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CENTER FOR REAL ESTATE

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CENTER FOR REAL ESTATE Quarterly Report

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SUMMARY AND EDITORIAL

ERIC FRUITS

Editor and Oregon Association of Realtors Faculty Fellow
Portland State University

In this issue's feature article, Mackenzie planning associate **Suzannah Stanley** surveys and compares system development and review fees in the Portland and southwest Washington region. In many cases, these fees can make or break the financial case for pursuing a development project. Her article provides valuable tools for analyzing SDCs and review fees across the region.

Andrew Crampton's **state of the economy** report finds market fundamentals remain strong with a regional economy at near full employment. With already robust employment, however, opportunities for further job growth are shrinking. This slowdown in growth may work its way into a growth slowdown in several real estate sectors, such as residential and office markets.

In **residential markets**, Jon Legarza sees slowing growth in many parts of the state, with lower transaction volumes, an increase in days-on-market, and modest upticks in sales prices.

Portland's **multifamily** market may be seeing the crescendo of a six year construction and rent growth boom for the Portland metropolitan area, according to Carlo

■ **Eric Fruits, Ph.D.** is editor of the Center for Real Estate *Quarterly Report* and the Oregon Association of Realtors Faculty Fellow at Portland State University. He is president and chief economist at Economics International Corp., a Portland-based consulting firm. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

Castoro. New deliveries and vacancies are up while rent growth is down—and even reversing in some parts of the central city core. At the same time several submarkets, such as east Gresham and Milwaukie are still experiences robust rent growth. The biggest question regarding the multifamily market involves Portland's new inclusionary zoning regulations, which many expect will depress developer interest in new construction. This quarter's issue interviews several major policy makers and developers to get candid assessment of the city's new regulations.

Melissa Beh's review of the **office** market finds robust demand for Class A space in the central city—forcing many potential tenants to look toward the suburbs or to occupy Class B or Class C space. While the financial troubles of brick-and-mortar retailers are making national headlines, Andrew Crampton reports overall investor confidence in Portland's **industrial** market, fueled primarily by on-line retailers demand for distribution space.

I hope you enjoy this latest issue of the Center for Real Estate *Quarterly Report* and find it useful. The *Report* is grateful to the Oregon Association of Realtors, RMLS, and Society of Industrial and Office Realtors for their continued support. ■

IMPACTS OF SYSTEMS DEVELOPMENT CHARGES AND REVIEW FEES IN PORTLAND AND SOUTHWEST WASHINGTON

SUZANNAH STANLEY

Mackenzie

Regional and local policies shape land use and development in a variety of ways. The fees implemented by jurisdictions for new development are based on a variety of factors and can vary widely depending on the project and jurisdiction. Because of this, fees for development review and infrastructure funding may be difficult to predict at a project's outset. A comparison, across jurisdictions of how development is evaluated and how fees are implemented can help developers determine project costs, and help inform the public sector on policies for fees and strategies for funding reviews and infrastructure.

Development decisions are influenced by the business economics and the need for profitability as well as broader project goals, community vision, and needs of the end users. There are many factors that impact project profitability, and still more that influence decision-making. Because the fundamental business decisions that drive privately funded development rely on profitability, it is important to understand the relationship between the cost of development and financial returns. To assist both private development companies and public sector planners, Mackenzie routinely evaluates one of these costs of development. Focusing on the project costs associated with permitting, development reviews, and systems development charges (SDCs) allows us to compare and track the fees throughout the communities we most frequently work in. Our fee comparison, and the methodologies discussed in this arti-

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cle, focus on several communities in Washington and Oregon. These comparisons provide insight into the approach and costs that communities use to help cover the costs of growth and development.

WHAT ARE PERMIT FEES AND SDCS?

Local jurisdictions charge three general categories of fees on development applications. First, there are fees charged for review services provided by the jurisdiction, such as building permit fees, mechanical or electrical permit fees, and design review/land use fees. Building permit fees are generally based on the construction cost of the new building or tenant improvement and, in most cities and counties in Oregon and Southwest Washington, do not vary significantly between jurisdictions since the cost of providing these services does not vary broadly. Land use review fees vary by type (design review, environmental review, site plan/site development review, etc.), and may be flat fees or based on site area, building area, or construction cost. These types of fees are established to help cover the city or county for staff time needed to review the development applications and verify a project's conformance with applicable codes. Most jurisdictions do not fully recover the cost of reviews, because doing so would put a significant burden on applicants.

The second general category of fees are systems development charges (SDCs) or impact fees. These fees are not meant to offset service or review time by jurisdiction staff; instead they are established to mitigate impacts of the proposed development to public systems that come from new development. Possible impacts include the effects of employees, trips, the creation of impervious area, stormwater infrastructure, roads, and in some cases emergency services and parks. These one-time fees provide a dedicated stream of revenue to fund capacity improvements to accommodate increased system demand from new development. Most of the time, SDCs help fund specific types of projects, or are spent within a designated area. They are generally based on building or site size, employees, water meter size, or other measurable factors, usually with varying rates charged by the proposed building use (office, retail, warehouse, etc.) based on the impact of the development on system needs. Credits or discounts are typically available for redevelopment projects where a building is demolished or reused, as the net impact of the new development will be less since it replaces a previous user.

SDC rates can vary within jurisdictions for special plan areas where infrastructure costs are higher or lower; for example, areas newly added into urban growth boundaries may have additional sewer or road SDCs to help the city more quickly recover the cost of extending service. Additionally, they often vary widely by jurisdiction. For example, for fiscal year 2016-2017, transportation SDCs for a 200,000 SF speculative warehouse building were $169,377 in Gresham, but in cities in Washington County they were nearly five times that, $829,400.

Jurisdictions may set their own SDC rates, but the revenue from SDCs must be spent in accordance with state law, which generally requires that the rate must be calculated to mitigate for an impact of development. SDCs are generally broken up into two categories:

1. **Reimbursement** fees, which may only be spent on capital improvements *associated with* the systems for which the fees are assessed,

2. **Improvement** fees, which may only be spent on capital improvements that *mitigate* a development's impact on capacity.

    a. The portion of the improvements funded by improvement fees must be related to the need for **increased** capacity to provide service for future users.

b. Capital improvements funded by SDCs must be included in a capital improvement plan adopted by the jurisdiction. (SDCs are only one of the revenue sources used by local governments to fund infrastructure improvements, and most jurisdictions do not use development to recover the full costs of infrastructure improvements; they also use other revenue sources like grant funds, state and federal funding sources, and local contributions.)

SDC credits can also be offered to foster development. For example, Lake Oswego has used urban renewal funds to pay SDC credits to encourage development on specific projects or in desired areas.

Finally, while less common, a third category of development fee is special taxes and cost recovery techniques. Some jurisdictions establish special fees, sometimes temporary, like arts taxes, emergency services impact fees, and technology fees to cover one-time costs. Most notable across the Portland area is the recent Affordable Housing Construction Excise Tax, established in 2016 by the Portland Housing Bureau to fund affordable housing development and programs. These fees can be very small (such as Gresham's technology fee charged at 3 percent of the building permit fees) or very large, like the Portland affordable housing tax at 1 percent of the project cost (for example, this tax would be $100,000 for a $10 million building in Portland). Taxes and special fees also may be charged state- or region-wide, like the Metro Construction Excise Tax which funds concept planning in new areas brought into the Urban Growth Boundary.

WHY ARE DEVELOPMENT FEES IMPORTANT?

In addition to the cost of land and construction of a new building or expansion, the cost of development includes property taxes, consultant fees, permit fees and SDCs, and more. Developers may also have to fund road improvements, build/extend regional trails, cover traffic signal improvements, and shoulder other related costs. Permit review fees are generally only a small portion of the overall cost of development, and often affect small business growth and startup more than they affect large development. SDCs, however, vary widely and may be a significant component of the project cost and thus affect business recruitment. SDCs generally make up the largest portion of fees paid to jurisdictions for development, and consequently tend to have a larger impact on steering development than permit review fees. On a large scale, higher SDCs may discourage development in some jurisdictions over others.

REGION

- Availability of construction services
- Existing regional infrastructure and capacity (*water, wastewater, electricity, transportation, etc.*)
- Proximity to clients/ customers
- Proximity to competitors
- Industry clusters
- Availability of materials and support services for business
- Proximity to airport and required service level
- Regional quality of life
- Local and regional population and labor force/demographics
- Business climate (*receptiveness to new economic development, labor laws*)
- Likely availability of suitable sites and/or buildings
- Business costs (*e.g., federal, state, and local taxes such as income, franchise, business activity and sales taxes*)

COST

- Land cost
- State and local incentives (*property tax abatements, labor training funding, local and state fee waivers, etc.*)
- Cost of living (*affects wage expectations*)
- Cost of construction
- Legal, financial, and marketing costs
- Continuing costs (*state and local taxes, wages, payroll taxes, utilities, etc.*)
- **Permit fees, SDCs, and development taxes**
- Infrastructure improvement costs

SITE

- Availability of development fee credits or discounts for previous development
- Area requirements to accommodate initial project and potential future growth
- Existing infrastructure
- Utility availability (*water, sewer, gas, electricity*), current and potential future
- Land use and permitting timelines in jurisdiction

PEOPLE

- Training availability (*college and technical school proximity, regional/ industry clusters, local training programs, etc.*)
- Workforce availability
- Technical skilled labor required and available

MACKENZIE'S PERMIT FEE AND SDC COMPARISONS

Each jurisdiction has a slightly different approach for fee and SDC calculation and assessment based on community goals, needs, and values. Some jurisdictions may choose to place more of the cost for development on an applicant, while other jurisdictions may subsidize the cost from other revenues. Subsidizing cost of development review or SDCs can be done to encourage development and may vary by the type or scale of development. Because fees and SDCs vary so widely by jurisdiction, and change over the years, for the past 10 years Mackenzie has prepared comparisons of fees for prototypical users if permitted in multiple cities and counties. The list of fees charged to a project is long and complex, and a comprehensive total of fees often cannot be calculated quickly and easily. While there are many factors that influence fees (site conditions, available SDC credits, even stormwater treatment methods), it is possible to compare fees for hypothetical, simple scenario, "apples to apples" projects in multiple jurisdictions.

Mackenzie prepares and annually updates permit fee and SDC estimates for prototypical retail, office, and warehouse buildings for seven jurisdictions in each of the Portland; Seattle; and Vancouver, Washington metro areas, as well as a combined estimate for a multi-family residential project in select cities. Each year we select jurisdictions in each of the market areas based primarily on recent client activity. We work with our in-house architects and civil engineers to develop generalized characteristics for the prototypical industry profiles used in our fee comparison. Other assumptions about the development impacts, such as vehicle trips (for transportation impact fees), employees, and equivalent dwelling units (for sewer and/or water SDCs) are generally calculated using formulas set by the jurisdiction and are also included in our estimates as the basis for calculating respective SDCs.

These estimates are available on our website on our Resources page (www.mcknze.com/resources) in summary form. Detailed footnotes for each assumption and fee, by jurisdiction, are available to clients/colleagues who reach out to us directly.

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DESIGN DRIVEN | CLIENT FOCUSED

Prepared for FY 2016-2017

Multi-Jurisdiction Permit Fee and SDC Comparison

Portland Metro
WAREHOUSE

Mackenzie prepares and annually updates permit fee and SDC estimates for hypothetical retail, office, and warehouse buildings for seven jurisdictions in each of the Portland; Seattle; and Vancouver, Washington metro areas as well as a combined estimate for a multi-family residential project in select cities. Find the most recent estimates on our website at http://mcknze.com/resources.

		CLACKAMAS CO	GRESHAM	HILLSBORO	PORTLAND	TUALATIN	WILSONVILLE	WOODBURN	
ASSUMPTIONS									**note**
A	Building Floor Area (SF):	200,000	200,000	200,000	200,000	200,000	200,000	200,000	A
B	Total Site Area (SF):	522,720	522,720	522,720	522,720	522,720	522,720	522,720	B
B	Impervious Site Area (SF):	444,312	444,312	444,312	444,312	444,312	444,312	444,312	B
C	Building Valuation (ICC):	$11,646,400	$11,646,400	$11,646,400	$11,646,400	$11,646,400	$11,646,400	$11,646,400	C
D	Equivalent Dwelling Units (EDUs):	53	2.0	2.0	2.0	2.0	2.0	N/A	D
E	Employees:	61	61	60	N/A	N/A	N/A	61	E
F	Trips- ADT 3.56/1,000 SF (ITE 150):	712	712	712	712	712	712	712	F
F	Trips- PM Peak 0.3/1,000 SF (ITE 150):	60	60	60	60	60	60	60	F
G	Water Meter Size:	1.5"	1.5"	1.5"	1.5"	1.5"	1.5"	1.5"	G
LAND USE REVIEW									
	DEVELOPMENT / DESIGN REVIEW								
H	Pre-Application Conference:	$400	$1,509	$0	$2,074	$220	$760	$508	H
H	Land Use Review Fee:	$36,835	$44,998	$5,775	$0	$2,590	$14,541	$14,397	H
SYSTEM DEVELOPMENT CHARGES									
I	Transportation SDC:	$391,200	$169,377	N/A	$236,000	N/A	$492,400	$328,800	I
I	Other:	N/A	N/A	$829,400	N/A	$829,400	N/A	$104,200	I
J	Stormwater SDC:	$36,434	$146,445	N/A	$89,751	N/A	$253,258	$48,874	J
J	Water Quality:	N/A	N/A	$37,868	N/A	$37,868	N/A	N/A	J
J	Water Quantity:	N/A	N/A	$46,283	N/A	$46,283	N/A	N/A	J
K	Sanitary Sewer SDC:	$375,789	$44,990	$10,600	$11,424	$11,099	$26,494	$72,340	K
L	Water SDC:	$15,777	$36,948	$39,605	$11,998	$19,215	$20,083	$33,362	L
L	Other:	$5,000	N/A	N/A	$10,740	N/A	N/A	$1,134	L
M	Parks SDC:	$3,647	$2,614	$52,860	$40,000	$0	$81,000	$1,884	M
BUILDING PERMIT FEES									
	BUILDING PERMIT								
N	Building Permit Fee:	$43,946	$46,725	$37,463	$43,692	$35,226	$49,720	$64,390	N
N	Building Plan Review:	$28,565	$30,371	$24,351	$28,400	$22,897	$32,318	$64,390	N
N	Fire/Life Safety Plan Review:	$15,381	$18,690	$14,985	$17,477	$15,852	$19,888	$41,854	N
N	Fire Plan Review:	N/A	N/A	N/A	$6,991	N/A	N/A	N/A	N
N	State Surcharge:	$5,274	$5,607	$4,496	$5,243	$4,374	$5,966	$7,727	N
O	Inclusionary Housing Construction Excise Tax:	N/A	N/A	N/A	$116,464	N/A	N/A	N/A	
P	Metro Construction Excise Tax:	$12,000	$12,000	$12,000	$12,000	$12,000	$12,000	N/A	O
Q	School Construction Excise Tax:	$28,400	$25,000	$25,000	$29,900	$28,400	$30,700	$30,700	P
	ENGINEERING PLAN REVIEW								
R	Engineering Plan Review:	$1,060	N/A	N/A	N/A	$321	N/A	$17,470	Q
S	EC/Grading Review or Permit Fee:	$1,400	$2,534	N/A	$1,848	$1,221	$1,500	N/A	R
T	LUCS Approval:	N/A	$90	N/A	$250	N/A	N/A	N/A	S
T	NPDES 1200-C Permit:	$1,932	$1,932	$1,932	$1,932	$1,932	$1,932	$1,932	S
U	Additional Permit Fees:	N/A	$1,775	N/A	$56,426	N/A	$885	N/A	T
TOTAL COST:		**$1,003,040**	**$591,605**	**$1,142,617**	**$722,609**	**$1,068,897**	**$1,043,446**	**$833,962**	
	COST PER SF:	$5.02	$2.96	$5.71	$3.61	$5.34	$5.22	$4.17	
	CHANGE FROM FY 15-16:	0.9%	0.0%	1.8%	20.6%	1.9%	2.1%	0.3%	
		CLACKAMAS CO	GRESHAM	HILLSBORO	PORTLAND	TUALATIN	WILSONVILLE	WOODBURN	

These estimates are based on the above assumptions, current jurisdictional fees, and Mackenzie's experience preparing project-specific estimates for our clients. Footnotes and details on assumptions used to generate these fees are available on request. For further information and/or methodology, contact Suzannah Stanley (sstanley@mcknze.com) or Gabriela Frask (gfrask@mcknze.com). Actual fees may vary at the time of permit application or issuance and these estimates are not meant to replace due diligence.

M.

The example developments included in the most recent multi-jurisdiction fee comparison are:

- A 15,000 SF multi-tenant retail building on a 75,000 SF site (20 percent building coverage, 15 percent landscaping). For the purposes of the estimate, three tenants were assumed, each with the minimum required plumbing fixtures per the 2014 Oregon Structural Specialty Code (OSSC). Mackenzie's estimate assumed this project would require a land use review in all jurisdictions; this is common, though in Portland land use review is generally only required within the Design overlay, which was assumed for this building. Staff-level Design Review (no public hearing) was assumed in Portland (i.e., likely not a downtown or design district site).

- An 80,000 SF 4-story office building on a 4-acre site, in more of a campus setting, with 20 percent landscaping. Plumbing fixture counts for this building type were also calculated per the OSSC. This building type was also assumed to require staff-level Design Review in Portland.

- A 200,000 SF warehouse building, shell-only with no tenants identified, on a 12-acre site with 15 percent landscaping. This building would have no fixtures at this phase; jurisdictions vary in how they calculate fees for this kind of project. Since no tenants or specific uses are identified, generally jurisdictions charge traffic and parks SDCs at the shell stage based on the least intensive likely use classification (generally warehouse). If tenants are proposed in higher categories like light industrial, additional SDCs are charged with the tenant improvement permits (not included in Mackenzie's estimate).

- An urban 5-story apartment building, with 125 units in a 100,000 SF building on a 20,000 SF site. Vehicle trips and equivalent dwelling units for this building type are generally simple to calculate, with most jurisdictions using a formula comparing the apartments to single-family homes. Since this site is assumed to be in a downtown location, a public hearing Design Review was assumed for Portland.

Generally, jurisdictions calculate building construction costs using the International Code Council's building valuation data (BVD), which are updated twice per year. (The BVD table offers averages of construction costs per square foot by building construction type and occupancy group, developed to aid jurisdictions in determining permit fees. The construction cost (per square foot) table reflects the relative value of one construction classification and occupancy group to another, so more expensive construction is assessed with greater permit fees than less expensive construction.

The data only represent average costs and are not representative of specific construction, but are useful for calculating permit fees.

Since some fees are also based on site development cost or grading, we have assumed generally flat sites for these examples. For impact fees that vary by subdistrict or neighborhood, either an average rate or a rate based on likely location (such as for the multi-family residential project, where a downtown location is assumed) was used.

OBSERVATIONS

Each year's comparison provides interesting insight into a jurisdiction's competitiveness for permit and SDC costs. Our estimates show the cost per square foot of building area as well as the change from the previous year's estimate.

However, a detailed analysis provides even more insight into regional trends affecting development costs. Mackenzie's 2016-2017 permit fee comparison found the following:

Portland Metro

- City of Portland fees increased an average of 20 percent in industrial, retail, and office uses since our 2015-2016 report, mostly as a result of the Inclusionary Housing Construction Excise Tax and an increase in Parks SDCs. However, it was still one of the lowest in total costs among the selected jurisdictions. (While our fee comparison does not address timelines, note that process and review times for land use and building permits also affect development feasibility across cities, and recent increases in development in City of Portland have caused their review timelines to be slower than in some other cities.)

- The City of Gresham had the lowest increase in permit fees from 2015, 0.03-0.1 percent across the three commercial uses, and the lowest total fees for office and warehouse uses. Our experience is that Gresham also has the shortest land use (i.e., development review) timeline for industrial development. (This may help make up for their development review fee, which is significantly higher than that of most jurisdictions.)

- Wilsonville had the highest fees for retail and office uses (about 4 times more than some jurisdictions). This was primarily a result of high transportation SDCs (more than 8 times higher than Portland for retail).

- Hillsboro was one of the least expensive for retail, but one of the highest for warehouse and office uses (due to a higher parks SDC and the Washington County Transportation Development Tax).

Southwest Washington

- For jurisdictions that we also reviewed last year, most permit fees decreased (unlike all Portland metro area jurisdictions).
- The City of Vancouver had the lowest fees for all uses in not only the Vancouver Metro comparison, but also the Portland Metro area.
- Clark County previously offered a fee waiver program to projects creating jobs; this offered a waiver from traffic impact fees and many permit and development review fees when the applicant could demonstrate job creation. This program was instituted during the recession when unemployment was at a peak, and was discontinued on January 3, 2017. Our comparisons assume a permit submitted after this date and thus the fee waiver is not included in our current fee comparisons.

Seattle Area

We also have similar permit fee comparisons on our website for the Seattle Metro area (updated in the beginning of each year, and available on our website on the Resources page). Of note, Redmond and Issaquah rival Wilsonville in the Portland metro area for the highest fees for retail and office uses. For warehouse fees, Seattle metro fees are generally less costly than those in the Portland area, but costlier than those in the Vancouver area. Because Seattle (city limits) is almost entirely built out and infrastructure extensions are not generally needed, Seattle does not charge SDCs.

Multi-Family Residential

We also recently began preparing a comparison of permit fees and SDCs for a multi-family residential project in three cities in the Portland and Seattle areas and City of Vancouver; this found that these fees were highest in Beaverton (1.5-23 times higher than in other compared cities), with City of Portland being the second highest. Beaverton and Portland had significantly higher parks and sanitary sewer SDCs than other jurisdictions.

Portland also has a new affordable housing construction tax charged on most building permits, in effect February 1, 2017. Part of Portland's inclusionary zoning project that authorized this tax was a requirement for all residential development projects with 20 or more units to make a portion of the units affordable *or* provide or fund affordable housing elsewhere. Mackenzie's estimate assumes a project using Option 1 of the available inclusionary housing provision options, which requires that 20 percent of units be affordable at 80 percent of area median income (AMI). While not reflected in this estimate, SDC discount incentives are available for projects providing housing affordable at 60 percent of AMI.

HOW ARE THE COMPARISONS USED?

Because the fee structure impacts the total cost of development, it is important to recognize the different approaches and costs within jurisdictions. Because these costs are a decision-making factor in the expansion and development of small and large businesses, communities and developers both benefit from a multi-jurisdiction comparison. Using the reports compiled by Mackenzie, a jurisdiction can assess if the overall permit or SDC costs are in alignment with community goals for specific development types, or if adjustments are necessary. A business or developer can also use this comparison to evaluate the costs of development in each jurisdiction, particularly when in the beginning stages of due diligence and proforma analysis. As our comparisons contain detailed breakdowns of fees, jurisdictions, applicants, owners, and developers can all use the data to assess how each element of a permit cost varies.

For projects similar to our prototypes, our developer clients have found that our reports are scalable for a rough estimate of total permit costs based on square footages. The cost per square foot for permit fees and SDCs identified in the estimate can be used in development proformas based on estimated building area. We have also received questions from clients and jurisdictions when they notice high or questionable fees on their projects during the development process. For larger users looking to expand in the area, these—and customized project type comparisons—are helpful in their exploratory or due diligence phase.

Our public-sector colleagues are also interested in the comparisons, with staff from building, planning, and economic development departments reviewing and discussing our findings with us. We also prepare custom fee comparisons that include more jurisdictions and product types, like estimates for sit-down and fast food restaurant building types in multiple subareas of a service district's jurisdiction. We have done this several times for public agencies so they can strategically market to specific users, or understand their jurisdiction's relative competitiveness.

CONCLUSION

The costs of development review and infrastructure funding varies by jurisdiction. Understanding how development is evaluated, and how fees are assessed and implemented, is important in articulating differences between jurisdictions, and identifying the associated project costs.

System development charges are one of the most significant costs to new development in our region. New developments impact existing infrastructure, and SDCs are an essential funding mechanism to maintaining and providing new city services. We hope that promoting a better understanding of SDC methods and outcomes will aid in the strategic consideration of project costs, and help inform policies on fees, and strategies for funding reviews and infrastructure. ■

THE STATE OF THE ECONOMY

ANDREW CRAMPTON

Portland State University

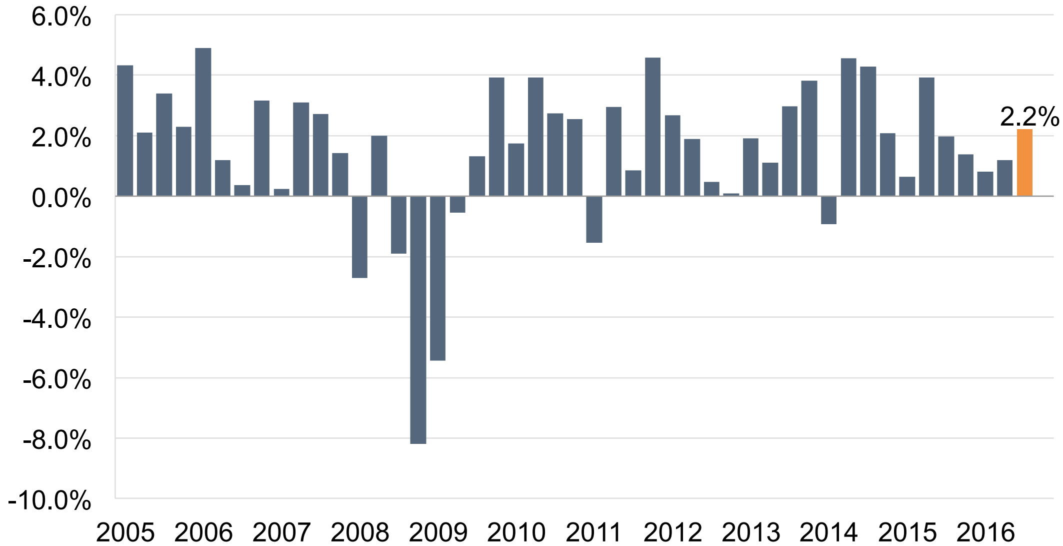
Although market fundamentals remain strong with record unemployment and continued economic growth, signs point to a softening market due to an economy nearing full employment.

The current business cycle, at 92 months, is one of the longest in US history, far longer than the 58 month average upturn since World War II. The current cycle is reaching the maturing phase, with real GDP growth settling at about two percent per year, and employment growth currently at approximately 2.5 million annually. In comparison with the hot economy before the financial recession, conservative financial lending standards and the limited construction labor supply will limit oversupply and market risk.

Global economic activity has increased due to long awaited cyclical recovery in investment, manufacturing and trade after a somewhat disappointing 2016. The IMF World Economic Outlook projects global growth to rise from 3.1 percent in 2016 to 3.5 percent in 2017 and 3.6 percent in 2018.

■ Andrew Crampton is a Master of Real Estate Development candidate and has been awarded the Center for Real Estate Fellowship. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

Figure 1: Gross Domestic Product, United States, Annualized Percent Change, 2005–2017 Q1



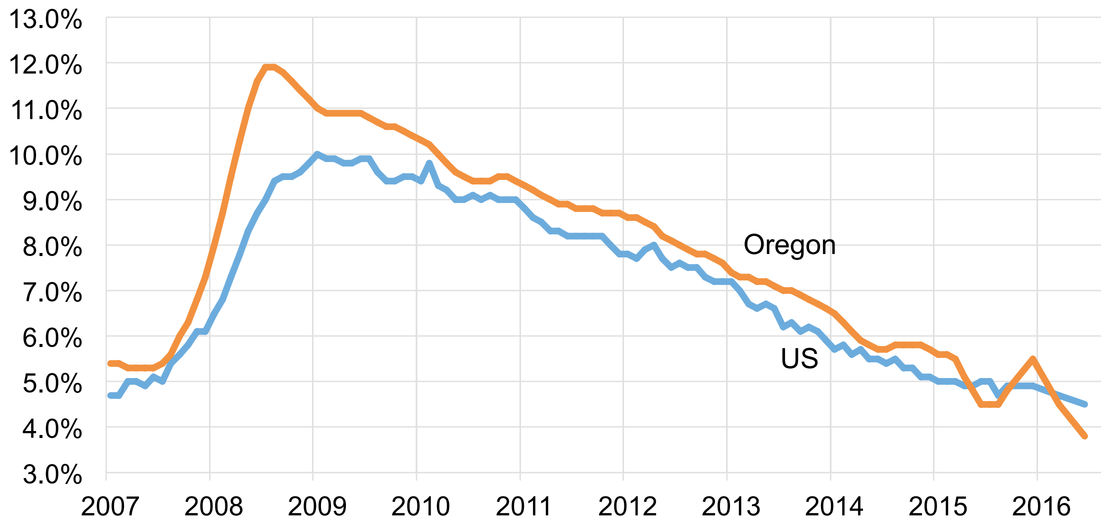
Source: Bureau of Economic Analysis (blue bars) and Wall Street Journal Economic Forecasting Survey (orange bars)

EMPLOYMENT

Oregon's unemployment rate decreased to 3.8 percent at the end of March, the lowest unemployment rate on record since tracking began in 1976, according to the State of Oregon Employment Department. Over the past 12 months, payroll employment added 39,500 jobs, totaling 2.2 percent with a four year growth rate of 3 percent. The current pace of the Oregon economy adding 3,000 jobs per month is relatively reflective of population growth, in comparison to the rapid 5,000 per month employment gains during the peak cycle of a few years ago. The Portland metro region's unemployment rate has held steady at 3.5 percent at the end of March.

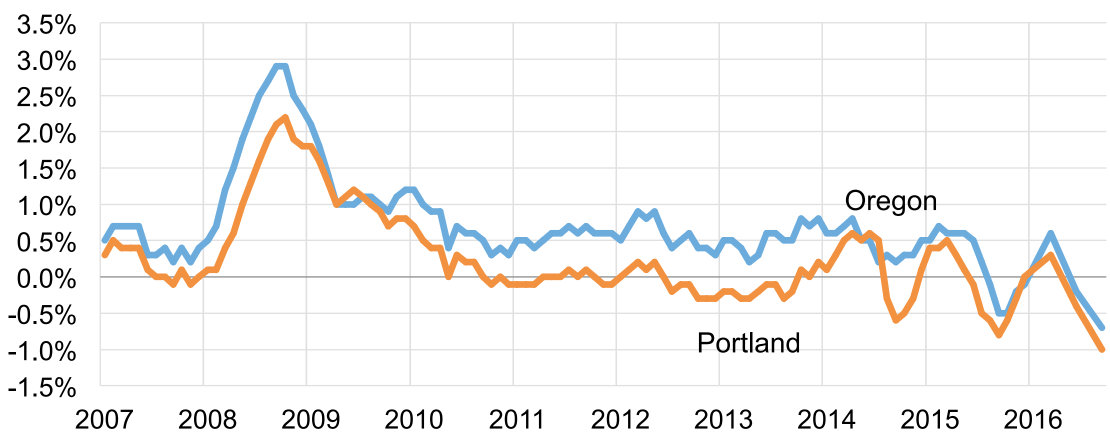
Although the Oregon and overall Portland metro economy had a robust start to 2017, overall gains have not been evenly distributed across the region, with a widening income gap, with average east Portland incomes at $55,425 while the overall city average steadily climbing to $87,778, according to the Oregon Employment Department.

Figure 2A: Unemployment Rate, Portland MSA, Oregon and United States, 2007-2017



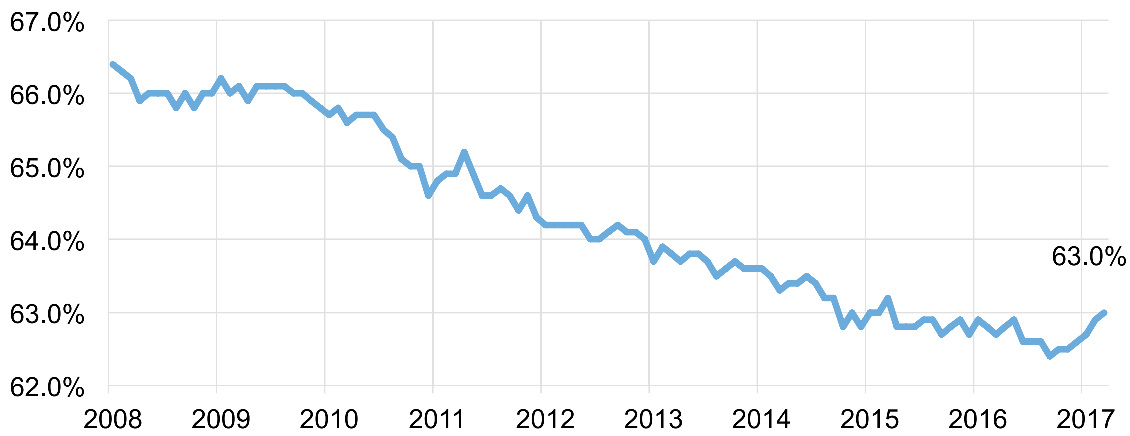
Source: U.S. Bureau of Labor Statistics

Figure 2B: Unemployment Rate, Portland MSA, Oregon and United States, 2007-2017



Source: U.S. Bureau of Labor Statistics

Figure 3: Labor Force Participation Rate, United States, 2008-2017



Source: U.S. Bureau of Labor Statistics

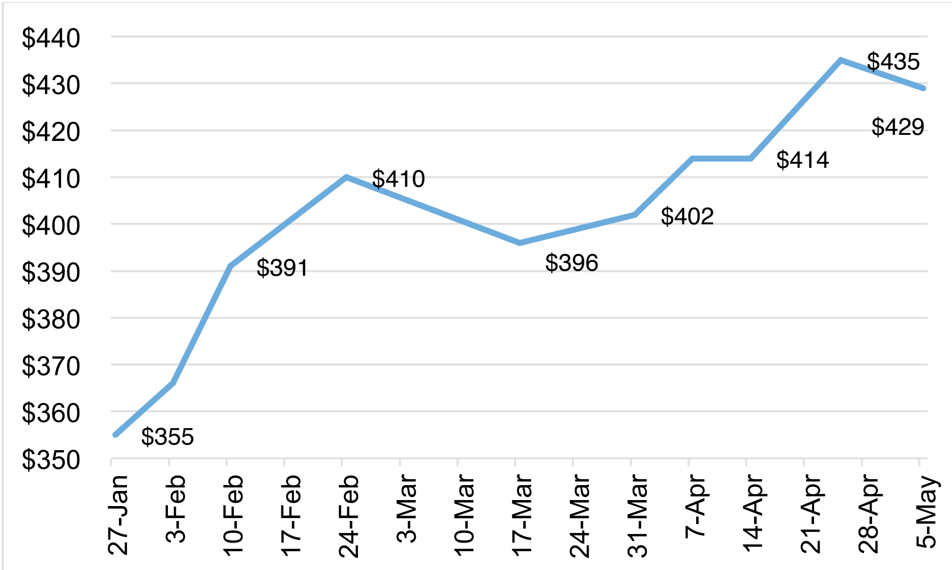
INFLATION

The Consumer Price Index for All Urban Consumers (CPI-U) decreased 0.3 percent in March on a seasonally adjusted basis, according to the U.S. Bureau of Labor Statistics, which was the first monthly decline during the last 12 months. Over the last 12 months, the all items index rose 2.4 percent before seasonal adjustment.

CONSTRUCTION CONSTRAINTS

In addition to perpetual construction labor shortages, construction costs from increasingly expensive raw materials will continue to place a ceiling on real estate growth. The expiration of US-Canada lumber trade agreements and hostile Trump Administration rhetoric to canadian lumber imports has caused dramatic increased in lumber prices.

Figure 7: Composite Framing Lumber Prices (NAHB)



Source: National Association of Homebuilders

LOOKING AHEAD

The retail market is the weakest performing property type, and investor concerns regarding the viability of this property type will increase in 2017. The growing on-line presence presents competition both for retail sales, and real estate deliveries. Industrial is now the preferred property type for 38 percent of American Investor Survey respondents, according to CBRE and retail has tumbled from 17 percent of respondents favoring this property in the 2016 CBRE survey, to 8 percent in 2017. ■

RESIDENTIAL MARKET ANALYSIS

Jon Legarza

RMLS Student Fellow
Master of Real Estate Development Candidate

Many of the single family housing trends in the first quarter of 2017 slipped following a continuation of steadily increasing quarterly trends over the last year. The winter home buying season is characterized by lower transaction volumes, modest upticks in sales prices and an increase in average days on market within the majority of the markets analyzed here.

In many of the markets analyzed, the transaction volume declined compared to last quarter, while the year-to-year transactions generally decreased also, indications from the harsh winter season. The number of real estate transactions in Portland decreased for both existing and new homes both from last quarter to this quarter and in the first quarter of 2017 when compared to the same quarter last year. While it is difficult to determine the reason for the decreasing trend, it is interesting to note that Portland's median home sale price increased last quarter from $343,450 to $349,900. Redmond, Bend and most counties in the Willamette Valley experienced a slight uptick in sales price. Eugene declined with regards to transaction volume and Salem and Marion County continued to decline following a last quarter decline. Sales volume is still above the boom years of the mid 2000s but permits continue to lag behind the mid-2000s.

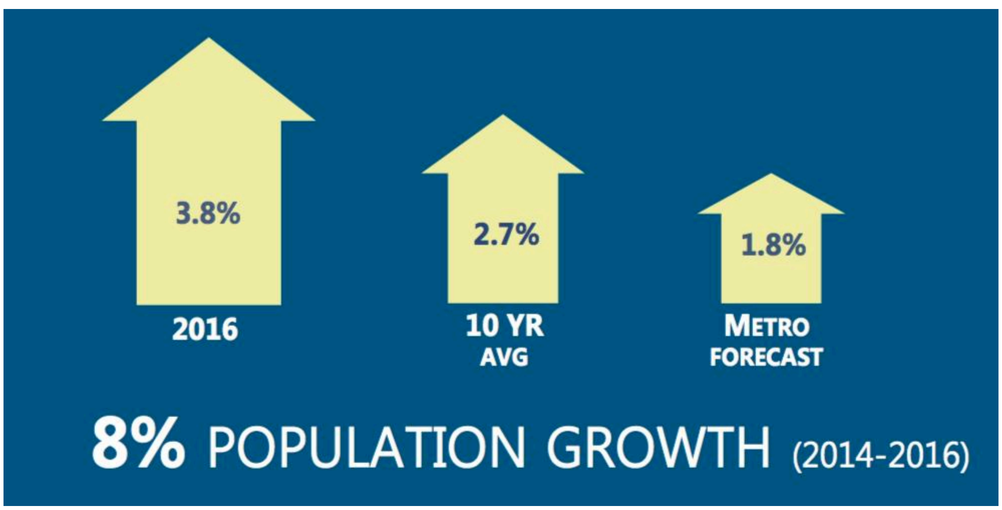
Permits for new single family homes were down approximately 2 percent statewide, continuing some of the trends from last quarter, with wide variation across the state. Portland's permit activity heavily influences the state figures. Portland's permitting of single family increased close to 20 percent or more compared to last quarter, while Eugene saw a 16.5 percent decline and Medford experience an

■ Jon Legarza is a current Master of Real Estate Development candidate through a joint program of Portland State University's School of Business Administration and School of Urban Studies and Planning. He is the 2016 RMLS Student Fellow at PSU's Center for Real Estate. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

approximately 31 percent decrease compared to last quarter. When compared to the same quarter last year, permit activity is down approximately 22 percent statewide. Leading the pack were Bend with a 17.4 percent decrease compared to the same quarter last year.

Attom Data Solutions, February 2017, published an article by John Burns, that provides great insight to demographic shifts over next 10 years. An important point he provides in the article is that 38 percent more people over the age of 65, baby boomers, are likely to keep working and using their cars. They will desire to be near their kids but look to suburban housing environments. Baby boomers are continuing to accumulate more student loan debt to help their children and grandchildren pay for college. Thus, allowing the opportunity for these younger generations to save money for a home.

The lack of land supply for new housing within the urban growth boundary continues to hurt the affordability in the Portland Metro market as seen in the existing home sale prices. As families wait for new affordable housing to be developed, suburban cities are starting to provide annual housing reports to show that Metro's growth calculations are in line with actual growth rates. An example is the City of Wilsonville's annual housing report, shown in the figure below.



In an interview with the City of Wilsonville, Planning Director, Chris Neamtzu, he indicated that the City of Wilsonville has worked to develop conceptual plans in anticipation of getting urban reserves annexed into their City. The City of Wilsonville now has more commuters traveling into the City to work in lieu of traveling to Portland. The importance of obtaining approval for the Frog Pond urban reserve for buildable land supply is vital for their community.

LOCAL PERMITTING

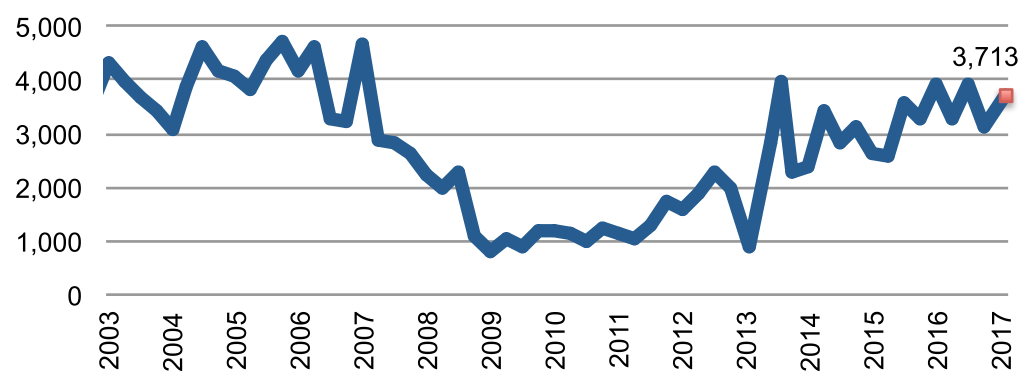
In the first quarter of 2017, there were 4,024 building permits for new private housing units issued in total across the state of Oregon. This is approximately

2 percent less permits than were issued in the prior quarter and nearly 22 percent less than were issued in the first quarter of 2016.

Building permits for new private housing
Oregon, statewide, seasonally adjusted

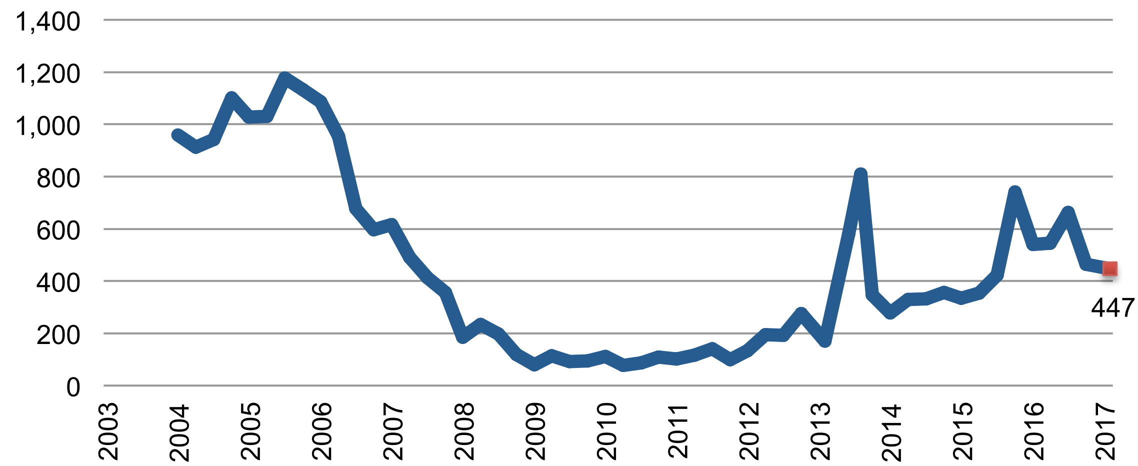
There were 3,713 permits for new private housing units issued in the Portland-Vancouver-Hillsboro metropolitan statistical area in the first quarter of 2017. This represents a 18.6 percent increase in permits compared to the fourth quarter of 2016, and a 4.9 percent decrease in year-over-year permitting. This increase could be attributed to permitting in the outer regions were land is available. The Portland market accounted for 92 percent of the new statewide permits this quarter.

Building permits for new private housing
Portland-Vancouver-Hillsboro MSA, seasonally adjusted



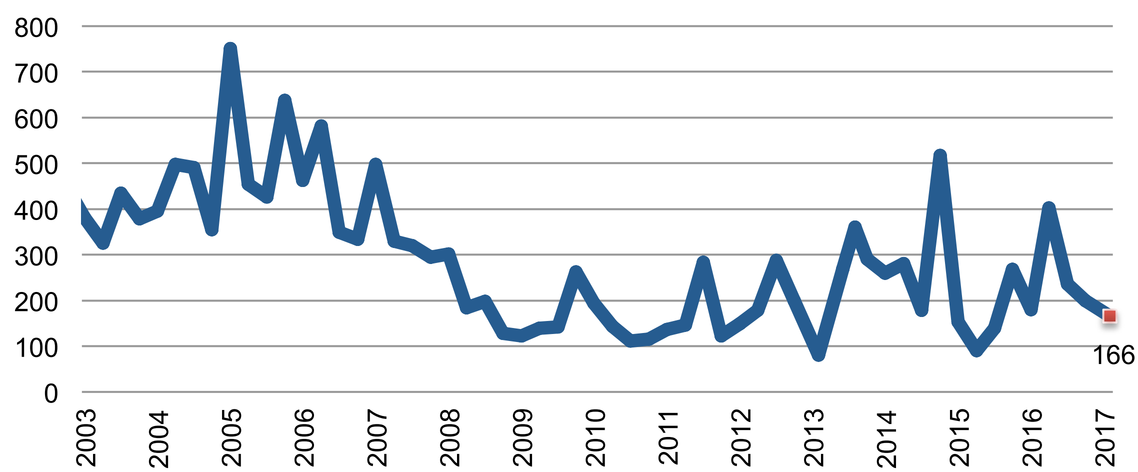
Bend MSA permitting rate declined to 447, by 3.9 percent compared to last quarter and by and even greater 17.4 percent decrease compared to the same quarter last year.

Building permits for new private housing
Bend MSA, seasonally adjusted

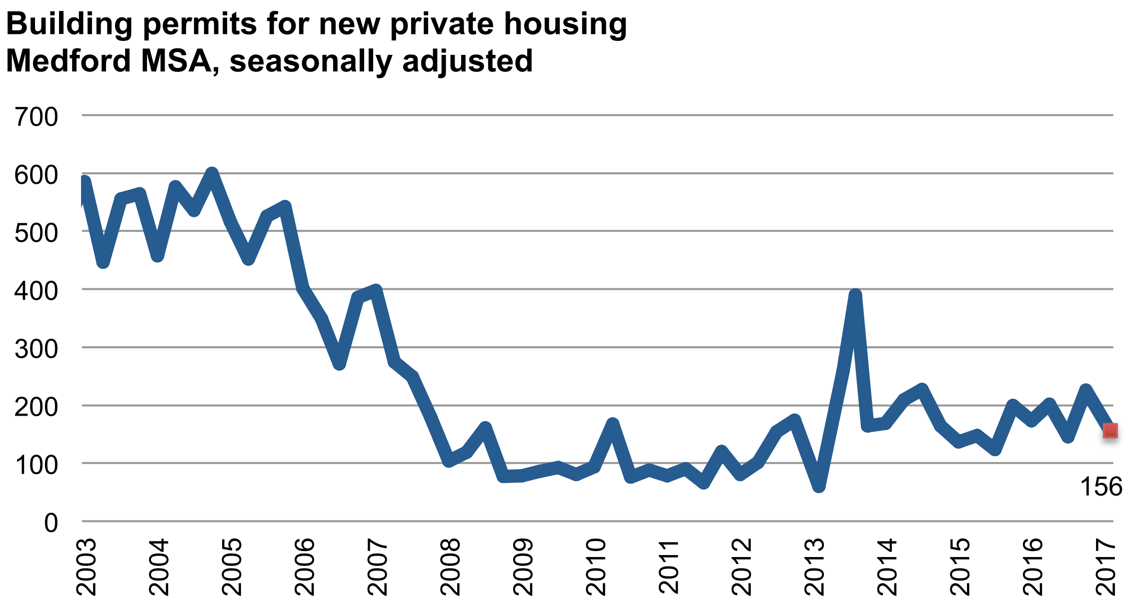


The Eugene-Springfield MSA's fourth quarter permitting continued to declined to 166 permits resulting in a 16.6 percent decrease for this quarter from last quarter. The decline in the Eugene market is second after Medford in the state. Permitting for new private housing units totaled 166. While lower than last quarter, this still represents a 7.8 percent decrease over the same quarter a year ago. Will this declining trend continue remains to be seen in the upcoming year along with the affordability of the new housing products.

Building permits for new private housing
Eugene-Springfield MSA, seasonally adjusted



Like Eugene, new permits in Medford MSA decreased this quarter, 156, by nearly 31 percent. Like Eugene, even this downward movement compared to last quarter represents a nearly 9.8 percent decrease compared to the same quarter last year.

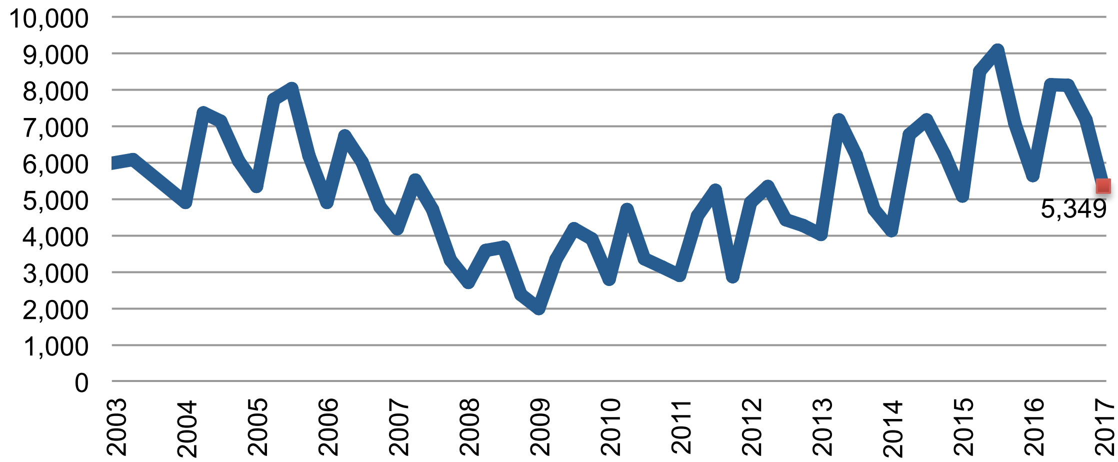


PORTLAND TRANSACTIONS

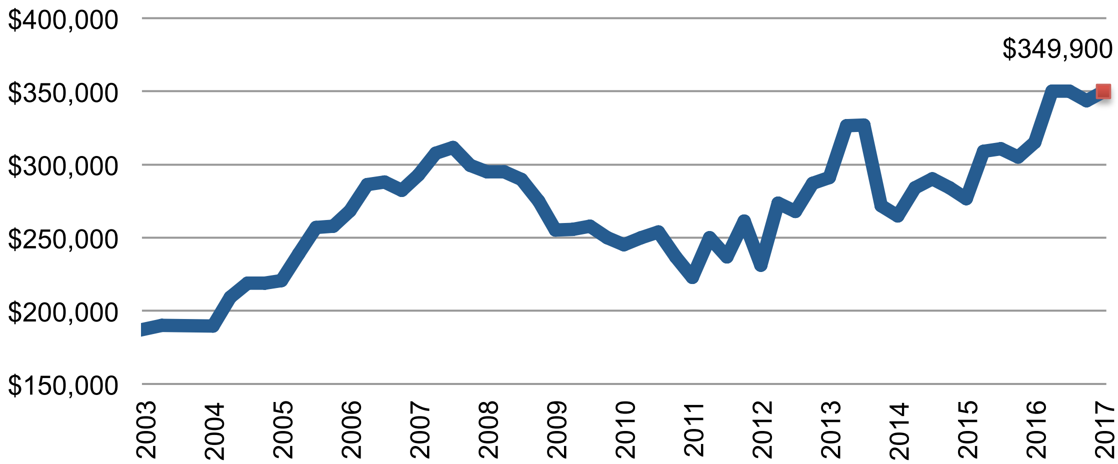
The first quarter showed signs of slipping from the previous quarter for existing home sales in the Portland market: over 5,349 transactions with a median sale price of $349,900. This number of transactions is a slight 5.1 percent decrease over the same quarter last year. However, the median sales price for existing homes increased by nearly 11 percent compared to the same quarter last year.

The average days on market for existing homes edged up by 10 days, to 44 days from 34 days last quarter. However these 44 days in the fourth quarter of 2016 represent only a 7.3 percent increase of the average days on market compared to the same quarter last year. Final sales prices in the first quarter continued to be above list price, but rose slightly from 99.34 percent last quarter to 99.51 percent this quarter.

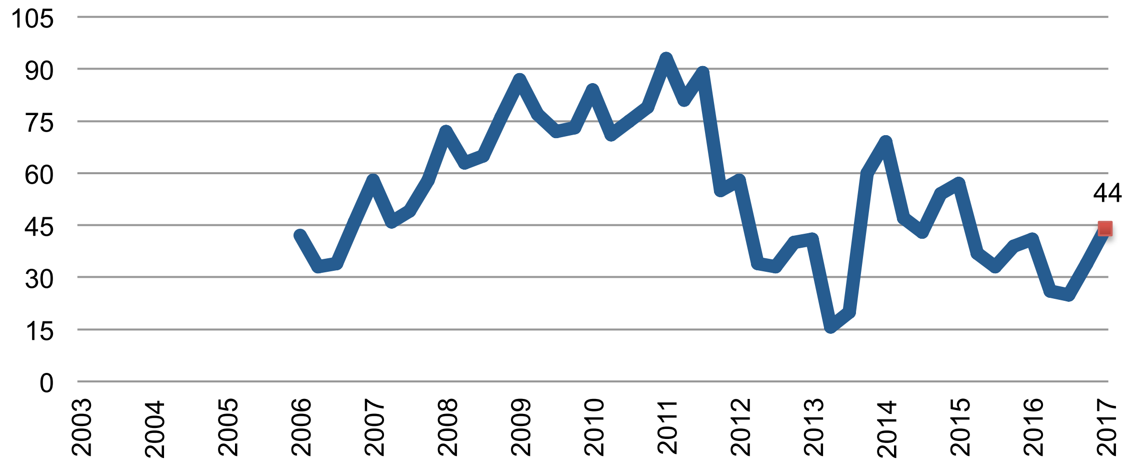
Number of transactions
Portland metro, existing homes



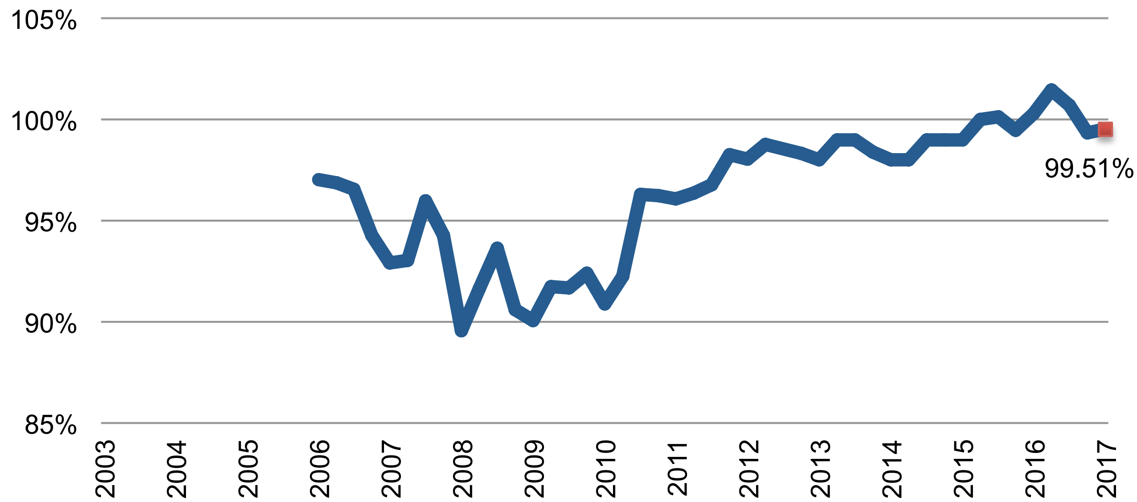
Median sales price
Portland metro, existing homes



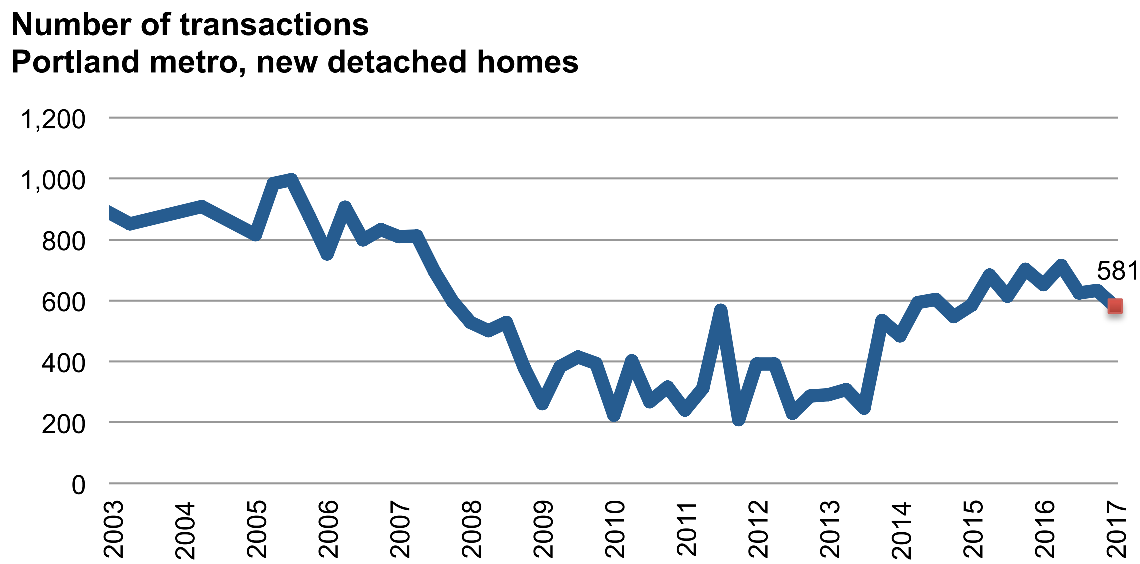
Days on market
Portland metro, existing homes

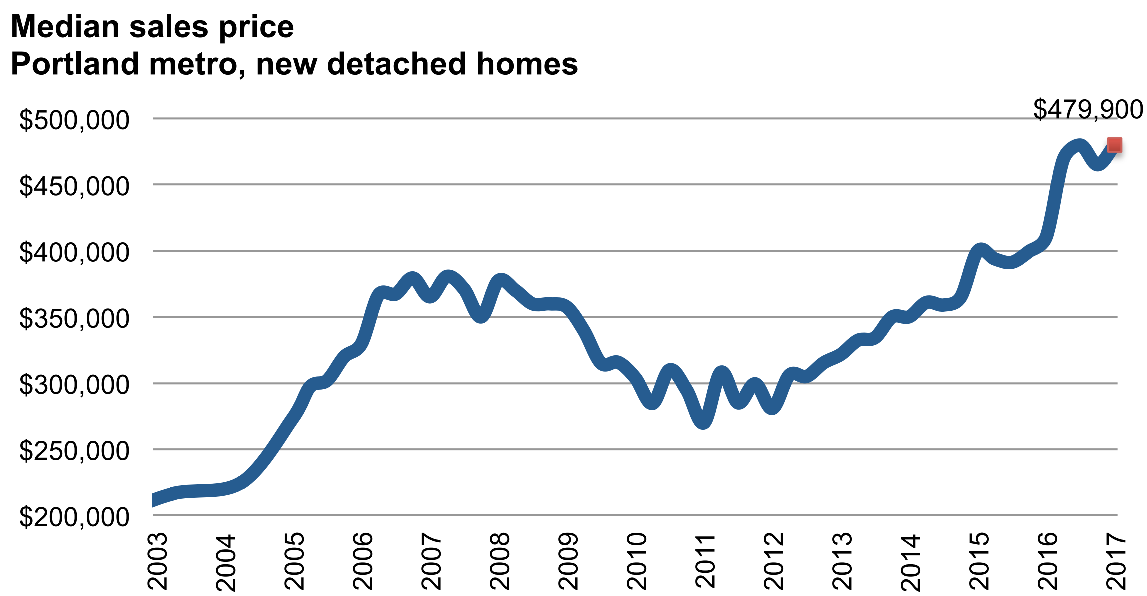


Ratio of sales price to list price
Portland metro, existing homes



In the sale of new homes for Portland, the number of transactions, 581, saw a 8.4 percent decrease compared to last quarter along with a 10.75 percent decrease compared to the same quarter last year. New home median sales price in the fourth quarter saw a slight increase compared to the last quarter. Last quarter, the median sales price for new homes was $465,000 compared to $479,900 this quarter – a increase of only 3.2 percent. Compared to the same quarter last year, however, new home prices have increased $69,400 or close to 17 percent perhaps due to the increased pricing for the land/lots and labor that is increasingly in short supply.



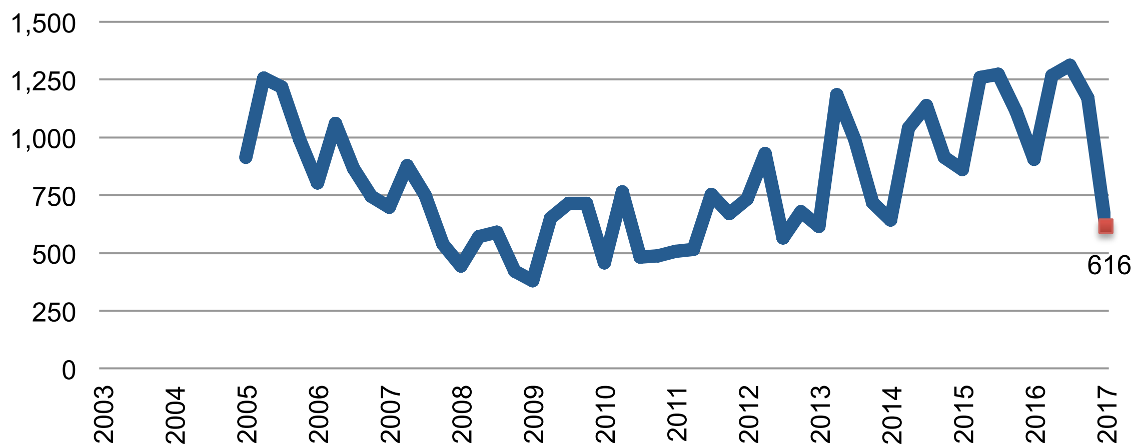


VANCOUVER AND CLARK COUNTY TRANSACTIONS

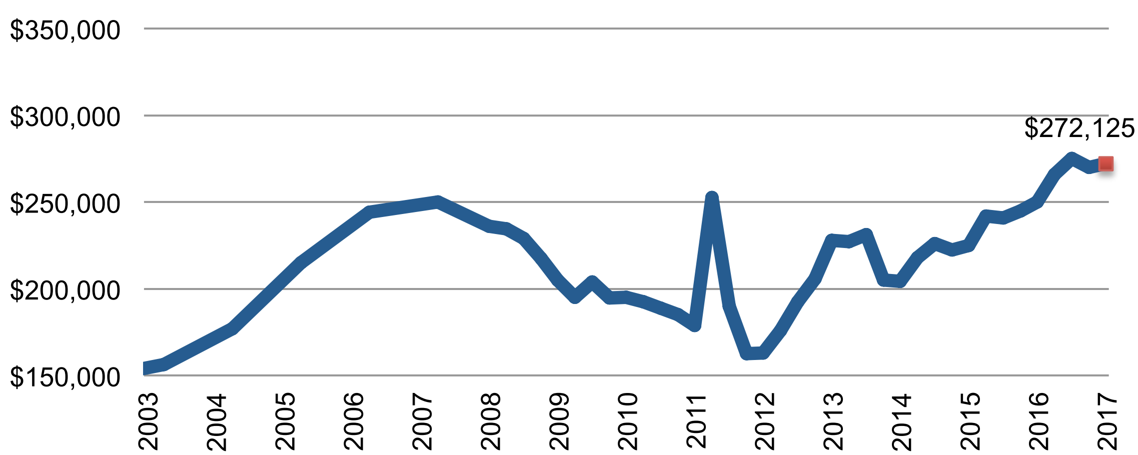
Like Portland, Vancouver experienced a significant level of decline in transactions of home sales this quarter compared to last quarter. Vancouver experienced a 47.4 percent decrease in transactions of existing homes compared to last quarter. While Portland experienced a slight decline in year over year transactions, Vancouver's transactions decreased by 31.9 percent compared to the same quarter last year. Clark County transactions were up 6.6 percent compared to last quarter and 44.5 percent higher compared to the same quarter a year ago.

Average days on market continued to increase quarterly for both Vancouver and Clark County, a reflection of sales activity, but also are at a substantial reduction compared to the same quarter last year. The average days on market for Vancouver, 43, represent an increase of 19.4 percent compared to last quarter and a slight increase of 2.4 percent compared to the same quarter last year. Clark County saw a 28.3 percent increase in average days on market compared to last quarter and a 15.7 percent decline compared to the same quarter a year ago. Transactions involving existing homes into Vancouver went to 616, with median sales price of $272,125 and 43 days on the market. Clark County excluding Vancouver transactions decreased to 616, median sales price increased to $325,000 and days on the market went up to 59.

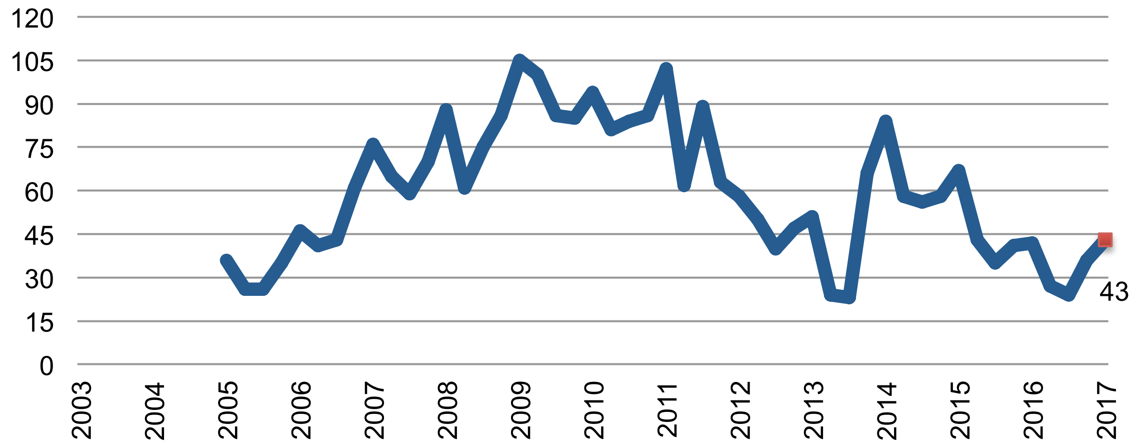
Number of transactions
Vancouver, existing homes



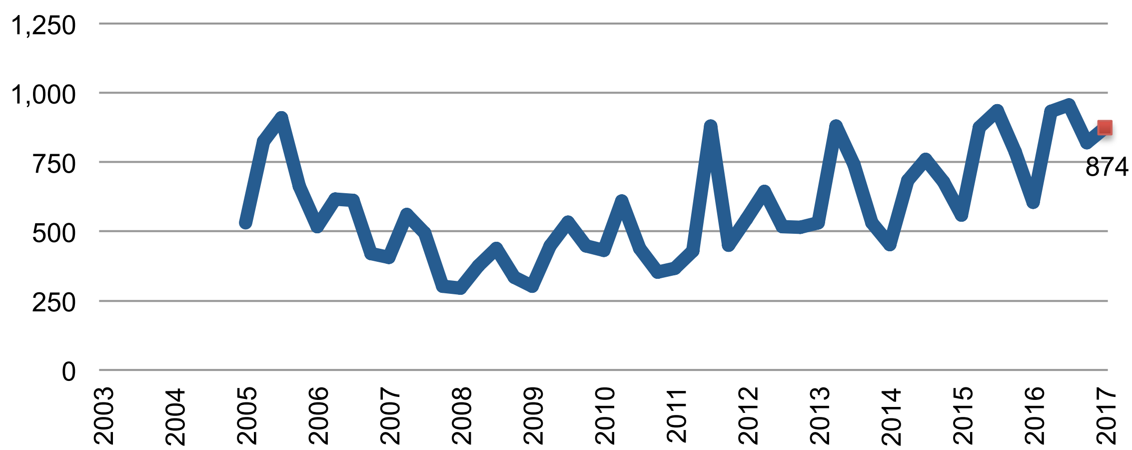
Median sales price
Vancouver, existing homes



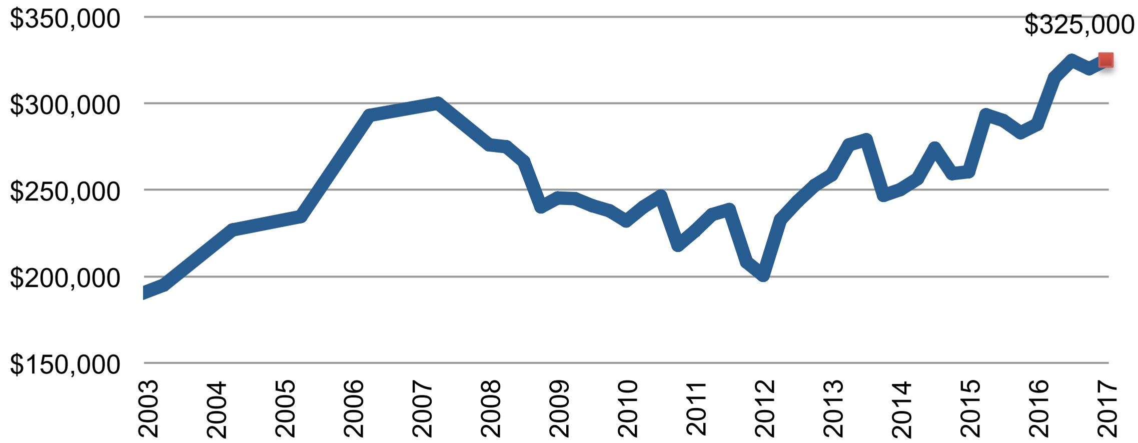
Days on market
Vancouver, existing homes



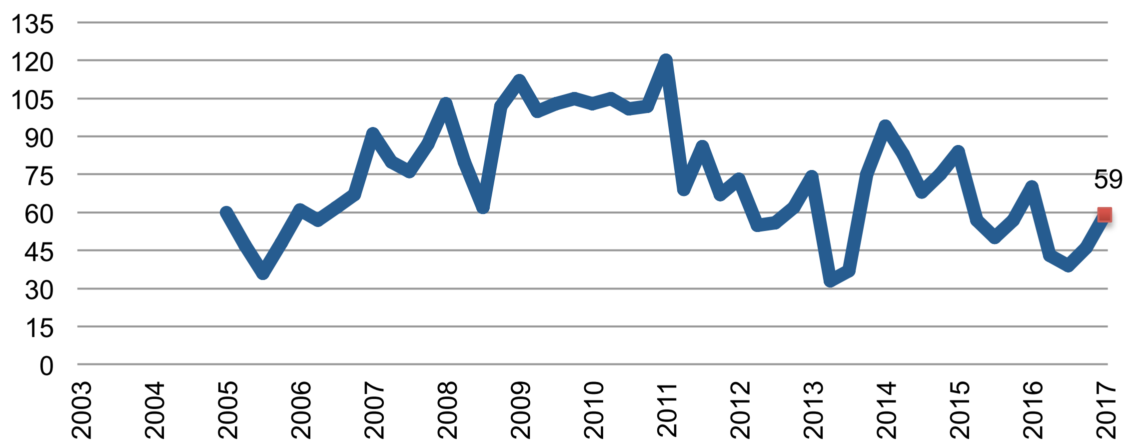
Number of transactions
Clark County, excluding Vancouver, existing homes



Median sales price
Clark County, excluding Vancouver, existing homes



Days on market
Clark County, excluding Vancouver, existing homes



CENTRAL OREGON TRANSACTIONS

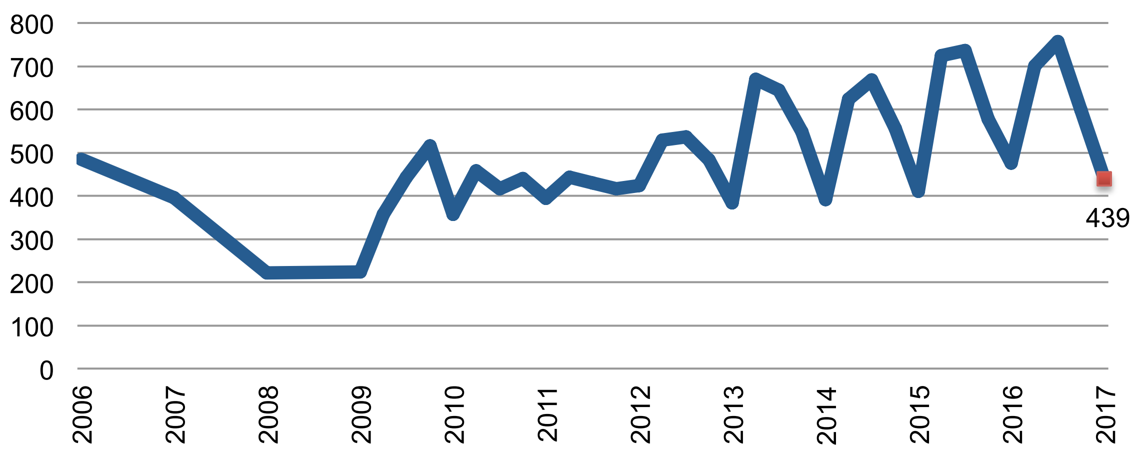
Transactions in Central Oregon saw decline in activity compared to the statewide continuation of upward trends from the previous quarter. Bend saw a 26.7 percent decrease compared to last quarter, and like Portland's slight year over year decline, Bend saw a 7.8 percent decrease compared to the same quarter last year. Redmond experienced a 41 percent decrease in transactions compared to last quarter but only a 14.7 percent decrease when compared to the same quarter last year. Bend under-one-acre numbers are 439 transactions, median sales price of $375,000 and 129 days on the market.

Median home prices in Central Oregon continued the steady, quarterly and year-over-year increases. Bend experienced nearly the same in median sales price at a 4.2 percent increase compared to last quarter, and nearly a 12.6 percent increase compared to the same quarter last year. Redmond saw a 6.8 percent uptick in home prices compared to last quarter, with a 13 percent increase compared to the same quarter last year.

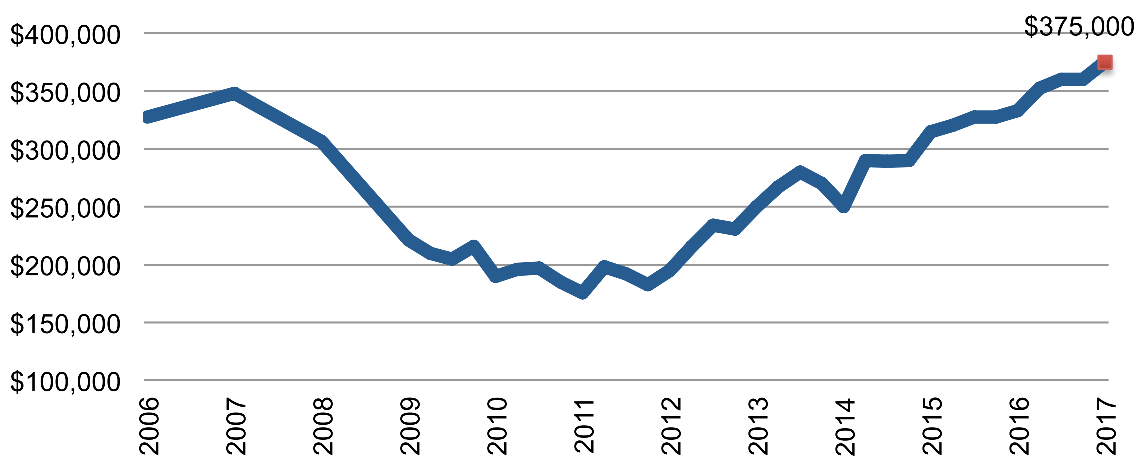
Average days on market are increasing overall from last quarter. Bend's average days on market followed suit for days on the market from 113 last quarter to 129 this quarter. Compared to the same quarter last year, where there was a 1 percent decline. Redmond saw a 30 percent increase in average days on market compared to last quarter, with a 26.4 percent increase when comparing this quarter to last year.

Redmond, the number of transactions dropped to 151 from 256. Median sales price increase to $272,450 from $255,000. Days on the market increased from 103 to 134.

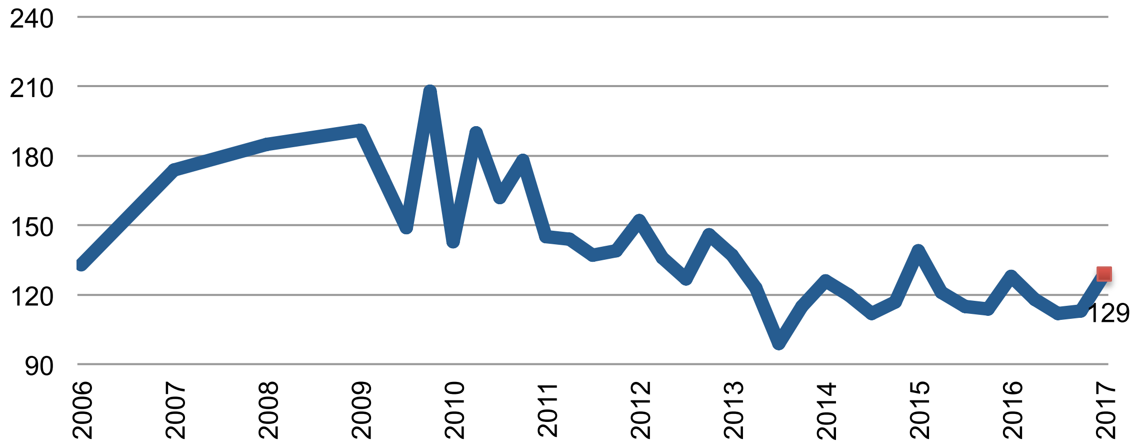
Number of transactions
Bend, under 1 acre



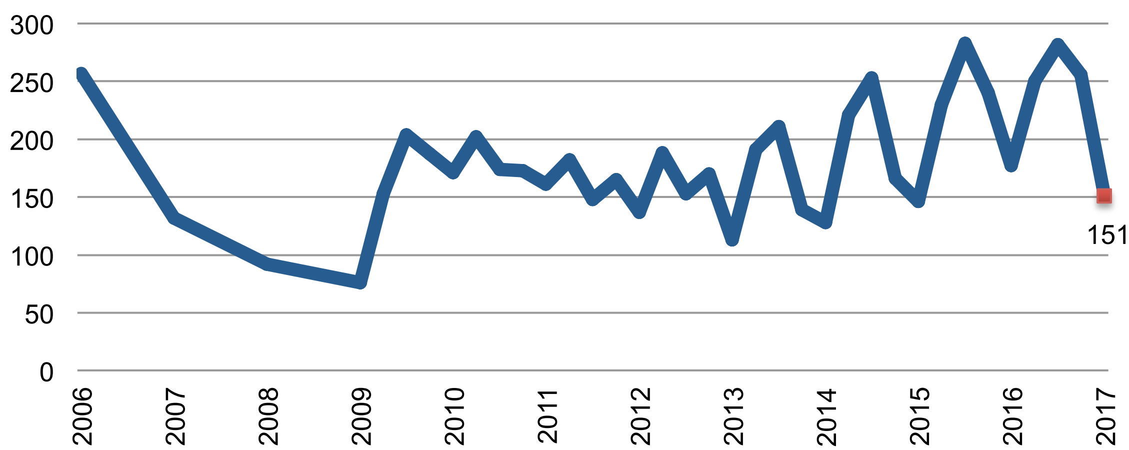
Median sales price
Bend, under 1 acre



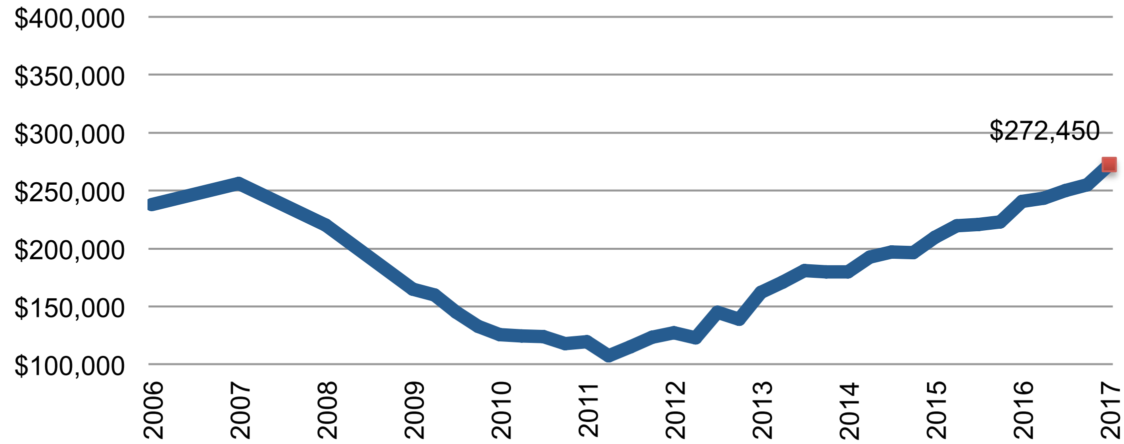
Days on market
Bend, under 1 acre



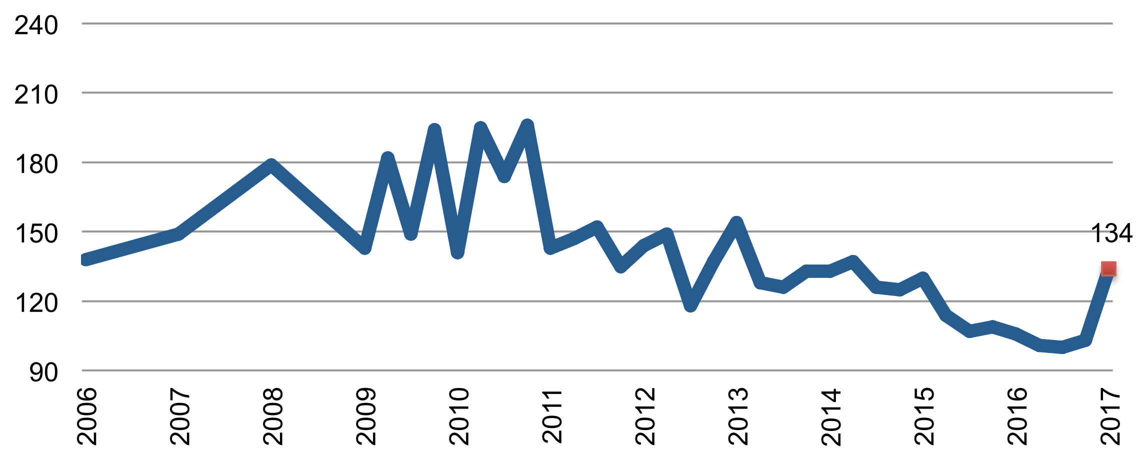
Number of transactions
Redmond, under 1 acre



Median sales price
Redmond, under 1 acre



Days on market
Redmond, under 1 acre

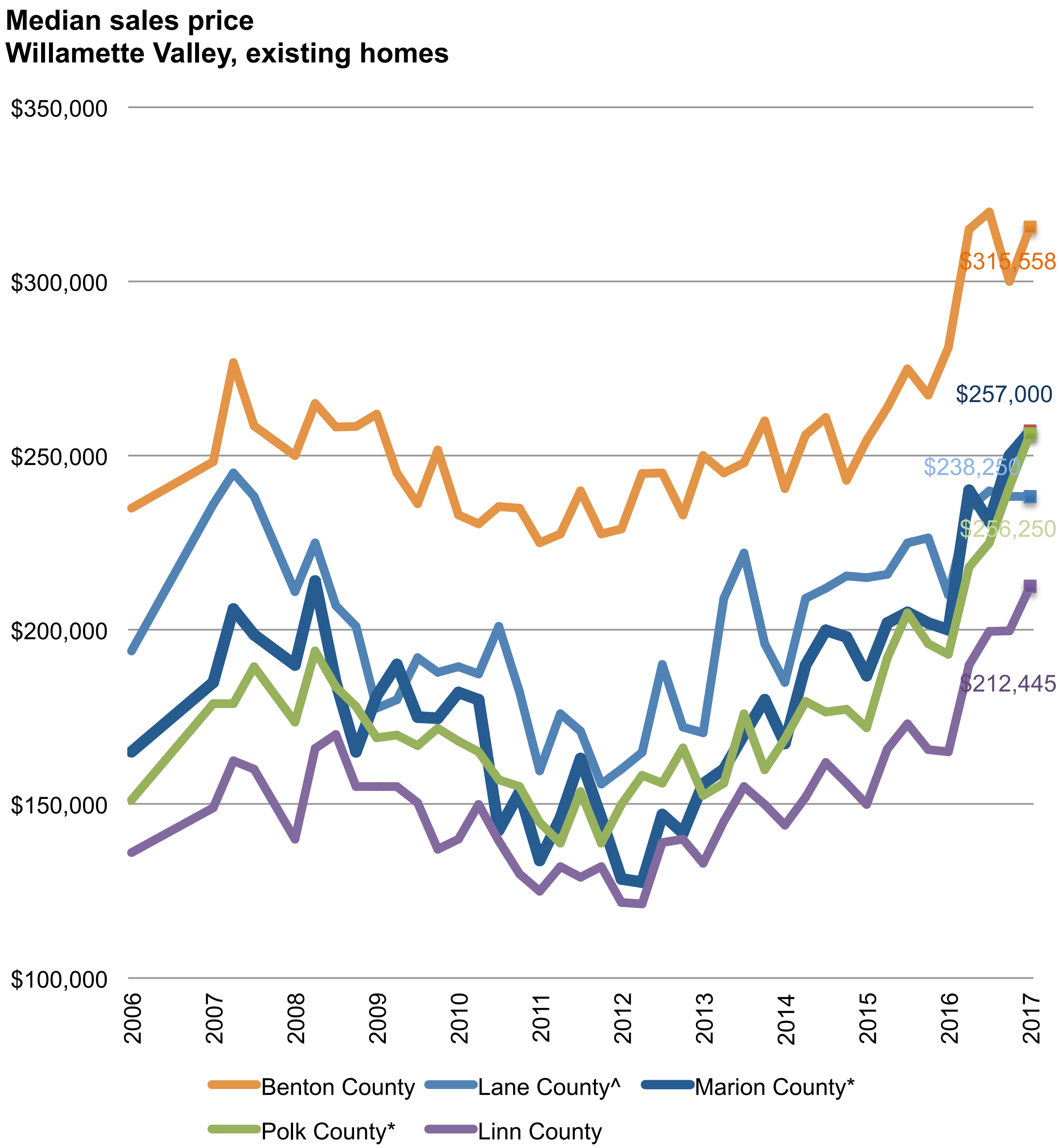


WILLAMETTE VALLEY TRANSACTIONS

The slight decrease in median sale prices seen in the Portland, Vancouver and Clark County areas this quarter was only evident in two counties across the Willamette Valley. However, Marion County, Polk County and Linn County experience increases in price when compared to both the previous quarter and the last quarter of the previous year. Data for the Willamette Valley counties including Salem is provided by Willamette Valley MLS.

- Benton County: $315,000 median price, a 5 percent increase from the prior quarter and a 12 percent increase year-over-year
- Lane County (excluding Eugene): $238,250 median price, flat from the prior quarter and a 5.2 percent increase year-over-year

- Marion County (excluding Salem): $257,000 median price, an 2.8 percent increase from the prior quarter and a 23.8 percent increase year-over-year.
- Polk County (excluding Salem): $257,000 median price, a 7 percent increase from the prior quarter and a 23 percent increase year-over-year
- Linn County: $212,445 median price, a 6.38 percent increase from the prior quarter and a 20 percent increase year-over-year.



^Excluding Eugene *Excluding Salem

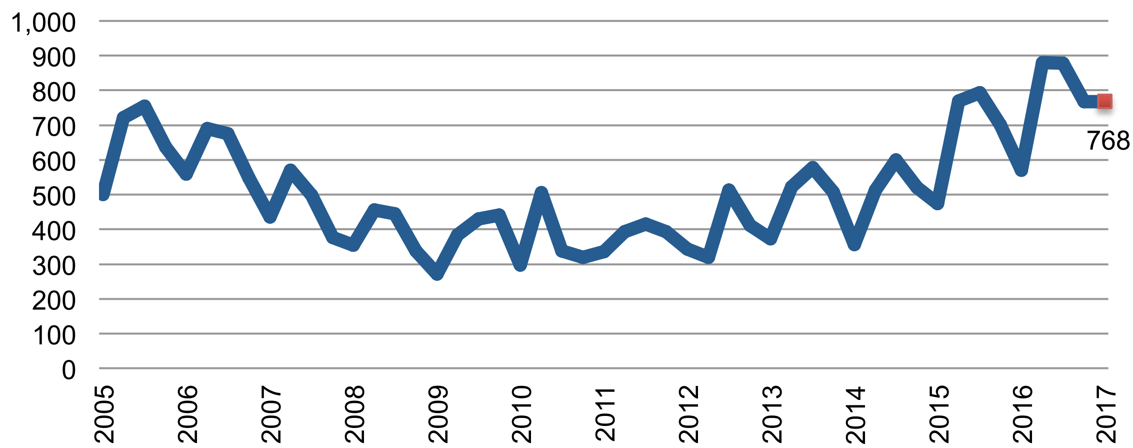
SALEM TRANSACTIONS

Transaction volume in Salem was consistent with the decline statewide of last quarter's trend. Transaction activity declined 13 percent compared to last quarter, but that volume represents a nearly 9 percent increase compared to last year.

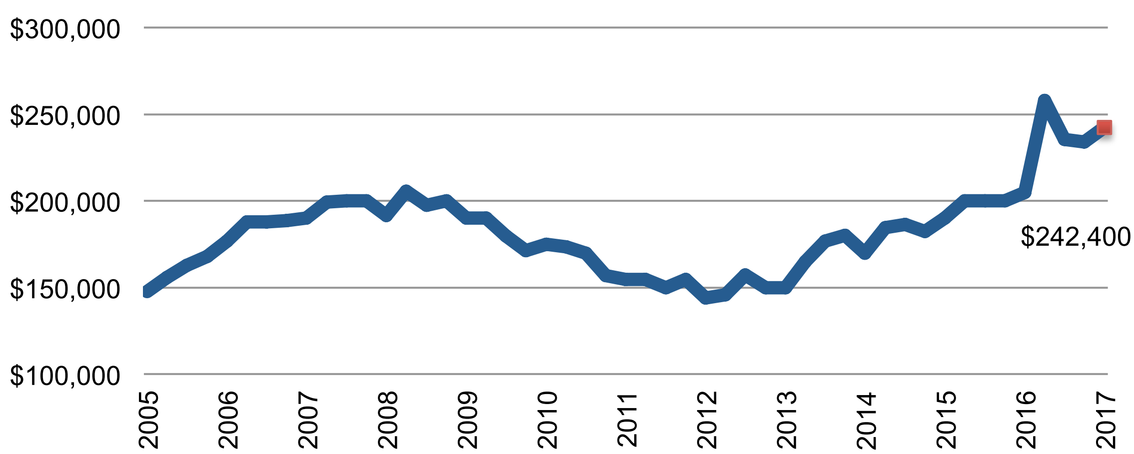
Median sales price in Salem declined as was seen across the state. Median home prices last quarter were $234,000, while this quarter prices only reached $242,200 – a increase of 3.4 percent. But compared to the same quarter last year, this decrease in price represents a 17 percent increase.

Average days on market also declined when compared to the previous quarter from a year ago. Compared to last quarter, average days on market decreased due to short supply, from 99 to 37.

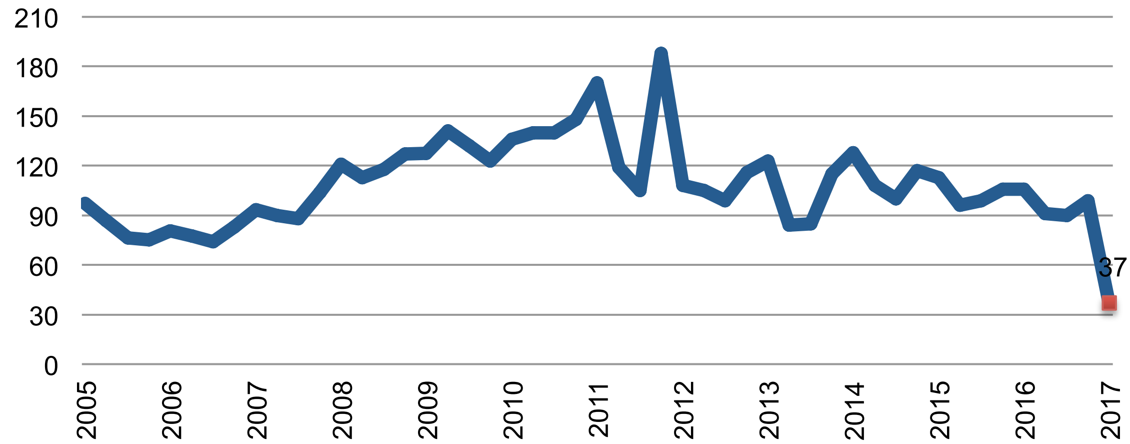
Number of transactions
Salem, existing homes



Median sales price
Salem, existing homes



Days on market
Salem, existing homes

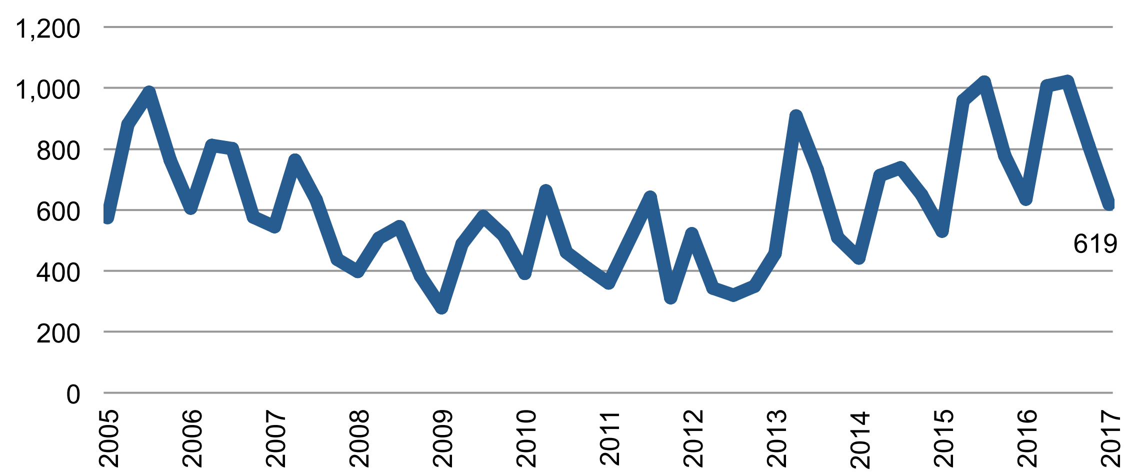


EUGENE-SPRINGFIELD TRANSACTIONS

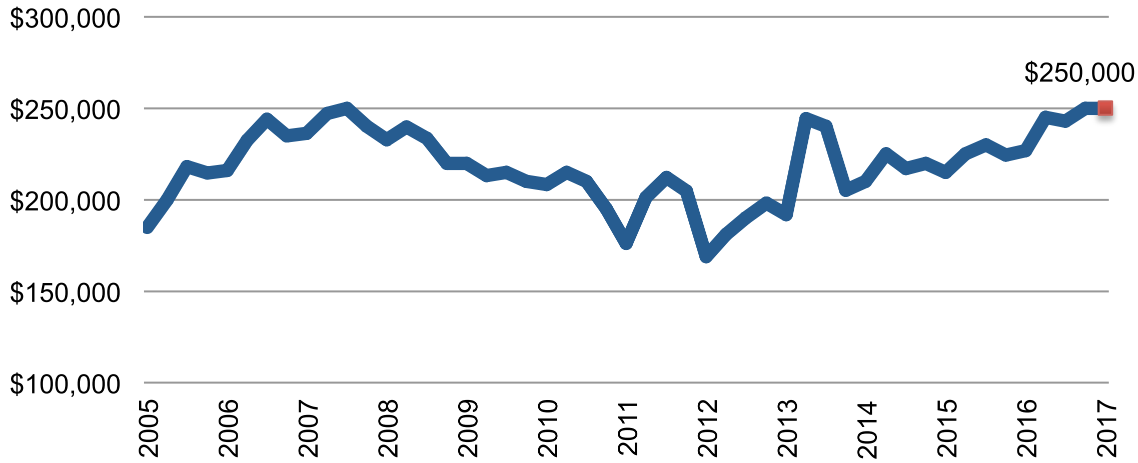
Like many other areas of the state this quarter, Eugene-Springfield experienced a decline in sales volume from last quarter combined with continued increase of average days on market. Transaction counts decreased 23.7 percent compared to last quarter, which is only a slight decrease of 2.5 percent compared to the same quarter last year. The number of transactions went from 812 down to 619.

Sales prices increased very slightly from $249,000 last quarter to $250,000 this quarter, a very slight increase of 0.04 percent. The percentage increase of average sales price compared to the same quarter last year is 10.1 percent. Average days on market increased a full 5 days this quarter compared to last, from 40 to 45 days on average. This represents a 12.5 percent increase compared to last quarter and a 29.7 percent decrease compared to the same quarter last year.

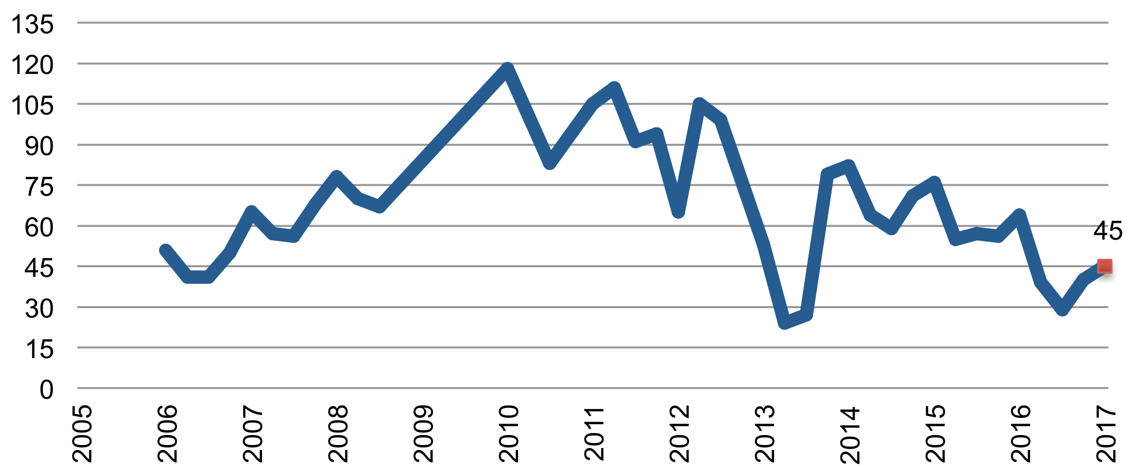
Number of transactions
Eugene-Springfield, existing homes



Median sales price
Eugene-Springfield, existing homes



Days on market
Eugene-Springfield, existing homes



SOUTHERN OREGON TRANSACTIONS

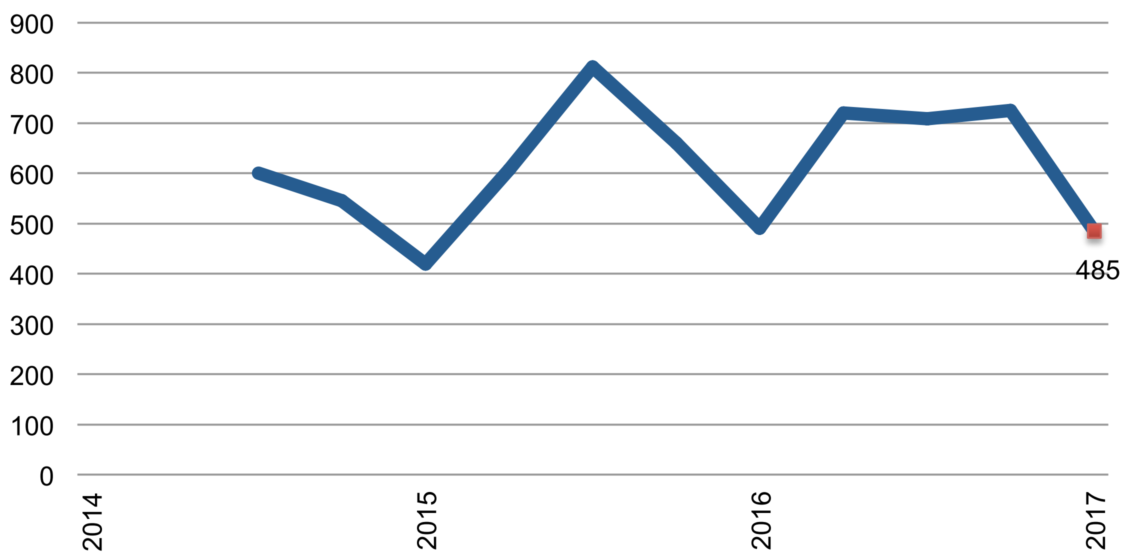
Trends in Southern Oregon tracked along side the trends across the state: largely less transaction volumes compared to last quarter from 725 to 485 for Jackson County. However, compared to last year, Jackson County saw only a 1.2 percent decrease in transaction volume while Josephine County saw 0.82 percent increase.

Median home prices decreased slightly from $250,000 to $243,000, compared to last quarter however increased more substantially compared to the same quarter last year. Average days on market had a slight increase compared to last quarter for Jackson County, but days on the market declined by approximately 34.7 percent in Josephine County when compared to the same quarter last year.

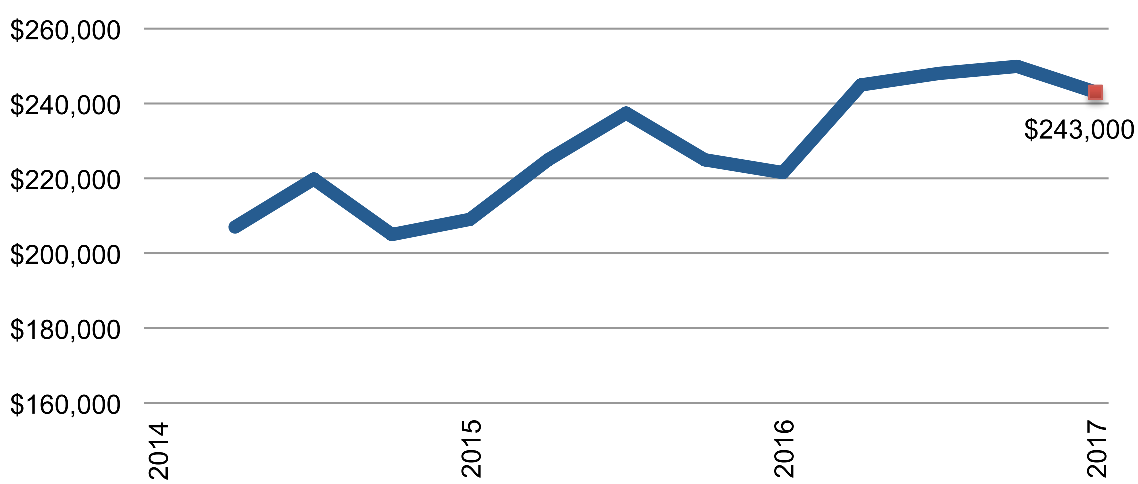
Data for southern Oregon is provided in rolling three-month groupings, and the most recent dataset available for this region covers the Januryfirst to March 3first, 2017 time period.

The following figures display the data for Jackson County and Josephine County. Josephine County existing transactions decreased from 175 to 123, median sale price increased from $209,500 to $216,500 and days on the market increase to 47 from 41.

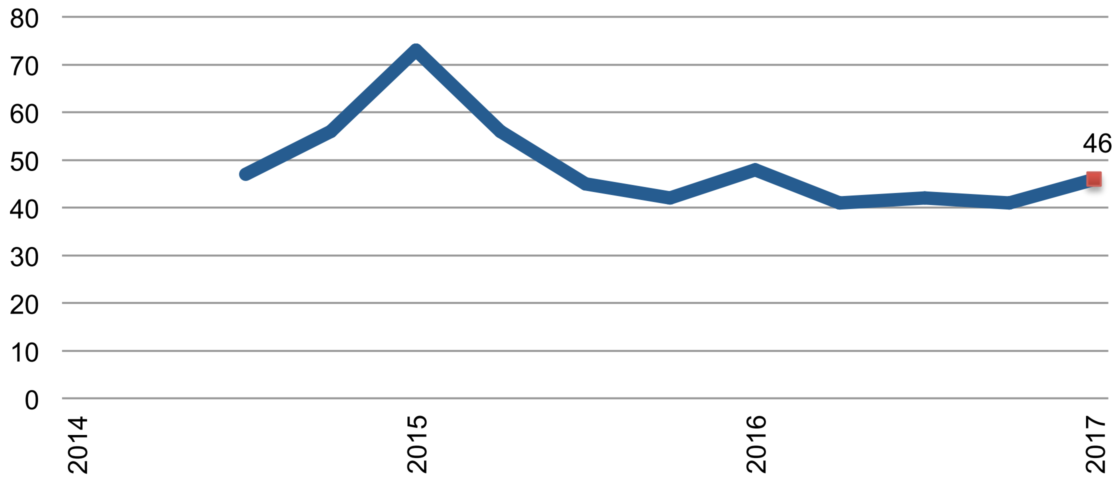
Number of transactions
Jackson County, existing homes



Median sales price
Jackson County, existing homes

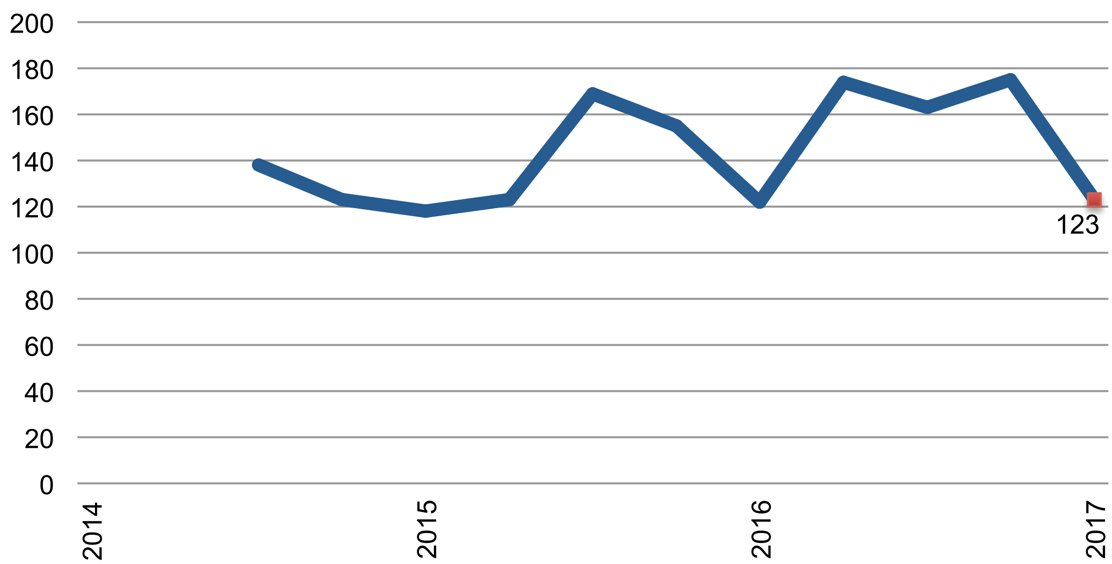


**Average days on market
Jackson County, existing homes**

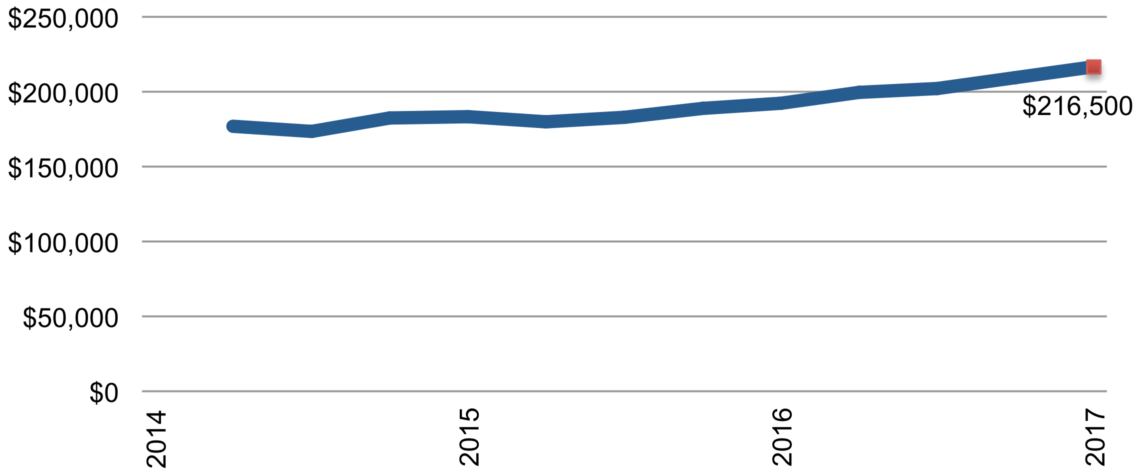


The following figures display the data for Josephine County.

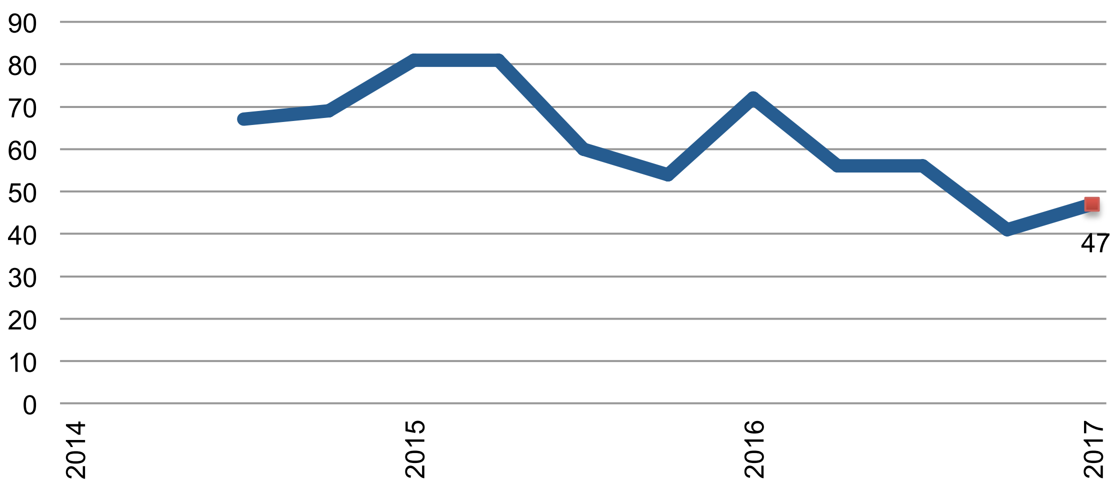
**Number of transactions
Josephine County, existing homes**



Median sales price
Josephine County, existing homes



Average days on market
Josephine County, existing homes



MULTIFAMILY MARKET ANALYSIS

CARLO CASTORO

Portland State University

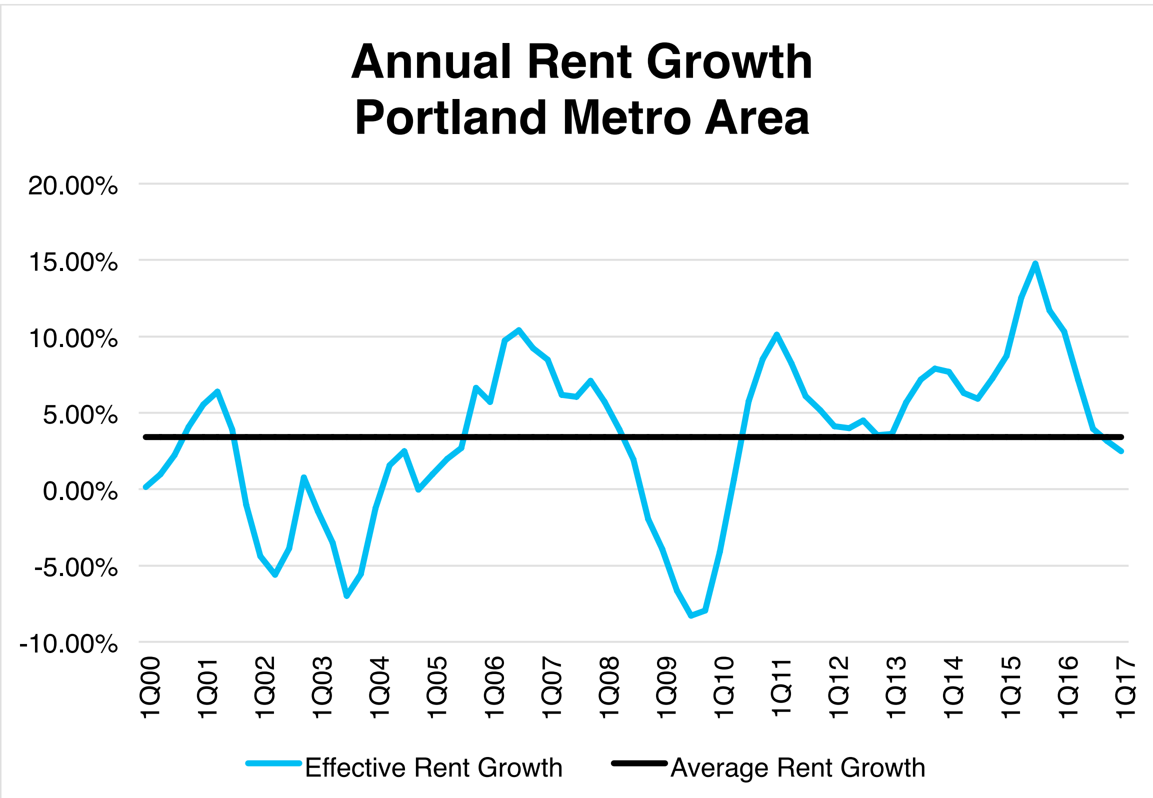
This year may prove to be the crescendo of a six year multifamily construction and rent growth boom for the Portland metropolitan area. New deliveries and vacancies are up while rent growth is down and even reversing in some parts of the central city core. However, as the saying goes "All real estate is local." Digging deeper into the numbers reveals robust rental growth in select submarkets while others follow suit with downtown.

■ **Carlo Castoro** is a current Master of Real Estate Development candidate through a joint program of Portland State University's School of Business Administration and School of Urban Studies and Planning. He is a full time Assistant Manager for Gerding Edlen and part time residential broker with Cascade Sotheby's International Realty. He is the 2017 Multi-Family Graduate Student Fellow at PSU's Center for Real Estate. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

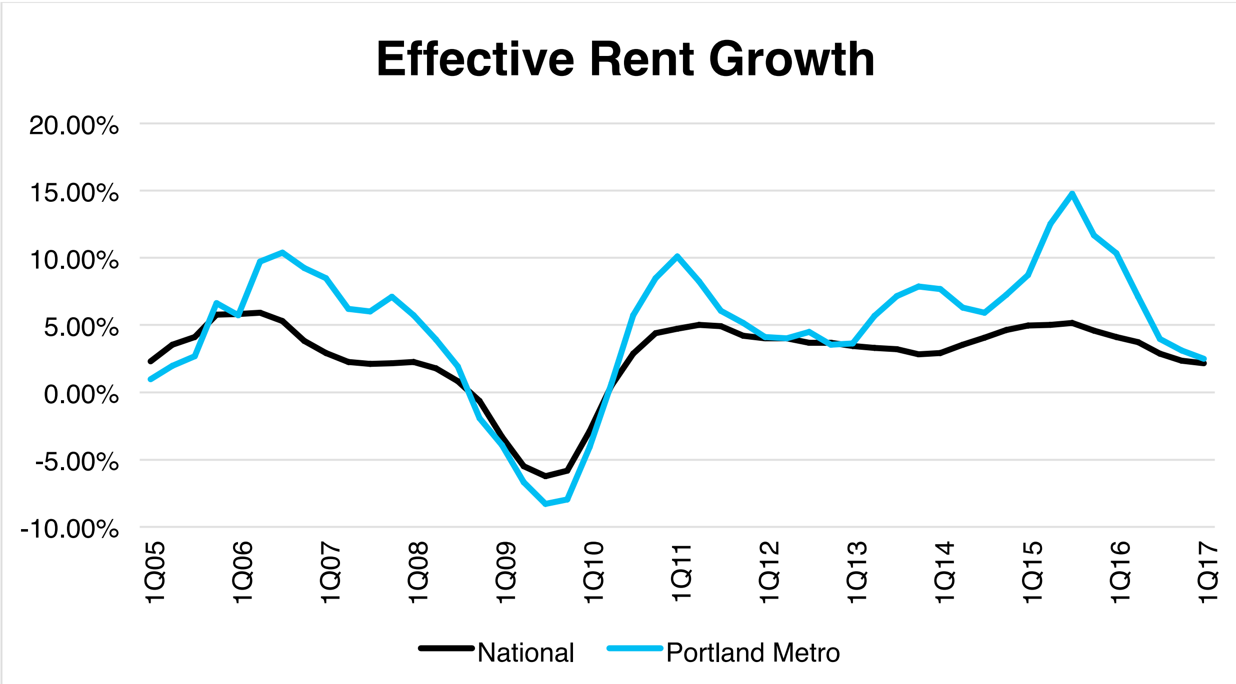
PORTLAND MULTIFAMILY RENTS CONTINUE DOWNWARD TREND IN 2017

Quarterly effective rent growth crept back into positive territory from a drop of 2.3 percent in the fourth quarter of 2016 to 0.3 percent increase the first quarter of this year. However, this was not enough to change the course of an overall downward trend for the Portland metro area.

Annual effective rent growth at 2.49 percent is the lowest Portland has seen in the seven years since the second quarter of 2010 and below the long-term average of 3.41 percent. Also, the gap is closing between Portland and nationwide effective rent growth figures. The following figures were created using numbers from the Axiometrics database.



Source: Axiometrics

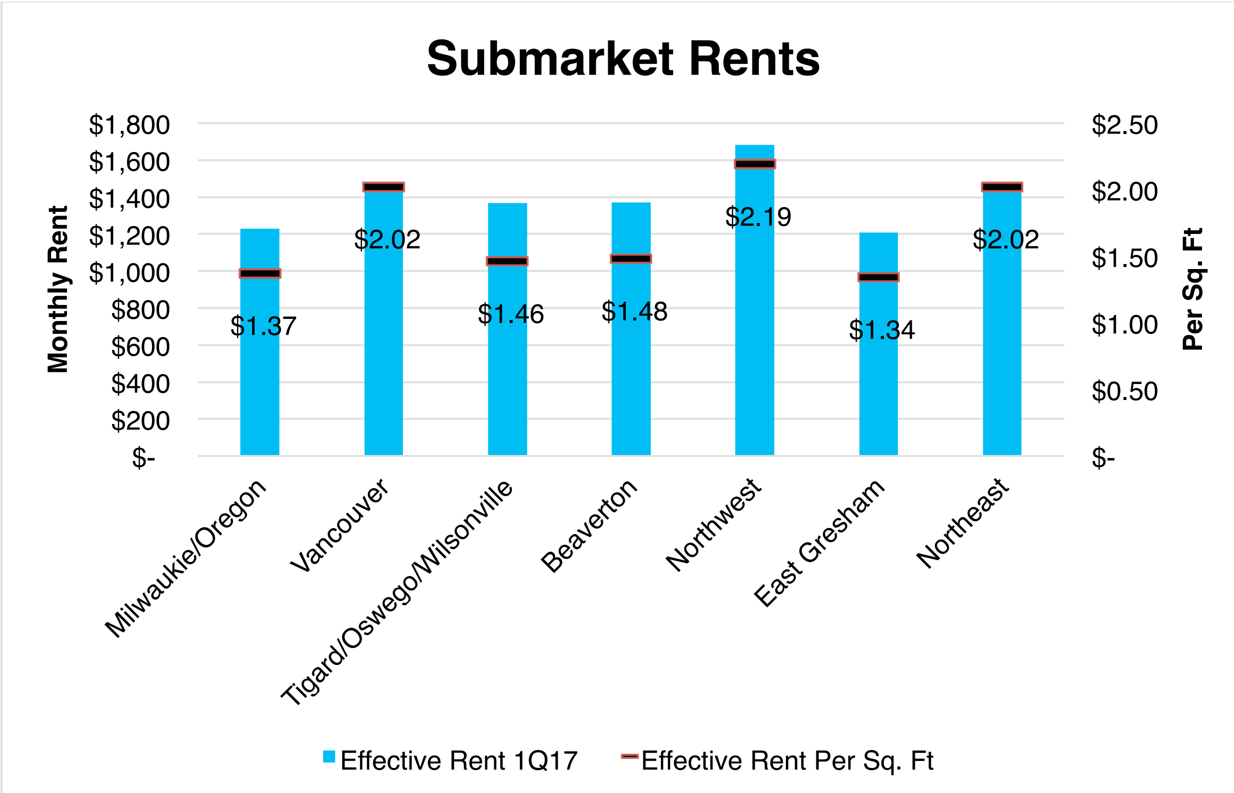


Source: Axiometrics

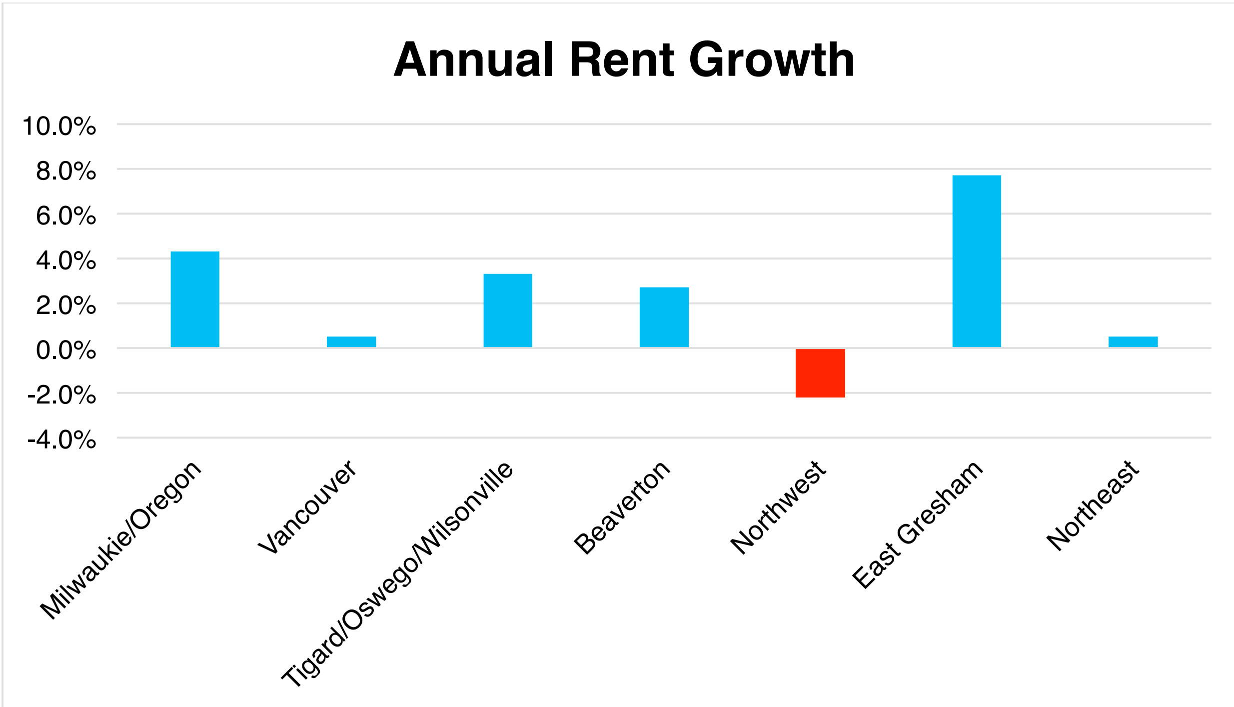
Drilling down into specific Portland submarkets shows a continuing trend of rent growth shifting outside the inner core of Portland. The large recent influx of supply in Northeast has diminished rent growth and plunged the northwest submarket into negative growth territory. East Gresham is still leading the pack with a robust 7.7 percent annual rent growth over the first quarter of 2016.

Submarket	Effective Rent 1Q16	Effective Rent 1Q17	Annual Rent Growth
Milwaukie/Oregon	$1,176	$1,229	4.3%
Vancouver	$1,465	$1,472	0.5%
Tigard/Oswego/Wilsonville	$1,322	$1,367	3.3%
Beaverton	$1,335	$1,372	2.7%
Northwest	$1,719	$1,682	-2.2%
East Gresham	$1,115	$1,208	7.7%
Northeast	$1,465	$1,472	0.5%

Source: Axiometrics



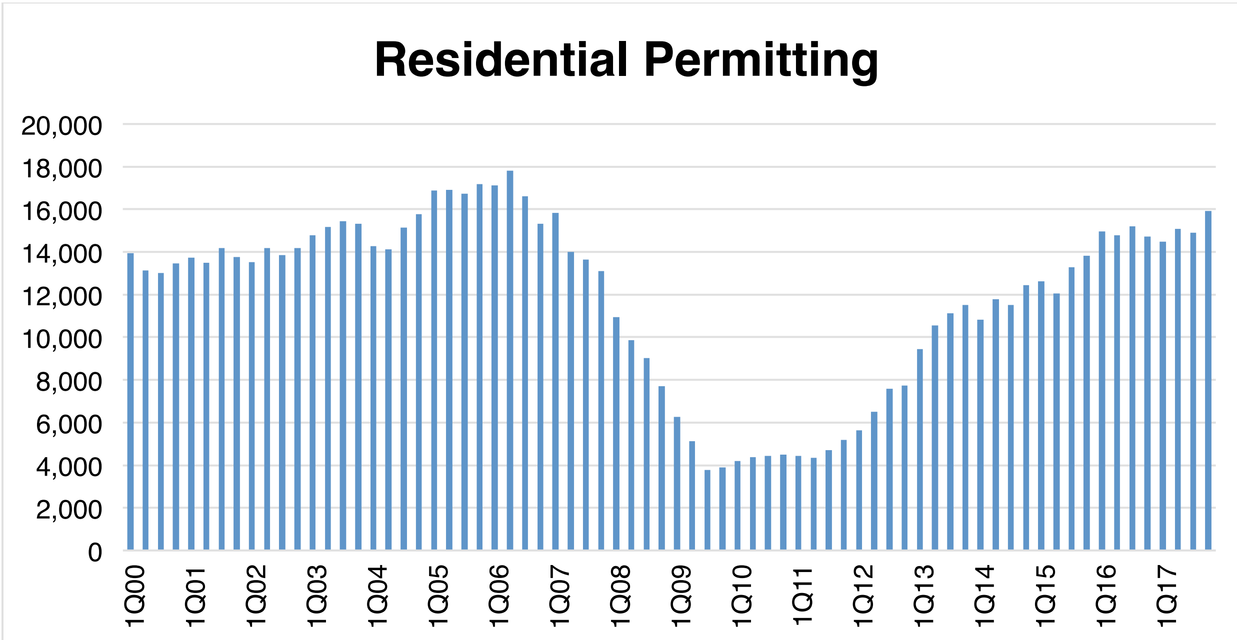
Source: Axiometrics



Source: Axiometrics

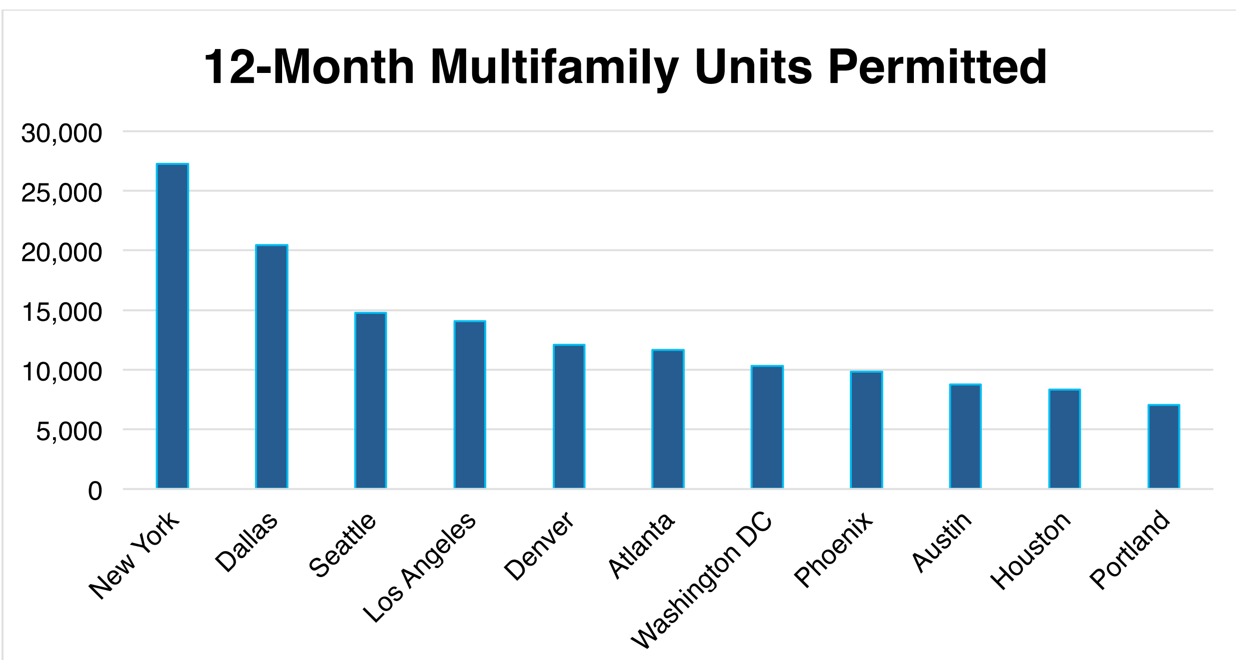
PERMITTING

The following chart was created based on information from Axiometrics database and shows the trailing 12 months permits at end of each quarter. Overall statistics show that despite the recent fluctuations, total permitting is projected to hover around 15,000 units year over year throughout 2017. Also of note, is when taking the long view on permit activity that Portland is still below the levels of the mid-2000's.



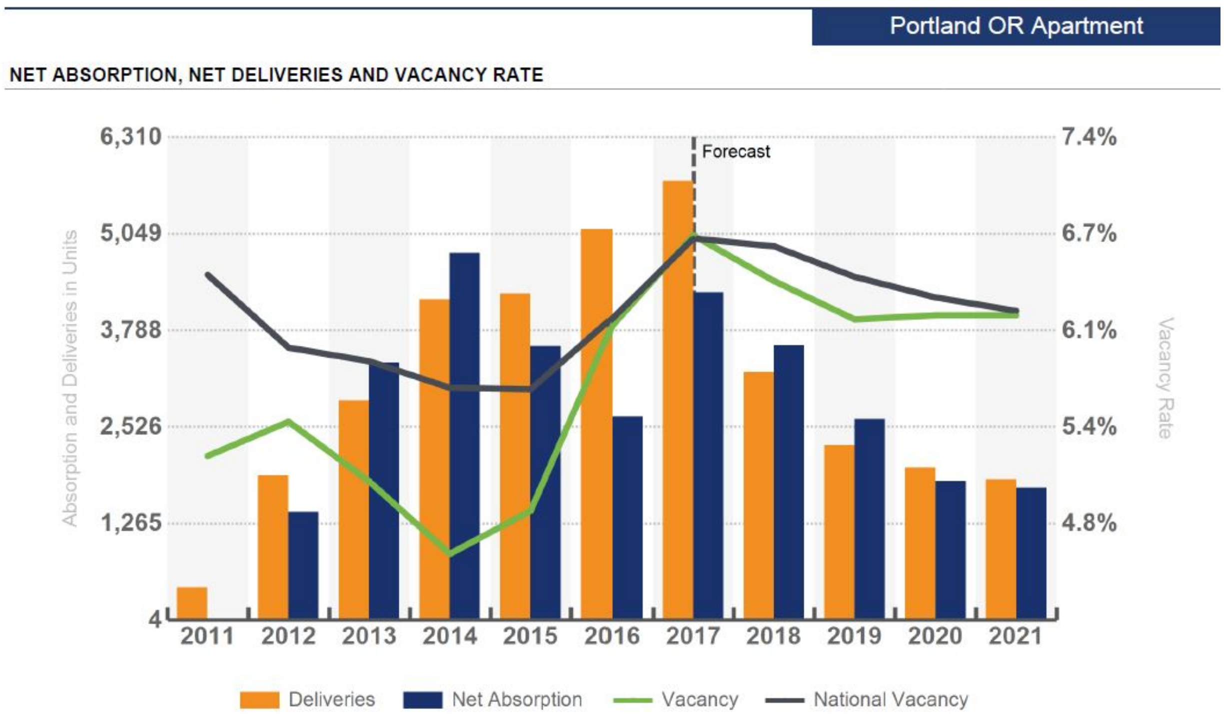
Source: Axiometrics

While we are at a local short term peak in multifamily permits it's interesting to see how Portland stacks up against the top Metro areas Nationwide. Portland does not crack the top ten but three Texan cities did make the list.

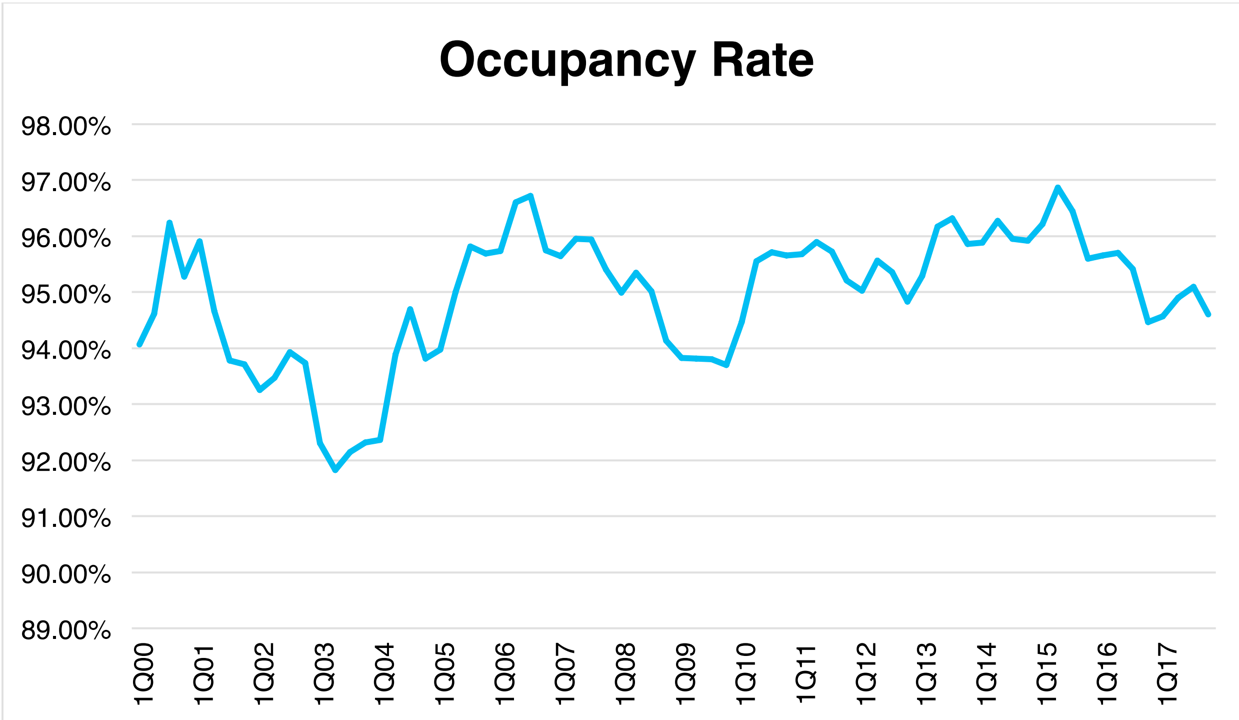


Source: Axiometrics

The following chart from CoStar shows 2017 to be a peak year for new deliveries in the Portland Metro area. This six year construction wave has driven up development costs across the city and when combined with increased vacancies, inclusionary zoning, and more stringent eviction legislation, the forecast shows a likelihood that the market will respond with fewer deliveries over the next five years.



Source: CoStar



Source: Axiometrics

SALES AND TRANSACTIONS

According to Investors Management Group Northwest, the volume of multifamily sales in 2017 are less than half of this time in 2016. That said, price per unit and per square foot are up over 25 percent over past year.

Portland Metro Multi-Unit Sales										
Sales			Units	Price	$/Unit	SqFt/Unit	$/SqFt	Built	Cap Rate	Total Sales
33	2017 YTD THRU 28 MAR 17	AVERAGE	60.7	$1,158,962	$ 171,442	$ 897	$ 198	1981.1	5.38%	$ 381,774,557
77	2016 YTD THRU 2 MAR 16	AVERAGE	45.2	$7,421,439	$ 133,736	$ 911	$ 156	1976.7	5.50%	$ 571,450,795

Notable sales in 2017 according to CoStar are as follows. Starwood Capital alone spent $133,789,390 on four properties this year.

HISTORICAL SALES TRANSACTIONS

Property	Submarket	Sale Date	Price	Units	Price Per Unit	Built	Buyer Name
Modera Goose Hollow, 2004 SW Jefferson St	Northwest Portland	4/5/2017	$47,500,000	134	$354,478	2015	Security Properties Inc., Lib...
Collective Portland, 2073 SW Park Ave	Northwest Portland	3/2/2017	$10,650,000	52	$204,808	1945	Charles & Harold Isen
Pioneer Vista,	Vancouver	3/1/2017	$21,922,460	109	$201,124	2016	Mark C. Frandsen
StoneRidge at Cornell, 14800 NW Cornell Rd	Hillsboro	2/28/2017	$46,500,000	233	$199,571	1985	Starwood Capital Group
Silver Oak Apartment Homes, 8701 NE 54th St	Vancouver	2/28/2017	$35,150,550	204	$172,307	1989	Starwood Capital Group
Sedona At Bridgecreek, 2220 NE Bridgecreek Ave	Vancouver	2/28/2017	$31,046,220	200	$155,231	1989	Starwood Capital Group
Larkspur Place Apartment Homes, 7609 NE Vancouver Mall Dr	Vancouver	2/28/2017	$18,092,620	100	$180,926	1994	Starwood Capital Group
The Ellington Apartments, 1610 NE 66th Ave	Central Northeast	2/6/2017	$47,000,000	263	$178,707		Portland Housing Bureau
Muse Apartments, 1315 NW 19th Ave	Northwest Portland	2/1/2017	$20,150,000	58	$347,414	2017	Pearlman Properties
Corbett Heights, 3916 SW Corbett Ave	Southwest Portland	2/1/2017	$15,000,000	48	$312,500	2015	Pearlman Properties
Northwood Apartments, 8338 N Interstate Ave	North Portland	1/31/2017	$14,000,000	57	$245,614	2015	Lighthouse Partners Inc

Source: CoStar

INCLUSIONARY ZONING

With the signing of Senate Bill 1533 in the 2016 Oregon legislative session, the state preemption on inclusionary housing was lifted. The bill reads that any new multifamily building with 20 or more units "may not require more than 20 percent of housing units within a multifamily structure to be sold or rented as affordable housing."

The City of Portland is using a menu style approach where developers can choose either (1) 20 percent affordable units at 80 percent area median family income (AMFI), (2) 10 percent affordable units at 60 percent AMFI, (3) pay a "fee en lieu" to an affordable housing fund, or (4) designate affordable units off-site.

The Barry Reports explains that "To avoid the requirements of IZ, there was a huge surge in permit applications … showing that between December 1, 2016 and February 1, 2017, developers submitted applications for 54 projects totaling 7,050 units. This is an unprecedented surge in applications and increased the total Metro area pipeline of proposed units by 28 percent in just these two months."

Going forward, the question will be whether permitting slows down in response to the city's inclusionary zoning policies.

COMMUNITY PERSPECTIVES

The following are some brief thoughts from key policy makers and participants in Portland's real estate markets.

Mark Edlen, Chairman of the Board, Gerding Edlen

What is your opinion on the current development environment in Portland?

Edlen: I'm bullish on the Portland economy. Major employers such as Nike, Intel, and Adidas pay great salaries and there is a strong budding entrepreneurial scene here. A lot of millennials come here for the great culture and now they're starting companies. OHSU is another major employment pillar and incredible contributor to our local economy. I'm cautiously optimistic about the current development environment in Portland right now. The local development community is strong and some national players with institutional capital are arriving.

How is Gerding Edlen's business model changing with the new inclusionary zoning legislation?

Edlen: We're pulling our horns back on new construction now that deliveries have caught up with demand. It will be interesting to see how this new supply is absorbed over the next few quarters. The addition of inclusionary zoning and escalating construction costs means rents must rise before new projects can pencil.

Mike Kingsella, Executive Director, Oregon LOCUS

What is your opinion on the current development environment in Portland?

Kingsella: Despite continued demand oriented tailwinds positively affecting our market, vis a vis population growth in the region as a whole, Portland continues to be a difficult development environment in which to operate. Hard costs (labor and materials) continue to escalate at a significant rate, and with continued geopolitical uncertainty the cost of capital has become more expensive. Additionally, many aspects of the development approval process and local regulatory environment add layers, costs and time to the development process, making projects harder to do. Recent conversations in Portland City Hall have been encouraging that there is an awareness of the impacts on getting the development needed to meet demand.

How might the market respond with the new inclusionary zoning legislation?

Kingsella: It is certainly possible that market rate development may shift geographically to the degree that program requirements and offsets in certain neighborhoods of the City of Portland are calibrated differently than others. Specifically, east of I-205 where market rates are between 60-80 percent AMFI lower density projects may work given existing offset structures, versus areas west of I-205 where the differential between market rent and affordable rents are not adequately offset. It's going to be critical for the commercial real estate industry and the City to work together, closely monitoring Inclusionary Housing program results and adjusting the program as necessary to achieve the housing affordability levels we all desire.

Eric Cress, Principal, Urban Development + Partners

What is your opinion on the current development environment in Portland?

Cress: Predictably, we are experiencing some softening in rents due to the delivery of a relatively large amount of apartment supply. I think we will likely be in a soft market as deliveries continue over the next 24 months. Financing is tightening and banks are proceeding with caution. That, in conjunction with additional regulation, will likely dampen new permit applications, providing for some market-strength in a couple of years. Of course, the capital markets are a whole other matter and no-one knows where we will be on that side of the equation. That said, we are long on Portland and continue to develop in select locations for a long-term hold.

How is your business model changing with the new inclusionary zoning legislation?

Cress: We are currently unable to proceed with projects in mixed-use zones where the Inclusionary Housing (IH) incentives are lower (specially in zones where the FAR allowance is 5:1 or less). Our calculations show that projects are still feasible in central-city zones; so those areas of the city will likely see continued deliveries of market rate and affordable housing through the IH program.

Kurt Creager, Director, Portland Housing Bureau

What is your opinion on the current development environment in Portland?

Creager: I think it's cooling. We do a lot of forecasting in the city and we're predicting a slowdown in 2018 mostly driven by interest rates and peaking prices. It felt like we were reaching a high watermark with respect to potential rents, land prices, labor and material prices. We think it's a plateau not a precipitous decline on the backend. One of the unintended results of the election is the anticipation of lower corporate tax rates, which led to a decrease in the value of Low Income Housing Tax Credits (LIHTC). They were worth $1.15 and are now down to $0.95 which created a gap in affordable housing deals using such credits.

How are developers' business models changing with the new inclusionary zoning legislation?

Creager: This legislation adds an element of complexity to the business model. People can't use the same proforma they have for the past ten years. They're going to have to look at market segments in a different way and understand what the impact on the building sociology will be with respect to the mixture of incomes. Some people have been doing this work for a long time, for example, Skip Grodahl with GSL Properties has about 10,000 units of housing including the Yards at Union Station. Skip has been working in this space for the past 20 years and this is just an adaptation for him. What I see in mature markets that have had inclusionary zoning for a long time, eg Virginia, is that ultimately after the market adjusts, the asking price of land will reflect the entitlements. In other words, inclusionary housing policies are baked into the zoning construct. It may take 18-36 months but closed sales of land will reflect those entitlements.

Dan Saltzman, Commissioner, City of Portland

What is your opinion on the current development environment in Portland?

Saltzman: It seems like a very robust environment, for multifamily in particular, with record levels of activity. Development is always at the whims of the economy, with respect to interest rates for example, but I think Portland is a strong market that is only going to strengthen over time as this remains a very desirable place to live.

How is your business model changing with the new inclusionary zoning legislation?

Saltzman: I think that many developers feel this is not doable and that the City is dictating a government solution to a problem that should be more market based in its solution. However, also think the market based solutions are not really working for people seeking affordable housing in our area due to price escalations on rents and home prices. It’s our goal to establish a requirement now that says, with input from the development community, affordable housing is part of their developments. We have a 25,000 unit deficit in affordable housing over the next 20 years and we can’t solve this problem by government investment alone. ■

OFFICE MARKET ANALYSIS

MELISSA BEH

Portland State University

The U.S. office market in the first quarter of 2017 saw rental rates rise. Class A rent rose 3.5 percent while demand for quality space continues to be steady; though occupancy growth slowed down to 3.6 million square feet. The new year brought the U.S. into a new phase of the economic cycle exposing a shift in supply and demand. While growth continues, companies are seeing a tightening in the labor market—making it hard to find skilled talent. With that said, development is thriving and this boom is forecasted to last until 2018.

■ **Melissa Beh** is a Master of Real Estate Development candidate and has been awarded the Center for Real Estate Fellowship. Any errors or omissions are the author's responsibility. Any opinions are those of the author solely and do not represent the opinions of any other person or entity.

Portland Metro's first quarter

- ✧ **JLL** focused on Portland's lack of affordable Class A options. This deficiency is forcing tenants to either pay higher rents or consider more economic choices such as moving to the suburbs or settling for Class B or C buildings. Tenant size continues to rise and developers are accommodating this demand with larger buildings, over 1.6 million square feet of office space is expected to be delivered over the next 18 months.

- ✧ **Colliers** underlined the prediction that the negative net absorption seen in the first quarter will return to a net positive in the coming months due to the stabilizing job growth rate in Portland and the timing of larger tenants beginning to take occupancy of recently executed leases.

- ✧ **CBRE** highlighted that the average asking rates have risen 7.2 percent year-over-year and have increased 15.9 percent in the past 24 months.

VACANCY

Table 1: Total Vacancy Rates by Brokerage and Class, First Quarter 2017

Brokerage	Total	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
CBRE	11.2%	11.7%	10.4%	10.1%	16.8%	12.3%
Colliers	8.8%	10.8%	11.6%	10.6%	8.5%	--
JLL	9.9%	9.4%	9.7%	9.6%	8.3%	--

Source: JLL; CBRE; Colliers International

CBRE's data shows overall vacancy rates in the Portland Metro Area rose by a full percent from 10.12 percent to 11.2 percent, but Class C office space in the CBD was hit the hardest with a 10 percent increase from the end of 2016 until now. JLL reported a rise in vacancy rates across the board except in the CBD Class C space which fell from 9.2 percent to 8.3 percent. Colliers data also supports an overall rise in vacancy rates both downtown and in the surrounding areas.

Table 2: Portland Direct Vacancy Rate by Market area and Submarket, First Quarter 2017

Location	Q1	Change from Q4
Portland CBD	8.9%	(0.2%)
Lloyd District	6.9%	(2.8%)
Portland Central City	**8.6%**	**(0.4%)**
Clackamas / Milwaukie Totals	6.7%	0.5%
Airport Way/Columbia Corridor	19.6%	0%
Close In Eastside	5.6%	(0.7%)
Outer Eastside	12.4%	(2.6%)
Portland Eastside Suburbs	**10.1%**	**(0.4%)**
217 Corridor / Beaverton	14.0%	(0.5%)
I-5 South Corridor	11.6%	0.4%
Kruse Way	10.8%	(2.3%)
Northwest	6.4%	(1.9%)
Sunset Corridor	8.6%	0.9%
SW Close In	6.0%	0.4%
Portland Westside	**10.2%**	**(0.6%)**
Cascade Park/Camas	6.7%	(0.9%)
CBD/West Vancouver	8.2%	(0.3%)
Hazel Dell / Salmon Creek	2.6%	1.1%
Orchards/Outer Clark	12.8%	(0.1%)
St. John's Central Vancouver	23.5%	(0.3%)
Vancouver Mall	4.8%	0.2%
Vancouver Suburbs	**8.4%**	**(0.3%)**
Portland Metro	**9.3%**	**(0.5%)**

Source: JLL

RENTAL RATES

CBRE reported an overall rise in rental rates (7.2 percent increase year-over-year, and 5.6 percent for downtown rates). Class B rates grew the most with a 13 percent year-over-year increase. Reported rates from both Colliers International and JLL also increased. JLL reported the highest rates both overall ($28.04) and in the CBD ($32.61), more than a dollar higher from their Q4 reports. As expected, rates from all sources have continued to trend up, despite the rise in vacancy rates.

Table 3: Average Quoted Rates ($/sf FSG) by Brokerage and Class, Frist Quarter 2017

Brokerage	Average	CBD	Suburban	CBD Class A	CBD Class B	CBD Class C
CBRE	$26.87	$30.90	$23.31	$33.71	$30.43	$26.41
Colliers	$24.11	$29.99	$23.31	$32.03	$29.84	$24.15
JLL	$28.04	$32.61	--	$34.94	$31.82	$25.32

Source: CBRE, Colliers International, JLL

Table 4: Portland Average Direct Asking Rent ($/sf)
Ranked by Market Area and Submarket, First Quarter 2017

Location	Q1	Change from Q4
Portland CBD	$32.61	$0.79
Lloyd District	$27.49	$0.16
Portland Central City	$32.22	$0.93
Clackamas / Milwaukie Totals	$23.46	$0.98
Airport Way/Columbia Corridor	$20.52	$0.59
Close In Eastside	$30.55	($0.27)
Outer Eastside	$20.55	$2.01
Portland Eastside Suburbs	$25.67	($1.34)
217 Corridor / Beaverton	$22.26	$1.51
I-5 South Corridor	$23.87	$1.12
Kruse Way	$29.77	$2.77
Northwest	$37.38	$10.15
Sunset Corridor	$22.74	$1.15
SW Close In	$22.36	$1.65
Portland Westside	$26.26	$4.07
Cascade Park/Camas	$21.00	$2.75
CBD/West Vancouver	$23.33	$0.18
Hazel Dell / Salmon Creek	$20.33	($0.48)
Orchards/Outer Clark	$18.01	$0.00
St. John's Central Vancouver	$19.47	$0.40
Vancouver Mall	$14.96	$1.11
Vancouver Suburbs	$20.55	$1.2
Portland Metro	$28.04	$2.60

Source: JLL

ABSORPTION AND LEASING

Table 5: Net Absorption (square feet) by Brokerage and Area, First Quarter 2017

Brokerage	Overall	CBD	Suburban
CBRE	(259,747)	(214,567)	(45,180)
Colliers	(154,735)	(56,051)	----
JLL	(107, 390)	(22,329)	----

Source: JLL; CBRE; Colliers International

CBRE, JLL, and Colliers reported an overall negative net absorption in all Portland Metro markets in the first quarter. This trend should correct itself in the coming quarters as leases are renewed and/or executed.

Table 6: Notable Lease Transactions, First Quarter 2017

Tenant	Building/Address	Market	Square Feet
City of Portland	Congress Center	CBD	67,438
City of Portland	400 Sixth Avenue Building	CBD	60,507
City of Portland	Columbia Square	CBD	41,381
Cloudability	334 NW 11th Ave	CBD	22,591
Zapproved	Machine Works	CBD	19,258
CLEAResult	First & Main	CBD	39,507
POWER engineers, Inc	*3 Centerpointe	Kruse Way	61,660
Social Security Administration	Block 300	Lloyd District	22,338

Source: CoStar; CBRE; Colliers International

SALES TRANSACTIONS

Colliers International and CoStar both noted one of the largest transactions in Q1 as the Umpqua Bank Plaza in the CBD. With a total price of $90, 000,000 it is one of the most notable transactions of the quarter. Congress Center was also a significant transaction within the CBD coming in at over $85,000,000.

Table 7: Notable Sales Transactions, First Quarter 2017

Building Address	Submarket	Price	Price/SF	SF
Umpqua Bank Plaza	CBD	$90,000,000	$325.29	276,676
Congress Center	CBD	$85,125,000	$221.13	384,951
American Bank Building	CBD	$53,000,000	$313.00	169,329
Riverside Centre & 5550 Macadam	SW Portland	$27,500,00	$193.00	142, 298
Gresham State Medical Plaza	Gresham	$23,500,000	$234.00	100,419
One Embassy Centre	217 Corridor/Beaverton	$16,750,000	$193.18	86,706
1881 SW Naito Pkwy	CBD	$14,000,000	$348.05	40,224

Source: CoStar; CBRE; Colliers International

DELIVERIES AND CONSTRUCTION

The City of Portland has officially started reconstruction on the Portland Building—though it is not scheduled to be completed until 2020. CoStar focused on three main deliveries: The Dairy Building on the east side, Mason Ehrman Annex, developed by Beam Development, in the CBD, and 3514 NE Sandy Blvd. in the Lloyd District. CBRE notes a number of new construction and renovation projects underway that are scheduled to be completed in the second quarter, such as, the Leland James building in NW, Towne Storage in the Central Eastside, the the Ballou & Wright Building in the CBD, and 6430 SE Lake Rd. in Clackamas/Milwaukie area.

Table 8: Portland Office Market
Construction and Deliveries by Submarket, First Quarter 2017

	Deliveries (YTD)	Under Construction
Portland CBD	28,000	618,480
Lloyd District	45,098	0
Portland Central City	73,098	618,480
Clackamas / Milwaukie Totals	0	17,495
Airport Way/Columbia Corridor	0	0
Close In Eastside	51,729	370,150
Outer Eastside	0	0
Portland Eastside Suburbs	51,729	387,645
217 Corridor / Beaverton	0	21,000
I-5 South Corridor	0	0
Kruse Way	0	0
Northwest	0	465,767
Sunset Corridor	0	0
SW Close In	0	110,120
Portland Westside	0	596,887
Cascade Park/Camas	0	0
CBD/West Vancouver	0	0
Hazel Dell / Salmon Creek	0	0
Orchards/Outer Clark	0	0
St. John's Central Vancouver	0	0
Vancouver Mall	0	0
Vancouver Suburbs	0	0
Portland Metro	124,827	1,603,012

Source: JLL

INDUSTRIAL MARKET ANALYSIS

ANDREW CRAMPTON

Portland State University

Large industrial users are the new paradigm for the Portland industrial market, and are spearheading the continued focus towards large single user buildings constructed in the region. Leading the charge is Amazon's recently announced 855,000 square foot fulfillment center at the Troutdale Reynolds Industrial Park, which would be the fourth largest industrial building in the Portland metro region. This enormous eastside presence is bookended by the 300,000 square foot Amazon distribution center in the Westside's Majestic Hillsboro Business Park, the largest speculative project in the Sunset Corridor. This large-user trend is expected to continue, with JLL projecting six new leases over 100,000 square feet, totaling almost 1.2 million square feet, will commence in the second quarter.

Absorption square footage increased dramatically in the past year. Colliers reports 878 thousand square feet of absorption in the first quarter, compared to 382,000 in the first quarter of 2016. Leasing was up with 49 leases above 10,000 square feet, totaling 2.1 million square feet, up 38 percent from last year. The lowering absorption rate is one of the early signs of a softening market after record level post-recession growth rate.

■ Andrew Crampton is a Master of Real Estate Development candidate and has been awarded the Center for Real Estate Fellowship. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

VACANCY AND RENTS

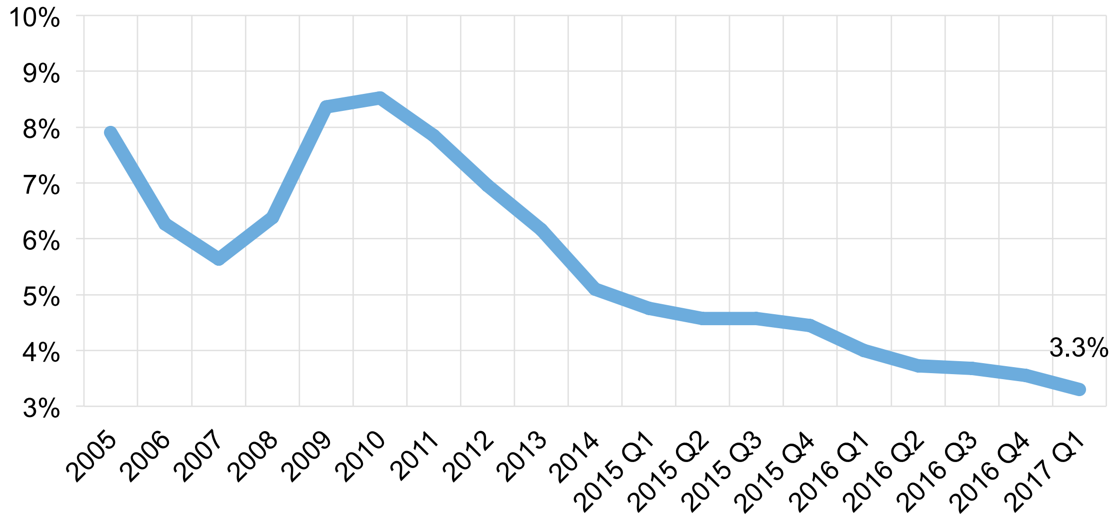
Overall vacancy declined to new post-recession lows in the first quarter of 2017, averaging 3.5 percent according to Kidder-Matthews, a 15 year low in the metro area. Large users drove industrial rents to an average of $0.55 per square foot, but rents should begin to steady as recent deliveries of large scale buildings have softened the vacancy rate. Buildings larger than 200,000 square feet have 5.9 percent vacancies while users of buildings under 200,000 square feet continue to struggle to find space in a re-oriented large user driven market. Kidder-Matthews report 2.7 percent vacancy rates in this sector. The Sunset Corridor/Hillsboro and NW Portland have the tightest vacancy rates with 1.3 percent and 1.9 percent, respectively.

Table 1: Portland Metro Industrial Quarterly Report Survey Q1 2017

	Capacity	JLL	CBRE	Kidder-Mathews	Average Q1 2017
Vacancy					
Industrial Vacancy	3.50%	3.50%	2.90%	3.50%	3.35%
- Flex	8.30%	7.60%	-	-	7.95%
- Weighted Average	3.94%	3.88%	2.90%	3.50%	**3.56%**
Rents *					
Industrial Market	$0.52	$0.58	$0.55	$0.55	$0.55
- Flex	$1.03	$1.00	N/A	N/A	$1.02
- Weighted Average	$0.57	$0.62	$0.50	$0.55	**$0.56**

* Asking rents; Industrial = shell space; Flex = shell and office space

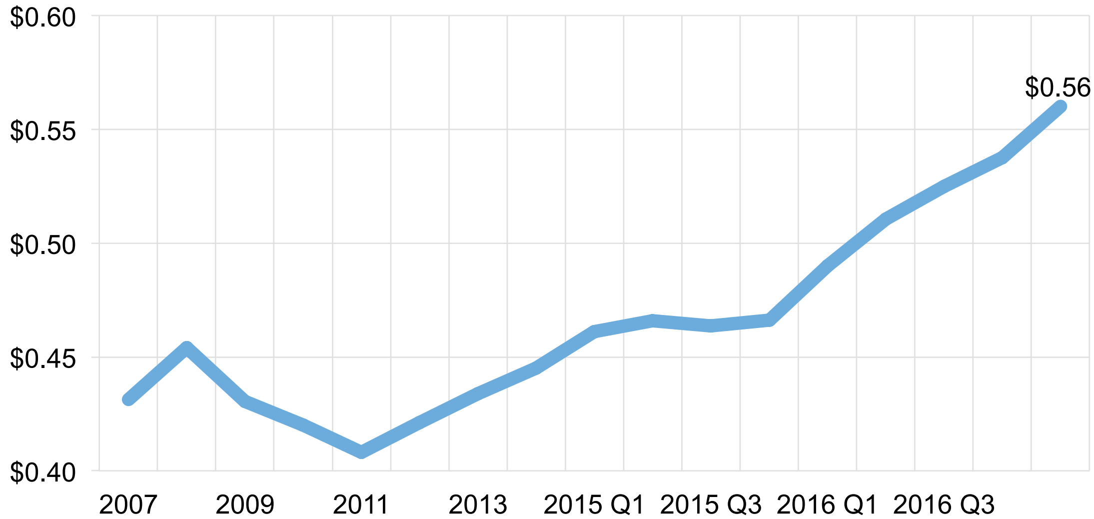
Figure 1: Portland Metro Industrial Vacancy Rate, 2007–2017 Q1



Sources: Average of Quarterly Reports from CBRE, JLL, Capacity, Kidder Matthews

Leasing activity during the First Quarter totaled 117 transactions covering 1,617,122 square feet of gross absorption, according to Kidder-Matthews. A substantial transaction in the first quarter was the 201,300 square foot lease signed by Lam Research Corporation in Tualatin.

Figure 2: Portland Metro Average Shell Asking Rents, 2007–2017 Q1



Sources: Average of Quarterly Reports from CBRE, JLL, Capacity, Kidder Matthews

ABSORPTION AND DELIVERIES

CBRE reports that user demand has slowed nationally, down 42 percent from the previous quarter and 48 percent from 2016 Quarter 1, reflecting the beginning signs of a softening economy.

Table 1 Portland Metro Industrial Net Absorption Last 4 Quarters (Source: JLL)

	Distribution / Warehouse	Flex	Total
Q2 2016	671,376	97,354	768,730
Q3 2016	427,411	174,317	601,728
Q4 2016	1,299,376	99,682	1,399,058
Q1 2017	133,720	25,497	
Total Past 4 Quarters	2,531,883	396,850	2,928,733

Source: JLL

INVESTMENT ACTIVITY

In the quarter's largest investment sale, acquired the Cameron Distribution Center at 16913 NE Cameron Blvd in the East Columbia Corridor from Denver-based Amstar Group. Kidder Matthew reports the $28.04 million sale price came out to $87 per square foot, underwritten at a 5.5 percent cap rate. Other large purchases include the region's largest owner-user buy, the French construction and engineering firm Oger International bought 1300 NE 25th Avenue in Hillsboro, a 112,500 square foot manufacturing property, for $8.1 million. Overall investor confidence in the industrial market is strong, fueled primarily by on-line retailers demand for distribution space. The overall US economy is also a key source of investor confidence due to the recent upgrade in expected GDP growth, full employment, and expected tax-breaks.

Industrial users will continue to grow in size, with JLL reporting that average leases have grown over 57.8 percent since 2010. Recent signs point to continued demand for these massive distribution centers as online retailers continue to impact brick and mortar retailers. Continued demand for data storage, last mile logistics and marijuana production point to continued demand for increasingly less available industrial properties. Although the market is focused on large end-users, the low vacancy rate for Industrial users under 100,000 square feet will present targeted investment opportunities. ■