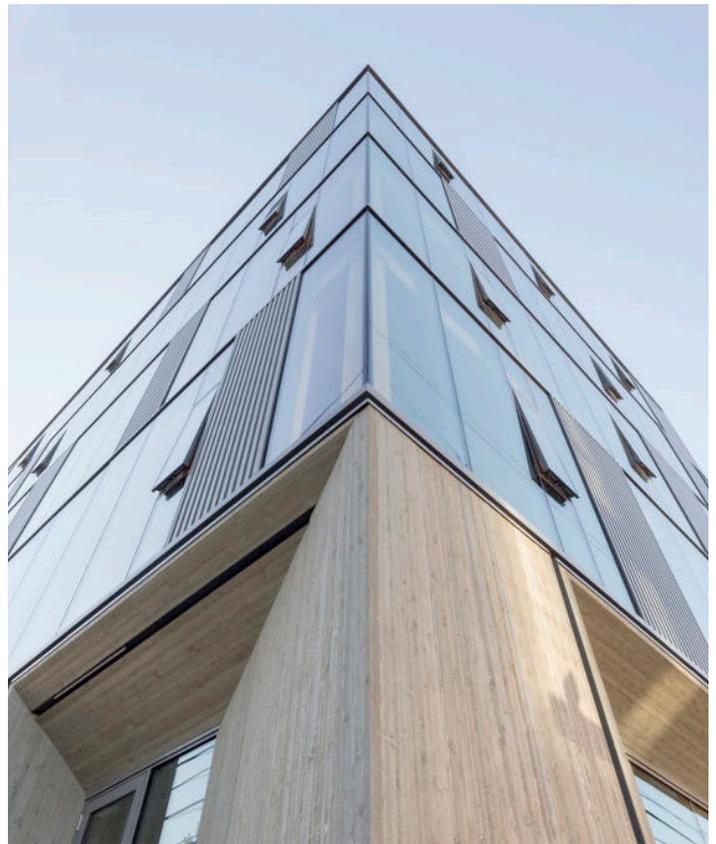


OFFICE MARKET ANALYSIS

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The national office market has positive momentum heading into the second half of 2018. Robust job growth continues to increase demand and contribute to this year's national construction list, which holds the largest amount of new square footage in nearly a decade. Office deliveries totaled 18 million square feet, almost doubling the 10.8 million square feet delivered in the first quarter. According to Cushman & Wakefield's US Office MarketBeat Snapshot, the second quarter of 2018 produced "a total of 22 markets [that] reported a new construction pipeline of 2.0 million square feet or more, the largest number of markets with more than 2.0 million square feet that Cushman & Wakefield has ever reported."

Despite increased construction, the national vacancy rate holds at 13.4 percent with all signs pointing toward tenant opportunity. Portland's office market follows the national trend, with an overall vacancy rate of 11.7 percent, highlighting the position of the market and ongoing demand. With market conditions favoring the tenant, approaches to creative office development are shifting, especially in Portland's downtown office market. In order to remain competitive, new construction and innovation rank first for developers catering not only to the tech industry, but now to other industries as well.



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OFFICE MARKET ANALYSIS

According to Newmark Knight Frank, approximately 1.1 million square feet of net absorption of office space occurred from 2013 to 2017. Portland's economy became more robust as an increasing technology community sparked a new type of demand. The Brewery Blocks, which were delivered to the market in 2002, were one of the first creative buildings in Portland, however the true creative office boom was driven by the technology sector from 2012 to 2016.

In a recent snapshot looking back at the fourth quarter of 2014, JLL noted that the Class A office space in the CBD had a vacancy rate of 6.4 percent—an all-time low. With creative spaces all leased up, the M Financial building was the only large block of creative space available for lease at that time. This shortage spurred a creative movement with efforts to renovate and reposition older buildings. Four years later, there is now record amount of ground up construction being built out as creative. JLL's Research Manager, Tim Harrison, noted there are currently 15 Class A new developments or redevelopments larger than 30,000 square feet with space available in the CBD that are catering to creative tenants. "Demand for creative space is now also coming from other professional service industries like advertising and marketing, architecture, engineering and co-working," Harrison added.

HFF also emphasized the recent trend of turning new creative space into recognized value. Logan Greer, office investment advisor for HFF, described a win/win situation for both tenants and property owners: "All types of tenants in the market are looking for a creative type of office; they want the space to be a tool for branding and to keep their talent happy." On the other side, "Landlords are continuously recognizing the value of it—the second-generation utility—that should a tenant occupy the space—it can easily be backfilled."

Noting the increased rents in the area, Newmark Knight Frank reinforced Portland's metro demand as steady, emphasizing a confidence in continued demand of tenants seeking premier Class A locations. They noted that the Portland metro's unemployment rate continues to track the national unemployment rate and will continue to do so into the second half of 2018. CBRE's recent report also supported these positive trends:

The region outperformed the nation in job growth with professional services, finance and healthcare leading the charge. Demand in the Portland office market was spurred by tenants looking for the best value to establish or expand their business. Investors focused on space in Portland stimulating activity and further evolving the region.

With a positive outlook moving into the rest of 2018, Portland's office market continues to sit at the forefront of possibility and attract a significant amount of institutional investor interest. HFF Research Analyst Devin Kopas confirmed, "There has been a renaissance of venture capital pouring into Portland." With this hype, a record number of new office construction has been added to the pipeline. A total of 1.5 million square feet of new office space is under construction and to be delivered by the end of 2018, solidifying tenant opportunity but also raising new questions about whether the right type of tenants exist to fill them.

VACANCY

Vacancy rates this quarter saw a large variance among reporting brokerage firms. The Portland office market vacancy rose slightly in the first quarter of the year to end at 11.7 percent according to JLL, contrasting from last quarter's 10.7 percent. Tim Harrison of JLL notes: "While absorption remains stable in the urban core, the delivery of construction in the second half of 2018 and the soon-to-be-vacated Wells Fargo Center means that

VACANCY

we will see an increase in vacancy and a general shift in market conditions toward the tenant.”

Newmark Knight Frank and CBRE’s vacancy predictions line up similarly to JLL’s while Colliers and Kidder Mathews see a lower vacancy rate at 9.7 percent and 7.1 percent, respectively. In an article from Portland Business Journal, Jon Bell states, “Despite the seeming slowdowns, no one is writing off Portland by any stretch. All of the attractiveness that’s made the Rose City popular with office tenants from near and far in recent years – relative value, cool and creative spaces, a talented workforce – remain in place. It may just take a little longer, or a shift out of the summer slowdown, to kick things back up.”

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

Brokerage	Total	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Colliers	9.7%	12.5%	10.8%	13.9%	15.4%	-
JLL	11.7%	10.9%	8.5%	13.8%	12.6%	-
Kidder Mathews	7.1%	10.2%	8.8%	9.8%	11.4%	6.1%
Newmark Knight Frank	10.3%	10.9%	-	-	-	-
CBRE	11.0%	10.9%	-	-	-	11.1%

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

RENTAL RATES

Rental rates ranged throughout 2017, however remained steady in the first half of 2018. The market’s average among brokerage houses ranged from \$25.56 to \$29.41, while Portland’s CBD range was higher, going from \$31.56 to \$33.67. According to Colliers, the second quarter’s Class A CBD average rental rate had a 10.4 percent annual change, while Class A Suburban had a four percent annual change. This contrasts last quarter’s 9.9 percent annual change for Class A CBD and 3.4 percent for Class A Suburban.

Newmark Knight Frank noted that “year-over-year, rents have experienced a growth rate of seven percent, largely because of buildings incorporating improved and innovative amenities, attracting top-of-the-line tenants.” The biggest jump the firm saw was in the Class A CBD sector with a first quarter average rental rate of \$32.56 jumping to \$34.93 to end second quarter.

Table 2: Average Direct Asking Rates (\$/sf FSG) by Brokerage House and Class, Second Quarter 2018

Brokerage	Market Average	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Newmark Knight Frank	\$27.90	\$32.05	\$34.93	\$31.53	-	-
Kidder Mathews	\$25.56	\$31.56	\$34.92	\$29.88	\$26.04	\$22.56
Colliers	\$26.22	\$32.01	\$35.75	\$30.27	\$26.34	-
CBRE	\$29.41	\$33.67	-	-	-	\$24.75

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

ABSORPTION AND LEASING

While Portland’s urban core continued to do well with 65,000 square feet in positive absorption the second quarter, the suburban submarkets were hit with large downsizes. Jacobs Engineering in Kruse Way, SureID in the Sunset Corridor, as well as Covergys’s call center in the I-5 South Corridor were all significant downsizes/closures. However, JLL noted:

Activity in the suburbs remains positive and the relocation and expansion of some large tenants in the Sunset Corridor, Kruse Way, and the 217 Corridor/Beaverton should reverse most of the negative absorption experienced thus far in 2018.

The second quarter included Aerotek’s lease of 28,323 square feet in the 217 Corridor/Beaverton submarket at 8300 SW Creekside Place. Underwriters Laboratories leased 26,033 square feet at 14301 SE 1st Street and the 41,070 square foot space in Tigard at 12123 SW 69th Ave was also leased to Rocky Mountain Cancer Center.

Table 3: Net Absorption (in square feet) by Brokerage House and Market Area, Second Quarter 2018 as well as First Quarter 2018 Comparables

Brokerage	Overall	Prior Quarter Overall	CBD	Prior Quarter Overall
Colliers	268,674	(171,273)	246,729	(439,917)
JLL	(143,726)	(10,030)	(11,391)	(1,992)
Kidder Mathews	1,181,619	(383,850)	202,976	(569,792)

Source: Colliers, JLL, and Kidder Mathews

Table 4: Net Absorption (in square feet) by Brokerage House, Year to Date

Brokerage	Overall
Colliers	(230,671)
JLL	(165,485)
Kidder Mathews	(383,850)

Source: Colliers, JLL, and Kidder Mathews

With so many options in the marketplace for tenants, several development firms with large spaces are holding out for the right tenant in terms of size, as opposed to dividing the space up for smaller clients. In a recent article, Field Office’s partner Jonathan Ledesma with the development firm project^ said, “We have large floor plates, and for a city like Portland, that’s something it needs, but it’s not something that we have a steady stream of tenants for. There are always three or five large tenants hovering, but lately we’ve seen, citywide, that that’s been a little lower.” project^ continues to wait for the right tenant for their 150,000 square foot east space.

Table 5: Notable Lease Transactions, Second Quarter 2018

Tenant	Building/Address	Market	SF
Rocky Mountain Cancer Center	12123 SW 69th Ave	Tigard	41,070
nLight, inc.	5408 NE 88th Street	Vancouver	26,350
Aerotek	8300 SW Creekside Place	217 Corridor / Beaverton	28,323
UL Underwriters Laboratories	14301 SE 1st Street	Cascade Park	26,033
Stantec	Moda Tower	CBD	21,664

Source: Colliers, Kidder Mathews, Newmark Knight Frank, and CoStar

**SALES
TRANSACTIONS**

Last quarter brought 803,481 square feet of sales, totaling \$166,546,842 in 15 office transactions. Melvin Mark and Becker Capital purchased the Five Centerpointe’s 114,000 square foot building from Seattle’s Urban Renaissance Group. URG bought the property for \$20.3 million back in 2012 and sold it for \$27.85 million. In addition, Menashe Properties purchased Unitus Plaza, located at 1300 S.W. 6th Ave, which is a 94,000 square foot building that is fully leased.

In an article from the Portland Business Journal, Jordan Menashe described his experience of the sale, “[We’re] extremely blessed to have the opportunity to acquire a full city block with a building and parking in an area that is nothing less than booming thanks to many great institutional firms that have planted their flag in the immediate area.” Referring to neighbors like the nearby Wells Fargo Center, the Broadway Tower, and PacWest Center, Menashe’s comments mirror the trend of increased institutional interest in and outside of the primary market.

In addition, NKF Capital Markets arranged the sale of the 100-year-old renovated and repositioned Towne Storage building, which set a new high-water mark for price per square foot. Nick Kucha, vice chairman of NKF, found “the sale of Towne Storage [to be] a testament to Portland’s ongoing appeal to institutional investors’ appetite for best-of-class investment opportunities.” The building was fully leased to Autodesk and purchased by CBRE Global Investors. While appealing to CBRE Global Investors, Autodesk’s Stacy Doyle also shared their perspective of the space, calling it “a more attractive—and visible—place to work,” describing the historic renovation a space that “embodied the future of making things.”

Table 6: Notable Sales Transactions, Second Quarter 2018

Building/ Address	Buyer	Seller	Market	Price	Price / SF
Five Centerpointe	Becker Capital Investment	Urban Renaissance Group	Kruse Way	\$27,850,000	\$243.70
Towne Storage	CBRE Global Investors	Westport Capital Partners	Lloyd District	\$62,750,000	\$627.36
Unitus Plaza	Menashe Properties	Erikson Realty, Ltd.	CBD	\$26,000,000	\$288.89

Source: Colliers, Kidder Mathews, and Newmark Knight Frank

**DELIVERIES AND
CONSTRUCTION**

New construction deliveries included Field Office—East by project^ at 165,653 square feet as well as the 35,000 square feet project located at 2424 SE Ninth Avenue by SolTerra Systems. The 9North building, expected to complete in September of this year, will bring 172,000 square feet of new office space to the market. Although it is not leased, Williams & Dame Development and Global Miller Properties as well as APEX Real Estate Partners, representing the deal remain confident in their product.

DELIVERIES AND CONSTRUCTION

Table 7: Notable Development Project Deliveries, Second Quarter 2018

Building/Address	Developer	Market	SF	Delivery Date
Nike North Expansion Building A	N/A	Sunset Corridor/Hillsboro	412,000	Q2 2018
Broadway Tower	BPM Real Estate - Office	CBD	177,800	Q4 2018
Field Office - East	Project^	Northwest	119,275	Q2 2018
Heartline	Security Properties	CBD	70,702	Q2 2018
7 SE Stark	Harsch Investment Properties	Central Eastside	70,000	Q1 2019
2422-2424 SE 9th Ave	N/A	Southeast	35,000	Q2 2018

Source: Colliers and CoStar

Figure 1: Press Blocks, Office Space Set to Deliver July 2019



Source: Mithūn

There was 2,503,330 square feet of office space under construction at the end of the second quarter, which included mostly ground up construction built for innovation. The Press Blocks, developed by Urban Renaissance Group is set to deliver its new 142,000 square foot creative space by July 2019. In addition, the Oregon Museum of Science and Industry selected Gerding Edlen to be the developer for its 18-acre riverfront campus, a hub the group is calling an “Innovation Quadrant.” Jill Sherman, partner at Gerding Edlen, expressed in a release: “Our team has been truly energized by OMSI’s vision and the opportunity to participate in the creation of a new, innovative and sustainable district that will benefit the wider community.” This project adds another layer to the innovation wave of diversified industries making changes in Portland’s office market.

DELIVERIES AND
CONSTRUCTION

Table 8: Notable Under Construction Projects, Second Quarter 2018

Building/Address	Developer	Market	SF	Delivery Date
Nike North Expansion Building B	Gerding Edlen	Westside	1,003,585	Q2 2018
Block 29 Center for Health & Healing	Oregon Health & Science University	Southwest	360,000	Q3 2018
Knight Cancer Institute Research Building	Oregon Health & Science University	Southwest	320,000	Q3 2018
9North	Williams & Dame Development	CBD	202,853	Q3 2018
Broadway Tower	BPM Senior Living Company	CBD	177,800	Q4 2018
The Press Blocks—Office	Security Properties + Urban Renaissance Group	Southwest	142,000	Q2 2019
7 SE Stark	Harsch Investment Properties	Lloyd District	100,000	Q1 2019
Waterfront Block 6	Gramor Development	Clark County	77,000	Q3 2018

Source: CoStar

Tim Harrison of JLL summarizes Portland's current place in the business cycle after second quarter, "As a city we've delivered record construction for three solid years and almost all of that is creative. With rising construction and input costs and vacancy increasing, development will start tapering off pretty significantly towards the end of 2019 and into 2020. After that we'll likely just start the cycle all over again once the availabilities have been absorbed." The second half of 2018 will reveal how these availabilities will be absorbed and the type of tenants that will continue to utilize Portland for its creativity and inventive appeal.