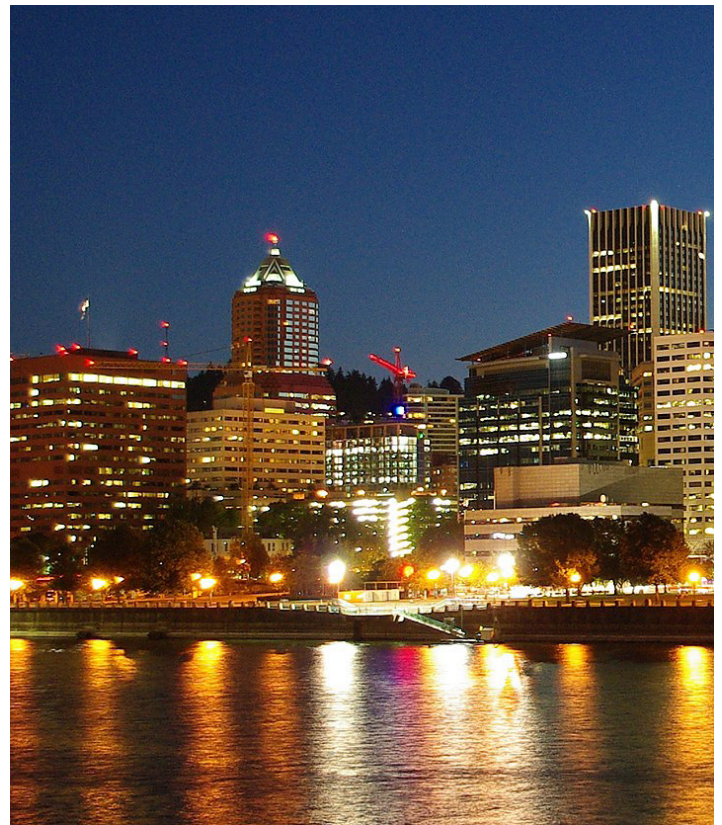


# OFFICE MARKET ANALYSIS

RILEY HENDERSON  
Portland State University

If the first quarter of 2017 can be characterized as mediocre, the second quarter has lifted the office markets across the board. The big story both nationally and locally is that absorption was back in the black in the second quarter, according to CoStar. Part of the slowdown in the first quarter may have been lingering effects of delayed leasing decisions due to an election year as well as absorption being historically low in the first quarter of every year. However, despite the good news in positive net absorption, CoStar reports the pace of national absorption is below the peak of 100 million square feet in 2015. This slowing in pace is a trend that is expected to continue.

While the economy as a whole is still expanding, it continues to grow at a less than thrilling pace. Early second quarter 2017 reports from the Bureau of Economic Analysis indicate a 2.6 percent increase in gross domestic product. This is an increase of 140 basis points from the first quarter of 2017. Looking into the future, a recessionary environment may be on our horizon. Despite the weakness of our current economic expansion, the fact remains that this is the third-longest economic expansion of the postwar era according to the National Bureau of Economic Research.



Riley Henderson is a Masters of Real Estate Development candidate through a joint program of Portland State University's School of Business Administration and School of Urban Studies and Planning. In addition, Riley is a commercial broker with NAI Elliott specializing in office leasing. He is the 2017 Oregon Association of Realtors Fellowship recipient. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

## OFFICE MARKET ANALYSIS

Currently, market fundamentals remain positive for the office sector. Rental rates continue to rise with a year-over-year growth of 2.3 percent, vacancy remains stable around 10.3 percent, construction is strong and sales volume is holding steady especially in smaller markets where investors perceive more value, according to CoStar. A trend that is playing out in Portland.

Locally, the Portland metro unemployment rate remains one of the lowest in the nation. This has helped keep the vacancy rate below 10 percent with Colliers reporting a vacancy rate of 8.2 percent in the second quarter of 2017. Both developers and investors are looking to capitalize on the hot Portland market. There is a substantial development pipeline in the works with around 2 million square feet under construction and every quarter as of late seems to produce yet another core asset transaction that sets a high water mark for Portland.

### Portland Metro's second quarter

- CBRE highlights Portland's athletic and outdoor industry growth is driving office leasing. Adidas has signed a lease for 80,000 square feet in Montgomery Park and Under Armour's takeover of the former YMCA on Barbur is set to be complete later this summer taking down approximately 73,000 square feet. Tech leasing has been slowing in the marketplace but the fierce competition in the footwear industry has been driving office activity this quarter.
- On the tail of a weak first quarter, Colliers' prediction of a bounce back in positive absorption for the second quarter came to fruition. Colliers is reporting 228,600 square feet of absorption which was particularly strong in the CBD. Rental rates in the outlying submarkets have been rising quickly resulting in tenants seeking less expensive space.
- JLL reports an increase in activity in the Portland office market that should make Portland's real estate professionals feel good about the year after a sluggish first quarter. Second quarter was anchored by the largest lease deal in two years when Autodesk took down the Towne Storage redevelopment in addition to the sale of 1320 Broadway to Credit Suisse for \$541 per square foot. This price set a new high-water mark for Portland on a price per square foot basis. However, JLL points out that uncertainty looms in the near future, with 2 million square feet of office set to deliver in the next year and a half, there is some questions as to whether the pace of office absorption in Portland can keep up with all of the new product.

## VACANCY

Vacancy rates across the submarkets and product classes remained relatively stable in the second quarter. Kidder Mathews is reporting the lowest Portland office market vacancy rate at 7.7 percent while CBRE reports the highest vacancy rate at 11.4 percent, which is an 11 basis point increase from the previous quarter. Colliers indicated that vacancy rates have lowered by 3 basis points for a market vacancy of 8.2 percent. From quarter to quarter, vacancy rates seem to be trending up at a very slow pace.

On the suburban office market side, CBRE is reporting an 11.9 percent vacancy rate with Tualatin on the top end of the vacancy rate at 21.6 percent and Wilsonville with the tightest market at 1.1 percent vacancy. The suburban markets have been performing well with Hillsboro seeing a 309 basis point decrease in vacancy according to CBRE.

The takeaway is that vacancy rates continue to remain stable in the Portland Market with a very slight trend upwards.

## VACANCY

Table 1: Total Vacancy Rates by Brokerage House and Class, Second Quarter 2017

Brokerage	Total	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
CBRE	11.4%	12.5%	10.1%	11.8%	20.3%	11.9%
Colliers	8.2%	10.0%	11.6%	9.3%	7.7%	-
JLL	9.8%	9.4%	9.5%	9.9%	8.4%	-
Kidder Mathews	7.7%	9.9%	-	-	-	7.0%

Source: CBRE, Colliers, JLL and Kidder Mathews

## RENTAL RATES

All of the large brokerage houses are reporting a rise in rental rates this quarter, which continues the upward growth trend. Rental rates have gone up 7 percent year-over-year, according to CBRE. Downtown Class A office leads the charge with an average rental rate of \$35 per square foot full service with new construction coming in around \$45 a square foot, full service, as reported by JLL. The strong increase in office rents across the market and specifically in the CBD has attracted institutional money as evidenced in the number of large core asset transactions in the CBD. The relative affordability of Portland's rents compared to other major West Coast markets continues to attract tenants looking to relocate or open secondary offices. For the short term, CoStar projects rental rates are expected to continue their upward trajectory and the lack of office development in the suburbs is likely to keep those markets strong in the coming years.

Table 3: Average Direct Asking Rates (\$/sf FSG) by Brokerage House and Class, Second Quarter 2017

Brokerage	Market Average	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
CBRE	\$26.75	\$31.18	\$34.25	\$30.68	\$26.85	\$23.31
Colliers	\$24.77	\$30.06	\$32.40	\$29.89	\$24.08	-
JLL	\$28.31	\$32.76	\$34.97	\$32.00	\$25.71	-
Kidder Mathews	\$24.56	\$29.55	-	-	-	\$22.21

Source: CBRE, Colliers, JLL and Kidder Mathews

## ABSORPTION AND LEASING

After the negative absorption seen in the first quarter of the year, the big story in Portland's office market is that absorption is back on the right track. CBRE reports 137,229 square feet of office was inked and Colliers is reporting 228,600 square feet of positive absorption in the second quarter 2017.

However, it's important to note that despite the positive absorption this quarter; year-over-year quarterly absorption is down 69 percent. This is a somewhat worrying trend as millions of square feet of new office construction is set to deliver in the next year and a large number of those projects are speculative office.

## ABSORPTION AND LEASING

Table 4: Net Absorption (in square feet) by Brokerage House and Market Area, Second Quarter 2017

Brokerage	Overall	CBD	Suburban
CBRE	137,229	(16,967)	107,863
Colliers	228,563	203,428	25,135
JLL	145,011	60,766	-
Kidder Mathews	282,334	96,872	190,360

Source: CBRE, Colliers, JLL and Kidder Mathews

Table 5: Net Absorption (in square feet) by Brokerage House and Market Area, Year to Date

Brokerage	Overall	CBD	Suburban
CBRE	77,419	(231,534)	62,683
Colliers	147,618	157,167	(9,549)
JLL	37,621	38,437	-
Kidder Mathews	374,607	111,565	98,016

Source: CBRE, Colliers, JLL and Kidder Mathews

Table 6: Notable Lease Transactions, Second Quarter 2017

Tenant	Building/Address	Market	Square Feet
Autodesk	Towne Storage	Central Eastside	108,750
Adidas	Montgomery Park	NW Close-in	79,657
Wells Fargo	Montgomery Park	NW Close-in	74,935
Farmers insurance	Pacific Parkway #A	Tigard	40,250
Undisclosed	6430 SE Lake Rd	Clackamas/ Milwaukie	17,495
Kittelson & Associates, Inc.	Pacific Center	CBD	16,537

Source: CBRE and Colliers

## SALES TRANSACTIONS

Once again, Portland continues to catch the eye of institutional investors in the second quarter. The sale of 1320 SW Broadway took the lead this quarter with a purchase price of \$95 Million, coming out to \$541 on a per square foot basis, a new record for a Portland office building. Only to be surpassed a few months later by the sale of Pearl West, which is an early third quarter transaction but comes in at \$563 per square foot. Both of these sales follow up other notable transaction in the last year including the Pacwest Center, Pioneer Tower, Umpqua Bank Plaza and the Congress Center. The volume and pricing of these assets at such a sustained level is not something the Portland market has experienced before. This is following two years of strong sales volume. According to CoStar, sales volume in 2016 was \$1.2 billion, slightly under the post recessionary sales peak of \$1.3 billion in 2015. Time will tell if 2017 can match those number but with rising

## SALES TRANSACTIONS

rents, relatively low vacancy and some strong sales already this year, things are trending in the right direction for the short term and institutional buyers have taken note.

Table 7: Notable Sales Transactions, Second Quarter 2017

Building/ Address	Buyer	Seller	Market	Price	SF	Price/SF
1320 Broadway	Credit Suisse	Urban Renaissance Group & Clarion	CBD	\$95,000,000	176,000	\$539.77
Sunset Corporate Park	Swift	Lone Star Funds	Sunset Corridor	\$24,500,000		\$191.80
AmberGlen Corporate Center	Swift	AmberGlen Properties, LP	Sunset Corridor	\$18,850,000	152,142	\$123.90
Summerlinn Center	S&G Properties NW	BHSUM, LLC	Lake Oswego	\$14,900,000	64,916	\$229.53
The Marquam Building	Bixby Land Co.	Weston	CBD	\$10,800,000	75,000	\$144.00
Parkway Plaza	Winkler Development	Specht	Vancouver Mall	\$7,250,000	52,969	\$136.87

Source: CBRE, Colliers and CoStar

## DELIVERIES AND CONSTRUCTION

Construction remains hot for Portland's office market as developers try to take advantage of favorable market conditions. JLL is reporting that there is 1,971,508 square feet under construction at the moment. The big question out there is who will fill the space? "Portland is historically not a strong 'leasing before construction starts' kind of town, with the majority of leasing occurring fairly close to delivery," according to JLL. Colliers is reporting that 28.5 percent of the development pipeline is now preleased which is an 18 percent increase from the first quarter of 2017. A substantial increase but there is still a significant amount of space without a tenant at the moment. Some of the large speculative projects like Field Office by Project^ and Broadway Tower by BPM Real Estate, both set to deliver in 2018 will be barometers of how the speculative office market is fairing in the coming year.

Table 8: Notable Development Projects Under Construction, Second Quarter 2017

Building/Address	Developer	Market	SF	Delivery Date
Knight Cancer Institute	OHSU	South Waterfront	332,000	2019
Field Office	Project^	NW Close-In	330,208	2018
9North	Williams & Dame/ Miller Global	CBD	202,168	2018
Broadway Tower	BPM Real Estate - Office	CBD	177,800	2018
The Leland James	Cairn Pacific / Capstone Partners	NW Close-In	118,000	Q3 2017
Under Armour	Interurban Development	Barbur Blvd/ Capital Hwy	108,698	Q3 2017

Source: Colliers and CoStar