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economic analysis

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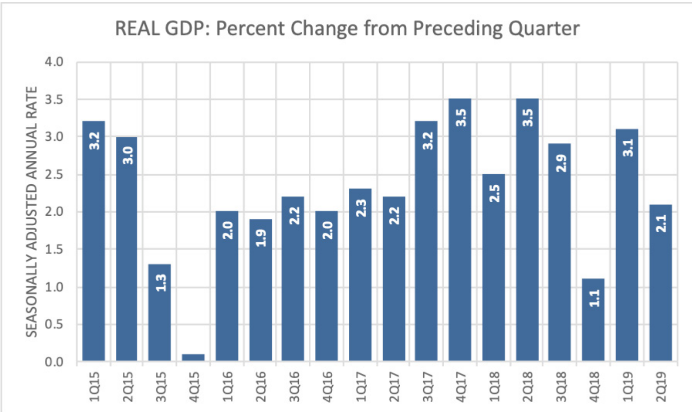
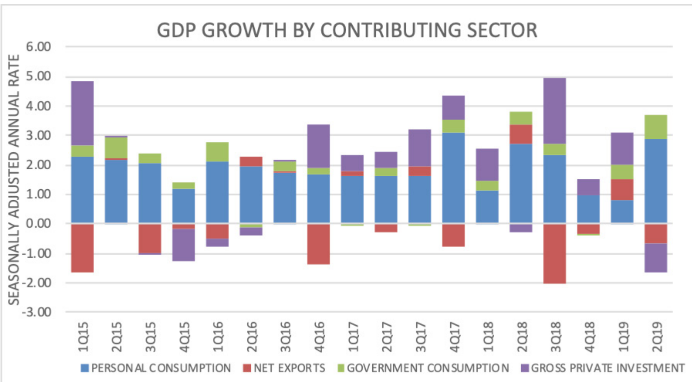


U.S. Bureau of Economic Analysis



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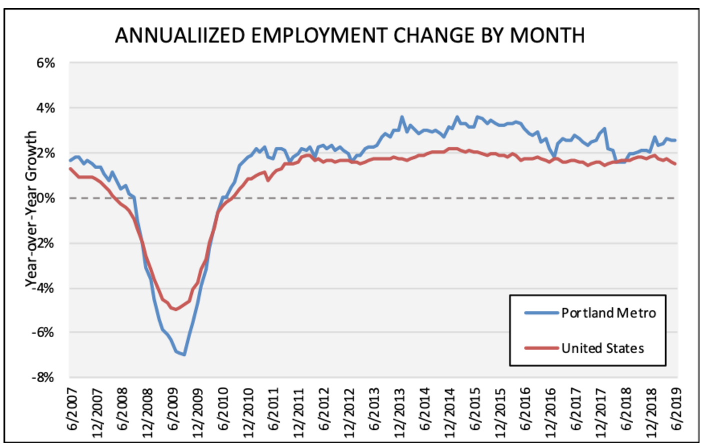
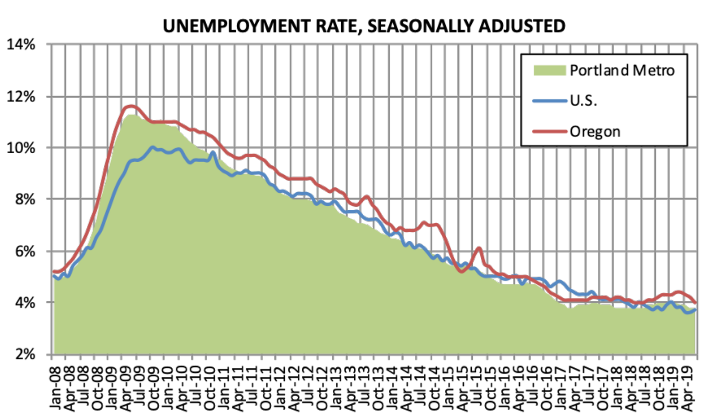


CES Employment, State of Oregon and BLS



Local Area Unemployment Statistics (LAUS)

The current expansion slowed moderately during the second quarter of 2019, with Gross Domestic Product (GDP) expanding at an annualized rate of 2.1%.

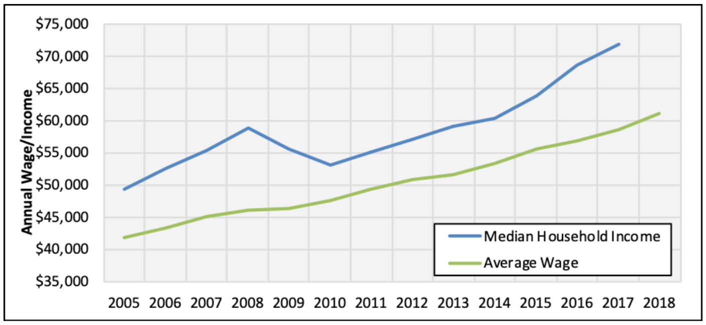
Personal and government consumption showed strong growth, which was offset by declines in net exports and private investment during the quarter. Consumer spending has been supported by gains in employment, real wages, and household wealth. Capital spending is expected to slow as the expansion matures, with delay in deliveries of Boeing's 737 Max showing up in reduced investments and exports. Price inflation is expected to remain modest due to slowing global growth, restrained commodity prices, and a strong dollar.

The four-county Portland Metro Area is currently adding roughly 30,000 new jobs per year. This represents a year-over-year growth rate of 2.6% – well above the national rate of 1.6%. The region has been outperforming the remainder of the nation during much of the recovery, largely due to a thriving tech sector and strong in-migration. However, an increasingly tight labor market has limited job growth in recent years.

The deceleration in the growth rate began to take effect as the regional unemployment rate dipped below 5.0%, affecting virtually all industries (healthcare being a notable exception). The unemployment rate has since fallen to 3.9% - well below the "natural rate" of 4.7-5.8%, which according to the Federal Reserve characterizes a healthy economy. A tight labor market reduces access to labor directly, and secondarily limits the growth in consumption, which in turn reduces the need for new hiring. The growth made a temporary bounce in mid-2018, likely reflecting an increase in available labor due to new graduates and summer migration.

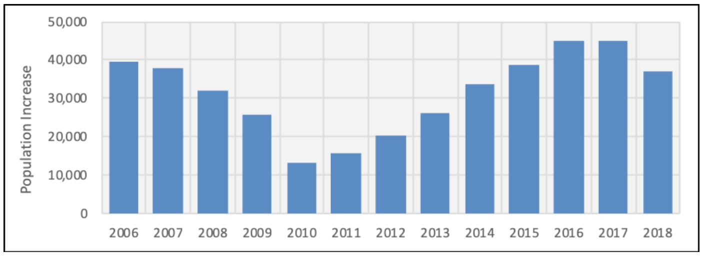
Wages in the Portland Metro Area have grown at a healthy rate since the recession and averaged $61,000 as of 4Q18. The average annual increase in the wage level since 2009 is 2.7%, which is high in a national context, reflecting growth in high-wage tech and business management jobs. The annual wage growth accelerated to 4% in 2015, the largest since pre-recession numbers, and has remained high at 3.4% and 4% for 2017 and 2018 respectively. This demonstrates that employers are increasingly forced to raise wages to attract workers.

AVERAGE ANNUAL WAGE AND MEDIAN HOUSEHOLD INCOME, PORTLAND METRO AREA (2005-18)



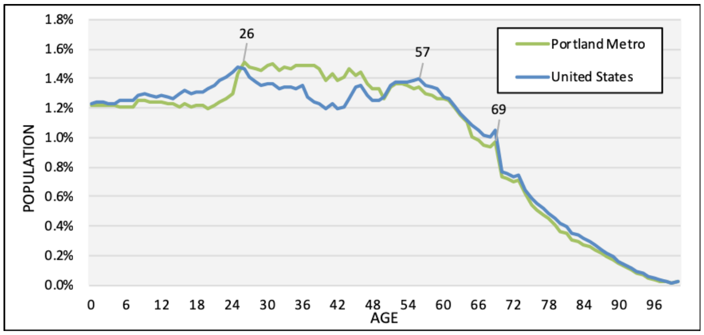
Oregon Employment Department, U.S. Census Bureau, JOHNSON ECONOMICS

ANNUAL POPULATION GROWTH, PORTLAND METRO AREA (2006 – 2018)

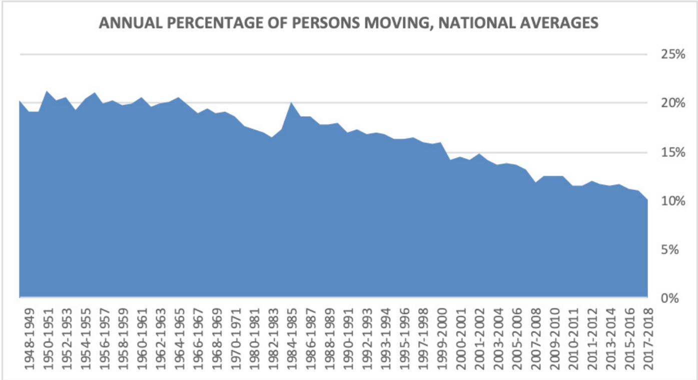


U.S. Census Bureau, JOHNSON ECONOMICS

POPULATION DISTRIBUTION, PORTLAND METRO AREA AND UNITED STATES (2016)



PSU NERC, U. S. Census Bureau, JOHNSON ECONOMICS



U.S. Census Bureau, Current Population Survey

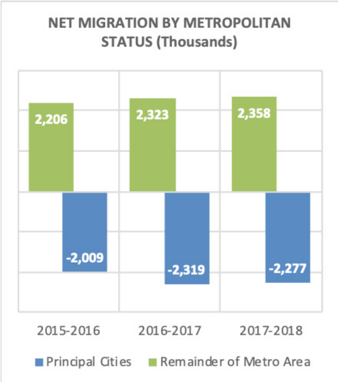
Household incomes declined rapidly as jobs were cut between 2008 and 2010 but rose at a robust annual rate around 3.0% in the three following years due to rising employment and wage levels, combined with household compression. The annual growth peaked at 7.6% in 2016 and decelerated to 4.7% in 2017 as increasing housing supply allowed for an increase in new single-income households. As of 2017, the median income level was $72,00 in the seven-county Metro Area. At this level, the typical household earns $18,900 more per year than in 2010 (+36%).

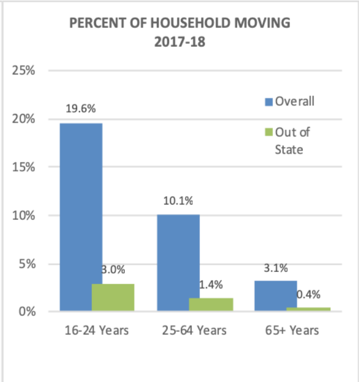
After accelerated growth during the first part of the current economic expansion, population growth in the seven-county Portland Metro Area topped out in 2016 with an added 45,000 individuals. Growth slowed to 37,500 in 2018 - still well above pre-recession levels. At an average household size of 2.60 (2017), this should translate into household formation of around 14,500 units per year, assuming adequate housing supply. Current household growth is weighted to smaller households without children, which likely translates into housing demand closer to 20,000 units per year.

The population distribution in the Portland Metro Area differs from the national distribution. The local population is somewhat younger overall, but with a smaller share of college-age residents and a larger working-age population. This twist is a result of relatively few universities located within the region, but a large tech sector that attracts young workers. As illustrated in the following chart, that there are relatively few millennials at the typical "move-out" age of 18-22 within the region. Estimates from the Census Bureau indicates even fewer younger millennials. The crest of the millennial wave was 26 years old in 2016, and is turning 29 in 2019.

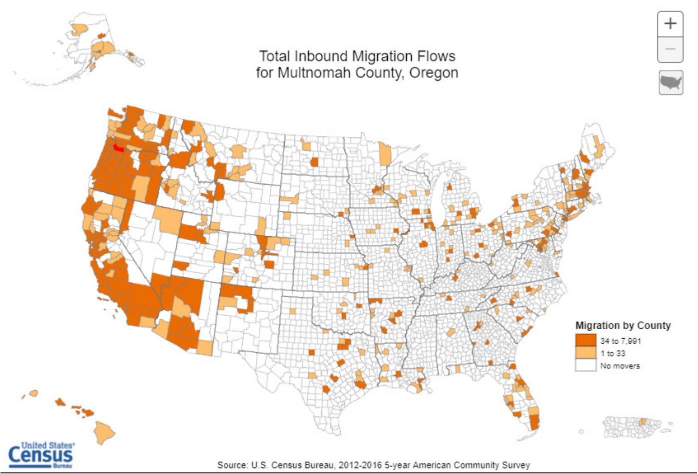
A key takeaway from this pattern is that the Portland metro area to a large extent imports a significant share of its millennials, many of whom are born and educated outside of the metro area. The local economy is heavily reliant on this ongoing migration for labor supply to support expansion with the local unemployment rate at a historically low. As a result, the local economy is vulnerable to marginal declines in the rate of migration.

The rate of migration within the United States has been dropping steadily, with only 10.1% of persons nationally moving their residence between 2017 and 2018. During that period, only 1.5% moved out of state.





U.S. Census Bureau, Current Population Survey



As household age they are significantly less likely to relocate, with the overall average rate declining from 19.6% of persons aged 16 – 24 to 10.1% for persons 25-64 and 3.1% for persons 65 and over. The general aging of the population plays a significant role in the declining rate of domestic migration within the United States. Migration trends nationally have also shown a significant move from principal cities to suburban jurisdictions within metropolitan areas.

For the Portland Metro Area, major sources of recent in-migration included more rural areas of the State of Oregon, as well as California, Washington, Idaho, Montana, and Arizona.

A recent study completed by the International Monetary Fund has linked declining mobility to rising income and home price inequality. While migration typically flowed from less to more prosperous areas, the relative rise of home prices and incomes in the prosperous areas has significantly outpaced the origin locations, discouraging worker migration out of economically challenged areas. Conversely, residents nearing retirement age have strong motivation to move from higher priced areas to more affordable locations.

The Portland Metro Area's ability to continue to attract migrants will be critical to sustain the current expansion cycle, as well as have a substantial impact on the character and magnitude of residential demand.

02 //

single family home

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Figure 1

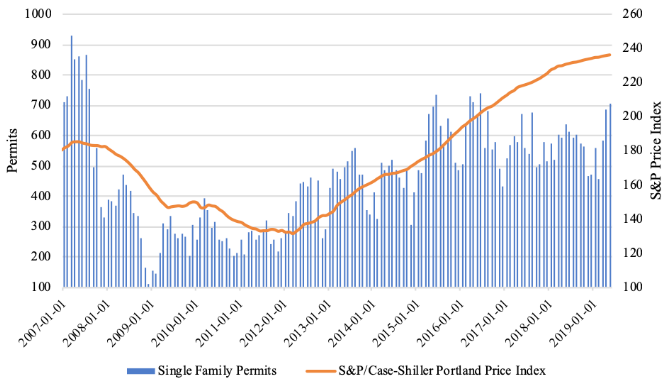
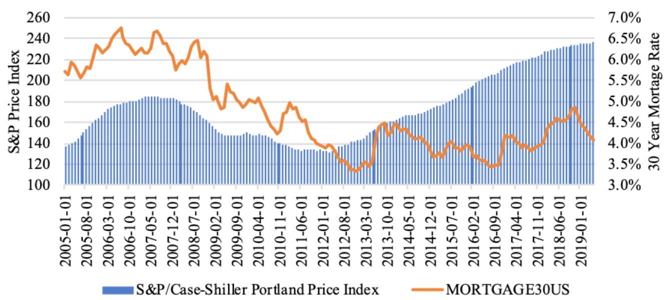


Figure 2



The Portland MSA has seen a massive rise in population in recent years. Since 2010, the U.S. Census Bureau's American Community Survey estimated that the Portland MSA has seen a 12.24% increase in total population (Open Data). While Portland has experienced an influx of residents in recent years who have been priced out of more expensive markets, notably San Francisco and Los Angles (Eisen, 2019), it has failed to meet rising housing demand with construction of traditional single-family homes.

When comparing the average permits issued in the MSA pre-financial crisis of 2007 versus the post crisis to July of this year, average monthly permits issued have fallen by 50.38% (FRED). This has begun to show signs of single-family housing undersupply relative to the rising housing demand brought on by the rise of secondary cities like Portland.

Further support of this undersupply is reflected in homeownership trends. When observing homeownership rates since 2000 at their lowest trough, overall ownership rates fell 5.09% within the MSA (U.S. Department of Housing and Urban Development, 2016). This is an interesting trend given the reduction in financing costs for traditional single-family homes. Mortgage rates for Americans have relatively decreased by 46.47% from June 2006 when comparing to today (FRED). Homeownership rates have not reflected this trend, with Millennials having the lowest homeownership of any previous generation (CNBC, 2019). Low homeownership rates are driven by a plethora of factors including rising home prices, wage stagnation, preference for urban environments, and many more factors.

This undersupply has resulted in rising home prices. S&P/Case-Shiller price index has estimated homes prices have seen a 45.55% increase in value within the MSA since 2014 (FRED). Value appreciation certainly is a byproduct of the market becoming a seller's market given the imbalances of demand and supply in recent years.

This trend however has started to reverse in the last year. Year to date, value has appreciated by only 0.65% and 2.65% year over year (FRED). This has signaled a slowdown in price appreciation. There a several factors that may be able to provide clarity on these trends. Home building permits since 2018 to July of 2019 have begun to rise towards pre-crisis levels, but still are still 36.66% lower (FRED). Additionally, home buyers are beginning to show concern about the looming recession. Forbes estimates more than a third of home buyers nationally think a recession is coming soon (Chamoff, August 2019). The prevalence of a recession in the mind of buyers makes them hesitant to pay higher price tags for homes. Rising supply with hesitant buyers would certainly begin to adjust a previous seller favored market into a neutral, if not a buyer's market.

In conclusion, Portland has seen massive growth in population in the last few years; however, the home builder market within the MSA has failed to match this growth even in the face of favorable conditions, such as lower mortgage rates. While homebuilders have began to reenter the market, rising concerns over the next recession may soon reverse this trend furthering market shortages.

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03 //

multi-family residential report

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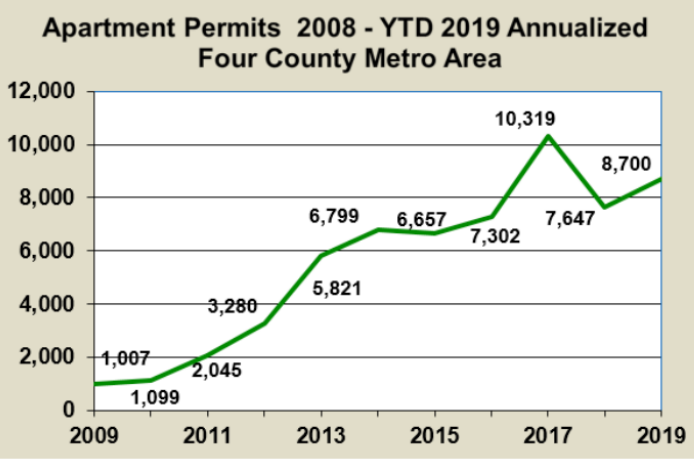
Portland's multifamily housing market has been bolstered somewhat by falling interest rates following the Fed's decision to lower interest rates by one quarter point, the first occurrence of this since the 2008 crisis.

The strong economic conditions that Portland has come to enjoy are still very much in play with unemployment rates as low as 3.8 percent, however many economists are of the opinion that this trend is a plateau. The heavy permitting for apartments left over from the pre-IZ rush is still providing stable deliveries, though new permitting is down for IZ-compliant projects going forward, prompting lawmakers to consider redefining the conditions of this regulation. Ever rising construction costs continue to challenge Portland's development efforts, further exacerbating future development efforts and foreign investment incentives.

SUPPLY, PERMITTING

Supply of new construction housing has continued with current trends, with nearly 900 units delivered in the downtown area and 1,733 units in the overall Portland MSA. The majority of new deliveries are 1-bedroom/studio (74 percent) in the downtown area as compared to 47 percent of surrounding suburban deliveries being 2-bedroom units. New permitting under IZ regulations is beginning to show signs of life with 70 percent of permits MSA-wide being issued in the downtown metro area, though these regulations have depressed permitting trends as developers and investors struggle to come to terms with changing economics of development and underwriting strategies. The trend of new permits appears to resume the steady demand characteristics of an undersupplied housing market, which Portland's ongoing housing crisis will continue to display for the foreseeable future.

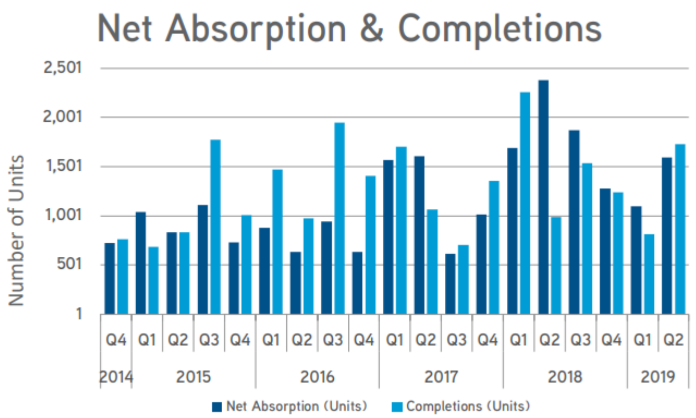


The City of Portland has recognized the disruption in housing development denoted in the graph to the right just before the 2017 mark caused by the new regulations and is reportedly considering making changes in this problematic policy to facilitate further new construction. Pre-IZ under-construction projects will continue to occupy the contracting labor force for another year, with 2,821 units still in the construction pipeline in the downtown area alone.

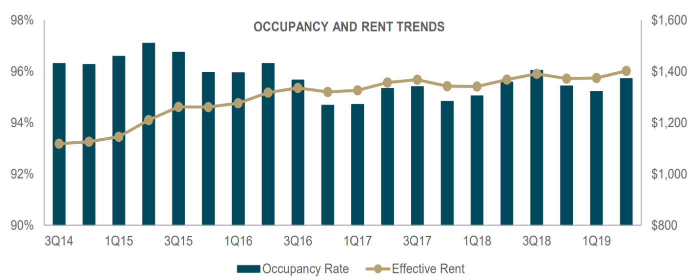
DEMAND, ABSORPTION

Portland's employment figures continue to lend confidence to developers and investors for the time being, with unemployment at 3.8 percent and the addition of over 30,000 jobs year-over-year. However, economists are predicting this trend to subside toward lower incomes and employment growth rates in the forecast for Q3 and Q4 of 2019, and into 2020 – down to 21,000 jobs added to the Portland MSA in 2020 accompanied by a 5 percent income increase.

Quarter 2 of 2019 has provided the first instance of deliveries outpacing demand absorption since Q1 of 2018, perhaps indicating that Portland's delivery pipeline is reaching the end of an economic investment cycle.



Colliers International Q2 2019 Multifamily Report



Berkadia Portland 2019 Q2 Multifamily Report

Property Name	Buyer	Seller	# Units	Built	Sold	$ / SF	Sale Price
Montessa	Dan O'Neill	Civitas Development	49	2015	May 30	$346	$14M
Sunnyside Belmont	Back Nine Apartment Investors	Green Light Development	63	2018	June 6	$323	$16.3M
Stevens Creek Apartments	T Barry Brenneke Co	Summit Realty Group	140	2018	May 1	$291	$38.3M
Sienna Lofts	Street Properties	Pathfinder Partners	75	2004	May 15	$250	$14M
Green Leaf Uptown	Green Leaf Capital Partners	Cascadia Development Partners	167	2018	May 23	$242	$57M
Icon Beaverton Apartments	Dragon Fountain	Trion Properties	61	1968	June 6	$226	$10.7M
The Pointe	Vista Investment Group	Green Leaf Partners	387	1994	June 24	$202	$68.8M

FIGURE 4: NOTABLE Q2 SALES
Colliers International, Barry Apartment Report

RENTAL RATES

Rental rates on average across the Portland MSA have risen 2.5% year-over-year, with median rent of $1,400/month. At $1.58/SF, this represents a decrease in growth rate of 80 basis points from the first quarter of this year – an indicator of a maturing market. Occupancy rates continue to indicate room to run for new deliveries, hovering at nearly 96% on average across the MSA.

Suburban markets downtown-adjacent are reporting slightly lower vacancy rates as compared to downtown proper – indicating that stronger leasing conditions exist outside of Multnomah County. As rental rates begin to plateau in a softening market and vacancy tightening under 5%, Portland's multifamily housing market may be due for an adjustment period to account for strict regulatory conditions and outside investment trepidation. Sales cap rates have followed accordingly, having leveled off over the last quarters of 2018 and into the first quarters of 2019 at about 5.4 percent, and have indeed begun to rise with an increase of 10 basis points as of this quarter. Rising construction costs and cap rates will be challenging for new development in the short-term, and likely inflationary in the long run.

Thanks to low interest rates in the second quarter, Portland's multifamily housing market has weathered another period without significant decline. This trend appears to be leveling off, as the effects of changing rent-control legislature begins to upset investor confidence in the Portland housing marketplace. Larger economic trends like population increase and job growth aren't enjoying the same pace of increase – 2019 representing the slowest growth rate in the last five years across these metrics. Rent control policies and Inclusionary Housing Zoning have still yet to make their full impact known as Portland continues to absorb the pre-IZ deliveries, but the overall trends of a softening multifamily market with sales volume decreased 40% year-to-date indicates that the City of Portland is beginning a downturn in multi-family residential investment activity.

04 //

office market analysis

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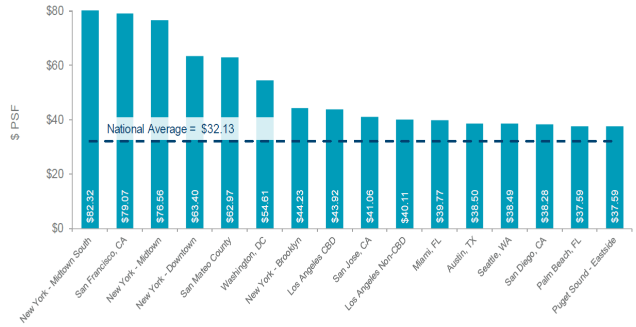
OFFICE MARKET AVERAGE RENT LEVELS



Source: Cushman & Wakefield Research

Brokerage	Total	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
CBRE	11.8%	13.5%	11.8%	10.4%	23.5%	10.4%
Colliers	10.3%	14.0%	13.7%	14.0%	15.3%	-
JLL	12.3%	13.8%	12.9%	15.1%	14.5%	
Kidder Mathews	7.50%	11.3%	10.6%	-	`	6.10%
Newmark Knight Frank	10.6%	12.3%				

TABLE 1 - TOTAL VACANCY RATES BY BROKERAGE HOUSE AND CLASS, SECOND QUARTER 2019

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

Brokerage	Market Average	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
CBRE	$30.98	$34.89	$38.36	$34.19	$30.06	$25.09
Colliers	$27.90	$33.20	$37.38	$30.77	$26.15	-
JLL	$32.38	$36.44	$39.78	$34.79	$27.38	-
Kidder Mathews	$27.49	$32.43	$32.28	$29.11	-	$24.06
Newmark Knight Frank	$30.14	$33.95	$37.22	$32.28	-	-

TABLE 2 - AVERAGE DIRECT ASKING RATES ($/SF/YR) FSG AVERAGE BY BROKERAGE HOUSE AND CLASS, SECOND QUARTER, 2019

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

In continuation of the last three years trend, the office market remains stable and healthy in the second quarter of 2019.

Demand continues to be strong supported by solid job growth. The national vacancy rate escalation is at 13 percent. The office market produced enough supply to meet the demand while market conditions remained tight enough to support rent escalation. Rent continues to trend upwards. At the close of the second quarter, the national average asking rent was a record high- up 4.4% from a year ago. The Portland Office Market continued to be robust across all market fundamentals in the second quarter. The quarter was characterized by lower vacancy and higher absorption, rental rate and no construction deliveries.

There is a continuing pattern of rent and sales growth both nationally and in the Portland market. According to Kidder Matthews, the preference for suburban office property over downtown property is a trend worth keeping an eye on. CoStar has also noted that Downtown's office vacancy rate spiked more than 2% in 2018 and now stands at 11.3%, well above its historical average of 9.6%, impacted by several large move-outs and the delivery of nearly half a million square feet of speculative space. Despite the rising vacancy downtown, Portland is experiencing exceptionally high rent growth. CoStar reports that among the 40 U.S. metropolitan regions with at least two million residents, only six others are seeing similarly high year-over-year pricing growth for office space – including Austin, Texas; Nashville, Tennessee and Orlando, Florida.

VACANCY & RENTAL RATES

Investment in Portland office property rebounded nicely in the second quarter of 2019 and pushed the average price per square foot to a new all-time high according to Kidder Mathews second quarter report. The report shows direct vacancy rates experienced a 10 basis point drop quarter-over-quarter, 2Q 2019 mirrored 2Q 2018's vacancy rate of 7.1 in a continuing trend from the last quarter but slowing in pace. The downtown office market showed stable vacancy rates, higher deliveries and significantly higher rental rates. The suburban office market continued drop in vacancy. It recorded a fifth consecutive quarterly decline.

Ongoing demand as well as an influx of Class A developments have continued to push Portland's lease rates. CBRE's Econometric Advisors forecasts that Portland's asking lease rates will continue to increase over the next five years by 13.8%, reaching $35.00 per sq. ft. by 2024. Downtown submarkets are predicted to show more

Brokerage	Q2 Overall	YTD total net absorption	Q2 CBD	YTD total net absorption CBD
JLL	327,211	428,964	87,542	112,311
Newmark Knight Frank	21,758	153,791	(17,779)	(162,123)

TABLE 3 - NET ABSORPTION (IN SQUARE FEET) BY BROKERAGE HOUSE AND MARKET AREA, SECOND QUARTER 2019 AND YTD
JLL & Newmark Knight Frank

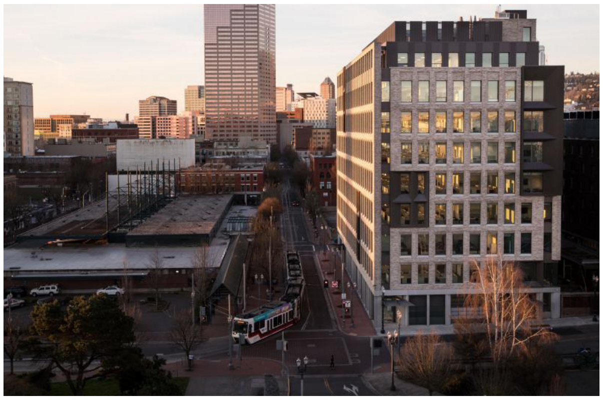


IMAGE 1 – GLADYS MCCOY BUILDING

Tenant	Building/Location	Submarket	Transaction Size (SF)
Sigma Design, Inc	18110 SE 34th St, Cascade Park	Suburb	90,000
WeWork, Flexible Space Tenant	830 Oregon Square	Lloyd District	55,395
New Relic	US Bancorp Tower	CBD	40,000
Education Northwest	Vestas	CBD	34,000
Skanska	1010 NW Flanders	CBD	21,000
Bullivant Houser Bailey	Umpqua Bank Plaza	CBD	17,000

TABLE 4 - NOTABLE LEASE TRANSACTIONS, SECOND QUARTER 2019
JLL, CBRE & Newmark Knight Frank, Kidder Mathews

IMAGE 2 - 830 OREGON SQUARE
The Oregon Square project will be WeWork's first space offering on the Eastside

robust 4.7% average annual increase while the suburban submarkets show a modest 1.4% increase.

The market's average lease rate among brokerage houses ranged from $27.90 to $32.38, while Portland's CBD Class A rate was higher, ranging from $39.78 to $32.28

ABSORPTION & LEASING

The second quarter of 2019 saw 327,211 sq. ft. of positive net absorption, with year to date net absorption a solid 429,000 sq. ft. More than 50 percent of the absorption came from the Multnomah County Health Department consolidating on 6th and Hoyt, which is the only substantial delivery of the quarter according to JLL. In this quarter most of the leasing activity was recorded in the suburban markets. The largest lease of the second quarter was the 90,000 sq.ft. lease by Sigma Design, Inc. in June. In the same month, WeWork a Co-working giant leased all of the 55,395 sq.ft. of the 830 Oregon Square building in the Lloyd District.

Overall, this quarter is characterized by low absorption across the brokerage house reports because there were no new or renovated office space that was ready for occupancy. Notably the one delivery came from an owner occupied space in downtown, the Multnomah County Health Department, The Gladys McCoy Building.

The 157,000-square-foot, Gladys McCoy Building, Multnomah County Health Department Headquarters became home to some 500 employees, including physicians, nurses, administrators and researchers. It will also include a pharmacy, three specialty clinics and a few floors of offices. The building will receive a LEED Gold certification, providing energy and water efficiency along with access to natural light for staff well-being. Much of the roof area is covered in eco-roof, helping to manage the stormwater runoff with native planting viewable on the 9th level. This project was delivered on time and under budget early in the quarter.

" I think the heart of Portland is still on the Eastside … the restaurants and shops are great. The food carts. The streets here are still fairly quiet. We love it here."
Joe Sundby, co-founder of Roundhouse

" The Central Eastside continues to be a popular draw for creative office users."
Mark Carnese, managing director with Cushman & Wakefield, is one of four brokers working with Capstone on leasing the property

Building/Address	Buyer	Seller	Market	Price	Price/SF
Montgomery Park	Unico Properties /Partners Group	Bill Naito Companies	NW Close-in	$255M	$388
Field Office West & East	Lincoln Property Co./ Goldman Sachs	Project^	Guilds Lake	$118M	$411
Park Square	PCCP LLC	CBRE Global Investors	CBD	$96.5M	$326
The Leland James	ASB Real Estate Invest	Cairn Pacific/ Capstone Partners	Pears District /Slab Town	$67.5M	$574
Leftbank	SKB Cos/Recap Real Estate Invest.	Alora Dev./Left Bank Project	Lloyd District	$16.25M	$270

TABLE 5 - NOTABLE SALES TRANSACTIONS, SECOND QUARTER 2019
Colliers, Kidder Mathews, CoStar

IMAGE 3 - MONTGOMERY PARK

IMAGE 4 - PARK SQUARE
A two building Park Square Office Park in downtown Portland, the third largest sale of the quarter.

IMAGE 5- LELAND JAMES BUILDING
The Leland James building in the fourth notable sale of the second quarter.

SALES TRANSACTIONS

Sales volume in the second quarter was close to $990 million. Major transactions include Field office, Park Square and Montgomery Park. A majority of the transactions occurred in the urban core. According to CoStar, Portland's market price for office space in the past quarter was $293 per square foot, representing a 7% year-over-year price increase over 2018's second quarter rate. Blockbuster deals drove office sales activity in the Portland metropolitan area to $632 million for the past three months, a decade high (and likely a historical high) for the area in terms of investment volume within a quarter.

The largest of the four office transactions belonged to Montgomery Park, an 18-acre complex that includes a 745,000-square foot office building. The deal also included a 335,000-square-foot historic warehouse and a three-acre development site capable of accommodating more than 800,000 square feet of new development. Unico and Partners Group plan to complete "significant" capital improvements to Montgomery Park complex to reposition and redevelop the site, transforming it into "a preeminent urban campus and bringing a first-class, amenity-rich tenant experience to the property".

> *" Purchasing one of Portland's landmark office properties in the Northwest district presents a unique opportunity to build and shape a premier neighborhood"*
> *Brian Pearce, Executive Vice President of Real Estate Services at Unico*

SERA architects redesigned the original 1973 office building as a new creative office and retail building that adds vitality to the Slabtown district – an area currently emerging from industrial use into a new active urban neighborhood.

Building/Address	Developer	Submarket	SF	Delivery Date
Nike North Expansion Building B	Gerding Edlen	Westside	1,003,585	Q3 2019
Block 29 Center for Health & Healing	Oregon Health & Science University	Southwest	360,000	Q3 2019
7 SE Stark	Harsch Investment Properties	Lloyd District	70,000	Q3 2019
District Office	Beam Development	Southeast	90,778	Q3 2019
Tree Farm	Guerrilla Development	SE Close-in	33,750	Q3 2019
5 MLK Office	Gerding Edlen	Lloyd District	119,570	Q4 2019
Beacon	10 Branch	Lake Oswego/ West Linn	8,490	Q1 2020
250 Taylor	Third & Taylor Development LLC	CBD	190,825	Q1 2020
Premier Gear & Machine Works	Sturgeon Development Partners	Northwest	64,483	Q2 2020
The Canvas at Press Blocks	Security Properties + Urban Renaissance Group	Southwest	140,000	Q4 2020
District Office	Beam Development	Southeast	90,778	Q2 2019
Adidas Expansion	Adidas America	Hayden Island	180,000	Q1 2020

TABLE 6 - NOTABLE RENOVATION/ UNDER CONSTRUCTION PROJECTS, 2019 - 2020
CoStar, Colliers

Q2 KEY POINTS

- Creative office space continues to be in high demand among tenants, developers, and investors.
- Market Rent and sale prices are anticipated to continue to go up
- Repositioning existing buildings has proven to be the more popular approach
- The Close-In Eastside continues to be top of mind as just over half of the ground-up office projects in the metro are in that submarket
- The continued trend in higher suburban office demand

DELIVERIES AND CONSTRUCTION

The second quarter finished with no deliveries, as no office assets finished construction. The market is still waiting for the over 1M s.f. of office space still in the development pipeline. According to Kidder Mathews, the delivery date of the Building B expansion of the Nike North campus was pushed back again, as the developers could not finish construction before the end of 2Q. Similarly, Oregon Health and Science University also had their 360K s.f. Block 29 expansion of the Center for Health and Healing in the Johns Landing submarket pushed back to July. A total of 647,000 sq. ft. of new development under is construction and 536,000 sq. ft. of space under renovation. Construction broke ground on the Tree Farm development in Central Eastside adding 33,750 sq. ft. Renovations also began on two projects in the CBD, 10 West and J.K. Gill Building whose combined square footage is 135,000 sq. ft.

05 //

industrial market analysis

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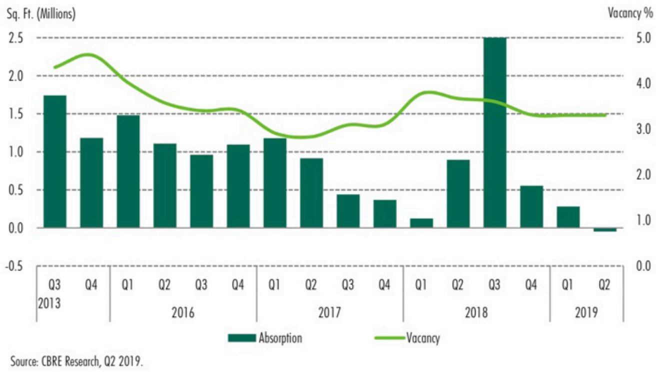

FIGURE 1 - HISTORICAL BASE MARKET TRENDS
Source: CBRE

FIGURE 2 - ASKING RENT AND VACANCY
Source: CBRE

FIGURE 3 - ASKING RENT RANGES AND AVERAGE
Source: CBRE

All good things must come to an end, or a slow down at the very least.

Since midway through 2009 the Portland industrial market has been steadily growing – led by the booming markets of Hillsboro and Tualatin - developers and employers have focused on locating in the Portland metro area. CBRE states that the industrial market here in Portland has grown by over 15 million square feet, much of this due to the access to both Seattle and San Francisco - both extremely high-priced markets with strong employment bases. Not only has growth steadily increased, but vacancy has dropped over 5% in that time as well. But now, here in mid-year 2019 the market has shifted to a negative absorption rate.

THE IMPACT ON RATES

Though there has been a noticeable slowdown in absorption that hasn't had much impact on rental rates. Figure 2 below shows the steady uptick in rates year over year at this point. Although vacancy rose a bit since quarter 2 of last year, the rates haven't caught up yet. There are many factors that go into that, especially with new builds - such as construction and labor costs.

Sunset and SW Portland are seeing the highest rates this quarter, with average asking rates around $.61 per square foot. NE Portland has seen the widest range, spanning $.22 in difference between the low end at $.43 and the high end, almost the highest asking in Portland at $.65.

WHAT COMES NEXT?

Like all sectors within real estate the political climate plays a significant role which impacts pricing, development, and the overall cycle.Gross Receipts Tax is one of the new factors that plays in all areas within real estate - creating more taxation on business in Oregon - thus leading to the possibility of companies locating elsewhere than Oregon to avoid from extra taxes.

Mark Childs of Capacity Commercial had some predictions for what's to come as well - and for the most part they were positive. The slowdown in absorption won't last and leasing and sales will pick up through the end of the year. While lease rates haven't reflected the recent negative absorption, that may change. Tenants are realizing the slight slowdown and that may impact rates negatively. Construction costs and overall slower labor not only impacts timing of transactions, but also a slight development slowdown and a bit stingier underwriting which overall impacts the cycle a bit. One thing that is positively helping acquisitions is the accessibility to financing.

NOTABLE SALES IN THE INDUSTRIAL SPACE

National Dermody Portfolio / Buyer: Colony Capital LLC / Seller: Dermody Properties / $1,160,000,000

Glisan Corporate Park / Buyer: Exeter Property Group / Seller: Trammell Crow / $56,500,000

Source: Capacity Commercial

With interest rates being extremely favorable to borrowers more groups are able to come up with capital to invest in projects. This has led to an uptick in finding quality real estate with older assets on it and developing those properties to a new use to fit the client's needs.

Overall the industry is changing, but no real red flags are on the horizon that would indicate that a major dip is coming.

WHAT TO KEEP AN EYE ON

Newmark Knight Frank highlighted a key influence within the industrial market that will play a huge factor in where the market goes next, and that is labor challenges. The report NKF did was titled "Where Are All The Blue-Collar Workers?" The stats showed that the construction, production, logistics, and transportation sectors all have a serious shortage of employees. Baby boomers make up a large number of this industry, and they are all getting closer and closer to retirement - not to mention the economic expansion which is set to create over 4 million new jobs in the next 10 years. Many believe automation will negatively impact this sector, but there will need to be focusing on maintenance, programming, and engineering the machines at all times. Currently the outlook is bleak for having the skilled people to do such jobs.

Portland may have found a solution. NKF has pointed out that the opportunity to focus on unemployed youth may be the right step forward. Portland has a program called Portland Opportunities Industrialization Center to help teach these unemployed youth the skills needed to succeed a this. There is even a Construction Pre-Apprenticeship Program, as well as the Oregon Tradeswomen - all created in an effort to combat this looming problem and set up the underserved for success.

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retail market analysis

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The Portland retail market didn't bring much change in the second quarter - keeping with the consistency of the vertical here in Portland.

Vacancy rates increased by just 10 basis points, and NNN lease rates ticked upwards almost 2% quarter-over-quarter from 2018 to 2019. Portland's retail market remains tight even with the slow leasing activity seen in the second quarter. Cap rates for investment sales saw some shifting quarter-over-quarter from 2018 to 2019 - Grocery/Power Centers rose from 6.25% to 6.94%, while Multi-Tenant retail dropped from 7.08% to 6.78%, and Single-Tenant jumped from 5.83% to 6.02%. Single-Tenant is still leading the way as far as overall value, and Grocery/Power trending in the wrong direction for sellers. The shift in Multi-Tenant is an interesting one, and could be linked back to the need for a good tenant mix, and wanting to off-set the potential to any vacancies that may come into play within an asset. Overall the retail market in Portland is still strong, but there are many drivers impacting the retail space both for better and for worse.

RETAIL DEVELOPMENT DRIVERS

Retail properties throughout the country are heavily dependent on parking. Parking comes at a premium, especially with urban metro assets. Urban street front retail has always been a sought-after product, but the addition of parking raises the bar. This holds true to shopping centers and even single tenant assets - how much parking is included? This question is raised quite often - and with good reason. But this won't always be the case.

This image shows the shift in how cars are projected to be used over the next decade. Currently over $2 trillion is spent on car ownership throughout the United States, with ride sharing barely even coming close. But the drastic shift occurs when ride sharing becomes the preferred mode of transportation and the demand for parking may be dramatically reduced. This change could lead to further development on parking lots to create a higher and better use. Such infrastructure used for parking currently clocks in at almost 3,600 square miles, or an area larger than Delaware and Rhode Island combined.

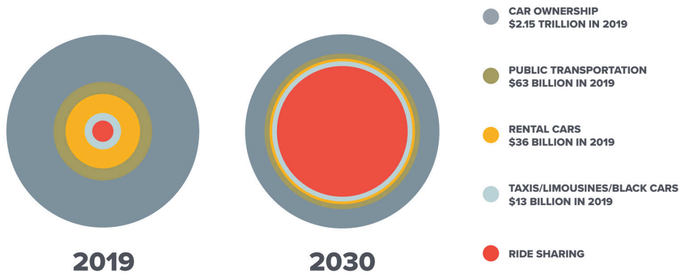

FIGURE 1
Source: Capital Pacific

RETAIL DEVELOPMENT SLOW DOWN

There will always be a multitude of reasons on why one real estate vertical is thriving in development, and others may be slowing down. In today's world all aspects of the industry have their risks - or road blocks, retail is no different.

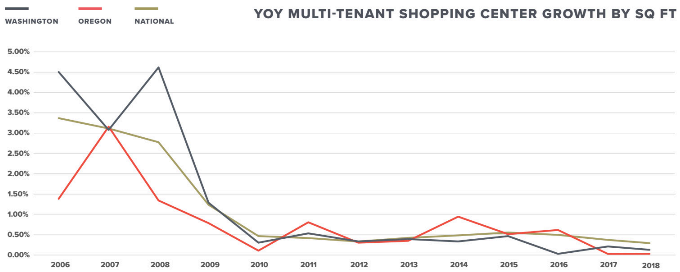

FIGURE 2
Source: Capital Pacific

This chart shows the lack of growth in shopping centers in Oregon, Washington, and Nationally. Here in Oregon there has been little to no growth. The real question is why? There have been large swings in construction costs, making it difficult for every project to pencil. With so much spent on construction and upfront costs the initial yield the project gives out is limited based on the upfront cost increases. Another assessment developers are taking into account is the change in taxes and overall political climate. Coming in 2020 Oregon will impose a gross receipts tax, essentially taxing businesses on their commercial activity which generates over $1 million. This on top of Oregon's income tax is a negative driver to the retail market in our state. The income tax that Oregon has impacts potential investors from wanting to enter the Oregon market. Although with the changes in the Washington excise tax - increases the overall tax - in 2020 there is less of a delta between the two markets.

WHAT TO KEEP AN EYE ON

While many brands who rely on brick and mortar stores focus their attention on declining sales, and lack of store traffic there are still some brands that are continuing the forward push to expand and continue driving for more growth. Domino's Pizza is one brand in particular with growth on their mind. Currently Domino's is the largest pizza chain in the world by sales and has over 16,000 locations. They have set goals to continue their rank at the top of the pack by expanding to over 25,000 locations and $25 billion in overall sales. What Amazon has become to many retailers in the traditional sense - GrubHub, UberEats, and DoorDash have been the major threats to the food sector. Instead of rolling over Domino's has devised a way to combat these threats. With the added fees, increased wait times, and large commissions taken by these apps, Domino's has devised the plan to open more locations to cut down on delivery time and work to increase same store sales and fend off the new age delivery systems. Domino's will continue to deliver from their locations - even via emoji text - and work to keep their consistent customer base. This is another example of the changing in retail, and brands needing to think different to survive in the changing retail world.