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industrial market analysis

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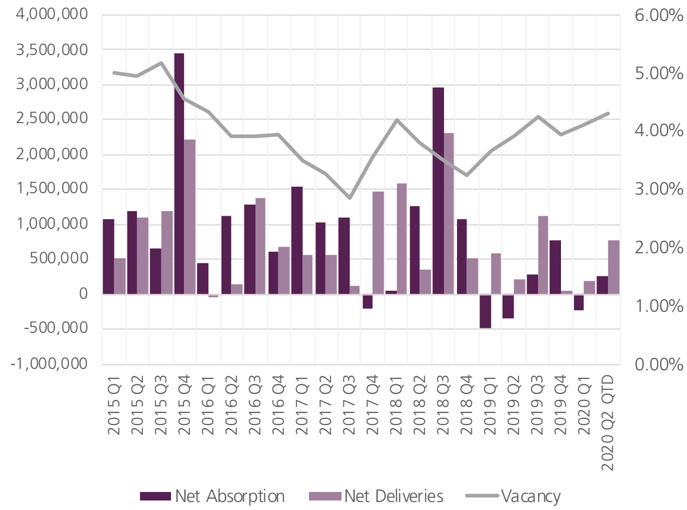
Prior to the first quarter of 2020, the industrial real estate market in the Portland metro area had been strong. The fourth quarter of 2019 had been one of growth coming off of a time of development and acquisitions by a number of large companies, most notably Amazon. This had been preceded by years of expansion coming out of the Great Recession. This upward trend has shifted slightly in 2020, primarily due to the effects of Covid-19. As a result of the pandemic, markets across the world have grinded to a halt in an effort to slow or stop the spread of the virus by mitigating the amount of people interacting with each other and moving around. This has significantly impacted most sectors of the economy, and the industrial real estate market is no exception.

CURRENT STATE OF THE MARKET

The vacancy rate in industrial space has increased to 4.3%, which is up from 3.8% one year ago. Although this is still quite a bit below the national average (5.4%), it marks a shift in the industrial market trend. Prior to this quarter, industrial real estate had been enjoying a sustained period of impressive growth in the Portland metro area, gaining 50% in asking rates in the past 10 years. This is more than any other real estate sector. Much of this growth is due to some key factors that make Portland unique in terms of industrial real estate. The first of the three factors that should be noted is Portland's location. Being on a port with deepwater access and having a large airport both set Portland up as an ideal distribution and manufacturing area for industrial purposes. Secondly, Portland's central location along the I-5 corridor allows it freedom to easily ship goods throughout the country. Lastly, Portland is cheap compared to other similarly positioned cities. For example, Portland industrial rents are $9.39 per square foot on average compared to Seattle which is $14.48. Because of these factors, Portland has been well positioned to take advantage of this economic growth.

Despite the region's advantages for industrial development, the Covid pandemic has taken its toll on the industrial real estate market. Leasing activity has slowed considerably. In the first quarter of 2020 there has been a negative net absorption of over 230,000 square feet. This lack of incoming tenants is likely due to several reasons, but the Covid pandemic is likely a significant contributing factor. With such economic uncertainty, companies and individuals are wary to spend and risk the capital to move their operation into a new building. They are preferring instead to stay in place and see what happens before they expend cash. Additionally, there is a delay in industrial construction. So as the 566,000 square feet of buildings come online in the first quarter of 2020, the tenants that were expected are simply not there. This reflects the fact that people who were looking for new industrial space prior to this pandemic are holding onto their cash for the moment. According to an article from the Portland Business Journal that referenced Patricia Raicht, a senior director for JLL, "On the industrial front, some transactions have closed, but seekers who were more inside the exploratory phase have generally paused their searches…" This pause is likely to cause difficulty for those looking to find tenants for their speculative developments. There is currently 6.2 million square feet of industrial space under construction in the Portland metro area. Of this 6.2 million, half of it is build-to-suit with the remaining half being speculative. This means that there is 3.1 million square feet of speculative industrial space set to come online in the upcoming quarters. When looked at

NET ABSORPTION, NET DELIVERIES, AND VACANCY FOR THE PAST FIVE YEARS



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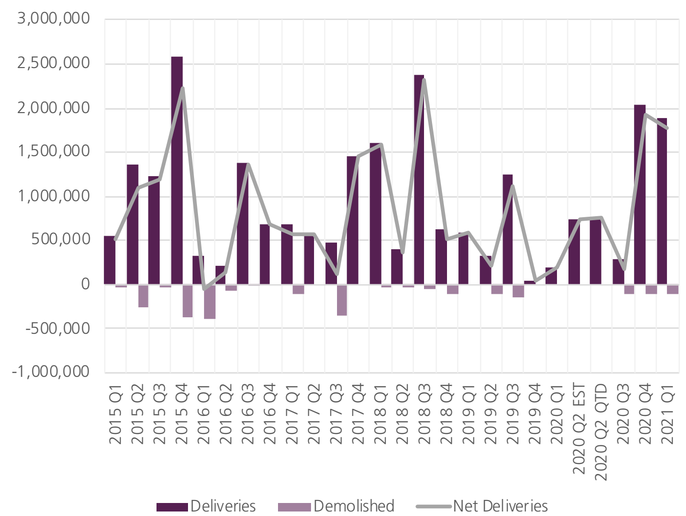
DELIVERIES AND DEMOLITION



CoStar

after seeing the 230,000 square feet of negative absorption in the Portland market during the first quarter, it is likely that prospective tenants may begin to search for concessions in their discussions with leasing agents. According to Mark Childs of Capacity Commercial Groups, "Owners and Landlords are certainly motivated to do deals, maybe conceding in areas they might not have last year, such as use, financials, term, maybe even a spiff in TIs or months free." These possible concessions are something that have not been common in the Portland metro recently due to the strength and desirability of its industrial market. Overall, the industrial real estate market has taken a major hit due to the Covid-19 pandemic and will likely see an increase in vacancy and owner concessions in the upcoming months which is likely to make the second quarter especially bad.

INDUSTRIAL REAL ESTATE'S ABILITY TO BOUNCE BACK

Despite the above negative observations about Portland's industrial real estate market, the region's market is well positioned to recover. This pandemic has drawn attention to the extent that our goods are produced in China, which can leave the United States economy vulnerable to issues in our supply chain. This, in turn, may cause some companies to spread out production and bring some of it back within the United States in order to diversify the production of goods. Because of the reasons previously stated in this article, such as Portland's proximity to a seaport and major airport and its relatively cheap industrial real estate, Portland could have a bump in industrial production due to this.

Another reason that industrial real estate will bounce back is that it simply has not been hit as hard by the pandemic as other market sectors. Whereas other markets such as retail have dropped in sales by as much as 50% in some areas, industrial production has only dipped slightly. Industrial production itself is innately more steady than that of other markets which has allowed it to weather the economic uncertainty much better than other sectors. This is why industrial real estate rents have leveled out instead of dipping like all other real estate sectors. It is industrial production that creates face masks, hand sanitizer, wipes, toilet paper, and everything else. People need industrial production. In fact, this virus has caused many people to stop shopping from retail shops and instead to turn to online shopping that holds its product in large warehouses and fulfillment centers. It is much less discretionary than retail and it requires people to physically be at the building as opposed to office which can become remote. These things give cause for optimism in regard to the industrial real estate market. Additionally, the government stimulus provided through the CARES Act

AVERAGE COST PER SQUARE FOOT FOR INDUSTRIAL SPACE

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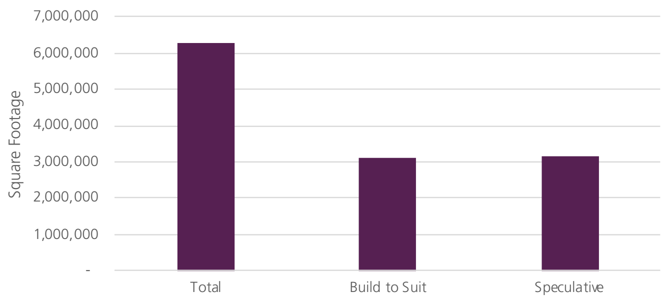
SQUARE FOOTAGE OF INDUSTRIAL SPACE UNDER CONSTRUCTION



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Portside Logistics Park in Vancouver, Washington by Specht Development https://spechtprop.com/specht_property/portside-logistics-park/

Bridgepoint I-5 in the East Columbia Corridor off of Marine Drive by Bridge Development http://www.sierraind.com/projects/bridge-point-i-5/

and the PPP Loan will likely be a major help to industrial businesses. Mark Childs points out that "the result of this will be that companies will be a little more flush, and that translates into buying things and hiring people." When companies are buying things and hiring people, this will spur production which needs industrial space.

So, despite the issues that Covid-19 has caused for the industrial real estate sector, it is the sector best positioned to bounce back. With the possibility of some production being moved back into the United States in order to protect itself in the event of another such pandemic, there will likely be increased demand for industrial real estate space. Portland is well suited to fulfill that need with 3 million square feet of its industrial square footage of under construction being speculative and ready to lease soon. The other 3 million square feet that is being constructed build-to-suit points to the industrial sectors strength even through the pandemic. These things along with the government stimulus that is arriving to help many of these industrial businesses to continue to produce throughout this pandemic points to positive growth for the industrial real estate market once this pandemic is over.

NOTABLE BUILDS AND TRANSACTIONS

Lastly, some of the notable builds and transactions that have occurred in Portland's industrial real estate market should be noted. The first building of note that is under construction is Portside Logistics Park in Vancouver by Specht Development set to be delivered in the second quarter of 2020. Specht development has been doing quite a bit of development throughout the Portland metro lately, especially in the East Columbia Corridor, and this project continues that trend in the Vancouver area. Another unique development is Bridgeport I-5 near Marine Drive in the East Columbia Corridor by Bridge Development. This development required quite a bit of unique planning in moving and storing all of the water onsite due to its location near the Columbia River. It is set to be completed in the third quarter of 2020.

Along with these buildings under construction, there has also been large purchases and leases of industrial real estate in quarter one of 2020. The largest purchase was Downton Development Group's acquisition of 3099 NE 172nd Avenue. They purchased 360,000 square feet of space from Panattoni Development Group for $47 million. BKM Capital Partners purchased 12242 SW Garden Place from The Blackstone Group for $42 million as part of a multi-market portfolio. One final transaction was the leasing out of 243,000 square feet of space to Core-Mark by Trammell Crow at 17225 SE 120th Avenue.

SOURCES

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