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Multi-Family Residential Report

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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 increase the replacement cost for these products, serving as a further challenge to the Portland market's ability to deliver affordable housing.

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FIGURE 1: ABSORPTION, COMPLETIONS

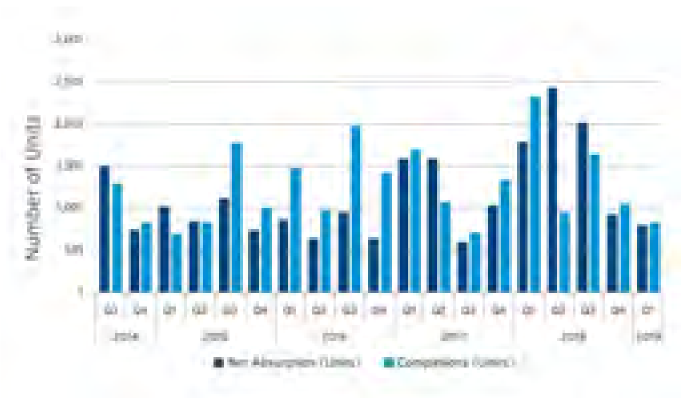

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FIGURE 2: DELIVERIES AGAINST DEMAND

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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 3: OCCUPANCY TRENDS AND RENTAL RATES

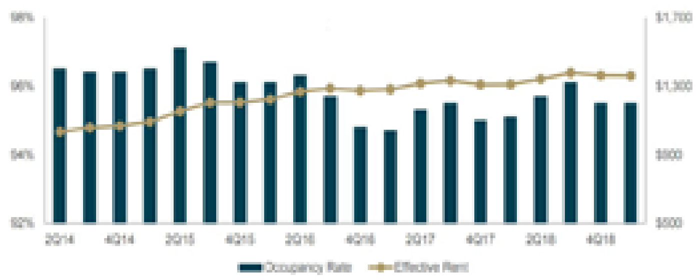

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FIGURE 4: PORTLAND CONSTRUCTION COST INDEX

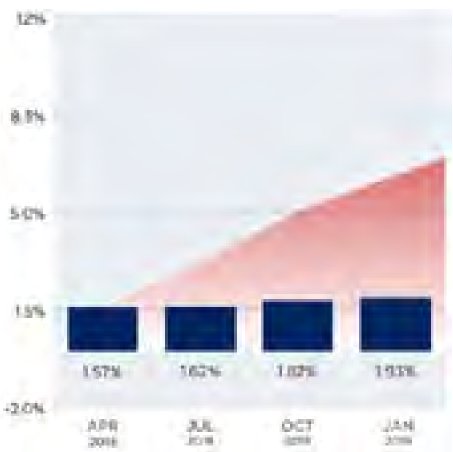

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FIGURE 5: NOTABLE SALES

Property Name	Buyer	Seller	# Units Built	Sold	$ / SF	Sale Price
Trio Pointe	Goldman Sachs	Pahlisch 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

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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.