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## office market analysis

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**The last quarter, the last year and the last decade were all wrapped up with a good note. On the last quarter publication we stated “The Portland Office Market is expected to remain robust in the next quarter due to sustained employment growth”. In an unpleasant turn, the sustained employment growth took a nose dive this quarter as the pandemic sends its shock waves across the globe. The unfolding global COVID-19 crisis has negated all forecasts and expectations of the global economy and Real Estate is not an exception.**

Early on economists and forecasters expected this will be a short term phenomena and once the lockdowns and the economic shut offs are lifted the economy will rebound quickly. As of the end of the first quarter of 2020 the shut downs are going strong and unemployment rate is increasing at unprecedented rate. Total nonfarm payroll employment fell by 20.5 million in April, and the unemployment rate rose to 14.7 percent, the U.S. Bureau of Labor Statistics reported. The same report shows the number of unemployed persons who reported being on temporary layoff increased about ten-fold to 18.1 million in April. The number of permanent job losses increased by 544,000 to 2 million. In the first quarter the white collar jobs of office users have not shown a significant loss as compared to other sectors, of the 20.5 million losses 2.5 million were in education and health services and 2.2 million professional and business services. Most of the job losses in professional and business services were in temporary help and in services to buildings and dwellings . The biggest question in the Office Market remains, would the job numbers in this sector sustain? How will the market fundamentals perform in the upcoming quarters and year? And what are the short and long term implications of the pandemic economic crisis on the Portland office market fundamentals?

The first quarter started strong as predicted at the end of 2019. Office market fundamentals generally remained stable despite a slight increase in the overall vacancy rate and drop in U.S. office leasing activity. As the virus spread West and stay at home orders were being contemplated, most offices started moving their operations to home offices by the conclusion of quarter. Almost all States has declared state of emergency and issued Stay at Home orders and social distancing, which forced businesses to move to home offices and online at the end of March 2020 . A drop in U.S. office leasing activity, as well as a significant increase in lease renewals, were two major signs of COVID-19's early impact on office markets in Q1 2020.

In comparison, the U.S office market has endured the coronavirus outbreak better than other commercial real estate sectors, but a CoStar analysis of worse-case economic projections shows this sector could end up being badly battered as well . Overall, it is predicted that the next quarter will be more devastating to the local and national economy. Economic forecasters predicts that the second quarter of 2020 will see one of the largest real GDP declines in U.S. history .

## THE SHORT-TERM AND LONG-TERM IMPACTS OF THE PANDEMIC ON OFFICE FUNDAMENTALS

### DEMAND SHOCK

Nationally, demand for office space and rents are expected to continue to decline over the next 12 months. The Federal and State governments has put economic measures to curb further economic fallout, however as the unemployment numbers continue to climb it's uncertain how it will prevent some businesses from shuttering altogether and others from contracting significantly. It is likely that leases will become more short-term, and businesses may move to smaller office spaces. Some shifts in practice by employers will inevitably affect the demand in office space. Whether it will be a negative, positive or net zero effect remains to be seen. Some of the changes being discussed are: dual-hub solutions to accommodate both urban and suburban locations, flexible work schedules, private office spaces, new office layouts conforming to the 6 feet physical distancing requirement and increase in teleworking . A New York Times article reports, a CEO of a real estate company is mulling reducing its footprint, the company has 32 branches across the city and region .

Q1 2020 Portland office market demand remained relatively stable as compared to the national trend and 2019. Nationally absorption took a big dip in the first quarter. Despite the pandemic the Portland number shows a negative 94,607 which is a better number than reported in Q4 2019. However it is important to note that 3 deliveries recorded in Q1 2020 were delayed deliveries from Q4 2019.

### COWORKING AND FLEXIBLE SPACES

In January 2020, Cushman & Wakefield predicted an increase in occupier demand for space flexibility and versatility as more employees utilize flex/coworking space based on their research showing 90% of real estate executives expect to have some of their employees utilize coworking/flex office by 2024. In the face of the pandemic JLL in the 2020 forecast series, predicts that coworking will likely decline as tenants are expressing interest in private spaces over public spaces and corporate culture over coworking. The most current survey by the National Association of Realtors also show, demand for coworking space may fall as freelancers decide to just work from home rather than in coworking spaces. Coworking giant WeWork said in a March investor presentation it expected Covid-19 to hurt its financials.

### NET ABSORPTION

Net Absorption	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020p
<b>U.S. Office Markets</b>					
<b>United States</b>	5839968	12521815	13489098	15334031	4135561
<b>Portland, OR</b>	191800	-34295	63035	-176631	-94607

*Cushman Wakefield, US-Office-MarketBeat-Q1-2020*

JLL's first quarter report names coworking as the largest cause for concern in the office sector. The industry cluster is responsible for 38 percent of total U.S. net absorption over the past 2 years. In this regard, Portland is somewhat insulated as coworking and executive suites account for just 1.5 percent of total office inventory . Though Portland's coworking share is small the effects are felt as companies are putting a brake on expansion plans. A Seattle-based coworking company is looking to sublease its Southeast Portland hub as it taps the brakes on national expansion plans for now .

**LEASING ACTIVITIES**

Leasing activities recorded a decline across the nation. According to the SIOR CRE Index, —an index that is based on 10 indicators of sales/acquisitions, leasing, and development compiled from a survey of SIOR members, the office index dropped 29%. In the office class A market, 21% of respondents reported an increase in leasing activity, down from 39% in the prior quarter.

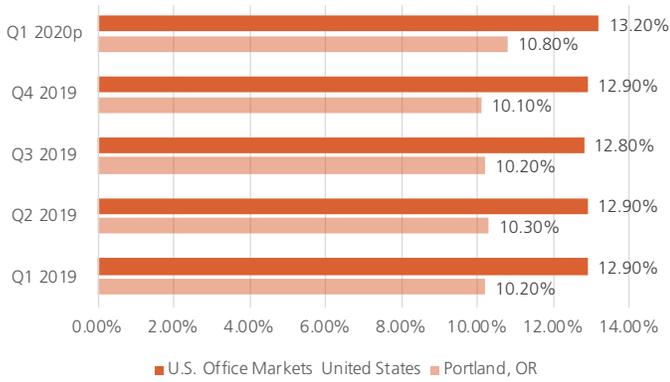
Overall the Portland market leased 559,582 SF in the first quarter of 2020. Notable leases include, Square leasing 64,000 SF at Aspect on Sixth, Tanner Point leased the top two floors a total of 40,100 SF to Ampere . Apple also leased 30,669 SF of the new creative office space of Seven Southeast Stark.

SIOR respondents reported weaker leasing activity and more landlords giving tenant concession, thus rent growth is expected to moderate. In Oregon the Governor ordered Commercial Eviction Moratorium for 90 days to protect businesses from eviction. At the same time the order puts expectations on commercial tenants to pay rent if they are able to pay. This implies that the use of PPP (Payroll Protection Program) or other funds to pay rent is expected. The assumption is that commercial tenants will pay their rent if and when they have secured the loans. At the conclusion of the first quarter most rents were paid in Portland. As reported on the Portland Business Journal, missed rent payments were in the single digits as of April, 2020 . It is however expected to decline in upcoming months further impacting revenue and property values. To minimize the impact and legal risk landlords are trying to be creative.

**LEASING INDICATORS**

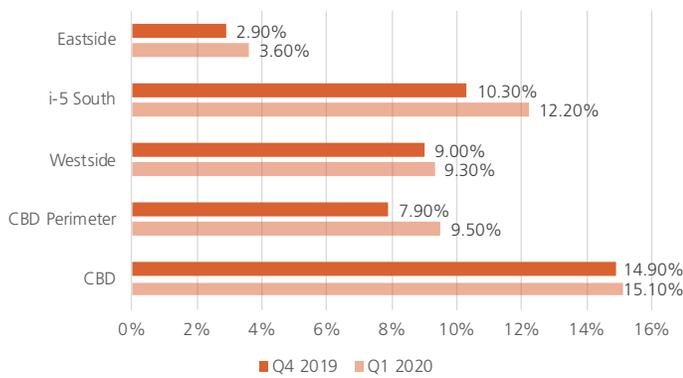


## VACANCY RATE



Cushman Wakefield, US-Office-Market ; Beat-Q1-2020; Colliers

## VACANCY RATE BY SUBMARKET



Cushman Wakefield, US-Office-Market ; Beat-Q1-2020; Colliers

## VACANCY

Overall vacancy rates on the national level increased 30 basis points as compared to 70 basis points for the Portland market. The percentage variations year over year was more stable in 2019. Vacancy is one fundamental that showed immediate impact from the Covid-19 crisis in the first quarter both at the national and local level. The short term impact on vacancy rate coupled with the incremental decline in job growth will have a long term negative impact on the sector from decline in demand, which in turn slows down or potentially stop supply (reflected in construction and deliveries).

Vacancy in the near-term is likely to increase considerably. The Portland market showed a 70 basis point leap in vacancy rate as leasing activities notably preleasing activities has died down due to the pandemic. The biggest increase in vacancy rates was recorded for the CBD perimeter and I-5 south submarkets.

## Q1 2020 PORTLAND KEY DELIVERIES

Building/Address	Developer	Submarket	SF	Delivery Date	Pre lease
7 SE Stark	Harsch Investment Properties	Lloyd District	70,000	Q1 2020	42%
District Office	Beam Development	Southeast	90,778	Q1 2020	70%
Tree Farm	Guerrilla Development	SE Close-in	33,750	Q1 2020	26%
250 Taylor	Third & Taylor Development LLC	CBD	190,825	Q1 2020	100%

Colliers

## Q1 2020 PORTLAND KEY SALES TRANSACTIONS

Property	Submarket	Seller/Buyer	SF	Price/SPSF
1800 SW 1 <sup>st</sup> Ave	Central Core	Oregon Pacific Investment & Development / GEM Realty Capital, Inc. & Libertas Co., LLC	187,199	\$52.8M/\$282.05/SF
Broadway Tower	Central Core	BPM Real Estate Group / Principal Real Estate Investors		\$132.3M/\$756/SF

## DELIVERIES

Three of the four deliveries that came on the market were delayed deliveries from the last two quarters. As shown on the chart below almost all had significant preleasing activity that has contributed to a higher absorption this quarter. 482,673SF delivered this quarter and 871,712 SF under construction. Oregon's governor deemed construction as essential business and construction continued in the Portland market. The construction market has not been significantly affected in this immediate quarter. However as demand continues to decline constructions will and deliveries will continue to decline through the end of the year.

## SALES

The Covid-19 crisis has brought an abrupt stop on sales and transactions nationwide. NAR's latest commercial Real Estate Trends & Outlook reported that in the office class A market, only 15% of respondents reported an increase in sales volume (22% in the prior quarter) .

In terms of sales volume, Portland recorded decade-high office investment in 2019. Due to the fact that the pandemic did not hit until the end of the quarter, it has not substantially affected sales volume for this quarter. However it is yet to be seen how the pandemic will affect future sales.

The biggest question remains how quickly will the economy rebound? I would like to conclude by quoting Don Ossey, a Portland real estate leader, "In real estate, (cycles) don't happen like the equities markets or securities markets where things change in (a) matter of hours. Real estate's a longer-cycle process. But I think there'll be a recovery that will be maybe slower. The pace of leasing, the pace of acquisitions will not be typical" .

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