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multi-family residential report

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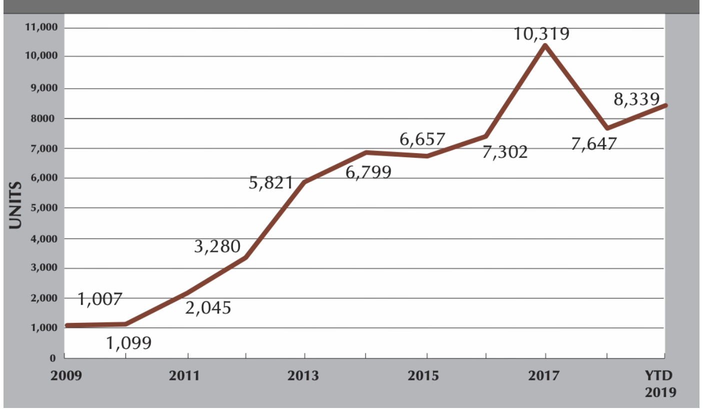
Heading into the second half of the year, the Portland metro area's multifamily housing market sustains its stable supply growth with continuous deliveries from projects that were squeezed through permitting prior to the City of Portland's Inclusionary Zoning (IZ) policy. However, as those projects all reach completion in the current year and through 2020, the number of new units proposed beyond that remains low in comparison, with projects in the pipeline quite reduced. This is attributed in part to the IZ policy, especially as it relates to the multifamily supply growth in the City of Portland. Across the broader metropolitan area, one of the largest contributors to stagnation is significantly higher construction costs, which affects the entire industry across all sectors.

Rental market demand is softening slightly, especially in downtown areas where the high-end rental inventory remains expensive. However, there has been an increase in "urban-style" rental unit inventory in the suburban markets, indicating a pointed trend of renters moving out of the city's core for more affordable, new and modern housing options nearby. This new inventory, combined with an increase in desirable jobs on the westside and the worsening commuting traffic, has decreased the relative appeal of living downtown. Suburban jurisdictions have also shown great willingness to support new development - often for mixed-use multifamily types - and they have continued to improve, invest in and encourage development in their urban cores to encourage this demographic movement.

Ultimately, as the rental rates temper their growth and the sales valuations soften, we see 2019 and 2020 as the time of stabilization in pricing. While this may feel like a downturn for the Portland Metro market due to the breakneck pace of the economy and trendy reputation with institutional investors over the last 3 to 4 years, it is a normalization of the market to a more stable and sustainable level.

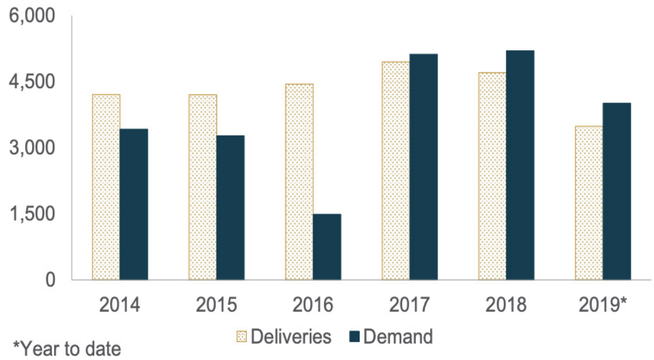
APARTMENT PERMITS 2008–YTD 2019 ANNUALIZED
FOUR COUNTY METRO AREA

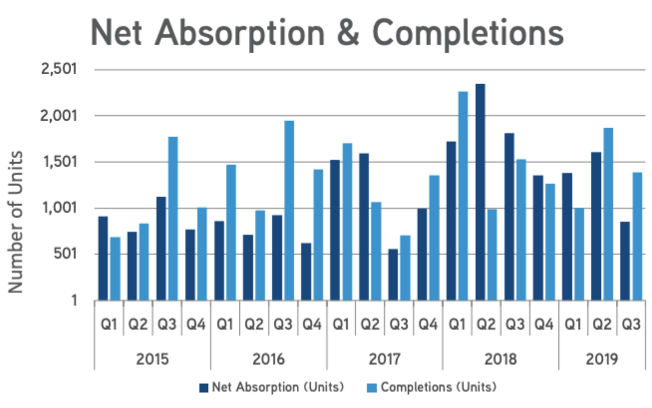


SUPPLY, PERMITTING

Since the implementation of inclusionary zoning, permit applications have declined and the number of affordable units produced under IZ is far below expectations. In response, it is expected that the City of Portland will be rolling out some changes to the policy to help mitigate the below-expectations response and encourage affordable housing production. Year to date through September figures suggest that approximately 8,339 units will be permitted in 2019. Supply figures indicate that year over year through September, Portland has 1,391 delivered units. Deliveries volumes are set to maintain this pace through the end of 2019 and into 2020, with an additional 6,700 market-rate rentals coming online. The anticipated supply is a result of the completion of several pre-IZ projects coming online over the next 12 to 24 months and will continue to affect rental rates as lease-up specials are widespread.

However, a regular stream of apartment development in the greater Portland Metro area increased development activity and densification of surrounding suburban cores, most notably in Beaverton, Gresham and Hillsboro. Many suburban jurisdictions are eager for mixed-use, dense development and have made several moves to encourage it, such as the creation of urban renewal districts, zoning flexibility, vertical housing tax credits, etc. As such – and with the recent expansion of the urban growth boundary – there is a push for 'urbanification' of suburban downtown cores, which not only means retail and commercial development but most importantly multifamily units to create high-density areas of activity.

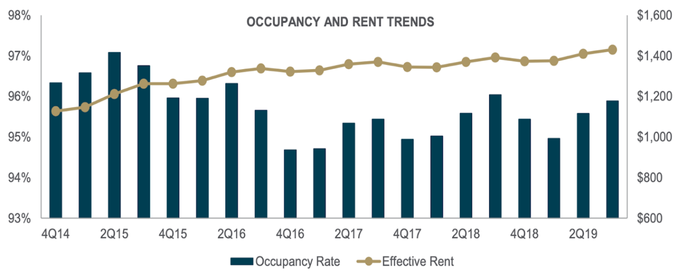


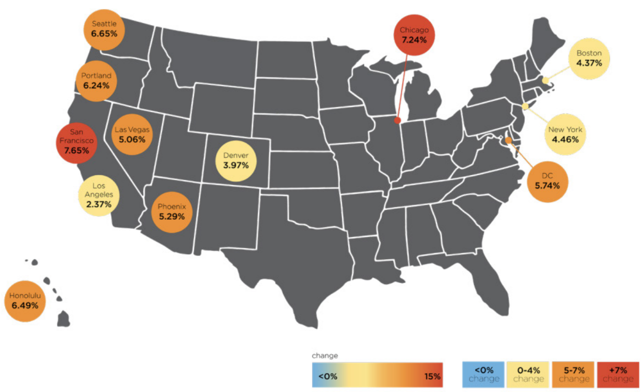


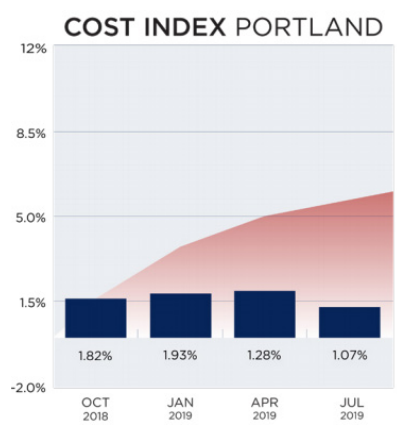
DEMAND, ABSORPTION

As of September 2019, apartment inventory has jumped to 4,570 units year over year as part of nearly 15,000 total additional units from 2016 to 2019. New inventory has been well received by the market, with positive absorption peaking in urban submarkets adjacent to the swell of new construction in the Central and East Portland submarkets. On an annual basis, leasing activity is still set to outpace supply growth: East Portland occupancy is at 96% – up 40 basis points – while Central Portland is up a considerable 20 points at around 94.6%. Overall, the consistent influx of jobs and Portland's ever-rising population have bolstered apartment absorption across greater Portland. There has also been a lift in rental demand thanks to an in-migration of nearly 13,1000 people, raising single-family home prices, and household formation exceeding regular population growth estimates.

In September 2019, Portland Metro-wide occupancy dropped 10 basis points (annual) to 95.9% though it still remains above the five-year average. Year to date, rent has grown 2.8% annually to average $1,431 per month. The biggest factor affecting properties over the last quarter has been the drop in interest rates, which has led many renters to purchase single-family homes when they would not have otherwise. This will continue to be a factor as interest rates just dropped again, with renters looking to purchase and move before or after the upcoming holiday season.







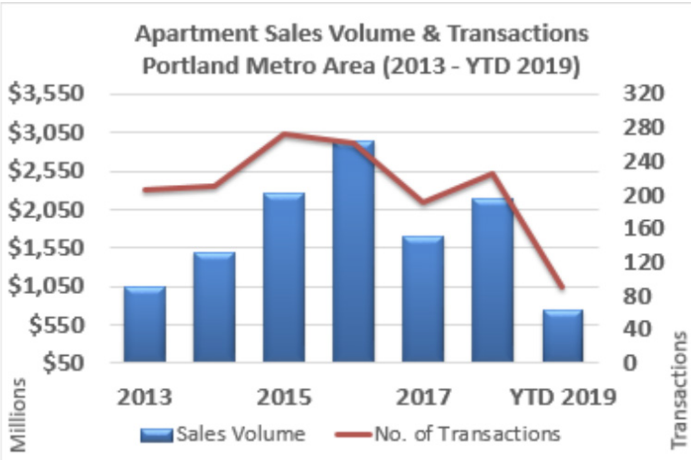
Portland's strong job market coincides with a rising household income: $79,982 as of July 2019, up 4.3% annually.

RATES, COSTS

Rental rates are still trending positively but tempering their growth from earlier in the year. Continual deliveries from completing projects keeps the competition high and the concessions generous. The most aggressive concessions are being offered in the high-end properties in the midst of lease-up, with the 'best' deals appearing in the downtown areas. Vacancy periods range from 30 to 60 days, with the longer periods in smaller suburbs such as Hillsboro and Clackamas. Conversely, the Inner, Central SE and North Portland areas still experience very quick turnarounds, with vacancy periods between 10 to 14 days. Total average rent for the Portland Metro area inched up to $1,431, representing a year over year increase of 2.8% to date.

One interesting cost increase to note during this year is the administrative cost of property management, which has sharply intensified due to new regulations. It has become extremely important for property management staff to be well-versed in the new policies passed earlier this year in both State and City capacities, depending on where the property is located, to ensure compliance. Landlords are now exposed to much more risk with the new stringent regulations, and as such, it has created an increase in overhead costs in the form of continuous training, additional staff, increased paperwork, reworked leases, legal fees, etc.

Construction costs for multifamily housing remain in the $160 to $250 per square foot range, which is about a 6.24% increase in aggregate year over year. To note, construction costs have increased more sharply in the neighboring cities of Seattle and San Francisco, but Portland still remains above the national average. This increase continues to be due to labor shortages and material price increases, inflating construction costs. In fact, the national construction unemployment level dropped to as low as 4% earlier this year. The political uncertainty and worsening trade wars have also contributed to unpredictable swings in material costs and availability. This not only affects new development but also the renovations required to keep aging properties competitive. Furthermore, Oregon's newly passed rent restrictions add another hurdle to the cost of owning multifamily units. This does not include any additional add-on costs due to BOLI / prevailing wage or MWESB / SDVBE require



PROPERTY	SALE DATE	SALE PRICE	# UNITS	PRICE/SF	YEAR BUILT	SELLER	BUYER
GRIFFIS SOUTH WATERFRONT 0650 SW Gaines St, Portland, OR	8/29/19	$116,130,000	331	$462.09	2009	BARINGS	Griffis Residential
RIVAGE 2200 NW Front Ave, Portland, OR	8/26/19	$91,000,000	260	$395.65	2016	Fore Property Company	Magnolia Capital
THE FRANK ESTATE 7510 SW Aloma Way, Portland, OR	7/31/19	$91,000,000	309	$284.94	1989	Heitman LLC	Prime Group
THE OSPREY 3750 SW River Pkwy, Portland, OR	8/2/19	$89,500,000	270	$276.66	2016	Mack Real Estate Group	Magnolia Capital
THE GROVE AT ORENCO STATION 6710 NE Vinings Way, Hillsboro, OR	8/28/19	$72,750,000	264	$297.85	1998	Greystar	Jackson Square Properties
EDGEWATER COVE 1937 Main St, Oregon City, OR	8/22/19	$69,000,000	244	$353.85	2018	Grand Peaks Properties, Inc.	The Blackstone Group L.P.
TUPELO ALLEY 3806-3872 N Mississippi Ave, Portland, OR	7/19/19	$58,000,000	188	$207.59	2009	JPMorgan Chase & Co.	Holland Partner Group

ments, as those restrictions are subjective to a number of factors, such as the jurisdiction of the project, the financing associated with the project, etc.

SALES ACTIVITY

Recently passed state and local laws, such as rent control and restrictions on no-cause termination notices, have softened prices and shifted the economy to a buyer's market. Institutional buyers have moved their focus away from Oregon with the increasingly strenuous regulations creating cash flow roadblocks for investment. The political environment has tempered the appeal as evidenced in sales and valuations, with a wide gap between buyer and seller expectations, leading to a 30% decrease in sales volume year-over-year in the Portland Metro market. However, with several large sales having taken place in July and August, the overall sales numbers for the year will increase, but still remain below those of 2018.

SOURCES

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Rider Levett Bucknall Q3 Construction Cost Report:

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Berkadia Multifamily Report 3Q 2019:

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Multifamily Northwest Apartment Report Fall 2019: https://www.hfore.com/files/14574_fall_2019_multifamily_nw_apartment_report_final.pdf

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