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economic analysis

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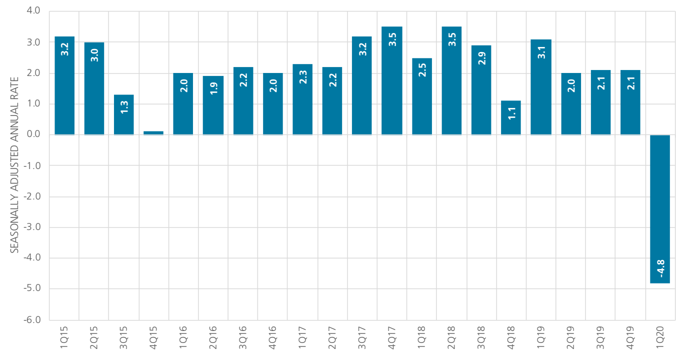
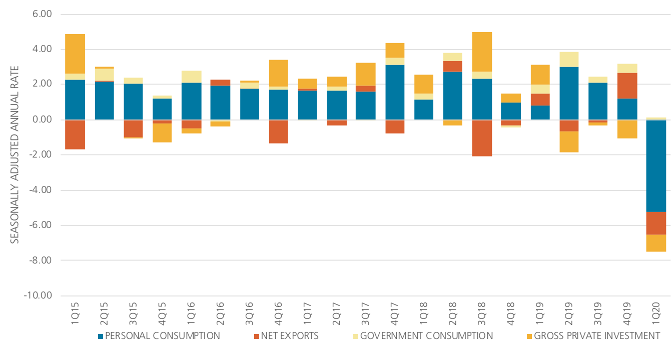
REAL GDP - PERCENT CHANGE FROM PRECEDING QUARTER



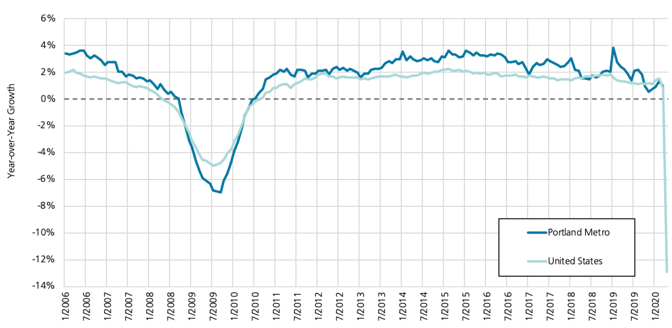
U.S. Bureau of Economic Analysis

GDP GROWTH BY CONTRIBUTING SECTOR



U.S. Bureau of Economic Analysis

RATE OF EMPLOYMENT GROWTH - YEAR OVER YEAR



Bureau of Labor Statistics, JOHNSON ECONOMICS

The first quarter of 2020 started out quite promising, with steady growth through February following by a severe shock associated with the Covid-19 pandemic. While we will discuss the quarterly performance, the ongoing projected impact on the economy and real estate markets will be the focus of this summary.

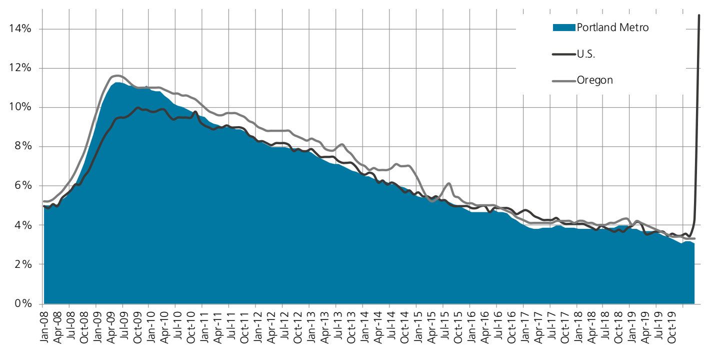
The expansion cycle at the national level ended abruptly in the first quarter of 2020, with real GDP estimated to have declined 4.8% during the quarter. The rapid decline can be attributed to actions taken throughout the nation and world in May to contain the spread of the virus and “flatten the curve” to assure that adequate capacity was available in the medical care system. The actions taken included a lockdown of many sectors of the economy. Governor Brown’s order took effect on March 23rd, and immediately shut many businesses including shopping malls, theaters, restaurants (sit down dining options), barber shops, and gyms. Further restrictions on travel have led to sharp declines in travel and leisure industries.

Drops in personal consumption, net exports, and private investment accounted for the decline in GDP during the first quarter, and are expected to be even more significant in the second quarter.

Employment levels in the Portland MSA were running roughly 24,000 higher year-over-year through February, began to decline in March, and have likely collapsed in April. The Portland metro area has largely followed and outperformed the national average in terms of employment growth during the expansion cycle. While local numbers are not yet available through April, the preliminary national levels indicate a decline of close to 13% in April. The May numbers are likely to be worse as the impacts of the shut-down filter through more sectors of the economy.

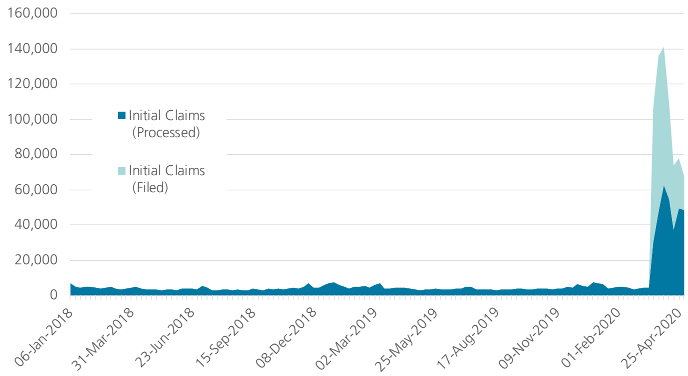
Only last quarter our primary concern was labor supply. No longer. The most recent unemployment estimate at a national level is 14.7%, and the local levels are expected to exceed that in short order. Initial claims have shot up dramatically in the State of Oregon in March and April, and will start showing up in unemployment rate statistics that are projected to exceed 20%.

UNEMPLOYMENT RATES OVER TIME



Local Area Unemployment Statistics (LAUS)

INITIAL CLAIMS FILES - STATE OF OREGON



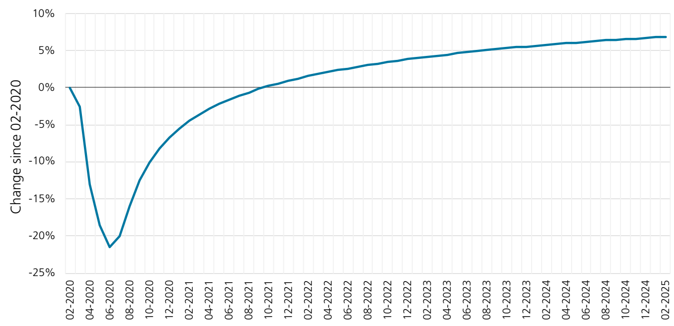
Oregon Employment Department

The State of Oregon hasn't released an April unemployment estimate yet, but the level of claims indicates that projected jobs losses will exceed 400,000 for the State of Oregon. Losses in the Leisure and Hospitality sector are expected to approach 130,000 jobs, representing about 60% of overall employment in this sector. Health care is expected to lose 64,000 jobs (24% of total employment), retail trade is expected to lose over 50,000 jobs (24% of total), and professional/business services is expected to lose 32,000 (12%). The overall anticipated job loss is estimated at 21% of total employment based on March 2020 levels, with significant losses seen in every sector.

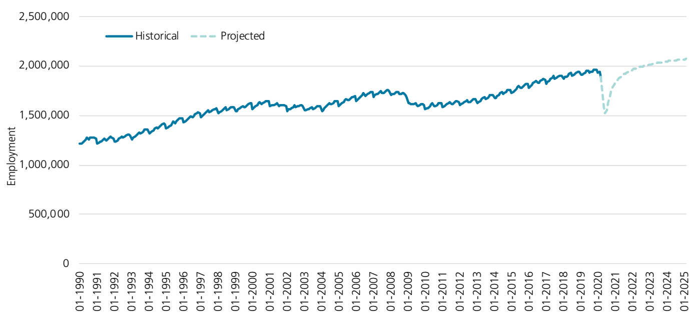
Forecasting a recovery scenario from this sharp downturn is complicated by uncertainty regarding how long stay-at-home orders remain in place and the nature and duration of precautionary measures that businesses will be forced to contend with that reduce their productivity. These measures are dictated by the spread of the virus, the access to protective equipment, and the development of effective treatment. Because of the many unknowns, and the unprecedented nature of this crisis, economists struggle to model the economy's trajectory. Estimates of the depth and duration of this downturn vary widely, but have generally become more pessimistic as the crisis has unfolded. We have charted a tentative anticipated trajectory for the Oregon economy on the next page, with the Portland metro economy expected to follow a similar path. We expect to make many revisions to this forecast over the coming months.

The tentative projection assumes that nearly 22% of all jobs will be lost by June this year. For reference, 337,000 unemployment claims above the historical average for the period have been registered with the State through the end of April. Though many of these likely represent reduced hours rather than layoffs, there are also a large number of additional 27,000 claims waiting to be processed. We will therefore assume that the April employment numbers, which are based on payroll during the first half of the month, will reflect a job loss of 13% from the February level. By June, we project that 415,000 jobs will have been lost statewide, and 280,000 in the Portland Metro Area. Again, we emphasize that these are tentative estimates associated with an unusual level of uncertainty.

FORECASTED EMPLOYMENT PATTERN, OREGON



HISTORIC AND PROJECTED EMPLOYMENT LEVELS, STATE OF OREGON



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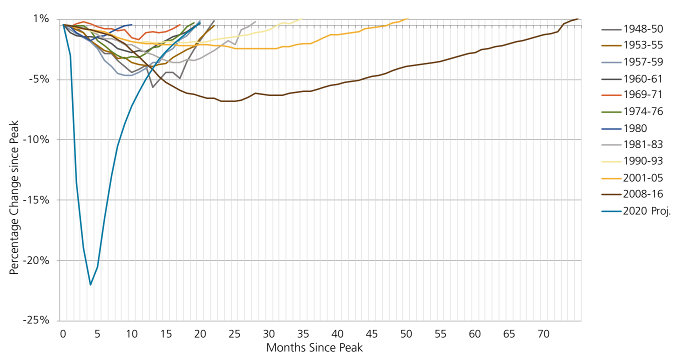
COMPARISON OF RECESSIONS, POST WWII



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The timing of the bottom and the subsequent recovery are dependent on the restrictions that remain in place as businesses are allowed to reopen. We expect the lifting of the restrictions to be gradual, in order to prevent a new wave of infections. During this reopening phase, job losses are likely to continue in some industries while others begin to hire. A complete return to normal may not happen until a vaccine is in place.

The projection indicates that we will have regained the lost jobs by October 2021 – a 20-month recovery – and that we will need at least another year to return to the pre-crisis growth trend. When compared to previous recessions, this would be a remarkably quick recovery for a downturn this deep. However, this crisis is very different from previous downturns. A rapid recovery is possible as long as we find ways to safely reopen businesses and avoid a financial meltdown. Much of this is dependent upon the duration of the shut-down and the nature of any precautionary requirements or limitations. The structural damage to the economy increases significantly over time, leading to a much less robust recovery scenario. The level and pace of job losses is unprecedented, and many businesses will likely be unable to weather the storm.

IMPACT ON REAL ESTATE MARKETS

The economic turmoil is expected have a profound impact on the local real estate markets, both in the short as well as long term. While the articles in this quarterly will address impacts on individual sectors, the following is a brief discussion of several areas of potential impact.

For all market types, short-term collections are likely to be impacted. The significant financial damage associated with the downturn will impact both businesses and household, which will likely be reflected in higher vacancy and collection losses. This will impact the property owner's ability to service debt and other obligations. In addition, a number of tenants are likely to be lost, and that space will need to be re-tenanted in a much more competitive environment.

For office, industrial, and retail space, has the nature of the business needs and space requirements changed substantively? A large number of restaurant and bar tenants will likely not survive this downturn, and new restaurants may have different space preferences. It is uncertain if the public will retain the same level of interest in public dining, and delivery services may account for a greater share of restaurant traffic. The shift from brick and mortar to online retail has been ongoing over the last decade, but the quarantine may have accelerated the shift to on-line retail.

In the office market, telecommuting has been undergoing a broad market test and may be performing better than anticipated. Time will tell if market preferences shift with respect to recent concepts such as open office space, workspace hoteling, and coworking spaces. The shift to online retail has implications for the industrial market, with a greater focus likely on fulfillment and inventory systems.

The residential markets will be impacted by many variables that need to be closely monitored. The level of in-migration into the Portland metro area has been one of the region's key advantages, and a key driver of residential demand. In a period of highly elevated unemployment rates, it is unlikely that recent levels can be maintained. In addition, the high unemployment rate will also likely lead to a reduced level of household formation. The tenure split between owner and renter will also likely be impacted, as lower anticipated levels of income reduce the ability to own. Long term preferences may also be impacted. Key drivers of recent development activity such as access to transit and urban amenities may lose some comparative luster, while access to outdoor spaces and lower-density solutions may have increased relative appeal.

Looking forward, the real estate markets are largely expected to be impacted by a reduction in demand. Lower levels of employment imply reduced space needs for commercial and industrial space, and demand for residential units is likely to be impacted by slower in-migration and lower household formation rates.