CONTENTS

HOSPITALITY MARKET 1
SONDRA STORM

PORTLAND HOUSING MARKET AND 2018 UGB 12
GERARD MILDNER

STATE OF THE ECONOMY 29
ANDREW CRAMPTON

HOUSING MARKET ANALYSIS 34
JON LEGARZA

OFFICE MARKET ANALYSIS 51
RILEY HENDERSON

INDUSTRIAL MARKET ANALYSIS 57
ANDREW CRAMPTON

RETAIL MARKET ANALYSIS 61
RILEY HENDERSON
PORTLAND’S HOSPITALITY INDUSTRY IS RIDING HIGH: WHAT’S ON THE HORIZON?

SONDRA STORM
Embarcadero Hospitality Group

A couple of years ago, my husband and I were in a large crowd on the Congress Street Bridge in Austin, Texas, waiting for two billion bats—the world’s largest urban bat colony—to emerge and flood the night sky at dusk. As we waited for dusk to fall, we struck up a conversation with a pair of Swedes, two young guys traveling to the States on vacation. They shared that there were three cities on the top of their list to visit in America: New York City, Austin, Texas, and Portland, Oregon. When we responded “We’re from Portland”, they smiled broadly and proclaimed, “Portlandia!”

It’s no secret that Swedes aren’t the only ones intrigued by Portland. The Rose City and Oregon’s many attractions have demonstrated increasing appeal to both domestic and international travelers. Travel Oregon reports lodging demand in Oregon has been increasing for eight consecutive years, with nearly 30 percent growth from 2008 to 2016 and 15.7 million rooms booked in FY 2015-2016. While the majority of visitors to Oregon are West Coast dwellers from nearby cities, the nationwide and overseas visitor counts continue to rise. In 2016, Oregon ranked 11th out of all 50 states for U.S. leisure traveler interest, with 13 percent of travelers interested in visiting, up from 6 percent in 2010. In 2016, international visitors spent $1.22 billion in Oregon, up from $1.15 billion in 2015. International travel to Oregon has increased by 25 percent between 2011 and 2016 with a 49 percent projected growth between 2016 and 2021.

Sondra Storm is CEO of Embarcadero Hospitality Group. In addition to hospitality, Sondra has extensive professional experience in community engagement and strategic planning in the public sphere. Embarcadero Hospitality Group (EHG) is a hotel development, management and consulting firm with offices in Portland and San Francisco. EHG’s principals have been involved in the development and management of over 20 hotels ranging from boutique independent to branded business-class properties. EHG frequently consults with private and public clients, including ports, cities, economic development organizations and urban planning firms. Sondra can be reached at sondra@embarcaderohg.com or 503-704-6776.
Though Portland is not a first-tier gateway city like Seattle or San Francisco, it has cultivated a strong appeal and identity especially popular among millennials, with increasing appeal among international travelers. Unlike the gateway cities that rely on their name, large populations, centers of commerce and the expected “big-brand” travel experiences, Portland has built a distinct, hip character that is uniquely Portland (no Hardrock Café’s here). Visitors come because of our creative restaurants and food carts, our walkable, bike-able and transit friendly city, our quirky charm, DIY ethos and natural beauty. It’s Portland’s vibe, rather than our tourist attractions that draw many visitors. There are approximately 276 hotels and more than 27,500 rooms in greater Portland, and much like other West Coast metro areas, Portland has a larger market share of “upper end” properties than nationwide averages (“Luxury”, “Upper Upscale” and “Upscale” market segments in industry insider terms). However, compared to the gateway cities, a higher percentage of Portland’s upper-end hotels are independent or “soft branded” properties rather than well-known brands like Hilton, Marriott, W and Ritz-Carlton.
Travel Oregon reports occupancies in the Portland metropolitan area are 76.7 percent and central business district hotels at 81.4 percent. These occupancies coupled with record guestroom rates, year after year, Portland hotels are doing better than ever. However, Portland’s lodging landscape is changing. The 600 guestroom Hyatt Regency at the convention center broke ground in August, 2017 and is due to open in 2019. A wide range of hotels—mostly downtown, and mostly on-trend boutique or “boutique-like” hotel projects—are in the pipeline. In the four-year period starting January 1, 2016, over 4,000 new rooms either have already opened, or are expected to come online by the end of 2019, a 13 percent increase in supply over all, according to HVS, a consulting firm specializing in the hospitality industry.

Will Portland’s hotel market be able to absorb the hefty shot of supply? How will the very large convention center headquarters hotel impact the market? The convention center and headquarters hotel aims to increase both supply and demand, drawing people to Portland for events that wouldn’t otherwise book in Portland. Yet, such events are often booked at a lower price point than other hotels, and they will introduce at least a modest element of the boom/bust guestroom rate dynamic typical of a market that is more reliant on convention based bookings. This will disrupt room rates at least in the offseason and on convention check-out days in Portland’s boutique-centric core.

Portland has been a sexy, highly sought-after location for hotel development in recent years. Developers are drawn to Portland because of the strong performance of existing hotels. Further, construction and development costs, while higher than the national average, are lower than Seattle and San Francisco. Developers are also picking up on the trend in travel toward unique, local “artisanal” experiences that Portland does so well. These factors combined with strong economic conditions have resulted in more than a dozen hotel openings in Portland over the last three years. Despite this rapid increase in supply, hotels in and near Portland have seen minimal fluctuation in their performance. Occupancies have remained relatively constant and room rates have increased steadily. Market demand has proven sufficient to absorb the influx in supply.

Portland’s city-wide occupancy in 2016 was 76.6 percent, with the average daily rate of nearly $137.00 and revenue per available room (RevPAR) at $105.00. In Portland’s central business district, 2016 saw occupancy at 81.4 percent, an average daily rate of $182.00 and RevPAR at nearly $149, according to Travel Oregon. We anticipate that demand for Portland rooms will remain high, but with the dramatic increase in supply, we anticipate a modest decline in occupancy for the next three years. However, the strength of the local economy should temper the decline, and we expect increases in average rates average daily rates, as the vast majority of the new supply falls in upper and upper-upscale price categories.
## Recently Opened

<table>
<thead>
<tr>
<th>Hotel</th>
<th>Location</th>
<th>Type/Market Segment</th>
<th>Year Open</th>
<th># of rooms</th>
<th>Central City</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residence Inn – Pearl District</td>
<td>1150 NW 9th Ave. Portland</td>
<td>Extended Stay - Upscale</td>
<td>2014</td>
<td>223</td>
<td>X</td>
</tr>
<tr>
<td>Society Hotel</td>
<td>203 NW 3rd Ave. Portland</td>
<td>Boutique – Lifestyle Economy/Midscale</td>
<td>2015</td>
<td>62</td>
<td>X</td>
</tr>
<tr>
<td>Hyatt House – Downtown</td>
<td>2080 SW River Dr. Portland</td>
<td>Extended Stay - Upscale</td>
<td>2016</td>
<td>203</td>
<td>X</td>
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<tr>
<td>Marriott AC Hotel</td>
<td>888 SW 3rd Ave. Portland</td>
<td>Lifestyle - Upscale</td>
<td>2017</td>
<td>204</td>
<td>X</td>
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<tr>
<td>Marriott Hi-Lo Autograph Collection</td>
<td>320 SW Stark St. Portland</td>
<td>Soft Brand Boutique - Upper Upscale</td>
<td>2017</td>
<td>120</td>
<td>X</td>
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<tr>
<td>The Duniway – Boutique rebranding of former Hilton</td>
<td>545 SW Taylor St, Portland</td>
<td>Soft Brand Boutique – Upper Upscale</td>
<td>2017</td>
<td>No net new rooms</td>
<td>X</td>
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<tr>
<td>The Dossier – Boutique rebranding of former Westin</td>
<td>750 SW Alder St, Portland</td>
<td>Boutique – Upper-Upscale/Luxury</td>
<td>2017</td>
<td>No net new rooms</td>
<td>X</td>
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<tr>
<td>Hampton Inn and Suites</td>
<td>19999 Tanasbourne Dr. Hillsboro</td>
<td>Upper Midscale</td>
<td>2014</td>
<td>106</td>
<td></td>
</tr>
<tr>
<td>Hampton Inn and Suites</td>
<td>315 SE Olympia Dr. Vancouver</td>
<td>Upper Midscale</td>
<td>2014</td>
<td>99</td>
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<tr>
<td>Embassy Suites</td>
<td>20001 Tanasbourne Drive Hillsboro</td>
<td>Upper Upscale</td>
<td>2014</td>
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<tr>
<td>TownePlace Suites</td>
<td>17717 SE Mill Plain Blvd. Vancouver</td>
<td>Extended Stay – Upper Midscale</td>
<td>2015</td>
<td>115</td>
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<tr>
<td>Candlewood Suites</td>
<td>2010 SE 192nd Ave. Vancouver</td>
<td>Extended stay - Midscale</td>
<td>2016</td>
<td>83</td>
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<tr>
<td>Residence Inn</td>
<td>3160 NE Brookwood Parkway. Hillsboro</td>
<td>Extended stay - Upscale</td>
<td>2016</td>
<td>146</td>
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<tr>
<td>Aloft</td>
<td>Hillsboro</td>
<td>Lifestyle - Upscale</td>
<td>2016</td>
<td>137</td>
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### PORTLAND AREA'S NEW SUPPLY AND CHANGING LANDSCAPE

<table>
<thead>
<tr>
<th>Hotel</th>
<th>Location</th>
<th>Type/Market Segment</th>
<th>Year Open</th>
<th># of rooms</th>
<th>Central City</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canopy by Hilton</td>
<td>NW Glisan St and 9th Ave Portland</td>
<td>Lifestyle - Upscale</td>
<td>Early 2018</td>
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<tr>
<td>Hampton Inn and suites</td>
<td>338 NW 9th Av. Portland</td>
<td>Upper Midscale</td>
<td>2017 or early 2018</td>
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<td>Harlow Hotel</td>
<td>738 NW Glisan Portland</td>
<td>Boutique – Midscale</td>
<td>TBD</td>
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<td>X</td>
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<tr>
<td>Grove Hotel</td>
<td>NW 4th Ave &amp; Burnside St Portland</td>
<td>Boutique – Upper Upscale</td>
<td>Nov. 2017</td>
<td>113</td>
<td>X</td>
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<tr>
<td>Woodlark</td>
<td>Corner of SW Alder &amp; SW Park Portland</td>
<td>Boutique - Upscale</td>
<td>Spring, 2018</td>
<td>150</td>
<td>X</td>
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<tr>
<td>Jupiter Hotel – Expansion</td>
<td>800 E Burnside St Portland</td>
<td>Boutique – Midscale</td>
<td>Early, 2018</td>
<td>81</td>
<td>X</td>
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<tr>
<td>Radisson Red</td>
<td>Broadway Tower Portland</td>
<td></td>
<td>Mid 2018</td>
<td>180</td>
<td>X</td>
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<td>Hotel Chamberlain</td>
<td>509 SE Grand Avenue Portland</td>
<td>Boutique</td>
<td>TBD</td>
<td>TBD</td>
<td>X</td>
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<tr>
<td>Hyatt Regency Convention Center Hotel</td>
<td>777 NE MLK Jr. Blvd Portland</td>
<td>Upper Upscale</td>
<td>2019</td>
<td>600</td>
<td>X</td>
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<td>Moxy Hotel</td>
<td>10th and Alder Portland</td>
<td>Lifestyle – Upper Midscale</td>
<td>TBD</td>
<td>179</td>
<td>X</td>
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<tr>
<td>Holiday Inn Express</td>
<td>1805 SW 192nd ave. Camas</td>
<td>Upper Midscale</td>
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<tr>
<td>Holiday Inn Express</td>
<td>Cascade Station – Portland Airport</td>
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<td>2018</td>
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<td>Oxford Suites</td>
<td>Hillsboro</td>
<td>Upper Midscale</td>
<td>TBD</td>
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<tr>
<td>Marriott AC</td>
<td>Vancouver Waterfront</td>
<td>Lifestyle - Upscale</td>
<td>2019</td>
<td>160</td>
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<td>Hotel Indigo</td>
<td>Vancouver Waterfront</td>
<td>Boutique softbrand - Upscale</td>
<td>2019</td>
<td>138</td>
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<td>Cambria Suites</td>
<td>Beaverton</td>
<td>Upscale</td>
<td>TBD</td>
<td>140-150</td>
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PORTLAND’S HOSPITALITY INDUSTRY

PORTLAND AREA’S NEW SUPPLY AND CHANGING LANDSCAPE

Source: Smith Travel Research, reported by HVS, 2016

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BOUTIQUE AND LIFESTYLE HOTELS ON THE RISE

Independent hotels and new “soft brands” and “lifestyle brands” that are designed to mimic the unique, local and artisanal qualities of the independents represent a larger portion of the hotel market in Portland, compared to other cities where national brands dominate. Kimpton hotels, the first “boutique chain” and recognized pioneers on the boutique front, chose Portland as their first location outside of San Francisco. Kimpton’s boutique hotels have been very successful in Portland, and boutiques and soft brands like the Nines hotel (affiliated with Starwood’s Luxury Collection), rather than traditional brands tend to be the market leaders in Portland.

Big brands like Marriott and Hilton have recognized the success of both the boutique and independent models and are trying to emulate them, to keep market share. Fueled by the success of boutique chains like Kimpton and Airbnb’s “live like a local” ethos, as well as the emergence of the Millennial traveler, the big brands are “going boutique” with the recent introduction of a flurry of numerous “lifestyle” and “soft” brands, including: Hilton’s Canopy Hotels and Curio Collection, Marriott’s AC and Moxy Hotels and “Autograph Collection,” Hyatt’s Andaz and Hyatt Centric Hotels and their Unbound Collection and several more from industry powerhouse families of brands, Intercontinental Hotels Group, Choice Hotels, Radisson, Wyndham Hotels and more. The Millennial generation has now surpassed both Gen-Xers and Baby Boomers in numbers of business travelers and they tend to value “experiences” over things and generally prefer hotels that incorporate unique design, local touches, and inviting public spaces over opulent lobbies and large guest rooms.

Hotel brands, once notorious for strict “brand standards” are loosening up. Brands have traditionally taken pride in consistency and uniformity, promising that the cinnamon rolls, pillow cases, even shower heads are exactly the same in Topeka, Kansas as in Seattle, Washington. But, today hotel chains are all too aware of the young adult’s desire for individualized experiences. As a result, companies like Hilton and Marriott are creating the aforementioned new brands to attempt to replicate the experience and aesthetics of an independent, locally inspired boutique hotel.

Portland already embraces the hallmarks of a boutique/lifestyle property: rooftop gardens, locally sourced everything, shared bikes and the latest foodie concepts. As the brands introduce new millennial-friendly prototypes into the market as fast as they can “put a bird on it”, Portland is a prime target for their new products.

At the same time, the mega-hotel is not dead, and on the opposite end of the conceptual spectrum, Portland is about to get a Hyatt headquarters hotel with all of the traditional amenities one expects from a giant convention center property.

Proponents of the deal emphasized that the 600-room hotel will draw dozens of large events and conventions, bringing thousands of new visitors to the region and pumping millions of dollars into the economy both in economic activity generated by guests and in transient occupancy taxes collected. Organizers report that Oregon currently misses opportunities for revenue when large events pass on Portland due to lack of hotel rooms in the city.

Several local hoteliers opposed the $74 million in public support and fought the capital stack structure that they assert bolsters the Hyatt corporation at the expense of local entrepreneurs who have invested in and shaped Portland’s robust market. They also assert that the hotel will put downward pressure on room rates.
PROS/CONS AND EXPECTED IMPACTS OF THE CONVENTION CENTER HOTEL

Photo source: Google Images

After several years of public meetings, modeling, analysis, lawsuits, and numerous delays the $224 million Hyatt Regency finally broke ground in August. Metro believes the new hotel will draw an additional 5-10 large events and conventions annually. In an August 2017 press release, Metro Visitor Venues General Manager, Scott Cruickshank stated that they anticipate at least 10 new conventions each year resulting in $900 million in convention related spending/year. Groups that once overlooked Portland because there was not a hotel big enough to accommodate their attendees, will now consider Portland.

Scheduled to open in the Winter of 2019, the hotel is expected to have a significant impact on Portland’s economy: Convention business is projected to grow by 33 percent; Tourism spending in the region is expected to increase by $120 million annually; and $10 million in new tax revenue is expected to be generated each year, according to Metro.

Advocates argue that Convention Center hotels can generate additional occupancy even as they add supply, because they can expand the market. The Oregon Convention Center projects to increase the demand for all hotels in the Portland area by 70,000 to 110,000 new room nights. If this occurs, only a portion of those new room nights will be booked at the Hyatt Regency and the rest will go to other area hotels.

But many local hoteliers are nervous and here’s why. Convention center hotels potentially depress rates not only because of the increase in supply, but also because of how they structure their rates. To be competitive for big groups, the Hyatt Regency will need a rate competitive with other cities vying for group business, an increasingly crowded group. At 600 rooms, the Hyatt’s expenses will be very large on a nightly basis, whether they are sold out or only one-third full. They have to pay their construction loan and their managers’ salaries no matter what the hotel’s occupancy is on a given night, so they have enormous incentive to fill their rooms (even if it is at a low price) to maximize economies of scale. These dynamics will put downward pressure on Portland area rates especially on days that conventions wind-up, and during the winter, late-fall, and early spring, when Portland hotels already have lower rates and occupancies.
Convention center hotels are vulnerable to boom/bust cycles. Cities tend to swoon about the potential revenue of convention hotel business. If not clear-eyed and discerning, they can work with consultants who give optimistic projections about the benefit to the city. The truth is hotels in the right market are great economic stimulators. In addition to transient occupancy taxes collected by hotels from guests, hotel guests typically spend as much in the community as they spend at a hotel. If a visitor spends $250 on a room, they generally spend $250 in the community.

Further, there is naturally excitement about a headquarters hotel that brings people in and “shows off” one’s city.

However, during the last recession, even though government agencies and companies tightened their belts, many cities continued to invest in conventions. As a result, convention centers across the country reduced rental rates and backfilled the loss of “high-impact” conventions with lower revenue generating events, such as seminars, banquets and social events. Hotel performance is cyclical, with broader swings than the retail or residential economy, and convention center hotels tend to swing even more broadly than the average hotel market. Beyond the convention center itself, many developers are concerned about a possible economic downturn and the 4,000 rooms recently added or soon to be added to the market should give developers pause.

Analyses of the impact of convention center hotels nationally reveal examples of both positive experiences. For example in Nashville, where their outcomes were strong, and other experiences where the reality hasn’t lived up to the hype. In the book Convention Center Follies, Heywood T. Sanders examines the surge in convention center development over the last two decades, fueled by public investment. He concludes that the return on investment is very limited. Sanders warns against viewing convention centers as an economic panacea and warns against the circular logic that often surrounds convention center development.

Embarcadero Hospitality Group frequently consults with both public and private entities, we have recommended for and against public/private partnerships based upon rigorous specifics. Every time a convention center has been proposed, we have recommended against, although many of these proposals have either been in extended metro areas already well-served by convention facilities, or smaller markets. This is not to say that we would have recommended against this project in Portland. Given that the convention hotel is moving forward, we have these recommendations for the parties involved:

Key Recommendations for Metro and the Oregon Convention Center:

1. Energetically engage an asset manager on an ongoing basis to ensure goals and philosophies are aligned and to ensure transparency with Hyatt.
2. Utilize the data collected by Travel Oregon and the Convention Center to capture baseline data and measure progress toward goals.
3. Work with the industry and other hoteliers to be collaborative to meet broader tourism goals.
4. The convention center booking team will need to creatively entice groups to come during Oregon’s wet winters. Conference bookers are often looking for warm sunny weather (think Las Vegas or Los Angeles). Conventions in the summer when rates are already at their highest could disturb local hotels’ abilities to maximize their rates.
5. The Convention Center sales team and Hyatt marketing team should consider the following trends:

- The increase in Airbnb and room sharing. Millennials are increasingly interested in staying at Airbnb rather than at the designated convention hotel. A recent joint study revealed that as many as one-third of group rooms are booked outside of the convention hotel.\(^2\)

- The experience-based ethos makes unique locations for conventions and meetings appealing; thus, organizers will need to think about creating a more modern experience and creating event packages that connect attendees to the city and the region.

- Meeting attendees are increasingly interested in better, “non-corporate” food and beverage, wellness programming, and the latest technology.

- Competitive pressure has shortened the booking window. Room night blocks associated with convention and trade show events used to be blocked more than 18 months in advance. In recent years, that period has shrunk and it is anticipated to continue to decrease.

Recommendaions for Local Hoteliers:

1. You do you! A convention center hotel is a particular thing and it is not everybody’s thing. Capitalize on the unique experience you offer to guests.

2. “Bleisure” (that’s business and leisure) is a rising trend. Millennials now make up the largest sector of business travel and they like to tack on a couple extra days to a business trip for leisure. Portland area hotels should take full advantage of that dynamic.

3. With potentially more rate volatility, general managers and rate managers need to be on top of their game, monitoring and adjusting rates as needed. We find that most mistakes are made by waiting too long to identify future high-demand events and dates. General managers often brag about the high rates they obtained for the last several rooms on sold out nights, but those don’t begin to make up for the lost revenue for the other 90 percent of their rooms due to “lazy” monitoring of rates that proved to be too low for the demand. In this manner, huge revenues are lost at many hotels in every market.

4. Make a big, sustained effort to get your guests to book directly on your website or by phone. Expedia and Priceline and their 10-30 percent fees are profit killers, if relied on too heavily. It cannot be overstated: Work your magic to get customers booking through you directly.

Recommendaions for The Public:

With $150 million of the total $224 million project cost coming from the hotel developer, the Hyatt Regency Portland is a large-scale investment in the Lloyd District. Over 80 percent of the public sector’s investment in the project comes from a $60 million Metro revenue bond that will be repaid with taxes generated by future hotel guests. The balance of the public investment includes $10 million in state lottery funds and a $4 million grant from the Oregon Convention Center’s reserves.

Metro estimates in FY 2015-2016 convention attendee spending was $729 million in the Portland metropolitan area. The number of events and attendance have increased year over year since 2013, according to HVS.
IN OUR VIEW?

Proponents have stated that they will see the following results and they should serve as benchmarks on the success of the project:

• Convention business to increase by 33 percent, note the convention center business increased by 11 percent from FY 2015 – 2016.
• Increase hotel room nights in the Portland area by 70,000 to 110,000 new room nights.
• Local tourism spending to increase by $120 million
• State, city and county taxes to raise $103 million in the first 10 years
• Once the hotel opens, the metropolitan region can expect total convention-related spending to approach upwards of $1 billion a year.

These data points along with regional rates and occupancies collected by Travel Portland should be monitored to show both progress toward goals and the impact on the local hotel industry. As with any complex, pioneering investment, reasonable arguments based on reasonable assumptions create competing scenarios that suggest that the Hyatt Convention Center will be a great benefit to Portland and its hotel market, or, alternatively that it will prove to be a modest benefit to the City generally, and hurt the hotel market. Time will tell.

Regardless, it is our view that Portland and its hotel market will continue to outperform the national averages for the foreseeable future; while riding the waves of economic expansions and enduring inevitable cyclical recessions.

Portland, with its proximity to superstar west-coast gateway cities, its wealth of natural and recreational assets, and its compelling identity and charm will slowly, but surely gain in status, and take its place as a prominent metropolitan “place to be” for business and lifestyle, among the already established west coast gateway cities: Vancouver, Seattle, San Francisco, Los Angeles, and San Diego.

As the market evolves, it is incumbent upon us in the hospitality industry to respond with ingenuity and to remain focused on the guest experience. If hotels can “tell the story” of Portland and inspire meaningful connections between guests and the city, each hotel and Portland’s hospitality and tourism market will thrive.


2 ASAE Foundation, Center for Exhibition Industry Research CEIR, Destination & Travel Foundation, Meeting Professionals International (MPI), and Professional Convention Management Association PCMA Education Foundation. The Event Room Demand Study – How Many Rooms Does Your Convention Really Use? July, 2015. Tourism Economics conducted the study.
Portland, Oregon’s urban growth boundary (UGB) has been an iconic policy for the urban planning profession for the past 40 years. The boundary is an element of an urban containment system to promote farm and forest protection and promote the development of dense, walkable urban spaces. Measured in these physical terms, the policy has been quite successful. Rural areas of the Willamette Valley remain productive farmland, specializing in wine, fruits, hazelnuts, nursery plants, and other agricultural products. And Portland’s downtown is recognized as a well designed urban core, with numerous greenspaces and parks and a revitalized downtown and urban neighborhoods.

At the same time, housing prices and rents in the Portland metropolitan area have been rising at rates significantly above the rate of inflation, with the City of Portland declaring a housing crisis. This paper argues that Oregon’s landmark land use regulations have been side-tracked in recent years by layering of local regulations that have reduced housing production and created a regional housing crisis. In addition, this paper reviews the prospects for an urban growth boundary expansion in 2018.

Gerard C. S. Mildner, Ph.D. is an associate professor of real estate finance and the academic director of the Center for Real Estate at Portland State University. Dr. Mildner has an undergraduate degree from the University of Chicago and a Ph.D. in economics from New York University. His research is focused on land use regulation, growth managements, rent control, urban transportation and the economics of local government. 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.
DEVELOPMENT OF PORTLAND’S UGB

Under the State of Oregon’s land use planning system, all cities within the state are mandated to have urban growth boundaries to contain its residential and commercial activities. Cities are required to analyze the capacity of their urban growth boundaries on a regular basis to insure 20 years’ worth of land for population and employment growth are maintained within these boundaries.

It’s widely recognized that Portland’s original UGB set in the late 1970’s had a generous land supply and didn’t initially have a significant impact on overall development costs. The boundary was particularly loose on the western edge of the metropolitan area in Washington County, where the county seat of Hillsboro was 20 miles west of downtown Portland. In addition, the boundary was established in the late 1970s prior to a pronounced recession in the early 1980s in the state of Oregon. As a result, the Portland metropolitan was able to grow within its newly established boundary with Washington County being a leader in the production of new housing units.

Starting the early 1990s, development within the Portland region accelerated and housing costs and land costs started to increase. In roughly 1995, the Portland metropolitan region achieved average housing prices that exceeded the national average for urban areas for the first time in history. Spurred by policies promoting economic development, Washington County attracted major investments by Intel and other information technology firms.

At the same time, the region engaged in a process to develop a long term development plan, known as the 2040 Growth Plan. In the language of the debate, citizens were told that the region faced a choice of “growing up or growing out.” That is, the region could continue with previous policies to provide generous amounts of land for low-density fringe development (i.e., “growing out”), or the region could minimize the need to expand into exurban farmland by promoting higher density inside the UGB (i.e., “growing up”).

Ignoring for a moment the pejorative language represented by the “growing out versus growing up” choice (who doesn’t want to be a grown-up), a conscious decision was made to seek to accommodate future growth within the existing urban growth boundary, rather than two available options: (1) promoting the development of satellite cities, or (2) promoting continued low-density development along the fringe of the urban growth boundary. The Portland-area regional government, Metro, implemented a long-standing policy known as the “Metropolitan Housing Rule,” which encouraged all jurisdictions within Metro’s boundary to set aside land for a variety of housing types. As a result, most jurisdictions have residential zoning that can accommodate mid- and high-rise construction, provided the demand for those products exist.

Throughout the 1990s, Metro made small UGB expansions, satisfying the desires of individual property owners, developers, and jurisdictions. State rules mandated that any urban growth boundary expansion focus on the protection of high quality farmland to preserve the agricultural economy. Since 1980, the area inside Portland’s UGB has expanded by 10 percent, while the population of the metropolitan area has grown by 78 percent.

In 2000, Metro determined that a large expansion of the UGB was warranted and they implemented an expansion in the Damascus area of Clackamas County, in the southeastern corner of the metropolitan area. The Damascus area was chosen because of the relatively poor soil quality and rugged terrain that made the land area less suitable for intensive agricultural development. The expansion decision led to a Metro-promoted ballot measure in 2004 to create a new City of Damascus that was approved by a wide
margin of local residents. Damascus became the first newly incorporated city in the state in 22 years.

However, soon after the creation of the City of Damascus, local residents became increasingly skeptical of the impact of incorporation and refused to adopt a local plan that would allow significant new housing to develop. The city engaged in prolonged debates about its future and was widely seen as dysfunctional. Ultimately, the local residents voted to dis-incorporate the jurisdiction in 2016. Today, the Damascus area remains a sparsely-populated portion of the metropolitan area, far removed from the highway grid of the region, largely unserved by water and sewer utilities. Portions of the former territory of Damascus have been annexed by the neighboring pro-development town of Happy Valley, so that some housing is being produced. However, the leadership of Metro, Clackamas County and Happy Valley recognizes that most of the Damascus territory won’t be developable in the foreseeable future.

Like most metropolitan areas, Portland experienced significant economic dislocations resulting from the Great Recession of 2008. Portland was one of the last metropolitan areas to experience a decline in home prices, but the decline that happened was quite severe. The average existing home price in the region declined from $311,700 in July, 2007 to $223,000 in January, 2011. The decline in home prices led to a precipitous decline in housing production, particularly in the suburban counties in the metropolitan area. Housing production in the four county region (including Clark County, Washington) averaged 14,000 units per year from 1990 through 2007. By 2009, housing production fell below 4,000 units. While the total number of housing units produced has risen in recent years, the average for the last four years is 12,000 housing units per unit. When comparing population growth against housing production, there is an absence of about 50,000 housing units arising from the recession.

In addition, the distribution of housing production in the recent years has been quite different than previous decades. Between 1990 and 2007, 67 percent of housing production in the four county region has come in the form of single-family homes, falling
to 62 percent in 2008-12, when housing production was depressed, falling to 47 percent single family in 2012-16, when overall housing production had recovered. And at the same time, there was a boost in construction in Portland and Multnomah County relative to the three suburban counties. In 1990-2007, Multnomah County comprised 23 percent of housing permits, rising to 33 percent in the years of reduced production (2007-12) and 37 percent in the recovery period, 2013-16.

There are a couple of explanations for these trends, with the most convincing being that the Great Recession delayed marriage and child-raising. Singles and childless couples tend to settle in central city neighborhoods where social gathering places are concentrated. In addition, the decline in wealth from the recession has damaged the ability of young couples to buy homes, and apartments tend to be more concentrated in Multnomah County. And market outcomes are the interaction of supply and demand, so the challenges of subdivision developers to find capital for land acquisition may have led to an abundance of apartment construction over single-family home construction.

In any case, the rising demand for apartments has led to significant rent increases, making Portland one of the fastest appreciating rental markets in the United States in recent years. Those market conditions have led to considerable turmoil in city and state housing policy. In October, 2015, the Portland City Council declared a housing emergency, vowed to increase affordable housing production and required that landlords give a 90-day notice for any rent increase exceeding 5 percent. In January, 2016, Portland Mayor Charlie Hales declared a moratorium on removal of homeless encampments on public property (that policy was rescinded in August, 2016). In March, 2016, the Oregon legislature removed a long-established prohibition on city governments implementing inclusionary zoning programs, and that option was quickly adopted by the City of Portland. Finally, in February, 2017, Oregon House Speaker Tina Kotek renewed her call for the legislature to remove its long-standing ban on cities implementing rent control. While the legislature did not follow that recommendation, the Portland City Council declared a housing emergency and passed an ordinance requiring landlords to offer to pay relocation
expenses of between $2,900 and $4,500 should a landlord implement a no-cause eviction or propose a rent increase of 10 percent or more.

One of the ironies of the shift from a housing market dominated by single family construction in the suburbs to multi-family construction in the central city is the widespread appearance of a housing construction boom, when in fact, the region is experiencing a 15 percent decline in housing production. Every apartment construction site of five stories or more warrants a tall construction crane, often requiring demolition of old structures, temporary vacation of streets for construction staging, and regular deliveries by cement trucks. Downtown and close-in Portland has been awash in construction activity, which is duly noted by journalists and local residents. Yet the dearth of single-family construction on the urban fringe has been largely unnoticed in the local press. Few residents are aware of the 15 percent overall decline in housing production.

Within this context, Metro made an evaluation in 2015 of the capacity of its urban growth boundary and whether it needed to be expanded. Under procedures which have evolved somewhat over the years, Metro produces a population forecast, estimates the demand for employment land and residential land, measures the availability of land inside the UGB, and determines if the UGB should expand to meet the deficiency. The population forecast for the region is probably the least controversial part of the process, but includes a complicated allocation of the expected growth between the Metro jurisdiction, neighboring Clark County, Washington (which is not governed by Metro) and smaller jurisdictions in nearby counties that are not part of Metro.

With that population forecast in hand, Metro computes a Housing Needs Analysis that determines the number of housing units needed over the next 20 years. There is a similar process that determines the amount of employment land that’s needed. Metro then surveys the various local jurisdictions regarding the development capacity available for new housing units and new employment activities. In doing this, Metro accounts for both undeveloped greenfield sites as well as opportunities for redevelopment activity, using a computer model known as Metroscope. Lands which are within established flood plains and having steep slopes are removed from this analysis.

Ultimately, Metro’s Urban Growth Report in 2014 determined the region had 10,400 surplus acres for single family construction, 10,300 surplus acres for single family construction, and 990 surplus acres for industrial land to meet 20 years of population growth. As a result, Metro determined no additional acreage was required within the UGB for either housing development or employment growth. While a coalition of suburban mayors argued for more land for development and there was a specific expansion proposal from the City of Wilsonville, the Metro Council in 2015 adopted the recommendation by Metro staff that no expansion of the urban growth boundary was warranted. Hence, in a region in which the central city declared a housing emergency, the regional government saw no reason to release additional land for housing development.

Behind the Metro staff recommendation has been a policy to accept city zoning limits as the development capacity of the region, rather than taking a market feasibility perspective. Historically, the City of Portland has generous zoning along the avenues and boulevards in the city, as well as town centers such as Portland’s Gateway district. However, building at high or even medium densities requires much higher rents than currently exist in those neighborhoods. And like most metropolitan areas, apartment rents at the core of the metropolitan area are much higher than they are closer to the metropolitan edge. And in particular, the drop off in rents from Portland’s downtown to
its eastside neighborhoods along 82nd Street, Cully Street, Gateway, and 122nd Street is particularly steep. As a result, much of the development capacity within Portland is only achievable if rents rise dramatically across the entire region, or if these East Portland neighborhoods gentrify to a significant degree.

To illustrate this, I draw upon some research we did for Holland Residential back in 2014. In that research, we collected development pro formas for a number of apartment projects built in the preceding three years. For each apartment project, we noted the development type and computed an average rent per square foot for each project. We found that in our market, apartment projects neatly segment into three development types. Garden apartments are two-story apartments with wood-frame construction that is usually built in outlying communities. They often have surface parking or tuck-under parking and rent for $1.00 to $1.20 per square foot. Mid-rise apartments are typically five story construction with four floors of wood-frame construction built over a one-story concrete podium for parking. Mid-rise apartment buildings are usually built in close-in neighborhoods up to three miles from downtown and rent for $1.70 to $2.10 per square foot. Beyond five stories, current building codes in Portland require more costly steel and concrete construction (although some experimentation with cross-laminated timber construction has been done in recent years). High rise projects will only be located in near downtown neighborhoods and require rents in the $2.70 to $2.90 per square foot range.

The result is what I call the “Wooden House Theory,” which ought to have some appeal in a timber-producing state such as Oregon. Generally, homebuilders facing somewhat high land costs can produce cheaper homes on a square foot basis by going from one-story to two-story construction. The roofing costs and land costs are reduced, and the savings overwhelms the extra cost of the staircase. In today’s housing market in Portland with its
increased land costs, ranch homes are no longer produced in any quantity. Yet two-story construction requires relatively low-cost and easily obtained labor skills and materials. What it does require is significant quantities of available land.

Going beyond two stories requires a significant increase in rents due to the combination of higher cost materials and higher skilled labor. While land costs are reduced from the smaller footprint of these taller structures, those savings are not compensated by the higher materials and labor cost. And finally, true high rise construction results in a luxury product that is only warranted in high amenity areas. And for both the mid-rise and the high-rise product, they face the additional opportunity cost of retiring an existing income-producing property. That is, given the absence of unoccupied sites close to the center of the metropolitan area, developers have to acquire already-developed sites near the center and pay property prices that account for the value of the structure being torn down.

In looking at data on average rents for existing apartments in the Portland market, we can see that the only a select number of close-in neighborhoods have rent levels that justify mid-rise construction. As a result, as the region switches from a suburban-based housing supply to an urban-based housing supply, we are turning to a high-cost product. And as the new housing supply arrives to market at a higher price point, that removes the competitive constraint on the pricing of existing apartments.

This change in the regional expectations can be seen from a 2013 map produced by the City of Portland in its Comprehensive Plan Update. The map shows the change in housing density expected in the year 2035, showing spikes north, south and east of downtown, but also along 82nd street, the Montavilla neighborhood, and the Gateway District several miles east of downtown.

When I saw this map, I was already familiar with the intensive new development happening in Portland’s Pearl District, South Waterfront, Division Street, and the Williams and Vancouver couplet north of downtown. However, I was surprised by the expectation of high density development in Gateway and 82nd Street, which I had remembered as typified by low-density housing, Chinese and Mexican food restaurants, and used car lots, not to mention the data I was familiar with on average apartment rents. Upon visiting
these locations, nothing had dramatically changed in these neighborhoods in terms of their physical development. From what I could tell, the 2013 city report was strictly aspirational and not a true market forecast.

The final element of the UGB decision that is worth examining is the operation of the MetroScope model, at least using the procedures that were in effect in 2015. The MetroScope model is essentially a population assignment model that finds the next best place for a household type to be placed in the metropolitan area. Households are assigned to locations that meet the demand represented by their household profile, as measured by age, income, and household size. As development capacity is used up, the additional households are assigned to the next best location within the UGB, assuming there is some additional housing development capacity.

The problem with the MetroScope model (the 2015 version) is that development capacity, as represented by the permitted zoning, was assumed to be developable. However, as discussed above, development at higher density levels requires high rent levels, which are often much higher than market rents in the location of those apartment buildings. And since zoning entitlements in much of the relatively low-income, low-rent neighborhoods of east Portland are quite generous, there was plenty of development capacity to handle the additional population growth expected over the next 20 years. In that sense, Portland’s generous zoning entitlements acted as a sponge to soak up whatever population and housing demand that Metro’s demographic forecasters threw at them.

To their credit, Metro’s planners estimated the housing prices and apartment rents that would need to be achieved to reach those development targets. They anticipated that average rents in the Portland region would need to rise by 37 percent in inflation-adjusted terms in 20 years to justify the higher costs of development. Factoring in a 2.5 percent annual inflation factor, that would mean that rents would rise by 124 percent—more than doubling their current levels. Home prices would rise even faster in Metro’s estimation—148 percent in 20 years.

To assess what that level of appreciation would mean, I’ve arrayed the median gross rent in the Portland metropolitan area in 2009 against 21 other US metropolitan areas, selected for their size and location.
In that diagram, we find that the rents in the Portland region are somewhere in the lower half of the distribution, competing with large metropolitan areas such as Chicago and Dallas, and west coast competitors like Phoenix, Denver, and Salt Lake City. More importantly, Portland area rents are substantially below those in the major cities in California, such as San Francisco and Los Angeles, which are important sources of employment growth for this region. Economic development agencies in the region routinely recruit Bay Area software firms, arguing that while Portland may not have the same cultural or climate amenities of California, our housing is one-third less expensive and we’re a short airplane flight away. Put differently, the software firm in Bay Area can convince some of their engineers to move to Portland, knowing that the engineer can afford to buy a nice house.

However, with the rent and price increases anticipated by Metro’s 20-year plan, that value proposition evaporates. If rents in Portland rise by 37 percent more than the rate of inflation for apartments elsewhere, the large discount relative to the California cities vanishes. The engineer in Silicon Valley won’t readily accept a move to Portland, and our competitors in Denver, Phoenix, Salt Lake City, and Austin will win those firm relocation opportunities.

In practice, the strategy of absolute containment of the region’s population is likely to result in reduced employment opportunities and slower economic growth. Workers will require compensation for accepting jobs in a high cost, modest amenity region. If firms cannot achieve significant cost savings from locating in Portland, expansion will occur in other cities, whether that’s our mountain state competitors, cities in Texas, or cities in the Southeast US, such as Atlanta and Charlotte. Children who grow up in the Portland area will more likely move to those cities to find employment, creating what I call the “Santa Barbara Effect.”
Our city will remain a nice place with amenities, but it won’t be a dynamic place where new employment and technology are developed. Homeowners will feel richer, but the resulting increase in home equity won’t matter until they retire and move to Arizona or Nevada. Additionally, the brunt of the transition to Metro’s policy to appreciate real property assets will be felt most harshly by the poor, who don’t own property. Low-income households have been shown to be losers in regions that constrained spatial expansion in the face of population growth pressure.

A further complication to Metro’s development plan for the next 20 years has been the imposition of inclusionary zoning in the City of Portland. Struggling to meet the political demand for more affordable housing production, city leaders followed a two-track strategy. In the first track, they proposed and the voters accepted a $258.4 million bond measure to produce and preserve affordable housing. In the second track, they lobbied the state legislature to remove the ban on municipalities implementing affordable housing mandates on new apartment construction. The legislature complied and the City of Portland is the only jurisdiction in the state with inclusionary zoning. Under the inclusionary zoning policy, all buildings of 20 or more housing units must set aside 20 percent of those units to be affordable to households with incomes 80 percent of the area median income.

Developers were given an option of paying a fee in lieu of providing units within their buildings, but that fee has been set sufficiently high to make it unattractive. Planners at the city favored projects with mixed levels of income in each building. Developers were also promised by the legislature to be offered incentives to provide housing units under the inclusionary policy, but that appears to have been delivered in the form of bonuses that were removed from the zoning code, and then offered back to developers if they provided affordable housing.

Evaluating these policies requires some analysis of the broader purposes and impacts of housing policy. Housing is a necessity in terms of household consumption, or in the language of economists, housing is income inelastic. The 10 percent of households with the lowest incomes spend approximately half of their income on housing. As incomes rise, housing expenditures increase much more slowly than income, with the highest-income 10 percent of households spending only 10 percent of their income. As a result, any policy that reduces housing costs tends to be progressive.

This can be seen in the cost of providing a housing unit. All housing units need to have at least one bathroom and one kitchen to meet most local zoning codes, and those two rooms are the most expensive rooms in a house. As a result, there are certain fixed costs of housing that must be paid into order to be housed, and those fixed costs are a greater percentage of a poor household’s budget.

Housing assistance can be provided in two broad approaches. Supply-oriented assistance programs offer housing units to low-income individuals at a reduced cost. In public housing units and Section 8 Existing Housing projects, apartments are set at a percentage of tenant income with the federal government paying the difference with market rents. With low-income housing tax credits and other programs, benefits are given to investors, who promise to hold rents to particular levels, usually set at 30 percent of benchmark income levels in a community (as was provided in the City of Portland’s inclusionary zoning regulation). In supply programs, the benefit follows the unit, so when the tenant leaves, the discounted rent applies to the new tenant.
Demand-oriented assistance programs give a voucher or certificate to households that meet the eligibility criteria who can then shop for apartments within their market. If they are accepted by the landlords, the tenant is expected to contribute 30 percent of their income in rent and the federal government will make up the difference between that and the apartment rent, which is set at the 80 percent percentile of rents in that market. In demand programs, the housing benefit follows the tenant, so if they decide to leave their apartment, they can seek an apartment elsewhere in the community under similar terms.

Given this outline, the cost of a household living in subsidized housing (under either supply or demand approach) varies enormously with income. Households with zero income will receive a benefit equaling the cost of their apartment. For two-bedrooms in Multnomah County, that amount is $1,330 per month or $15,960 per year. The true benefit of household is something less than this amount in that they might have spent their money different had they been given cash instead of a rent voucher. At higher incomes, the household is expected to contribute more, so the federal subsidy and the tenant benefit is less.

For tenants in supply-oriented programs, the true benefit is less insofar as they are assigned a particular unit, which almost certainly would not be the unit they would have rented had they been given the cash equivalent. This inefficiency of supply-oriented projects has been estimated by economists as a consumption inefficiency of approximately 20-35 percent compared to demand projects. In some cases this inefficiency corresponds to location of the unit being offered. Given a voucher, the recipient would choose a location closer to their work or their children’s school. But in many cases, the inefficiency result from the agency spending dollars on new construction with less space, when the household would prefer old construction with more space. As showed below when looking at average house prices in the Portland region, new homes sell for a considerable premium over older homes.

A second inefficiency of supply-oriented housing assistance is production inefficiency. Over the years, economists have measure the cost of providing housing of equivalent quality by public, private, and non-profit developers and managers. Publicly-built housing tends to be about 30 percent more expensive than privately built housing. Supply-oriented programs are sometimes built by the private sector using tax incentives or zoning
bonuses, but often the value of those benefits to investors and developers exceed the amount of benefit that tenants receive from the project in terms of reduced rents.

In addition, housing benefit in the United States has always been a rationed benefit, rather than a benefit that all eligible households receive, which creates a horizontal inequity. That is, since the inception of federal housing policy in the 1930s, Congress has never allocated enough funds for every eligible household to receive housing benefits. Unlike other social welfare benefits like Medicaid or Social Security, only a fraction of households receive housing benefit. To illustrate this, if we add all the households below the US poverty line, which roughly translate into eligibility for housing assistance, and compare it to all the public housing, tax credit housing, Section 8 assistance housing, and other programs, we find that only 50 percent of those households could be served. And since some housing assistance goes to families above the poverty line, the 50 percent measure of horizontal inequity is actually a lower bound.

Given this brief outline of the economics of housing assistance, Portland’s inclusionary zoning policy has numerous flaws. First, tenants will receive benefits because they live in particular units. If they are unhappy with their unit or their life circumstance cause them to move, they will lose their benefit and return to paying market prices. Hence, the policy suffers from consumption inefficiency.

Second, developers have strong incentives to reduce construction costs on the inclusionary housing units they build, although they must keep the quality level between the subsidized units and the market rate units the same. Since they are expected to set rents at a level that is the same across the entire city, developers will be most likely to build affordable housing units either in buildings with low overall amenities or in districts where rents and land costs are low. The developers will be incentivized by the zoning bonuses offered as compensation, but that value of the benefit to the developer will exceed the benefit gained by the tenants.

We won’t know the full impact of this legislation for a while, but there was a rush of permit applications submitted to the city prior to the February 1 implementation deadline and hardly any permits requested after the deadline. CoStar forecasts that apartment
construction in 2018 will fall dramatically. We are likely to see a lot of buildings proposed in the 15-19 unit range—because these buildings wouldn’t be subject to the regulation—thereby reducing the overall housing production from a given amount of land. Housing analysts are expecting to see new construction in places like Beaverton, Milwaukie, and Gresham to the west, southeast, and east of the City of Portland, however these are three of the lowest rent areas in the entire metropolitan area. Instead, there is likely to be a lull in construction after the pre-February permits have been utilized. Rents will then rise, followed by new construction in these close in suburbs once they reach the higher price points required for redevelopment and mid-rise construction. In that sense, Portland’s inclusionary policy really takes on an exclusionary character.

Seen in that light, Portland’s inclusionary zoning policy is really a development tax that is being used to create a stream of social benefits. And as a development tax, the benefits will be highly skewed to a few individuals (horizontal inequity) and harm the interests of many of the poor. That is, reduced apartment rents will be a benefit to the small number of residents that receive them. As rents rise in the neighborhood around them, they will likely become long-term tenants. But for the majority of low-income households in the city and the region, rents will continue to increase and they will suffer. There will be multiple sources of their suffering, but the connection between that suffering and inclusionary zoning will be indirect and not obvious.

Portland’s affordable housing bond is a more appropriate source of revenue than a development tax given the problem being addressed. Low household incomes and high housing costs represent a social problem for the region, so using a development tax on the industry that provides housing doesn’t make sense. Funding affordable housing with a tax increase on all property owners is a more appropriate response.

In fact, designing a demand-oriented program at a regional or state level would be even better. The natural geography for housing markets is regional, and the federal government encourages local public housing authorities to make their Section 8 vouchers portable across county lines. Unfortunately, housing policy at the local level is dominated more by housing providers than housing recipients, so city policy tends to be biased in favor of the less efficient strategy of providing units, not portable vouchers.
Due partly to the dissatisfaction with the 2015 Urban Growth Boundary decision, Metro Council has planned for an accelerated review of the urban growth boundary in 2015, three years ahead of the mandatory six-year schedule. Due to wariness resulting from the Damascus case, Metro is asking local jurisdictions to nominate UGB expansion sites by December 31, 2017, that they would be willing to concept plan. One interpretation is that Metro is ceding its growth management responsibilities to local government, but maybe a better interpretation is that Metro is giving preference for expansion with willing and motivated local partners. Finally, Metro staff have also modified its MetroScope model to better estimate the economic feasibility of higher density projects, rather than accepting zoning capacity as given. For parcels inside the UGB, MetroScope will simulate pro forma models of a variety of development types and select the type (and corresponding density) that delivers the highest return to landowners.

The last of these changes suggests that Metro may find a shortage of land for future development, since high density projects in low rent areas will be less likely to meet this test. However, it’s unclear how much of a change in capacity will result from the modified MetroScope model. It’s also unclear whether cities will do the concept planning for urban reserves (or announce the intent to do concept planning) prior to the December 31 deadline. The cities will be reluctant to spend money on concept planning when they don’t know if their proposed expansion sites will be chosen. And frankly, the existing residents will have little incentive to annex new land to their jurisdiction unless they bring in more tax revenue than they cost in expenditures. And from a housing market point of view, no individual jurisdiction is an island. For example, if Wilsonville adds land to its city and housing is developed there, it won’t be that Wilsonville housing prices are reduced or moderated, while prices in neighboring communities rise. In that sense, Wilsonville will be performing a public service for the region, without any specific benefit to existing residents. For communities with unhappiness about the existing level of public services, adding new land and residents will be a challenging ask by local officials.

However, given the need to analyze these Urban Reserves (which Metro has designated as the first places for the UGB to be expanded someday), I organized a class of Portland State students to evaluate their potential. In this effort, the various urban reserves were organized into seven groups, which I listed counter clockwise:

1. Gresham, Boring, and Damascus
2. Hillsboro, Forest Grove
3. Southwest (Beaverton, Tigard, King City)
4. Sherwood
5. Wilsonville
6. Stafford (Tualatin, Lake Oswego, West Linn)
7. Lake Oswego
METRO’S 2018 UGB DECISION

The two urban reserves bordering Gresham and in the direction of Boring have good potential for industrial development or housing development based upon their topography, but suffer from a lack of access to the existing highway network in the region. One could imagine highway spurs to the north or west to connect these locations to I-84 or I-205 respectively, but until they are built, these sites don’t look ripe for development. The Damascus urban reserve remains very far from appropriate infrastructure or a willing jurisdiction for reasons described previously, and the class decided not analyze it in any detail.

The Hillsboro urban reserves have good development potential, especially given that the Sunset corridor already has more employment than housing units. Many workers at Intel, Nike, and other firms end up reverse commuting given the lack of housing opportunities on the west side. In particular, the South Hillsboro (or South Witch Hazel) urban reserve seems like a prime candidate for housing development, given the progress made in developing the other South Hillsboro UGB addition next door. The urban reserves north of US-26 seem promising for housing development, too, building off the development success of the Bethany neighborhood to the north. However, an outstanding challenge for these urban reserves are the lack of adjacent jurisdictions. For each area, Hillsboro and/or Beaverton would be the logical partner, but they would either need to annex other established neighborhoods or pursue a cherry-stem annexation. Finally, the Forest Grove urban reserve is located on a distant edge of the metropolitan area, and doesn’t seem ripe for development.

The Southwest suburban cities of Beaverton, Tigard, and King City border three different urban reserves that all border or straddle the relatively new Roy Rogers Road in Washington County. Each of these reserves are close to Scholls Ferry Road, which is a high income corridor for Washington County, and near the Bull Mountain neighborhood and the River Terrace planned community. The significance is new homes in any of these
expansion areas would likely command high prices and would develop more rapidly than other places. In addition, new subdivisions in these areas would create relatively good commutes for workers at Intel and other tech firms in Washington County. The challenge will be getting the jurisdictions that border these expansion areas to concept plan these areas.

The city of Sherwood has four urban reserves on their border with the most developable ones being Sherwood West and Tonquin Road. Sherwood West would end up as an extension of already developing residential areas. Tonquin Road would be ideal for light industrial. The reserve is distant from the highway network, but served by rail and close to existing industrial users.

There are six urban reserves that border the city of Wilsonville. The Southwest Wilsonville urban reserve is nestled between an existing neighborhood, the Willamette River, and rural reserves, and would likely develop as a high income residential area. Grahams Ferry urban reserve is located north of the Villebois planned community and also has good potential for residential development. On the east side of Interstate 5, the Advance urban reserve would build upon the existing Frog Pond development. Finally, there are three urban reserves north of the Argyle Square shopping district that have great potential for either industrial or residential development (I-5 East, Elligsen Road North, and Elligsen Road South). The industrial market tends to be strongest on flat ground next to freeway interchanges, so for employment land, Metro may want to limit residential development there, to preserve opportunities for industrial and flex space development. Towards the north, these urban reserves won’t have freeway access, so residential development becomes more likely.

The Stafford urban reserve is a large territory sandwiched between Tualatin, Lake Oswego, and West Linn. The leadership of those communities, particularly West Linn, were very reluctant to see this area be classified as an urban reserve, preferring to have a nearby open space amenity. Yet the area is serviced by a major interstate highway and is located next to the highest income communities in the state. As a result, there is existing infrastructure capacity and great development potential. The Stafford dispute has been reconciled and this area offers great development potential for high and low density residential, as well as some employment and retail potential. The Stafford area has a significant downhill slope from Lake Oswego south to the Tualatin River and therefore will need major infrastructure improvements to complement the interstate highway. As a result, the most likely short-term development could come from Tualatin extending its infrastructure east in the Borland area towards the Stafford Road intersection. If such an expansion is proposed, Lake Oswego and West Linn may become motivated to propose expansions of their own.

Finally, Oregon City has five small urban reserves on its southern and eastern borders, Beaver Creek Bluffs, Henrici Road, Maple Lane, Holly Lane/Newell Creek, and Holcomb. These expansion areas will be a challenge to develop for a variety of reasons, including low housing prices in the community and high infrastructure costs. In addition, the city is currently planning for the development of three existing neighborhoods, Park Place, Beaver Creek, and South End. Once those areas develop, expansion into the nearby urban reserves seem more likely.
CONCLUSION

Given this range of options and uncertainty, it’s unclear how the urban growth boundary debate in 2018 will result. If a housing land shortage is recognized, there is a range of good options for expansion should local governments be willing (Hillsboro, Beaverton, Tigard, King City, Sherwood, Wilsonville, and Tualatin). Identifying which community is willing requires a political analysis beyond the scope of this paper. If a shortage of industrial land is identified, then the choices are more narrow. Sherwood has a good site for light industrial, but Wilsonville has the best sites for warehousing and distribution, which requires good highway access. In both the residential and employment case, Metro might find it necessary to recruit a jurisdiction rather than seek a volunteer.

Finally, Metro’s Urban Growth Report may find the no need for expansion of the Urban Growth Boundary, which would seem like an odd result when the City of Portland has declared three years of housing emergency and rents and prices are appreciating rapidly. In that environment, land owners outside the UGB may need to approach the Oregon state legislature to expand the boundary on their own, much as they did in the 2013 “grand bargain.” This outcome would distress local planners, who don’t want to see the legislature act as a regional zoning body. On the other hand, if housing consumers cannot get a satisfactory response from the regional government, they may need to seek a more responsive forum.
The overall national economy remains strong, with real US gross domestic product increasing at an annual rate of 3.0 percent in the third quarter of 2017 according to the advance estimate release by the Bureau of Economic Analysis. In the second quarter, real GDP increased 3.1 percent. The increase in real GDP in the third quarter reflected positive contributions from personal consumption expenditures, private inventory investment and nonresidential fixed investment. Global economic activity is solidifying, with global growth projected to rise to 3.6 percent in 2017 and 3.7 percent in 2018, according to the October IMF World Economic Outlook.

Meanwhile, the Oregon economy has begun to slow from the full-throttled rates of growth as it approaches full employment and transitions down from peak growth rates. These stabilizing employment growth rates are accompanied by positive wage growth.

In addition to strong market fundamentals, surveys of real estate industry professionals provide positive projections. The NAIOP CRE sentiment index, which is a survey of commercial real estate developers, owners, and investors intended to project general conditions in the commercial real estate market, reported cautious optimism regarding the next 12-months, with overall conditions expected...
to improve over the next 12 months, although growth is expected to decrease from the feverish six month pace. High rent growths, cap rate compression and continued refinancing of long-term loans at lower interest rates are among the key positive trends from the survey. Key concerns identified include increasing construction labor and material costs, and geopolitical uncertainty. Some survey participants expect a maturing market cycle, although demand isn’t expected to change over the 12 month horizon.

**Figure 1: Gross Domestic Product, United States, Annualized Percent Change, 2005–2017 Q3**

![GDP chart](image)

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

**EMPLOYMENT**

In September, Oregon’s nonfarm payroll employment dropped by 3,800 jobs, according to the State of Oregon Employment Department, partially caused by 3,700 job loss in the leisure and hospitality industry from seasonal post-summer transition offsetting a spike in June and July employment increases. However, Dr. Thomas Potiowsky cautions that this dip could be a potential correction of the exorbitant 7,000 average monthly job gains between February and July and might correct once year-over-year numbers are benchmarked. The Oregon unemployment rate continued a strong yearly performance, with the September rate of 4.2 percent significantly below the 4.9 percent September 2016 rate. The Oregon unemployment rate closely aligns with the national unemployment rate of 4.2 percent. The Portland metro unemployment rate ticked up slightly to 4.3 percent in September, a gradual increase from a record low 3.5 percent during Spring 2017.
Figure 2A: Unemployment Rate, Oregon and United States, 2013-2017 Q3

Source: State of Oregon Employment Department

Figure 2B: Unemployment Rate Change, Portland MSA and Oregon, Jan 2014-September 2017

Source: State of Oregon Employment Department
EMPLOYMENT

Figure 2C: Unemployment Rate, Portland MSA, Oregon and United States, Jan 2008-September 2017

Source: State of Oregon Employment Department

Figure 3: Labor Force Participation Rate, United States, 2007-Sep. 2017

Source: Bureau of Labor Statistics

CONSTRUCTION CONSTRAINTS

The source of greatest concern identified in the NAIOP CRE survey was construction labor costs, with the -2.43 score the greatest negative ever recorded in the CRE index. This large negative score indicates expected increasing construction costs amidst continuing labor shortages. Analysis by Walsh Construction found a severe shortage of both skilled and unskilled construction labor in the Portland market is an acute local problem that isn’t reflected in national cost index surveys. This shortage is a result of Portland being one of the fastest growing markets in the country that has created an imbalance between supply and demand, and will be perpetuated over the next four-year cycle as the rapid entitlement increase in projects vesting before Portland’s inclusionary zoning rules took effect. National cost indexing surveys are indicating a 4-6 percent increase in the building construction market, with the Portland market experiencing a 10-15 percent price escalation in the multi-family market during the first six months of 2017. This rapid price escalation can potentially dampen real estate growth and perpetuate an acute supply and demand in balance with continued employment and economic growth.

Ed Sloop, chief cost estimator for Walsh Construction, identifies the labor shortage as a
CONSTRUCTION CONSTRAINTS

result of unprecedented spike in construction demand coupled with severe labor drain that occurred during the great recession. “This perfect storm has created a market imbalance that has slowed project construction timelines as skilled labor is less and less available.” However, according to Mr. Sloop, price estimates in the past three months have begun to stabilize from the unprecedented cost escalation seen in first six months of the year. If cost estimates continue to stabilize as more data becomes available, this will have a big positive impact on the real estate market’s growth potential.

LOOKING AHEAD

Projected global growth is strengthening due to notable pickups in investment, trade and industrial production, combined with stronger global business and consumer confidence. The Oregon economy is gradually moving from full-throttle growth to a maturing market cycle, although increased construction labor constraints present a future potential barrier to continued growth projections.

The Oregon Office of Economic Analysis analyzed new census data to determine Portland has ranked fifth best among the nation’s 100 largest metros in both high-wage job growth and educational attainment increases. Today, 40 percent of Portland’s working-age population holds a college degree, a six percentage point increase in the past decade, reflecting key industry shifts towards scientific, technical and medical fields. This continued high-skilled, high-educated labor force will help sustain continued growth in the Oregon and Portland metro economies.

The Urban Land Institute Emerging Trends reports that industry insiders expect a modest decline in going-in cap rates due to conservative lending practices, an extended real estate cycle, and low premium levels. The ULI survey identifies land and construction costs as the top real estate development issue, with construction labor shortages pushing up the development time on projects and impact projected financial returns. Addressing the labor shortage by encouraging high school graduates to pursue construction management careers, funding technical skills programs, and supporting labor unions will be vital for the real estate industry to address the labor shortage and allow on-time project deliveries to meet critical demand.
RESIDENTIAL MARKET ANALYSIS

JON LEGARZA  
RMLS Student Fellow  
Master of Real Estate Development Candidate

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

In many of the markets analyzed, the transaction volume increased compared to last quarter, while the year-to-year transactions generally increased, also indications from the strong summer season. The number of real estate transactions in Portland increased for existing and decreased for new homes both from last quarter to this quarter and in the third quarter of 2017 when compared to the same quarter last year. While it is difficult to determine the reason for the renewing trend, it is interesting to note that Portland’s median home sale price stabilized last quarter at $380,000. Redmond, Bend and most counties in the Willamette Valley experienced an uptick in sales price. Eugene declined with regards to transaction volume and Salem and Marion County increased 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.

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.
Permits for new single-family homes were up approximately 30 percent statewide, reversing 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 61 percent or more compared to last quarter, while Eugene saw a 18 percent increase and Medford an approximately 2 percent increase compared to last quarter. When compared to the same quarter last year, permit activity is up approximately 22 percent statewide.

With the lack of available land for home-builders and governmental agencies challenged to get land approved local builders are looking at ways to provide more innovative housing products. Are these innovations enough that the market will respond to the new concepts? Do these new concepts provide better “value” of a new and improved residential solution for the customers? As we look at the strong suburban single family market the population growth of Washington and Clackamas County are starting to surpass Multnomah County. The opportunity for builders to create pocket or cottage communities is attracting young families to their products. Many of these are located within proximity to high-end grocery stores and other newer amenities. Builders in other markets are looking at single-family rentals and stacked flat housing products such as Avilla Grace in Phoenix and the Cleo at Playa Vista in Los Angeles. These successful products have both attracted different buyers within the housing markets. Will these products appear within the higher density markets of the Portland Metro area?

In the third quarter of 2017, there were 6,162 building permits for new private housing units issued in total across the state of Oregon. This is approximately 30 percent more permits than were issued in the prior quarter and nearly 22 percent more than were issued in the second quarter of 2016.

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

There were 6,162 permits for new private housing units issued in the Portland-Vancouver-Hillsboro Metropolitan Statistical Area (MSA) in the third quarter of 2017. This represents a 61 percent increase in permits compared to the second quarter of 2017 and a 26 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 80 percent of the new statewide permits this quarter.
Bend MSA permitting rate decreased to 441, by 6.3 percent compared to last quarter and by an even greater 33.8 percent decrease compared to the same quarter last year.

The Eugene-Springfield MSA’s second quarter permitting decreased to 176 permits. Whether this decrease is a trend continue remains to be seen in the upcoming year along with the affordability of the new housing product.
LOCAL PERMITTING
Like Eugene, new permits in Medford MSA decreased this quarter, to 174.

Building permits for new private housing
Medford MSA, seasonally adjusted

PORTLAND TRANSACTIONS
The first quarter showed signs of flattening from the previous quarter for existing home sales in the Portland market: over 7,942 transactions with a median sale price of $380,000. This number of transactions is a 2.3 percent increase over the same quarter last year. However, the median sales price for existing homes showed stabilization with same median price compared to the quarter last year.

The average days on market for existing homes followed also stabilized at 26 days. Final sales prices are almost identical to list prices.

Number of transactions
Portland metro, existing homes
In the sale of new homes for Portland, the number of transactions, 622, is an 18.8 percent decrease compared to last quarter along, but represent a 0.33 percent increase compared to the same quarter last year. New home median sales price in the second quarter saw a slight decrease compared to the last quarter. Last quarter, the median sales price for new homes was $491,981 compared to $489,946 this quarter – a decrease of 2.09 percent. When compared to the same quarter last year, however, new home prices have increased 2 percent perhaps due to the increased pricing for the land/lots and labor that is increasingly in short supply.

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

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

Like Portland, Vancouver experienced an increase in transactions of home sales this quarter compared to last quarter. Vancouver experienced a 5.08 percent increase in transactions of existing homes compared to last quarter. While Portland experienced a slight increase in year over year transactions, Vancouver’s transactions decreased by 0.76 percent compared to the same quarter last year. Clark County transactions were up 11.21 percent compared to last quarter and 4.7 percent higher compared to the same quarter a year ago.

Average days on market continued to stabilize 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, 25, represent a stabilization compared to last quarter and a slight decrease of 2.4 percent compared to the same quarter last year. Clark County saw a 0.33 percent decrease in average days on market compared to last quarter and a 15.38 percent decline compared to the same quarter a year ago. Existing home transactions for Vancouver shot back up to 1,303 with median sales price of $300,000 and 25 days on the market. Clark County excluding Vancouver transactions increased to 1,002, median sales price increased to $352,500, and days on the market went down to 35.
VANCOUVER AND CLARK COUNTY TRANSACTIONS

Days on market Vancouver, existing homes

Number of transactions
Clark County, excluding Vancouver, existing homes

Median sales price
Clark County, excluding Vancouver, existing homes
Central Oregon saw an increase in activity compared with the previous quarter. Bend saw a major increase of 167 percent compared to last quarter and a 36 percent increase compared to the same quarter last year. Redmond experienced a 13 percent decrease in transactions compared to last quarter and a 185 percent increase when compared to the same quarter last year. Bend under acre numbers are 1,029 transactions, median sales price of $399,000 and 107 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 2.32 percent increase compared to last quarter, and nearly a 10.86 percent increase compared to the same quarter last year. Redmond saw a 1.75 percent uptick in home prices compared to last quarter, with a 13.96 percent increase compared to the same quarter last year.

Average days on market are decreasing overall from last quarter. Bend’s average days on market followed suit for days on the market from 109 last quarter to 107 this quarter. Compared to the same quarter last year, there was a 4.46 percent decline. Redmond saw a 5.17 percent increase in average days on market compared to last quarter, with 10 percent increase when comparing this quarter to last year.

Redmond, the number of transactions increased to 377 from 132. Median sales price increase to $284,900 from $280,000. Days on the market decreased from 116 to 110.
Median sales price
Bend, under 1 acre

Days on market
Bend, under 1 acre

Number of transactions Redmond, under 1 acre
The increase in median sale prices seen in the Central Oregon, Eugene Springfield and Salem areas this quarter was only evident in four of the five counties across the Willamette Valley. However, Lane County, Benton 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: $344,950 median price, a 1.46 percent increase from the prior quarter and a 7.8 percent increase year-over-year
- Lane County (excluding Eugene): $266,000 median price, a 2.31 percent increase from the prior quarter and a 10.86 percent increase year-over-year
- Marion County (excluding Salem): $270,000 median price, an 1.03 percent increase from the prior quarter and a 16.88 percent increase year-over-year.
- Polk County (excluding Salem): $250,000 median price, a 5.62 percent decrease from the prior quarter and a 11.11 percent increase year-over-year
- Linn County: $234,600 median price, an 8.06 percent increase from the prior quarter and a 17.59 percent increase year-over-year.
Transaction volume in Salem was consistent with the increase statewide of last quarter’s trend. Transaction activity increased 7.88 percent compared to last quarter, but that volume represents a nearly 10.7 percent increase compared to last year.

Median sales price in Salem increased as was seen across the state. Median home prices last quarter were $255,000, while this quarter prices reached $260,000 – an increase of 1.96 percent. Compared to the same quarter last year, this increase in price represents a 10.33 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 15 days, or 17.18 percent, from 88 to 73.
Like many other areas of the state this quarter, Eugene-Springfield experienced an increase in sales volume from last quarter combined with continued decrease of average days on market. Transaction counts increased 8.15 percent compared to last quarter, which is an increase of 3.82 percent compared to the same quarter last year. The number of transactions went from 981 upward to 1061.

Sales prices increased very slightly from $265,000 last quarter to $275,000 this quarter, an increase of 3.77 percent. The percentage increase of average sales price compared to the same quarter last year is 13.17 percent. Average days on market decreased a full 6 days this quarter compared to last, from 34 to 28 days on average. This represents a 17.65 percent decrease compared to last quarter and a 3.45 percent decrease compared to the same quarter last year.
Trends in Southern Oregon tracked alongside the trends across the state: largely more transaction volumes compared to last quarter from 637 to 782 for Jackson County. Compared to last year, Jackson County saw a 22.76 percent increase in transaction volume while Josephine County saw only a 3.26 percent increase.

Median home prices increased seven percent from $258,500 to $276,250, compared to last quarter. Average days on market experienced a slight decrease compared to last quarter for Jackson County, but days on the market declined by approximately 35.71 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 July 1 to September 30, 2017 time period.

The following figures display the data for Jackson County and Josephine County. Josephine County existing transactions increased from 184 to 190, median sale price increased slightly from $220,000 to $236,250 and days on the market decrease to 37 from 36.
The following figures display the data for Josephine County.

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

**Number of transactions Josephine County, existing homes**
SOUTHERN OREGON TRANSACTIONS

Median sales price Josephine County, existing homes

Average days on market Josephine County, existing homes
OFFICE MARKET ANALYSIS

RILEY HENDERSON
Portland State University

The Portland office market wrapped up the third quarter in strong fashion. However, there are signs that the market may be cooling down. The question on top of mind for those in the office market is where are we relative to the real estate and business cycles? And perhaps even more pressingly, the question is will the large amount of office space currently under construction be able to be absorbed in the marketplace? Without the ability to see into the future, we can only rely on current economic data and the ability to make an educated guess about future market conditions. No one is anticipating a downtown turn to a degree that was experienced during the Great Recession but how deep and when the timing of the downturn is up for debate.

With the talk and concern about a potentially softening in the office market, it’s easy to forget about the tremendous gains our once quiet little town has made since the Great Recession. Josh Lehner of Oregon’s Office of Economic Analysis recently published a paper titled “Portland in Transition” which highlights some of those gains our market has made. Mr. Lehner points out that “Among the nation’s 100 largest metros, Portland ranks fifth best in both high-wage job growth and educational attainment...

Riley Henderson is a Masters 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. In addition, Riley is a commercial broker with NAI Elliott specializing in office leasing. He is the 2017 Oregon Association of Realtors Fellowship recipient. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.
increases.” Additionally, “Portland now ranks 16th highest for the share of working-age residents with a college degree. In 2007 Portland ranked 27th highest.” These are remarkable improvements that Mr. Lehner singles out will likely continue to attract talent to our market and keep it relatively strong despite a possible softening in the short run.

Increasingly the ability to attract and retain talent is becoming a big concern for companies. According to the Bureau of Labor Statistics, our national employment rate at the end of the third quarter was 4.2 percent. The strong gains in employment are great for the national economy however, labor is becoming a greater scarcity and companies are finding the need to differentiate themselves against their competitors in the hopes of attracting top talent. One of the ways in which companies are differentiating themselves is by their location. Companies seeking to stand out among their competitors and incentivize potential employees are moving into the central business district. They are seeking amenity rich environments that younger talent especially desire. This has been a trend nationally but closer to home, evidence of this can be seen by Autodesk’s lease of the newly renovated Towne Storage in the Central Eastside as well as companies like Zapproved, Lattice Semiconductor, and Netop relocating from the suburbs to the CBD. This activity and desire for centrally located office space in an amenity rich environment should help drive the CBD office market in the coming years.

Portland Metro’s third quarter at-a-glance:

- JLL sees continued strength in the office market, reporting a total of 220,000 square feet of positive net absorption in CBD Class A Office this quarter. Vacancy rates are up 90 basis points despite the strong absorption as some of the new construction hits the market place faster than the market can absorb. JLL highlights four large office properties currently on the market that could potentially help end the year at post a recession high sales volume.

- While much of the attention has been on what’s happening in the CBD and close-in, Kidder Mathews is highlighting that 403,610 square feet of office space was absorbed in the suburban submarkets this quarter. This has pushed suburban vacancies down to 6.6 percent. Kidder Mathews notes that the bulk of the leasing activity this quarter was from small to medium sized deals. They speculate that tenants needing large spaces are delaying leasing decisions until the larger projects under development are delivered.

- The third quarter office market is performing well according to the Colliers market report. Vacancy is down while net absorption and rental rates are up. This activity is keeping investor confidence strong and sales volume up. This quarter, the highest price paid per square foot was $583 by Stockbridge Capital for the Wieden & Kennedy Building. However, the substantial development pipeline has tempered expectations, Colliers is predicting vacancy rates to increase as new product hits the market.

- CBRE is reporting a more pessimistic third quarter noting that annual absorption is at 14,111 sq. ft. and the vacancy rate has climbed up. It’s not all bad though as asking rates crept up slightly in the quarter. Broker sentiment indicates that we have reached our cycle peak and are the market is now on the downhill. However, the expectation for the slowdown is that it will be brief. CBRE draws a connection between the San Francisco and Portland office markets. Despite an increasing asking rent, our market is still relatively affordable and some tech tenants in San Francisco will look north to take advantage of our cheaper rents, which will bolster our market.
VACANCY

Overall most firms are reporting a slight decrease in the vacancy rate in Q3. Colliers, Kidder Mathews and Cushman & Wakefield all report a vacancy rate decline ranging from 30 to 60 basis points on the overall vacancy rate. JLL reports an increase of 90 bps year-over-year and CBRE reports an increase of 36 basis points from the second quarter.

The CBD submarket performed very well this quarter with Class A office space leading the way. In fact, in the last three years across all submarkets, Class A vacancy has dropped 280 basis points.

Regardless of how the vacancy data is interpreted, the take away is that vacancy rates remain stable with no sharp increase or decrease anticipated in the near future. The first phase of development coming out of the recession definitely favored multifamily product but the strong office market fundamentals has caught the attention of developers. The uptick in deliveries will most likely outpace the markets ability to absorb the product pushing the rate upwards in the future.

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

<table>
<thead>
<tr>
<th>Brokerage</th>
<th>Total</th>
<th>CBD</th>
<th>CBD Class A</th>
<th>CBD Class B</th>
<th>CBD Class C</th>
<th>Suburban</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBRE</td>
<td>11.7%</td>
<td>12.4%</td>
<td>9.5%</td>
<td>11.7%</td>
<td>18.8%</td>
<td>12.3%</td>
</tr>
<tr>
<td>Colliers</td>
<td>7.9%</td>
<td>9.6%</td>
<td>9.3%</td>
<td>10.6%</td>
<td>7.9%</td>
<td>-</td>
</tr>
<tr>
<td>JLL</td>
<td>9.9%</td>
<td>9.7%</td>
<td>8.7%</td>
<td>11.8%</td>
<td>9.1%</td>
<td>-</td>
</tr>
<tr>
<td>Kidder Mathews</td>
<td>7.4%</td>
<td>9.3%</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>6.6%</td>
</tr>
</tbody>
</table>

Source: CBRE, Colliers, JLL and Kidder Mathews

RENTAL RATES

Overall, rental rates climbed upward this quarter. This has been the trend since coming out of the recession and points to the overall strength of the office market to date. Despite the concerns about the rise in construction, the increase in rents this quarter may point to the market having more room to run.

Table 3: Average Direct Asking Rates ($/sf FSG) by Brokerage House and Class, Third Quarter 2017

<table>
<thead>
<tr>
<th>Brokerage</th>
<th>Market Average</th>
<th>CBD</th>
<th>CBD Class A</th>
<th>CBD Class B</th>
<th>CBD Class C</th>
<th>Suburban</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBRE</td>
<td>$27.34</td>
<td>$31.02</td>
<td>$34.16</td>
<td>$30.33</td>
<td>$26.55</td>
<td>$23.87</td>
</tr>
<tr>
<td>Colliers</td>
<td>$25.04</td>
<td>$30.46</td>
<td>$33.07</td>
<td>$30.07</td>
<td>$23.79</td>
<td>-</td>
</tr>
<tr>
<td>JLL</td>
<td>$28.22</td>
<td>$32.49</td>
<td>$35.47</td>
<td>$31.78</td>
<td>$26.03</td>
<td>-</td>
</tr>
<tr>
<td>Kidder Mathews</td>
<td>$25.06</td>
<td>$30.16</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>$22.54</td>
</tr>
</tbody>
</table>

Source: CBRE, Colliers, JLL and Kidder Mathews
Absorption in the marketplace stayed positive in the third quarter. Leasing activity in 2017 got off to a slow start with negative absorption in the first quarter but by the second quarter, the numbers were back in the black. The largest lease signed this quarter was Northwest Natural’s new downtown headquarter office building of 180,000 square feet, followed by the 103,279 square feet at Sunset Corporate Park III for a Wells Fargo call center. Adidas also made headlines when they leased out 79,657 square feet at Montgomery Park. Adidas rapid growth has pushed them to seek space outside of their campus in northeast Portland.

Table 4: Net Absorption (in square feet) by Brokerage House and Market Area, Third Quarter 2017

<table>
<thead>
<tr>
<th>Brokerage</th>
<th>Overall</th>
<th>CBD</th>
<th>Suburban</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBRE</td>
<td>(63,308)</td>
<td>(209,030)</td>
<td>22,105</td>
</tr>
<tr>
<td>Colliers</td>
<td>593,781</td>
<td>183,833</td>
<td>-</td>
</tr>
<tr>
<td>JLL</td>
<td>302,224</td>
<td>156,714</td>
<td>-</td>
</tr>
<tr>
<td>Kidder Mathews</td>
<td>478,730</td>
<td>93,755</td>
<td>403,610</td>
</tr>
</tbody>
</table>

Source: CBRE, Colliers, JLL and Kidder Mathews

Table 5: Net Absorption (in square feet) by Brokerage House and Market Area, Year to Date

<table>
<thead>
<tr>
<th>Brokerage</th>
<th>Overall</th>
<th>CBD</th>
<th>Suburban</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBRE</td>
<td>14,111</td>
<td>(209,030)</td>
<td>22,105</td>
</tr>
<tr>
<td>Colliers</td>
<td>685,149</td>
<td>269,241</td>
<td>-</td>
</tr>
<tr>
<td>JLL</td>
<td>339,845</td>
<td>195,151</td>
<td>-</td>
</tr>
<tr>
<td>Kidder Mathews</td>
<td>619,168</td>
<td>248,602</td>
<td>422,632</td>
</tr>
</tbody>
</table>

Source: CBRE, Colliers, JLL and Kidder Mathews

Table 6: Notable Lease Transactions, Third Quarter 2017

<table>
<thead>
<tr>
<th>Tenant</th>
<th>Building/Address</th>
<th>Market</th>
<th>Square Feet</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northwest Natural</td>
<td>250 Taylor/ SW 250 Taylor</td>
<td>CBD</td>
<td>180,000</td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>23175 NW Bennett</td>
<td>Sunset Corridor</td>
<td>103,279</td>
</tr>
<tr>
<td>McAfee</td>
<td>55 West Bldg 3</td>
<td>Sunset Corridor</td>
<td>103,000</td>
</tr>
<tr>
<td>Tokyo Electron</td>
<td>Tanasbourne Commerce Center I</td>
<td>Sunset Corridor</td>
<td>57,000</td>
</tr>
<tr>
<td>eBay</td>
<td>Fifth Ave. Building</td>
<td>CBD</td>
<td>56,645</td>
</tr>
<tr>
<td>Farmers Insurance</td>
<td>Pacific Parkway Center</td>
<td>Tigard</td>
<td>40,250</td>
</tr>
</tbody>
</table>

Source: CBRE and Colliers
Investment sales for office properties continues to be strong in Portland. The third quarter saw two properties trade at the above $500 per square foot threshold. The most expensive property sold this quarter was the Wieden Kennedy Building at NW 13th and Glisan sold to Stockbridge Capital for $583.68 per square foot. After that was Pearl West which was reported in the second quarter report but the sale technically fell very early on in the third quarter. That property sold for $563 per square foot. At the current pace of sales, JLL anticipates 2017 will end with the largest total yearly sales volume since the recession.

Table 7: Notable Sales Transactions, Third Quarter 2017

<table>
<thead>
<tr>
<th>Building/Address</th>
<th>Buyer</th>
<th>Seller</th>
<th>Market</th>
<th>Price</th>
<th>SF</th>
<th>Price/SF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weiden + Kennedy</td>
<td>Stockbridge Capital</td>
<td>JP Morgan</td>
<td>CBD</td>
<td>$103,250,000</td>
<td>176,986</td>
<td>$583.68</td>
</tr>
<tr>
<td>Pearl West</td>
<td>BPM Real Estate</td>
<td>LaSalle Investment Mgmt.</td>
<td>CBD</td>
<td>$87,500,000</td>
<td>155,465</td>
<td>$562.83</td>
</tr>
<tr>
<td>Meier &amp; Frank</td>
<td>Deutsche Bank</td>
<td>Gerding Edlen</td>
<td>CBD</td>
<td>$64,852,425</td>
<td>133,000</td>
<td>$486.66</td>
</tr>
<tr>
<td>New Market Theater &amp; Blagen Block</td>
<td>NBP Capital</td>
<td>Swift</td>
<td>CBD</td>
<td>$32,250,000</td>
<td>120,279</td>
<td>$268.13</td>
</tr>
<tr>
<td>6Y</td>
<td>KBS Realty Advisors</td>
<td>Swift</td>
<td>CBD</td>
<td>$28,200,000</td>
<td>109,420</td>
<td>$260.46</td>
</tr>
<tr>
<td>Lloyd Plaza</td>
<td>Weston Investment Co.</td>
<td>Washington Holdings</td>
<td>Lloyd District</td>
<td>$28,000,000</td>
<td>96,052</td>
<td>$291.51</td>
</tr>
</tbody>
</table>

Source: CBRE, Colliers and CoStar

The third quarter didn’t see much in the way of large deliveries and what was delivered was mostly preleased. The largest projects to hit the market were Towne Storage at the Burnside Bridgehead delivering 108,750 square feet and the Under Armour headquarters off of Barbur Boulevard delivering 108,698 square feet. The Towne Storage project has been leased entirely to Autodesk, which is moving out of their location on Kruse Way. The Under Armour headquarters takes over the former YMCA. The largest speculative project delivered this quarter was the Fair-Haired Dumbell located at the intersection of Martin Luther King Boulevard and East Burnside. This project brought 32,850 square feet of creative office space to the market.

On the construction side, some of the larger speculative projects are nearing completion. By the end of the year, a total of 357,677 square feet of new office space is slated for delivery across five projects and by the end of the first quarter of 2018 a total of 787,885 square feet of office space across an additional eight projects will hit the market. The speed at which this large amount of office space is absorbed will be closely watched by those in the market, but given our strong talent pool and relative market affordability to other west coast cities our market is well positioned for the long-term.
## DELIVERIES AND CONSTRUCTION

### Table 8: Notable Development Projects Under Construction, Third Quarter 2017

<table>
<thead>
<tr>
<th>Building/Address</th>
<th>Developer</th>
<th>Market</th>
<th>SF</th>
<th>Delivery Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nike North Expansion</td>
<td>Gerding Edlen</td>
<td>Sunset Corridor</td>
<td>887,000</td>
<td>2018</td>
</tr>
<tr>
<td>Field Office</td>
<td>Project^</td>
<td>NW Close-In</td>
<td>330,208</td>
<td>Q1 2018</td>
</tr>
<tr>
<td>Clay Pavillion</td>
<td>Killian Pacific</td>
<td>SE Close-In</td>
<td>75,000</td>
<td>Q1 2018</td>
</tr>
<tr>
<td>9North</td>
<td>Williams &amp; Dame/ Miller Global</td>
<td>CBD</td>
<td>202,168</td>
<td>Q3 2018</td>
</tr>
<tr>
<td>Waterfront Block 6</td>
<td>Gramor</td>
<td>Vancouver CBD</td>
<td>77,000</td>
<td>Q3 2018</td>
</tr>
<tr>
<td>Broadway Tower</td>
<td>BPM Real Estate - Office</td>
<td>CBD</td>
<td>177,800</td>
<td>Q4 2018</td>
</tr>
</tbody>
</table>

Source: Colliers and CoStar
Unprecedented delivery rates driven by large end-users is beginning to soften vacancy rates, with CBRE reporting that overall metro Portland vacancy rates have slightly increasing to 3.1 percent. The Northeast submarket experienced the highest jump in vacancy, doubling from 2.2 percent in the first quarter to 4.5 percent in the third quarter. This increase was fueled by large deliveries; six new spec buildings have come online, led by the Vista Logistics Park Buildings A, B and C which totaled 733,232 square feet. The total speculative construction in the Port of Portland's Vista Business Park is over 1.2 million square feet, according to JLL. Development continues at a furious pace, with over 3.3 million square feet of industrial space under construction at the end of the quarter, reflecting strong demand, limited supply and investor continued confidence.

Amazon announced Trammell Crow as the developer of a 1 million square foot major distribution facility on a Port of Portland owned-parcel on North Lombard Street. The facility will employ 1,000 workers out of an expected state total of 3,500 workers when all announced facilities open in 2018. Nationally, Amazon is estimated to rent 114 million square feet of warehouse space, up from 9 million in 2009 according to Jonathan Peterson of Jefferies. Increased e-commerce demand is fueling national deliveries of large industrial space, JLL estimates 225 million square feet of warehouse deliveries by year-end, which is double the 10-year average of 120 million square feet. Buildings above 200,000 have seen a 160 point basis point vacancy decrease since the start of 2017, from 5.8 percent to 4.2 percent, according to Kidder Matthews.

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.
CBRE reports that overall vacancy remains one of the lowest in the nation, at 3.1 percent, which is 31 basis points below the 2016 third quarter.

Table 1: Portland Metro Industrial Quarterly Report Survey Q3 2017

<table>
<thead>
<tr>
<th></th>
<th>Colliers</th>
<th>JLL</th>
<th>CBRE</th>
<th>Kidder-Mathews</th>
<th>Average Q1 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Vacancy</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industrial Vacancy</td>
<td>3.5%</td>
<td>3.4%</td>
<td>3.1%</td>
<td>3.4%</td>
<td>3.3%</td>
</tr>
<tr>
<td>- Flex</td>
<td>7.80%</td>
<td>6.7%</td>
<td>-</td>
<td>7.25%</td>
<td></td>
</tr>
<tr>
<td><strong>Rents</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industrial Market</td>
<td>$0.59</td>
<td>$0.61</td>
<td>$0.6</td>
<td>$0.63</td>
<td>$0.61</td>
</tr>
<tr>
<td>- Flex</td>
<td>$1.065</td>
<td>$1.06</td>
<td>$1.05</td>
<td>N/A</td>
<td>$1.055</td>
</tr>
</tbody>
</table>

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

Figure 1: Portland Metro Industrial Vacancy Rate, 2007–2017 Q3

Sources: Average of Quarterly Reports from CBRE, JLL, Colliers, Kidder Matthews
Figure 2: Portland Metro Average Shell Asking Rents, 2007–2017 Q3

CBRE reports a year-to-date total net absorption of 2,533,343 compared to 2016’s year-to-date absorption of 3,550,284, however CBRE believes this is a reflection of a lack of inventory options rather than softening tenant demand. There remains a gap between large square footage buildings being delivered in the current construction pipeline and small to mid-size users unable to find available space.

Table 2: Portland Metro Industrial Net Absorption Year-to-Date

<table>
<thead>
<tr>
<th></th>
<th>Distribution/Warehouse</th>
<th>Manufacturing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1 2017</td>
<td>(254,236)</td>
<td>387,956</td>
<td>133,729</td>
</tr>
<tr>
<td>Q2 2017</td>
<td>582,882</td>
<td>193,261</td>
<td>776,143</td>
</tr>
<tr>
<td>Q3 2017</td>
<td>896,181</td>
<td>338,583</td>
<td>1,234,764</td>
</tr>
<tr>
<td>YTD Totals</td>
<td>1,224,827</td>
<td>919,800</td>
<td>2,144,627</td>
</tr>
</tbody>
</table>

Source: JLL

Investment Activity

The quarter’s largest investment sale was the Interstate Crossroads Distribution Center located in the East Columbia Corridor developed by Specht and sold to WPT Industrial REIT at a total price of $56,000,000 at a price of $113.60 per square foot, according to Kidder Matthews. Other large purchases include the Eastridge Business Park, a series of 25 buildings sold at a price of $95.11 per square foot, and the Terminal 1 sold to Lithia Motors at a total price of $11,125,00 at $115.70 per square foot.

Overall investor confidence in the industrial market is incredibly 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, however increased construction cost escalation that is disproportionately impacting the Portland region could hamper potential deliveries.
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.
Nationally, the retail market remains stable but by many indications the peak of the cycle is over as growth starts to stall if not retract. Annual rent growth, store expansion and absorption are all down this quarter according to CoStar national data. Large department stores continue to close or significantly downsize their footprint. This has had a larger impact on low quality retail and poorly positioned properties. E-commerce, led by Amazon’s rapid growth across the nation is challenging the way traditional brick and mortar stores do business. E-commerce has been a threat to retailers for years now and yet many companies are still struggling to adapt leading to further store closings. But despite the continued stories of a retail apocalypse in the news, the overall market remains healthy even in a rapidly changing marketplace.

It is worth highlighting one retailer that been very adept at adjusting its strategy to changing consumer preferences and market conditions. Bonobo’s is a men’s clothing retailer that started as an online clothing company and has moved to open physical stores around the country. The company’s unique approach to retailing caught the attention of Wal-Mart, which purchased the Bonobo’s for $310 million dollars earlier this year. Bonobos just recently opened up a Portland location in downtown in the third quarter. Their 1,292 square feet Portland location is hardly

Riley Henderson is a Masters 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. In addition, Riley is a commercial broker with NAI Elliott specializing in office leasing. He is the 2017 Oregon Association of Realtors Fellowship recipient. Any opinions expressed are those of the author alone and do not represent the opinions of any other person or entity.
a large footprint for a national retailer but the company’s innovative approach allows them to operate in such a small footprint. Their physical stores are called Guideshopes. Customers come in to try clothing items but do not leave with any merchandise. Any purchases they make in store are shipped directly to the customer from a nearby distribution facility. This allows Bonobos to maintain a large variety of showroom samples for customers to try on, but keeps their overall inventory low. This strategy greatly reduces a store’s overhead by allowing them to occupy far fewer square feet than if they followed the traditional retail model and kept inventory on hand.

In addition to Bonobo’s, other retail companies that started online are now finding the need to open brick and mortar stores. Companies following this trend include Amazon, Warby Parker, Suit Supply, and Indochino. Even with very quick delivery times, customers still enjoy the opportunity to interact with and try on merchandise in addition to having a social experience.

Locally, the Portland market is performing well. The population growth, low unemployment and lack of new retail supply will continue to bolster our market despite the national slowdown. The Portland market continues to draw investment attention due to the relative affordability of Portland assets compared to major West Coast markets and the Portland markets higher cap rates. As the retail market cools, Portland is poised to weather the downturn well.

Vacancy rates climbed slightly in the third quarter, ending 200 basis points higher than in the second quarter as 125,154 square feet of retail space was given back to the market. The expectation is that leasing activity will pick up heading into the fourth quarter of 2017 and the overall rate is expected to remain near its current level of 4.5 percent for the short term according to Portland CoStar data. Additionally, the lack of large speculative deliveries will keep the vacancy rate from climbing sharply.

Table 1: Portland Retail Vacancies by Submarket, Third Quarter 2017

<table>
<thead>
<tr>
<th>Submarket</th>
<th>Vacancy Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBD</td>
<td>9.4%</td>
</tr>
<tr>
<td>Clark County/ Vancouver</td>
<td>6.3%</td>
</tr>
<tr>
<td>I-5 Corridor</td>
<td>6.0%</td>
</tr>
<tr>
<td>Lloyd District</td>
<td>7.6%</td>
</tr>
<tr>
<td>Northeast</td>
<td>4.7%</td>
</tr>
<tr>
<td>Northwest</td>
<td>3.1%</td>
</tr>
<tr>
<td>Southeast</td>
<td>3.8%</td>
</tr>
<tr>
<td>Southwest</td>
<td>3.7%</td>
</tr>
<tr>
<td>Sunset Corridor</td>
<td>3.1%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4.3%</strong></td>
</tr>
</tbody>
</table>

Source: Kidder Mathews
Table 2: Portland Retail Vacancies by Product Type, Third Quarter 2017

<table>
<thead>
<tr>
<th>Property Type</th>
<th>Vacancy Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malls</td>
<td>3.8%</td>
</tr>
<tr>
<td>Power Centers</td>
<td>4.0%</td>
</tr>
<tr>
<td>Shopping Centers</td>
<td>7.2%</td>
</tr>
<tr>
<td>Specialty</td>
<td>0.0%</td>
</tr>
<tr>
<td>General Retail</td>
<td>2.7%</td>
</tr>
</tbody>
</table>

Source: Kidder Mathews

At the end of the third quarter, a total of 127,154 square feet of retail space was given back to the market. This included the closing of a 23,474 square feet Value Village off of 82nd Ave. The national retailer Gymboree has announced bankruptcy and will be closing their two Portland area stores. Year-to-date absorption numbers are in the red, with the market experiencing 48,773 square feet of negative absorption.

The largest retail lease of the quarter was executed by H Mart for 21,124 square feet at the former Zupans Grocery on Belmont. This is the fourth Oregon location for H Mart, which is an Asian grocery store. Kidder Mathews reports that the decrease in leasing activity can be attributed to a summer slowdown and the expectation is that leasing activity will pick up heading into the end of the year. The expectation for 2017 is that net absorption will end up being positive, a good sign despite all of the sirens sounding about the end of retail.

Table 3: Portland Retail Absorption, Third Quarter 2017 and YTD.

<table>
<thead>
<tr>
<th>Submarket</th>
<th>Q3 2017 Net Absorption</th>
<th>YTD Net Absorption</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBD</td>
<td>(16,193)</td>
<td>(198,974)</td>
</tr>
<tr>
<td>Clark County/ Vancouver</td>
<td>(52,884)</td>
<td>(109,836)</td>
</tr>
<tr>
<td>I-5 Corridor</td>
<td>(801)</td>
<td>46,662</td>
</tr>
<tr>
<td>Lloyd District</td>
<td>(8,602)</td>
<td>(625)</td>
</tr>
<tr>
<td>Northeast</td>
<td>38,125</td>
<td>97,226</td>
</tr>
<tr>
<td>Northwest</td>
<td>(1,086)</td>
<td>(5,493)</td>
</tr>
<tr>
<td>Southeast</td>
<td>(52,125)</td>
<td>78,031</td>
</tr>
<tr>
<td>Southwest</td>
<td>12,898</td>
<td>62,692</td>
</tr>
<tr>
<td>Sunset Corridor</td>
<td>(46,486)</td>
<td>17,259</td>
</tr>
<tr>
<td>Total</td>
<td>(127,154)</td>
<td>(48,773)</td>
</tr>
</tbody>
</table>

Source: Kidder Mathews
RENTAL RATES

Rental rates remained stable this quarter with an average asking rent of $19.00/NNN. Close-in retail is pushing above $25.00/NNN on average. Looking at averages among retail can be somewhat deceiving especially in retail. There’s a $12.34 per square foot difference between the asking rents for malls and asking rents for neighborhood centers according to CoStar. Rent growth in Portland has been continually growing and the near term expectation is that rents will continue to trend upwards through the end of the year although at a slower pace than previous quarters. Beyond that, the expectation is that rents will soften but the lack of new supply will moderate a decrease in rates. Year over year, rents growth has posted a very strong 5.7 percent increase according to Kidder Mathews data.

DELIVERIES AND CONSTRUCTION

Very little space was delivered to the market this quarter. Overall retail construction is down compared to the historical average, which has insulated the Portland retail market from a spike in vacancy. By the end of 2017 two build-to-suite projects will be delivered, adding 74,000 square feet to the market. A 38,000 square feet location will be occupied by Restoration Hardware at their new concept store at NW 23rd and Glisan. Another 36,000 square feet will be occupied by 24 Hour Fitness at their new Gladstone Crossing location. Outside of those two projects, CoStar indicates that an additional 30,800 square feet will be delivered at Cedar Hills Crossing before the year is out.

Longer term, there is a total of seventeen retail developments under construction, which will bring 510,469 square feet to the market by the end of 2018. This construction activity will put pressure on rental rates and vacancy numbers however much of the space under construction is preleased or build-to-suite retail. Fortunately, there is not a large amount of speculative retail space to be delivered keeping the market healthy and helping protect it from severe shocks resulting from a national retail slowdown.

Table 4: Notable Retail Developments, Third Quarter 2017

<table>
<thead>
<tr>
<th>Building/Address</th>
<th>Market</th>
<th>SF</th>
<th>Delivery Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cedar Hills Crossing</td>
<td>North Beaverton</td>
<td>128,652</td>
<td>2018</td>
</tr>
<tr>
<td>Community Center</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The Dahlia</td>
<td>SE Outlying</td>
<td>56,800</td>
<td>2018</td>
</tr>
<tr>
<td>The Union at St. Johns</td>
<td>Rivergate</td>
<td>80,00</td>
<td>2018</td>
</tr>
<tr>
<td>4339 Pacific Hwy</td>
<td>Yamhill County</td>
<td>60,000</td>
<td>2018</td>
</tr>
</tbody>
</table>

Source: CoStar and Kidder Mathews

Table 5: Notable Retail Sales Transactions, Third Quarter 2017

<table>
<thead>
<tr>
<th>Building/Address</th>
<th>Buyer</th>
<th>Market</th>
<th>Price</th>
<th>SF</th>
<th>Price/SF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jantzen Beach Super Center</td>
<td>Kimco Realty Corporation</td>
<td>Hayden Island</td>
<td>$131,750,000</td>
<td>732,542</td>
<td>$180.00</td>
</tr>
<tr>
<td>Fourth Plain Center (5 Properties)</td>
<td>Steve Usdan</td>
<td>Vancouver</td>
<td>21,500,000</td>
<td>117,143</td>
<td>$184.00</td>
</tr>
<tr>
<td>Walgreens</td>
<td>Giustina Resources</td>
<td>Gresham</td>
<td>$5,700,000</td>
<td>13,737</td>
<td>$415</td>
</tr>
</tbody>
</table>

Source: CoStar and Kidder Mathews
SALES TRANSACTIONS

The largest transaction of the third quarter was by Kimco Realty Corporation, which purchased the 732,542 square feet Jantzen Beach Center for $131.8 million or $180 per square foot. The property traded at a 5.4 percent cap rate and was 96 percent occupied at the time of sale. Cap rates continue to be low for well-positioned properties and long-term single tenant investments. Kidder Mathews highlights the sale of a Popeye’s restaurant at 5949 NE Martin Luther King Blvd. This property sold at a 5 percent cap rate, which equates to $1,098 per square foot. Although 2017 has seen some very large retail properties trade, the overall sales volume is down from the peak of 2015.

Investor sentiment for retail assets in the Portland market remains strong. The underlying market fundamentals remain stable and construction activity is not expected to deliver a large surplus of space to the market. Online retailing will continue to challenge the traditional brick and mortar presence of certain retailers and the market will see fall-out from that transition. However, well-positioned retail should have no problem succeeding in a growing market and investors recognize the strength of the Portland market making it an attractive location to place capital in the near and long term.