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QUARTERLY REPORT

Volume 13, Number 2 | Spring 2019

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MICHAEL LOWES

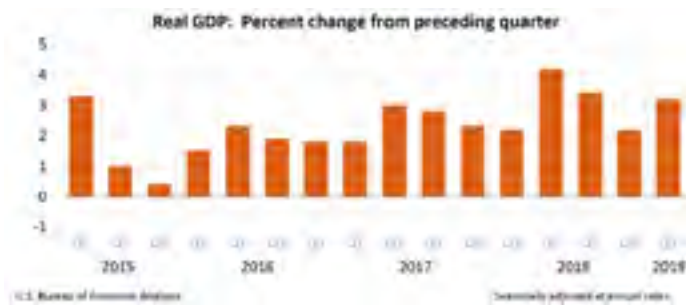
01 //

Economic Analysis

JERRY JOHNSON
Portland State University

At a national level, the current expansion cycle has continued through 39 consecutive quarters. Gross Domestic Product (GDP) during the first quarter of 2019 expanded at an annualized rate of 3.2%. The current consensus anticipates a significant reduction in the rate of expansion during the second quarter, as the first quarter numbers reflected some one-time factors such as a rush to bring in goods from China before tariffs took effect, which increased inventories in the first quarter.

JERRY JOHNSON is an adjunct professor at Portland State University's Center for Real Estate.



The continuation of the current expansion cycle is expected to continue, the pace of growth will likely decline. While slowing expansion is likely to reduce pressure on interest rates, which will help keep financing costs stable and capitalization rates for income properties low as well.

The Portland metropolitan area has outpaced the national rate of growth throughout the current expansion cycle, but that differential has diminished over the last few years.

While employment growth is expected to continue over the next year or two, the local market is no longer significantly outperforming the national average.

One of the limiting functions to overall employment growth during the remainder of this expansion cycle will be labor supply. The local unemployment rate has held steady at roughly 4.0% since the beginning of 2017, with additional labor needs addressed by in-migration and increases in labor force participation. With an estimated unemployment rate now at just 3.9%, continued expansion will increasingly need in-migration for additional labor force. The tight labor market will also place upward pressure on wages.

The Portland metro area has been the beneficiary of sustained net in-migration for decades, which has accounted for the bulk of population growth at the statewide and metro area level. The rate of natural increase (births less deaths) has declined steadily while in-migration has also declined. While the forecast is for in-migration to continue at high levels this pattern is not supported by historical trends. Some of the decline in natural increase is addressed later in this section in the discussion of trends in the millennial generation.

At a statewide level, the area of most significant population growth has been in the 65+ age cohorts. Growth in the key 25-44 age groups that are critical to support labor force needs declined in 2018. Labor force participation rates for working age households (25-54) are now over 80%, close to their historic high.

California has been the primary source of net in-migration to the State of Oregon, accounting for a net inflow of just under 20,000 residents from 2013 through 2017. The state had a net out-flow of to Washington during the period of over 3,600 residents.

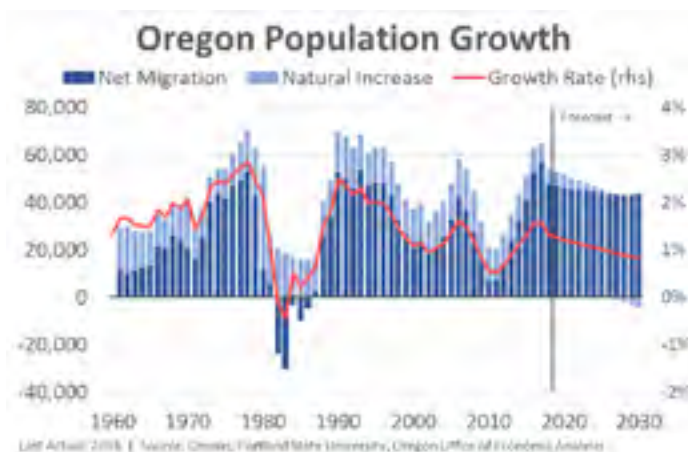
Demographic trends are expected to have a significant impact on the local residential markets, which will also impact the local potential for economic expansion. The strong demand for apartments in this business cycle can largely be attributed to the millennial generation. The millennial generation have largely moved out from their parents' households and established their own households. Thus, we expect more moderate growth in apartment demand going



SOURCE: CES Employment, State of Oregon and BLS



SOURCE: Local Area Unemployment Statistics (LAUS)



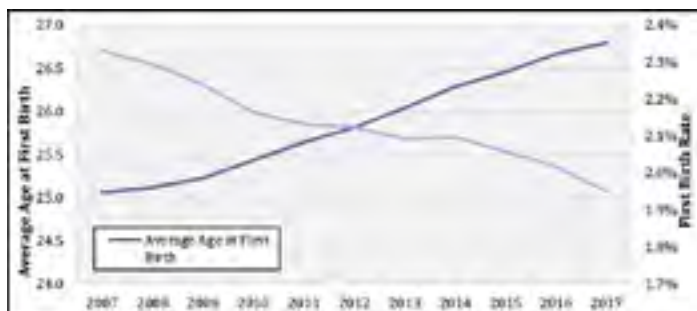


RATE OF FIRST-TIME BIRTHS BY AGE, UNITED STATES (2007-17)



SOURCE: Centers for Disease Control and Prevention, JOHNSON ECONOMICS

RATE OF FIRST-TIME BIRTHS AND AVERAGE AGE AT FIRST BIRTH (2007-17)



SOURCE: Centers for Disease Control and Prevention, JOHNSON ECONOMICS

forward. The next question is when these millennials will move into the family stage, and whether that will leave a vacuum in the apartment market as these millennial families move into more family-friendly housing.

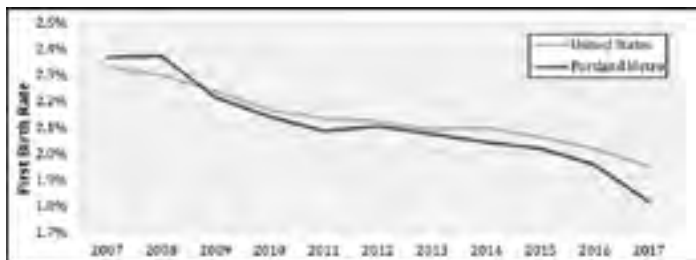
On the national level, the millennial wave has not yet produced a birth wave. Though 27-year-olds represent more first-time births than any other age level, and the number of 27-year-olds increased considerably leading up to 2017, the number of first-time births within this age group is declining. We get a clear picture of what is going on when we compare age-specific rates of first-time births in 2007 and 2017. In 2007, 19-year-olds had a higher rate of first-time births than any other age group. 6.1% of all 19-year-old women in 2007 became mothers for the first time that year. By 2017, that rate had declined to 3.4%. The rate of first births declined dramatically across all ages below 30.

For the entire female population between 15 and 49, the share of first-time births declined from 4.2% to 3.0% over the ten-year period, while the average age at first birth rose from 25 to 27. In other words, women today wait longer before becoming mothers than they did before, and they also have a greater tendency to avoid having children altogether. The data does not provide any indication that these shifts have ran their course.

There are several economic reasons that may explain this trend. Millennials are more burdened by student debt than any preceding generation. In addition, they also spend more on rents, as rent levels have increased considerably faster than wages and incomes over the past ten years. Escaping the rising rents has also become more difficult, as the threshold to homeownership is now much higher than it was before the last recession. Fewer young couples have the family-friendly setting they are looking for when raising children, and fewer can afford to forego the second income while raising their children. We see the impact of this most clearly on the Hispanic population, which has seen the steepest declines in birth rates over the past ten years.

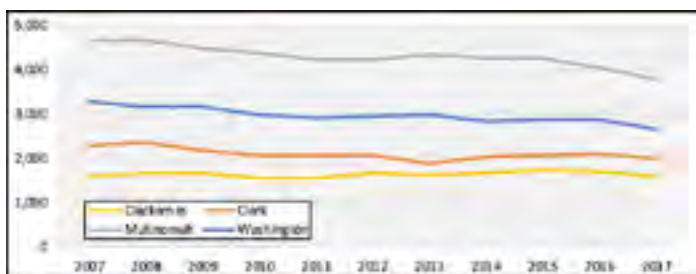
Trends in birth rates and family formation in the four-county Portland Metro Area mirror those at the national level, with steep declines among the youngest women and gains among women in their thirties and forties. The declines in birth rates are more pronounced in the Portland Area than nationally.

RATE OF FIRST-TIME BIRTHS (PERCENT OF FEMALE POPULATION AGE 15-49, 2007-17)



SOURCE: U.S. Census Bureau, Centers for Disease Control and Prevention, JOHNSON ECONOMICS

FIRST-TIME BIRTHS BY COUNTY, PORTLAND METRO AREA (2007-17)



SOURCE: Centers for Disease Control and Prevention, JOHNSON ECONOMICS

While the female population between 15 and 49 grew by 10% over the 2007-17 period, there was a 15% decline in first births, from 11,800 to 10,100 annually. Again, the data does not indicate that the decline in first-time births is leveling off, as declines in 2017 are steeper than in previous years.

The steepest declines in first-time births over the past ten years have been in Multnomah and Washington counties (-18% and -19% respectively), despite these having seen much stronger population growth within child-bearing ages. However, growth in these counties has been weighted to high education levels, and therefore has not contributed to more births. Note that these are also the counties with the highest rent levels, and thus with the highest thresholds for single-income families.

The impact of these patterns on the local real estate markets has been a level of sustained strength in the rental residential beyond what would be expected by demographic patterns. The household formation patterns of the millennial generation combined with debt burden and housing market options have fundamentally altered the tenure split locally towards rental housing. This pattern indicates that the local rental apartment housing markets are likely to show greater strength than underlying demographic trends would indicate based on previous experience. They also indicate a future demand for lower-priced ownership housing options as these household eventually enter that market.

02 //

Residential Market Analysis

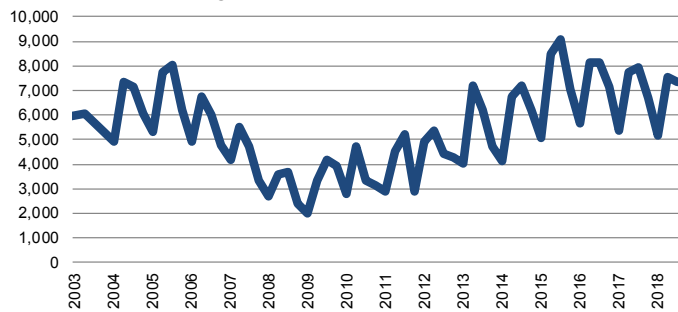
JARROD HOWARD
Portland State University

As we look at the first quarter of 2019, the state of Oregon and the Southwest Washington markets are continuing to cool down. Overall transaction volume has decreased, building permits are down from the previous year, and existing prices stayed fairly consistent. Where market prices are continuing to increase is in new home construction. In Portland and Vancouver new median sales prices are at an all-time high. This can be attributed to a supply constrained market with only periodic annexations of the Urban Growth Boundary as well as the continued climb in construction costs across the state, which is a result of the Portland Metro Area's significant economic growth through this cycle in combination with a lack of skilled labor (subcontractor employment has actually decreased). Because of these factors, Homebuilder's are unable to reach pricing for the majority of the market. Homebuilder's simply cannot provide housing at an optimal price given Portland's market constraints. It is not just Portland either. As the population continues to grow and the demand for households increase, prices are forcing people out. Neighboring cities are seeing home price increases as well, with price increases spreading west to Hillsboro/Beaverton, east toward Gresham, as well as south toward Salem.

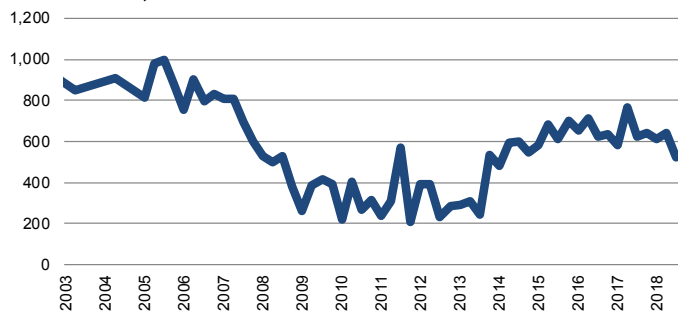
In order to combat the supply issue, Metro approved the UGB expansion in Hillsboro, Beaverton, King City and Wilsonville. Despite these expansions, a housing shortage is still expected given the projections for demand, population and overall economic growth for the year 2035. Master planned communities like South Hillsboro, River Terrace, Villebois, and Bethany may slow pricing slightly, but only temporarily.

JARROD HOWARD 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 2018 RMLS Student Fellow at PSU's Center for Real Estate. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

Number of transactions
Portland metro, existing homes



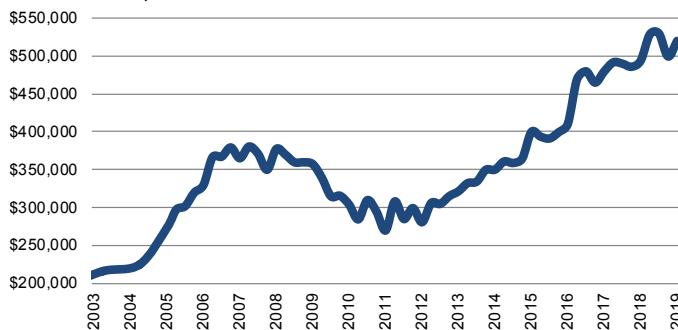
Number of transactions
Portland metro, new detached homes



Median sales price
Portland metro, existing homes



Median sales price
Portland metro, new detached homes



Market by Market

LOCAL TRANSACTIONS

For four straight quarters, the volume of existing homes sold in the City of Portland has fallen. 1,093 fewer houses were sold in the first quarter of 2019, which is a decrease of over 19% from the prior quarter. The median sales price stayed constant from the previous year, while the sales price to list price ratio slightly decreased. Transaction counts for new single-family homes within the City of Portland dropped from the previous year by 41, while the median sales price slightly increased.

"City of Portland" and "Portland Metro" refers to the three counties on the Oregon side.

Data for local transactions for Portland, Vancouver, Clark County, Eugene and Lane County sourced from RMLS.

VANCOUVER AND CLARK COUNTY

Across the board, Vancouver saw a decrease in transactions. While the transaction count saw its second straight quarter decrease, median sales price stayed constant. Sales price over list price slightly increased from the previous quarter to 98.49%.

Clark County saw its second straight year decreasing with only 693 transactions, which is 120 less than the previous quarter. Similar to Vancouver, the sales price and listing price ratio steadily increased from last quarter at 98.91 percent.

CENTRAL OREGON

Transactions in Bend slightly increased from the previous year, but median sales prices skyrocketed almost 26,000 dollars from the previous year. The Bend market remains hot late as days on market decreased substantially from the previous year to 92 days.

Transactions in Redmond increased by almost 40% from a year ago, amounting to 230 houses sold in the first quarter. The median sales price for homes increased slightly and the average days only increased by a few days.

Data for Central Oregon came from COAR, Central Oregon Association of Realtors.

WILLAMETTE VALLEY

The Willamette Valley saw substantial increases to the median sales price from the previous quarter as well as the prior year. Lane County increased the most at almost 12 percent from the previous year, while Benton County was the only one to decrease from the previous year.

Data for Willamette Valley, including Salem, came from Willamette Valley Multiple Listing Services.

SALEM

Salem's market appears to be tightening as existing median prices jump significantly from both the prior year and the prior quarter. Days on market increased to 91 from 76 and the number of transactions in Salem slowed down from a year ago.

EUGENE

The first quarter median sales prices stayed constant from a year ago at \$275,000 and days on market shot down 15 days to an average of 28 days on market. In addition, transaction volume increased to 1090 transactions, a record count for any first quarter.

Data for local transactions for Portland, Vancouver, Clark County, Eugene and Lane County came from RMLS.

SOUTHERN OREGON

The Jackson County and Josephine County markets continue to mirror each other in the first quarter; median sales prices increased from the previous year, transactions fell and average days on the market increased slightly. Jackson County's median sales price for the first quarter was \$278,000 and 81 fewer homes were sold from the previous quarter. Josephine County ended in a median sales price of \$247,900, which is over a three percent increase from the past year, for the first quarter. Transaction dropped to 127.

Data for Southern Oregon came from Rogue Valley Realtors.

Multi-Family Residential Report

CHASE BENNINGTON
Portland State University

The Portland metro area's multi-family housing supply has experienced a surge of deliveries in 2018, which can be expected to continue through the end of 2019. The adoption of the Inclusionary Zoning policy in 2017 has sharply reduced the number of new units proposed in the City of Portland, and completion of those projects initiated prior to the adoption of this policy will continue throughout the next year or so. As the market begins to soften with rising vacancies for some products and increasing concessions in advance of the investment market cycle's end, overall vacancies remain low and the demand for affordable housing remains high. Recently adopted Statewide rental rate controls mark Oregon as a market to watch during the next acquisition period, and the gap between overdelivered market-rate housing and underdelivered affordable housing grows increasingly worrisome. Significantly increasing construction costs and rising cap rates have increased the replacement cost for these products, serving as a further challenge to the Portland market's ability to deliver affordable housing.

CHASE BENNINGTON is a candidate for the Master of Real Estate Development degree at Portland State University since the Spring of 2018. He is an Executive Director for the Center for Real Estate's Emerging Leaders club, with an expected graduation in the Summer of 2019. Any opinions expressed are those of the author solely and do not represent the opinion of any other person or entity.

SUPPLY, PERMITTING

Following the rush to obtain permitting when Inclusionary Zoning caused its initial stir in the development world, delivery of new housing continues to flow into the Portland MSA. With 5,863 units currently under construction, 9,703 in the planning phase, and another 9,795 prospective projects, Portland's MSA will see sustained housing deliveries through the rest of 2019 and into 2020 as these projects come on-line. There is still a supply issue however, as the pre-IZ housing does not provide an affordable solution, which is a figure Portland is still struggling with – since the permitting pre-IZ finished, permits for new apartment construction have plummeted.

DEMAND, ABSORPTION

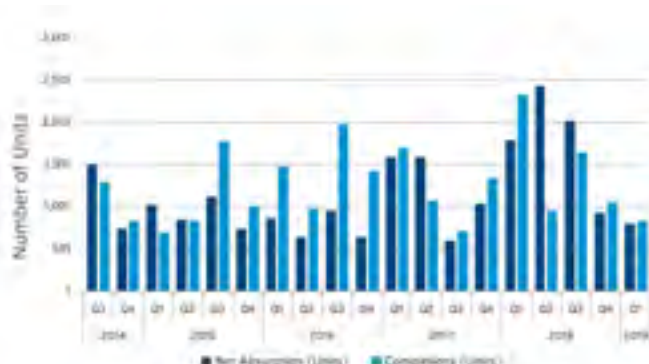
Portland's still-rising population and growing employment numbers (2.1 percent increase in employment since Q1 last year) continue to offer steady demand for new housing. Average market vacancy for rental housing fell 40 basis points from Q1 2018 and is now at 4.5 percent. The spike of recent pipeline deliveries has differently impacted vacancies in the downtown area of class A rental housing, which is at 6.5 percent average (with some projects reporting over 10 percent vacancy in the downtown area) – indicating that while overall demand for housing is still strong, there is an oversupply of top-of-the-market housing downtown. With a 6 percent increase in median household income in the last year, buying power has risen and many families are choosing to rent instead of buying a home – single-family home sales have fallen over 12 percent year-over-year.

In the wake of the Inclusionary Zoning permitting flood that saw mass delivery from early 2018, Q4 2018 and Q1 2019, this trend is the tailing off as new introductions are sharply reduced and the market cycle slows. In the last two years, deliveries have outpaced demand for market-rate housing but projections for 2019 have seen this over-delivery trend ending in aggregate despite the unmet need for affordable housing.

RENTAL RATES, COSTS

Rental rates in Portland continue to rise, up 3.3 percent since Q1 last year to an effective rental rate of \$1.54 / square foot. Total average rent for the Portland MSA is \$1,360, representing a year-over-year increase of 3.8 percent. Oregon passed a state-wide rent control act which will limit annual rental cost increases to 7 percent (plus inflation, which is 3.3 percent for 2019) which could contribute to a cap in overall project value for some, but current growth trends are well within this limit. A

FIGURE 1: ABSORPTION, COMPLETIONS



Colliers International Q1 2019 Multifamily Report

FIGURE 2: DELIVERIES AGAINST DEMAND



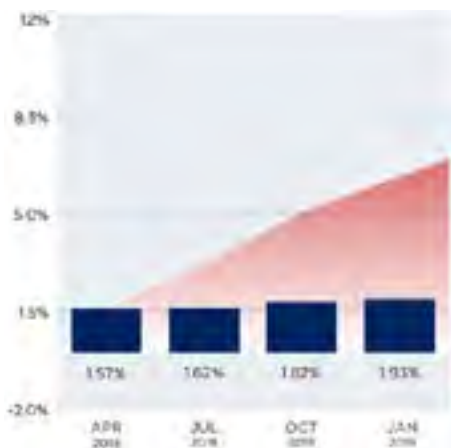
Berkshire Hathaway Q1 2019 Multifamily Report

FIGURE 3: OCCUPANCY TRENDS AND RENTAL RATES



Berkadia Q1 2019 Multifamily Report

FIGURE 4: PORTLAND CONSTRUCTION COST INDEX



Colliers International Q1 2019 Multifamily Report

FIGURE 5: NOTABLE SALES

Property Name	Buyer	Seller	# Units Built	Sold	\$ / SF	Sale Price
Trio Pointe	Goldman Sachs	Pahlich Homes	240	2017 Jan 29	\$232	\$58M
206 Apartments	Blackstone REIT	Praedium Group	203	2014 Feb 28	\$202	\$54M
Springville Oaks	Blackstone REIT	Praedium Group	112	2014 Feb 28	\$261	\$29.4M
Fernwood Apartments	S.A. Weilbach	Westland Investors	110	1991 Jan 4	\$181	\$17.6M
Westfal Apartments	Cooper St. Capital	OR Pacific Investment	56	1910 Jan 18	\$289	\$10M

Rider Levett Bucknall Q1 2019 Construction Cost Report

likely unintended consequence of this rent control act will be the incentive for owners to move projects closer to market over time, at the highest rate allowed. Many units are available to the market from property owners that have allowed their projects to trail well below market rates throughout this cycle. These owners will now have incentive to start moving closer to market if they want to capture the full value of their property at sale, as they will not be able to make this rental adjustment quickly.

Construction costs for multifamily housing are in the range of \$160-\$250 per square foot, which is over 7 percent greater in aggregate than costs year-over-year. Both material and labor costs have risen sharply over the last several years, boosting the replacement cost of units and the now restricted rent levels necessary to justify navigating these rising costs. Another possible factor in this steady rise in costs is the need for use of prevailing wage rate contractors in order to qualify for Portland's building incentives – increasing labor costs up to 30 percent in some projects.

SALES ACTIVITY

While the full effects of Inclusionary Zoning won't fully impact Portland's markets for some time to come, it will be important to observe market sales trends as final pre-IZ deliveries come on-line and rent increase caps punish owners with sub-market rental rates. Rising construction costs and increased costs associated with increased SDCs and IZ requirements have made new construction projects more difficult to underwrite, obscuring the health of the City of Portland's rental market to come. The small relief from rising rents attributable to the recent influx of supply and rent control may be short-lived, underrealized, or simply backfire.

04 //

Office Market Analysis

MELISSA MEAGHER
Portland State University

As we conclude the first quarter of 2019, office market fundamentals remain healthy nationally. According to Urban Land Institute's Real Estate Economic Forecast, the national unemployment rate sits at 3.8 percent with average job growth of 1.6 million per year through 2021. Leasing activity remains moderate and takes a slight dip in comparison to last quarter. Cushman and Wakefield's U.S. Office MarketBeat reports, "New leases for office space totaled 70.0 million square feet (msf) in the first quarter of 2019, down approximately 6.3% from the 74.7 msf of new leases in the fourth quarter of 2018." Some of the highest priced U.S. markets, especially those in the western region, bore the brunt of this slowdown with several companies looking for cheaper options.

MELISSA MEAGHER is a Master's of Real Estate Development candidate at Portland State University. Melissa specializes in innovative mixed-use projects, 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.

Office: Asking Rent by Market
Highest Priced U.S. Markets



Specifically, Oakland, San Diego, San Francisco, and Seattle, hit notable office rents per square foot, with averages of \$39.92, \$43.44, \$81.92, and \$40.21, respectively. With an average asking price of \$33.06 per square foot, Portland sits just above the national average of \$31.97 and continues to be the most competitive option in the west. Developers have quickly recognized this, many of them shifting from multifamily to office development, specifically, bullish development of flex space in Portland's Close-In Eastside as well as redevelopment in the North-west submarket. The strength of the office market and pressures on multifamily returns from Portland's recent implementation of the Inclusionary Housing Ordinance have certainly helped speed this transition.

With Portland's office market sending a message about its competitive rental prices of "catch them while you can" to companies and start-ups in the west, developers compete to find strategies that will make their spaces stand out from the rest. Adaptive reuse has increasingly drawn local developers' attention because of its ability to not only allow them to reach their highest and best use, but to also still carry Portland's authenticity forward. Anna Langley of Langley Investment Partners states, "I believe in Portland – and I believe that the Portland office market will thrive as long as we start thinking of creative ways to make projects competitive that also reflect the character of the community." Langley recently developed Redfox Commons, the only office redevelopment that delivered this quarter. The new 60,000 square foot space at the intersection of Northwest 27th and Northwest Wilson Street weaves together two World War II era warehouses and hints at Portland's industrial past with its design and preservation of the structure's original lumber. Completed earlier this year, the project stands out at the newest creative office space in Portland with opportunities abound. Langley insists, "It's time to be unique; we can't keep seeing the same ideas repeating; there are so many beautiful buildings ready for repurposing." With an increased number of adaptive reuse projects and renovations in the works, other developers have clearly taken note. As we move into the second quarter, it will be fascinating to see how the creative futures of former buildings are designed and how they may reconfigure the office market as a whole.

IMAGE 1: 2019 ASKING RENTS BY MARKET: HIGHEST PRICED U.S.

Brokerage	Total	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Colliers	10.2%	13.5%	13.0%	14.4%	13.0%	-
JLL	13.0%	14.5%	13.1%	17.0%	14.0%	-
Kidder Mathews	7.5%	11.2%	11.1%	10.4%	9.3%	6.1%
Newmark Knight Frank	10.7%	12.4%	-	-	-	-
CBRE	11.6%	12.8%	10.5%	10%	22.4%	10.4%

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

TABLE 2: AVERAGE DIRECT ASKING RATES
(\$/SF FSG) BY BROKERAGE HOUSE AND
CLASS, FIRST QUARTER, 2019

Brokerage	Market Average	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Newmark Knight Frank	\$29.44	\$33.43	\$36.82	\$32.00	-	-
Kidder Mathews	\$27.00	\$32.21	\$35.46	\$30.37	\$25.24	\$23.65
Colliers	\$27.31	\$32.95	\$36.39	\$30.87	\$25.79	-
CBRE	\$31.01	\$34.78	\$38.11	\$34.39	\$30.95	\$25.07
JLL	\$32.12	\$36.16	\$39.78	\$34.91	\$27.33	-

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

VACANCY & RENTAL RATES

Despite a significant amount of deliveries last quarter, vacancy rates this quarter remain static, showcasing Portland's strong demand for office space. Kidder Mathews reports, "Direct vacancy only rose by 50 basis points (bps) year-over-year...furthermore, despite the slight increase in vacancy, rental rates grew 4.23% year-over-year and are now higher than at any other time in the last 15 years."

Ongoing demand as well as class A developments have continued to push Portland's rental rates higher. According to CBRE's Econometric Advisors Forecast, "Portland's average asking lease rates will continue to increase gradually over the next five years as the market continues to grow and expand with new developments." The market's average rental rate among brokerage houses ranged from \$27.00 to \$32.12, while Portland's CBD was higher, ranging from \$32.21 to \$36.16.

**TABLE 3: NET ABSORPTION (IN SQUARE FEET)
BY BROKERAGE HOUSE AND MARKET AREA,
FIRST QUARTER 2019 AND PREVIOUS QUARTER**

Brokerage	Q1 Overall	Q1 Overall 2018	Q1 CBD	Q1 2018 CBD
JLL	99,248	(79,878)	17,720	(258,296)
Newmark Knight Frank	144,008	(209,365)	65,028	(102,120)

Source: JLL & Newmark Knight Frank

**IMAGES 2 & 3: THE DAIRY BUILDING –
ONGOING RENOVATIONS UNDERWAY**



Source: Costar and Intrinsic Ventures

**TABLE 4: NOTABLE LEASE TRANSACTIONS,
FIRST QUARTER 2019**

Tenant	Building/Address	Market	Square Feet
University of Western States	800 NE Tillamook	Olive Eastside	152,642
Squiers	District Office	SE Close-in	31,692
East West College of Healing Arts	1515 Market Square	CBD	30,307
Jacobs Engineering (Expansion)	Jacobs Center	CBD	24,521
PacificSource	Crown Plaza	CBD	24,021
6 Degrees Health	Five Oaks West—Credence	Sunset Corridor/Hillsboro	24,000

Source: CBRE & Newmark Knight Frank

ABSORPTION & LEASING

The first quarter of 2019 saw 99,248 square feet of positive net absorption, contrasting last quarter's 79,878 square feet of negative net absorption. Jerry Holdner, Director of Research at Kidder Mathews, noted:

Suburban markets as a whole saw far more net absorption than their downtown counterparts, with the Central Business District ending the quarter with 75,870 s.f. of negative net absorption. Downtown space is still considered prime real estate, so it is likely that net absorption will reach positive territory over the year.

As noted in last quarter's report, flex space has continued to pick up steam in the Portland office market. This is showcased in this quarter's lease transactions that include three flex space providers. The Dairy Building, located in the Southeast Close-In submarket, is an example of an adaptive reuse project catered to flex space tenants. The 46,503 square foot former Dairy Building has been renovated in the past couple of years and is now host to startups and tech tenants like Activity Connection, Nice Touch Corp, Intuitive Digital, Sproutbox Media, Blue Blazes, and Photos to Canvas. The Dairy Building includes a centrally located event space and common room for tenants to build relationships with each other as well as their clients. Riley Henderson of NAI Elliott, who represents developer/owner Mike Lindquist and Intrinsic Ventures, said "The tenants here are in a community; in a traditional space you don't sense that...now, you feel like you're in it."

**TABLE 5: NOTABLE SALES TRANSACTIONS,
FIRST QUARTER 2019**

Building/Address	Buyer	Seller	Market	Price	Price/SF
Heartline Building	Intercontinental Real Estate Corporation	Security Properties, Inc.	Northwest	\$48.5 M	\$672
Former Hanfield Pet Hospital	W.P. Carey, Inc.	Hanfield Pet Hospital	NE Close-in	\$25 M	\$164
Cornell West	Vista Investment Group, LLC	TA Realty	Sunset Corridor	\$22 M	\$189
Forum Building	Bersoffe Solutions, Inc.	East West College	Lloyd	\$17.5 M	\$116

Source: Colliers, Portland Business Journal

SALES TRANSACTIONS

A notable transaction to start the year included Security Properties' \$48.5 million sale of the Heartline Building to International Real Estate, Inc. for \$672 per square foot. This was higher than the per-square-foot high-water mark of Towne Storage at \$627 in 2018. In a recent press release, Nick Kucha, vice chair at Newmark Knight Frank, said, "The sale of Heartline is a testament to the strength and desirability of Portland's Pearl District, along with the quality of the asset."

The JLL research team also summarized Portland's sales trends:

Capital markets [in Portland] remain upbeat as well, with the quarter registering \$194 million in sales. This number is set to swell significantly with the sale of Montgomery Park at the end of the first quarter. As Portland's second-largest multi-tenant office building, expect to see the highest pricing for a single asset since US Bancorp Tower's sale in 2015.

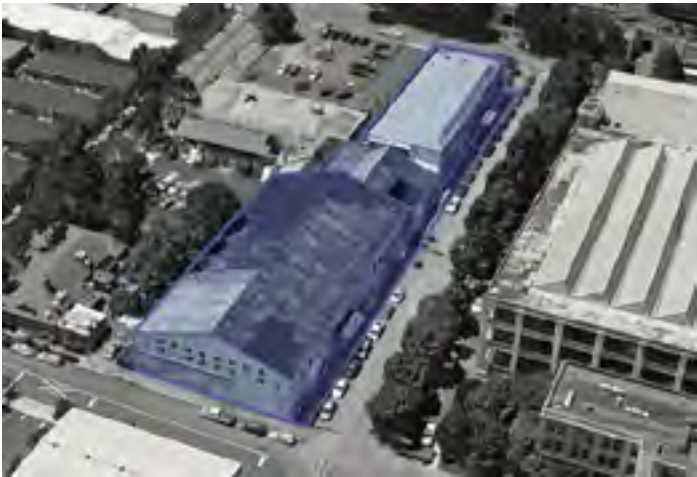
Field Office, the creative office development from project[^], also sold to Goldman Sachs and Lincoln Property Company in May. The "anti-office office" located on NW Front Avenue just north of the Fremont Bridge is a block size urban campus with 287,000 square feet. Anyeley Hallova of project[^] noted, "We wanted to redefine an office's relationship with nature." The firm developed a Flora Field Guide that describes the compilation of the 78 species of plants and trees located throughout the project. The guide notes, "Field Office was created around the notion of blurring the line between indoors and outdoors, work and play, commerce and creativity, architecture and landscape."

TABLE 6: NOTABLE DEVELOPMENT PROJECT DELIVERIES, FIRST QUARTER 2019

Building/Address	Developer/Owner	Market	SF	Delivery Date
Redfox Commons	L&L Investment Partners	NW Close-in	60,000	Q1 2019

Source: Colliers and CoStar

IMAGES 4, 5, & 6: REDFOX COMMONS – DELIVERED IN FIRST QUARTER 2019



Source: Lever Architecture

DELIVERIES AND CONSTRUCTION

According to Newmark Knight Frank, there are seven office buildings currently being renovated that total 529,813 square feet. For reference, two years ago, half of this amount was under renovation. Scott Miller, Research Analyst at NKF, states: “Many older office buildings located in prime locations are getting facelifts as landlords modernize spaces and provide more amenities that are in demand.” Additionally, developers are increasingly re-vamping manufacturing buildings to create different uses than were originally intended.

After four years of implementation, the Redfox Commons building was delivered earlier this year. According to Langley, flex space is intriguing because the design “depends on the culture of that particular business as well as their vision.” With Redfox Commons, she’s held back for the right tenant that may need a higher density buildout. “Tech tenants have changed,” she notes, “...each company now thinks about the ‘cost per employee’” in terms of the space’s use, sense of character, aesthetic compatibility with its brand, location, and affordability.

TABLE 7: NOTABLE RENOVATION/UNDER CONSTRUCTION PROJECTS, 2019 - 2021

Building/Address	Developer	Submarket	SF	Delivery Date
Nike North Expansion Building B	Gerding Edlen	Westside	1,003,585	Q1 2019
Block 29 Center for Health & Healing 250 Taylor	Oregon Health & Science University Third & Taylor Development LLC	Southwest	300,000	Q1 2018
The Canines at Prime Hooks	Security Properties & Urban Renaissance Group	Southwest	190,825	Q3 2020
Adidas Expansion	Adidas America	Hayden Island	140,000	Q2 2020
5 MLK Office	Gerding Edlen	Lloyd District	119,520	Q4 2019
District Office	Beam Development	Southwest	90,778	Q2 2019
7 SE Steak	Harsco Investments Properties	Lloyd District	70,000	Q2 2019
Premier Gear & Machine Works	Sturgeon Development Partners	Northwest	64,883	Q2 2020
Boscon Lake Oswego	TD Branch	Lake Oswego/West Linn	8,030	Q1 2020
Tree Farm	Guerrilla Development	SE Close-in	33,750	Q3 2020

Source: CoStar

IMAGE 7: PREMIER GEAR & MACHINE WORKS BUILDING – UNDER CONSTRUCTION



Source: LRS Architects

Located at 1715 NW 17th Avenue in the same submarket as Redfox Commons, the renovation of the existing Premier Gear & Machine Works Building is yet another example of an adaptive reuse in the works. Sturgeon Development Partners bought the property in July 2017 for \$6.75 million and hired LRS Architects to revamp four buildings that span an entire city block into creative office space. Julio Rocha with LRS stated in a recent article, “One of our primary goals is to take the disparate pieces of each building and unify them into a series of cohesive spaces.” The adaptation of the space desires to celebrate industrial roots by using most of the existing structure and elements. Listed for a triple net lease at \$32.00 per square foot, the project is set to be completed in 2020.

With any expansion or booming market, the triumph of a city’s authenticity is at stake. In the first quarter of 2019, what we have seen in Portland’s office market is healthy competition to restore elements of the city’s past in order to cater to the city’s future. Catch it while you can.

05 //

Industrial Market Analysis

MICHAEL LOWES
Portland State University

The industrial market in the Portland metropolitan area started off 2019 stable in the major categories - there was decreased vacancy, a slight uptick in lease rates, and net absorption was in the positive. CBRE Econometric Advisors forecasts 2019 to be a positive year for the industrial market, and for the major categories mentioned above to stay on track. One major shift expected from 2018 to 2019 is from build-to-suit projects leading the way to this year the expectation will be for more speculative developments. A major problem Portland metro area consistently faces in the industrial market is the scarcity of developable industrial zoned land. As a result, speculative developments will be a major key for tenant expansion. With the lack of land available the demand will remain high for projects and space.

Source: CBRE

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FIGURE 1: NET ABSORPTION COMPARISON



Source: CBRE

FIGURE 2: SUBMARKET BREAKDOWN

Submarket	Market Available (SF)	Percent (SF)	Vacancy Rate (%)	Avail. Rate (%)	Q1 2019 Net Absorption (SQF)	YTD Net Absorption (SQF)	Under Construction (SQF)	YTD Deliveries (SQF)
Total Figures								
Northeast	45,668,758	2,579,426	5.6	6.4	(371,227)	(371,227)	1,380,574	212,288
Northwest	28,529,774	1,075,118	3.7	3.6	(275,405)	(275,405)	17,000	0
Southwest	36,615,838	434,209	1.4	5.3	332,902	332,942	279,080	0
Southeast	58,338,569	1,197,862	2.0	0.5	88,267	88,267	267,486	(171,339)
Sunset	24,544,931	771,822	3.4	0.7	11,791	17,779	75,000	0
Clark County	23,888,694	578,134	2.4	0.8	89,371	89,371	348,731	0
Total	228,037,724	6,536,539	2.8	4.3	100,000	100,000	1,000,000	200,000

Source: CBRE

FIGURE 3: QUARTER OVER QUARTER TRENDS



Source: CBRE

ABSORPTION

2019 started off with modest though positive numbers in absorption. The quarter ended with 101,130 square feet of positive net absorption. This is significantly down from the past three quarters. New product in the Northeast and Southwest came online equaling 384,927 square feet of industrial assets - reflecting the completion of Columbia Industrial Park and Duck Delivery. There is still upwards of 2.0M square feet of industrial product currently under construction.

As you can see the year started off positive, but net absorption had been way up since the second quarter of 2018. The overall net absorption and that of business parks remains about the same. The local industrial markets are considered to be supply constrained with unusually low vacancy, and as a result net absorption has largely been limited to the introduction of new supply.

Net absorption during the first quarter in the Southeast submarket at 372,942 square feet, along with Clark County at 89,371 square feet and the Southwest with 88,267 square feet helped keep Portland in the positive for net absorption. Both the Northwest at negative 295,495 square feet and Northeast with negative 171,727 square feet struggled in terms of absorption during the quarter.

VACANCY

Vacancy rates dropped from 3.8% in the first quarter of 2018 to 3.2% during the same time in 2019 - and relatively stable from the end of 2018 to now. Continuing its strong start to the year the Southeast submarket saw the lowest vacancy rate in Portland at 1.4% with Sunset coming next, but a full percentage higher at 2.4%. The Northeast continued its slow start to the year with a 5.6% vacancy rate - a full 2.6% higher than the Southwest which was next at 3.0%.

The changes in these vacancy rates for year over year can be shown in the increase in leasing activity within these submarkets. Clark County saw a vacancy rate decrease of 220 basis points, with the Southeast and Northeast just behind at 130 basis points and 120 basis points each. The Northwest had a significant increase in vacancy rate of 1.0% since the beginning of 2018, although still only 3.6% overall.

Source: CBRE

RENTAL RATES

Per NGKF rental rates have continued to rise here at the start of 2019. Currently average shell rates are at \$0.72 per sq. ft NNN lease. Up from \$0.69 at the end of 2018 and \$0.66 this time last year. With vacancy rates continuing to stay low, asking rates have sustained their steady increase.

FIGURE 4: ASKING RENT AND VACANCY



Source: NGKF

NOTABLE LEASE TRANSACTIONS

Wymore Transfer Company / Clackamas, OR /
161,654 sq. ft.

CJ Logistics (Hankook Tires) / Portland, OR / 130,800 sq. ft.

Imperial Brown, Inc. / Hillsboro, OR / 113,144 sq. ft.

Source: CBRE and NGKF

NOTABLE SALES TRANSACTIONS

Colony Capital Transaction / Nationwide (54 total assets/5
in Portland) / \$1.16BN

Sunshine Dairy Foods Portfolio / NE/Columbia Corridor /
44,448 sq. ft. building & Adjacent Parcels on 1.2 acres
of land / \$8.1M

920 SE Stark / Southeast / 14,864 sq. ft. / \$5.8M

Source: CBRE and NGKF

Per Kidder Matthews, although very little leasing activity has taken place to start the year in this submarket, the Sunset Corridor/ Hillsboro leads the way in rental rates at \$1.05. Clark County on the other end of the spectrum had the lowest rates at \$0.54 with significant leasing activity. The most leasing activity was in the Northeast submarket and they saw rental rates right around \$0.61. As you would expect the smaller the size of the building the higher the rate and so on - with rates around \$1.00 for buildings up to 9,999 sq. ft. and \$.53 for building over 200,000 sq. ft.

Source: Kidder Matthews

WHAT TO KEEP AN EYE ON

As mentioned above, speculative development will be a major component of industrial development in 2019 in comparison to build to suits. Due to the lack of industrial zoned land, speculative development will help fit the majority of tenants vs. building assets that are meant for one single use. Lots of focus has been on a “new” sort of industrial product - shifting away from just ceiling heights and loading docks and bringing in more tech and robotics. Mark Childs of Capacity Commercial Group said, “robotics are going into buildings, but little of that impacts the shell”. Much of these new operational measures or features will be brought on by the tenant themselves. Some firms will have more difficulty fitting into existing shells, such as Amazon who utilizes 45-foot-high building with two levels of storage and mezzanines for a total of three levels within their structure.

Another main reason build to suit may be lessening this year is due to the niche needs for some clients and the impact that can have for the building on the secondary market. Mr. Childs said, “most build to suits for users are for manufacturing companies that need specialty items - floor drains, bridge cranes, electrical, unique building configuration/height/office, etc.”. Developing an asset with such distinct features for certain companies can lead to some problems. “Most add little value, some can detract. While one user can over build a parcel (more than 50% site coverage) and make it work for them, sometimes part of the building needs to be torn down to make the site more generic and usable by a greater percentage of the market”. Based on Mark’s comments above, this is a significant reason developers, with the little industrial land accessible, want to keep buildings more generic. This way they can build product that appeals to a higher percentage of users. As tenants grow, and the lack of product and usable land stays minimal brokers need to get creative to solve the ongoing problem of - where to next? “You relieve constraints until you find what they want - geography, price, size, new vs. used”. Sacrifices may have to be made as Portland continues to struggle with industrial inventory. But as the sector continues to grow and our city continues to expand there surely will be some creative solutions that will need to take place.

Source: Interview with Mark Childs of Capacity Commercial Group

Retail Market Analysis

MICHAEL LOWES
Portland State University

The retail market continued to stay strong through the beginning of the new year. As many still wonder when the eventual apocalypse will come, retail properties still continue to be sold, availability continues to shrink, and lease rates continue to rise. Net absorption was in the negative this quarter, much of that was due to the large amount of move ins that ended 2018. From 2018 to 2019 leasing activity is about on par, but in comparison to last quarter there was a steep drop of over 24% - though still having 144 transactions totaling 426,589 square feet. The year over year vacancy rate has dropped, but stays the same from last quarter at around 3.0%. New construction is expected to deliver around 200,00 square feet of product in 2019.

Much of the strength of retail in Portland can be linked back to the continued growth of the metro area - population and jobs alike. Portland's retail sector has remained pretty constant, which isn't true for everywhere else. A key factor may be the lack of a sales tax in the Oregon portion of the metropolitan area, making it more appealing vis-a-vis Washington for retail sales.

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FIGURE 1: SUBMARKET BREAKDOWN

Submarket Breakdown

Submarket	Total Transactions	Grand Transaction Value	Total Transaction Price	Total Transaction Price	% of Total Absorption	Q1 2019 Absorption	Q2 2019 Absorption	Q3 2019 Absorption	Q4 2019 Absorption	Total Absorption
Overall	2,875,802	\$1,585,340	\$1,585,340	\$1,585,340	100.0%	44,285	48,224	54,538	55,428	202,475
Single Tenant	1,517,134	\$1,484,111	\$1,484,111	\$1,484,111	52.7%	27,485	30,295	34,815	34,815	127,410
Multi-Tenant	1,358,668	\$1,101,229	\$1,101,229	\$1,101,229	47.3%	16,800	17,929	19,723	20,613	75,065
Shopping Centers / Retail	1,139,832	\$1,101,229	\$1,101,229	\$1,101,229	40.8%	11,415	12,415	13,415	14,415	51,660
Power Centers	20,000	\$1,101,229	\$1,101,229	\$1,101,229	0.7%	1,415	1,415	1,415	1,415	5,660
Office	10,000	\$1,101,229	\$1,101,229	\$1,101,229	0.3%	700	700	700	700	2,800
Industrial	10,000	\$1,101,229	\$1,101,229	\$1,101,229	0.3%	700	700	700	700	2,800
Healthcare	10,000	\$1,101,229	\$1,101,229	\$1,101,229	0.3%	700	700	700	700	2,800
Education	10,000	\$1,101,229	\$1,101,229	\$1,101,229	0.3%	700	700	700	700	2,800
Government / Non-Profit	10,000	\$1,101,229	\$1,101,229	\$1,101,229	0.3%	700	700	700	700	2,800
Portland Total	1,517,134	\$1,484,111	\$1,484,111	\$1,484,111	52.7%	27,485	30,295	34,815	34,815	127,410

Source: Kidder Mathews

FIGURE 2: QUARTER OVER QUARTER TRENDS

Market Breakdown

	1Q19	4Q18
Direct Vacancy Rate	3.00%	3.00%
Availability Rate	4.00%	4.40%
Asking Lease Rate	\$19.20	\$19.11
Leased SF	426,589	565,176
Sold SF	840,864	1,223,550

Source: Kidder Mathews

FIGURE 3: PRODUCT TYPE TRENDS

Multi	4,384,022	2.84%	2.84%	2.84%	12.08%	10.84%	1.84%	19.84%	\$20.15
Shopping Centers	1,274,714	2.84%	2.84%	2.84%	11.07%	10.84%	1.84%	19.84%	\$20.15
Shopping Centers	1,274,714	2.84%	2.84%	2.84%	11.07%	10.84%	1.84%	19.84%	\$20.15
Specialty	1,274,714	2.84%	2.84%	2.84%	11.07%	10.84%	1.84%	19.84%	\$20.15
Office / Retail	1,274,714	2.84%	2.84%	2.84%	11.07%	10.84%	1.84%	19.84%	\$20.15

Source: Kidder Mathews

ABSORPTION

At the end of 2018 we saw consistent positive net absorption in the local retail markets, a trend that came to an end at the beginning of 2019. Overall it was a relatively lackluster quarter in terms of absorption, but the Central Business District and the Lloyd District helped to keep that number from dipping any lower.

The I-5 Corridor, Northeast, and Southeast really struggled to start the year. The I-5 Corridor and Southeast had strong overall years in 2018, so it will be interesting to see if they rebound in the quarters to come. Overall Portland as a whole saw the year start in the red, this is of concern considering the strong end of year numbers in total net absorption.

VACANCY

Vacancy rates in the retail market from the end of 2018 through the first quarter of 2019 are stable at 3.0%. Vacancy rates in the sought-after Northwest district are the lowest of all the submarkets at 1.5% and the Lloyd District was right behind at 1.6%. The I-5 Corridor has the highest vacancy rate of the submarkets at 3.6%, which would make sense given its drastic change in net absorption as well. With none of the submarkets reporting vacancy levels in excess of 5.0%, we would consider all of them to be supply constrained in aggregate with respect to retail space.

Shopping Centers starting the year off incredibly strong with 185,102 square feet of leasing activity already - Centers had a total of 309,807 in all of 2018. Specialty Retail struggled to start off the year with little to no leasing activity and the highest vacancy rate at 5.4%.

RENTAL RATES

Average leasing rates continue to climb in in the first quarter up to \$19.20 vs. \$19.11 to close out 2018. Portland's CBD and Northwest district led the way on average in terms of rental rates - \$25.48 and \$24.83 respectively. Both these districts can thank their lack of inventory to help drive up their rental rates. Southeast has the lowest rates at \$17.47, but also has the most inventory in all of Portland.

Malls and Power Centers led the way for product type rental rates, both at about \$23.17. Shopping Centers are coming in at \$18.55. Just like the above-mentioned districts, product types with tight inventory demonstrated pricing power through escalating lease rates.

The biggest shift in cap rates so far have been in the Grocery/Power Center sector - though there have only been 4 sales thus far the average cap rate sits at 6.84% in comparison to 6.30% in 2018. Strip Centers cap rates have come down a bit to 6.73% against 6.81% in 2018 - so far there have been 31 such sales in the first quarter. Single Tenant cap rates still remain extremely strong at 5.84%, rising just a bit from 5.80% in 2018 - based on the 33 sales this year. Though still very early it's clear that no extreme shift in retail investment sales has occurred, and the assets still remain strong.

NOTABLE SALES IN THE RETAIL SPACE

Cascade Station	Portland, OR	MetLife	\$140M	6.97%	399,055sf	Best Buy, HomeGoods, and Ross
Gresham Village Shopping Center	Gresham, OR	Quattro Development	\$9.535M	4.76%	241,322sf	Starbucks and Outback Steakhouse
Terry Lane Retail Center	Grants Pass, OR	Private Investor	\$5.6M	6.15%	10,199sf	MOD Pizza, Aspen Dental, Jersey Mikes, and Batteries + Bulbs

Source: Capital Pacific

WHAT TO KEEP AN EYE ON

The shift in Big Box Retail. As many believe the retail apocalypse still looms it can be seen clearly in the changing of Big Box stores. We've seen the departure of Toys "R" Us, Sears, and Shopko, to name a few, but it's those that are still hanging on that will need to make changes to survive. A popular phrase spoken more than ever in the retail industry is "right-sized" in terms of a retail space. One such retailer that has done this well in comparison to their competition would be Pacific NW based pet supply chain Mud Bay. With 17 Oregon locations, and 6 more slated to open this year, their footprint on average is 5,200 square feet. Fortunately for Mud Bay their competitors have not adapted as well. Brands like Petco and PetSmart, which occupy on average 14,500 square feet and 25,000 square feet per store respectively, were both recently downgraded in their credit ratings by the S&P for negative outlook. Mud Bay has seen their store count grow as they have been able to operate out of a smaller space. This makes the asset more appealing to potential investors as well, considering the lack of risk in the smaller box and not having to worry about potential back-fill of struggling brands in large footprints.

Pharmacy type assets have made strides to create more profit boosting tools within their spaces. As Amazon continues its dominance in all things retail, as well as the pharmaceutical industry, companies have needed to get creative on how to compete. CVS has their MinuteClinic which offers certain services normally done by a patients' primary care doctor, and now Walgreens is joining them. The goal is not to replace one's normal doctor, but rather be a service for those who need attention not during the normal 9am - 5pm physician schedule. Erik Gordan, a professor at the University of Michigan's Ross School of Business said, "the pharmacies need new profit centers and they need to add services that will draw customers to their stores instead of to Walmart or online sellers". These services will actually get customers inside the pharmacies for services that they need. A current trend that has been seen is that Millennials are hesitant to pick a primary doctor, as they have the mindset that they will get care when they need it, and don't need to establish it before then - a distinct advantage for these new services.

Source: *Why More People Are Using CVS, Walgreens Instead of Family Doctor* - Detroit Free Press

Beyond just doctor's services Walgreens and CVS are tapping into the dental industry as well. Six CVS locations are now offering in store SmileDirectClub services for invisible braces. Walgreens has done the same with a Florida location adding in an Aspen Dental office. Another tool these two brands are utilizing to attract and retain their customer base. The competition with Amazon rages on, and new tactics will be popping up every day on how to combat them.

Source: *Don't Just Buy Toothpaste at CVS, Walgreens. Get Your Dental Care in Stores Too* - Fortune