
INDUSTRIAL MARKET ANALYSIS

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Portland's industrial market continues to exhibit strong fundamentals in the third quarter. Despite over 1.2 million square feet of new space delivered in the quarter, net absorption kept pace with deliveries and vacancies remaining at historic lows. Rental rates remain at or near historic highs. These trends are expected to continue as tenant demand for small and large spaces remains strong.

VACANCY AND RENTS

In the third quarter, CBRE declared that "Portland's industrial market fundamentals are stronger than ever." Indeed, Metropolitan Portland's industrial market continues to see both occupancies and asking rates at or near historic highs. A review of quarterly research reports from four leading commercial real estate firms reveals a metro-wide vacancy rate of 4.82 percent in the third quarter, 3 basis points below the prior quarter and 59 basis points below the third quarter of 2014. This vacancy rate is especially impressive in light of the delivery of over one million square feet of new, mostly speculative space. Distribution/warehouse vacancy rates remain flat versus the prior quarter and 58 basis points below the prior year, while flex space vacancy stood 60 basis points below the prior quarter and 80 basis points below the prior year.

■ Adam Seidman is a Master of Real Estate Development candidate and has been awarded the Center for Real Estate Fellowship. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

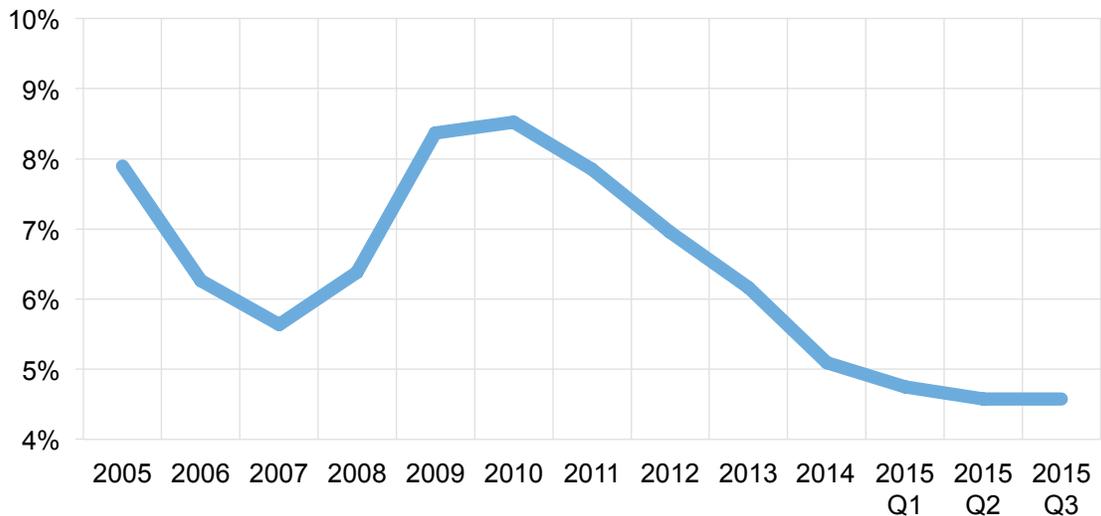
Table 1: Portland Industrial Quarterly Report Survey Q3 2015

	Colliers	JLL	CBRE	Kidder Mathews	Average - Q3 2015	Chg vs Prior Qtr	Chg vs Prior Year
Vacancy							
- Distribution/Warehouse	5.00%	4.20%	4.40%	4.70%	4.58%	00 bps	-58 bps
- Flex	10.20%	9.70%	-	-	9.95%	-60 bps	-80 bps
- Weighted Average	5.47%	4.71%	4.40%	4.70%	4.82%	-03 bps	-59 bps
Rents *							
- Distribution/Warehouse	\$0.47	\$0.50	\$0.41	\$0.48	\$0.46	-0.5%	3.6%
- Flex	\$0.93	\$0.97	\$1.07	-	\$0.99	2.1%	19.1%
- Weighted Average	\$0.51	\$0.54	\$0.47	\$0.48	\$0.50	-0.2%	5.6%

* Asking rents; Industrial = shell space; Flex = shell and office space

Sources: Quarterly Reports

According to CBRE, this is the ninth consecutive quarter of declining vacancy rates. Kidder Mathews note that there is demand from a broad base of sectors, from the food industry to e-commerce, driven by Portland's strong population growth.

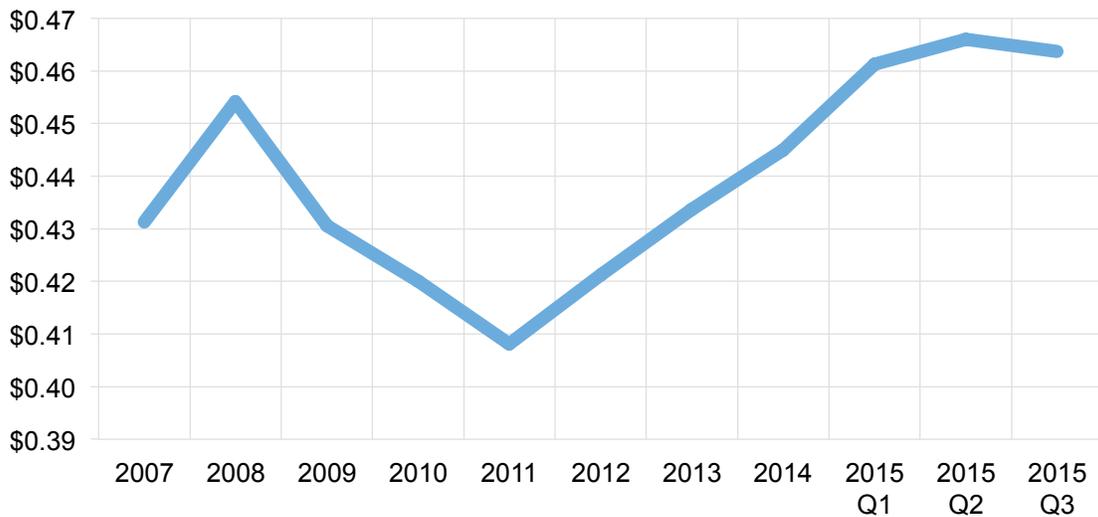
Figure 1: Portland Distribution/Warehouse Market Vacancy Rate, 2007–2015 Q3

Sources: Average of Quarterly Reports from CBRE, JLL, Colliers, and Kidder Mathews

Along with steady vacancy rates, asking rental rates dipped slightly but remained virtually unchanged in the third quarter. The quarterly report survey

showed monthly distribution/warehouse asking rates of \$0.46/square foot and flex rates of \$0.99/square foot, for a combined weighted market average of \$0.50/square foot. Distribution/warehouse rates were down 0.5 percent from the second quarter but up 3.6 percent year-over-year. Capacity Commercial Group notes that shell rents for smaller and close-in properties are reaching \$0.50/square foot and up. Flex rates increased 2.1 percent from the second quarter and exhibited strong annual growth of 19 percent.

Figure 2: Portland Distribution/Warehouse Market Asking Rents, 2007–2015 Q3



Sources: Average of Quarterly Reports from CBRE, JLL, Colliers, and Kidder Mathews

ABSORPTION AND DELIVERIES

Colliers report positive net absorption of 1.16 million square feet in the third quarter, up from 900,000 square feet in the second quarter. Over the past four quarters, the market has absorbed nearly 4 million square feet of space (2.9 million square feet excluding Intel's Mod1 site). This net absorption run rate is higher than the market's average annual net absorption from 2004-2014 of 2.55 million square feet. With another strong quarter of net absorption expected in the fourth quarter, 2015 is on pace to have the strongest net absorption and deliveries of any year since 2007. Capacity Commercial Group notes that leases totaling 1.1 million square feet are either underway or in active negotiations.

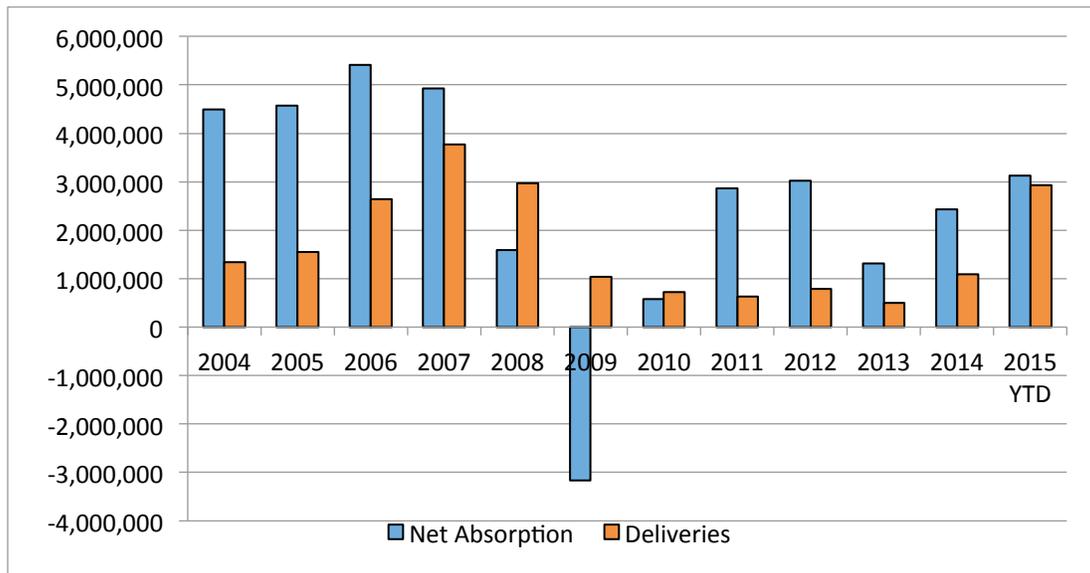
Notable deliveries in the quarter include 493,000 square feet at Specht's Interstate Crossroads Distribution Center, 212,000 square feet for the Swan Island FedEx distribution center, and 145,000 square feet at Trammell Crow's Southwest Industrial Park.

Table 2: Portland Industrial Net Absorption Last 4 Quarters

	Distribution/		
	Warehouse	Flex	Total
Q4 2014	848,170	14,689	862,859
Q1 2015	1,129,776	-68,708	1,061,068
Q2 2015	-218,400	1,129,200	910,800
Q3 2015	835,434	325,453	1,160,887
Total	2,594,980	1,400,634	3,995,614
<i>w/out Intel</i>	2,594,980	300,634	2,895,614
AVG 2004-2014			2,549,245
<i>Peak Annual</i>	2006:		5,412,028
<i>Trough Annual</i>	2009:		-3,169,003

Source: Colliers International

Figure 3: Portland Industrial Net Absorption and Deliveries, 2004–2015 YTD (Through Q3)



Sources: Colliers Quarterly Report and Colliers/Capacity Commercial Presentation

Table 3: Notable Portland Industrial Lease Transactions Q3 2015

Tenant	Building	Submarket	Size (s.f.)	Type
KeHE Distributors	PDX Logistics Center Bldg 1	Airport Way	383,040	New
Unisource Worldwide	I-84 Industrial Center	East Columbia	226,290	Renewal
LKQ Auto Parts	Interstate Crossroads	East Columbia	225,000	New
Trailblazer Foods	Halsey Crossing	East Columbia	134,400	New
Mergenthaler	Bybee Lake II	Rivergate	123,120	New

Sources: CBRE and Colliers

UNDER CONSTRUCTION

JLL notes that there is known tenant demand for approximately 2.6 million square feet of space, with over 60 percent of this demand coming from users seeking spaces over 100,000 square feet. Capacity Commercial Group notes that leasing activity for large blocks has been occurring mainly in the Airport Way/East Columbia submarket due to its space availability and options.

To meet known and speculative demand, there are over 2.5 million square feet of space currently under construction. This does not include Intel's 1.6 million square feet at Ronler Acres. Much of the future supply, 1.9 million square feet, is located in the Northeast Portland submarkets. This area includes the following notable projects that together represent over 1.3 million square feet of space:

- Cameron Distribution Center: 321,000 square feet, due to deliver Q4 2015
- Colwood Industrial Park: 425,000 square feet in Phase 1, due to deliver 2016; total project could deliver up to 845,000 square feet
- PDX Logistics Center: 355,000 square feet in Building 3, due to deliver 2016
- Gateway Corporate Center: 211,000 square feet in Buildings D and E, due to deliver 2016

INVESTMENT ACTIVITY

Kidder Mathews reports that transaction volume for the third quarter was \$188 million, up from \$143 million in the second quarter and \$121 million in the first quarter. The Kelley Point Distribution Center transaction, at \$75 million, accounted for 40 percent of the quarter's sales volume. The average sales price in the quarter was \$90.09 per square foot, up from \$71.72 in the second quarter and \$70.56 in the first quarter. The average market capitalization rate decreased to 5.99 percent in the third quarter, as compared to 6.41 percent in the second quarter and 7.02 percent in the previous quarter.

Capacity Commercial Group notes that investor demand is strong across all categories, from older single-tenant spaces to newer institutional-grade offerings. CBRE notes that close-in spaces are driving up the average per-square foot values, as their sales prices are over \$133/square foot, or 45 percent above the market average.

Table 4: Notable Portland Industrial Sales Transactions Q3 2015

Address	Location	Size (s.f.)	Price	Price/s.f.	Type
Kelley Point Distribution Center	Portland	1,034,500	\$ 75,518,500	\$ 73.00	Investment
Birtcher Center @ Townsend Way	Fairview	397,934	\$ 34,500,000	\$ 86.70	Investment
Ogden Business Park	Vancouver	300,583	\$ 18,050,000	\$ 60.05	Investment
Quad 217 Corporate Center	Beaverton	77,592	\$ 6,600,000	\$ 85.06	Investment
Wubben Industrial Park Bldg E	Vancouver	54,600	\$ 6,250,000	\$ 114.47	Investment

Sources: Colliers and Kidder Mathews

LOOKING AHEAD

With Portland's economy in an expansionary phase, the near- to mid-term fundamentals for the industrial sector look strong. 2.5 million square feet of mostly speculative space are in the pipeline and should be delivered over the next four quarters. Given historical trends as well as known demand in the market for larger spaces, most of this space will likely be absorbed by the end of 2016, leaving vacancy rates virtually unchanged from their current low levels. This amount of new space, coupled with low vacancy rates, should also lead to an increase in the overall shell rates of distribution and warehouse spaces over this time period. The market continues to watch for the potential impact of marijuana legalization on the industrial market; this will likely begin to impact the market over the next four quarters as businesses and investors look to find space for warehousing and distribution needs. ■