
INDUSTRIAL MARKET ANALYSIS

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The Portland area's industrial market continued a strong second quarter, with robust demand for increasingly limited available industrial space pushing vacancy rates to historically all-time lows. Colliers reports vacancy rates of 4.3 percent, a decrease of 20 basis points from the first quarter. The combination of large institutional investors, strong employment growth and increasing population growth are fueling a pipeline of an expected 4 million square feet of projects proposed and under construction, according to Colliers. Major projects include a 303,360 square foot building under construction in the Hillsboro Brookwood Business Park, with speculation that Amazon is the end-user, according to Capacity Commercial Group.

VACANCY AND RENTS

Metropolitan Portland's industrial vacancy continues to reach new lows in the second quarter of 2016, with CBRE reporting a drop from 4.0 percent to 3.6 percent. Colliers reports a region-wide vacancy rate of 4.3 percent, a decrease from the 2015 third quarter vacancy rate of 4.9 percent. Portland's eastside submarket showed the greatest improvement in vacancy this quarter, with the Southeast experiencing a 68 basis point improvement quarter-over-quarter while the Northeast dropped 50 basis points. Both submarkets are now below three percent vacancy.

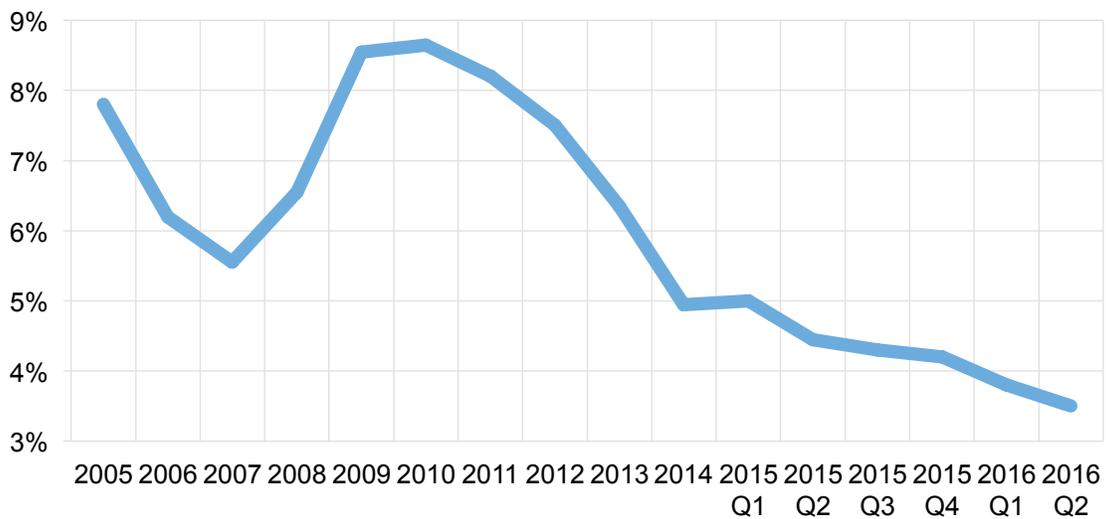
■ **Andrew Crampton** is a Master of Real Estate Development candidate and has been awarded the Center for Real Estate Fellowship. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

Table 1: Portland Metro Industrial Quarterly Report Survey Q2 2016

	Colliers	JLL	CBRE	Mathews	Q2 2016
Vacancy					
- Distribution/Warehouse	4.30%	3.40%	4.00%	4.20%	3.98%
- Flex	8.30%	8.60%	-	-	8.45%
- Weighted Average	4.66%	3.89%	4.00%	4.20%	4.19%
Manufacturing		4.7%			
Rents *					
- Distribution/Warehouse	\$0.52	\$0.56	\$0.43	\$0.53	\$0.51
- Flex	\$0.97	\$0.96	\$1.05	-	\$0.99
- Weighted Average	\$0.56	\$0.60	\$0.49	\$0.53	\$0.54

Portland’s industrial market fundamentals remain strong at the mid-year point. CBRE reports that overall vacancy fell below 4 percent and is now just 7 points from reaching 3.5 percent. As vacancy continues to contract, relocation options for mid-sized and larger tenants becomes more difficult, and more renewals-in-place with smaller tenants becoming displaced if room for expansion is necessary. The total sales volume from the second quarter was nearly \$229 million, according to Kidder Mathews. The average sale price per square foot was \$98. With nearly 3 million square feet under construction and broker sentiments that most of it will be leased prior to delivery, the market may see up to 5 million square feet delivered per year.

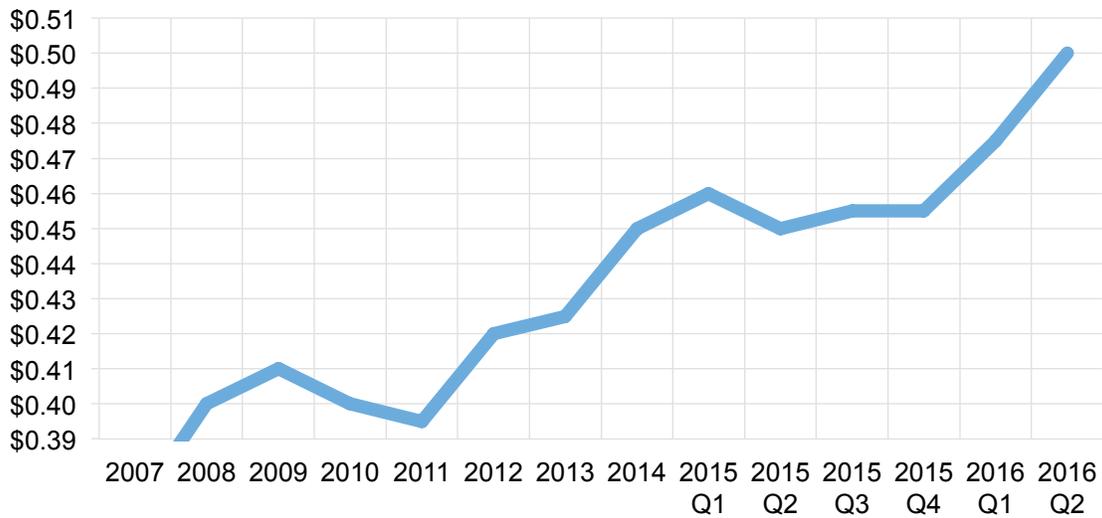
Figure 1: Portland Metro Distribution/Warehouse Vacancy Rate, 2007–2016 Q2



Sources: Average of Quarterly Reports from CBRE, JLL, Colliers

Strong demand also pushed up asking rental rates to record high levels in the second quarter. Asking rates in distribution/warehouse space is priced at \$0.43 triple-net with newer, well-located asking up to \$0.50 per square foot. The surcharge for office space is now at an average of \$0.85 per square foot, according to CBRE. Distribution/warehouse transactions are between \$0.38 to \$0.40 per square foot for older warehouse space, and up to \$0.42 to \$0.45 per square foot in Portland’s newer facilities. Asking rates for flex spaces continue increasing to an average high of \$1.05. JLL reports that the Portland Industrial market has experienced a 12 month increase of 12 percent to \$0.56 per square foot, with new product typically leased before occupancy.

Figure 2: Portland Metro Distribution/Warehouse Asking Rents, 2007–2016 Q2



Sources: Average of Quarterly Reports from CBRE, JLL, Colliers

ABSORPTION AND DELIVERIES

CBRE reported positive net absorption of over 671,376 square feet in the second quarter and 1,244,480 net absorption YTD. Of the leases signed above 10,000 square feet in the second quarter, 91 percent were from companies that were either stable or growing. Large users continue a shift in Portland’s industrial market towards national and multinational corporations. Portland saw an increase in large users in 2015 with 25 leases signed for spaces over 100,00 square feet averaging more than 315,00 square feet, up 66 percent from the previous year. This trend is continuing in 2016, with the average year to date lease size of the top 5 leases at 171,208 square feet, anchored by the 235,200 square foot PDX Logistics Center transaction. The large spike in 2015 top 5 lease size was fueled by the 600,000 square foot Subaru Distribution Center at the Port of Portland’s Gresham Vista Business Park.

Integra Realty Resources estimates a change in value over the next 12 months to increase 0.1 percent to 1.9 percent for flex industrial and 2 percent to 3.9 percent for industrial. Construction square footage is projected to deliver 2,500,000 in the next 12 months and annual absorption of 250,000 square feet of flex industrial and 1,000,000 of industrial.

Table 3: Average Square Footage of Yearly Top 5 Leases

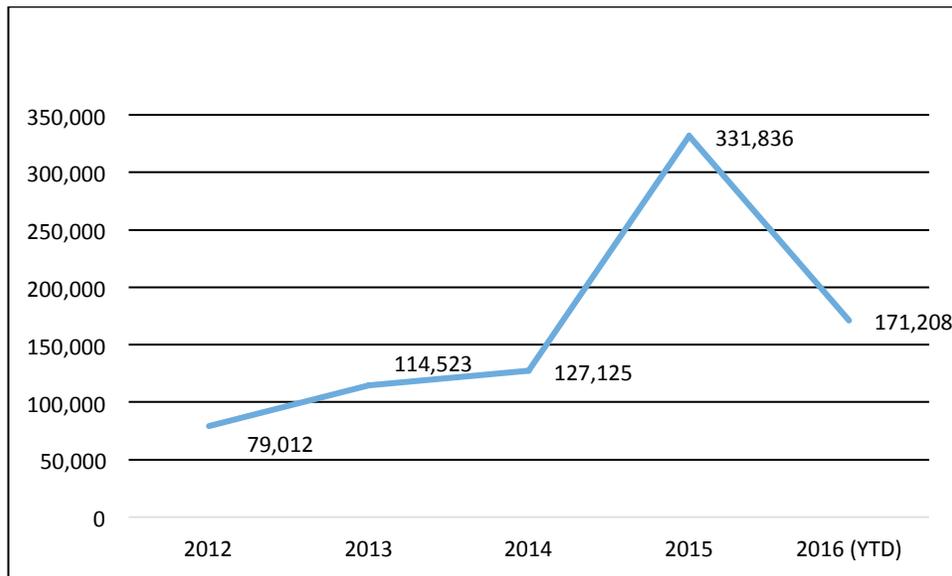


Table 2: Portland Metro Industrial Net Absorption Last 4 Quarters (Excluding Intel)

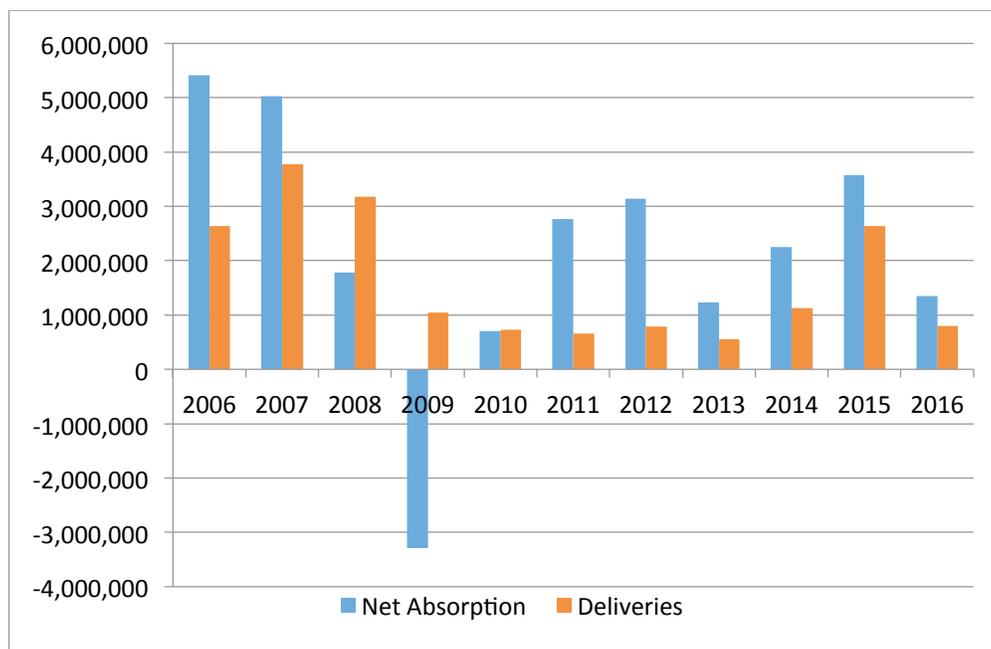
JLL Deliveries and Absorptions

	Distribution/Warehouse	Flex	Total
Q3 2015	1,759,619	156,810	1,916,429
Q4 2015	1,908,179	1,237,599	3,145,778
Q1 2016	573,104	5,696	578,800
Q2 2016	671,376	97,354	768,730
Total Last 4 Quarters	4,912,278	1,497,459	6,409,737

Source: JLL

Despite this long-term trend towards large institutional corporate owners, the recent completion of major projects including the PDX Logistics Center and Gresham Vista Business Park could lead to a second cycle of speculative investment in smaller speculative projects. JLL reports that projects ranging in size from 25,000 square feet to 75,000 square feet currently account for 30 percent of the speculative development currently underway, which will address a much needed market gap for mid-sized users.

Figure 3: Portland Metro Industrial Net Absorption & Deliveries, 2005–2016 YTD (Excluding Intel)



Sources: 2006-2016 Colliers Quarterly Reports and 2016 JLL Quarter 2 Report

Industrial Demand

JLL is currently tracking 4.1 million square feet of industrial demand. The demand is primarily being driven by large users, with the average size requirement being 115,000 square feet and 1.7 million square feet required from tenants seeking spaces in excess of 200,000 square feet. Over 44 percent of these users are in the logistics and distribution sector, with 84 percent looking for space in the NE Columbia Corridor. As Portland’s population continues to surge, the expansion of delivery and freight service centers will follow suit, keeping the demand for warehouse and distribution space strong.

INVESTMENT ACTIVITY

JLL reports that 2016 has seen over \$142 million in sales so far, with the sale of PDX Logistics Phase I for \$44.6 million and a cap rate of 5.7 percent being the largest this year

According to CBRE, the overall price per square foot increased in the quarter from \$103.10 to \$110.62. While all classes of industrial building sales continue toward pre-recession levels, investment sales are nearly level with owner/user product at \$105.12 per square foot.

Table 4: Notable Portland Metro Industrial Lease Transactions Q2 2016

Notable Lease Transaction Q2 2016		
Address	Location	Size (s.f.)
UPS	Portland	235,200
Bay Valley Foods (Renewal)	Portland	150,000
Cummins	Portland	120,000
AOSOM	Wilsonville	105,361
Kellogg's	Portland	95,576

Sources: CBRE and JLL

LOOKING AHEAD

Portland is running out of prime undeveloped industrial land. The recent purchase of 47.5 acres of the former Colwood golf course for the new 789,837-square-foot U.S. Postal Service's mail distribution center has taken prime industrial development land out of the market. Developers, who may have waited for a build-to-suit tenant in previous cycles, are showing signs of a willingness to move forward on a speculative basis to capture demand in the market. The employment data captured this increased activity as the construction sector was the second best performing industrial sector for the third month in a row, adding 2,800 year-on-year jobs in May.

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. ■