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## OFFICE MARKET ANALYSIS

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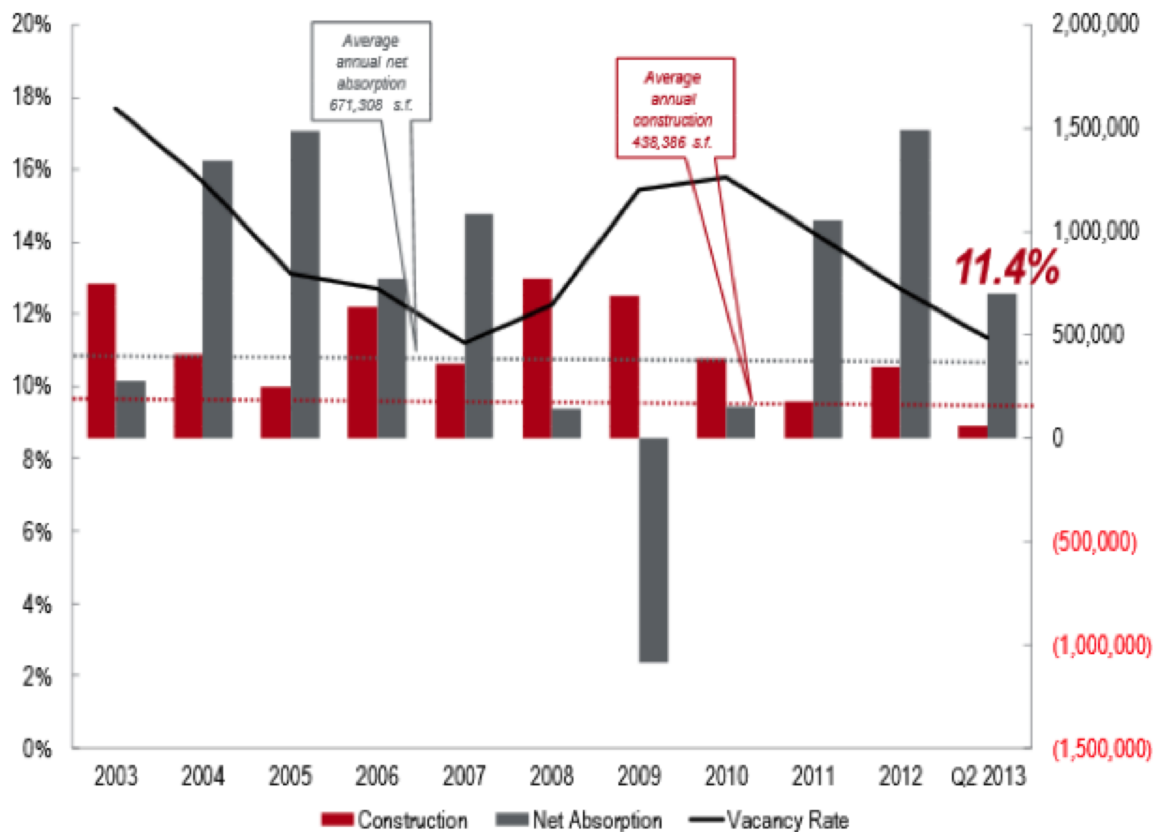
All eyes have been on the Fed and where it will go with quantitative easy. Speaking in June, Ben Bernanke gave a reminder to Wall Street that quantitative easing is fixed to the poor health of the national economy and will eventually be tapered off as the economy continues improves. This sent a spell of short lived ripples through Wall Street and the resulting major losses were recovered as the month came to a close.

The second quarter of 2013 saw continued growth across major economic sectors in the U.S. and the State of Oregon alike. Lease rates are either holding steady or moving up as most real estate sectors see increased sale and lease activity while unemployment continues to drop. Despite improvements, Oregon's unemployment remains stubbornly high at just under eight percent.

Vacancy rates in the Portland office sector continue to fall, now at the averaged level of 10.5 percent. Office vacancy nationally now stands at 16 percent and is anticipated to drop to 15.9 percent by year's end. Absorption, though nominally decreasing, remains in positive territory at 716,577 square feet on the year. Office lease rates have made marginal gains. From last quarter office rates across Portland have increased by 0.9 percent to \$19.98 per square foot, as Class A office space increase 10 percent up to \$24.39 per square foot. Construction remains minimal with

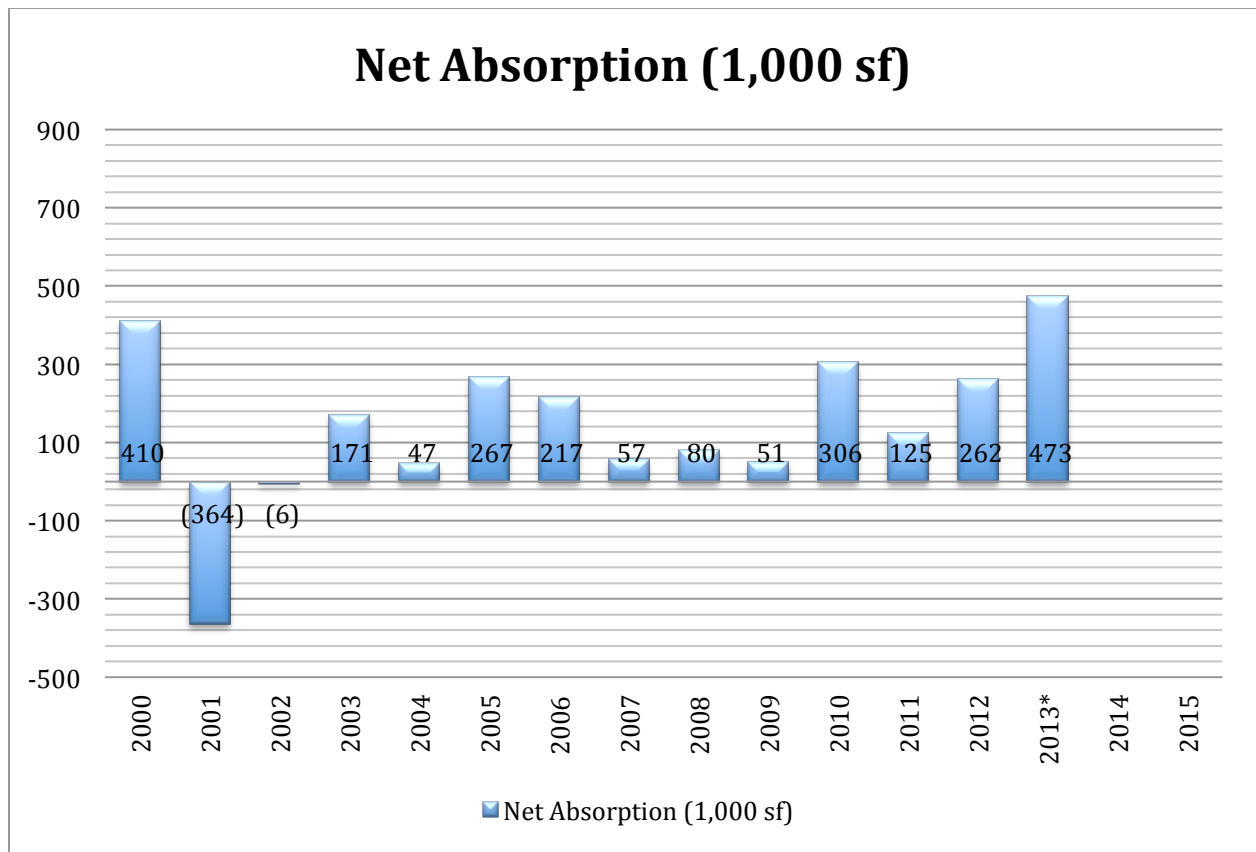
■ Geoff Falkenberg is the Oregon Association of Realtors fellow at the Portland State University Center for Real Estate. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

the delivery of one office building, containing approximately 11,000 square feet. This is up from zero deliveries last quarter.



Source: Jones Lang Lasalle

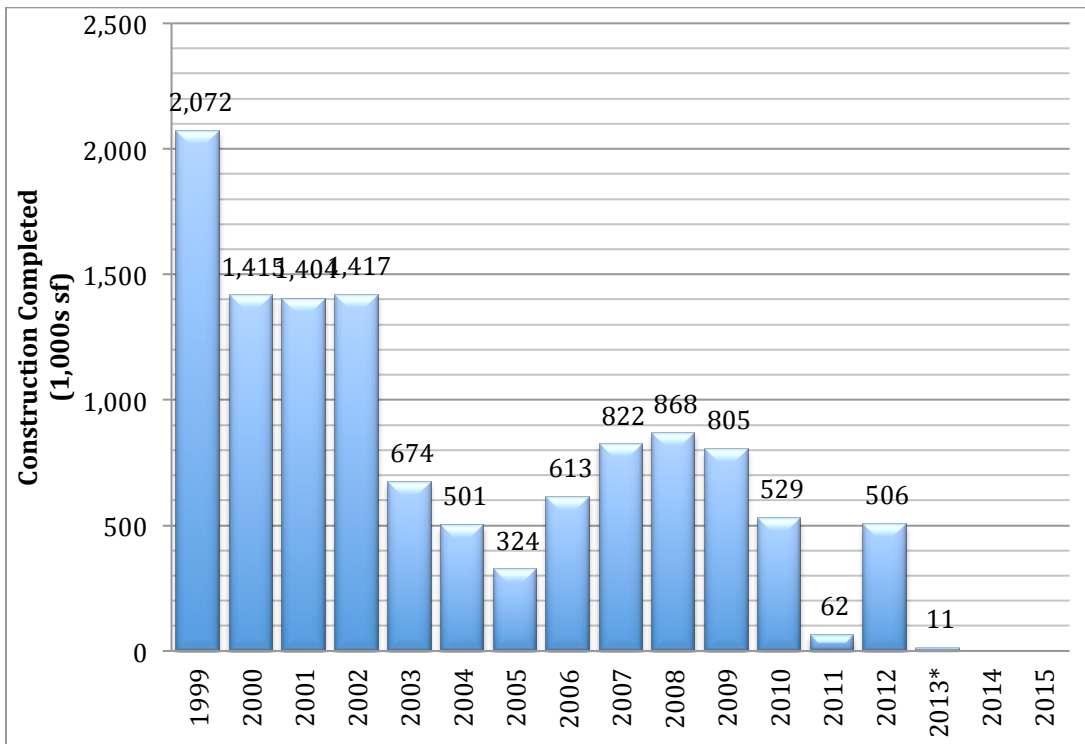
Last year saw the net absorption of approximately 1.5 million square feet of office space and the development of approximately 500,000 square feet of new office space. So far this year there has been approximately 700,000 square feet absorbed with the introduction of just 11,000 square feet of new office space. Portland now has the second lowest vacancy in the U.S., behind difficult-to-develop San Francisco. When pressed about the lack of new office development, low vacancy, and continued absorption, John Russell of Russell Development responded that there is no need for new large scale office development located in the CBD in the foreseeable future due to much of the demand coming from smaller businesses that can re-adapt current available footage into creative space, adding that current needs for larger contiguous space are being met by the reshuffling of larger tenants between buildings.



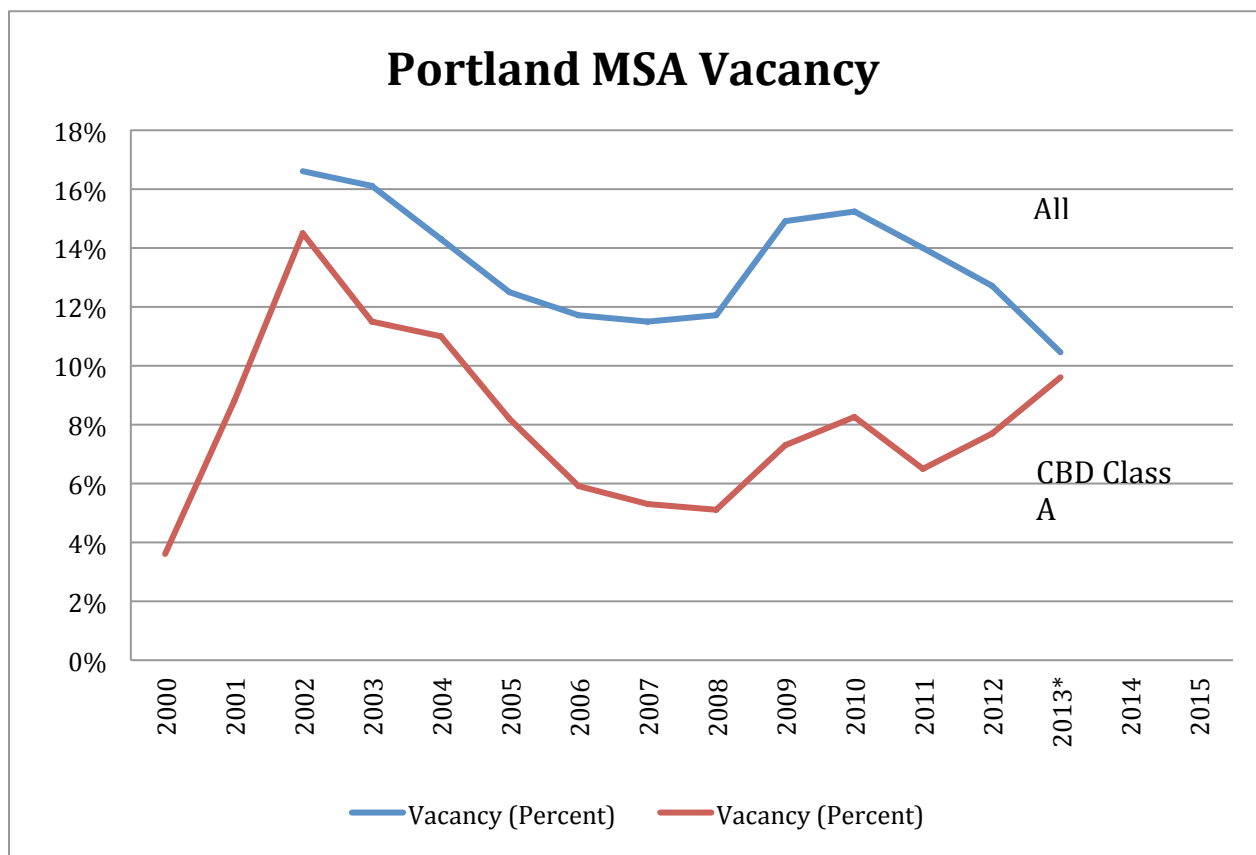
The usage of Class A office space is beginning to evolve in Portland. As the Pearl and other attractive areas fill with creative space tenants the demand for smaller areas with the creative space feel continues to grow beyond what the market can provide. Class A space and amenities like the US Bancorp Tower, Umpqua Bank Plaza, and Fox Tower have been converting their floors into open spaces to attract growing companies like Webtrends (65,000 square feet) and K&L Gates (21,206 square feet). On the year Class A Net Absorption stands at 473,139 square feet, as reported by Co-Star, and as reported by NAI Norris, Beggs, & Simpson, vacancy specifically in the CBD rose slightly to 10.07 percent. The rise in vacancy took place despite multiple new large leases in the US Bancorp Tower and the Thetus Corp.'s lease of the 31,358 square feet lease of the Historic US National Bank Block.

The majority of new lease agreements have taken place in the CBD with a nice even mix of new, renewal and expansion agreements.

Completed lease transactions				
Tenant	Building/Address	Submarket	SF	Type
Stream Global Services	Hollywood Video	I-5 South Corridor	119,077	New
Integra	SEH Campus - Building 1	Cascade Park/Camas	85,000	New
WebTrends	US Bancorp Tower	CBD	64,676	New
FiServ	4550 Macadam Building	SW Close In	54,616	Renewal
Pacificorp	PSU	CBD	43,218	Renewal
Oregon Health Authority	The Lincoln Building	CBD	28,089	Expansion
Pacific Crest Securities	US Bancorp Tower	CBD	27,714	Renewal
Key Bank	Pacwest Center	CBD	27,000	Renewal
Evanta	Koin Center	CBD	25,000	Expansion
DTI	Pittock Block	CBD	22,000	New
K&L Gates	Umpqua Bank Plaza	CBD	21,179	New
UTI	400 Sixth Ave Building	CBD	20,600	Expansion
Kronos	Tigard Triangle Commons - Bldg 1	217 Corridor/Beaverton	19,353	New
Janrain	Dekum Building	CBD	17,156	Expansion
Clinitient	1515 Building	CBD	16,000	Renewal
Colliers International	Pacific Center	CBD	15,880	New

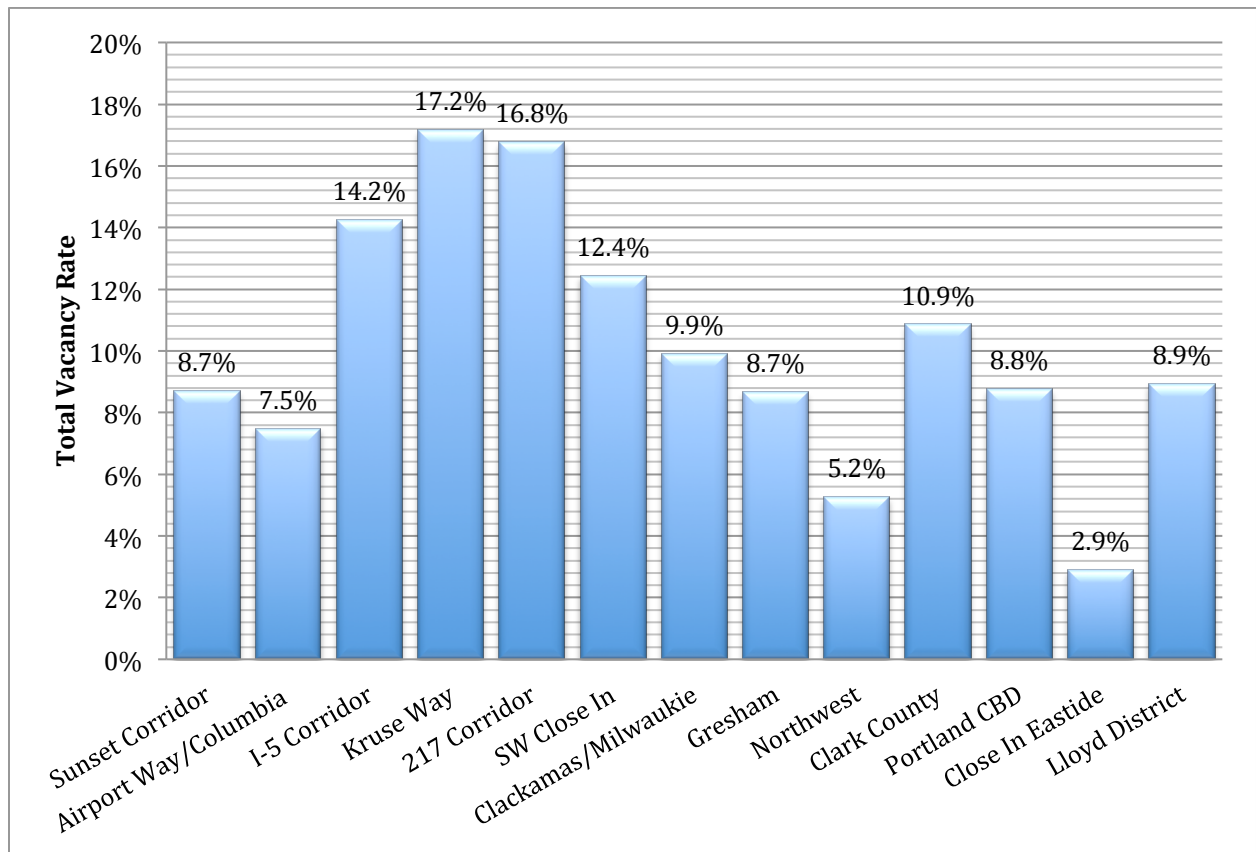


The second quarter saw the year's only delivery, a 10,916 square foot building located at 333 SW Warner Milne Rd., a medical/dental office, 100 percent leased. As compared with zero square feet of deliveries in the first quarter of this year, development is still slow in the office sector. Currently there are 111,827 square feet of office space under construction in Portland; most office development is focused on re-purposing/overhauls and owner-user projects. Southern Miss, located at the corner of N. Mississippi and N. Cook, is adding 24,300 square feet of new office space, half of which is pre-leased. The overhaul of 4600 SW Macadam will bring 55,527 square feet back into the Portland market. Killian Pacific has plans to build a 60,000 square feet that should be finished in the first few months of 2014, located at 240 SE Clay.

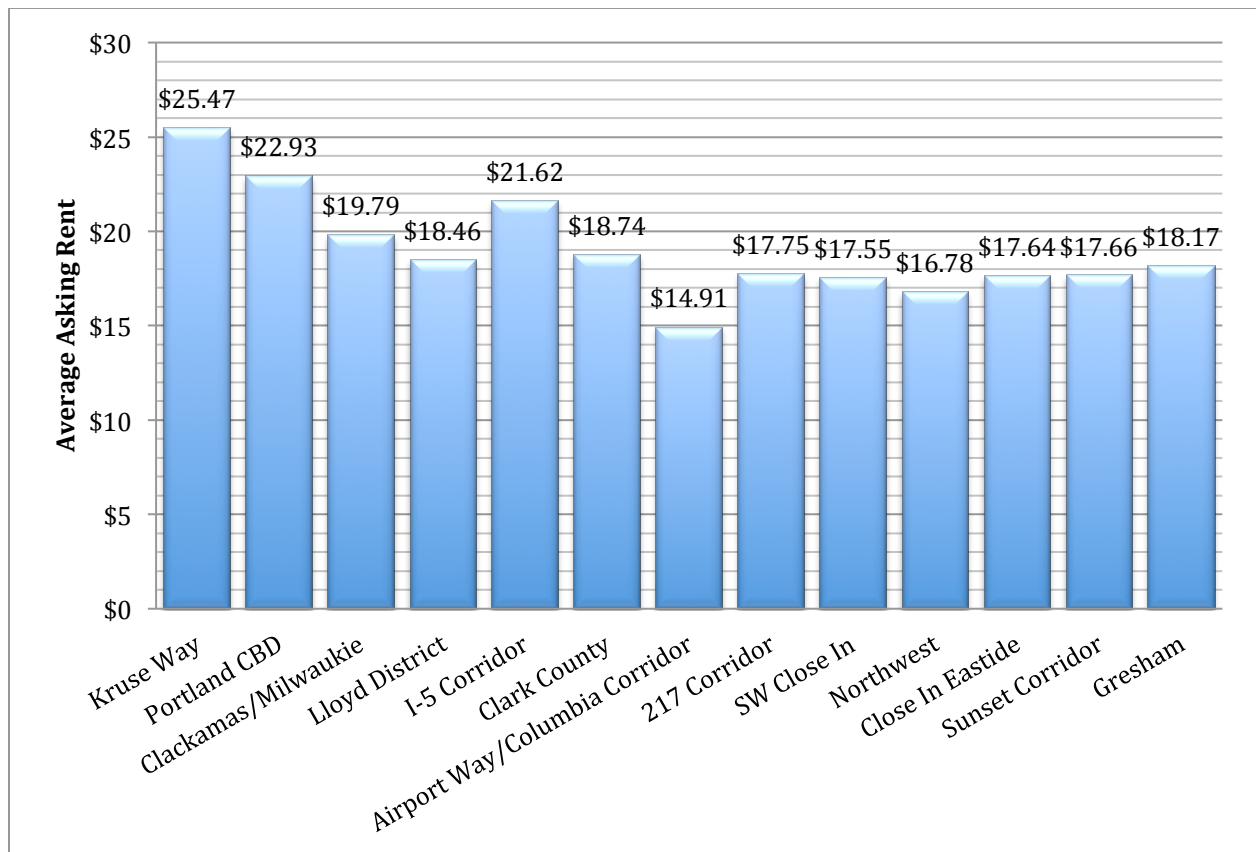


The average reported vacancy between CBRE, Co-Star, Jones Lang LaSalle, Norris & Stevens, and Kidder Matthews currently stands at 10.45 percent. CBRE is reporting on the high end at 12.60 percent and Co-Star, Kidder Matthews, and Norris & Stevens each reporting on the low end at 9.30 percent. Despite the large variance in stated vacancy all are clear on the well-being and direction of Portland's vacancy. Co-Star and Norris & Stevens are reporting a decrease in Class A, B, and C vacancy. All agencies are reporting a decrease in urban and suburban vacancy. In the urban market a lack of large contiguous Class A office space is keeping demand

high and rents on an even keel, while the relatively more affordable historic properties are tapping into creative space demand. Of all the suburban market areas, Kruse Way continues to bring up the rear with 17.2 percent vacancy, as reported by Co-Star. 17.2 percent is an improvement though, bolstered by several smaller leases totaling nearly 70,000 square feet of absorption.

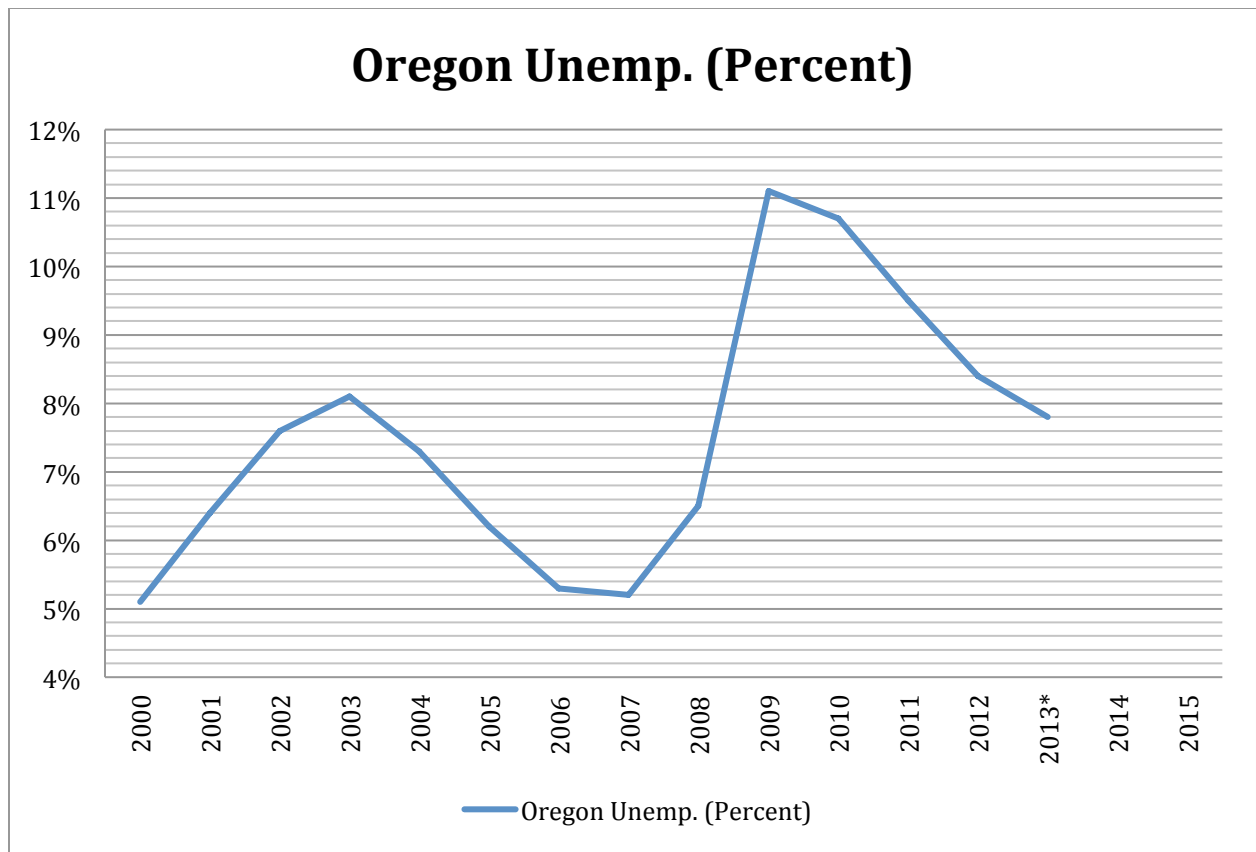


Most subsectors saw decreases in vacancy. The Hillsboro/Sunset Corridor saw the largest absorption outside of the CBD totaling 128,025 square feet, bringing vacancy down to 8.7 percent. Clackamas/Milwaukie with a reasonably strong vacancy rate of 9.9 percent did see the largest net negative absorption of -36,283 square feet.



Although market signs are giving generalized positive indications, rents have dropped in two notable areas. The Lloyd district has dropped from \$18.74 last quarter to \$18.46 this quarter and rents in the Northwest have dropped from \$17.26 last quarter to 16.78. The Lloyd district a negative absorption of -4,510 square feet and the Northwest did retain a positive absorption of 2,737 square feet despite, or perhaps due to, the fairly large drop in lease rates.

The Sunset Corridor will be an area worth watching. Salesforce.com has made clear its intentions to occupy 115,000 square feet of the Synopsis building B, after nearly 12 years of dormancy. Also, Nike purchased two multi-tenant properties next door to its world headquarters for a grand total of \$84.5 million. This purchase was in lieu of a purchase downtown in the South Waterfront area.



A year ago Oregon's unemployment rate stood at 8.8 percent, as of May it has dropped to 7.9 percent, below the national average. Leading this trend is the Portland area; with the one of fastest growing metropolitan job markets in the nation, 21,800 jobs have been added in the last year. This is a growth rate of 2.2 percent, as compared the national average of 1.8 percent. Portland's unemployment in May is registered at 7.3 percent and 8.3 percent a year ago.



Source: Kidder Matthews



As the year has passed the halfway mark the Fed appears to be thinking about a change in course in anticipation of an improving economy. Portland has seen unemployment drop, newcomer businesses arrive, and demand for office space increase as local businesses sprout up and expand. Cap rates have compressed and are beginning to level off. ■