06

RESIDENTIAL MARKET

Multifamily Residential Report

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**The Portland metropolitan area in this report is defined as Vancouver, Beaverton, Gresham, Hillsboro, Milwaukie, Lake Oswego, Oregon City, Fairview, Wood Village, Troutdale, Tualatin, Tigard, West Linn, Battle Ground, Camas, and Washougal.*

INTRODUCTION

As we head into 2022, the multi-family sector remains a strong asset class within the Portland metro area. Portland still offers the second most affordable rents when compared to the 11 west coast metros; only Fresno, California offers more affordable rents. Portland's affordability continues to drive in new residents, but that could be slowing down due to rapidly rising rents fueled by sustained demand and an oncoming lack of new construction.

The vacancy rate has returned to pre-pandemic levels except for the downtown core. Capitalization rates for multi-family housing remain below 5% for the Portland metro area, and after a record-breaking sales year, new players continue to enter the market as the fundamentals remain strong. We can see the first results of the inclusionary zoning era within the City of Portland, and developers are getting creative. The suburban markets saw the strongest rent growth, and they remain an attractive opportunity as demand has been increasing in most of these areas. The trend of renters seeking large unit sizes and more open or green space remains an ongoing phenomenon. With over 9,000 units being absorbed in the metro area for 2021, how will the multi-family supply keep up with the demand?

DEVELOPING IN A CHALLENGING CLIMATE

The City of Portland and the State of Oregon have instituted new regulations on developers and property owners in a very unhealthy way, which may disrupt the overall Portland metro economy. New regulations such as statewide rent control and inclusionary zoning coupled with the City of Portland's notoriously slow permitting processes has practically brought new development to a halt within the city limits.

Inclusionary zoning only affects the City of Portland. At its most restrictive level, it requires developers of projects with 20 or more units to either commit 20% of the building to be affordable units or pay a fee in lieu. In return for including affordable units or paying the fee, additional FAR and height limits are granted. While the additional FAR is attractive in many instances, requiring the affordable units or paying the fee lowers the profitability of the project. When this is compounded by rising land values, new projects simply become unfeasible. Developers remain skeptical about paying the fee in lieu because there is not much information on where the funds will be allocated.

Despite the current climate, developers are thinking outside the box. Portland-based developer Solterra is currently building a beautiful and unique LEED designed, 90,000 square-foot, 104 unit building at 1130 NE Alberta Avenue. The project is called Cascada and will be a combination hotel and apartment building. The Building of Development Services application was approved for the housing units to be used as "Co-Living/ Lodging". The developer on their website describes the units as flexible accommodations where residents can stay for a day or a year. The units will feature full-size kitchens, essentially making the building an upscale version of an extended-stay hotel. The building appears to be circumventing the goals of the city and the purpose of inclusionary zoning which is to provide more affordable units. Solterra was not available for comment, and opinions expressed are solely of the writer.

Another example that will be commonplace is developers only building 19 units on separate parcels to avoid triggering the inclusionary zoning ordinance. Northbound 30 Collaborative located in the Northwest neighborhood is an example of this. The developer divided their larger parcel into eight 5,000 square-foot lots and on each lot will sit a 5-story 18-unit building. This will be a mass timber project that features open spaces between buildings. Like Cascada, it will be ecologically sustainable, but not equitable.

Once a building finishes construction and its initial lease-up, its rents are at its highest for 3-5 years until new product comes online. When new product is added, older products filter down with lower rents until the building needs a renovation. Then, rents go back up temporarily but not quite to their original amounts. Ultimately, the property then filters downward again. If there is steadily new product coming available, then older product will filter down and build up the affordable housing stock for the city. If new production stops while supply is low and demand is high, price competition will occur, which is counteractive to the City's goals of providing more affordable units.

The City of Portland has disrupted the natural cycle of developers filling the multi-family needs of the city. For the time being, many 19-unit or less properties will be built, and some developers will find interesting ways to circumvent the policy. However, mid-rise development will be put on hold, which works against the density increases the city is trying to create. The lack of development will continue to decrease supply and increase rents as renters compete over remaining inventory. On a positive note, the elimination of single-family zoning will provide the city and the metro area with a growing tri- and quadplex stock.

CAP RATES

Coming off a record-breaking sales year, cap rates continue to tighten as the Portland metro improved from 4.6% to 4.5% from the fourth quarter of 2021 to the first quarter of 2022. The suburban cities of Hillsboro, Tigard, Wilsonville, Beaverton, and Clark County continue to have slightly stronger cap rates than the urban core as remote work drives renters to look for larger units and more green space. For buildings with at least 20 units, no Portland submarket with a decent amount of multi-family properties exceeds a 5% cap rate.

Single-family home pricing has skyrocketed in the Portland metro area, slowing the ability of Millennials and Gen-X households to make the move from renters to home ownership. Gen-X and Millennials aged 25-45 are considered the largest labor pool in the United States but continue to struggle with the transition to home ownership due to high pricing; lack of new inventory; high debt to income ratios; and the growing generational mentality to have flexible employment, which enables them to move around frequently. These factors ensure that multi-family projects remain desirable in this market. As demand continues and the rate of new supply drops, rents will continue to rise as renters compete for the limited availability in the market. Insufficient future supply could be fatal if prices rise too high and Portland is no longer is known as the affordable west coast destination, pushing renters to look for other markets.

SALES ACTIVITY

In 2021, the total volume of sales ($3.7 billion) and average sales price per unit ($285,000) both broke records. Sales continue to trade as a few buildings that recently leased up have changed hands. The Heather Lodge was completed in Happy Valley in April 2021 and was sold for $71 million to The Randall Group based in Portland. It is a 178-unit, 4-story property built on 4.3 acres offering studios and 1- , 2- , and 3-bedroom units.

At the time of sale, it was fully occupied and achieved a sale price per unit of $398,876. Portland continues to remain an attractive market for larger or institutional investors as we have seen annual sales average $1.5 billion over the past five years. Table 1 shows notable sales over the past 4 months. Two new to market investors include Canadian REIT Rise Investment Trust, and Starwood REIT based out of Miami.

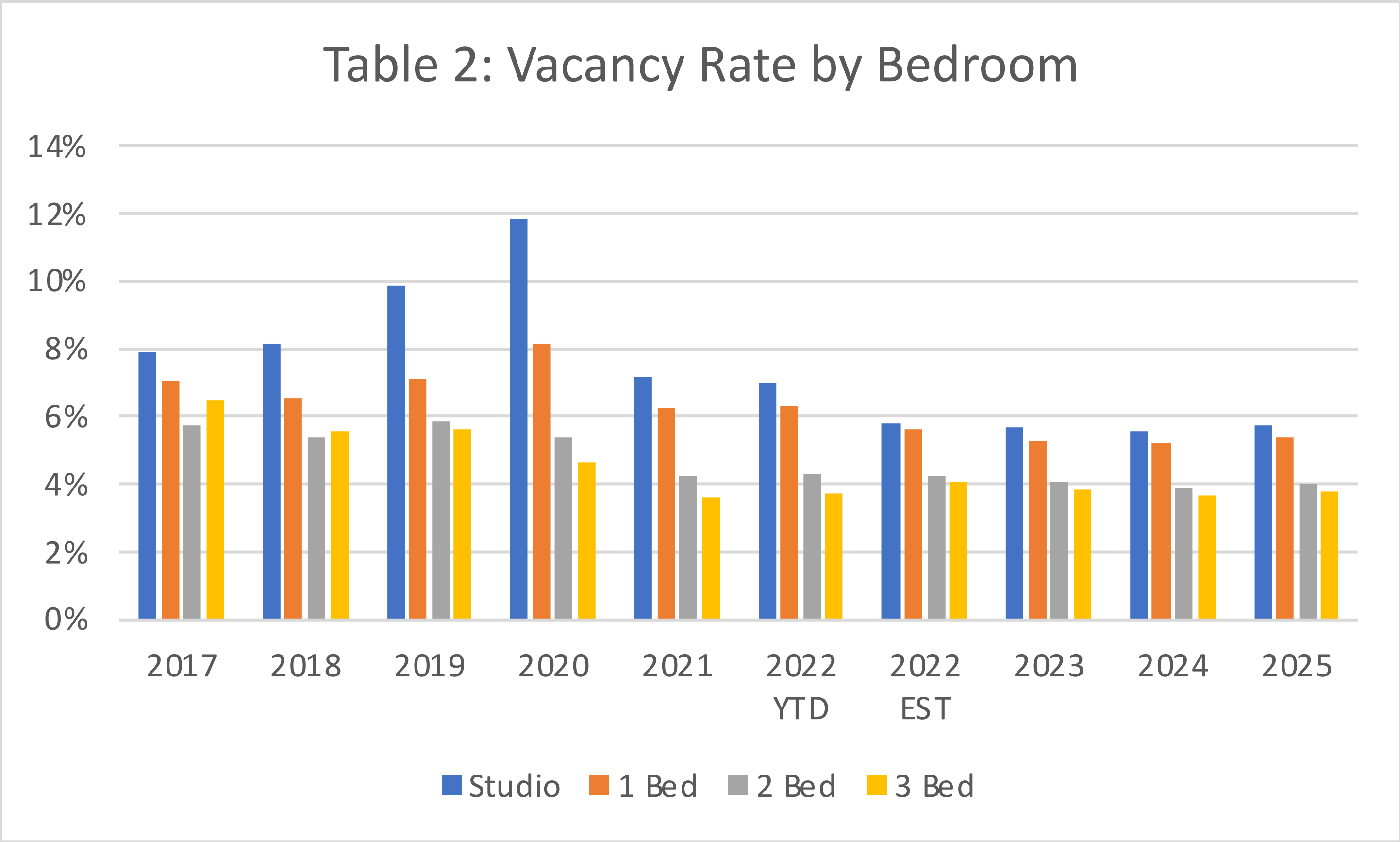
Table 1: Notable Sales Last 4 Months

	Apartment Name	Buyer	Seller	Sales Price ($ Million)	Sale Date	Vacancy at Sale	Units	Sale Price Per Unit	GBA (SF)
1	Kado NW	The Wolff Company	Holland Partner Group	$80.60	Dec-21	4.3%	196	$411,224	228,305
2	Revere Apts	The Wolff Company	Fore Property Company	$78.50	Dec-21	9.5%	693	$372,038	160,458
3	10th @ Hoyt	Rise Properties Trust	Prometheus Real Estate Group	$75.50	Dec-21	5.6%	178	$421,348	194,044
4	Verso	Brookfield Real Estate Income Trust	Rembold Companies	$74.00	Dec-21	4.0%	172	$430,223	165,000
5	Heather Lodge	The Randall Group	Fore Property Company	$71.00	Jan-22	0.0%	178	$398,876	150,000
6	Q21	Fairfield Residential	Rosan	$65.00	Dec-21	0.0%	166	$391,566	130,000
7	Lakemont Ridge	T Barry Brenneke Company	Urban Form Development	$42.00	Nov-21	NA	131	$320,611	475,000
8	Union Park	Coast Equity Partners	Timberland	$34.50	Nov-21	2.0%	120	$287,500	109,000
9	Our Heroes Place	ColRich	Prestige Development	$25.35	Dec-21	7.2%	49	$517,347	44,838
10	Arbor Heights	Kennedy Wilson	Cigna Investments	$120.75	Dec-21	3.0%	348	$346,983	285,260

VACANCY AND ABSORPTION

The market has almost returned to pre-pandemic vacancy numbers, and the urban core is the only remaining area that has not fully rebounded. Within the urban core, Southeast and Central Northeast submarkets have the lowest vacancy rate of 5.4%, followed by Southwest at 7.4%; Northwest & Northeast at 8.9%; Downtown/CBD at 9.2%; and North Portland at 9.6%. Southwest has seen excellent absorption, as many renters want to be in the core but out of downtown. OHSU's expansion also brought new jobs to the area and helped fill units.

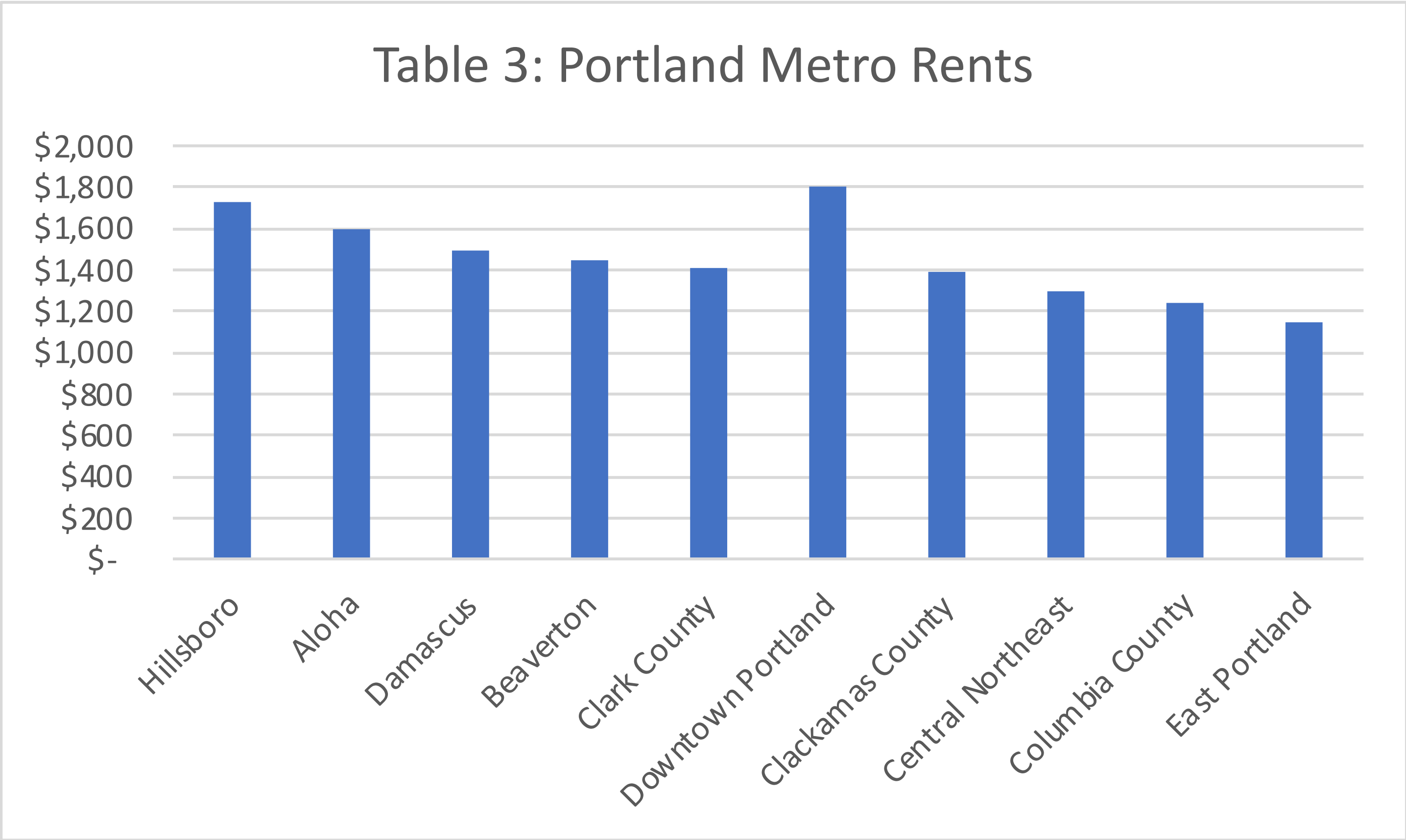
The North and Central Eastside neighborhoods provide more affordable options for renters interested in an urban lifestyle but are priced out of the Downtown core. Portland neighborhoods that have appreciated over the past decade provide young professionals with trendy living options at prices they can afford. Meanwhile, the suburbs like Hillsboro and Beaverton benefit from the presence of Intel and Nike. These submarkets have been consistently receiving the most institutional interest other than Vancouver. Absorption for 2021 was the highest in Vancouver at 1,761 units. Outside of the urban core, Gresham saw 614 units absorbed beating out cities like Beaverton and Hillsboro. CoStar estimates that 45% of the Portland metro's residents are renters as homeownership remains out of reach for them.



When looking at unit mix, 2- and 3-bedroom units have the lowest vacancy in the market, with studios having the highest vacancy. Table 2 shows vacancy by unit type. During the pandemic, when studio vacancy was abnormally high, 2- and 3-bedroom units were inversely being absorbed. The demand for these units is a result of lack of construction of 2- and 3-bedroom units, as well as a shift in renters' preferences to desire larger units. While studios remain desirable to some, developers should be aware of their tenant mix and not overload studios.

RENTS

According to the Apartment Investors Journal published by Norris & Stevens, "As of the first quarter of 2022, average rent levels in Portland have reached $1,520 per month, reflecting year-over-year growth of 9.1%." Table 3 shows monthly rents and annual rent growth of submarkets within the Portland metro.



Downtown rents have grown by well over 5% year-over-year, but companies will need to continue to commit workers to the urban areas for this trend to continue. Tech and apparel sector office leases have been the bright spot of downtown activity over the past year, but the central business core remains a shell of its pre-pandemic form. The upcoming departure of the Umpqua Bank headquarters will deal another significant blow to central Portland in the coming months.

SUPPLY

Portland metro area construction peaked in 2018 when 14,000 units were delivered, part of a 30% increase in supply over the last decade. During this time, developers delivered an average of approximately 8,500 units each year, while only 4,000 units are under construction for 2022. Net absorption is approximately 9,300 units per year, so it appears that a shortage is coming fast.
Prior to the pandemic, investors feared that too much product was coming to market and slowed down

investment.

After the initial shock of the pandemic, tenants started moving to Portland for its affordability compared to the other major west coast markets. The expansion of remote work is playing a factor in the relocations to Portland as well. As Portland city officials instituted aggressive regulations, developers have gone to seek projects elsewhere creating a vacuum of limited supply and rising rents and land prices, counteracting the City's plan to make more affordable units available. Table 4 shows some of the new development.

Table 4: Under Construction

Property	City/Submarket	# of Units	Owner	Expected Delivery
West End District Apts	Beaverton	424	Sisters of St Mary of Oregon	Q1 2022
The Quarry	Hillsboro	352	Katerra	Q2 2022
Alta Art Tower	Goose Hollow	314	Wood Partners	Q1 2022
South Waterfront 45	SW (Waterfront)	291	Caim Pacific	Q3 2022
Modera Morrison	Central Eastside	247	Mill Creek Residential Trust	Q2 2023
Skylar Grand	Central Eastside	170	Fairfield Residential	Q3 2022
Overland	Tigard	219	Greystar	Q4 2022

LOOKING FORWARD

Despite the ongoing pandemic, the multi-family market in the Portland metro area has recovered and is arguably the metro's strongest asset class. Steady job growth coupled with affordable west coast living has kept the Portland metro a desirable place to live. The Vancouver submarket has led the way in year over year rent growth, vacancy decline, construction starts, cap rates, and sales. Vancouver will continue to remain attractive for investors as Oregon's rent control bill and Portland's inclusionary zoning don't affect this part of the metro area.

There is still desire from consumers to live in transit-oriented communities within Portland's metro area, but due to the city's logjam with permits, developers will start seeking out projects along these transit corridors within the suburbs. The City of Portland should continue to see more sales as once empty buildings now fill new residents at higher rents and with less concessions. The southwest waterfront, which was at one time considered a failure, has stabilized as consumers enjoy being close to, but not in the downtown core.

The City of Portland should find ways to incentivize new companies to relocate downtown to fill the vacancies in both the office and multi-family buildings. New supply will be the biggest segment to watch. If developers don't deliver enough properties, rents will rise, and the market will risk losing current residents.

RESOURCES

1. Apartment Investors Journal by Norris and Stevens Fall/Winter 2021 Cascada. (2022, Jan 30). Retrieved from SolTerra: https://solterra.com/our-projects/cascada-alberta-arts-district/

2.Costar Portland Multifamily Report Q1 2022

3. Kidder Matthews Portland Multifamily Report Q4 2021

4. New Commercial Mixed-Use Building at 1130 NE Alberta, LU 19-187641 DZM (City of Portland, Bureau of Development Services Dec 17, 2019).

5. Multi-Family NW Apartment Report Fall 2021

6. Yardi Matrix Portland Multifamily Fall Report 2021