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Office Market Analysis

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As we conclude the first quarter of 2019, office market fundamentals remain healthy nationally. According to Urban Land Institute's Real Estate Economic Forecast, the national unemployment rate sits at 3.8 percent with average job growth of 1.6 million per year through 2021. Leasing activity remains moderate and takes a slight dip in comparison to last quarter. Cushman and Wakefield's U.S. Office MarketBeat reports, "New leases for office space totaled 70.0 million square feet (msf) in the first quarter of 2019, down approximately 6.3% from the 74.7 msf of new leases in the fourth quarter of 2018." Some of the highest priced U.S. markets, especially those in the western region, bore the brunt of this slowdown with several companies looking for cheaper options.

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Office: Asking Rent by Market
Highest Priced U.S. Markets



Specifically, Oakland, San Diego, San Francisco, and Seattle, hit notable office rents per square foot, with averages of \$39.92, \$43.44, \$81.92, and \$40.21, respectively. With an average asking price of \$33.06 per square foot, Portland sits just above the national average of \$31.97 and continues to be the most competitive option in the west. Developers have quickly recognized this, many of them shifting from multifamily to office development, specifically, bullish development of flex space in Portland’s Close-In Eastside as well as redevelopment in the Northwest submarket. The strength of the office market and pressures on multifamily returns from Portland’s recent implementation of the Inclusionary Housing Ordinance have certainly helped speed this transition.

With Portland’s office market sending a message about its competitive rental prices of “catch them while you can” to companies and start-ups in the west, developers compete to find strategies that will make their spaces stand out from the rest. Adaptive reuse has increasingly drawn local developers’ attention because of its ability to not only allow them to reach their highest and best use, but to also still carry Portland’s authenticity forward. Anna Langley of Langley Investment Partners states, “I believe in Portland – and I believe that the Portland office market will thrive as long as we start thinking of creative ways to make projects competitive that also reflect the character of the community.” Langley recently developed Redfox Commons, the only office redevelopment that delivered this quarter. The new 60,000 square foot space at the intersection of Northwest 27th and Northwest Wilson Street weaves together two World War II era warehouses and hints at Portland’s industrial past with its design and preservation of the structure’s original lumber. Completed earlier this year, the project stands out at the newest creative office space in Portland with opportunities abound. Langley insists, “It’s time to be unique; we can’t keep seeing the same ideas repeating; there are so many beautiful buildings ready for repurposing.” With an increased number of adaptive reuse projects and renovations in the works, other developers have clearly taken note. As we move into the second quarter, it will be fascinating to see how the creative futures of former buildings are designed and how they may reconfigure the office market as a whole.

IMAGE 1: 2019 ASKING RENTS BY MARKET: HIGHEST PRICED U.S.

Brokerage	Total	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Colliers	10.2%	13.5%	13.0%	14.4%	13.0%	-
JLL	13.0%	14.5%	13.1%	17.0%	14.0%	-
Kidder Mathews	7.5%	11.2%	11.1%	10.4%	9.3%	6.1%
Newmark Knight Frank	10.7%	12.4%	-	-	-	-
CBRE	11.6%	12.8%	10.5%	10%	22.4%	10.4%

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

TABLE 2: AVERAGE DIRECT ASKING RATES (\$/SF FSG) BY BROKERAGE HOUSE AND CLASS, FIRST QUARTER, 2019

Brokerage	Market Average	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Newmark Knight Frank	\$29.44	\$33.43	\$36.82	\$32.00	-	-
Kidder Mathews	\$27.00	\$32.21	\$35.46	\$30.37	\$25.24	\$23.65
Colliers	\$27.31	\$32.05	\$36.39	\$30.87	\$25.79	-
CBRE	\$31.01	\$34.78	\$38.11	\$34.39	\$30.05	\$25.07
JLL	\$32.12	\$36.16	\$39.78	\$34.91	\$27.33	-

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

VACANCY & RENTAL RATES

Despite a significant amount of deliveries last quarter, vacancy rates this quarter remain static, showcasing Portland's strong demand for office space. Kidder Mathews reports, "Direct vacancy only rose by 50 basis points (bps) year-over-year...furthermore, despite the slight increase in vacancy, rental rates grew 4.23% year-over-year and are now higher than at any other time in the last 15 years."

Ongoing demand as well as class A developments have continued to push Portland's rental rates higher. According to CBRE's Econometric Advisors Forecast, "Portland's average asking lease rates will continue to increase gradually over the next five years as the market continues to grow and expand with new developments." The market's average rental rate among brokerage houses ranged from \$27.00 to \$32.12, while Portland's CBD was higher, ranging from \$32.21 to \$36.16.

TABLE 3: NET ABSORPTION (IN SQUARE FEET) BY BROKERAGE HOUSE AND MARKET AREA, FIRST QUARTER 2019 AND PREVIOUS QUARTER

Brokerage	Q1 Overall	Q1 Overall 2018	Q1 CBD	Q1 2018 CBD
JLL	99,248	(79,878)	17,720	(268,296)
Newmark Knight Frank	144,038	(209,365)	65,028	(102,125)

Source: JLL & Newmark Knight Frank

IMAGES 2 & 3: THE DAIRY BUILDING – ONGING RENOVATIONS UNDERWAY



Source: Costar and Intrinsic Ventures

TABLE 4: NOTABLE LEASE TRANSACTIONS, FIRST QUARTER 2019

Tenant	Building/Address	Market	Square Feet
University of Western States	800 NE Tillamook	Outer Eastside	152,642
Squires	District Office	SE Close-in	31,692
East West College of Healing Arts	1515 Market Square	CBD	30,307
Jacobs Engineering (Expansion)	Jacobs Center	CBD	24,521
PacificSource	Crown Plaza	CBD	24,021
6 Degrees Health	Five Oaks West—Credence	Sunset Corridor/Hillsboro	24,000

Source: CBRE & Newmark Knight Frank

ABSORPTION & LEASING

The first quarter of 2019 saw 99,248 square feet of positive net absorption, contrasting last quarter’s 79,878 square feet of negative net absorption. Jerry Holdner, Director of Research at Kidder Mathews, noted:

Suburban markets as a whole saw far more net absorption than their downtown counterparts, with the Central Business District ending the quarter with 75,870 s.f. of negative net absorption. Downtown space is still considered prime real estate, so it is likely that net absorption will reach positive territory over the year.

As noted in last quarter’s report, flex space has continued to pick up steam in the Portland office market. This is showcased in this quarter’s lease transactions that include three flex space providers. The Dairy Building, located in the Southeast Close-In submarket, is an example of an adaptive reuse project catered to flex space tenants. The 46,503 square foot former Dairy Building has been renovated in the past couple of years and is now host to startups and tech tenants like Activity Connection, Nice Touch Corp, Intuitive Digital, Sproutbox Media, Blue Blazes, and Photos to Canvas. The Dairy Building includes a centrally located event space and common room for tenants to build relationships with each other as well as their clients. Riley Henderson of NAI Elliott, who represents developer/owner Mike Lindquist and Intrinsic Ventures, said “The tenants here are in a community; in a traditional space you don’t sense that. . .now, you feel like you’re in it.”

TABLE 5: NOTABLE SALES TRANSACTIONS, FIRST QUARTER 2019

Building/Address	Buyer	Seller	Market	Price	Price/SF
Heartline Building	Intercontinental Real Estate Corporation	Security Properties, Inc.	Northwest	\$48.5 M	\$672
Former Hanfield Pet Hospital	W.P. Carey, Inc.	Hanfield Pet Hospital	NE-Class-in	\$25 M	\$164
Cornell West	Vista Investment Group, LLC	TA Realty	Sunset Corridor	\$22 M	\$189
Verum Building	Benefits Solutions, Inc.	East West College	Lloyd	\$17.5 M	\$118

Source: Colliers, Portland Business Journal

SALES TRANSACTIONS

A notable transaction to start the year included Security Properties’ \$48.5 million sale of the Heartline Building to International Real Estate, Inc. for \$672 per square foot. This was higher than the per-square-foot high-water mark of Towne Storage at \$627 in 2018. In a recent press release, Nick Kucha, vice chair at Newmark Knight Frank, said, “The sale of Heartline is a testament to the strength and desirability of Portland’s Pearl District, along with the quality of the asset.”

The JLL research team also summarized Portland’s sales trends:

Capital markets [in Portland] remain upbeat as well, with the quarter registering \$194 million in sales. This number is set to swell significantly with the sale of Montgomery Park at the end of the first quarter. As Portland’s second-largest multi-tenant office building, expect to see the highest pricing for a single asset since US Bancorp Tower’s sale in 2015.

Field Office, the creative office development from project[^], also sold to Goldman Sachs and Lincoln Property Company in May. The “anti-office office” located on NW Front Avenue just north of the Fremont Bridge is a block size urban campus with 287,000 square feet. Anyeley Hallova of project[^] noted, “We wanted to redefine an office’s relationship with nature.” The firm developed a Flora Field Guide that describes the compilation of the 78 species of plants and trees located throughout the project. The guide notes, “Field Office was created around the notion of blurring the line between indoors and outdoors, work and play, commerce and creativity, architecture and landscape.”

TABLE 6: NOTABLE DEVELOPMENT PROJECT DELIVERIES, FIRST QUARTER 2019

Building/Address	Developer/Owner	Market	SF	Delivery Date
Redfox Commons	L&L Investment Partners	NW Class-B	60,000	Q1 2019

Source: Colliers and CoStar

IMAGES 4, 5, & 6: REDFOX COMMONS – DELIVERED IN FIRST QUARTER 2019



Source: Lever Architecture

DELIVERIES AND CONSTRUCTION

According to Newmark Knight Frank, there are seven office buildings currently being renovated that total 529,813 square feet. For reference, two years ago, half of this amount was under renovation. Scott Miller, Research Analyst at NKF, states: “Many older office buildings located in prime locations are getting facelifts as landlords modernize spaces and provide more amenities that are in demand.” Additionally, developers are increasingly re-vamping manufacturing buildings to create different uses than were originally intended.

After four years of implementation, the Redfox Commons building was delivered earlier this year. According to Langley, flex space is intriguing because the design “depends on the culture of that particular business as well as their vision.” With Redfox Commons, she’s held back for the right tenant that may need a higher density buildout. “Tech tenants have changed,” she notes, “...each company now thinks about the ‘cost per employee’” in terms of the space’s use, sense of character, aesthetic compatibility with its brand, location, and affordability.

TABLE 7: NOTABLE RENOVATION/UNDER CONSTRUCTION PROJECTS, 2019 - 2021

Building/Address	Developer	Submarket	SF	Delivery Date
Nike North Expansion Building B	Gerding Edlen	Westside	1,003,585	Q1 2019
Block 29 Center for Health & Housing 250 Taylor	Oregon Health & Science University Third & Taylor Development LLC	Southwest (CBD)	300,000	Q1 2018
The Canvas at Prime Hooks	Security Properties & Urban Renaissance Group	Southwest	140,000	Q2 2020
Aldias Expansion	Aldias America	Hayden Island	180,000	Q1 2020
5 MLK Office	Gerding Edlen	Lloyd District	119,570	Q4 2019
District Office	Beam Development	Southwest	90,778	Q2 2019
7 SE Stark	Hirsch Investment Properties	Lloyd District	70,000	Q2 2019
Premier Gear & Machine Works	Sturgeon Development Partners	Northwest	64,883	Q2 2020
Beacon Lake Oswego	TD Branch	Lake Oswego/West Linn	8,000	Q1 2020
Tree Farm	Guerrilla Development	SE Close-in	33,750	Q3 2020

Source: CoStar

IMAGE 7: PREMIER GEAR & MACHINE WORKS BUILDING – UNDER CONSTRUCTION



Source: LRS Architects

Located at 1715 NW 17th Avenue in the same submarket as Redfox Commons, the renovation of the existing Premier Gear & Machine Works Building is yet another example of an adaptive reuse in the works. Sturgeon Development Partners bought the property in July 2017 for \$6.75 million and hired LRS Architects to revamp four buildings that span an entire city block into creative office space. Julio Rocha with LRS stated in a recent article, “One of our primary goals is to take the disparate pieces of each building and unify them into a series of cohesive spaces.” The adaptation of the space desires to celebrate industrial roots by using most of the existing structure and elements. Listed for a triple net lease at \$32.00 per square foot, the project is set to be completed in 2020.

With any expansion or booming market, the triumph of a city’s authenticity is at stake. In the first quarter of 2019, what we have seen in Portland’s office market is healthy competition to restore elements of the city’s past in order to cater to the city’s future. Catch it while you can.