OFFICE MARKET ANALYSIS

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The national office market continues to be on a tear after the first quarter of 2018. Absorption and rental rates are up while the vacancy rate was unchanged. New office deliveries totaled 12.3 million square feet across the country for the first quarter of 2018. New deliveries have exceeded the 10 million square feet mark in 10 of the past 11 quarters according to CBRE national research. Seventy percent of the deliveries this quarter were preleased. In the same CBRE report, it was noted that five markets, Manhattan, San Francisco, Washington D.C., Seattle, and Dallas account for 49 percent of the entire construction pipeline. Manhattan alone made up 17 percent of the total new office pipeline.

In contrast, the Portland market is off to a somewhat slower start. Leasing activity has been down, which is similar to the first quarter of 2017, but overall market fundamentals are strong. Vacancy rose very slightly and absorption was negative in the quarter but rental rates continued a steady climb and there were a handful of notable institutional sales in the quarter. The big development pipeline is starting to deliver some of the larger projects and there's still plenty more on the way. There has been a desire from tenants to lease an entire

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building as evidenced by Autodesk taking Towne Storage, Expensify taking most of 401 SW 5th, NW Natural relocating to 250 SW Taylor and Vacasa leasing 90 percent of the Heartline project. According to Tim Harrison, Senior Research Analyst at Jones Lang Lasalle, "new to this office cycle is the diversity of office developments. This is driven by the competition for top talent and companies looking for creative, amenity rich space in a thriving neighborhood as a way to stand out from the competition." New projects catering to these requirements should keep development pipeline full through 2018 and into 2019.

Co-working companies continue to take down a large amount of space in the Portland market. WeWork inked their third location by taking 70,190 square feet in the Power + Light building and Industrious, a newer co-working concept has leased 28,323 square feet at 811 SW 6th Ave. WeWork now leases 170,569 square feet across their three locations in the Portland market. Nationally WeWork has 10 million square feet leased according to CoStar. Despite the conflicting opinions about the longevity of co-working concepts, they are certainly a force to be reckoned with in the current office market.

Portland Metro's first quarter 2018 at-a-glance:

- Colliers reports that office market metrics show a mixed start to 2018 but market sentiment is high due to the amount of activity. Absorption was negative and vacancy increased to 9.95 percent in the quarter. Of the new construction coming online, 41 percent is now preleased. Colliers highlights the sale of 38 Davis, a Gerding Edlen mixed-use development that was sold to Unico Properties out of Seattle for $54.25 million as an example of the strength of the market.
- JLL noted that 2018 is off to a similar start as the first quarter of 2017. Vacancy rose slightly to end the quarter at 10.7 percent as demand could not keep up with new deliveries. Despite the increase in vacancy, the market sentiment is positive as rents still increasing and leasing activity remaining remains strong.
- The outlook from Kidder Mathews was overwhelmingly positive. They noted that despite the slight increase in vacancy and slowdown in leasing activity, the market fundamentals are very strong as evidenced by the recent sale transactions. In addition to the previously highlighted 38 Davis, Kidder Mathews mentions the sale of 309 SW 6th and One Pacific Square as CBD assets sold to institutional investors in the quarter.

VACANCY

Depending on who is reporting, the Portland office market vacancy rose slightly in the first quarter of the year to end at 10.7 percent according to JLL and 6.7 percent according to CoStar. This is due to a combination of negative absorption in the quarter and an increase in new office deliveries. Predictions for where the vacancy rate goes from here are mixed. Kidder Mathew and Colliers predict the vacancy rate will go down boosted by the strong pre leasing activity on new construction and demand for new space while JLL predicts vacancy will continue to rise.

VACANCY

Table 1: Total Vacancy Rates by Brokerage House and Class, FIrst Quarter 2018

Brokerage	Total	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Colliers	9.95%	12.8%	10.2%	15.3%	16.1%	-
JLL	10.7%	10.2%	8.3%	13.3%	10.9%	-
Kidder Mathews	7.6%	10.3%	-	-	-	6.6%
CoStar	6.7%	10.8%	8.7%	12.2%	13.8%	5.7%

Source: Colliers, JLL, Kidder Mathews and CoStar

RENTAL RATES

Rental rates climbed throughout 2017 and after the first quarter of 2018, rates increased yet again. The average rental rate was $23.81 per square feet. This is a 0.1 percent increase from the end of 2017 which is a smaller increase than has been seen in previous quarters.

However in order to keep the rental rates rising and attract strong tenants, landlords are increasing their concessions especially in the face of a more competitive market as noted by JLL in their quarterly office report. As Tim Harrison sees it, "Investors have a predefined exit strategy that they need to achieve. The way they can keep the base rent up and still be competitive in the marketplace is offer concession in the form of free rent and tenant improvements."

The belief in the market is that rental rates still have some room to increase in the short to mid term but will eventually start to flatten as the new deliveries hit the market.

Table 3: Average Direct Asking Rates ($/sf FSG) by Brokerage House and Class, First Quarter 2018

Brokerage	Market Average	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Colliers	$26.16	$31.79	$35.08	$30.38	$25.11	-
JLL	$28.76	$33.32	$36.89	$32.30	$26.32	-
Kidder Mathews	$25.23	$31.37	-	-	-	$22.55
CoStar	$25.88	$30.61	-	-	-	$23.42

Source: Colliers, JLL, Kidder Mathews and CoStar

ABSORPTION AND LEASING

Absorption in the first quarter of 2018 was negative with a bulk of the space coming up occurring in the CBD. Kidder Mathews highlights Vestas Americas and Corinthian Colleges as two examples of companies giving up a large amount of space. Out in the suburbs, Holiday Retirement and Convergys closed their doors in the quarter. The market is generally not concerned about the negative absorption. Last year started in similar fashion only to end the year around 780,000 square feet of positive net absorption. So long as the second quarter can bounce back, there are few worries at this point and despite the negative absorption there are some highlights. As previously noted, WeWork took a large amount of space at the Power + Light building but in addition to that lease, FireServe took 29,128 square feet at 115 SW Ash. The law firm Markowitz, Harbold, Glade

ABSORPTION AND LEASING

& Mehlhaf P.C. will relocate from their PacTrust headquarters to Broadway Tower after signing a lease for 19,424 square feet. JLL indicated that there are some larger office deals currently under negotiating in the westside suburban submarkets that should help lift absorption numbers in the coming months.

Table 4: Net Absorption (in square feet) by Brokerage House and Market Area, First Quarter 2018

Brokerage	Overall	CBD	Suburban
Colliers	(230,671)	(439,917)	-
JLL	(10,030)	(1,992)	-
Kidder Mathews	(383,850)	(569,792)	156,983
CoStar	(256,434)	(479,335)	-

Source: Colliers, JLL, Kidder Mathews and CoStar

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

Brokerage	Overall	CBD	Suburban
Colliers	(230,671)	(439,917)	-
JLL	(10,030)	(1,992)	-
Kidder Mathews	(383,850)	(569,792)	156,983
CoStar	(256,434)	(479,335)	-

Source: Colliers, JLL, Kidder Mathews and CoStar

Table 6: Notable Lease Transactions, First Quarter 2018

Tenant	Building/Address	Market	Square Feet
WeWork	Power + Light Building	CBD	70,190
Vacasa	Heartline Building	CBD	60,152
Unknown	Kruse Oaks I	Kruse Way	49,890
Industrius	6Y	CBD	28,323

Source: Colliers, Kidder Mathews and CoStar .

SALES TRANSACTIONS

Last year was a very strong year for office sales with a total sales volume of $1.2 billion over 42 transactions. The average price per square feet was $305.86. This is a strong increase in both the per square foot price and total volume over 2016 numbers. Cap rates have increased from 6.23 percent to 6.38 percent over the same time period. The increase in price per square feet can be attributed to the strong rent growth the market has been experiencing.

It will remain to be seen if 2018 can top 2017 but so far office investment sales are off to a good start. There were three transactions above the $50 million mark in the quarter. 38 Davis sold for $54,250,000 ($437.48 per square foot) to Unico Properties. The US National Bank Block sold for $53,925,000 ($259.39 per square foot) to Westport Capital Partners. That is the same capital group behind the renovation of the Towne Storage building

SALES TRANSACTIONS

which recently traded for $627.36 per square foot, a new high water mark for price per square foot in Portland but will be reported in second quarter figures. Lastly, One Pacific Square, the current home to NW Natural Gas until they relocate to 250 SW Taylor, sold for $52,100,000 ($218.22 per square foot) to Specht Development and an unidentified capital partner.

Tim Harrison of JLL noted that in 2005, JLL surveyed the number of institutional owners in the CBD and found that institutions owned around 38 percent of assets. Fast-forward to today, it is now estimated that institutions own approximately 61 percent of the assets in the CBD. The expectation heading into 2018 was that the Portland office market would continue to attract institutional investors looking to place capital outside of primary markets and so far that expectation is being met. This is driven by institutions with capital to deploy looking for higher yields.

Table 7: Notable Sales Transactions, First Quarter 2018

Building/ Address	Buyer	Seller	Market	Price	SF	Price/ SF
38 Davis	Unico Properties	Gerding Edlen	CBD	$54,250,000	124,006	$437.48
US National Bank Block	Westport Capital Partners	SKB Companies	CBD	$53,925,000	207,006	$259.39
One Pacific Square	Specht Development Inc.	Menlo Equities	CBD	$52,100,100	238,751	$218.22

Source: Colliers and Kidder Mathews

DELIVERIES AND CONSTRUCTION

In the first quarter year, 11 new developments were delivered to the market bringing 430,255 square feet of office space to the market. The market spent much of 2017 trying to determine how much of an impact all of the new construction would have on the market. The sentiment was all over the place but so far any concerns about oversupply should be tempered. Most of the new deliveries had a moderate to substantial amount of preleasing.

DELIVERIES AND CONSTRUCTION

Table 8: Notable Development Projects Under Construction, First Quarter 2018

Building/ Address	Developer	Market	SF	Delivery Date
The Silica	Rujax V, LLC	NE Close-In	31,000	Q2 2018
Flatiron PDX	Southern Miss, LLC	NE Close-In	24,300	Q2 2018
4000 Columbia House	Killian Pacific	St Johns Vancouver	45,000	Q3 2018
Heartline	Security Properties	CBD	70,702	Q3 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
7 SE Stark	Harsch Investment Properties	Central Eastside	70,000	Q1 2019

Source: Colliers and CoStar

The largest delivery in the quarter was Field Office West. Located at 2035 NW Front Ave, this two building office development is North of were much of the traditional office has been built. This 164,555 building delivered with 35 percent leased, which is substantial for an unproven market area. The second half of the Field Office development is set to deliver in the second quarter of the year. The second largest delivery was Clay Pavilion by Vancouver based developer Killian Pacific. This Central Eastside located 75,000 square feet building was almost entirely leased to Simple. The Central Eastside has been a strong, if not somewhat surprising market for new development. Capstone Partners delivered their two building Custom Block project with 7 percent preleased.

The sentiment among brokerage houses seems to have changed from slightly pessimistic to mildly optimistic about the markets 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.