

OFFICE MARKET ANALYSIS

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The national office landscape ended the year strong with most of the major metrics showing positive improvements across the board. The economy has been strong, leading businesses to expand and increase their office footprint. The national vacancy rate remained unchanged at 9.4 percent, which is across all office classes. Rental rates increased 2.2 percent in the quarter to \$25.15 per square foot nationally. Tech companies continue to take down large amounts of office space; the two largest leases signed nationally in the fourth quarter are by Amazon for 738,902 square feet of space in Seattle and Dropbox for 736,550 square feet of space in San Francisco. Additionally, Apple opened their new campus in 2017 taking up 2,800,000 square feet at their custom designed Apple Park.

Locally the Portland office market continued its strong performance on the back of two previous quarters of solid market growth. The biggest unknown in the office market this year has been the amount of new construction in the development pipeline. But as some of that space starts to hit the market, the early signs are positive that the deliveries may not have as large of an impact on the market as previously thought.



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The Portland metropolitan area's third quarter at-a-glance:

- Colliers notes that 2017 started off rocky but the market quickly recovered and has not looked back since. They report that 780,000 square feet was absorbed over the year. With 1.15 million square feet of office product currently under construction, they predict most of it will be absorbed over 2018 and into early 2019 assuming we see about the same amount of absorption in 2018 as we did in 2017. They note some recently announced leases in speculative projects that may be early indicators of a strong leasing market in 2018.
- In JLL's fourth quarter report, the Portland office vacancy rate has remained under 10 percent going on four years in a row. In another sign of the recent strength of the market, JLL states that the sale of CBD office properties has surpassed \$1 billion in total volume in a year for the first time. The largest sale of the quarter was the trading of the Wells Fargo Center for \$188 million. Looking into next year, the biggest challenge to the market as reported by JLL is not so much the coming deliveries but challenges with finding experienced workers in a very tight labor market as the economy nears full employment. This may slow down office expansion.
- Wrapping up the year, Kidder Mathews highlighted the strong sales activity through the year. They report that the average price per square foot of sales jumped up 25 percent to end the year at \$276 per square foot. There is an appetite for stabilized properties and investors seeking yield through the repositioning of existing properties. They highlight the sale of the U.S. Customs building. Purchased for \$4.74 million, the developer Vista Investment Group repositioned the building and leased the entire property to WeWork. They sold the building in 2017 for \$30 million, which equates to \$448 per square foot.

VACANCY

The Portland office market vacancy ended the year below 10 percent, which should make investors feel good about the performance of the market in 2017. The lowest reported vacancy rate was by Kidder Mathews at 7.0 percent and the highest market vacancy rate was 9.9 percent according to JLL. The expectation for vacancy rate is that this is the lowest it will hit this cycle. However, in previous quarters the vacancy rate has been projected to rise but it seems that firms are predicting the rate to be more stagnant than rise precipitously. This is in part due to the strong leasing activity seen in the last quarter of the year.

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

Brokerage	Total	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Colliers	9.2%	9.8%	8.6%	11.6%	9.7%	-
JLL	9.9%	9.5%	8.8%	10.8%	9.4%	-
Kidder Mathews	7.0%	8.8%	-	-	-	6.7%

Source: CBRE, Colliers, JLL and Kidder Mathews

RENTAL RATES

Once again, rental rates trended upward in the fourth quarter to end the year on a positive note. The average rental rate was in the mid to high \$20 per square foot range. This has been a strong year for rental rate growth. According to CoStar, rates have increased 3.3 percent from the end of the third quarter.

So long as vacancy remains low, landlords should continue to have the ability to incrementally raise rates in the coming year. However, the office landscape is expected to become increasingly competitive. The expectation is that landlords will increase their incentive packages rather than lower rates at first. If the glut of new construction substantially effects the market, expect to rental rates to stay stable for the near to mid-term as investors use larger incentives to lure tenants. Longer term, if the incentives are not working to fill buildings, rates will start to drop towards the end of 2018.

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

Brokerage	Market Average	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Colliers	\$25.87	\$30.86	\$34.15	\$29.83	\$24.50	-
JLL	\$29.23	\$33.67	\$36.28	\$32.63	\$26.11	-
Kidder Mathews	\$25.88	\$30.61	-	-	-	\$23.42

Source: CBRE, Colliers, JLL and Kidder Mathews

ABSORPTION AND LEASING

Leasing activity in the quarter continued a strong streak resulting in year-to-date net absorption somewhere between 558,000 square feet and 781,000 square feet depending on who is reporting. Colliers reports there were four leases above 30,000 square feet in Portland's CBD signed this quarter.

Amazon signed the biggest lease in the month at the under-construction Broadway Tower. This 83,955 square foot lease adds to their presence in the area as they occupy a majority of the newly renovated Oregonian Building across the street from Broadway Tower.

Over the course of the year two large companies signed leases to relocate their headquarters. NW Natural signed a lease for the 250 Taylor project although that is just getting underway and occupancy is not projected to be until 2020. Autodesk signed a lease at the Towne Storage building taking the entirety of that adaptive reuse development. In total they took down 100,022 square feet on 17 SE Third Avenue to relocate from Kruse Way. With more new speculative office hitting the market, Portland may see some other large leases signed in 2018 by companies who have been unable to find large contiguous space options in our previously supply constrained market.

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

Brokerage	Overall	CBD	Suburban
Colliers	303,853	221,206	-
JLL	249,016	(32,907)	-
Kidder Mathews	300,144	206,240	24,064

Source: CBRE, Colliers, JLL and Kidder Mathews

ABSORPTION AND LEASING

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

Brokerage	Overall	CBD	Suburban
Colliers	778,485	396,529	-
JLL	588,861	162,244	-
Kidder Mathews	834,761	410,385	384,680

Source: CBRE, Colliers, JLL and Kidder Mathews

Table 6: Notable Lease Transactions, Third Quarter 2017

Tenant	Building/Address	Market	Square Feet
Amazon	Broadway Tower	CBD	83,995
loavation	US Bancorp (plaza)	CBD	62,033
Oregon State University	Meier & Frank Building	CBD	39,500
Appearance	Field Office – West	CBD	30,865

Source: CBRE and Colliers

SALES TRANSACTIONS

The appetite for CBD properties in the year was very strong from institutional buyers. This pushed up the total sales volume above \$1 billion for the first time as noted by JLL. The year also saw a few records set on a price per square foot basis, as investors were willing to pay a premium for stabilized assets. The Oregonian Building, Pearl West and the Weiden & Kennedy Building all traded this year above the \$500 per square feet threshold. Each transaction set a new record for price per square foot.

In addition to the appetite for stabilized assets, investors believe in the Portland office market long term as value-add properties also made up a significant portion of the sales volume in the year.

The fourth quarter saw the sale of the Wells Fargo Center. Kidder Mathews reports that the building was only 57 percent leased at the time of sale and was in desperate need of upgrades which the new owner plans to do. They see a lot of potential in a major renovation and reposition of that very notable asset.

The attention on Portland's office market from institutional capital is expected to remain in the coming year. As the new developments deliver to the market and get leased up, developers will be looking for exist strategy's hoping long-term ownership groups will take them out. As long as the strong underlying fundamentals of the market remain, the expectation is that there won't be a shortage of buyers as evidenced by the record setting sales in 2017.

SALES TRANSACTIONS

Table 7: Notable Sales Transactions, Fourth Quarter 2017

Building/ Address	Buyer	Seller	Market	Price	SF	Price/ SF
Wells Fargo Center	Starwood	Wells Fargo	CBD	\$188,000,000	884,941	\$212.44
400 SW Sixth Ave	SteelWave	Felton Properties	CBD	\$68,000,000	208,477	\$326.18
William Barnhardt Center	Consolidated Tomoka	National Financial Realty	Sunset Corridor	\$39,750,000		\$187.62
US Customs House	Vista Investments	Eastern Real Estate	CBD	\$30,000,000		\$448.20
Captain Couch, Merchant & Norton House	NBP Capital	Swift	CBD	\$19,000,000		\$215.67

Source: CBRE, Colliers and CoStar

DELIVERIES AND CONSTRUCTION

There has been a substantial amount of office development undertaken in the year as developers turned their attention to the market for opportunities. Until this recent development wave, the office market had been starved for new properties and companies looking to expand had few options for large spaces. This month saw some of the new construction hit the market. The largest project delivered was the Leland James developed by Cairn Pacific and Capstone Partners. This project in Northwest delivered 118,000 square feet and was 28 percent preleased at the time of delivery. Another smaller sized office project delivered in the month was Twelfth and Morrison developed by Menashe Properties. This project contains 62,381 square feet and according to Colliers was 54 percent preleased at delivery.

The sentiment among brokerage houses seems to have changed from slightly pessimistic to mildly optimistic about the market's ability to absorb the large amount of construction in the pipeline. The large office leases signed to date on speculative developments is lifting expectations that the market can absorb the new product efficiently without a large hit to vacancy or rental rates.

**DELIVERIES AND
CONSTRUCTION**

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

Building/ Address	Developer	Market	SF	Delivery Date
Field Office	Project^	NW Close-In	330,208	Q1 2018
Clay Pavillion	Killian Pacific	SE Close-In	75,000	Q1 2018
Custom Blocks	Capstone Partners/ Premium Property USA	Central Eastside	71,594	Q1 2018
Heartline	Security Properties	CBD	70,702	Q1 2018
Redfox Commons	L&L Investment Partners	Guilds Lake	60,000	Q2 2018
9North	Williams & Dame/ Miller Global	CBD	202,168	Q3 2018
Waterfront Block 6	Gramor	Vancouver CBD	77,000	Q3 2018
Broadway Tower	BPM Real Estate - Office	CBD	177,800	Q4 2018

Source: Colliers and CoStar