
OFFICE MARKET ANALYSIS

ALEC LAWRENCE

Portland State University

The Portland Metro economy continues to perform strongly, with 3.2 percent job growth over the last 12 months spread over a diverse group of industries. The State of Oregon's Office of Economic Analysis (OEA) has also revised its initial winter estimates with more optimistic projections. Despite a small uptick in unemployment from 5.4 percent in June to 5.7 percent in July due to an influx of "people entering the labor market or who are leaving their jobs voluntarily," unemployment closely trailed the national rate of 5.3 percent in July and sits well below the July 2014 Portland Metro rate of 7.0 percent. Nick Beleiciks, Oregon's state employment economist, notes, "Oregon's economy is adding jobs so fast right now that many of [the recently unemployed] will find work quickly."

The third quarter brokerage reports focused on the strength of the market for landlords and developers:

- **Colliers** highlighted the expanding prospects for a Bioscience District anchored by OHSU in the South Waterfront and OMSI in the Central Eastside and connected by the now open Trimet Orange Line and Tilikum Crossing. OHSU's has proposed one million square feet in construction in addition to its Knight Cancer Institute, which should stimulate additional development.
- **Kidder Mathews** focused on the continued strength of creative office in the Portland Metro with decreasing vacancy, slightly increasing rents, none to minimal free rent offered, and four development proposals during the quarter for creative office.

■ **Alec Lawrence** is a Master of Real Estate Development candidate and has been awarded the Center for Real Estate Fellowship. Any errors or omissions are the author's responsibility. Any opinions are those of the author solely and do not represent the opinions of any other person or entity.

- **CBRE** led its report with an analysis of increasing tenant improvement (TI) dollars in the Downtown submarket. CBRE finds three factors at play: 1) while there are a large number of deliveries on the horizon, large tenants in need of space now are looking to Portland's older inventory, and that inventory is often in need of upgrading; 2) new institutional landlords are locked in to meeting high rent requirements but have capital for TIs; and 3) in the race for creative office cachet, tenants are accepting high rents for the right TI and building. CBRE's conclusion: despite higher TIs, tenants are accepting longer terms and higher rates with "landlords squarely in the driver's seat."
- **JLL** leads with an overview of increased development activity. Noting that "developers shift into high gear," with total 2015 deliveries projected to be 532,980 square feet and 1.2 million square feet forecasted for 2016. According to JLL, 50 percent of that development pipeline is already preleased.

VACANCY

CBRE found vacancy to be at its lowest rate since the fourth quarter 2007 but calls for vacancy rates to increase to historic average rates as new construction and redevelopment projects deliver. CBRE's data show Suburban vacancy rates at their lowest rate in Portland's recorded history at 12.8 percent.

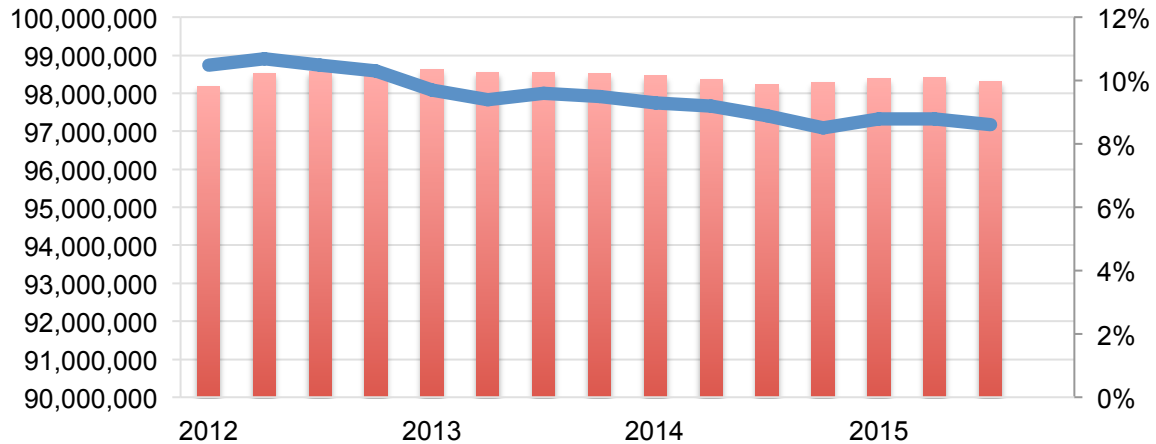
Kidder Mathews mirrored the sentiment, noting the continued "steady pattern of decline" in vacancy, with their data indicating that total Portland Metro office vacancy decreased slightly to 8.6 percent from 8.8 percent during the third quarter 2015. In terms of direct vacancy, the 8.6 percent vacancy rate in the third quarter marks a year-on-year decrease of 30 basis points from 8.9 percent in the third quarter 2014 and the fifth consecutive quarter of below 9.0 percent vacancy rates.

Table 1: Total Vacancy Rates by Brokerage, Class, and Quarter-to-Quarter Change, Third Quarter 2015

Brokerage	Total	CBD	CBD Class A	CBD Class B	CBD Class C	Q-to-Q Change
CBRE	11.0%	9.9%	--	--	--	Decrease
Colliers	9.8%	10.0%	10.0%	10.5%	8.8%	No Change
JLL	9.1%	7.7%	7.4%	7.9%	8.0%	--
Kidder Mathews	10.3%	--	--	--	--	Decrease
NAI	--	10.8%	10.2%	10.0%	13.5%	*Increase

*Change for Central City. Source: Brokerage Quarterly Reports

Figure 1: Portland Office Market Total RBA (square feet) and Direct Vacancy Rate (%), 2012-2015



Source: Kidder Mathews

JLL reported a Portland Metro third quarter 2015 direct vacancy rate of 8.7 percent. Two market areas outperformed the average direct Portland Metro rate: Portland Central City with an average direct vacancy rate of 6.9 percent and the Portland Eastside with an average direct vacancy rate of 8.1 percent. Seven individual submarkets outperformed the average direct Portland Metro rate: Lloyd District (4.1 percent), Close In Eastside (4.6 percent), Vancouver Mall (5.1 percent), Sunset Corridor (5.5 percent), the CBD (7.2 percent), Kruse Way (7.2 percent), and Airport Way/Columbia Corridor (7.8 percent).

Table 2: Portland Vacancy Rate Ranked by Market area and Submarket, Third Quarter 2015

Market Area	Submarket	Vacancy
Ranked by Market (Portland Metro Shown for Comparison)		
Portland Central City	Total	6.9%
Portland Eastside Suburbs	Total	8.1%
Portland Metro	Total	8.7%
Portland Westside	Total	10.5%
Vancouver Suburbs	Total	10.6%
Ranked by Submarket (Portland Metro Shown for Comparison)		
Portland Central City	Lloyd District	4.1%
Portland Eastside Suburbs	Close In Eastside	4.6%
Vancouver Suburbs	Vancouver Mall	5.1%
Portland Westside	Sunset Corridor	5.5%
Portland Central City	Portland CBD	7.2%
Portland Westside	Kruse Way	7.2%
Portland Eastside Suburbs	Airport Way/Columbia Corridor	7.8%
Portland Metro	Total	8.7%
Portland Westside	SW Close In	9.4%
Vancouver Suburbs	Hazel Dell / Salmon Creek	9.8%
Vancouver Suburbs	CBD/West Vancouver	10.4%
Portland Eastside Suburbs	Clackamas / Milwaukie Totals	10.9%
Vancouver Suburbs	Cascade Park/Camas	11.0%
Portland Westside	Northwest	12.8%
Portland Eastside Suburbs	Outer Eastside	13.5%
Portland Westside	I-5 South Corridor	14.0%
Vancouver Suburbs	St. John's Central Vancouver	14.4%
Portland Westside	217 Corridor / Beaverton	14.7%
Vancouver Suburbs	Orchards/Outer Clark	15.5%

Source: JLL

RENTAL RATES

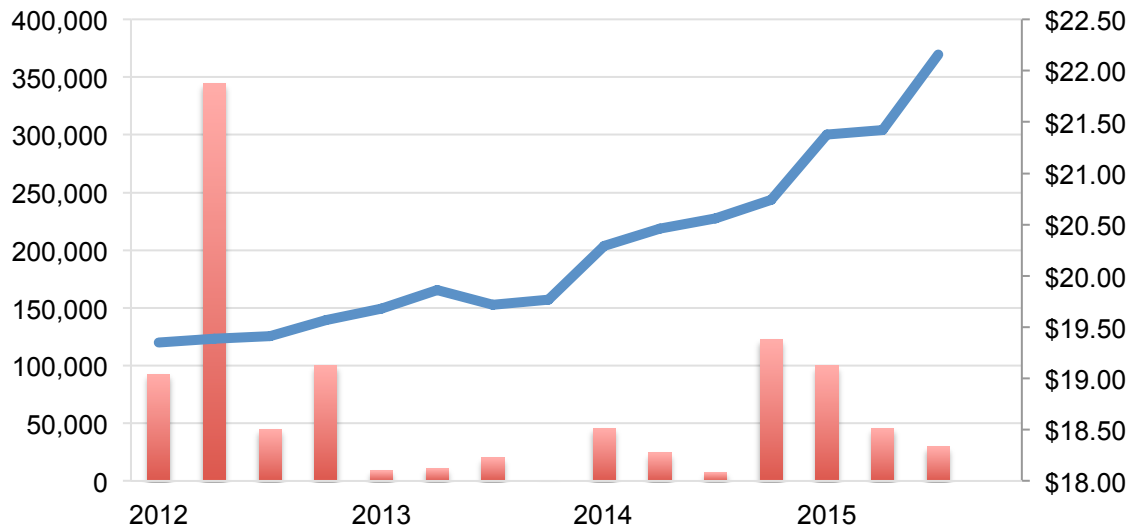
Table 3: Average Quoted Rates (\$/SF FSG) by Brokerage, Class, and Quarter-to-Quarter Change, Third Quarter 2015

Brokerage	Average	CBD	Suburban	CBD Class A	CBD Class B	CBD Class C	Q-to-Q Change
CBRE	24.07	27.53	21.29	--	--	--	Increase
Colliers	22.73	27.62	--	29.91	27.42	21.51	Increase
JLL	24.08	28.95	--	31.22	28.38	24.57	Increase
Kidder Mathews	22.16	--	--	--	--	--	Increase
NAI	--	--	--	--	--	--	Increase

Source: Brokerage Quarterly Reports

Kidder Mathews indicates that the overall average quoted FSG rental rates rose to \$22.16 for the third quarter. A 7.8 percent year-over-year increase from \$20.56 in the third quarter of 2014. CBRE notes this is the 13th straight quarter that rental rates have increased and that rates are increasing at a faster pace than last year (6.7 percent year-over-year increase in 2015 versus a 3.7 percent increase in 2014).

Figure 2: Portland Office Market Average Asking Rents (\$) and Deliveries (square feet), 2012-2015



Source: Kidder Mathews

JLL data show the overall Portland Metro average direct asking rent at \$24.08. The Portland Central City market area is the only market area outperforming the Portland Metro with an average direct asking rent of \$28.60. However, viewed by submarket, JLL data indicate that the Close-In Eastside submarket has the highest overall average direct asking rents at \$29.72. Three other submarkets are outperforming the Portland Metro average: Portland CBD (\$28.95), Kruse Way (\$28.60), and the Lloyd District (\$24.92).

Table 4: Portland Average Direct Asking Rent (\$/p.s.f.) Ranked by Market Area and Submarket, Third Quarter 2015

Market Area	Submarket	Average Direct Asking Rent (\$/p.s.f.)
Ranked by Market Area (Portland Metro shown for Reference)		
Portland Central City	Total	28.60
Portland Metro	Total	24.08
Portland Eastside Suburbs	Total	23.03
Portland Westside	Total	21.95
Vancouver Suburbs	Total	20.12
Ranked by Market Area (Portland Metro shown for Reference)		
Portland Eastside Suburbs	Close In Eastside	29.72
Portland Central City	Portland CBD	28.95
Portland Westside	Kruse Way	28.60
Portland Central City	Lloyd District	24.92
Portland Metro	Portland Metro	24.08
Portland Westside	Northwest	23.45
Portland Westside	Sunset Corridor	22.23
Portland Eastside Suburbs	Clackamas/Milwaukie	22.15
Portland Westside	217 Corridor/Beaverton	21.00
Vancouver Suburbs	Hazel Dell/Salmon Creek	20.98
Portland Westside	I-5 South Corridor	20.66
Vancouver Suburbs	Cascade Park/Camas	20.55
Vancouver Suburbs	CBD/West Vancouver	20.47
Vancouver Suburbs	St. John's Central Vancouver	19.87
Portland Eastside Suburbs	Airport Way/Columbia Corridor	19.29
Portland Eastside Suburbs	Outer Eastside	19.08
Portland Westside	SW Close In	18.29
Vancouver Suburbs	Orchards/Outer Clark	18.01
Vancouver Suburbs	Vancouver Mall	16.77

Source: JLL

ABSORPTION AND LEASING

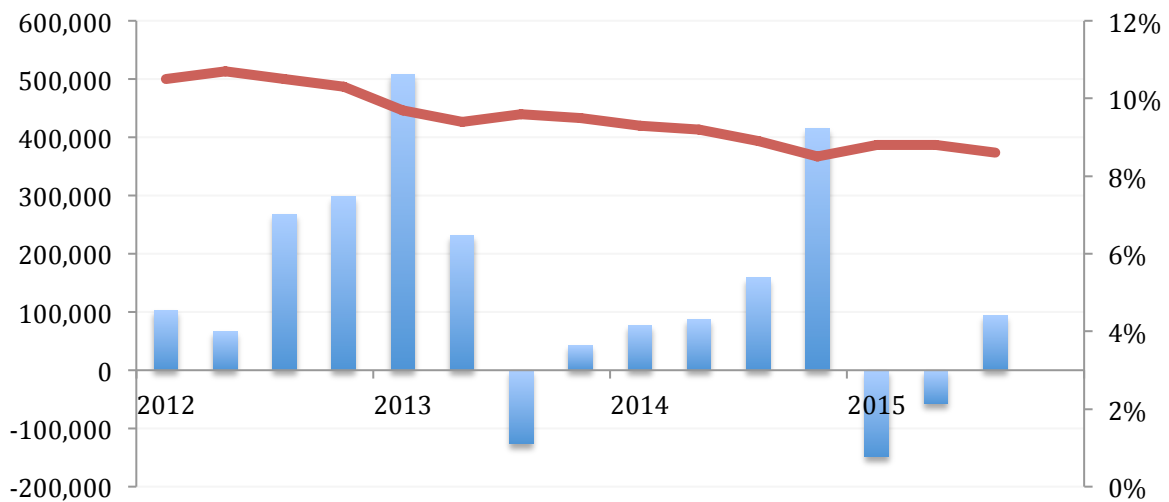
As related by Kidder Mathews, Portland experienced positive net absorption during the third quarter with a total of 94,221 square feet absorbed. Year-to-date absorption rates vary considerably by brokerage house with CBRE data indicating an overall 627,514 year-to-date absorption figure and Norris & Stevens data indicating an overall 1,177 year-to-date absorption figure. CBRE calls for Portland to surpass its 2014 total net absorption and points to potential demand for CBD space of over 500,000 square feet based on its knowledge of current tenants in the market. JLL suggests that weak third quarter absorption is not a product of a sluggish market, instead pointing to limited supply and upcoming deliveries on the horizon that are preventing large tenants from moving as they wait out additional deliveries.

Table 5: Net Absorption (square feet) by Brokerage and Area, Third Quarter 2015

Brokerage	Overall	CBD	Suburban
CBRE	206,796	(18,070)	159,534
Colliers	73,970	(96,602)	--
JLL	24,982	59,201	--
Kidder Mathews	94,221		
NAI	(147,329)	(187,526)	40,197

Source: Brokerage Quarterly Reports

Figure 3: Portland Office Market Net Absorption (square feet) and Vacancy (%), 2012–2015



Source: Kidder Mathews

Table 6: Portland Area Net Absorption Ranked by Submarket, Third Quarter 2015

Submarket	Net Absorption	As A Percent of Rentable Area
Total	206,796	0.5%
Suburban	159,534	0.7%
Downtown	47,262	0.2%
Beaverton	52,120	1.4%
Lloyd Center	47,891	2.4%
Vancouver	30,837	0.7%
Eastside	26,309	1.0%
Kruse Way	22,754	1.0%
West Hills	19,386	2.4%
WA Square	18,888	1.5%
Northwest	17,441	0.4%
Clackamas	15,644	1.3%
Lake Oswego	7,691	1.3%
Wilsonville	3,251	0.4%
Johns Landing	1,034	0.1%
Barbur Boulevard	-458	-0.1%
Tualatin	-4,643	-0.5%
Airport Way	-7,712	-1.4%
Hillsboro	-9,939	-0.9%
Tigard	-15,628	-0.8%
CBD	-18,070	-0.1%

Source: CBRE

Table 7: Notable Lease Transactions, Third Quarter 2015

Building/Address	Tenant	Market	Square Feet
AmberGlen Business Center	Nike	Sunset Corridor	105,505
CDK Plaza	CDK Global [renewal/expansion]	CBD	90,000
541 NE 20th Ave	Hanna Andersson	Lloyd/Central Eastside	51,335
Kruse Oaks III	Navex	Kruse Way	43,304
Kruse Woods V	Black & Veatch Corporation [renewal/expansion]	Kruse Way	32,671
AmberGlen Corp Center	Kaiser Permanente	Sunset Corridor	31,882
321 Glisan	Pacific Northwest College of Art	NW	31,644
Park Avenue West	Morgan Stanley	CBD	31,448
Pioneer Tower	Geffen Mesher [renewal expansion]	CBD	31,433
Tanasbourne Com. Center	Nike	Sunset Corridor	28,889
Arneson Building	Logical Position	Kruse Way	26,922
Commonwealth Building	Quantum Spatial	CBD	24,252
Fox Tower	Ruby Receptionist	CBD	19,290
Waterfront - Block 6	MJ Murdock	Vancouver	18,000
334 NW 11th Ave	Deskhub	CBD	17,991
2 & Taylor	Jama Software	CBD	17,920
Moda Tower	Moda Health Services Group [renewal/expansion]	CBD	16,700

Source: Colliers International; NAI Norris, Beggs & Simpson; CBRE

SALES TRANSACTIONS

Table 8: Notable Sales Transactions, Third Quarter 2015

Building Address	City	Price	Price/SF	SF
US Bancorp Tower	Portland	\$372,500,000	\$338.42	1,100,703
Block 300	Portland	\$155,252,000	\$429.10	361,808
Port of Portland Bldg	Portland	\$47,500,000	\$395.83	120,001
West End Building	Lake Oswego	\$20,100,000	\$226.17	88,871
Riverview Tower	Vancouver	\$18,750,000	\$114.43	163,856
New Market Theater Block	Portland	\$15,500,000	\$179.70	86,255
The Pettygrove Building	Portland	\$8,650,000	\$192.22	45,001
Parkway Plaza IV	Vancouver	\$8,636,680	\$170.00	50,804
221 Molalla Ave	Oregon City	\$6,287,260	\$182.97	34,362
Parkway Courtyard	Wilsonville	\$6,050,000	\$258.71	23,385
DHS Office Building	Oregon City	\$5,750,000	\$174.50	32,951
19 NW 5th Ave	Portland	\$2,750,000	\$118.40	23,226

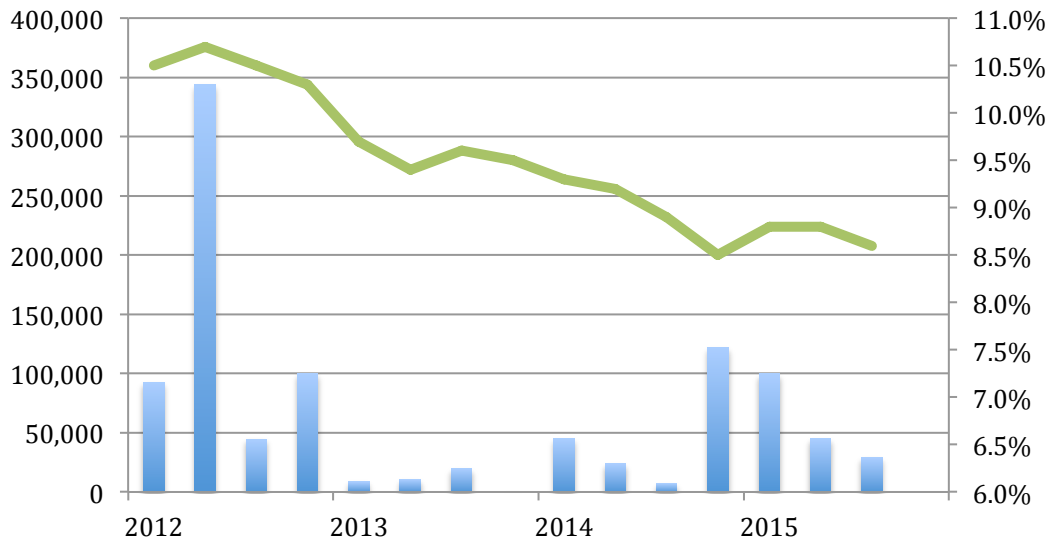
Source: Colliers International; NAI Norris, Beggs & Simpson; CBRE

DELIVERIES AND CONSTRUCTION

JLL is projecting a total of 532,980 square feet of deliveries for 2015, one of the highest figures in recent memory, with another 1.2 million square feet of new deliveries estimated to deliver during 2016. According to JLL, most new developments have taken place in the CBD and close-in submarkets with suburban rents not yet high enough to justify new development.

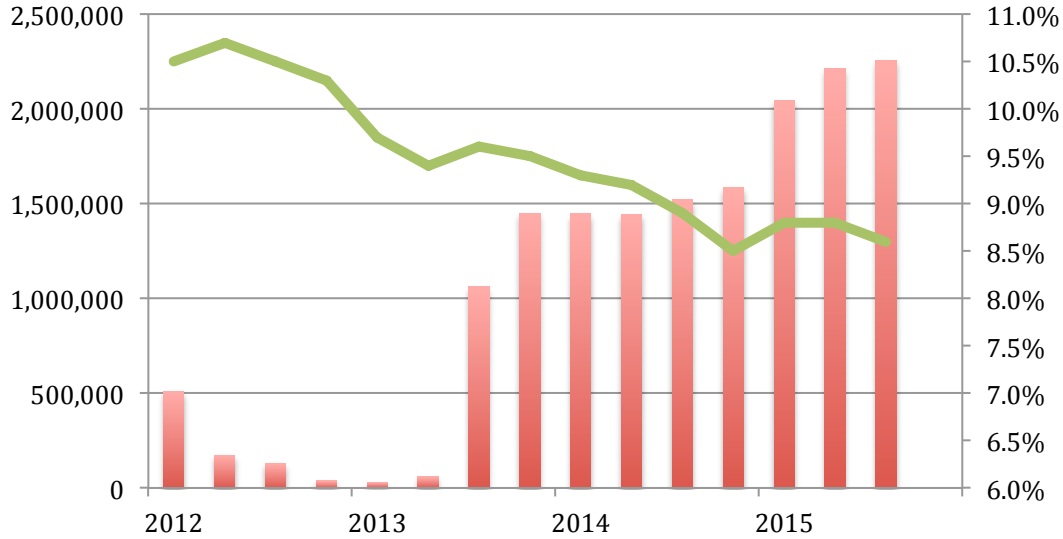
Kidder Mathews points to four creative office developments in the pipeline: the 100,000 square foot renovation of the Towne Storage Building, the 28,000 square foot renovation of The Stagecraft Building, the 45,000 square foot renovation of Laika’s former headquarters at 1400 NW Pettygrove Street, and the 75,000 square foot renovation/expansion of the Premier Press building. There were also two new office developments announced: the Field Office, a 270,00 square foot space proposed at NW 17th Avenue and Broadway Tower, a mixed-use building with 170,000 square feet of office at SW Columbia Street and Clay Street.

Figure 4: Portland Office Market Deliveries (rentable square feet) and Vacancy (%), 2012–2015



Source: Kidder Mathews

Figure 5: Portland Office Market Construction (rentable square feet) and Vacancy (%), 2012–2015



Source: Kidder Mathews

Table 9: Portland Office Market Construction by Submarket, Number of Buildings, Total RBA, and Preleasing, Third Quarter 2105

Submarket	Under Construction Inventory				Average Building Size	
	Buildings	Total RBA	Preleased SF	Preleased %	All Existing	U/C
Westside	0	0	0	0	28,821	1,000,000
CBD	5	576,029	372,996	64.8%	71,027	115,206
Northeast	2	300,671	268,567	89.3%	9,173	150,335
Clark County	2	254,000	232,880	91.7%	13,302	127,000
Southeast	1	72,000	0	0.0%	9,288	72,000
Northwest	1	29,933	29,933	100.0%	16,852	29,933
Lloyd District	1	24,400	5,124	21.0%	23,599	24,400
I-5 Corridor	0	0	0	0.0%	16,711	0
Southwest	0	0	0	0.0%	15,996	0
Totals	12	1,257,033	909,500	72.35%	204,769	1,518,874

Source: Norris & Stevens