03

COMMERCIAL MARKET

Office Market Analysis

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EMPLOYMENT

Aggregate employment levels remain a problem within the Portland metropolitan area ("MSA"). The unemployment rate in the Portland MSA was 3.4% in the fourth quarter. This was down from the fourth quarter 2020 rate of 7.1%, a steep 52.1% year-over-year ("YOY") decline. Month-over-month within the quarter showed incremental progress. For example, the unemployment rate fell 2.9% from October to November 2021 alone, from 3.5% to 3.4%. Non-government hiring across the MSA rose by over 10,300 jobs in the fourth quarter. These results also mirror the same trends seen on the national and Oregon state level. The Oregon unemployment rate dropped each month in the fourth quarter from 4.7% on September 1, 2021, to 4.1% on December 31, 2021.

Employment recovery by sector in the MSA also showed strong gains with those industries heavily affected by the COVID-19 pandemic showing fast bounce-back growth. The leisure and hospitality industries devastated in 2020 saw gains of more than 1,000 jobs YOY with retail – as well as construction, manufacturing, and wholesale trade – gaining more than 3,000 new hires in October 2021 alone. The only sector which saw job losses in the fourth quarter of 2021 was government employment, which saw a seasonally adjusted loss of 5,600 jobs. Most of this loss occurred in public schools amid the expiration of pandemic government assistance programs.

Despite these strong statistical gains and recent spurts in new hiring, the employment numbers for all of 2021 in the MSA are grim. Across Oregon, the economy is more than 30,000 jobs below the peak employment watermark in February 2020, the start of the pandemic. Public school teaching and staff shortages are so acute statewide that there are 9,000 fewer school related employees today than in the fourth quarter of 2019. To make matters worse, employers across Oregon and especially within the MSA are reporting severe staffing shortages and extreme difficulty in filling open positions.

This has been particularly acute in the hospitality, education, transportation, retail, and service industries. For example, the Oregon Restaurant and Lodging Association currently has 23,000 open positions employer members cannot fill. The Oregon Employment Department reported that a whopping 100,000 jobs listed on its website in the fourth quarter

went unfulfilled, a staggering 131% increase YOY from 2020.

The employment outlook within the MSA going into the first quarter of 2022 does not offer much optimism. Employers battered by pandemic losses cannot offer the wage increases many potential employees are demanding. The expiration of special pandemic "hazard" pay rates also acts as a psychological deterrent or pay cut for many seeking jobs in the most crippled service sectors such as hospitality and retail. Ironically, wages across Oregon and especially within the MSA have risen more than 17% since the start of the pandemic, or more than $7,500 per year for the average Oregon employee, but these numbers are not attracting new job seekers into the local markets. In fact, the overall gains in unemployment rates are more a consequence of the declining labor participation rate than actual real net employment growth. In the fourth quarter, Oregon's labor participation rate fell to just 61.5%, slightly lower than the decline at the national level of 63.4%.

OFFICE MARKET

The MSA ended the fourth quarter of 2021 with an overall office vacancy rate of 14.6%, rising forty basis points since the end of the third quarter of 202, and more than 190 basis points YOY. The key weakness in the MSA office market is once again the Central Business District ("CBD") which ended 2020 with nearly 20% of all available space empty, or a rate of 19.2%. The office vacancy rate in the CBD continues to increase, up eighty basis points from the end of the third quarter 2021 and more than 370 basis points YOY.

Outside the CBD, the MSA saw somewhat better news. Overall office space showed a minor positive net absorption in the fourth quarter; yet it showed high negative net absorption overall for the entirety of 2021, a negative 1,823,413 square feet. New leasing within the MSA for the entire year was just 2.72 million square feet, higher than in 2020, but far lower than pre-pandemic levels in 2019. The pricing for Class A office properties declined 2.9% YOY, down to an average $29.92 per square foot.

The highest-Class A rates within the MSA are all suburban properties. For example, the rate in Lake Oswego is $35.87 per square foot, up 8.7% YOY, with some landlords asking for more at select "hot" suburban properties. In contrast, some Class A office spaces in the CBD are sitting empty at just $20 per square foot, or less.

As expected, all the major new leases signed in the MSA for Class A office space are in the suburbs. The largest new MSA leases signed in the fourth quarter of 2021 were for 366,000 square feet by ZoomInfo in the Vancouver Waterfront Terminal, and 82,500 square feet in the Amber Creek development in Hillsboro. Both are new projects. The only bright spot from a leasing perspective within the CBD is the signing for 28,762 square feet for a new supermarket in the Northwest District.

With a current negative absorption rate across the MSA, and especially within the CBD, the news only appears worse for Class A office property owners. More than 735,132 square feet of new Class A is currently under development with 160,000 square feet at the new Ritz-Carlton hotel and office complex being built in the CBD. While this new total MSA Class A office development inventory total is below the historic five-year average for the MSA, just 38% of this total, or 466,181 square feet, has been pre-leased. Still, employers from outside Oregon are looking at the relatively inexpensive prices of Class A space in Portland compared to Seattle, Los Angeles, San Francisco, and other comparable cities and taking a decidedly "wait-and-see" approach, given all of Portland's recent public image troubles. Nevertheless, new Class A office space continues to hit the market without much current leasing interest. For example, the new 67,000 square feet Class A office building developed by Sturgeon Development Partners in the Slabtown neighborhood of Portland has received interest from Apple and Google. However, it still sits empty without a single tenant since its completion in October 2020.

SUBLEASE MARKET

One major headwind creating trouble for property owners of all types in the MSA and especially the CBD is the strong subleasing market for every genre and variety of real estate. While subleasing signs are most visible in empty retail storefronts, efforts by existing lessees to exit their space commitments by passing along savings to sublessees is stifling demand for new leases from primary lessors across all property types. While subleasing can avoid complete lessee rent defaults and provide property owners with some income in the event of the failure of a tenant business, subleasing decreases new potential net income to lessors by allowing the leasing of existing space below the current lease rate by new occupants. This situation means new tenants sign new subleases at lower per square foot rates than other space held in lessor inventory without any net impact on existing property absorption rates. The fact is that many of these subleases offer space that is completely built-out, down to furnishings and artwork on the walls, which makes the situation more competitive for lessors with empty space to lease.

SUBMARKET STATISTICS

Submarket	Total Inventory	Direct Vacancy Rate	Total Vacancy Rate	Total Availability Rate	Q4 2021 Total Net Absorption	YTD Total Net Absorption	Q4 2021 Leasing Activity	YTD Total Leasing Activity	Total Rental Rate
CBD	28,638,568	17.5%	18.9%	25.7%	-146,785	-1,147,370	92,005	840,020	$28.81
Pearl District/Chinatown	3,169,147	22.9%	24.8%	31.6%	50,745	-136,951	40,316	191,343	$26.51
Downtown	**31,807,715**	**18.0%**	**19.5%**	**26.3%**	**-96,040**	**-1,284,321**	**132,321**	**1,031,363**	**$28.71**

The size of the MSA sublease market is huge. Of the ten largest leases signed in the CBD within the last six months of 2021, five were subleases. More than 1.6 million square feet of all types of commercial space was offered for sublease in the first quarter of 2021, with more than 1.47 million still available on the last day of 2021. The sublease market is mostly small business owners seeking to avoid their rental obligations due to pandemic disruptions. Huge blocks of Class A office, retail, and other types of space were offered by major employers. For example, Comcast put up 56,000 square feet of Class A office space for sublease in Beaverton.

Other cities are reporting slowly declining subleasing activity which matches the experience in Portland. Seattle lost 377,000 square feet of Class A office from its subleasing market between the second and fourth quarters of 2021. San Francisco lost 289,000 square feet of Class A office over the same time period. But with a high negative absorption rate of nearly 1.8 million square feet of Class A office in the MSA in 2021, nearly 750,000 square feet of new Class A office is currently under construction and joining these properties in 2022. Further, more than 1.4 million square feet of Class A office and other properties is currently available for sublease. Because of this, property owners and especially spec developers of Class A properties will likely see bleak times in 2022, specifically with respect to prices per square foot and the terms new tenants will demand.

RESOURCES

Market trends portland office - kidder mathews. (n.d.). Retrieved February 3, 2022, from https://kidder.com/wp-content/uploads/market_report/office-market-research-portland-2021-1q.pdf