
INDUSTRIAL MARKET ANALYSIS

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The Portland metro's industrial market kept on rolling in the first quarter of 2016, with a continuation of trends seen throughout the past year: strong tenant demand and limited supply pushing rents to historic highs and vacancies to historic lows. After seeing deliveries of over 2.6 million square feet in 2015, 2016 opened up with deliveries of just 300,000 square feet, two-thirds of which was in one project. With around 65 percent of all new and planned product already pre-leased, the new supply in the pipeline is not likely to significantly cool off the trends in lease rates and occupancy levels. Demand continued across the size spectrum, and three new leases of over 100,000 square feet per lease were inked. All of these dynamics continued to attract institutional investors, who drove down capitalization rates to all-time lows, pushing sales prices even higher.

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VACANCY AND RENTS

Metropolitan Portland's industrial market continued to show strength in the first quarter, with strong demand and limited new supply driving occupancies and asking lease rates to new historic highs. A review of quarterly research reports from four leading commercial real estate firms revealed a metro-wide average vacancy rate of 4.43 percent in the fourth quarter, 26 basis points below the prior quarter and 91 basis points below the first quarter of 2015. This drop in vacancies comes despite a significant rise in deliveries in 2015 to a seven year high. Distribution/warehouse vacancy rates dropped 28 basis points versus the prior quarter and 88 basis points below the prior year, while flex space vacancy ticked up 10 basis points above the prior quarter but remained 140 basis points below the prior year.

Table 1: Portland Metro Industrial Quarterly Report Survey Q1 2016

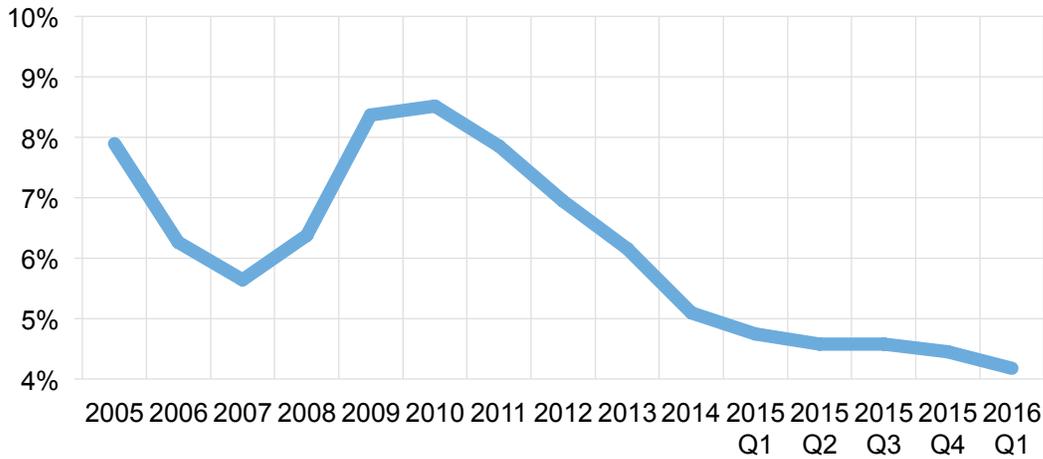
	Colliers	JLL	CBRE	Kidder Mathews	Average - Q1 2016	Chg vs Prior Qtr	Chg vs Prior Year
Vacancy							
- Distribution/Warehouse	4.60%	3.60%	4.00%	4.50%	4.18%	-28 bps	-88 bps
- Flex	10.10%	9.10%	-	-	9.60%	10 bps	-140 bps
- Weighted Average	5.10%	4.11%	4.00%	4.50%	4.43%	-26 bps	-91 bps
Rents *							
- Distribution/Warehouse	\$0.50	\$0.52	\$0.43	\$0.51	\$0.49	5.4%	7.1%
- Flex	\$0.95	\$0.96	\$1.05	-	\$0.99	-1.0%	8.0%
- Weighted Average	\$0.54	\$0.56	\$0.49	\$0.51	\$0.52	4.5%	7.3%

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

Sources: Quarterly Reports

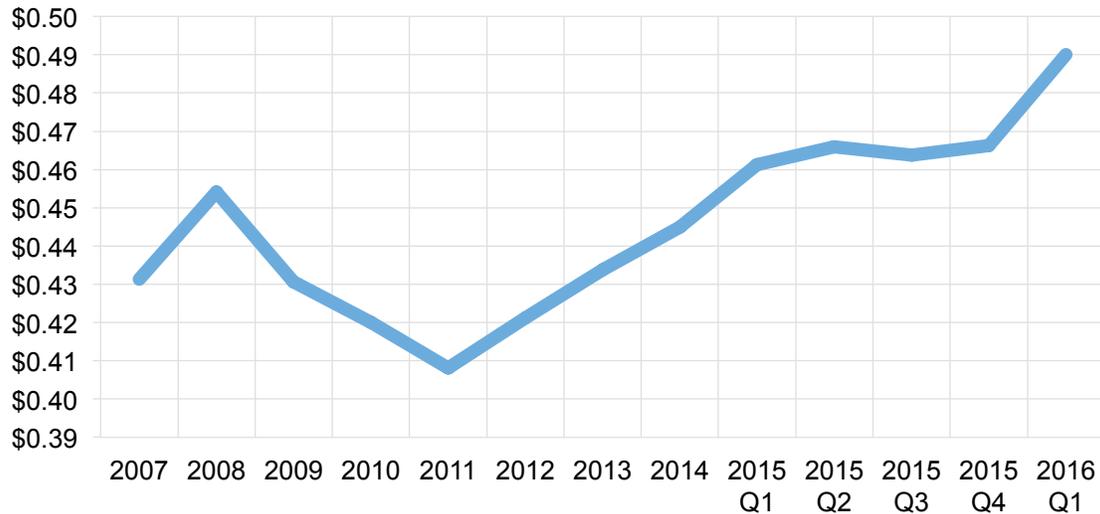
In their April forecast presentation, Capacity Commercial and Colliers noted that the true market vacancy may be closer to 3 percent. They also reported that 60 percent to 65 percent of new and under construction product in the market is already leased, so new supply will not likely lead to higher vacancy rates. According to JLL, vacancies are being pushed so low in part due to the fact that “the growing demographics of Portland are catching the eyes of national and international companies. The need for same day/next day shipping and the favorable geographic location of Portland means that Portland is perfectly situated for companies wanting to distribute throughout the Pacific Northwest.”

Figure 1: Portland Metro Distribution/Warehouse Vacancy Rate, 2007–2016 Q1



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

Strong demand also pushed up asking rental rates to record high levels in the first quarter. The quarterly report survey showed monthly distribution/warehouse asking rates of \$0.49/square foot and flex rates of \$0.99/square foot, for a combined weighted market average of \$0.52/square foot. Distribution/warehouse rates were up a strong 5.4 percent from the prior quarter and 7.1 percent year-over-year. Capacity Commercial noted that asking rates for closer distribution/warehouse spaces are up to \$0.50 to \$0.55/square foot, and that close-in southeast Portland spaces are at or above \$0.75/square foot. Record rates are being seen for spaces of all sizes, and Kidder Mathews reported that LINC’s new lease at Gateway Corporate Center, at \$0.46 for the shell, represents a new high water mark for warehouse spaces over 100,000 square feet. Flex rates declined 1.0 percent from the prior quarter but are still up 8.0 percent year-over-year.

Figure 2: Portland Metro Distribution/Warehouse Asking Rents, 2007–2016 Q1

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

ABSORPTION AND DELIVERIES

Colliers reported positive net absorption of over 386,000 square feet in the first quarter and 2.8 million square feet for the last 4 quarters, not including Intel's new construction. The first quarter's net absorption was significantly down from the prior 2 quarters, driven by a lack of new deliveries. The quarter's deliveries totaled just over 300,000 square feet, dominated by the 210,000 square feet in Gateway Corporate Center's Buildings D and E.

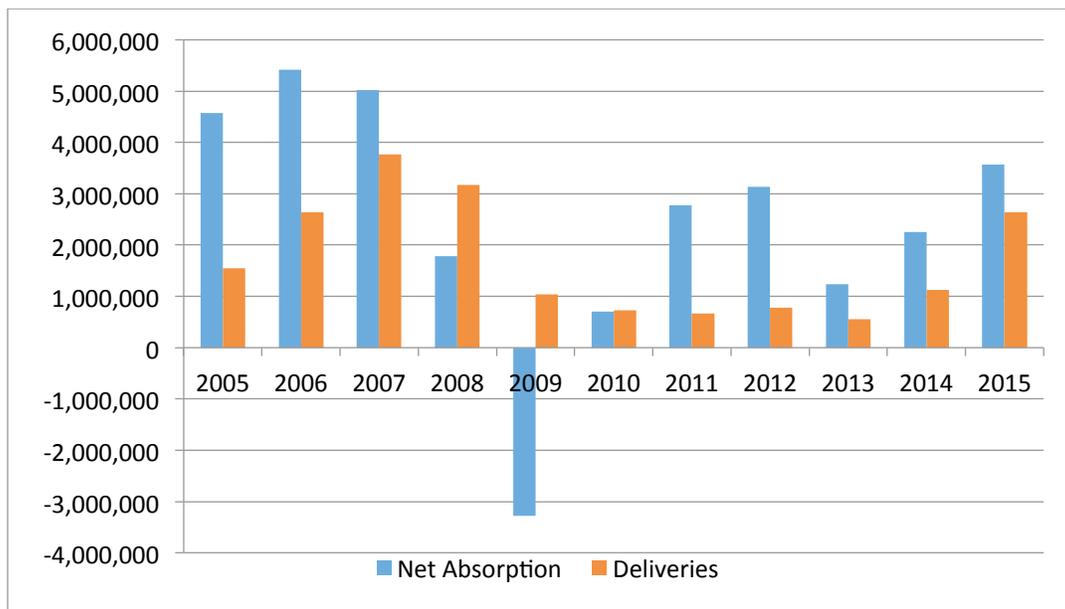
In their April forecast presentation, Capacity Commercial and Colliers estimated that only 505,000 square feet are available of the over 2.4 million square feet delivered over the past few quarters, reflecting a leased rate of over 80 percent. This available space is located in 3 projects: Specht's Interstate Crossroads, Holland's Cameron Distribution Center, and New York Life's Gateway Corporate Center. In addition, a significant amount of space was taken off the market when PDC and the City of Portland announced that they would purchase the Colwood Industrial Center site for the location of the USPS distribution facility. This took over 800,000 square feet off of planned space off the market, further exacerbating the tight rental market.

Table 2: Portland Metro Industrial Net Absorption Last 4 Quarters (Excluding Intel)

	Distribution/ Warehouse		Flex	Total
Q2 2015	-187,334		20,511	-166,823
Q3 2015	674,514		245,826	920,340
Q4 2015	1,564,058		78,577	1,642,635
Q1 2016	331,199		54,805	386,004
Total L4Q	2,382,437		399,719	2,782,156
AVG 2005-2015				2,470,962
AVG 2005-2007				5,003,616
<i>Peak Annual</i>	<i>2006:</i>			5,412,028
<i>Trough Annual</i>	<i>2009:</i>			-3,283,498

Source: Colliers International, does not include Intel absorption of 2.7 million s.f. of flex space

Figure 3: Portland Metro Industrial Net Absorption & Deliveries, 2005–2015 (Excluding Intel)



Sources: Colliers Quarterly Report and Colliers/Capacity Commercial Presentation

Colliers and JLL reported 3 lease transactions in the first quarter over 100,000. Capacity Commercial noted that lease sizes continue to get bigger, as more national and international companies look to Portland as a key distribution hub.

Table 3: Notable Portland Metro Industrial Lease Transactions Q1 2016

Tenant	Building	Submarket	Size (s.f.)	Type
Bunzl Distribution	205 Logistics Center	Clackamas	190,600	New
OnTrac	Portside Industrial Park	West Vancouver	162,240	New
Logistics Insight Corp.	Gateway Corporate Center	East Columbia	105,535	New
Bell-Carter Foods	Rivergate Corporate Center	Rivergate	91,200	New
Amazon	The American Steel	Guilds Lake	89,481	New

Sources: Colliers and JLL

UNDER CONSTRUCTION

JLL noted that there is known tenant demand for approximately 3.4 million square feet of space, with over half of this demand coming from tenants seeking spaces over 200,000 square feet. With Colwood Industrial Center, and its over 800,000 square feet of space, now off the market, there are even fewer large spaces available compared to last quarter. At the other end of the spectrum, Kidder Mathews reported that there continues to be a severe shortage of smaller spaces (5,000 to 20,000 square feet) in the market, but noted that increasing shell rates are driving the potential for development of smaller projects with smaller spaces, which would require shell rates between \$0.55-\$0.65 to “pencil.” Some larger projects in the pipeline also have the potential for divisibility for smaller spaces.

There are approximately 2.5 million square feet of space currently under construction in the Portland metropolitan area. Norris & Stevens noted that the average building size under construction is 130,000 square feet, versus a market average size of 30,000 square feet for all industrial buildings. Although 60 percent of total supply under construction is speculative, analysts reported that between 50 percent and 60 percent is already pre-leased. Notable projects in the pipeline include:

Northeast:

- PDX Logistics Center: 355,000 square feet in Building 3, due to deliver Q2 2016 (100 percent leased)
- Logisticenter 185: Approximately 230,000 planned square feet in 3 buildings, due to deliver Q4 2016
- Gresham Vista Business Park: 600,000 square foot build-to-suit for Subaru, due to deliver Q4 2016 (100 percent leased)

Other:

- Portside Industrial Center: 300,000 square feet of speculative space in Vancouver, due to deliver Q4 2016 (46 percent leased)
- Majestic Brockwood Business Park: 300,000 square feet of speculative space in Hillsboro, due to deliver Q4 2016
- Clackamas Distribution Center: 190,000 square feet of speculative space in Clackamas, due to deliver Q4 2016 (100 percent leased)

INVESTMENT ACTIVITY

Kidder Mathews reported sales volume of \$124 million for the quarter, down from \$174 million the previous quarter. They noted that strong investment interest from domestic and foreign institutional investors is pushing prices above replacement costs. According to CBRE, the overall price per square foot jumped 6 percent in the quarter to \$103/square foot.

As reported last quarter, 2015 saw a record high transactional volume (in terms of value) in the metropolitan Portland market. In fact, Capacity Commercial and Colliers noted that through the 3rd quarter of 2015 the metropolitan area saw an increase in investment sales of 105 percent, the 8th highest growth rate of any market in the country.

The most significant transaction in the quarter was the sale of PDX Logistics Center to Clarion Partners for over \$46 million, or nearly \$95/square foot. Capacity Commercial noted that capitalization rates, in the high 5 percent range on average, are at all-time lows.

Table 4: Notable Portland Metro Industrial Sales Transactions Q1 2016

Address	Location	Size (s.f.)	Price	Price/s.f.	Type
PDX Logistics Center I	Portland	491,200	\$ 46,600,000	\$ 94.87	Investment
I-84 Industrial Center	Portland	423,300	\$ 22,300,000	\$ 52.68	Investment
Rockwood Corporate Center	Portland	131,037	\$ 11,250,000	\$ 85.85	Investment
Harvest Court International	Beaverton	76,500	\$ 7,407,431	\$ 96.83	Investment
7440 SW Bonita Road	Tigard	49,950	\$ 4,500,000	\$ 90.09	Investment

Sources: Colliers and Kidder Mathews

LOOKING AHEAD

There is a looming lack of close-in developable industrial land. This lack of land is set to further constrain the available supply in the market. With demand expected to continue to remain strong for space in the metropolitan area, this dynamic is set to drive rents higher, keep vacancies low, and push new development to outlying areas of the metro and also to more challenging development sites.

With the market's fundamentals likely to remain strong over the next four quarters, demand for limited supply is also set to drive industrial sales prices even higher, pushing capitalization rates to even lower levels. Most analysts expect speculative developments to continue, and some predict that future projects are likely to be smaller in overall size than those currently under development, with many targeting small- and mid-sized tenants. ■