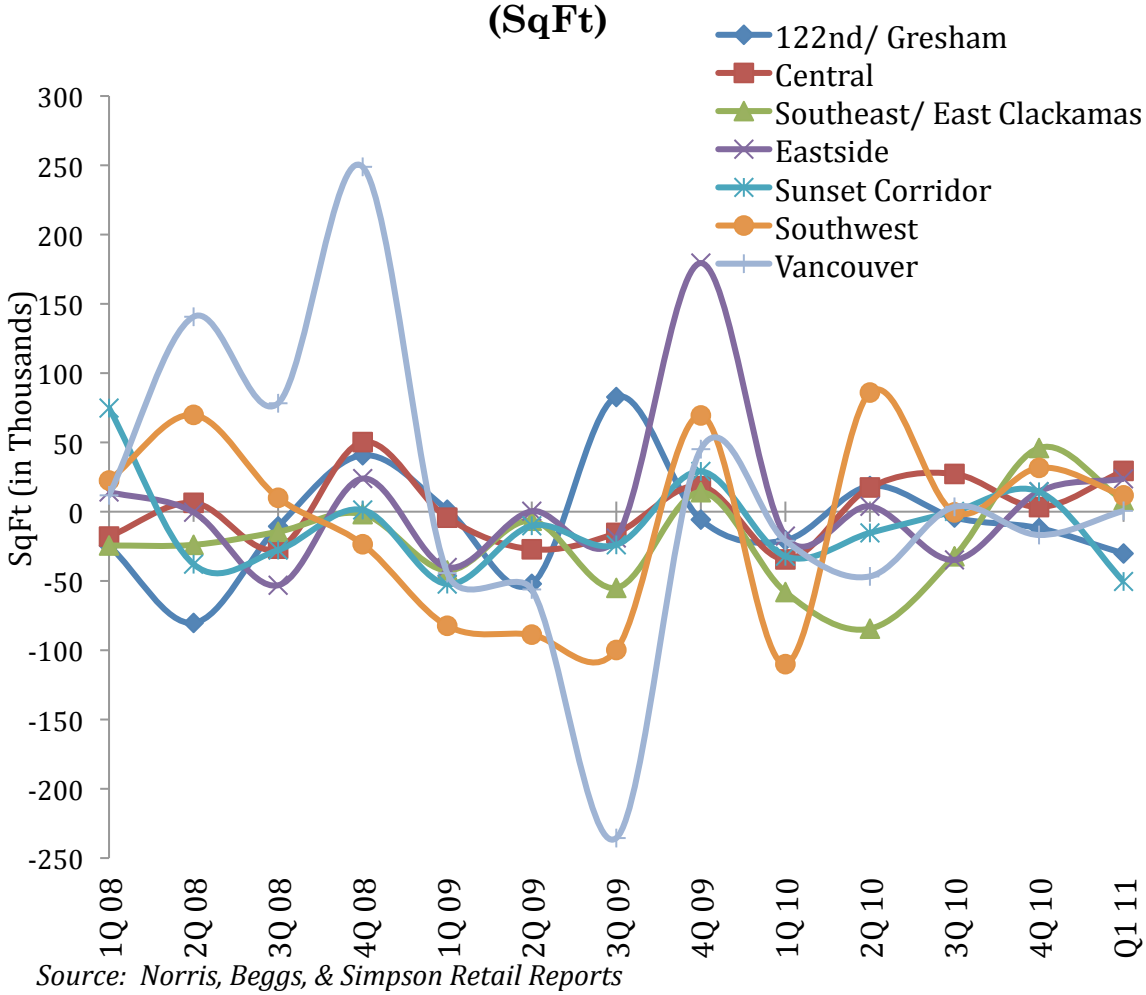
Table 1: Major Retail Lease Transactions, 1st Quarter, 2011

Tenant	Property	SqFt	Submarket
Albertina Kerr Centers	Cascade Station	19,480	E Portland
Odd Ball Shoe Company	1805 NW Thurman St	11,140	Portland City
Partners in Careers	Minnehaha Center	11,000	Vancouver

Source: Portland Business Journal, and Q1 2011 Reports from Norris Beggs Simpson

[1] Schaefer, Steve. " U.S. Economy Slows As Consumer Spending Decelerates", *Forbes*, April 28, 2011.

Figure 1: Total Net Absorption by Submarket (SqFt)



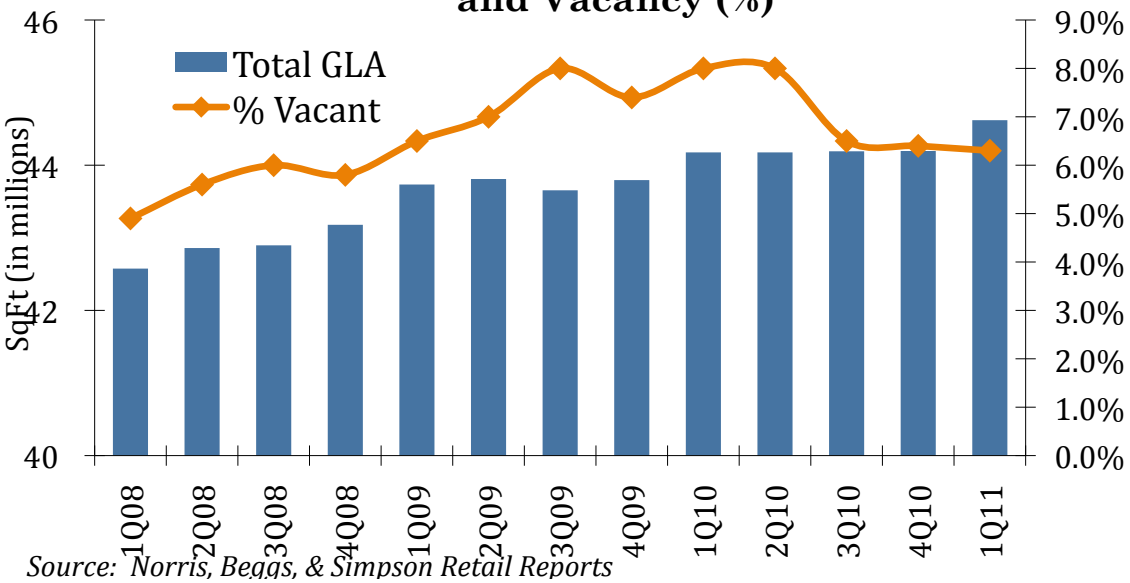
Source: Norris, Beggs, & Simpson Retail Reports

Kidder Matthews references six consecutive months of Case Shiller housing price decline and a large inventory remaining on the market as another drain on consumer confidence. Finally, while the unemployment rate is improving, dismal measures of underemployment and labor force participation leave a substantial portion of working people with little disposable income, particularly as the rise in the cost of goods outpaces personal income.

Norris, Beggs and Simpson reports that retail vacancy remained stable in the fourth quarter, dropping to 6.4 percent. This is the lowest vacancy seen since the first quarter of 2009, following a year of slow and incremental improvements in vacancy largely explained by a lack of new product in the market. Norris, Beggs, and Simpson report only 67,286 square feet under construction in the first quarter, a slight uptick from previous quarters, but at only 0.1 percent of total metropolitan inventory, supply is growing very slowly. Total absorption was reported at negative

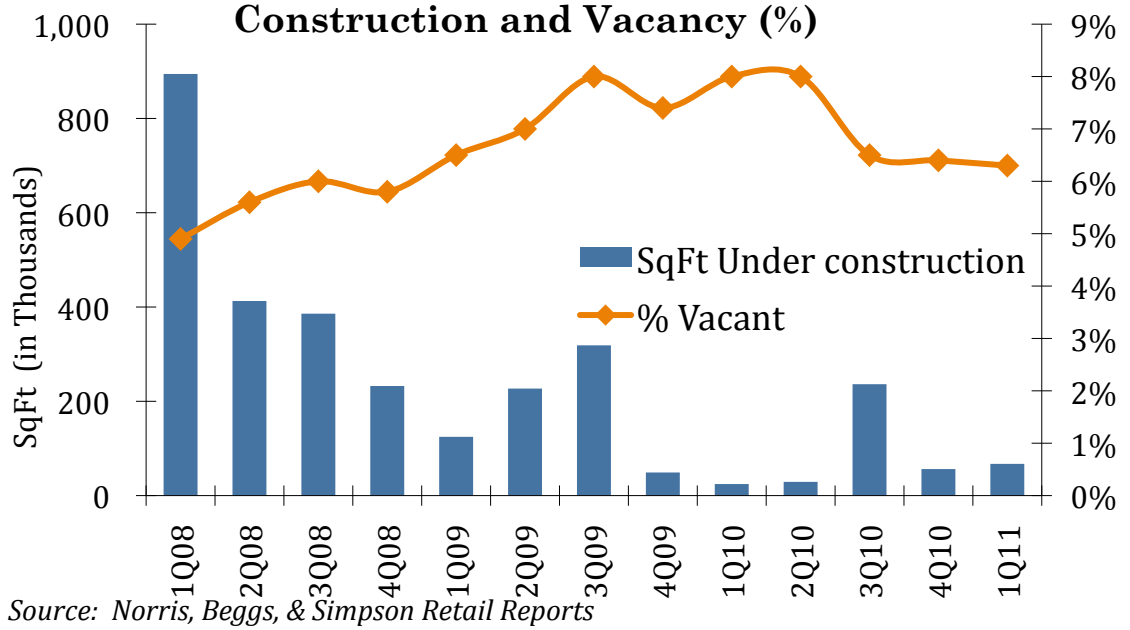
6,946 square feet. Central City vacancy improved 130 basis points to 7.8 percent, while Eastside improved 60 basis points to 3.6 percent, the tightest of all submarkets reported by Norris, Bess, and Simpson.

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



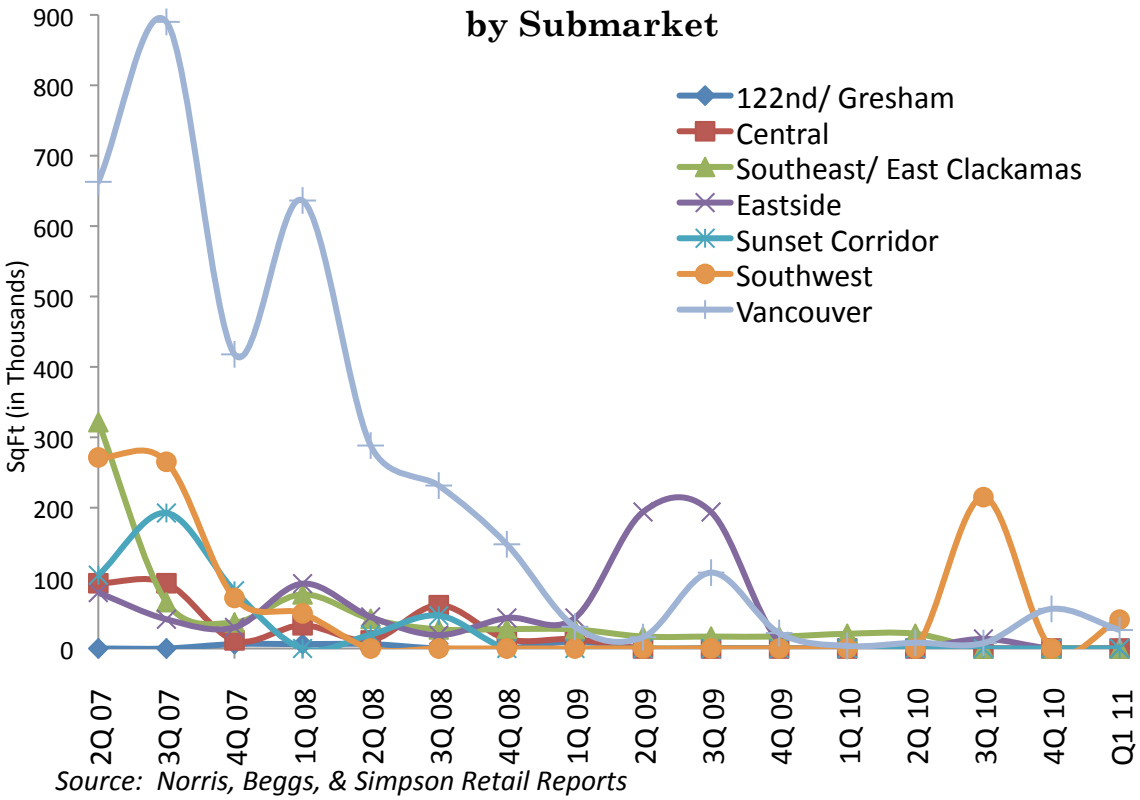
Source: Norris, Beggs, & Simpson Retail Reports

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



Source: Norris, Beggs, & Simpson Retail Reports

Figure 4: Total Retail SqFt Under Construction by Submarket



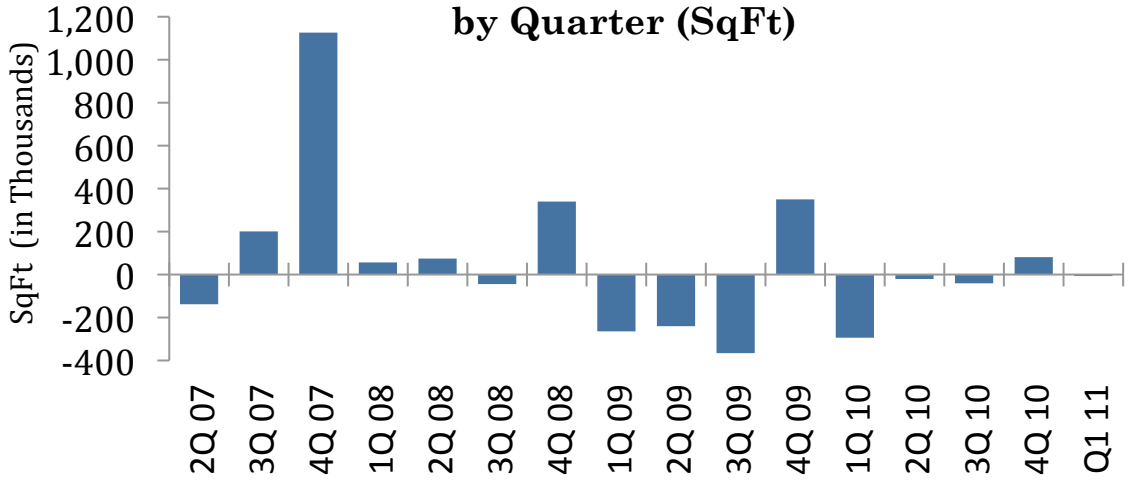
Source: Norris, Beggs, & Simpson Retail Reports

Vancouver carries the highest vacancy rate at 8.2 percent, with flat absorption. Sunset Corridor saw an abrupt rise in vacancy from the fourth quarter to 6.3 percent. Kidder Matthews reports that average retail quoted rents for the Portland market currently jumping $.08 to $17.01/square foot (triple net), representing the first increase in rates seen since a peak of $18.16 in Q4 2008. Vacancy is also reported as up 30 basis points to 6.2 percent following negative absorption of 411,573. Kidder Matthews numbers show two buildings delivered to market at 124,00 square feet of rentable building area total with 352,425 square feet under construction.

Walmart is reportedly considering major investments in the metropolitan area, with as many as 17 new stores being proposed over the next five years.[2] The stores being discussed include some supercenter-style box developments, but most are targeted to take advantage of local and national grocery store development incentive programs focused on areas that are under-served in terms of fresh food options. Most of the proposed stores are far smaller than a typical Walmart at between 40,000 and 50,000 square feet, with a higher percentage of inventory devoted to food products.

[2] Gunderson, Laura. "Wal-Mart study considers 17 more stores in Portland area", *Oregonian*, May 3, 2011.

Figure 5: Total Retail Net Absorption by Quarter (SqFt)



Source: Norris, Beggs, & Simpson Retail Reports

Along these lines, some existing Walmart stores are looking to expand, as well, including the Walmart in Lents, which will expand its 134,000 square foot store by 21,500 square feet including a full remodel and addition of a full service grocery store.[3] Other expansions proposed by Walmart include a new 80,000 square foot location at Delta Park East in North Portland, a 43,000 square foot store at 17275 NW Cornell Rd in Beaverton, and stores in Newport, Cottage Grove and Dallas. Target Stores has also announced plans to expand grocery options in existing stores in Tigard, Tanasbourne, Hillsboro, Southeast Portland and Happy Valley stores. Such expansions in grocery may have the effect of reducing market share for local chains with smaller distribution who cannot compete with Walmart and Target on price point, such as Fred Meyer, Safeway, Alberston's, New Seasons, and newcomers like Grocery Outlet.

Despite some industry projections that Portland has more grocery stores than the market can handle, attracting full-service providers to neighborhoods considered "food deserts" has recently become a prominent goal of local planning efforts. This commitment was underlined with PDC's recent RFI for the "Recruitment of Grocery Store Development in Underserved Neighborhoods," intended to ease development and operation costs on developers willing to build in designated areas. Walmart has applied for this program, but many prominent local brands have not, including Fred Meyer, Safeway and Albertson's citing the lack of viability for such stores, even with government subsidies. As Bob Lamb, of Lamb Stores, is quoted in the Oregonian, "Some of us would like to bring water to those 'food deserts,' but in some cases, there's a reason there's no water there."[4] It is unclear how Walmart's neighborhood

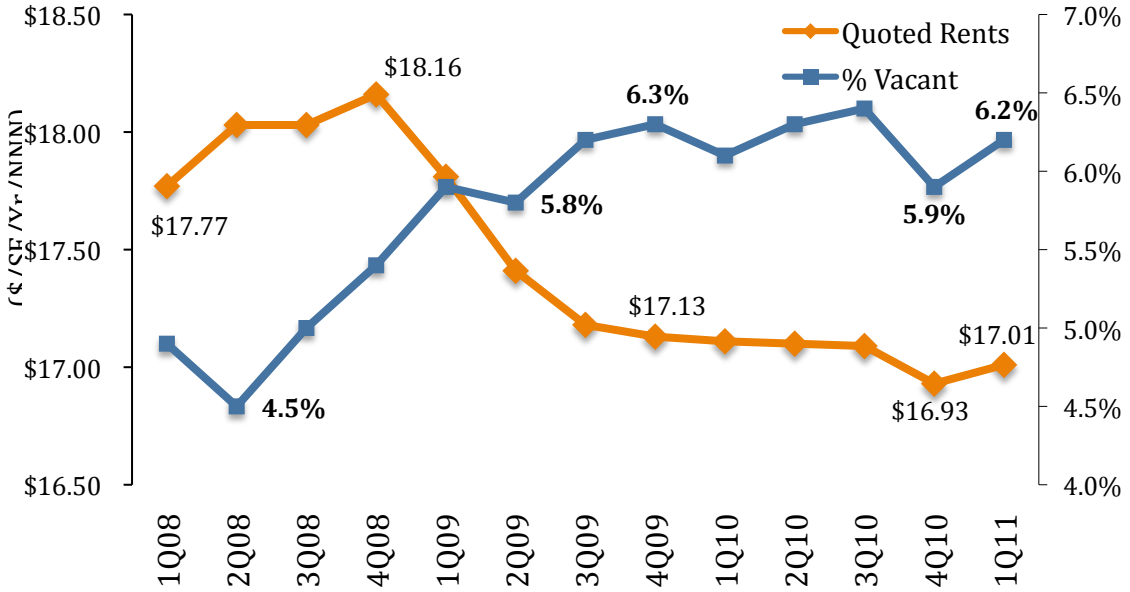
[3] Bjork, Nick. "Walmart in Lents neighborhood to expand", *Daily Journal of Commerce*, April 27, 2011.

[4] Gunderson, Laura. " Walmart and Target load up on groceries in Portland area", *The Oregonian*, May 7, 2011.

store efforts will be viewed by citizens and local government, but with lower costs than comparable stores, Walmart may be one of only a few viable options in otherwise risky markets.

Apart from grocery expansions, Target is reportedly proceeding with plans to take over an 85,563 square foot space at the Galleria in downtown Portland for a small-format, urban store in line with their recent models. [5] Typical Target stores average approximately 126,000 square feet, with some Super Targets exceeding 160,000 square feet. Contingent on historic design reviews and permitting, the store would look to begin build out by the third quarter of 2011.

Figure 6: Quoted Rents and Retail Vacancy (%)



Source: Kidder Matthews Q1 2011 Retail Report

[5] Bjork, Nick. " Target gets serious about downtown Galleria space", *Daily Journal of Commerce*, April 27, 2011.

INDUSTRIAL MARKET ANALYSIS:

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In the first quarter of 2011, the Portland industrial real estate market continued to struggle to meet the definition of a recovery. Most major measures portray a local industrial market that is simply holding ground or worse, with few signs of substantial positive movement across brokerage analyses. The most encouraging signs for the coming year are found in national hints of an upswing in trade and manufacturing activity over the past three quarters. Nationally, industrial firm fundamentals are strong and have been improving for more than two years following decreased values of the dollar relative to other major currencies. But rising prices and uncertainty in oil loom large on the horizon and leave many questions as to whether such performance can continue.

CoStar reports a 10 basis point national drop in industrial vacancy to 9.9% with over 30 million square feet of net absorption in the last two quarters, a level of performance not seen since mid-2007. The Portland metro market has failed to keep this pace, however. Despite two consecutive quarters with no new delivery, vacancy either rises or remains flat in five reports considered.

Most industrial activity in the first quarter was owner or user driven. Absorption has been boosted by some industrial tenants taking the opportunity to downsize, upgrade, or improve locations based on low but stabilized rents across submarkets. As has been the case for the past few years, in a market favoring tenants, transactions times are long with owners making substantial concessions in rent and improvements in order to move product. Little to no speculative activity has taken place, as investors view industrial market opportunities warily. Based on

the lack of new speculative product on the market, several firms have chosen to undertake custom build projects to meet their own needs, with the most prominent being Subaru's 413,000 square foot build-to-suit project at Rivergate Corporate Center and McLane Foods' 165,000 square foot refrigerated expansion in Tigard.

Table 1: Industrial Market Vacancies and Asking Rents, Q4, 2010

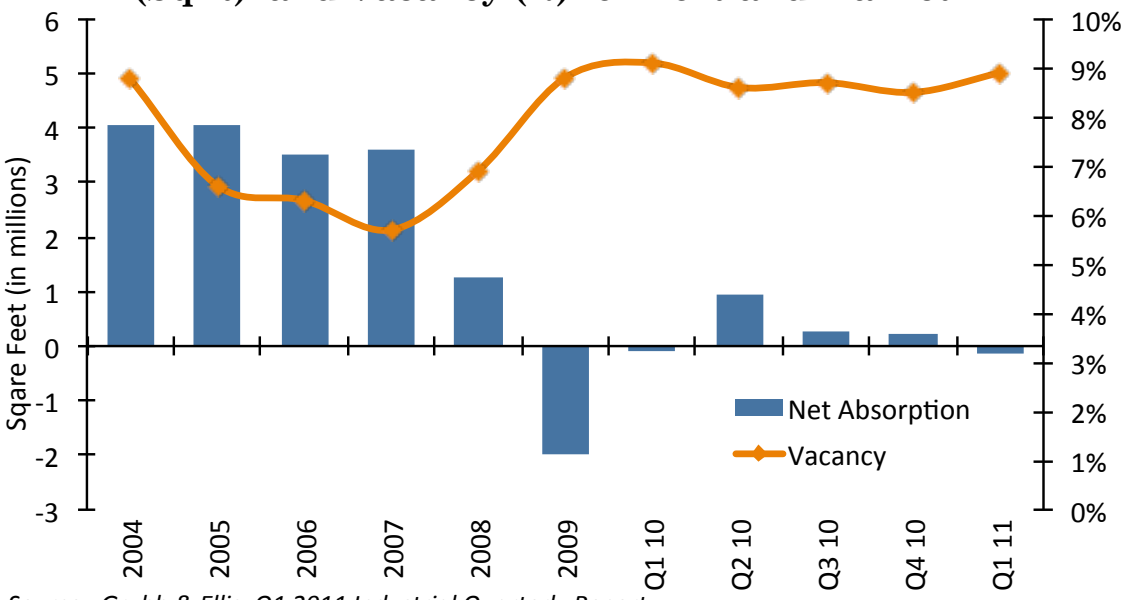
	CB Richard Ellis	Cushman & Wakefield	Grubb & Ellis	Norris, Beggs & Simpson	Kidder Matthews	Median
Market-wide Vacancy	8.1%	7.1%	8.9%	15.9%	8.4%	8.4%
Previous Quarter	8.1%	7.0%	8.5%	15.0%	8.5%	8.5%
First Quarter 2010	8.2%	-	9.1%	14.6%	8.4%	8.8%
First Quarter 2009	7.3%	7.6%	8.0%	13.0%	7.1%	7.6%
Warehouse/Distribution	-	-	10.5%	N/A	N/A	10.5%
Previous Quarter	-	-	8.2%	N/A	N/A	8.2%
First Quarter 2010	-	-	9.1%	N/A	N/A	9.1%
First Quarter 2009	8.0%	7.3%	8.2%	N/A	N/A	8.0%
R&D/Flex Vacancy	12.1%	-	10.7%	17.8%	N/A	12.1%
Previous Quarter	11.2%	-	9.8%	19.1%	N/A	11.2%
First Quarter 2010	-	-	9.2%	18.0%	N/A	13.6%
First Quarter 2009	10.1%	9.5%	7.2%	13.6%	N/A	9.8%
Asking Monthly Shell Rates	$0.38	N/A	$0.41	N/A	$0.44	$0.41
Previous Quarter	$0.38	N/A	$0.43	N/A	$0.44	$0.43
First Quarter 2010	-	N/A	$0.41	N/A	$0.45	$0.43
First Quarter 2009	$0.40	N/A	$0.42	N/A	$0.48	$0.42
Asking Monthly Flex Rates	$0.78	N/A	$0.69	N/A	N/A	$0.74
Previous Quarter	$0.88	N/A	$0.70	N/A	N/A	$0.79
First Quarter 2010	-	N/A	$0.74	N/A	N/A	$0.74
First Quarter 2009	$0.85-$1.05	N/A	$0.81	N/A	N/A	$0.81

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

Grubb & Ellis report a 40 basis point hike in the vacancy rate to 8.9 percent in the first quarter, approaching the 9.1 percent peak seen in Q4 2010. The average vacancy between the five brokerages considered in this analysis rose 30 basis points. Only Kidder Matthews reported a drop in vacancy, though small at 10 basis points to 8.4 percent, while CB Richard Ellis held their rate steady at 8.1 percent. Consistent with prior reports and reflecting the use of different source data, Norris, Beggs & Simpson reports vacancy rates in a much higher range from other brokerages with a 90 basis point rise in the first quarter to 15.9 percent, a number higher than any seen in the past 5 years of their industrial reports. They also report

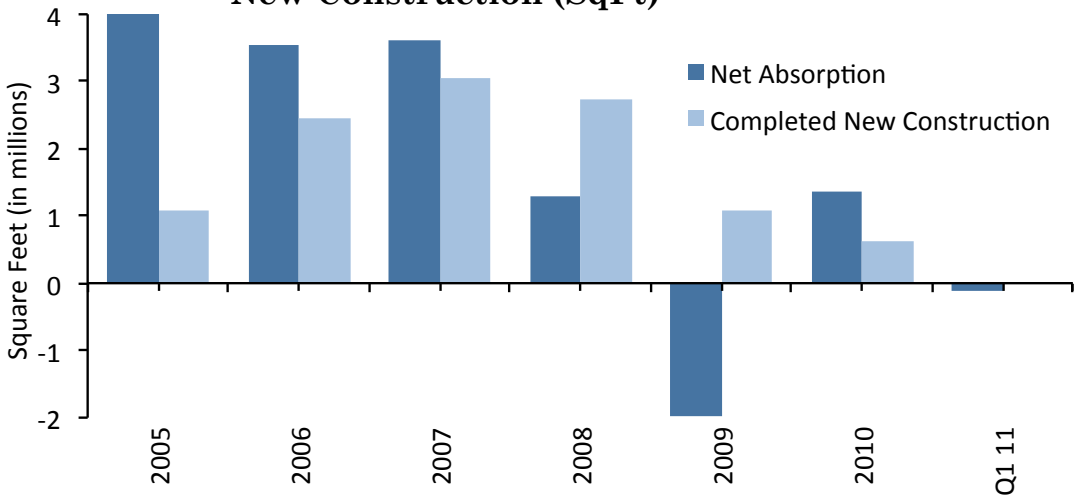
R&D/Flex vacancy rates dropping from 19.1 percent to 17.8 percent in the first quarter with positive 153,618 square feet of absorption, 101,182 square feet of which is within the Southwest Sunset submarket which dropped over 100 basis points in vacancy to 20.4 percent vacancy.

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



Source: Grubb & Ellis, Q1 2011 Industrial Quarterly Report

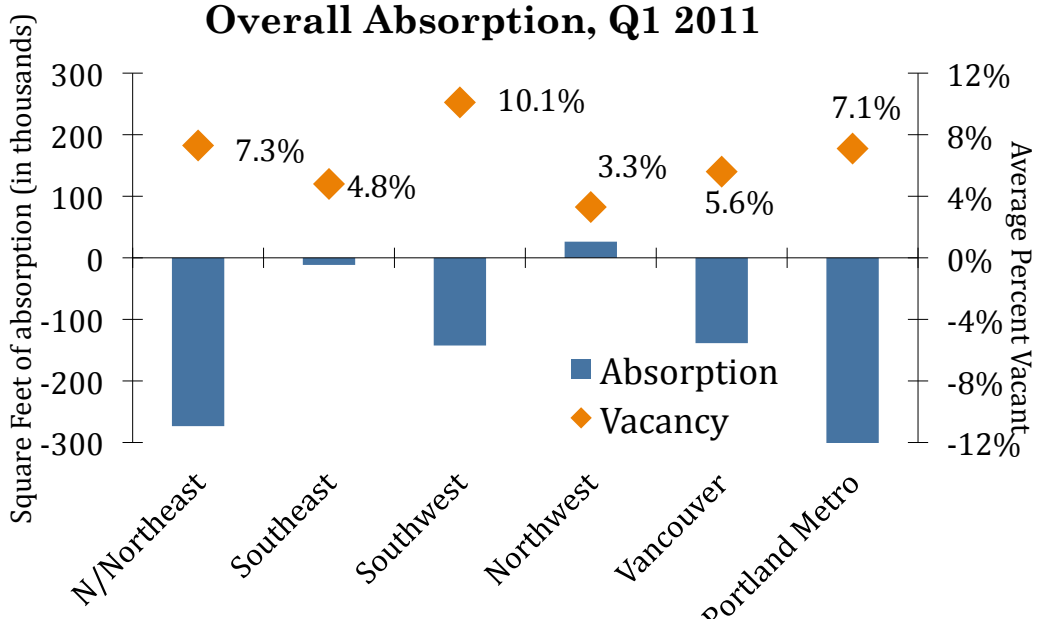
Figure 2: Industrial Absorption and New Construction (SqFt)



Source: Grubb & Ellis, Q1 2011 Industrial Quarterly Report

For all industrial categories, Southwest Sunset remains ahead in terms of vacancy at 6.4%, despite negative absorption over the last quarter. Notably, Norris, Beggs & Simpson vacancy rates for R&D/Flex had been steadily climbing since late 2008, when the category bottomed out at 13.2 percent vacancy, making a drop of this magnitude more significant. The Vancouver submarket reported a nearly 4 percent drop in R&D/Flex vacancy to a 15.6 percent, though the significance of this adjustment may be low given the small number of properties considered in their analysis.

Figure 3: Submarket Vacancy and Overall Absorption, Q1 2011



Source: Cushman and Wakefield, Q1 2011 Industrial Report

Grubb and Ellis report a large jump in vacancy for warehouse/ distribution at 230 basis points to 10.5 percent while Flex/R&D jumps 90 basis points to 10.7%. Swan Island and Close-In Southeast continue to post the lowest submarket vacancies at 5.8 and 6.4 percent respectively, though Swan Island experienced negative 88,718 square feet of absorption and a 360 basis point vacancy jump from the fourth quarter of 2010. The I-5 South Corridor and 217 Corridor in Beaverton had the highest vacancy rates at 12.4 and 12.3 percent respectively. Northwest Portland had the highest overall absorption value of all Grubb & Ellis submarkets, adding an impressive 264,643 square feet driving vacancy down 290 basis points to 6.8 percent.

Table 2: Major Industrial Lease Transactions, 1st Quarter, 2011

Tenant	Property	(SqFt)	Submarket
OIA Global Logistics (short-term)	Rivergate Logistics Center	113,989	Portland
RM Beverage Washington LLC	Columbia Business Center	58,178	Vancouver
RM (Maletis) Beverage	Columbia Business Center	58,172	Vancouver
Stag Parkway	Marine Drive Distribution Center	53,000	N/NE Portland
West Coast Event Productions	NW Naito Parkway	52,380	NW Portland
Power Freight Systems	PDX Corp Center	51,078	E Portland
Wilson Sporting Goods	NE Campus Drive	45,000	Hillsboro
CSI Geosynthetics	SE Columbia Way	43,286	Vancouver
Galaxy Wine Company	Guilds Lake	33,000	NW Portland

Source: Norris Beggs & Simpson, CB Richard Ellis, Kidder Matthews and Cushman & Wakefield Q1 2011