Fall 2018

Center for Real Estate Quarterly, Volume 12, Number 4

Portland State University. Center for Real Estate

CENTER FOR REAL ESTATE QUARTERLY REPORT

Volume 12, Number 4
Fall 2018

A publication of Portland State University Center for Real Estate
Available for download at: http://www.pdx.edu/realestate/research_quarterly.html

Portland State UNIVERSITY

CENTER FOR REAL ESTATE QUARTERLY REPORT

A PUBLICATION OF
PORTLAND STATE UNIVERSITY CENTER FOR REAL ESTATE
P.O. BOX 751-SBA
PORTLAND, OREGON 97207-0751

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OREGON HOUSING UNDERPRODUCTION AND A SMART GROWTH SOLUTION

MICHAEL WILKERSON, RANDALL POZDENA, MADELIINE BARON, AND MARLEY BUCHMAN
ECONorthwest

Oregon's economy has recovered handily from the Great Recession and is now in one of the longest economic expansions in modern history. This growth has brought new, high-paying jobs, new residents from across the country, and has put Oregon on the map as one of the fastest-growing states in the U.S.

Strong in-migration has seen many Oregon cities growing faster than the national average over the past 10 years. At the same time, generational preferences and household demographics have shifted, as baby-boomers downsize and millennials form new households and upgrade from apartments to single-family homes. Preferences for both generations have shifted toward walkable, urban housing near transit and desirable amenities in high-opportunity areas.

However, the supply of housing has not kept pace with this demand. Our econometric model, detailed in the following pages, estimates Oregon underproduced approximately 155,000 housing units, or roughly 9.0 percent of the 2015 housing stock over the 2000 to 2015 time period. This time period encompasses the pre-recession building boom, the subsequent market crash, and most of the strong, current development cycle.

In the current cycle, the construction sector lagged behind strong demand for several years as it recovered from the market crash. As of 2018, residential housing construction starts have yet to return to their pre-recession peaks statewide.

While this current imbalance in supply and demand was exacerbated by the last recession, it continues a longer trend that many housing markets throughout the state have felt for decades: restrictive local development and land-use policies that reflect opposition to high-density, affordable or multi-family housing developments in favor of low-density, single-family homes. Localized opposition in established single-family neighborhoods has prevented the addition of new units in high-opportunity areas.

ECONorthwest is the Pacific Northwest's largest economic consulting firm. They provide independent, insightful, and relevant analyses that strengthen policy and investment decisions. Since 1974, ECONorthwest has served a diverse range of public and private-sector clients across the United States: business management and labor unions; conservationists and energy companies; public planning departments and private developers; litigation plaintiffs and defendants. Their studies are conducted by staff vetted for strong economic, financial, and policy evaluative skills.

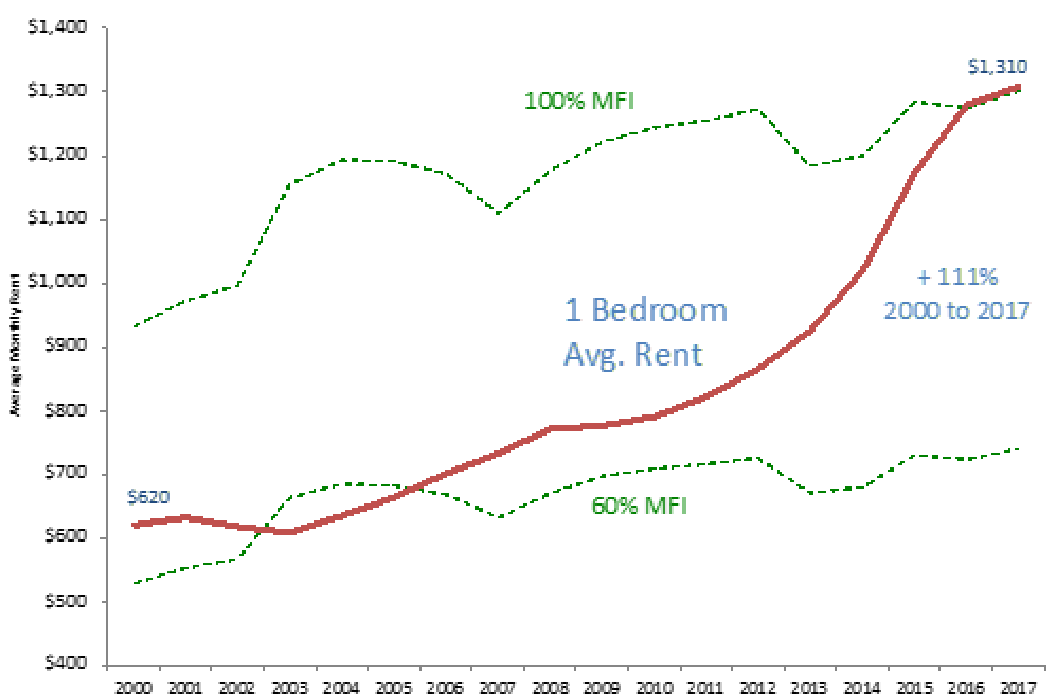
Some of the barriers to increasing housing production include:

- Zoning restrictions, which create a shortage of zoned high-density sites and prohibit the addition of "missing middle" units in single-family neighborhoods;
- Escalating and misaligned fee structures, such as impact and linkage fees charged per unit instead of square footage;
- Poorly calibrated inclusionary housing exacerbated by rapidly changing market conditions; and
- Lengthy review processes that add cost and allow for manipulation by growth opponents.

As a result, Oregon has seen a growing imbalance in supply and demand. Historically this has been due to restrictive land use policies and anti-density opposition, but more recently, it is due to the construction sector lagging behind strong in-migration and preferences for urban living.

The consequences have changed the nature of Portland's housing market from a lower-cost alternative in a smaller city setting, to a higher-cost city in the national spotlight. The figure below exemplifies this, showing that average one-bedroom rents in Portland used to be affordable to a household at 60 percent of median family income, and are now barely affordable to a household at the MFI.

Figure 1: Changing affordability in Portland rents



Source: Costar, HUD, ECONorthwest Calculations.

This strong increase in home prices and rents has strained households at many income levels, but has particularly hit low-income households, who have fewer choices in where to live. In addition, this growth has caused a divergence in the outcomes between renters and homeowners. Housing is increasingly less affordable to households earning less than the median income, while home values have risen for households who already own homes in these areas.

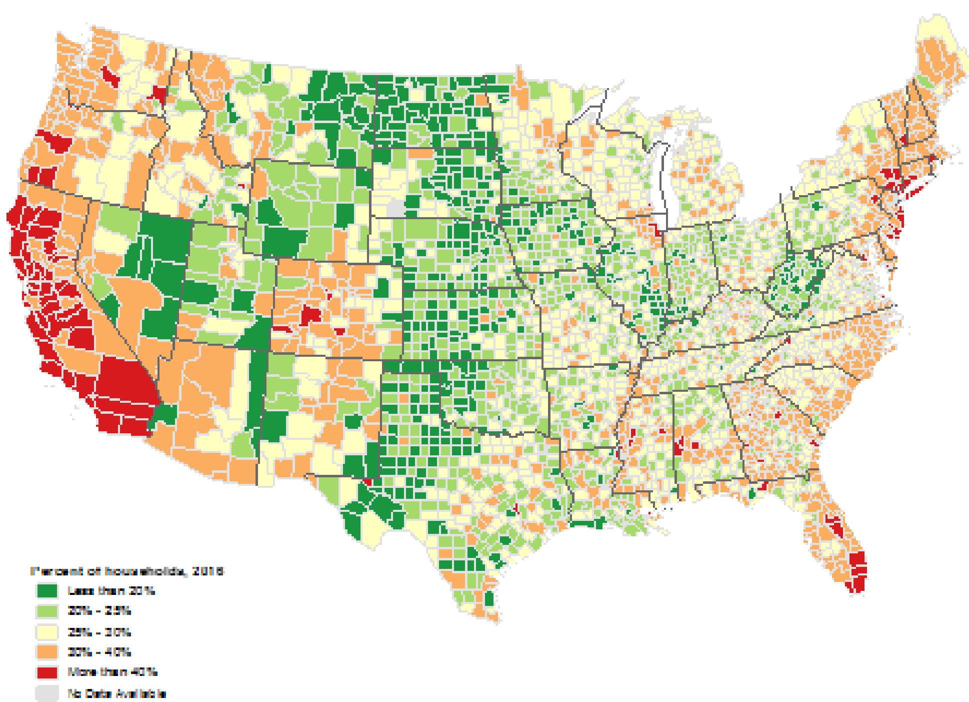
In many areas across the state, these conditions translate into economic pain for thousands of households: In 2016, 53 percent of all Oregon renter households were cost-burdened (see below); more than 13,200 people were homeless; rapidly rising rents and home prices pushed many households to the outer edges of the Portland metro area. Traffic has worsened, with the Oregon Department of Transportation reporting that a 3 percent increase in population increased congestion in the Portland region by 13.6 percent, with daily vehicle hour of delays up 22.6 percent from 2013-2015.

COST BURDENING

Cost burdening occurs when incomes lag behind rapidly rising rents and housing prices. Although incomes have begun to rise in recent years, they were stagnant for several decades while housing costs increased at much higher rates. This divergence has led to increased cost burdening rates across Oregon.

In every county in Oregon except for one, at least 25 percent of households experience cost burdening, and in the majority of counties—particularly on the western side of the state—more than 30 percent of households are cost-burdened.

Figure 2: Percent of households that spend more than 30 percent of gross income on housing, 2016



Source: St. Louis Federal Reserve GEOFRED.

HOUSING STARTS TO HOUSEHOLD FORMATION

If a region is becoming less affordable to all residents over time, the most straightforward explanation is that the number of units supplied is not sufficient to keep up with market demand. A deeper dive into the relationship between housing units and household formation is that they are related, or endogenous. This means that the decision to form a household is influenced by the price of housing, while the price of housing is also influenced by the rate of household formation.

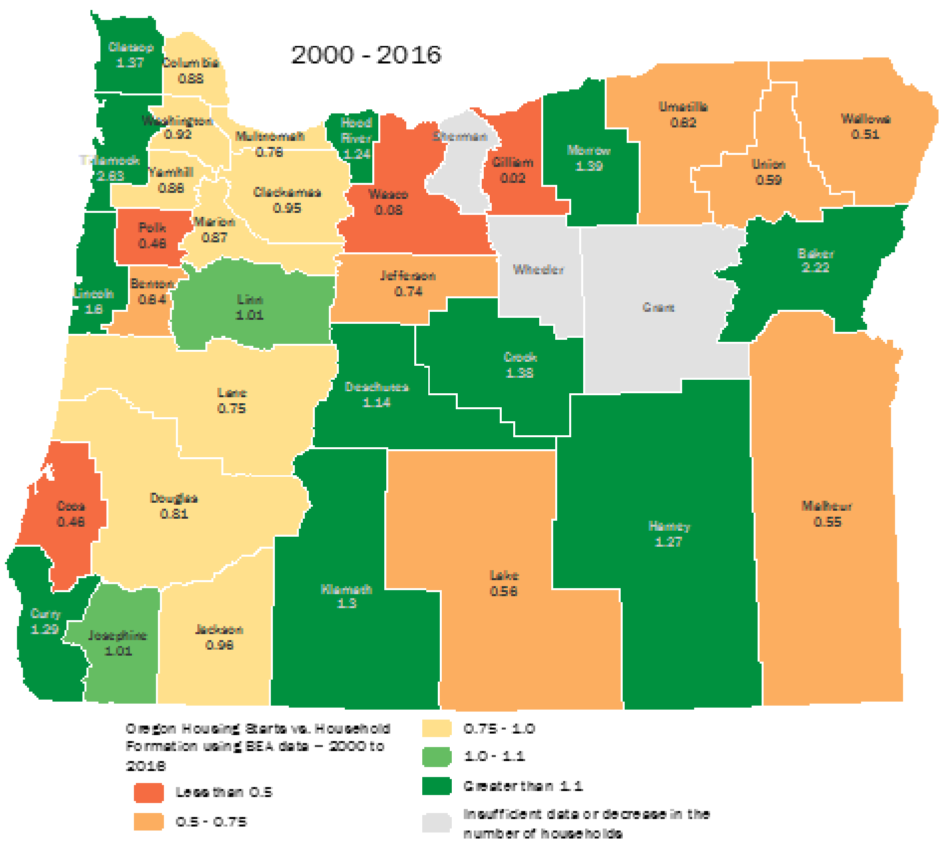
Nationally, 11 units have been produced for every 10 new households formed since 1960. This ratio of 1.1 new units for each household formed is seen as the minimum needed to account for vacancy, demolition and obsolescence, while still maintaining market conditions and accommodating demand for new housing.

From 2000-2016, Oregon produced only 0.89 units for every household formed, including the building boom, subsequent bust, and most recent increase in housing construction. Put differently, for every 100 households formed during this time period, only 89 units were built.

More recently, since the end of the Great Recession—2010 to 2016—housing production fell further behind household formation. Statewide, only 63 units were produced for every 100 households formed. Despite the number of cranes crowding skylines across the western portion of the state, 37 out of every 100 newly formed households had to compete for a limited stock of housing during the economic recovery.

Diving deeper into the data, it is clear that some counties in Oregon produced more than 1.1 units per household formed in the run up to the housing market crash. However, only seven counties in Oregon produced units at the baseline ratio since 2010—none of which are highly populated. In two tourism heavy counties, Hood River and Tillamook, these ratios may be boosted by the production of vacation homes, which do not help the affordability crisis affecting year-round residents.

Figure 3: Housing units vs. household formation, 2000-2016



Source: U.S. Census Annual Estimate of the Residential Population 2017 (population), U.S. Census 2010 (people per household), U.S. Census 2000 (household count), Moody's Analytics (housing starts).

CALCULATING UNDERPRODUCTION

To more accurately measure the relationship between housing units and household formation, a model that solves for a measure of the constraint on supply from observed market data is required.

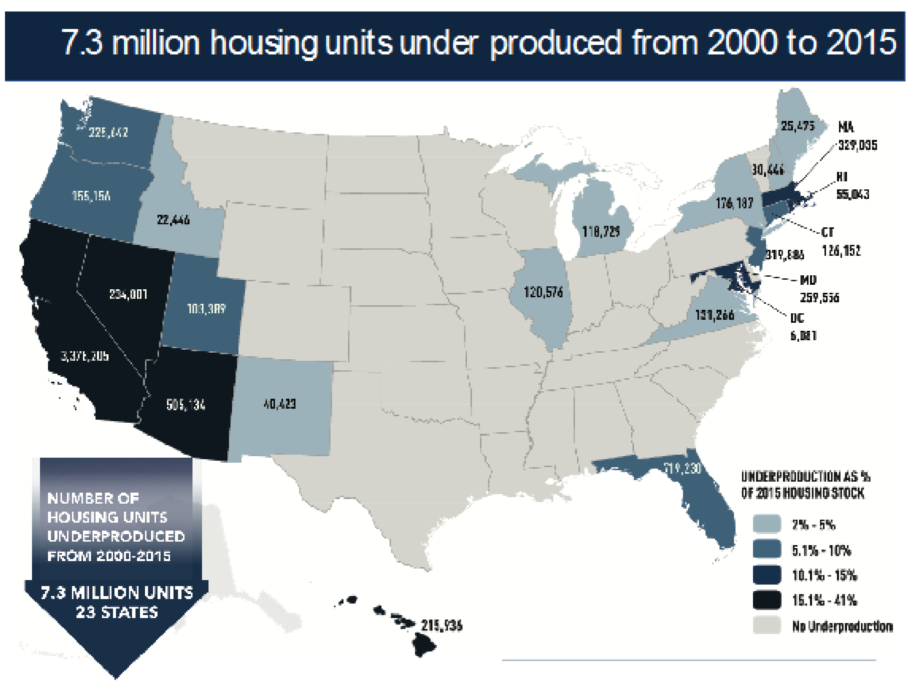
The price elasticity of supply is an approximate measure of housing supply constraints—it measures the percent change in quantity supplied divided by the associated percent change in price. We expect the supply elasticity to be positive, indicating that when prices rise, the quantity of housing supplied will also increase.

However, in some markets, this elasticity may be weakened: rising prices may not result in much increase in supply due to constraints on the market. These constraints may be natural, geographic boundaries (e.g., water, slopes, or forestland) or artificial limitations (e.g., market regulations on development).

To calculate the amount of underproduction at the state level, we first use a regression analysis on historical home price and income data to determine the elasticity of price with respect to income. We then calculate the price elasticity of supply from the estimates of the housing price elasticity with respect to income, and the assumed elasticities of housing stock demand with respect to price and income. This step allows us to estimate each state's historic relationship between the production of housing units (supply) and its income growth.

Using this relationship, we then calculate each state's baseline housing production through 2000 and forecast the number of units that would have been produced in 2015 if each market maintained its historic equilibrium. Then using the actual number of housing units in 2015, we calculated the total units that were under- or over-produced from 2000 to 2015 at the state level. Given that the underproduction process may have been going on prior to that period, the reported underproduction volumes may understate cumulative underproduction. The historic data needed for this calculation were not available for smaller geographies.

Figure 4: National housing units underproduced from 2000-2015



Source: ECONorthwest estimates, Census Bureau ACS 1-year Estimates of housing Stock.

The map above shows which states under-produced housing during the 2000-2015 time period. States that produced housing at their long-run equilibrium rate are in grey. Nationally, 23 states under-produced housing to the tune of 7.3 million units, or roughly 5.4 percent of the total housing stock in the United States.

This model demonstrates that Oregon underproduced 155,000 units over the 2000-2015 timeframe. This figure estimates statewide underproduction, but fails to shed light on regional housing markets and the supply and demand imbalances playing out locally. Because data used in the econometric model were not available at smaller geographies, we use a simplified approach to evaluate the imbalance in supply and demand at the county level in Oregon.

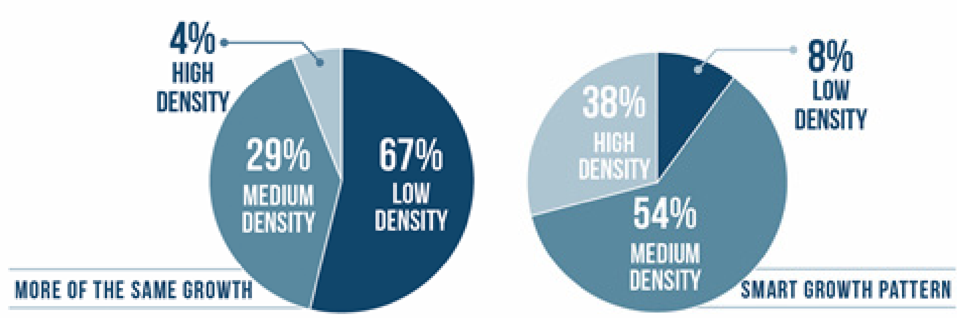
SMART GROWTH VS. MORE OF THE SAME

After estimating underproduction, we evaluate the development impacts of two different growth patterns: More of the Same development which continues the status quo, or Smart Growth development which leverages existing infrastructure by building housing at higher densities inside transit corridors and high-opportunity neighborhoods.

If Oregon were to develop these 155,000 underproduced housing units over a 20 year timeframe, it could continue its current pattern with More of the Same growth or adopt a Smart Growth approach building higher density housing near transit corridors and high-opportunity neighborhoods.

In a More of the Same approach, 70 percent of the 155,000 housing units would be single-family homes, 28 percent would be missing middle and medium-density, and only 2 percent would be in residential apartment towers.

In a Smart Growth pattern, only 9 percent of the newly developed units would be single-family homes, 63 percent would be missing middle and medium-density housing, and 28 percent would be in residential apartment towers. Building these units in walkable, transit-oriented areas via Smart Growth development would use only 18 percent of the land needed in the More of the Same scenario, protecting farm and forestland and valuable natural areas. In addition, building housing near transit and employment has the potential to reduce vehicle miles driven by as much as 34 percent, reducing carbon emissions significantly.



CONCLUSIONS

The conclusions herein support the need to enact innovative public-private solutions that increase the supply and reduce the cost of new housing in our urban centers. Pervasive longtime homeowner sentiments that "all new housing is bad" have become conventional wisdom, stemming from the unwarranted and factually unsupported belief that new units overburden schools, strain city finances and make traffic worse. Overcoming this unproductive narrative requires a public conversation that focuses on delivering units as cost-effectively as possible.

Because Oregon has strong land-use policies governing growth management and protecting forestland and farmland, the state must make the best use of the land inside each growth boundary. The Smart Growth scenario in this report describes what is possible by developing compact housing communities around transit corridors and in high-opportunity neighborhoods: narrowing the gap between supply and demand; reducing costs for local governments by leveraging existing roadway and sewer infrastructure; and building housing near jobs, transit, and amenities.

Focusing on developing missing middle and medium-density housing in underutilized sites and in transit corridors can also reduce transportation costs for households while creating net-positive fiscal revenue for local governments. This type of growth adds density in single-family neighborhoods through ADUs, quads, and garden-style apartments to increase density in walkable, high-opportunity areas. ■

OPPORTUNITY ZONES

DENIZ ARAC
Portland State University

As part of the Tax Cuts and Jobs act, that President Trump passed on December 22, 2017, a new section of code was added that created a new Opportunity Zone program. The initial information provided more questions than answers, and many investors were timid to jump in right away while others were more opportunistic and created funds at the onset of the program. On October 19th, 2018 the IRS released some clarifications and requests for input. This article will include the clarifications that were released.

The Opportunity Zone program is meant to increase investment in distressed communities around the country. This program allows investors to defer capital gains tax and provides an opportunity for tax-free appreciation for a new investment properly made in a "Qualified Opportunity Zone" (QOZ). QOZs are located in current low-income areas. We will look at how these areas were selected, what the incentives of the plan are, the mechanics of deferring capital gains tax and then we will dive deeper into Oregon specifically.

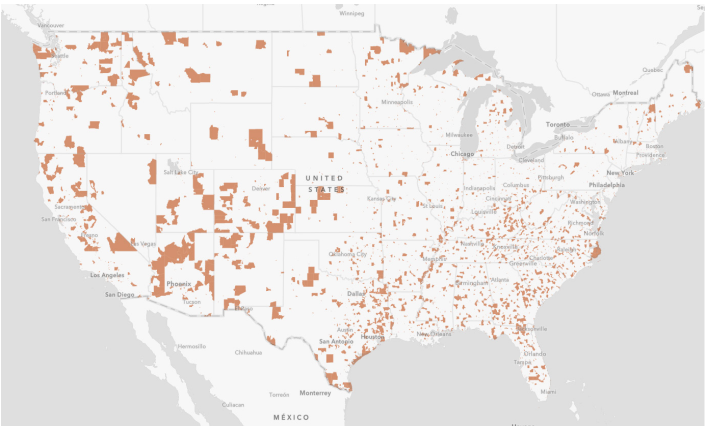


Figure 1: Qualified Opportunity Zones in the United States (Economic Innovation Group)

Deniz Arac is a candidate for the Masters in Real Estate Development degree and currently works as a development manager for the Trammell Crow Company. Any errors of omissions are the author's responsibility. Any opinions are those of the author solely and do not represent the opinions of any other person of entity.

OPPORTUNITY ZONE SELECTION

IRC 1400Z-1 and 1400Z-2 are the Internal Revenue Code sections behind the new regulations. QOZs are based off the 2011-2015 American Community Survey data from the Census Bureau (Haun, 2018), which identified 41,000 population census tracts that are eligible based on low-income standards.

The nomination for a QOZ was borne by the chief executive officer of each state. They had until March 21, 2018, to provide their nominations based of the list of tracts that were eligible. The nomination process was finalized in June 2018 and there were 8,761 communities nationwide designated as QOZs, according to the IRS. The federal government felt it was important to have a local lens on each state which is why the governor of each state was responsible for nominating the low-income census tracts.

The process included analysis, collaboration, and engagement to select QOZ nominees. The selection was not only just for distressed communities, but also areas that were attractive for investors to still make a successful investment regardless of the tax implications. Governors could nominate up to 25 percent of the eligible areas. Figure 1 shows the QOZ selections around the country and Figure 2 shows a survey of the selection process from the Governor's office on the nominations of QOZ.

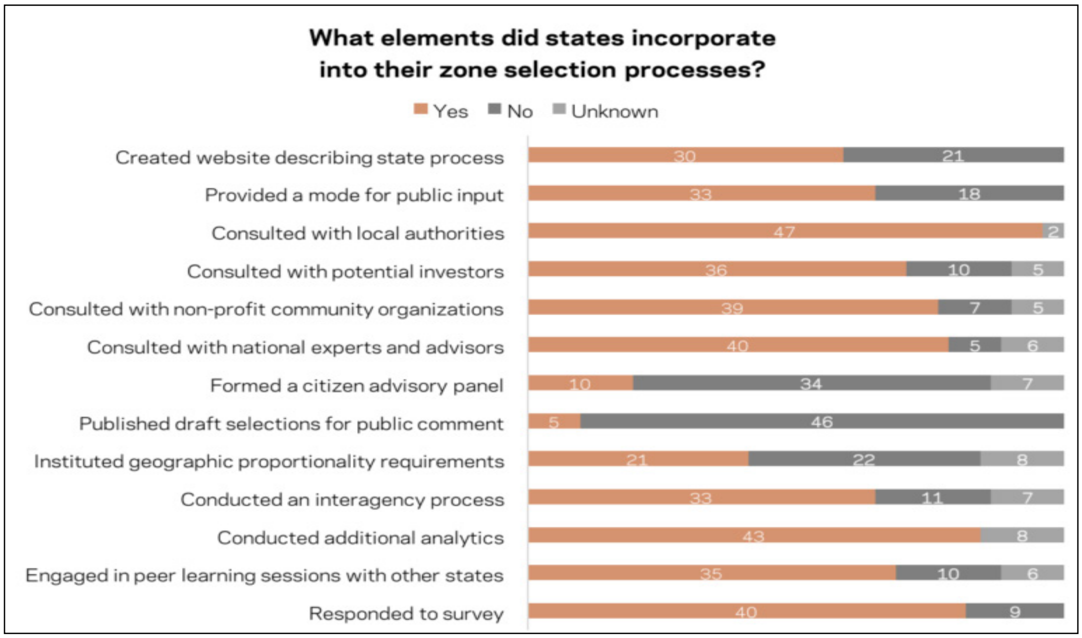


Figure 2: Factors affecting nomination for Qualified Opportunity Zones (Economic Innovation Group)

Businesses or trades that operate in a QOZ can also benefit from deferred taxes. To qualify as a Qualified Opportunity Zone Business (QOZB), substantially all the tangible property owned or leased by the taxpayer must be in the QOZ. This is to help businesses that operate in these low-income areas attract investments.

OPPORTUNITY ZONE TAX INCENTIVES

To encourage investment into the low-income communities and QOZs, the Federal government had to create an attractive tax incentive package for investors. The incentives for the investors are increased the more patient an investor is. The IRS identifies the following incentives:

- **Temporary Tax Deferral:** Capital gains from essentially all investments are eligible for tax deferral if reinvested into a Qualified Opportunity Fund (QOF). The deferred gain must be realized by the end of 2026 or when the investment is sold, whichever is earliest.

OPPORTUNITY ZONE TAX INCENTIVES

- **Step-Up in Basis:** Capital gains reinvested into a QOZ, will have the basis of the original investment increased 10 percent if the investment is held for at least 5 years. Then if held for 7 years, the basis is then increased an additional 5 percent for a total of 15 percent. Table 1 shows the holding period and basis step-up relationship. This tax can be deferred until the earlier of, the date on which the investment in a QOF is sold or exchanged, or December 31, 2026. To maximize the 15 percent basis step-up, investors must hold for 7 years before the end of 2026, meaning investments would need to be in by 2019 to optimize the program.

Table 1:Capital Gains and Holding Period

Holding Period (Years)	Basis Step-Up
5-6	10%
7-9	15%
10+	Fair Market Value

Source: IRS

- **Permanent Exclusion from Taxable Income of Capital Gains:** Once the investment in a QOF is sold or exchanged, and is held for at least 10 years, there will be no capital gains tax on that transaction.

OPPORTUNITY ZONE FUNDS

To invest, or reinvest, into a QOZ, the funds must be in a Qualified Opportunity Fund (QOF). A QOF is just the investment vehicle that is formed as a partnership or corporation that the dollars must be in to invest in a QOZ. Any partnership or corporation that is set up to be a QOF can self-certify. There are rules that a QOF must follow including:

- At least 90 percent of their capital must be in Opportunity Zones. However, if the QOF invests in a partnership or corporation to meet the qualified opportunity business requirement, only 70 percent of the tangible property of the subsidiary corporation or partnership must be held for use in qualified opportunity zone business property.[1]
- The investment into a QOF must also be an equity interest and cannot be a debt instrument. Although debt can still be used on the same investment.
- Like a 1031 exchange, the investors must follow 180-day rule for deferring gains (must invest within a 180-day period beginning at date of sale or exchange). Unlike a 1031, there is no third party holding the funds and you only have to invest the gains of a sale or exchange and not the full proceeds.
- Property must have been purchased after 2017.
- Ground-up projects (referred to as Original Use of the property) in the QOZ must commence with a QOF. Meaning the project could not have started with funds prior to the investment of the QOF.
- Renovations of existing buildings (referred to as substantially improved property) must be improved with funds from the QOF.

[1] *For example, if a QOF has $10 million in assets and wants to hold only $6.3 million in qualified opportunity zone business property, it can do so by investing $9 million in a partnership and having the partnership invest $6.3 million (i.e., 70 percent of its assets) in qualified opportunity zone business property.*

OPPORTUNITY ZONE FUNDS

- Unique to a QOF is once the capital gains are placed into the fund, the cash is safe harbored as “working capital” for up to 31 months, to take into account how long a real estate transaction and construction may take for a project. There must be a written plan that outlines the financial property is being held for the acquisition, construction or substantial improvement of tangible property in a QOZ.

DURATION

The Opportunity Zone Program expires in December 31, 2028, but even after the QOZ lose their designations, the investments will still be able to preserve their rights for basis step-ups after 10 years. This will be preserved into December 31, 2047.

Qualified substantial improvements, renovations, are determined by improving the properties basis by double within the 30-month period. This calculation does not include land. For example, say a QOF purchases a vacant building in a QOZ for $10 million; $4 million of the purchase price is attributed to the land while $6 million is attributed to the building. The QOF would need to put $6,000,000 of improvements into the building within the 30-month time frame to qualify for the substantial improvement clause.

OREGON/SW WASHINGTON OPPORTUNITY ZONES

Turning to our region, let’s take a deeper look into the QOZs that Governor Kate Brown nominated and were selected. Figure 3 shows the whole state. Figure 4 shows the majority of the Portland MSA. Figure 5 drills deeper into the Portland Central City and Figure 6

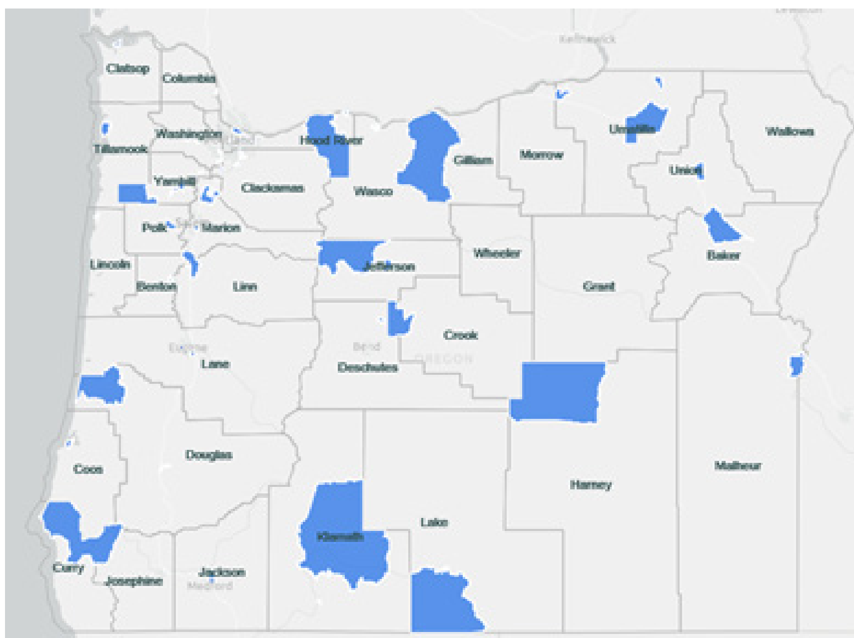


Figure 3: Oregon Qualified Opportunity Zones (State of Oregon)

OREGON/SW WASHINGTON OPPORTUNITY ZONES

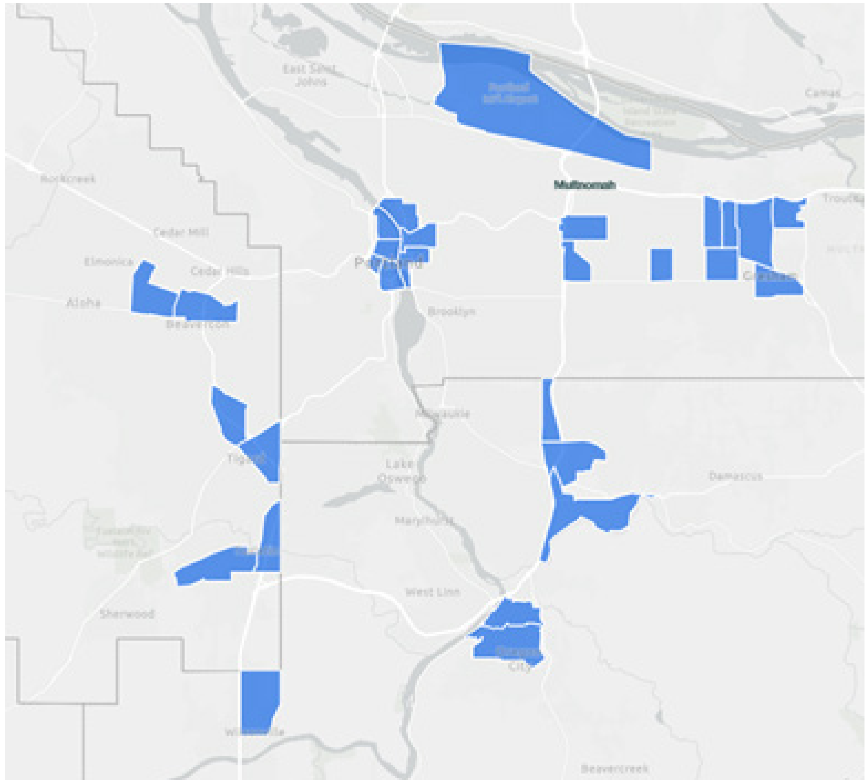


Figure 4: Portland MSA Qualified Opportunity Zones (State of Oregon)

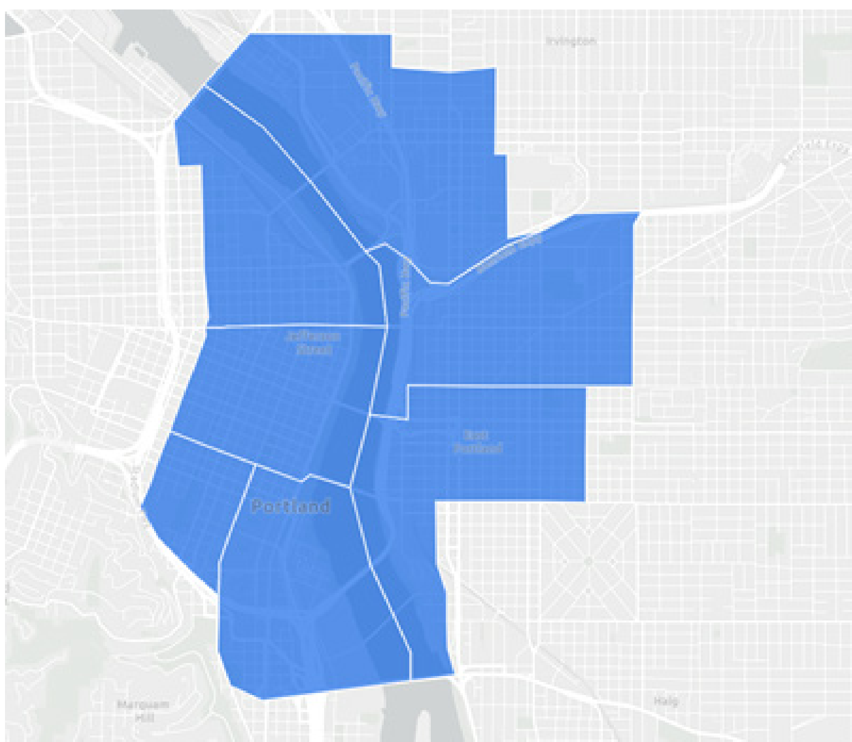


Figure 5: Portland Central City Qualified Opportunity Zones (State of Oregon)

OREGON/SW WASHINGTON OPPORTUNITY ZONES

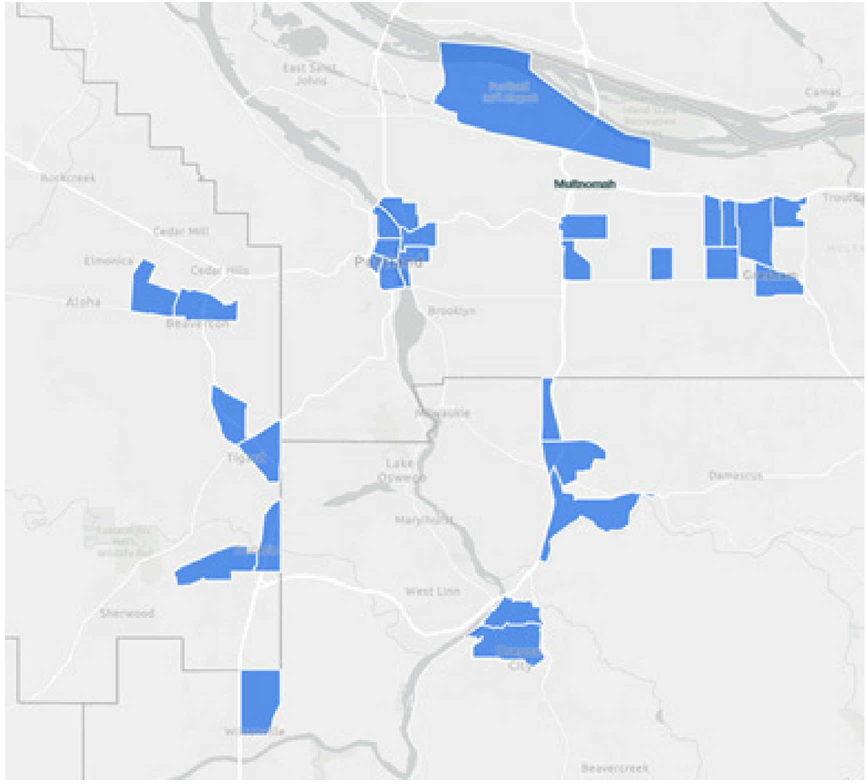


Figure 6: East Portland and East County Qualified Opportunity Zones (State of Oregon)

Table 2: Qualified Opportunity Zones by Oregon county

County	# of QOZ	County	# of QOZ	County	# of QOZ
Baker	1	Hood River	2	Multnomah	17
Benton	2	Jackson	3	Polk	2
Clackamas	6	Jefferson	2	Sherman	1
Clatsop	1	Josephine	1	Tillamook	1
Columbia	1	Klamath	2	Umatilla	3
Coos	2	Lake	1	Union	1
Crook	1	Lane	5	Wasco	2
Curry	1	Lincoln	1	Washington	8
Deschutes	4	Linn	2	Yamhill	3
Douglas	2	Malheur	2	Total	86
Harney	1	Marion	5		

Source: Business Oregon

OREGON/SW WASHINGTON OPPORTUNITY ZONES

shows East Portland and East County. State-wide there are 800 census tracts, and 366 were eligible based on the low-income communities' designation according to Business Oregon. With an allowable nomination of 25 percent, about 91 zones could have been nominated. Oregon nominated and selected 86 zones. Table 2 shows the breakdown by county: 31 different counties have a QOZ, with Multnomah having the most at 17. Washington is second with 8 then Clackamas with 6.

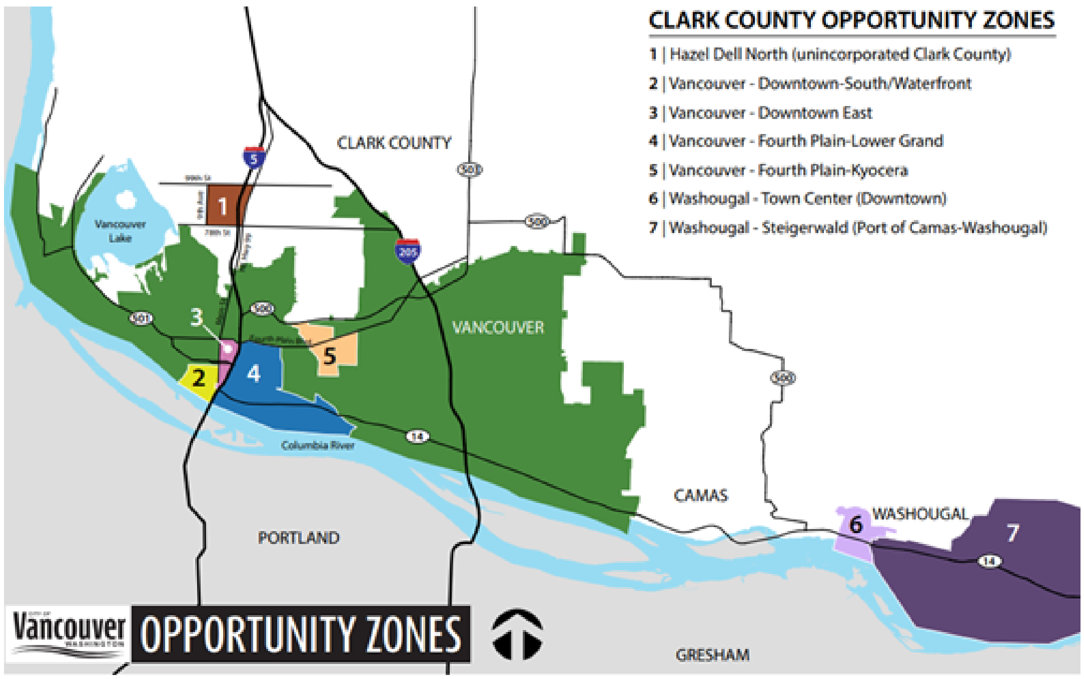


Figure 7: Clark County Qualified Opportunity Zones (City of Vancouver, 2018)

CONCLUSION

Looking at the Portland Central City QOZs, many of these areas are desirable for investments. Many real estate transactions that have occurred in this cycle would have fallen within these QOZs. These areas include the Pearl District, South Waterfront, inner Southeast and Lloyd. With more outside investors starting to infuse money into the Portland market, the opportunity to defer capital gains tax may boost the investments into Portland even more. Figure 7 shows Clark Counties QOZs, which also includes areas that have received quite a bit of investment recently. The original use projects are pretty straightforward on being able to achieve the benefits from a QOZ, since any improvements on the land will qualify. The substantial improvements are not quite as straightforward. For a substantial improvement project to qualify, the value of the improvements must be double the value of the building minus land. This is not an issue on projects where a large capital infusion is required, but on a value-add opportunity it could be more difficult.

Say QOF "A" purchases a vacant building and will be convert it to an office building. The purchase price was \$10 million with land being \$4 million of the costs. QOF needs to put an additional \$6 million into the project to qualify. It is safe to assume the building will require a seismic upgrade, complete demolition and build back of the interior and MEP systems, exterior upgrades and potentially a new penthouse level. With all of these improvements the costs will likely be above \$6 million.

CONCLUSION

Consider QOF "B" which invests in a garden style apartment with the same costs of QOF "A." QOF "B" just plans to upgrade units (paint, appliances, cabinetry and flooring), add an amenity and paint the exterior of the building. Adding $6 million of improvements would be much more difficult to incorporate while still expecting realistic rents for the apartments. Therefore, the program would likely spur more original use and office building investments than it would for small-to-medium scale apartment investment. When you look at the macro picture of the intent of the program, this could have a profound effect on how the QOZ effects the communities they reside in.

Isaac Jones, Senior Tax Manager with Perkins & Co, had this to say about the current state of the program, "With the issuance of these long awaited proposed regulations on October 19th, though there are still unanswered questions, this guidance gives us enough clarify for investors and developers to start moving forward and taking advantage of the truly unique tax benefits of these new code sections.". To Isaac's point we are now seeing many more listings from brokers labeled as "Opportunity Zone" developments sites, and many QOF are being created. We will have to wait and see if the market takes full advantage of this opportunity before the end of 2019. ■

STATE OF THE ECONOMY

ERIC FRUITS, PH.D.
Portland State University

The United States and Oregon's economies have many of the marks bustling growth over the past year: output, employment, and hourly wages are up while unemployment and poverty are down. Nevertheless, there are some signs that growth is slowing: employment growth is leveling off and unemployment is stabilizing; home sales are slowing as is the construction of new housing. Factors such as trade disputes and rising interest rates may place drag on the economy, while increased investment under the Tax Cuts and Jobs Act are likely to provide a further boost over the next few years.

In Oregon, the gains in employment and incomes are doing little to improve the affordability of housing in the state. The Great Recession gutted the state's middle income households, while the net migration of higher income households are bidding up housing prices, especially in the Portland metropolitan area. In addition, implementation of Oregon's land use laws combined with local regulations discouraging housing construction have unnaturally restricted supply, resulting in what amounts to a housing shortage throughout the state.

Eric Fruits, Ph.D. is the editor of the Quarterly Report the Oregon Association of Realtors faculty fellow at Portland State University. He is an adjunct at Portland State University where he teaches course in economics and real estate. Dr. Fruits is the president of Economics International Corp., an Oregon based consulting firm and the chief economist at the International Center for Law & Economics.

U.S. ECONOMY

The U.S. economy is performing well, with consistent growth enabling higher interest rates. Robust growth in over the past year has spurred job creation and helped to reduce unemployment rates to near-record lows. Wage growth has picked up recently, outpacing consumer price inflation. In turn, these factors are supporting growth in private consumption, which is encouraging firms to invest and hire yet more workers, stimulating GDP growth and putting upward pressure on consumer prices.

	2017	2018	Percent Change
Employment, thousands	146,963	149,500	1.7%
Unemployment rate	4.20%	3.70%	-.05%
Average hourly wage	$26.51	$27.25	2.8%
Consumer price index	246.39	251.99	2.3%
Gas price, per gallon	$2.645	$2.836	7.2%
Interest rate, 30-year mortgage	3.81%	4.63%	0.8%
New home sales	637,000	553,000	-13.2%
Existing home sales	5,370,000	5,150,000	-4.1%
Gross domestic product, trillions	$19.59	$20.66	5.5%
Federal debt as share of GDP	104.12%	103.35%	-0.8%

Table 1: U.S. Economic Metrics

Looking forward to 2019, rising trade barriers around the world are likely to weigh on business sentiment while higher interest rates may dampen U.S. consumer spending and slow growth in the housing market.

The renegotiation of the North American Free Trade Agreement (NAFTA) in late September—which has been rebranded as the United States Mexico Canada Agreement (USMCA) but is structurally similar to NAFTA—has eased some trade and inflation concerns. The deal must now be passed by legislatures in all three countries. Despite the Democratic gains in the U.S. House of Representatives, only the Senate approves treaties, so there is little risk of the approval process breaking down.

The Tax Cuts and Jobs Act has been a boon to consumer confidence, with consumer spending driving a large portion of GDP growth over the year. In general, economists see much of the potential stimulus from the tax cuts coming from changes in business taxation. However, less than a year in the new tax rules, increased investment is expected to occur over the next few years.

The U.S. Federal Reserve raised the benchmark federal funds rate in September and are expected to raise rates again in December. Consumers and businesses have so far shown resilience to moderately higher interest rates (Figure 1), although new and existing home sales have declined over the past year as mortgage interest rates have increased. In turn, as shown in Figure 2, housing starts over the past quarter have been below the 12-month moving average.

Rising interest rates and high costs associated with trade tensions and tariffs could harm residential and commercial real estate markets through increased construction costs as well as dampened demand. Offsetting these risks are increased employment and wages that would stimulate further demand for residential and commercial real estate.

U.S. ECONOMY

Figure 1: U.S. 30-year fixed rate mortgage rate, 2007-2018 (Freddie Mac)

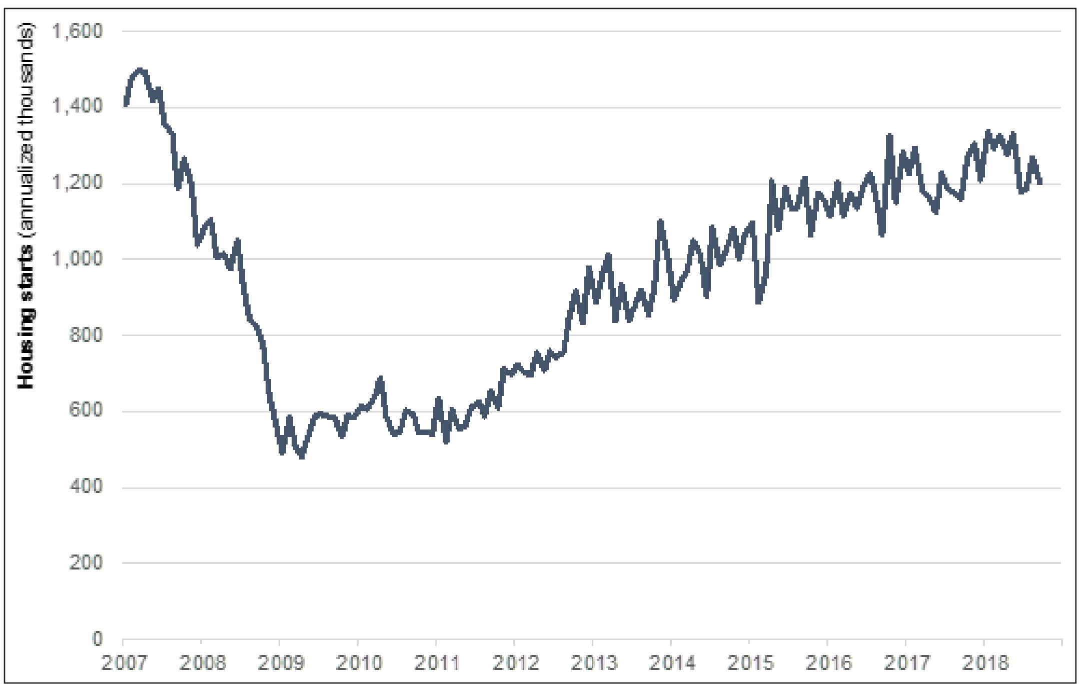


Figure 2: U.S. new privately owned housing units started, seasonally adjusted annual rate, 2007-2018 (U.S. Bureau of the Census and U.S. Department of Housing and Urban Development)

OREGON EMPLOYMENT, INCOMES AND HOUSING AFFORDABILITY

The U.S. and Oregon have seen robust employment growth over the past year, with unemployment at near all-time lows. Figure 3 shows that Oregon saw the biggest gains in employment over 2014 and 2015. As the state reaches full employment, Oregon job growth has more-or-less matched U.S. job growth since 2016. Oregon unemployment rate has flattened out at around 4.0 or 4.1 percent over the 18 months or so. This suggests that job growth has slowed to match population and labor force growth over this period.

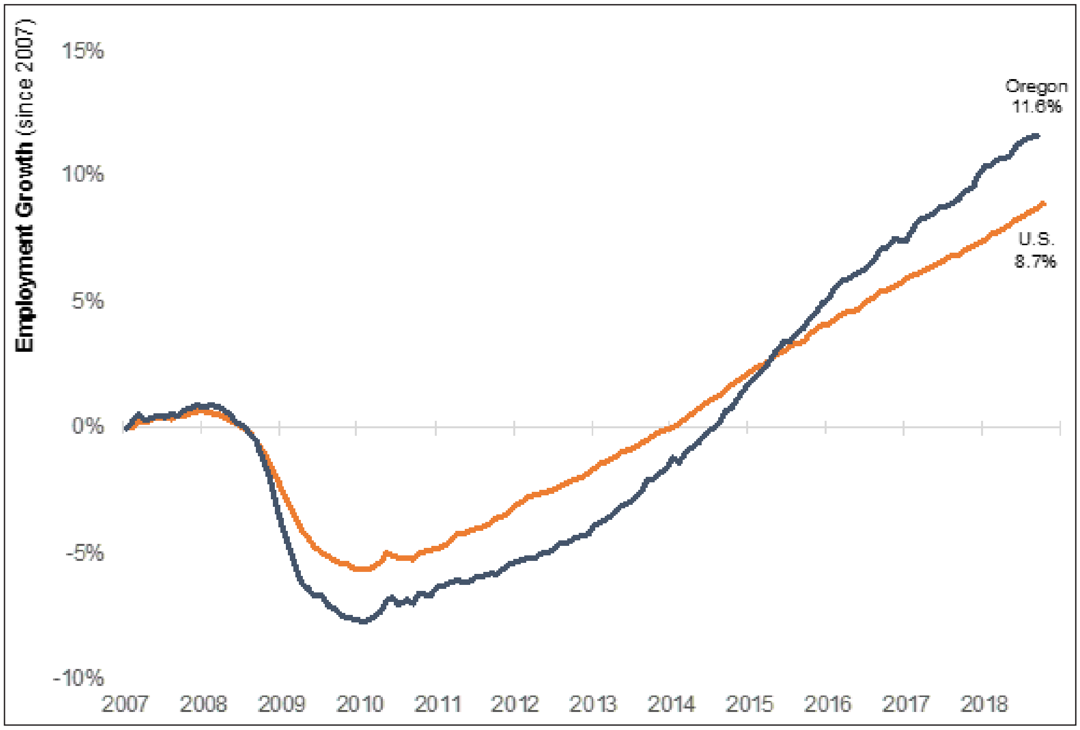


Figure 3: U.S. and Oregon employment growth, 2007-2018 (U.S. Bureau of Labor Statistics)

Middle wage jobs took the biggest hit in in the last recession, with a loss of more than 100,000 jobs, according to the Oregon Office of Economic Analysis. As shown in Figure 4, since the recession, high wage (e.g., professional and business services) and low wage (e.g., leisure and hospitality) jobs in Oregon have increased from pre-recession highs, while middle wage jobs (e.g., durable goods manufacturing) have declined throughout the state. With the steep decline—and slow recovery—of middle wage employment, Oregon household income inequality has worsened since 2007.

Figure 4 provides the Gini coefficient for Oregon from 2007 through 2017. The Gini coefficient is a widely used measure of income inequality. It ranges from zero (perfect equality in which every household receives equal income) to one (in which one household receives all income and every other household receives nothing). Prior to the recession, Oregon's Gini coefficient was 0.447. In the first year of the recession, the state's income inequality "improved" as high, middle, and low wage earns lost jobs. As the bottom dropped out of middle wage employment through 2009 and 2010, income inequality worsened. Middle wage employment stagnated through 2001-2014, further worsening income inequality.

It was during this period of rising income inequality that Oregon returned to pre-recession levels of in-migration. According to the Oregon Employment Department, and shown in Figure 5, approximately 87 percent of the state's population growth last year came from net migration. The combination of increasing net migration and sluggish production of new housing has led to an increase in housing prices, making home ownership unaffordable for a growing portion of the Oregon households.

OREGON EMPLOYMENT, INCOMES AND HOUSING AFFORDABILITY

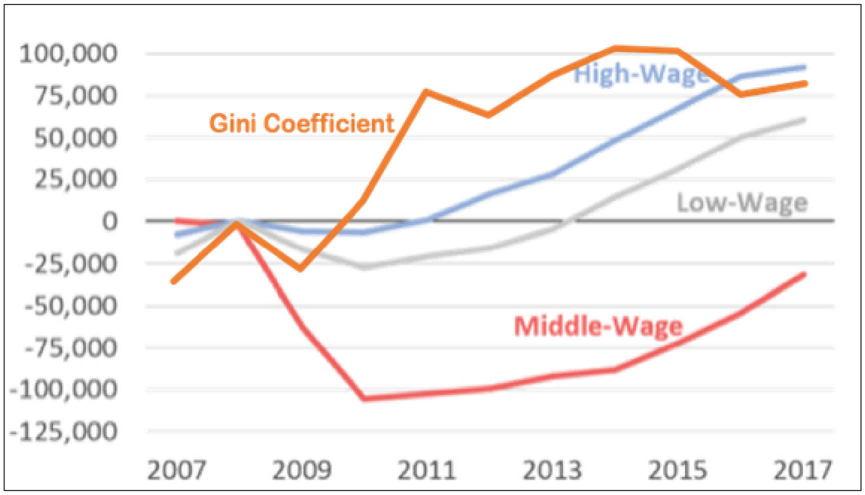


Figure 4: Oregon job polarization and household income inequality, Gini coefficient and employment change from pre-recession peak, 2007-2017 (U.S. Census Bureau; U.S. Bureau of Labor Statistics; Oregon Office of Economic Analysis. Gini coefficient range of 0.442-0.462.)

Indeed, it was also during this period of rising income inequality that Portland area housing prices began to grow faster than Portland area incomes, as shown in Figure 6. From 2011 through 2014, Portland area home prices increased by 24 percent while Portland area per capita personal income grew at half that rate. Since 2014, income have increased 15 percent while the Case-Shiller home price index increased 40 percent.

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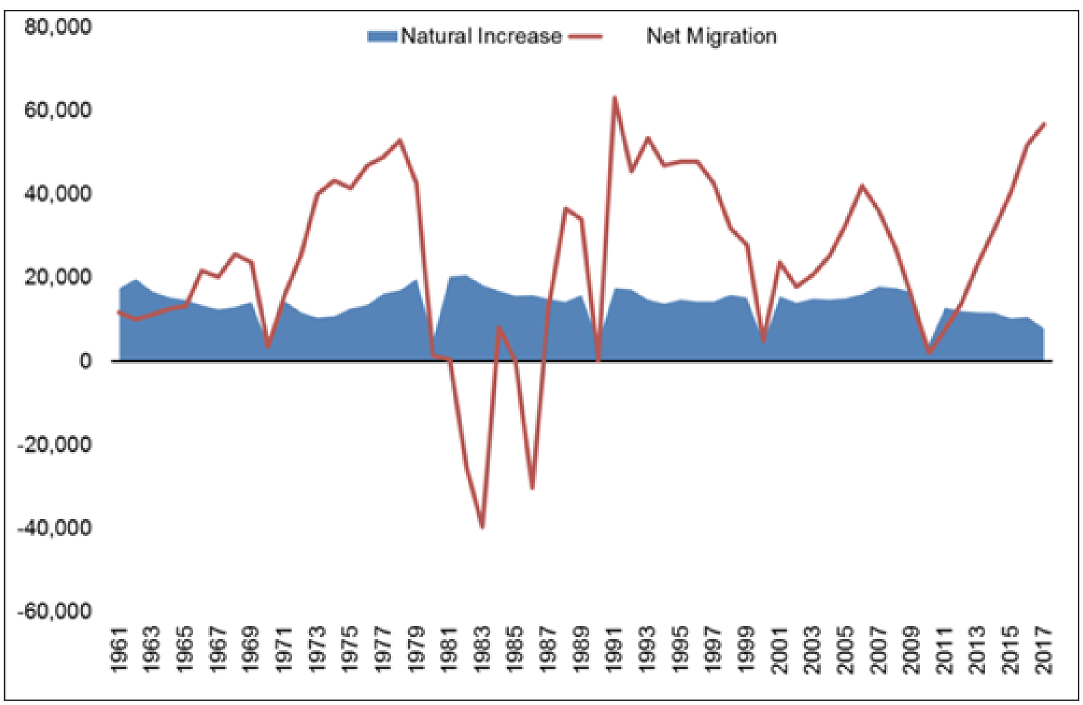

Figure 5: Oregon population growth, natural increase and net migration, 1961-2017 (Oregon Office of Economic Analysis)

OREGON EMPLOYMENT, INCOMES AND HOUSING AFFORDABILITY

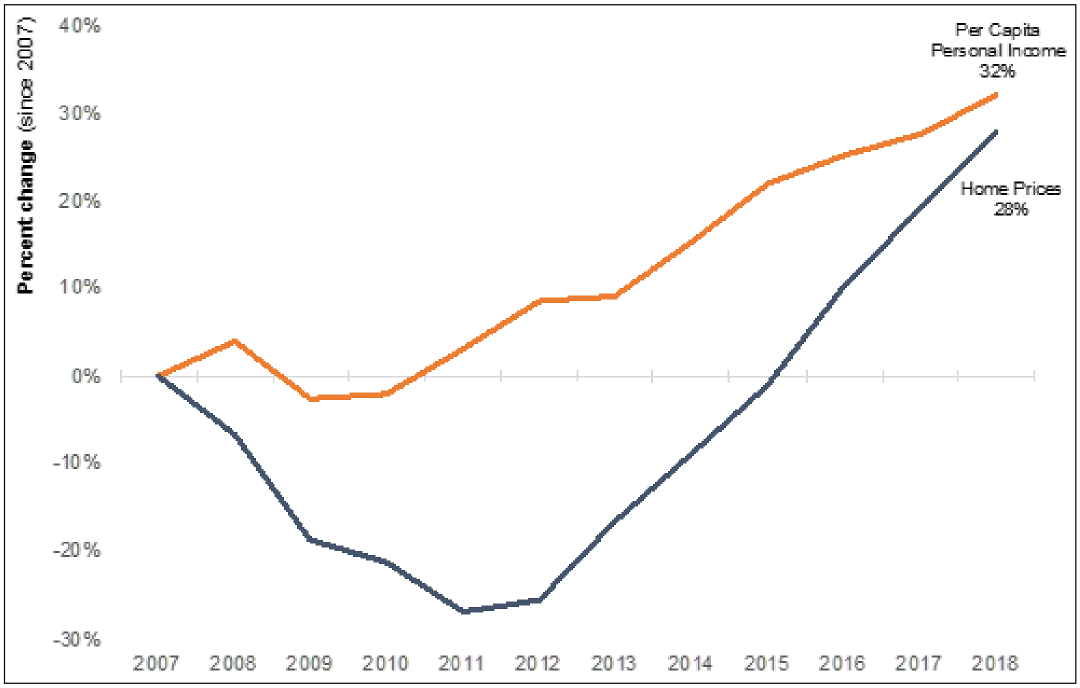

Figure 6: Portland area personal income and Case-Shiller home price index, 2007-2018 (U.S. Bureau of Economic Analysis; S&P Dow Jones)

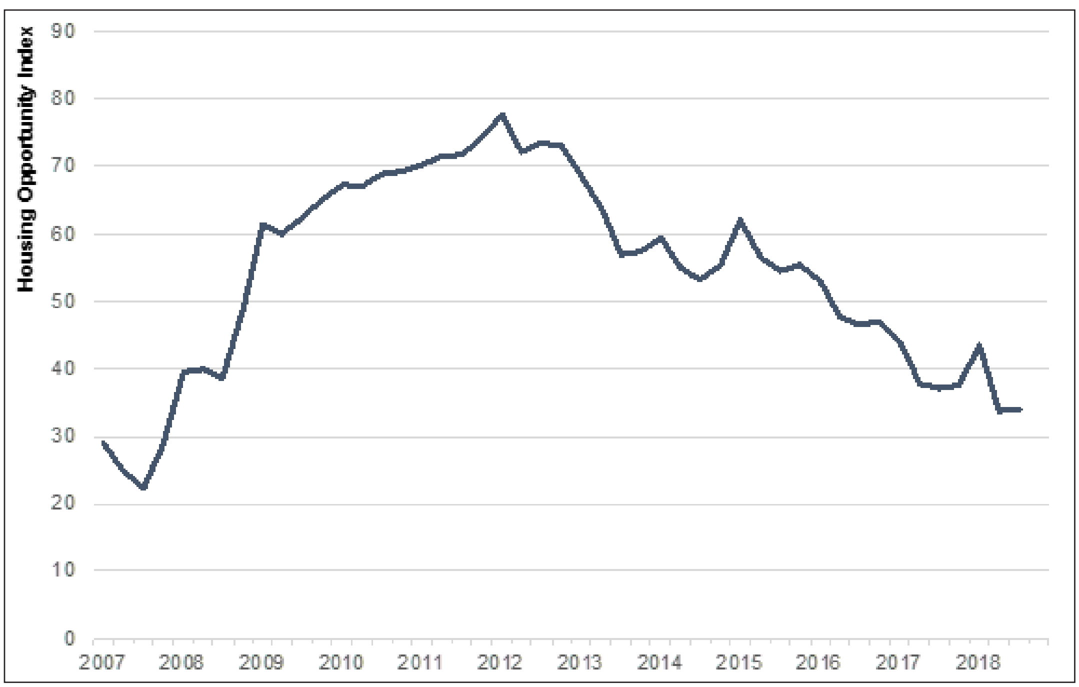

Figure 7: Portland area Housing Opportunity Index, 2007-2018 (National Association of Homebuilders and Wells Fargo. The Housing Opportunity Index measures the share of households for which monthly income is available for housing is at or above the monthly cost for the unit.)

OREGON EMPLOYMENT, INCOMES AND HOUSING AFFORDABILITY

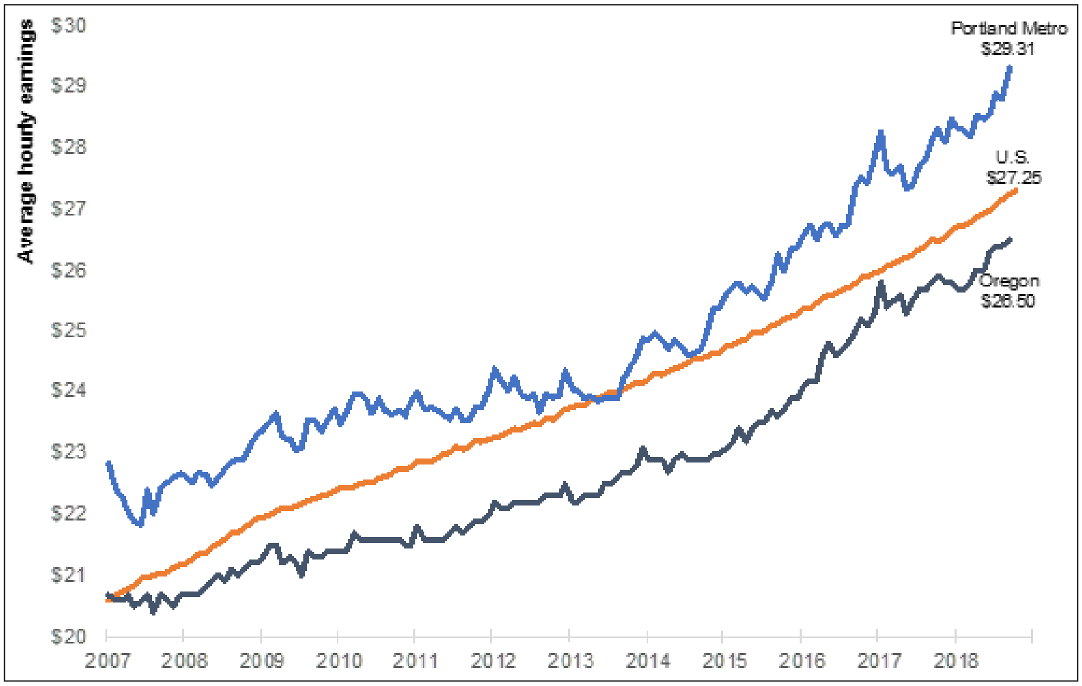

Figure 8: U.S., Oregon, and Portland metro average hourly earnings, 2007-2018 (Federal Reserve Bank of St. Louis and U.S. Bureau of Labor Statistics)

net migration. The combination of increasing net migration and sluggish production of new housing has led to an increase in housing prices, making home ownership unaffordable for a growing portion of the Oregon households.

The gap between income growth and housing costs is reflected in the NAHB/Wells Fargo Housing Opportunity Index, shown in Figure 7. Since the end of 2011, housing affordability has steadily declined. In the third quarter of 2018, only one-third of households have income available for housing that is at or above housing costs.

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Oregon's land use laws and local burdens on new construction of single-family homes have resulted an underproduction of housing units relative to population growth. The Oregon Business Plan estimates the state needs to produce 30,000 units a year in the foreseeable future to make up for previous years of underproduction. In contrast the Oregon Office of Economic Analysis forecasts fewer than 25,000 units per year through 2028. Potential inclusionary housing laws, rent controls, and property tax reforms are likely to further stifle production and reduce housing affordability in the Portland region and throughout the state. ■

RESIDENTIAL MARKET ANALYSIS

JENNIFER VOLBEDA
Portland State University

The third quarter in Oregon and Southwest Washington continue to show a strong but cooling market, remaining in favor of sellers. Portland and Vancouver have been feeling the pain of exaggerated sales price for some time now, but our neighboring cities are feeling the pressure now as well. Perhaps it's because we've priced ourselves out of the big cities like Portland and Vancouver, and that's why the focus is now being shifted.

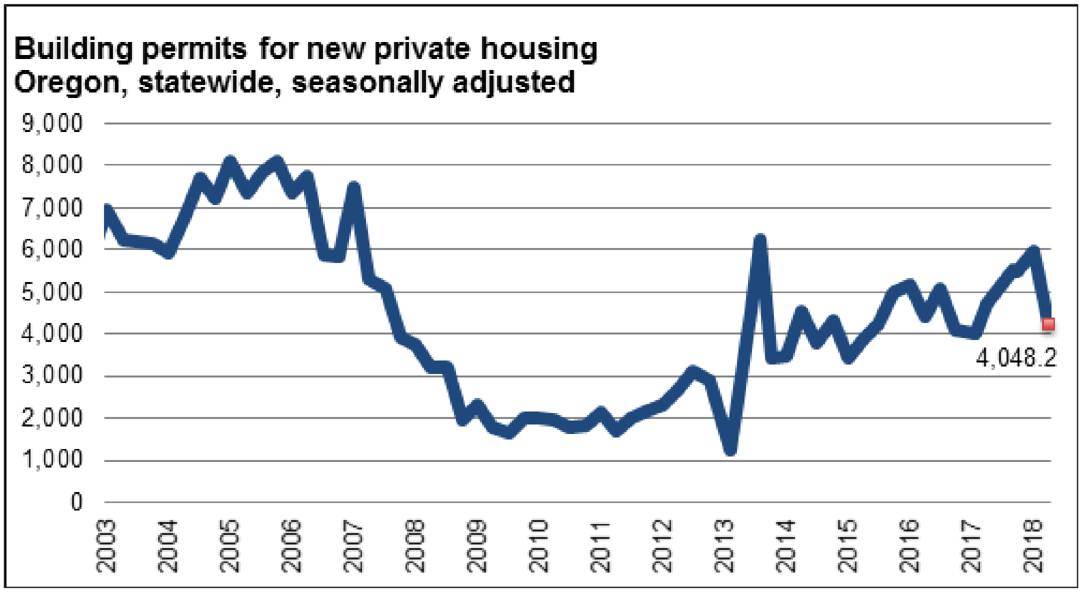
Places like Bend and Lane County are seeing slowing sales because of skyrocketing prices. Bend in particular has seen an increase in sale price by over 50 percent in just three years, which has been making it increasingly difficult to afford to live and work there. While the Bend market is tough for buyers, Redmond may be reaping the benefits from a market like this, offering a slightly cooler market much more easily attainable for buyers. Unlike most of the cities and counties this quarter, Redmond was the only market to have a decrease in sales price, and one of only two markets that had an increase in homes sold.

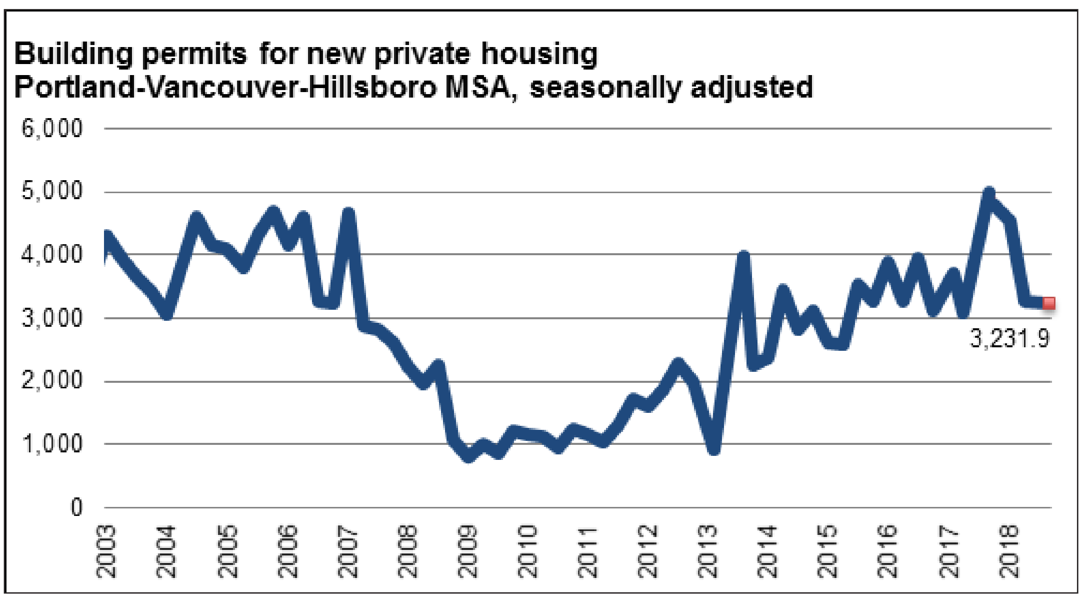
Permitting and construction have been decreasing statewide over the past year, ending with nearly 27 percent fewer permits issues across Oregon. Whether it is because of the tough restrictions required to obtain a permit, rising construction costs for both labor and materials, or the rising increase in cost for land, it is unlikely that the supply of new homes in the market will be able to meet the demand in the foreseeable future, as discussed elsewhere in this issue of the Quarterly. With the market already so tight in the market for existing homes, and fewer permits being issued for new homes, along with our current supply and inability to meet demand from a growing population, it is unlikely that the prices will soften any time soon.

Jennifer Volbeda 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. She is the 2017 RMLS Student Fellow at PSU's Center for Real Estate.

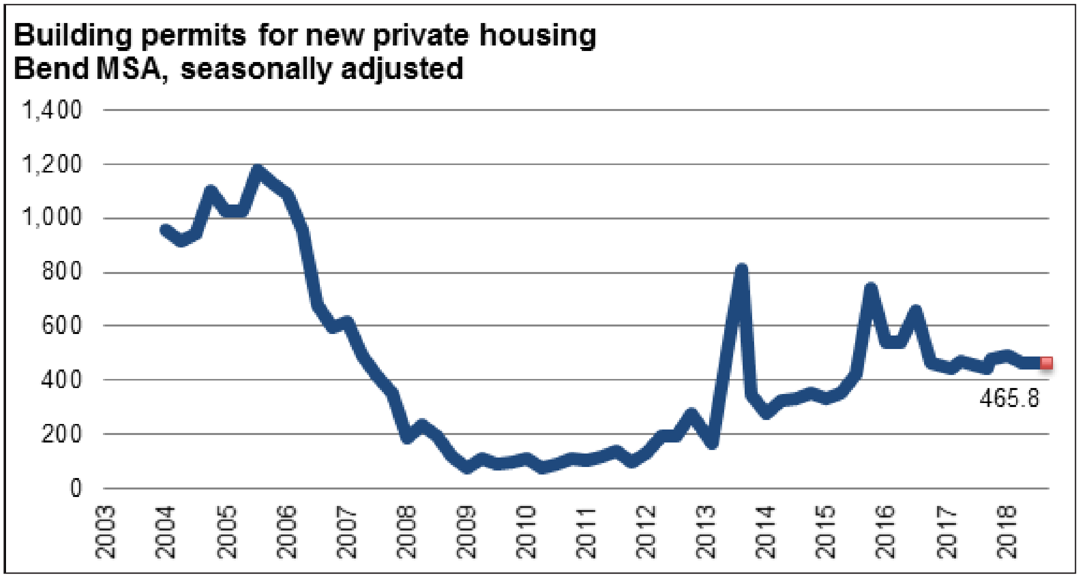
LOCAL PERMITTING

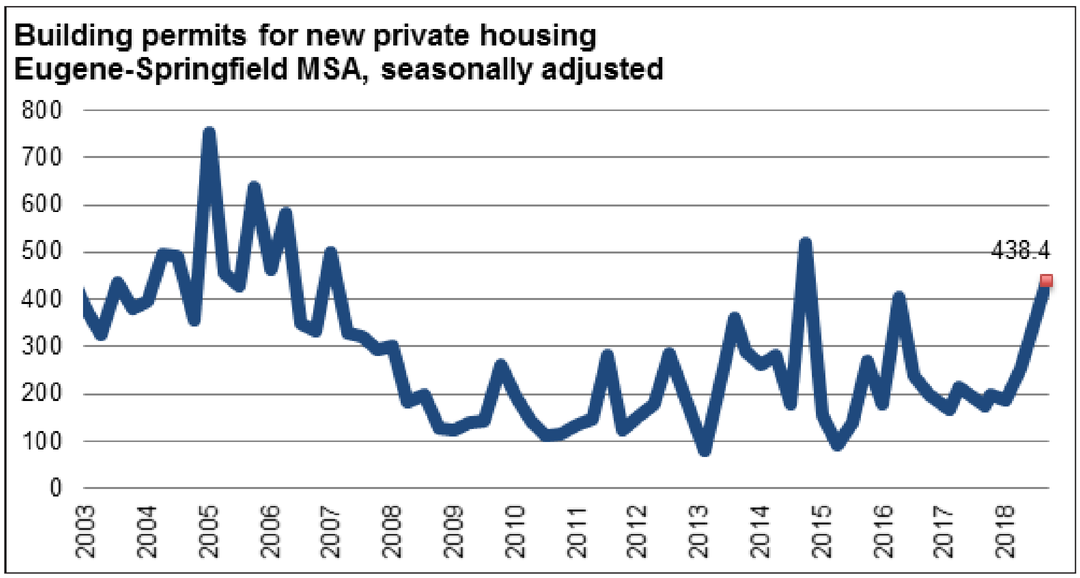
Permitting in the state of Oregon has continued a downward trend over the past four quarters, according to information published by the Federal Reserve Bank of St. Louis. The quarter ended with 4,048 permits issued, nearly 27 percent fewer than in the third quarter of 2017. This overall shift is exaggerated mostly due to the shift away from building in Portland. Portland saw more than 35 percent fewer permits than the third quarter of last year, driven largely by a decline in multifamily permits. While Medford also saw a downward shift, both Bend and Eugene issued more permits this quarter.

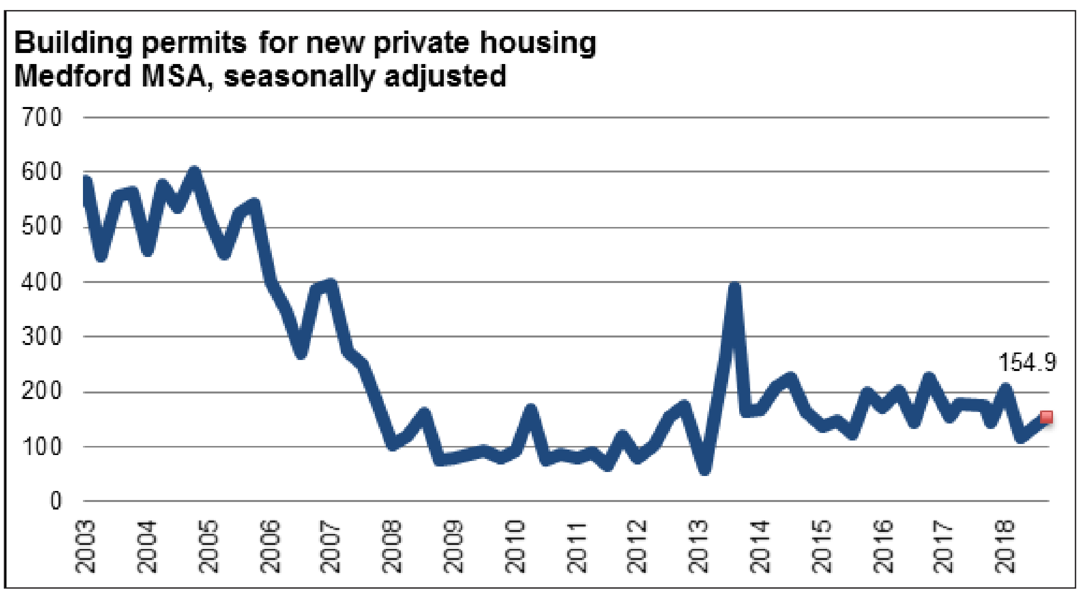




LOCAL PERMITTING



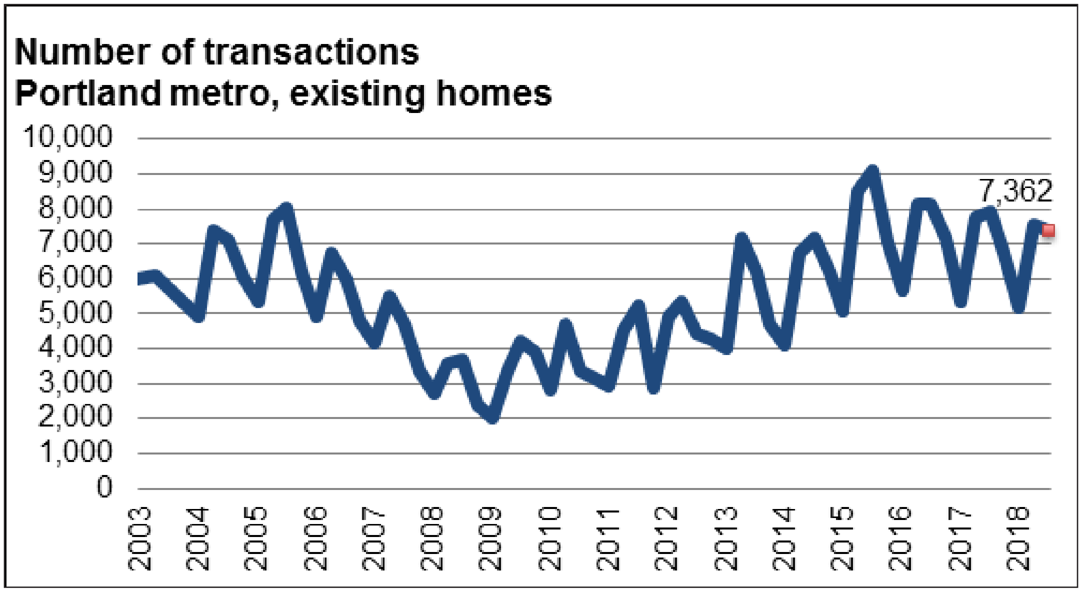


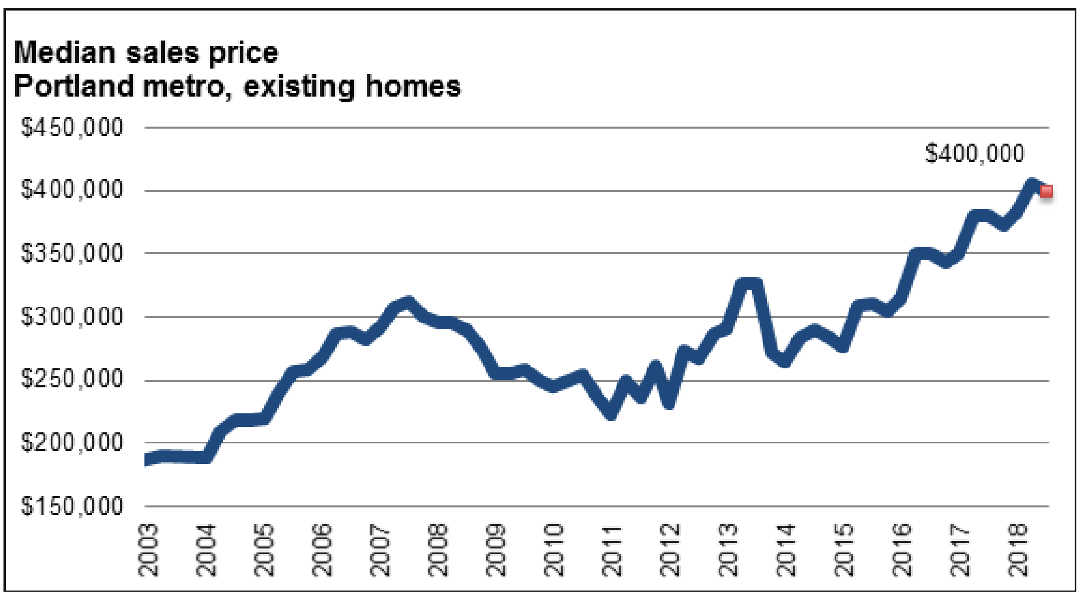


PORTLAND TRANSACTIONS

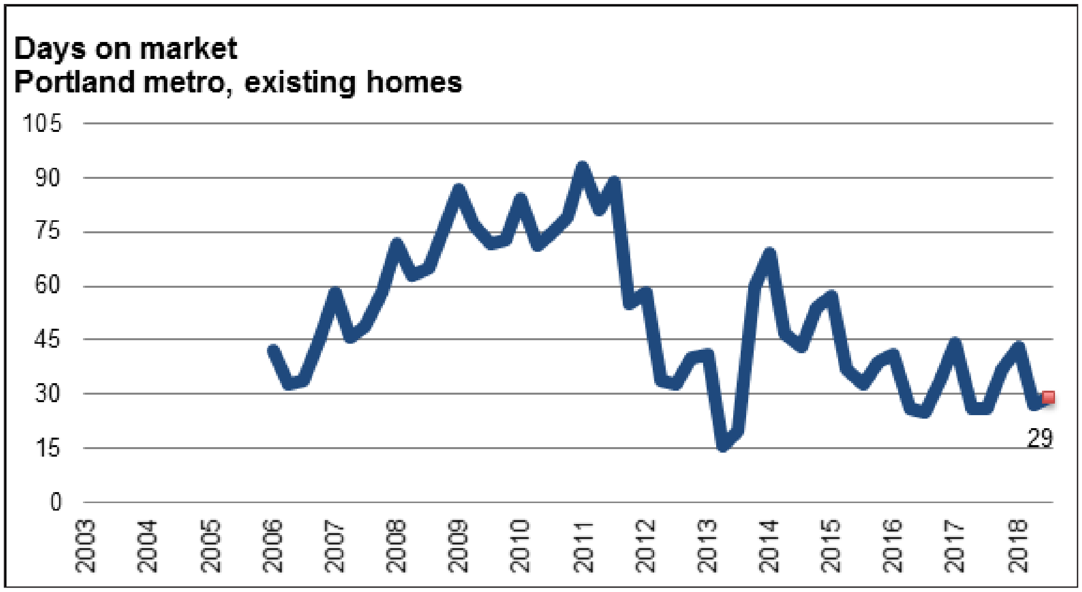
The market for existing homes within the City of Portland has continued its trend downward for the third year in a row, according to RMLS. The third quarter saw 196 fewer houses sold, or a 2.5 percent decrease from the prior quarter, and 580 fewer houses than the same quarter of last year. In addition to the fewer number of houses sold, the median sales price and sales price to list price both decreased as well.

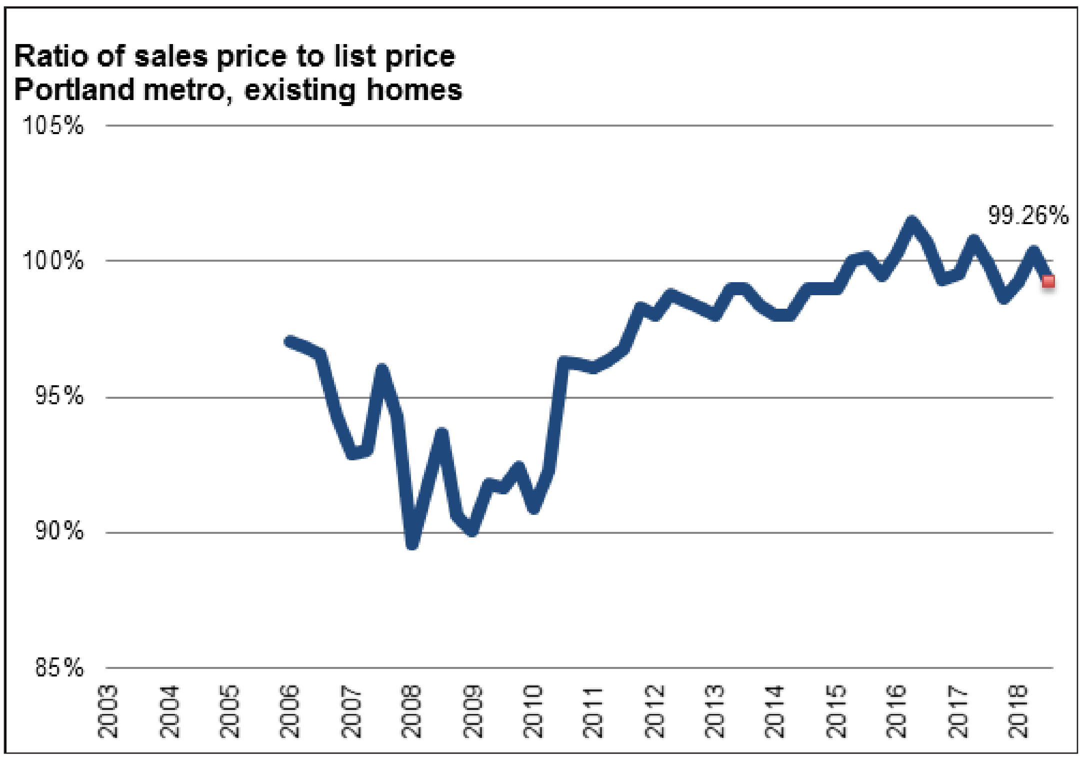
On the other hand, while the market for existing single family homes appears to be cooling, transaction count and median sales price for new single family homes within the City of Portland tell a very different story. The third quarter saw a drop in transaction count of over 16 percent from the same quarter of last year as well as an 8 percent increase in median sale price.



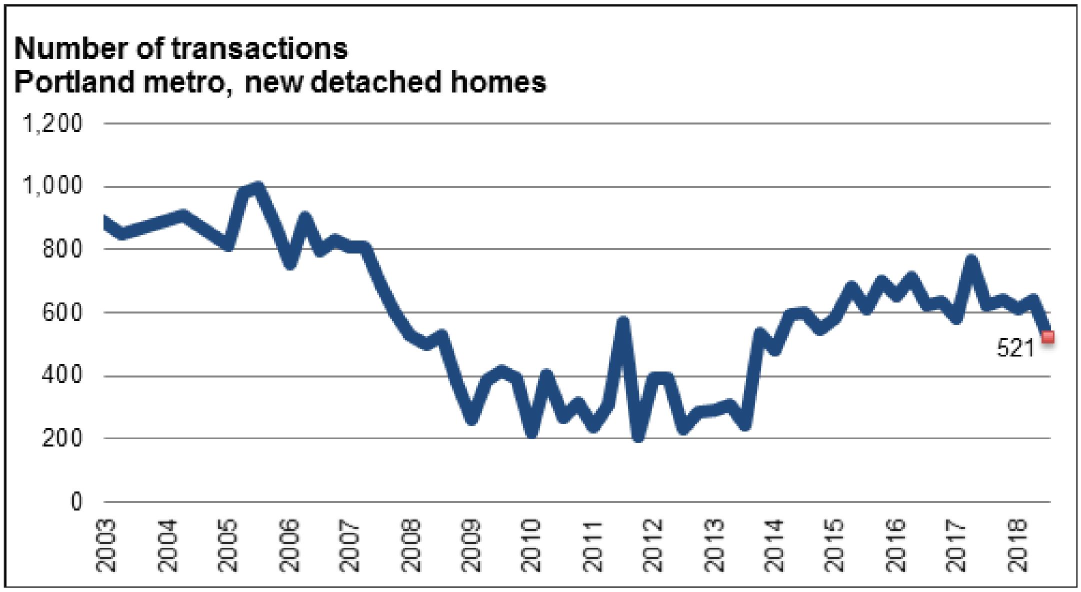


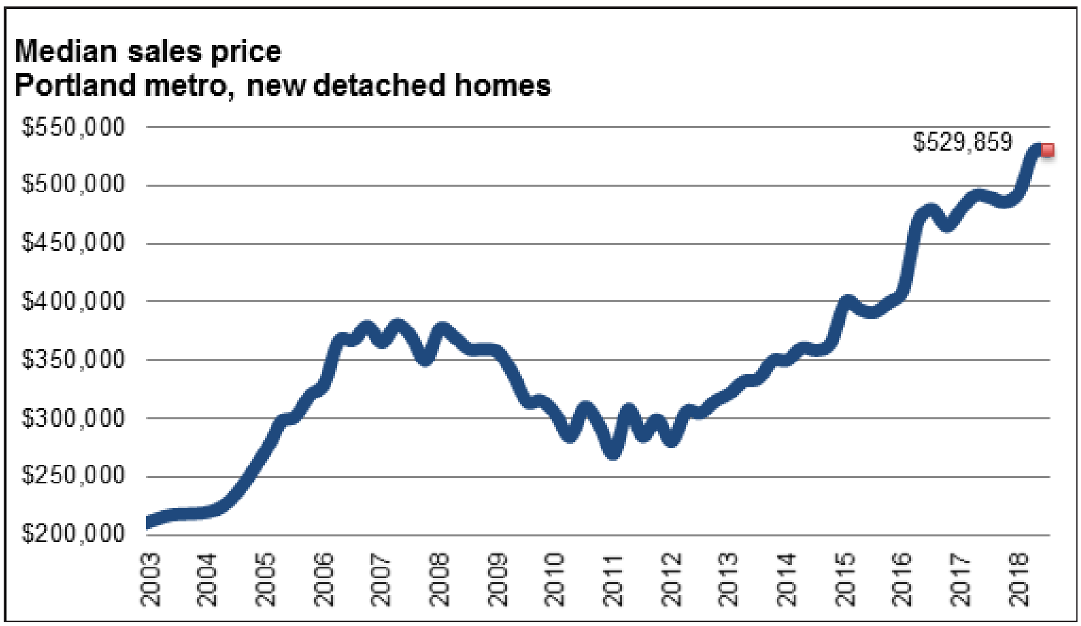
PORTLAND TRANSACTIONS





PORTLAND TRANSACTIONS



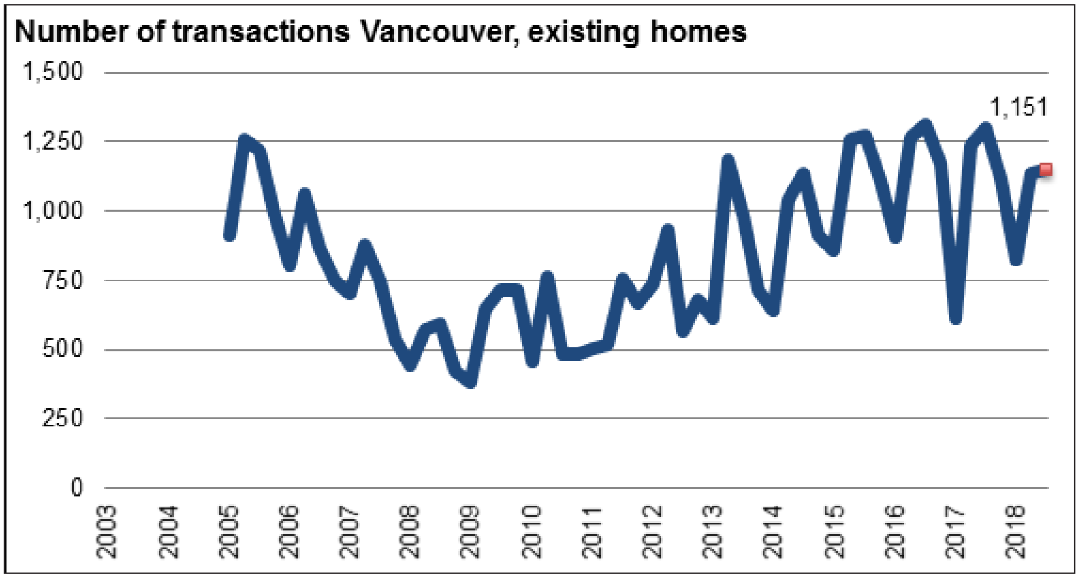


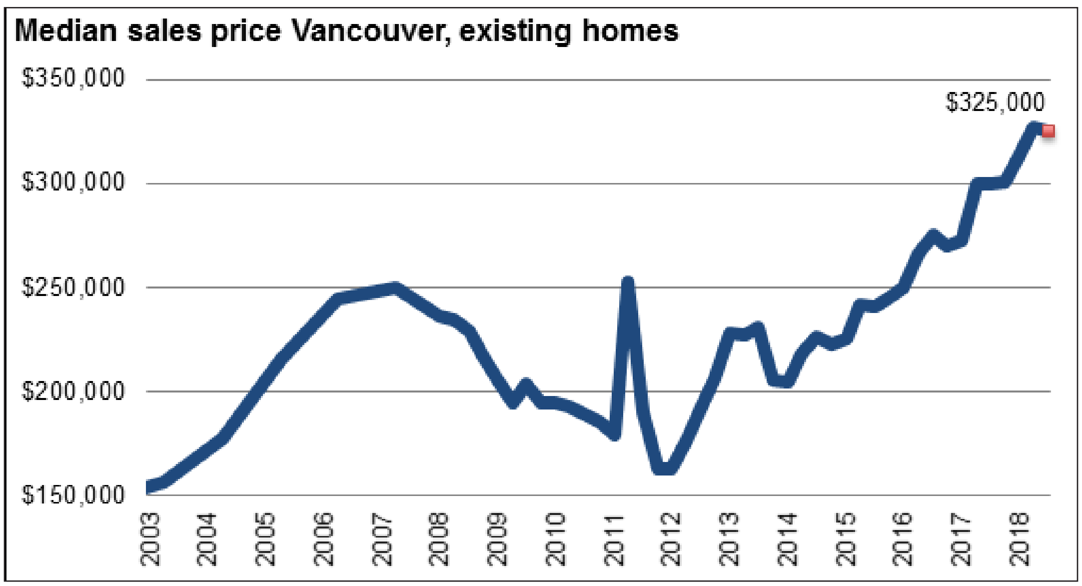
VANCOUVER AND CLARK COUNTY

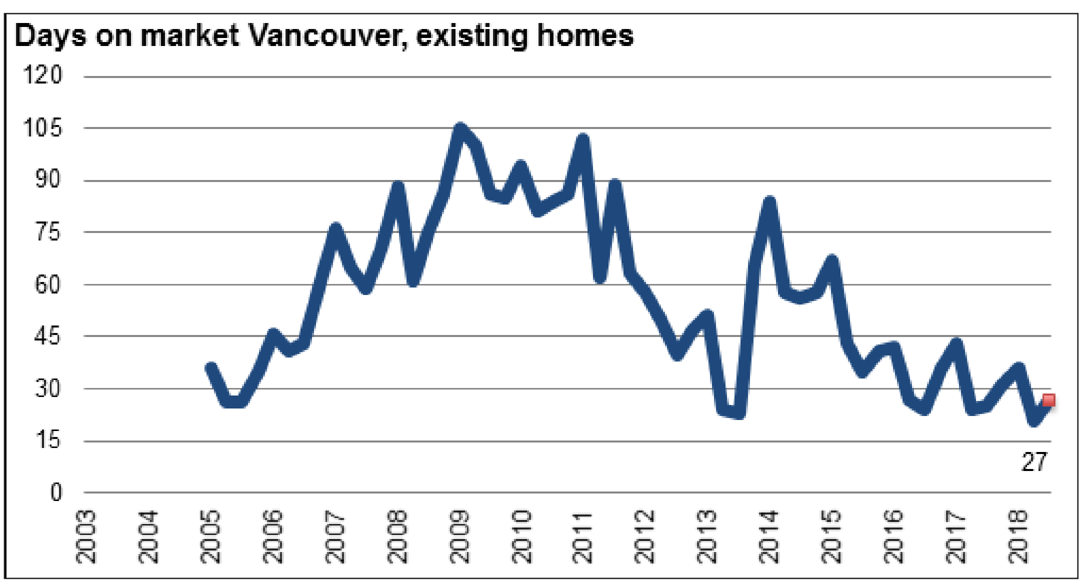
The third quarter in Vancouver brought in the fewest number of transactions seen in a third quarter since 2014. While transaction count is appearing to begin stabilizing, median sales price continues on up which is represented by nearly an 8.5 percent increase from the third quarter of last year. Sales price over list price dropped over 66 percent from the third quarter of last year, with last year being the all time high at over 299 percent in 2017, and now coming in at just over 99.5 percent.

Clark County continues trending upwards with the highest number of transactions in a quarter since publication of the Quarterly, and a tie for the highest median sales price as well. Similar to Vancouver, the ratio between sales price and listing price has decreased dramatically from last year, to just over 99 percent.

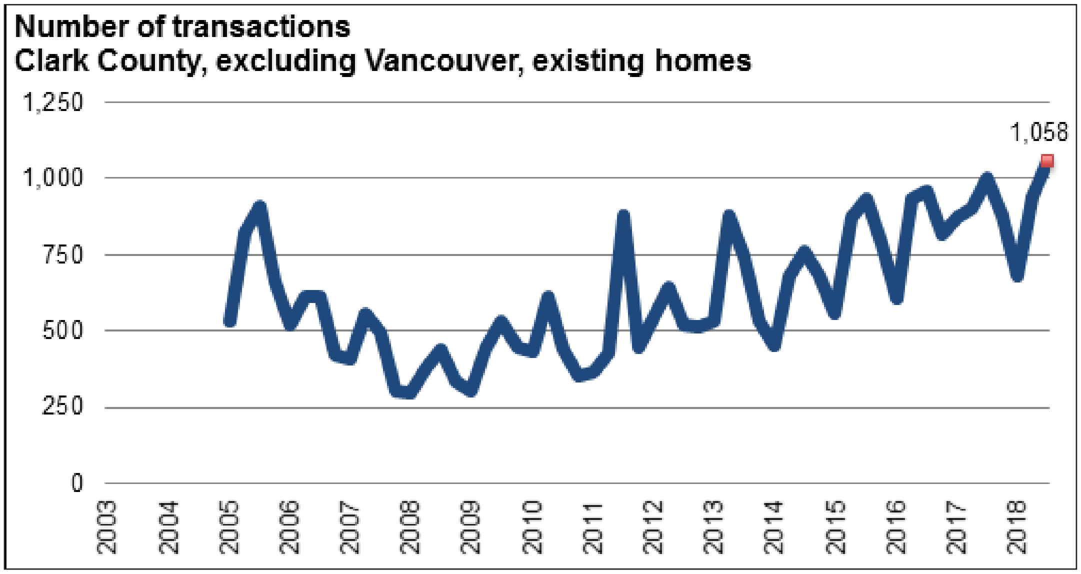
VANCOUVER AND CLARK COUNTY

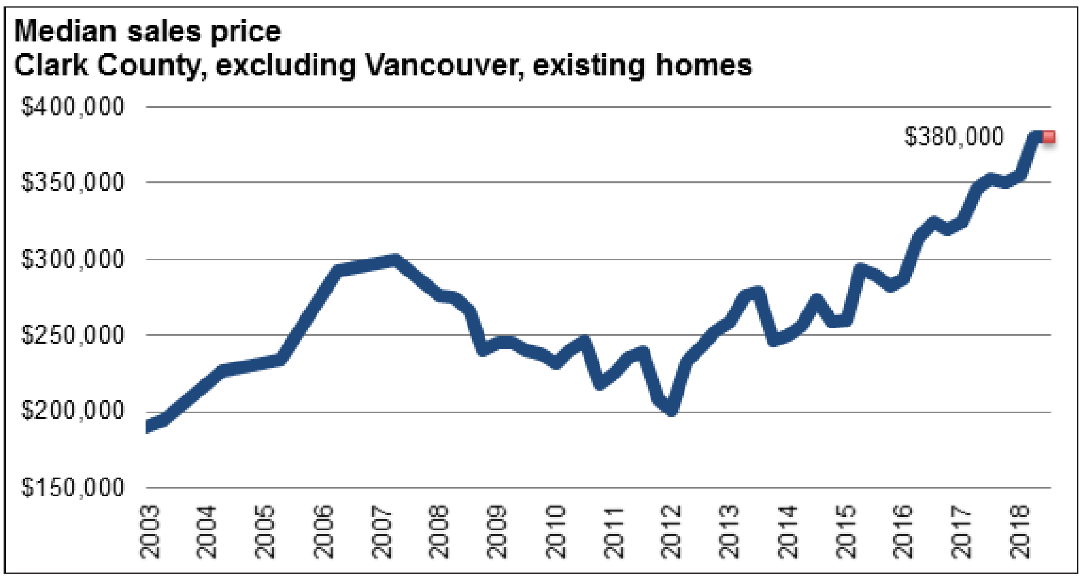


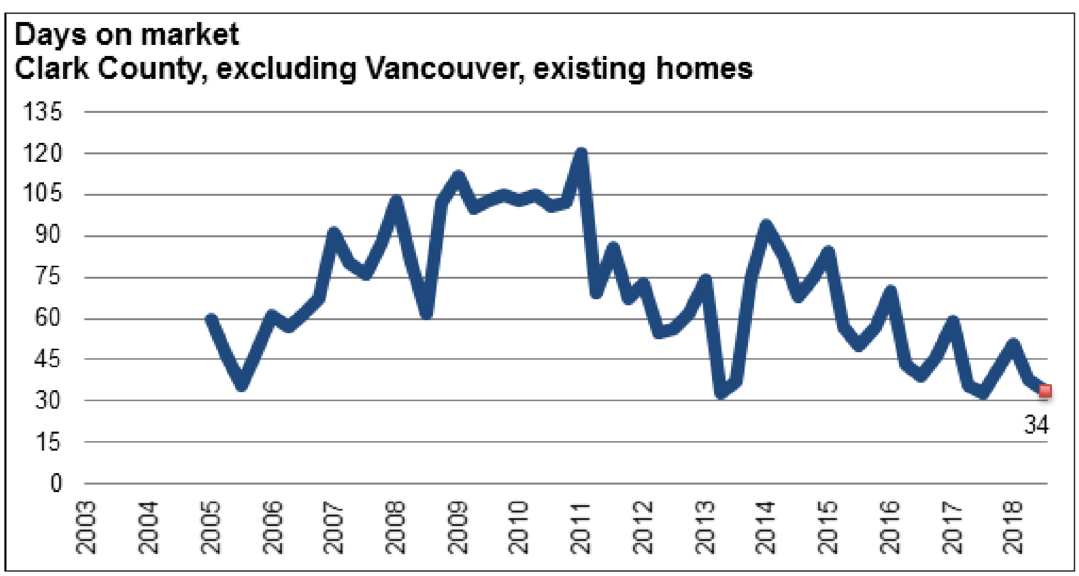




VANCOUVER AND CLARK COUNTY



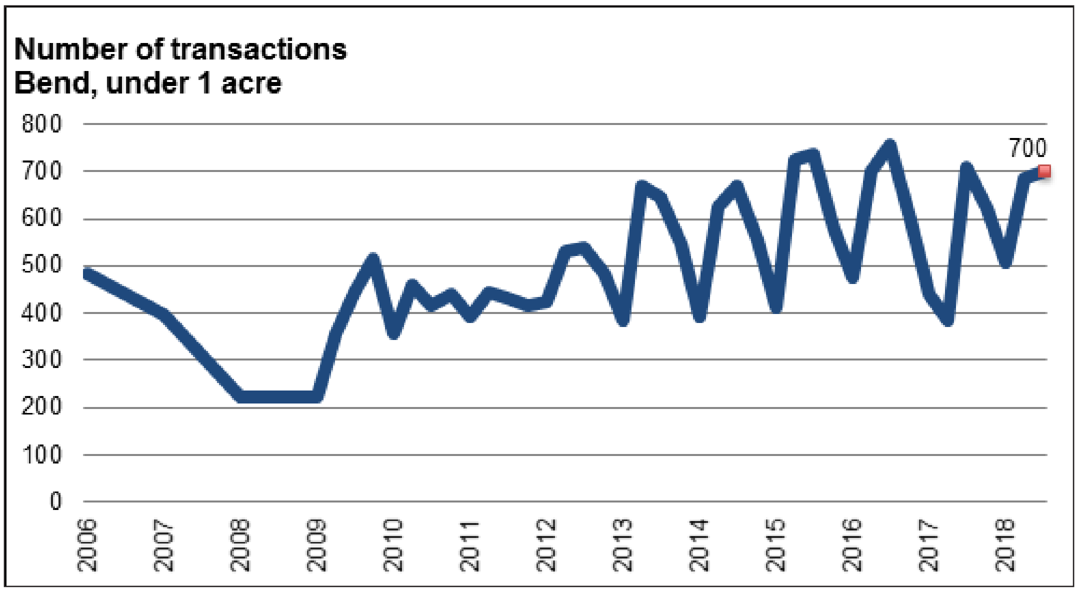


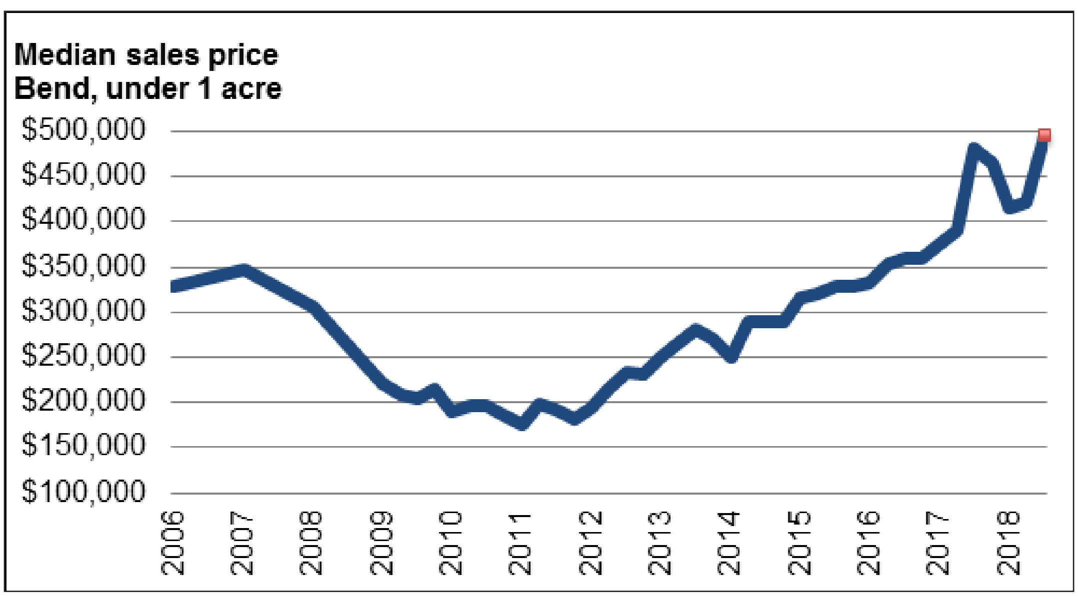


CENTRAL OREGON

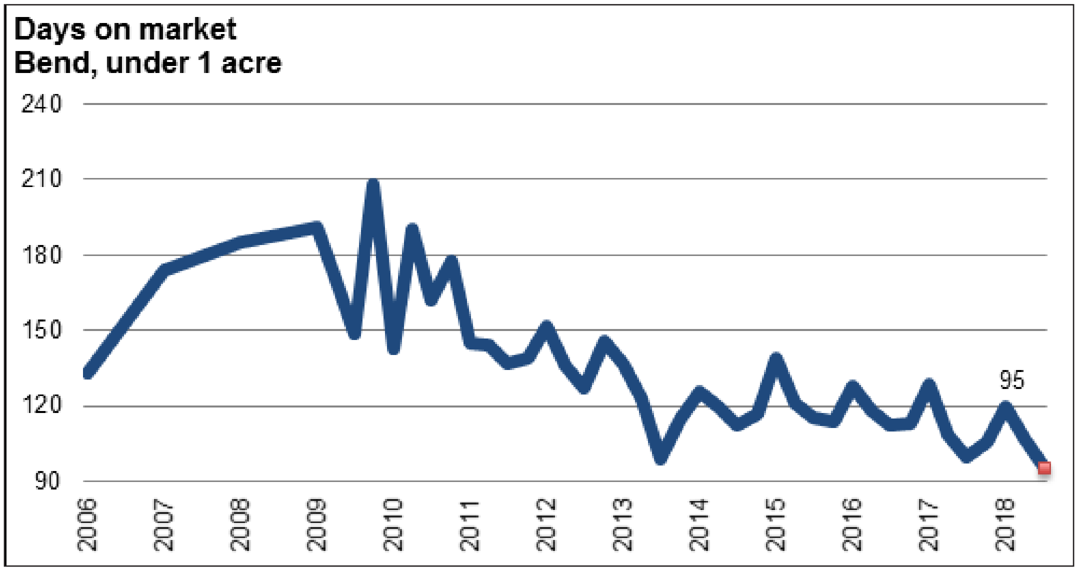
Bend, much like Vancouver, had the fewest number of transactions in a third quarter since 2014 with a count of 700 homes sold, according to the Central Oregon Association of Realtors. In addition to fewer transactions, the median sales price for homes increased by over three percent, to end as the highest median price ever recorded in Bend since publication of the Quarterly. Days on market also hit a record, coming in at an average of 95 days, which means houses are staying on the market for a record-setting short amount of time.

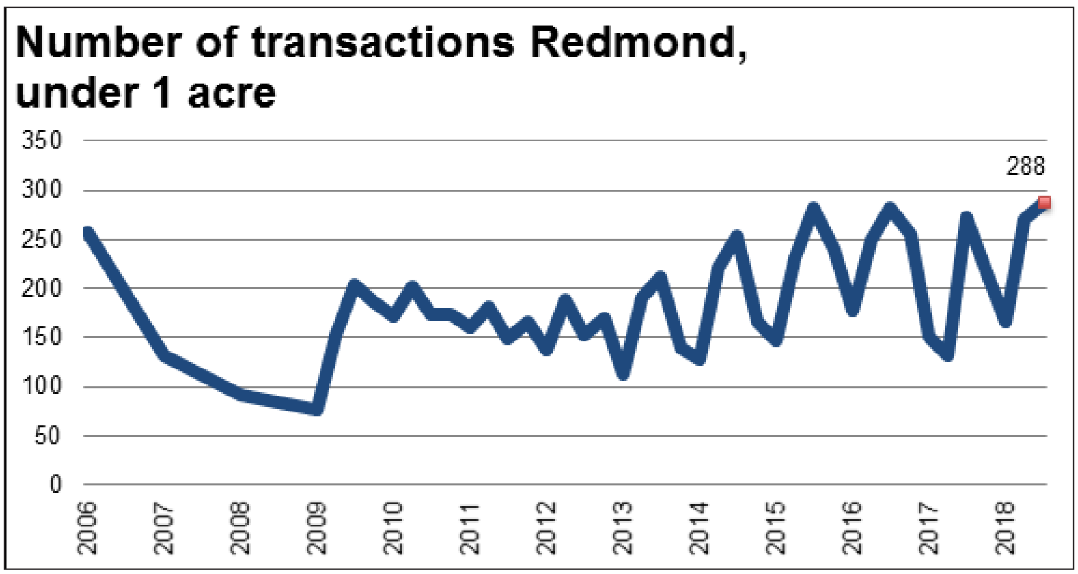
Redmond had a five and a half percent increase in transactions from 2017, coming in at 288 houses sold in the third quarter. The median sales price cooled by nearly nine percent from the same quarter last year with average days on market increasing five days, from 101 average days on market in the third quarter of 2017 to 106 in 2018.

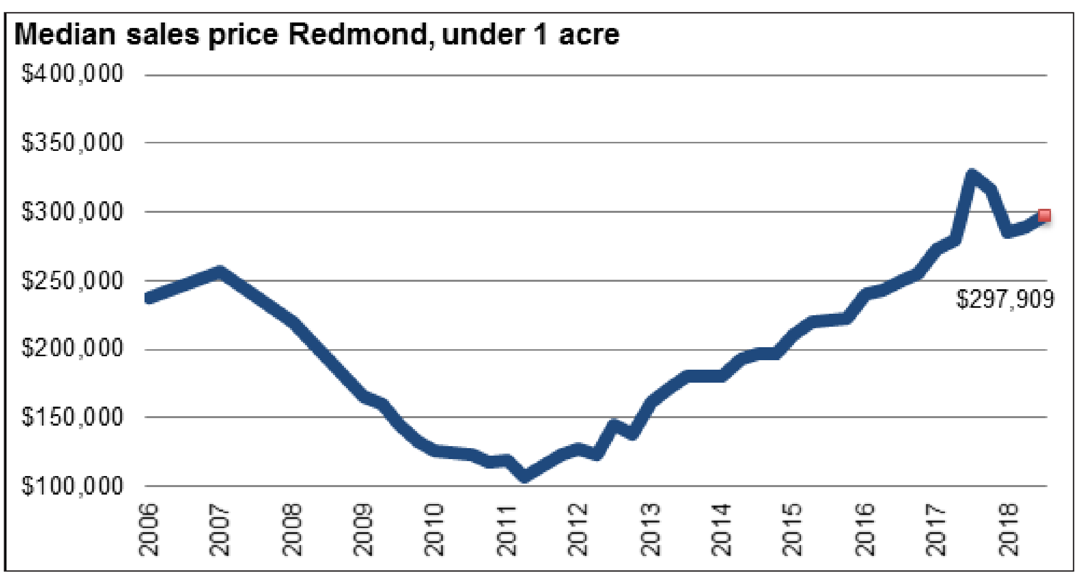




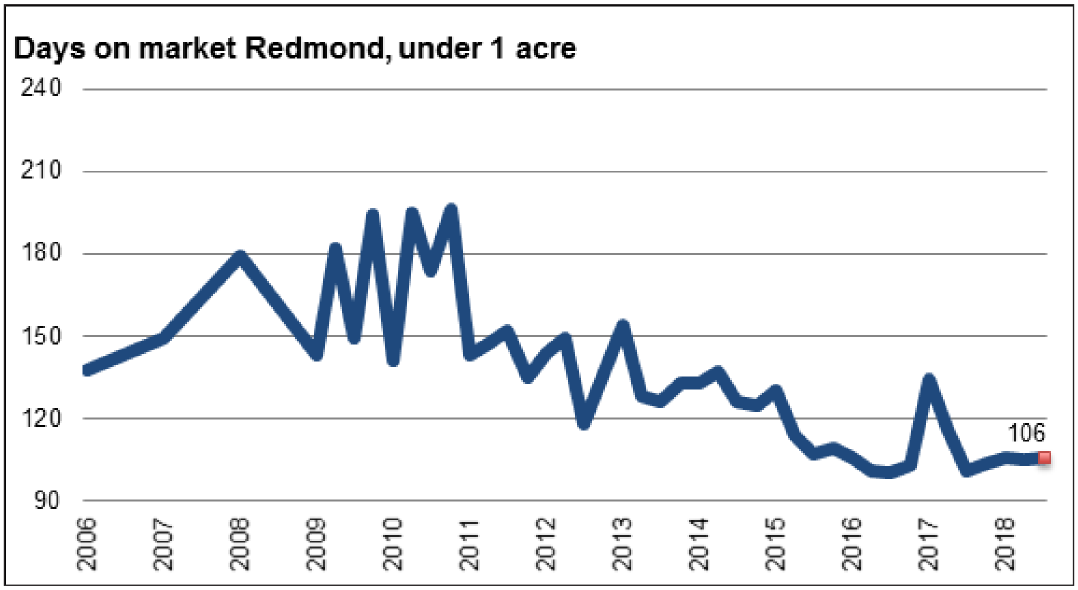
CENTRAL OREGON





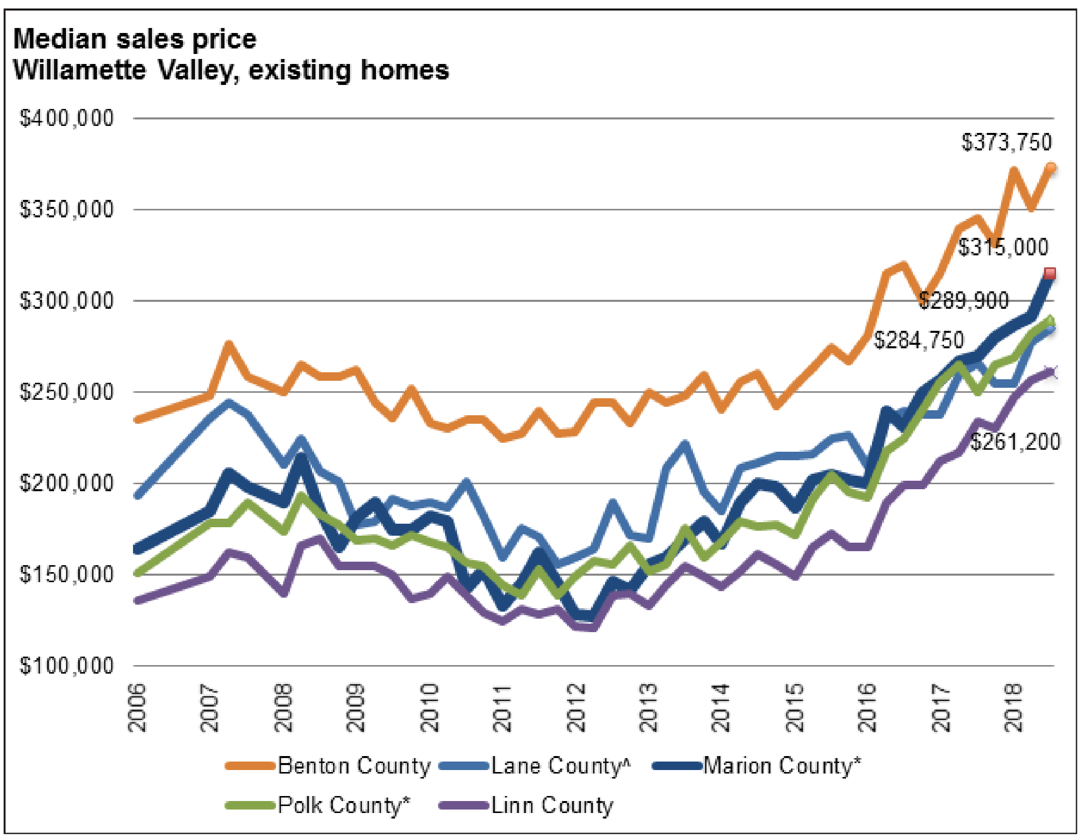


CENTRAL OREGON



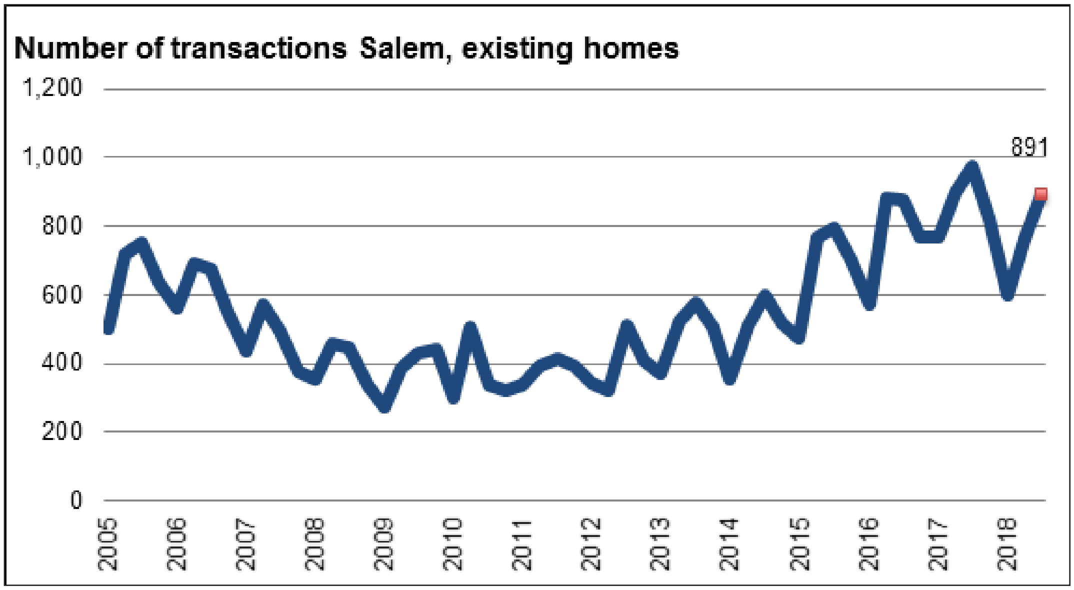
WILLAMETTE VALLEY

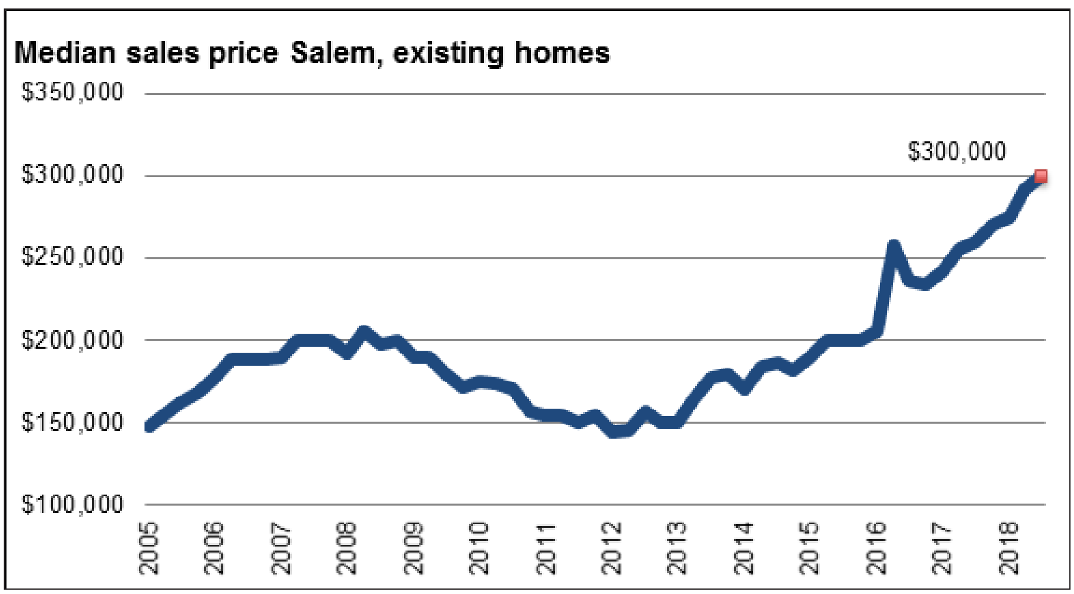
The third quarter within the Willamette Valley saw sizable increases to the median sales price all around from the same quarter last year, according to the Willamette Valley Multiple Listing Services. Lane County had the smallest increase at seven percent, ending at a median price of $284,750. Benton County was slightly higher at just over an eight percent increase, ending at $373,750 for the median sales price. Linn County, with a median sales price of $261,200 is an increase of over 11 percent from last year. Polk and Marion County had the steepest increases year over year with just under 16 percent (Polk County) and 16.5 percent (Marion County).



SALEM

The third quarter shows Salem continuing to be a hot market, with increased median sales price, increased number of transactions and fewer days on market, according to RMLS. Median sales price increased over 15 percent from the same quarter last year, a $40,000 increase over the past year. While transaction count increased from last quarter by nearly 17 percent, there were 8 percent fewer transactions year over year. Average days on market decreased by over 11 percent from the same quarter last year, at 65 days.





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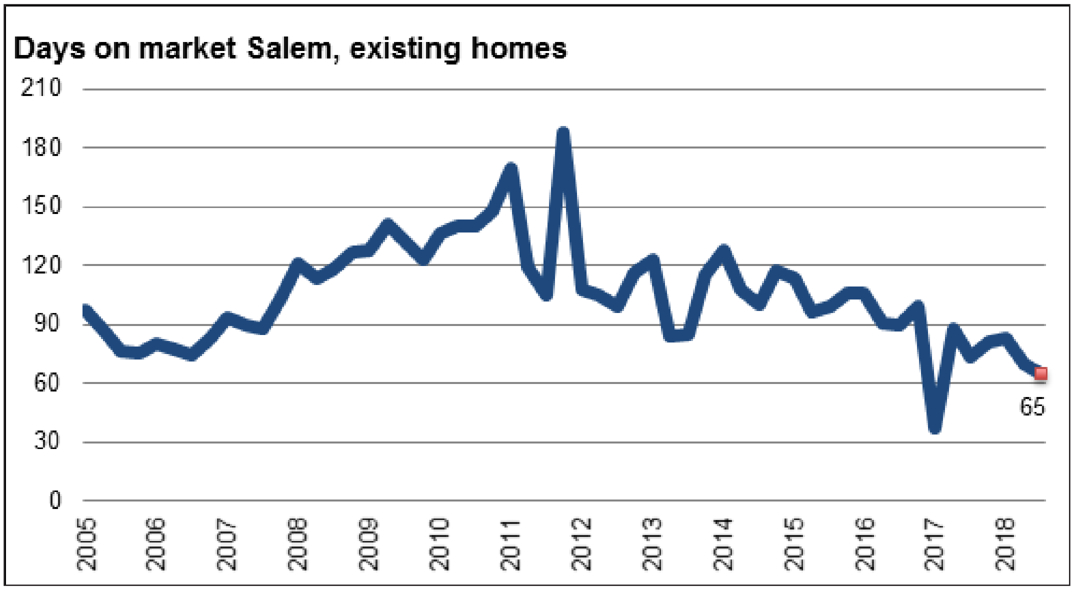
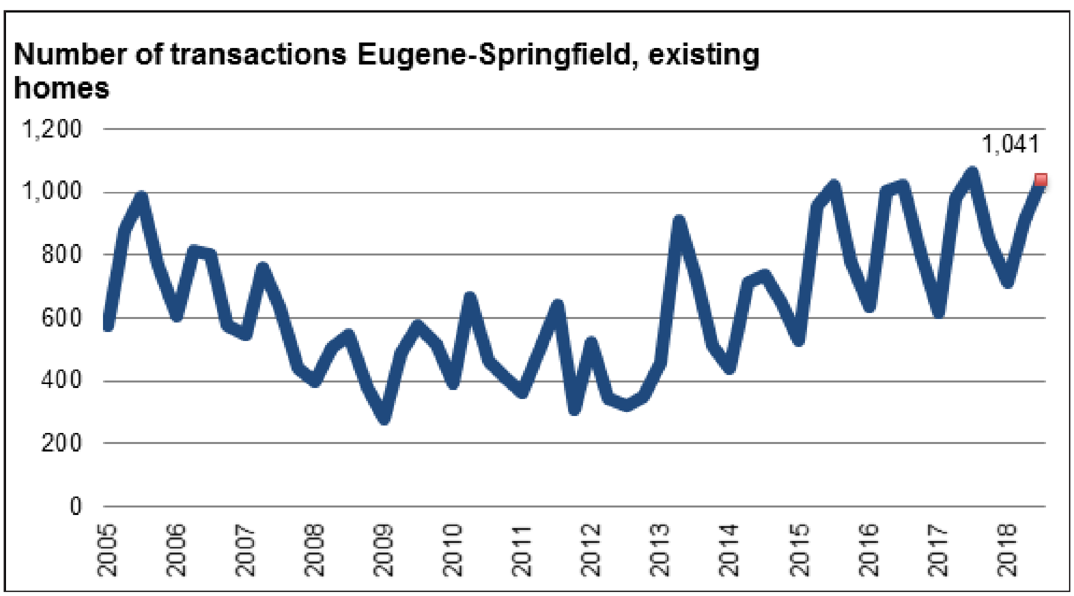
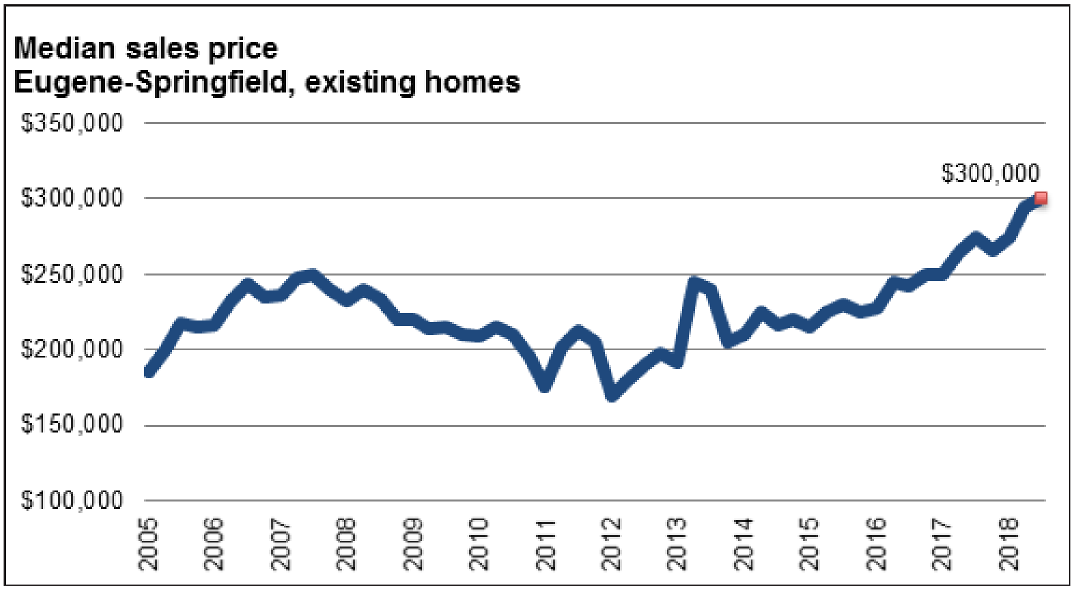


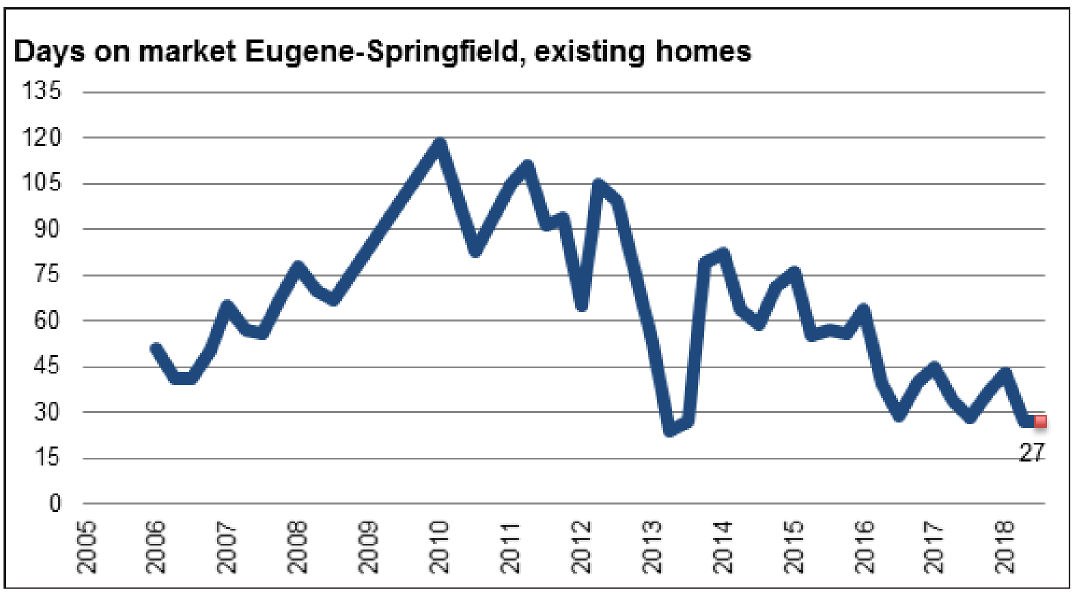
EUGENE

The third quarter saw an increase in median sales price by over nine percent from the same quarter of last year, ending at $300,000, according to RMLS. Along with the higher median sales price, there were 1,041 transactions of existing homes sold in the Eugene-Springfield area this past quarter, a two percent decrease from the same quarter of last year. Both days on market as well as the ratio between sales price over list price had very little change from last year.



EUGENE

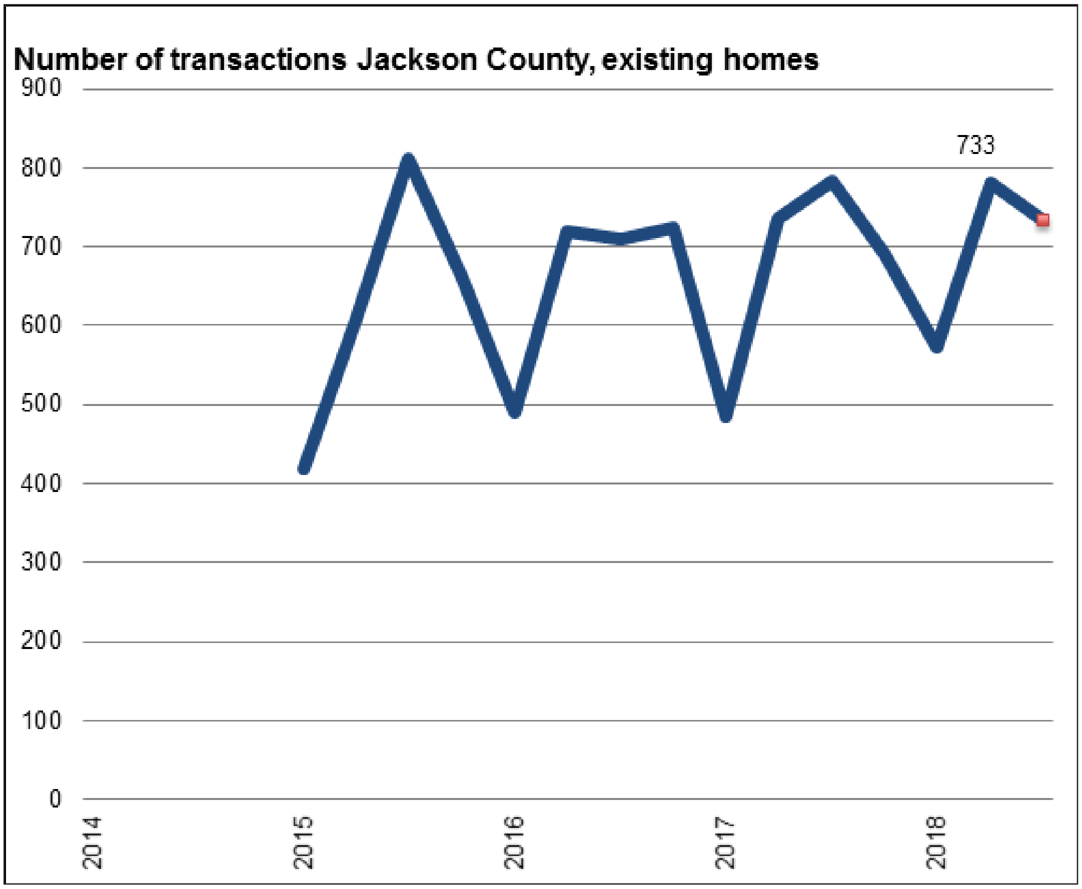


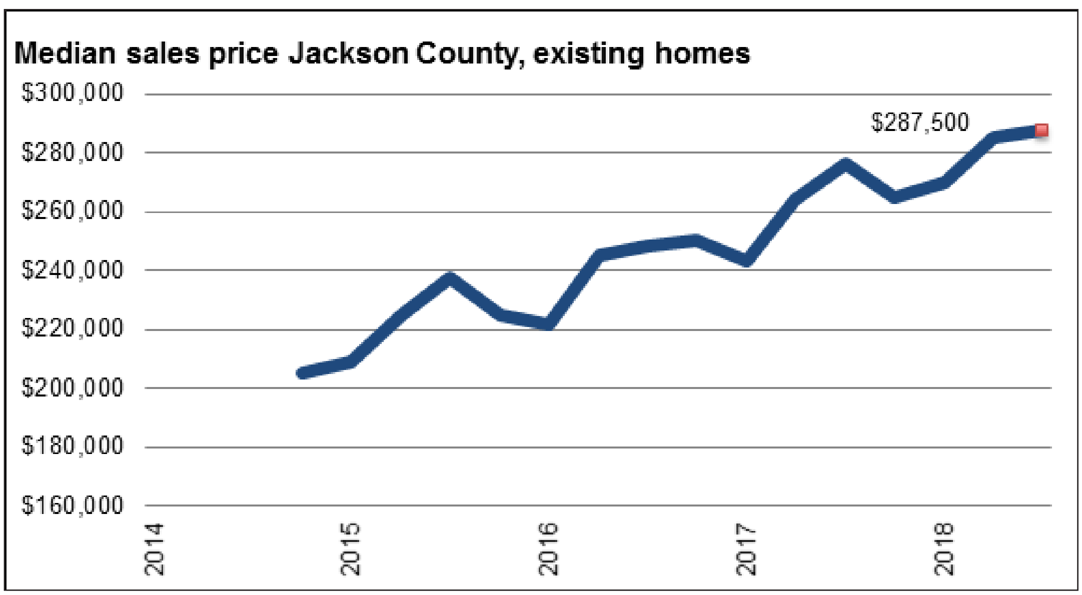


SOUTHERN OREGON

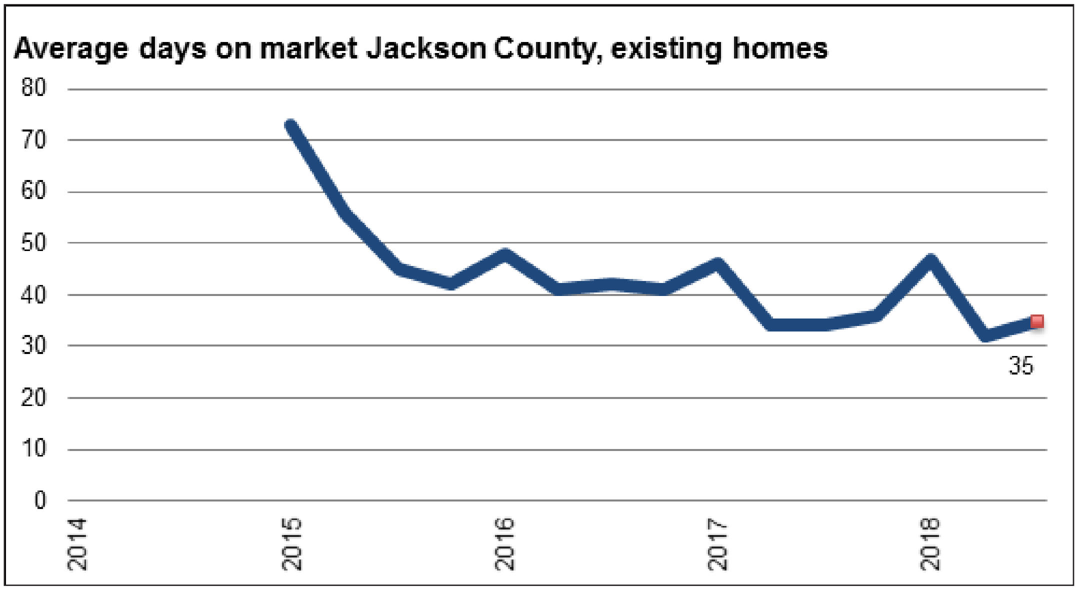
The markets for both Jackson County and Josephine County paralleled each other for the third quarter; higher median sales pricing, fewer transactions with a higher count of days on market, according to Rogue Valley Realtors. Jackson County, with an increase of four percent from last year, had a median sales price of $287,500. There were 49 fewer homes sold this quarter as well as a one day increase in average days on market. Josephine County prices increased by 10 percent from the past year, resulting in a median sales price of $260,000 for the third quarter. There were only two fewer transactions than last year, but faced a 22 percent increase in days on market. ■

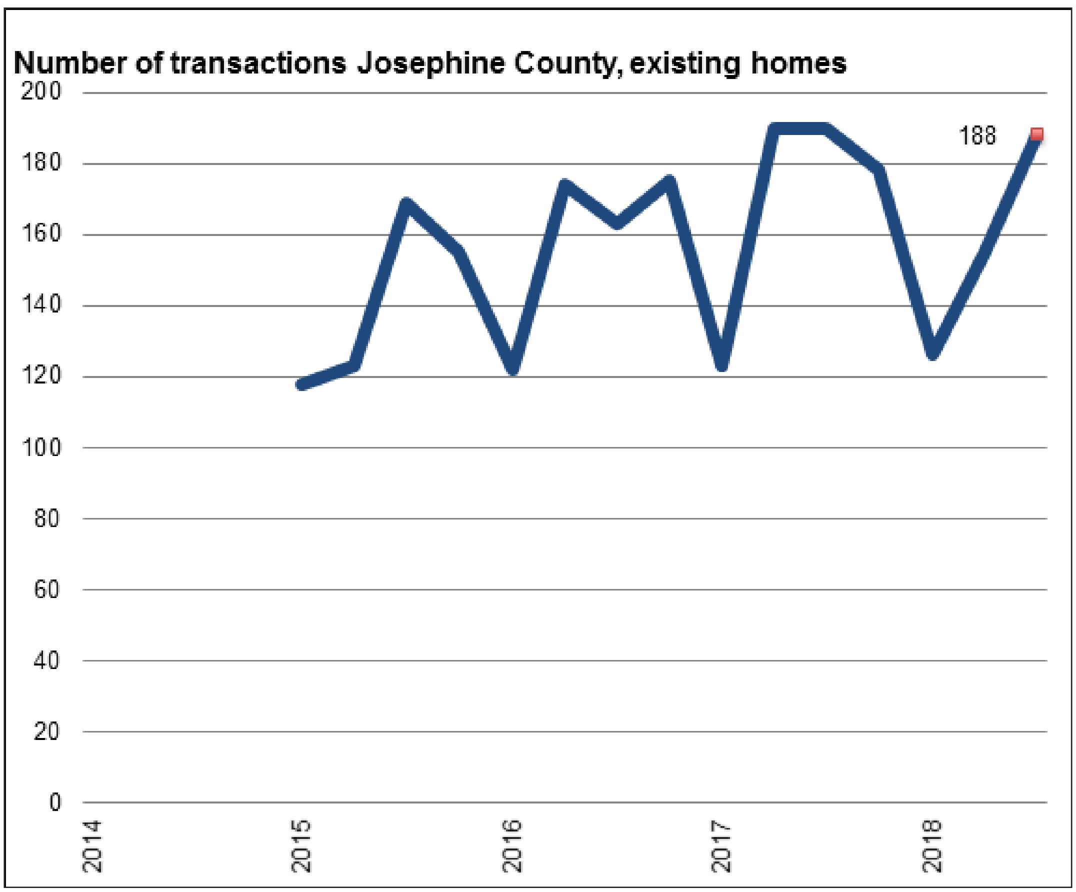
SOUTHERN OREGON



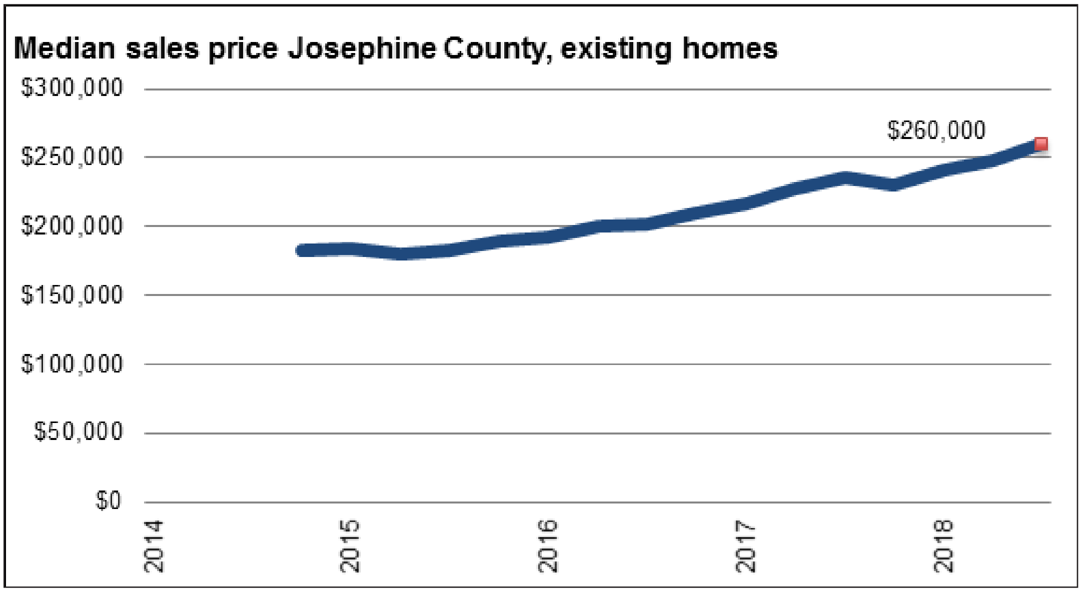


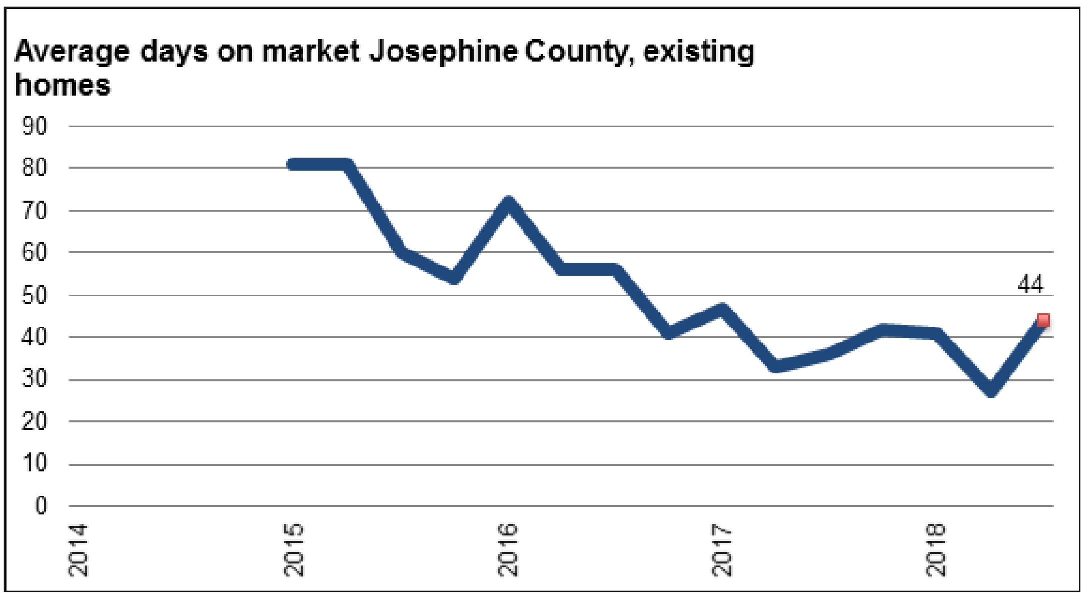
SOUTHERN OREGON





SOUTHERN OREGON





RESIDENTIAL MARKET ANALYSIS

DENIZ ARAC
Portland State University

As has been the story for the last couple of years, multi-family projects continue to deliver while others continue to break ground at a record pace in the Portland metropolitan area. Projects still in the vesting period of pre-Inclusionary Zoning, are continuing to move forward. However, the effects of IZ were expected to be delayed and the pipeline of projects permitted after the regulations kicked in has been significantly decreased. This combined with additional city regulations (unreinforced masonry, tenant screening and tenant protections), rising construction costs, interest rate increases, and fears of market oversupply are headwinds in the current multifamily boom in Portland. With a steady, but slowing, stream of net migration, there is still a forecasted shortage of housing in Portland for the foreseeable future. Thus, the Oregon Office of Economic Analysis, still expects that the Portland economy has room to run.

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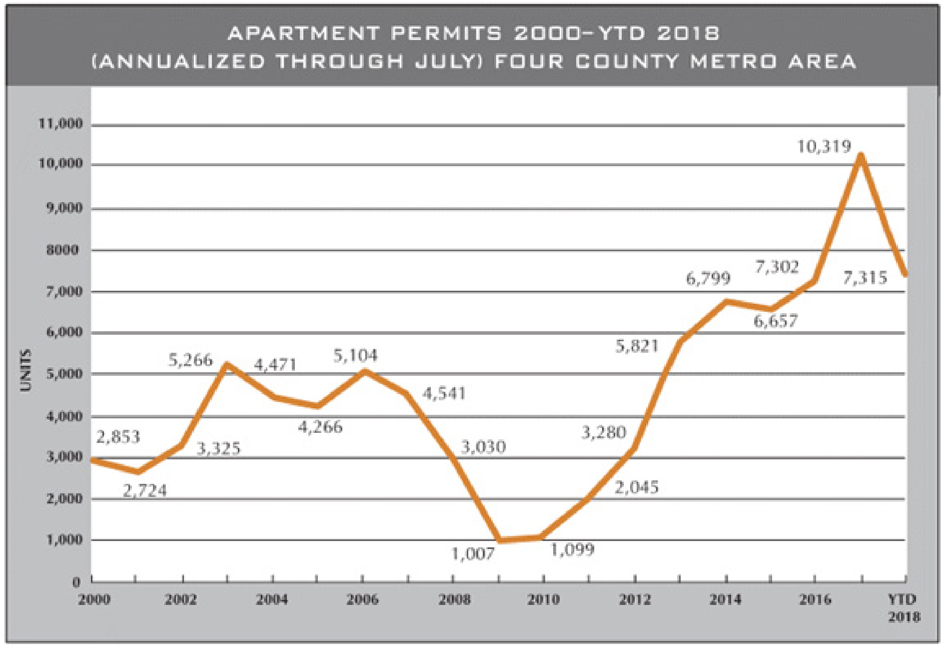
PERMITS AND SUPPLY

Figure 1: Apartment Permits YTD



Source: (McConachie, Barry, Knakal, & Lehner, 2018)

The Portland's inclusionary zoning (IZ) ordinance the city introduced in February 2017 has had a significant impact on number of permits submitted prior to and submitted after the ordinance went into effect. The Bureau of Planning and Sustainability has released the most recent permitting numbers and only 5,000 of the original 19,000 units that were submitted for permits prior to IZ have received building permits. Figure 1 shows the decline in apartments unit submitted in the last year. BPS has stated that they want to leave the program as-is for three years before making any changes, but have already started looking at modifications to get voluntary participation for pre-IZ vested projects to fall under the IZ regulations. While IZ was a part of the decline in permits submitted, the market has also been facing a labor shortage and regulations that are affecting construction costs, making many projects not feasible.

The first three quarters of 2018 have delivered around 4,300 units so far, and a total of around 6,000 are slated to be delivered by years end, according to CoStar. This still leaves almost 10,000 units under construction. The effects of IZ have not yet effected the supply, but a lag was expected because of the time span between permitting and actual construction. A vested permit can keep its status for three years with proper extensions. Forecasting out to 2020 and beyond, if IZ remains in place, it is likely when the number of new units will decrease dramatically, especially in the Central City. It should be noted that outside of the Central City, where IZ regulations have not been put in place, the area has seen an up-tick in multifamily projects as developers look to find where projects are feasible.

CONSTRUCTION COSTS

There is a familiar story with construction costs nationally and locally. Construction costs in the Portland MSA have increased 6.51 percent in the last year, according to the North America Quarterly Construction Cost Report. These increases are close to the nations highest, with only Chicago (6.79 percent) at a higher year-over-year increase.

The reasons for cost increases includes tariffs, a fear of regulatory volatility, lack of skilled workers, and the amount of projects in construction. Suppliers, for commodities such as

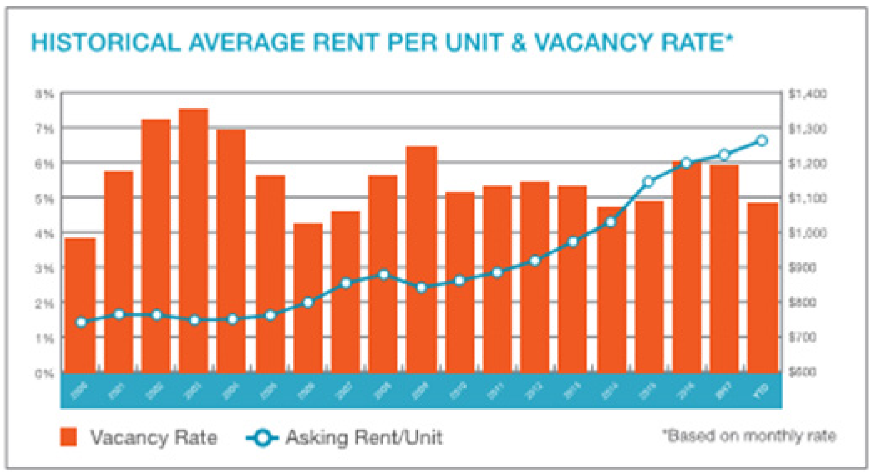
CONSTRUCTION COSTS

steel, have been only holding quoted prices for a short period—24 hours to a week—due to the trade and regulatory climate. Developers are feeling the crunch with one high profile project, Framework in the Pearl, being shelved for the time being. The significance of that is the Framework project was supposed to be an example of how cross-laminated timber can be a viable alternative to steel and concrete high-rise construction. While the seismic, fire and acoustics have proven out, the cost volatility has proven insurmountable at this point.

Subcontractors in the market have been so busy the last few years that they've been very selective on projects they will look at. With the drop in multifamily permitting activity, the sector is set to see a lull once the pre-IZ projects either fall out of the permit process or are completed, could turn the market for subcontractor services a buyer's market.

RENTS AND VACANCIES

Figure 1: Apartment Permits YTD



Source: (McConachie, Barry, Knakal, & Lehner, 2018)

With the glut of pre-IZ supply coming on the market, the sentiment in the market was that vacancies would increase and rents would level out. Instead, vacancies actually decreased by 0.45 percentage points and rents have continued to rise, according to the economists at the State of Oregon.

The Portland metro area's average vacancy is down to 4.4 percent while average rents are now $1.62 per square foot. Downtown Portland and northwest Portland have the highest vacancies at 6.09 percent and 6.33 percent, respectively. The corresponding average rents have increased to $2.47 per square foot and $2.11 per square foot. Downtown and northwest are where much of the Class A multifamily product has been delivered. Higher vacancies and increased concessions on virtually all new deliveries show that there is a softening in this part of the market.

Elsewhere in the region, the number of buildings offering incentives have lowered slightly in many areas since Spring 2018. The Troutdale/Fairview/Gresham area has the lowest vacancies around 2.87 percent and have the lowest average market rates at $1.32 per square foot.

The Bend/Redmond submarket has an average vacancy rate of 2.99 percent and average rent of $1.60 per square foot. This could be interpreted as a signal for developers to start to venture outside of the Portland MSA, where IZ and construction costs have been deterrents of development in the last year.

SALES

Cap rates have flattened out for multifamily projects at 5.3 percent, with a median per unit price of $169,000 for the latest quarter, according to MultifamilyNW. There was a total of 52 transactions this quarter, with the largest being Indigo @ Twelve I West, which sold for $206 million. With the current regulations slowing new construction, Portland's multifamily could see an upside in the purchase of multifamily properties in Portland in the near future. ■

OFFICE MARKET ANALYSIS

MELISSA MEAGHER
Portland State University

The start of the second half of 2018 was strong for Portland's office market. Rental rates continued to increase with some submarkets holding a record amount of rate increases year-over-year. Leasing activity remained strong while construction costs continued to rise, affecting sales transactions. Vacancy rates rose slightly, but because of Portland's attractive appeal as an alternative to other markets in the West, investors remain confident. As Seth Platsman of Macadam Forbes summed up:

> "Portland feels it is uniquely positioned to absorb this vacancy, especially when looking at competing markets. Average gross asking rates in San Francisco have exceeded $70 per square foot. In addition, the median home price in San Francisco is approximately $1.5 million. Portland's pitch to growing companies in the Bay Area: pay 70 percent less for comparable office space and give your employees a more realistic opportunity to purchase a home."

Most notably, a large number of leases in suburban markets will result in a lower suburban vacancy rate than the urban core for the first time in 15 years. In a video from Cushman & Wakefield, Chris Nelson, Principal of Capstone Partners, touched on why rental rates have continued to rise despite new developments in the pipeline in both urban and suburban markets:

> "The migration of companies to Portland is a combination of new incubating companies that are growing and tech companies here in Portland—the companies are just chasing where the people want to be, particularly millennials that are finding Portland as a good place to relocate to."

With Portland Metro's unemployment rate sitting at 3.8 percent and employment growth of 43,200 jobs added year-to-year, there is a large incentive for new tenants to enter the market. Jason DeVries of Cushman and Wakefield's Portland office also confirms, "Companies look at it as: I've got a great labor force, they have a great quality of life, and then you add in the fact that we are a cheaper alternative than Seattle and San Francisco from a real estate perspective—it's kind of a no-brainer."

Melissa Meagher 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. While completing her graduate degree Melissa is a part-time strategy analyst for Leland Consulting Group as well as an asset manager for CEG Multifamily, specializing in innovative mixed-use projects, city branding, and market analytics. She is the 2018 Society of Industrial and Office Realtors Fellowship recipient and scholar. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

VACANCY

Vacancy rates this quarter saw a large variation among brokerage firms. The Portland office market vacancy rose slightly in the second half of the year to end at 11.9 percent according to JLL, ticking just above last quarter's 11.7 percent. Tim Harrison of JLL notes:

> "The downsize of Wells Fargo at the Wells Fargo Center and the closure of the Art Institute at M Financial Plaza together with new development, will push vacancy up in the Urban Core above 12 percent. Conversely, after a tough first half of the year, activity in the Westside suburbs has picked up and a number of large leases have been signed and set to commence in the next six months. This should result in suburban vacancy falling below urban vacancy for the first time in over 15 years."

Newmark Knight Frank and CBRE's vacancy predictions line up similarly to JLL's while Colliers and Kidder Mathews see a lower vacancy rate at 9.7 percent and 7.1 percent, respectively. CBRE notes, "Jive Software's closure was the largest reason for negative absorption … the company downsized from approximately 50,000 square feet and remaining employees will work from home."

Table 1: Total Vacancy Rates by Brokerage House and Class, Third Quarter 2018

Brokerage	Total	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Colliers	9.70%	12.50%	10.10%	14.70%	16.50%	-
JLL	11.90%	11.00%	8.80%	14.70%	13.70%	-
Kidder Mathews	7.10%	9.90%	8.60%	10.50%	11.80%	6.20%
Newmark Knight Frank	10.10%	10.50%	-	-	-	-
CBRE	11.00%	10.90%	-	-	-	11.10%

Source: Colliers, JLL, Kidder Mathews, CBRE and Newark Knight Frank

RENTAL RATES

Rental rates were steady in the first half of the year but are now seeing a resurgence in the second half of 2018. According to CBRE, "New construction paired with demand pushed average lease rates up with an increase of 9.7 percent year-over-year for the overall Portland market." The market's average rental rate among brokerage houses ranged from $25.83 to $31.21, while Portland's CBD range was higher, ranging from $31.68 to $35.27.

According to JLL, the close-in Eastside's newest developments are pushing rents to the highest in the Portland metro area. Harrison notes, "The Close-In Eastside took over as Portland's most expensive submarket, with average rents now $40.00 FSG per square foot." This is 24.9 percent above the submarket's average asking rate year-over-year. Other leading submarkets leading the pack are the suburban submarkets of John's Landing at $30.18 per square foot and Kruse Way at $31.99 per square foot.

RENTAL RATES

Table 2: Average Direct Asking Rates ($/sf FSG) by Brokerage House and Class, Third Quarter 2018

Brokerage	Market Average	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Newmark Knight Frank	$28.29	$32.73	$34.87	$33.73	-	-
Kidder Mathews	$25.83	$31.68	$34.58	$30.07	$25.48	$22.68
Colliers	$26.11	$32.01	$35.79	$30.86	$26.12	-
CBRE	$29.99	$34.70	-	-	-	$25.07
JLL	$31.21	$35.27	$38.76	$34.58	$27.56	

Source: Colliers, JLL, Kidder Mathews, CBRE and Newark Knight Frank

ABSORPTION AND LEASING

The third quarter saw 250,903 square feet of positive net absorption, contrasting 2017's 428,339 square feet of absorption. The second quarter saw the several downsizes and closures, including Jacobs Engineering in Kruse Way, SureID in the Sunset Corridor, as well as Covergys' call center in the I-5 South Corridor. However, third quarter's absorption assisted their recoveries. JLL noted, "Solid absorption in the Urban Core and Westside suburbs helped the market recover from the heavy losses in the Westside Suburbs in the first half of the year." Year to date, JLL notes of a negative 133,380 square feet in the Portland office market overall, while Colliers reports negative 171,273 square feet year to date.

Table 3: Net Absorption (in square feet) by Brokerage House and Market Area, Third Quarter 2018 and Year to Date

Brokerage	Q3 Overall	YTD Overall	Q3 CBD	YTD CBD
Colliers	$326,165.00	($171,273.00)	$249.89	-
JLL	$84,346.00	($133,380.00)	$56,470.00	$5,509.00
Kidder Mathews	$519,282.00	$1,100,193.00	-37,910	-245,906

Source: Colliers, JLL and Kidder Mathews

The most notable lease transaction was Genentech's lease in the Lloyd Center Tower. The San Francisco-based company already employs more than 400 people on a 75-acre campus in Hillsboro. Looking to expand and continue to build its talent base, the company assessed over ten cities before choosing Portland. In a recent article in the Portland Business Journal, Claire Scott, Vice President of Access Solutions, described Genentech's selection process:

> "When we were looking for locations we took into account what would be a great location in terms of connectivity with the organization and patients and community. We loved the mission-driven culture we found in Oregon and Portland."

In addition, 24 Hour Fitness leased the 48,499 square foot space located at 4204-4224 NE Halsey Street. Block 29 Center for Health and Healing, a project by Oregon Health & Science University, is also 100 percent pre-leased.

ABSORPTION AND LEASING

Table 4: Notable Lease Transactions, Third Quarter 2018

Tenant	Building/Address	Market	Square Feet
Genetech	Lloyd Center Tower	Lloyd District	$61,990.00
24 Hour Fitness	4204-4224 NE Halsey Street	NE Close-In	$48,499.00
Rohde & Schwarz, Inc.	Rock Creek Corporate Center	Sunset Corridor/Hillsboro	$44,142.00
Vetsource	Cascade Station II	Airport Way	35,000
SAIF	2 Centerpointe	Kruse Way	$21,011.00
Cable Huston	Broadway Tower	CBD	17106

Source: Newmark Knight Frank and Kidder Mathews

SALES TRANSACTIONS

According to Costar, "the first six months of 2018 saw 37 office sales transactions with a total volume of $394,609,542." In the third quarter, sales activity dipped. Director of Research at Kidder Mathews, Jerry Holdner, explained:

> "Portland's office market experienced a quarter-over-quarter drop of roughly half in sales dollar volume and building square footage sold. Additionally, average price said per square foot fell 8.5% quarter-over-quarter. While the summer malaise adversely affected the overall office sales numbers for Q3, there were some significant transactions that took place."

These transactions include Unico Properties and American Realty Advisors' purchase of the nearly 400,000 square foot Moda Tower from UBS Financial Services for $178 million. In a recent press release from Unico Properties, Ben Pearce, Vice President of Real Estate Services, stated, "Office tenants and employees are seeking extremely walkable locations with direct access to transit and amenities … [and] MODA Tower is precisely aligned with these demands." Albert Pura, Senior Director at ARA, expanded on why the two companies chose Portland for their second partnership:

Portland's CBD has quickly emerged as one of the nation's fastest growing tech and innovation hubs … Firms are continuing to migrate to the region in search of strong value alternatives as compared to San Francisco, Los Angeles, and Seattle. MODA Tower will benefit from this ongoing economic growth and migration of jobs, driving long-term demand for the property.

Unico Properties also added The Weatherly building, a $20 million investment in the SE close-in submarket, to its portfolio. Located at 615-540 SE Morrison Street, the 63,608 square feet of Class B office space was sold by Mayfield Investment Co, Inc. Other notable sales transactions include Crown Acquisition Associates' acquisition of Sunset Corporate Park, Phase II located in the Sunset Corridor/Hillsboro submarket, which is a 103,279 square foot building that is fully leased. The property was sold by Washington Capital Management for $32,250,000.

In addition, the two mixed-use properties known as The Bailey Building and The Water Tower in the Johns Landing submarket were acquired by ScanlanKemperBard Companies for $24 million. The seller was Melvin Mark Companies who had purchased the Water Tower

SALES TRANSACTIONS

in 2008 for $19.7 million. According to a recent press release from Melvin Mark after the sale, the team was proud of their action plan that "stabilized the building roster, kept long-term tenants happy with the refurbished property and attracted interest from a range of office and retail users." Todd Gooding, the President of buyer SKB, stated in a press release:

> "We are grateful to Melvin Mark for the opportunity to acquire this asset as we are firm believers in the John's Landing Submarket. The water views, neighborhood amenities and historical architectural features provide a unique urban experience at a price point and parking ratio typically found in the suburbs."

Table 5: Notable Sales Transactions, Third Quarter 2018

Building/Address	Buyer	Seller	Market	Price	Price/SF
Moda Tower	Unico Properties	UBS Financial Services	CBD	$178M	$446.77
Sunset Corporate Park, Phase II	Crown Acquisition Associates	Washington Capital Management	Sunset Corridor	$32.25M	$312.26
The Water Tower + Bailey Building	ScanlanKemperBard Companies	Melvin Mark Companies	Johns Landing	$24.8M	$201.32
The Weatherly	Unico Properties	Mayfield Investment Co, Inc.	SE Close-In	$20M	$314.43

DELIVERIES AND CONSTRUCTION

New construction deliveries totaling 507,932 square feet were completed during the third quarter of 2018, contrasting second quarter's 728,355 square feet. The Knight Cancer Institute Research Building, a development by Oregon Health & Science University, delivered its 320,000 square foot space in the Southwest market. This was the largest property to deliver in this quarter. Brian Druker, Director of the OHSU Knight Cancer Institute, said in a press release, "We want this to be the building where we end cancer as we know it…We're trying to bring a collaborative spirit to defeating cancer."

Figure 1: Knight Cancer Institute Research Building Delivered, Third Quarter 2018

Source: SRG Partnership

DELIVERIES AND CONSTRUCTION

The building is on track to receive its LEED Platinum status and comply with the 2030 Energy Challenge. Tiffani Howard, project liaison for Knight Cancer Institute, said, "We believe we can move cancer research forward much faster if we work together in teams, so we are committed to team science." An article from Tradeline Inc. showcases this importance of flexibility and collaboration in the future of office building designs. For OHSU, the design of the Knight Cancer Institute had to meet the changing needs of research. The article explains:

Flexibility is evident throughout the building:

- The structure is post-tensioned concrete, which allows for a wide structural bay and eliminates columns in the labs
- The moveable, flexible lab casework allows write-up desks to change to lab tables or vice versa
- The overhead and service carriers, which provide all of the primary lab utilities, support fluid adjustments
- All offices and small meeting rooms are nearly identical in size, allowing flexibility over time for a growing community

Table 6: Notable Development Project Deliveries, Second and Thrid Quarter 2018

Building/Address	Developer/Owner	Market	SF	Delivery Date
Nike North Expansion Building A	N/A	Westside	412,000	Q2 2018
Knight Cancer Institute Research Building	Oregon Health & Science University	Southwest	320,000	Q3 2018
Field Office – East	Project^	Northwest	165,653	Q2 2018
First Tech Federal Credit Union	Swinerton Builders	Sunset Corridor/Hillsboro	156,000	Q3 2018
Heartline Building	Security Properties, Inc.	CBD	70,702	Q2 2018
Flatiron PDX	Southern Miss, LLC	NE Close-in	28,740	Q3 2018
Convene	Killian Pacific	St Johns/Central Vancouver	45,000	Q2 2018
The Murdock	Gramor Development	Clark County	77,000	Q4 2018
7 SE Stark	Harsch Investment Properties	Lloyd District	70,000	Q2 2019
Tree Farm	Guerilla Development	SE Close-In	43,000	Q4 2018

Source: CoStar

Other notable mentions were the 156,000 square foot First Tech Federal Credit Union by Swinerton Builders as well as Flatiron PDX, a project by Southern Miss, LLC in the NE Close-In submarket. The Flatiron PDX building is expected to deliver this month and also reflects similar attributes to the flexible design concepts previously mentioned in OHSU's project. According to Works Progress Architecture, the project's "five floor plates will be open loft space…[with] unique triangular geometry resulting in a weave of bay windows and open space at the corners." The design has already attracted Remote.ly, which has leased 8,4000 square feet on two floors of the building to compete in the hot coworking field.

DELIVERIES AND CONSTRUCTION

Figure 2: Flatiron PDX – Office Space To Be Delivered

Source: Works Progress Architecture

Table 7: Notable Under Construction Projects, Third Quarter 2018

Building/Address	Developer	Market	SF	Delivery Date
Nike North Expansion Building B	Gerding Edlen	Westside	1,003,585	Q4 2018
Block 29 Center for Health & Healing	Oregon Health & Science University	Southwest	360,000	Q4 2018
9North	Williams & Dame Development	CBD	202,853	Q4 2018
250 Taylor	Third & Taylor Development LLC	CBD	190,825	Q4 2019
Broadway Tower	BPM Senior Living Company	CBD	177,800	Q4 2018
The Press Blocks – Office	Security Properties + Urban Renaissance Group	Southwest	142,000	Q2 2019
5 MLK Office	Gerding Edlen	Lloyd District	119,570	Q4 2019

Source: CoStar

DELIVERIES AND CONSTRUCTION

In addition to Flatiron, rapid development is also still underway, with several projects expected to deliver next quarter. According to JLL's Tim Harrison, the upcoming fourth quarter's "delivery of Broadway Tower, 9North and the Meier & Frank building … will add an additional 4.6 percent of Class A office space to the CBD." Harrison adds:

> "The 19 story Broadway Tower is another successful addition to Portland's office market by development group BPM Real Estate. The mixed-use tower will feature a 180 room Radisson Red Hotel on the bottom 8 floors, while the top 11 floors are 94 percent pre-leased. Additionally, the Meier and Frank Building is roughly 43% pre-leased."

Figure 3: 7 SE Stark Street – Office Space Under Construction – Lloyd District

Source: Costar

With its recent office space of 7 SE Stark Street slated for the second quarter of 2019, Harsch Investment Properties confirmed that the "Central Eastside has long been known as Portland's 'industrial sanctuary' and has seen exceptional growth and revitalization in recent years." As Jon Bell of the Portland Business Journal predicted:

> "This submarket…is in the midst of a renaissance fueled by the in-migration of office users (local and out-of-state) including creative, software, tech, engineering, design and other firms attracted to Central Eastside for its edgy, creative, and urban vibe."

With its 24.9 percent jump in average rental rates year-to-year, the Central Eastside submarket is reflective of Portland's growth and will certainly be interesting to take a closer look at in the upcoming year. With several companies ranging from biotech to medical to tech now choosing Portland and its hot submarkets for cheaper alternatives to other markets, the demand for flexible and collaborative office space has only just started to kick in. ■

INDUSTRY MARKET ANALYSIS: GUEST CONTRIBUTOR

MARK CHILDS
Capacity Commercial

Well, we've arrived. Amazon has now hit the Portland/Vancouver industrial market database. For years I've been able to share how we're doing with considerable certainty due to our quite sophisticated data base. Those days are over, at least for the next year or so (and then who knows what Amazon will be up to). In the past, I've identified that we've been running at about 3 million square feet of net absorption per year for the last few years and adding a little more than 2 million square feet per year of new construction. Not surprisingly, our vacancy rate has been dropping.

This past quarter we absorbed 2.2 million square feet (almost 9 million square feet at an annual rate) and completed 1.9 million square feet of new construction. Definitely an interruption to our normal process.

During the past quarter, Amazon completed and occupied two buildings in the greater Portland/Vancouver area. A 918,000 square foot building in Rivergate (North Portland) and an 857,000 square foot building in Troutdale. The Troutdale building actually has two additional complete floor mezzanines inside of it, resulting in about 2.2 million

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INDUSTRY MARKET ANALYSIS

square feet of floor space for Amazon. Additionally, Amazon is constructing 1.0 million square feet in Salem, has 300,000 square feet in Hillsboro, 100,000 square feet in NW Portland, making it difficult to track the real world through the Amazon noise.

Our data base tracks leased space. Amazon leases, while developers and institutional owners that end up doing the work and owning the product. I've heard that one national owner of industrial real estate (think tens of millions of square feet) has had to quit investing in Amazon occupied buildings because Amazon has grown to more than 10 percent of what should be a very diversified portfolio.

As with most new concepts, speed to market is very important. When Amazon decided to build essentially a three-story product in Troutdale (as in very heavy footprint) on old riverbed, the structural engineers identified an issue with soft soils. No problem: Amazon told the developer to solve the problem and they would pay for it. The solution was over 4,000 concrete columns drilled around 50 feet deep to reach solid bedrock. I guess you pay what's needed to provide two-hour delivery.

Backing out the Amazon impact, it appears we had around 500,000 square feet of absorption with little new "conventional" product delivered, resulting in the vacancy rate dropping to 3.5 percent for warehouse-type product.

The "last mile" delivery demand for close-in warehouse space is driving urban vacancies down and causing close-in land prices to rise to the point where some industrial properties can potentially be torn down and redeveloped with modern industrial product. Examples of this effect would include:

- Rivergate vacancy has dropped to below 2 percent because it has quick access to downtown;
- Tualatin vacancy is below 1 percent because it has quick access to the southwest Portland metro purchasing power;
- Wilsonville vacancy has risen from less than 2 percent to more than 5 percent because with increased congestion, you can't get there anymore;
- Not tracked due to the small data base, but I estimate northwest Portland is less than 0.5 percent vacant.

Lease rates continue to slowly creep northward, still being in the low $0.50s on Portland's eastside and low $0.60s on the westside. Building prices are almost impossible to peg, as there are so few clean examples available to transact. Let's just say they are in the $100 to $150 per square foot range, which is still cheaper than new construction. Cap rates continue to get depressed, generally running around 5 percent for institutional grade product and 6-7 percent for smaller properties purchased by local individuals.

Getting around town continues to be a problem, although I've noticed that heading south on I-5 at the Hwy 217 interchange during afternoon rush hour has gotten better. Oregon Department of Transportation has just finished adding a new freeway lane from Hwy 217 to the I-205 interchange. Contrary to what I heard the head of Metro say recently, possibly adding capacity to a constrained system can increase throughput. Who'd of thunk it.

Discussions appear to be re-beginning on the Columbia River Crossing, mostly spurred on by the Washington side. At the same time, TriMet is looking to put the funding for a new southbound $2.2 billion light rail line on the ballot in 2020. Along with these big projects, the state seems to be moving forward on tolling I-5 and I-205.

Despite my concerns about industrial vacancy and the potential for transportation gridlock, I'm glad I don't do retail real estate. Industrial real estate seems to be in great shape, and with the tax cuts, should be doing well for at least a couple more years, if not longer. Absent

MARK CHILDS

INDUSTRY MARKET ANALYSIS

the Amazon impact, I think we're still on course to meet my forecast of 2.5 million square feet absorbed this year—we already have more than 1.5 million square feet to date—and expect next year to be healthy also. We've got almost 4 million square feet under construction, so hopefully we won't run out of space anytime soon. ■

RETAIL MARKET ANALYSIS

MELISSA MEAGHER
Portland State University

Approaching the final quarter of 2018, Portland's retail market remains strong. Rental rates continue to increase while vacancy rates have decreased slightly. Net absorption is positive 266,930 square feet with six buildings of retail space delivered and 862,344 square feet under construction at the end of the third quarter. Low unemployment combined with steady, but slowing, population growth as well as several projects under construction have kept the retail market healthy and steady.

In terms of the national retail market, research from Frost and Sullivan in a recent Bloomberg article predicts that retail stores are far from dying. The report states, "First, people tend to be more trusting of physical merchants, relative to e-commerce sites. Second, the ability to 'handle' and 'evaluate' a product with immediacy often 'trumps a lower price.'" Because of this, national reports point toward a continued presence of opportunity in physical stores.

Lou Elliott, Principal of NAI Elliott, also summarizes the state of retail at the end of the third quarter:

> "As the string of debt-caused large name retail bankruptcies continues unabated—Sears, PetSmart—and Amazon looks at ever more areas to expand its reach, many retailers are still fragile. But, innovation in all retail sectors, including grocery, is reshaping and revitalizing the brick and mortar retail landscape. Commercial retail estate owners are adapting, as well, and the much touted "retail apocalypse" seems to be disappearing in the rear-view mirror for many landlords and tenants."

In Portland, the Oregon's September Economic Revenue and Forecast also confirmed, "The [Oregon] economy follows the U.S. Business cycle overall, albeit with more volatility. The good news is job gains are enough to match population growth and absorb the workers coming back into the labor market. Wages are rising faster than in the typical state, as are household incomes."

Mark McMullen and Joshua Lehner, economists for the Oregon Office of Economic Analysis, verified in their report: "The regional economy continues to transition down to more sustainable rates [and] ongoing improvements in these deeper measures of economic well-being are also expected to continue."

With evidence of regional expansion, employment growth, and strong wage gains the Portland retail market has the opportunity to leverage its real estate to its best use with signs pointing to opportunity in the last quarter of 2018.

Melissa Meagher 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. While completing her graduate degree Melissa is a part-time strategy analyst for Leland Consulting Group as well as an asset manager for CEG Multifamily, specializing in innovative mixed-use projects, city branding, and market analytics. She is the 2018 Society of Industrial and Office Realtors Fellowship recipient and scholar. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

VACANCY

At the end of the third quarter, Portland's vacancy rate lowered slightly to 3.0 percent. The largest change in vacancy rate involved the Lloyd District submarket, seeing a drop from 3.5 percent to 2.9 percent in the third quarter.

General retail properties' vacancy rates rose while malls, power centers, and shopping centers vacancy rates declined. Vacant sublease space, which continues to see a decreasing trend, totaled 193,938 square feet.

Table 1: Portland Retail Vacancies by Submarket, Third Quarter 2018

Submarket	Q3 2018 Vacancy Rate	Q2 2018 Vacancy Rate	Change from Previous Quarter
CBD	6.10%	5.80%	0.30%
Clark County/ Vancouver	4.00%	4.40%	-0.40%
I-5 Corridor	3.80%	3.90%	-0.10%
Lloyd District	0.029	0.035	-0.006
Northeast	0.024	0.024	No change
Northwest	0.021	0.022	-0.001
Southeast	0.029	0.03	-0.001
Southwest	0.029	0.031	-0.002
Sunset Corridor	0.024	0.025	-0.001
Portland Total	0.03	0.034	-0.004

Source: Kidder Mathews

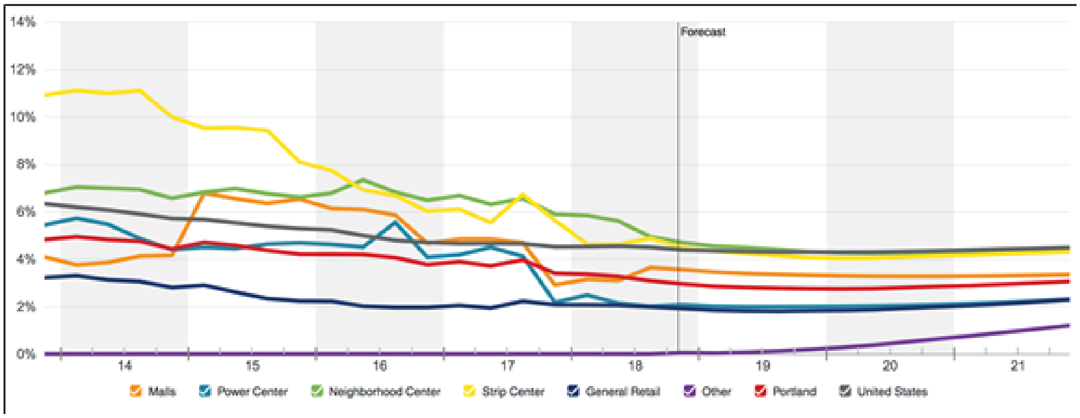
Table 2: Portland Retail Vacancies by Product Type; Third Quarter 2018

Property Type	Q3 Vacancy Rate	Q2 Vacancy Rate	Change from Previous Quarter
Malls	2.20%	2.50%	-0.30%
Power Centers	1.90%	2.00%	-0.10%
Shopping Centers	5.30%	5.90%	-0.60%
Specialty	0.00%	0.00%	0.00%
General Retail	2.60%	2.20%	0.40%

Source: Kidder Mathews

VACANCY

Figure 1: Knight Cancer Institute Research Building Delivered, Third Quarter 2018



Source: SRG Partnership

ABSORPTION

Ending last quarter with a positive 266,930 square feet of absorption, the market is seeing a net absorption positive of 620,534 square feet year to date. The shopping center, power center, and mall sectors all reported positive absorption with 258,128 square feet, 9,326 square feet, and 28,134 square feet, respectively. Specialty centers had zero direct net absorption in third quarter.

Table 3: Portland Retail Absorption, Third Quarter 2018 and YTD

Submarket	Q3 2018 Net Absorption	YTD Net Absorption
CBD	-6,703	7,957
Clark County/ Vancouver	52,468	221,586
I-5 Corridor	104,153	125,533
Lloyd District	34,387	5,773
Northeast	-4,659	135,582
Northwest	2,253	-9,919
Southeast	19,585	17,415
Southwest	57,816	132, 850
Sunset Corridor	7,630	-16,243
Total	266,930	620,534

Source: Kidder Mathews

RENTAL RATES

Average rental rates raised from second quarter to third quarter. NAI Elliott reports average asking rates of $21.53 per square foot. In contrast, Kidder Mathews reports the average asking lease rate was $19.27 per square foot. This is a slight jump from second quarter's $18.96 per square foot, which was a 1.28 percent increase from the end of the second

RENTAL RATES

Table 4: Portland Retail Asking Rents by Submarkets, Third Quarter 2018 v. Second Quarter 2018

Submarket	Q3 Avg Rental Rate	Change from Previous Quarter	Q2 Avg Rental Rate
CBD	$23.95	$1.51	$22.44
Lloyd District	$20.66	$0.14	$20.52
I-5 Corridor	$19.67	$1.31	$18.36
Clark County	$18.15	$0.03	$18.12
Northwest	$24.73	$0.73	$24.00
Northeast	$19.27	$0.91	$18.36
Southeast	$17.16	$0.12	$17.28
Southwest	$21.11	$0.13	$21.24
Sunset Corridor/Hillsboro	$19.46	$0.46	$19.92

Source: Kidder Mathews

quarter in 2017. All submarkets with the exception of Northeast, Southeast, and the Sunset Corridor/Hillsboro, increased from the last quarter. Most notably, the average rental rate in the CBD submarket increased from $22.44 in second quarter to $23.95 in third quarter. According to an analysis of third quarter's rates, NAI Elliot's Marketing Director recognized, "The retail market is gaining strength in Portland's suburban submarkets. Minimal vacancies and construction are causing rental rates to rise in shopping centers and the current market heavily favors landlords."

Table 5: Select Top Retail Leases (Based on Leased SF for Deals Signed in Third Quarter 2018.)

Building	Submarket	SF	Tenant Name
5253 SE 82nd Avenue	Clackamas/Milwaukie	99,663	Undisclosed
10329-10355 SW Cascade Boulevard	217 Corridor/Beaverton	24,482	Ashley Furniture Home Store
3800 River Road N	Marion County	18,532	Undisclosed
Troutdale Market Center	NE Outlying	11,690	Undisclosed
Hillsboro West Shopping Center	Sunset Corridor/Hillsboro	9,872	Community Action
10030 SW Beaverton Hillsdale Hwy	217 Corridor/ Beaverton	9,800	Undisclosed

Source: CoStar

DELIVERIES AND CONSTRUCTION

A total of six retail projects were delivered this quarter, which added 70,233 square feet to the market. This adds to the 462,616 square feet of retail space constructed in the last four quarters, according to Costar. In looking at the breakdown of project size delivery there were 26 buildings under 50,000 square feet delivered this year with 163,295 square

Table 6: Project Size Delivery Analysis, Year to Date Development 2018

Building Size	# Bldgs	GLA	SF Leased	Single-Tenant	Multi-Tenant
< 50,000 SF	26	216,138	163,295	9,489	206,649
50,000 – 99,999 SF	--	--	--	--	--
100,000 – 249,999 SF	1	128,652	126,079	--	128,652
250,000 – 499,999 SF	--	--	--	--	--
>= 500,000 SF	--	--	--	--	--

Source: CoStar

feet leased mostly to multi-tenant leases. At the end of third quarter retail inventory in the Portland market area totaled 189,396,976 square feet in 18,346 buildings and 1,169 centers. Currently, there is an additional 862,244 square feet of retail under construction across the market.

Table 7: Notable Development Under Construction, Third Quarter 2018

Building	Submarket	SF	Start Date	Delivery Date
Cedar Creek Plaza	I-5 Corridor	70,000	Q3 2017	Q3 2018
1818 SW 4th Avenue	CBD	41,000	Q3 2017	Q1 2019
Restoration Hardware	Northwest	36,000	Q2 2017	Q4 2018
701 Columbia Street	Clark County	26,000	Q3 2017	Q1 2019
1969 Willamette Falls Drive	West Linn	25,010	Q3 2018	Q2 2019
Goodwill	Clark County	25,000	Q2 2018	Q4 2018
Sideyard	Lloyd District	20,000	Q1 2018	Q1 2019
17550 Provost Street	Lake Oswego	17,673	Q3 2018	Q2 2019
17510 Provost Street	Lake Oswego	15,581	Q3 2018	Q3 2019
Discovery Block	Northeast	13,000	Q1 2018	Q1 2019
Ridgefield Pioneer Village	South	11,649	Q2 2018	Q2 2019
11360 SW Canyon Road	Southwest	11,304	Q2 2018	Q1 2019

Source: CoStar and NAI Elliot

SALES TRANSACTIONS

The sales volume at the end of the third quarter was lower than past quarters; however, with an average cap rate of 6.6 percent in the Portland market, investors remain confident.

The largest sale price of third quarter was the O'Brien Autogroup's purchase of 107 SE Grand Avenue for $26 million. The property is 36,000 square feet and located in the Lloyd District submarket. Inland Real Estate Group of Companies sold its 76,843 square foot property at 18656-18645 NW Tanasbourne Drive to Agree Realty Corporation. Retail Opportunity Investments also acquired King City Plaza, the 62,676 square foot property located at 15705-15785 SW 116th Avenue, from Tobias Investment Co. The 8,480 square foot site at 20665 SW Blanton also closed, bringing a new opportunity for Washington County who purchased the property for $8.6 million. Although sales volumes have declined

Table 8: Notable Sales Transaction, Third Quarter 2018

Building / Address	Buyer	Seller	Submarket	SF	Price	Price/SF
107 SE Grand Avenue	O'Brien Autogroup	Bob Wentworth	Lloyd	36,000	$26.06M	$723.75
18565-18645 NW Tanasbourne Drive	Agree Realty Corporation	Inland Real Estate Group of Companies	Hillsboro	76,843	$19.86M	$258.64
King City Plaza	Retail Opportunity Investments	Tobias Investment Co.	Portland	62,676	$15.89M	$250.27
205 Commerce Center	Giustina Resources	Kensington Investment Group	Vancouver	36,394	$13.3M	$359.81
20665 SW Blanton Street	Washington County	Tualitin Valley Fire & Rescue	Aloha	8,480	$8.55M	$1,008.25

Source: CoStar

Table 9: Portland, OR Retail vs. National Index Sales, Third Quarter 2018

Sales	Portland, OR	National Index
12 Month Properties Sold	648	47,666
Market Sale Price/SF	$252	$231
Average Market Sale Price	$2.7 M	$2.6 M
12 Month Sales Volume	$616 M	$57.3 B
Market Cap Rate	6.60%	7.00%

Source: CoStar

in the past couple of years, Anderer confirms that "over the cycle, reported cap rates have gradually declined from just below 8% in 2010 to now about 6.5%." Demand for retail space remains strong. ■