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SUMMARY AND EDITORIAL

ERIC FRUITS
Editor and Adjunct Professor, Portland State University

Our two lead articles come from keynote speakers at the Center for Real Estate’s 8th Annual Conference. Hessam Nadji, of Marcus & Millichap, provides an overview and outlook for real estate in Portland and the rest of the United States. He forecasts that the overall Portland commercial real estate economic picture is extremely positive is expected to stay that way. He say that everything we have been hearing about a single family housing market coming back is real: “It’s not a head fake; it’s sustainable.” Blake Eagle, founder the National Council of Real Estate Investment Fiduciaries, explains how institutional involvement in commercial real estate turned the business into a data driven profession.

The Quarterly welcomes Angela Guo who will be writing on the U.S. and Oregon economy. We also welcome Geoff Falkenberg, who will be writing on Oregon’s office, industrial, and retail sectors. Evan Abramowitz continues providing analysis of residential and multifamily markets.

I hope you enjoy this latest issue of the Center for Real Estate Quarterly Report and find it useful. The Report is grateful to the Oregon Association of Realtors (OAR) for their continued support. ■

■ Eric Fruits, Ph.D. is editor of the Center for Real Estate Quarterly Report and an adjunct professor at Portland State University. He is a managing economist with Nathan Associates Inc., where he directs the firm’s Pacific Northwest practice. 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.
REAL ESTATE OVERVIEW & OUTLOOK FOR PORTLAND AND THE U.S.

Hessam Nadji
Marcus & Millichap

Thank you very much. Good morning. It’s a pleasure to be here in Portland. We are honored to be a part of this great program. I’m going to give you a little bit of overview of what’s happening with the national and local Portland economy and commercial real estate markets. As someone who works in research, but is part of a brokerage community, accurate forecasting is probably the most important thing that we do. Every year we try to have a diverse set of forecasts for a variety of things that affect our investment community.

YOU SAY OPTIMISTIC, WE SAY OBJECTIVE

Let’s start with breaking up some, I won’t say misinformation, but very tilted information. The press is so biased against good news. It’s interesting—when I get the privilege of being on some TV show afterward I’ll get emails from people who say “you are very optimistic.”
In reality, we try to be very objective, pointing out the positive and the negative; and just because we point some positive things out that really makes us come across as very optimistic when it comes to the press. But there are a lot of great things going on over the US economy that are not discussed very often. And I want to start with sharing some of those with you.

EMPLOYMENT
To start with, take a look at this long term chart of total US employment. The U.S. lost 8.7 million jobs in the great recession. Of course you all know it was the worst since the great depression. It could have been a lot worse, by the way. You can debate, in many ways, how the government handled the situation; but in the end, I think the measures that were taken saved us from a much worse outcome. We lost 8.7 million jobs, we’ve regained 6.2 million of those 8.7. So we are a long way toward recovering the terrible impact on US employment.
CONSUMER SPENDING

Take a look at the consumer. The graph above shows, on the left, the percent increase or decrease in retail sales. Seventy percent of our economic output is driven by consumption; and those blue lines there are previous recessions. Retail sales, on a percentage basis, never really collapsed; they never went deeply negative; except this last time, you can see the nose dive in retail in 2009, which was a very scary time because we couldn’t really predict where the bottom was.

But since then, we’ve recovered. And on the right, I’m showing you monthly retail expenditure in nominal terms—core retail, excluding autos and gas—which are very volatile. If you look at the monthly expenditures, we are now 12% higher in total expenditures in the US then we were at the peak in 2007. So the expenditures that were coming out of everybody refinancing their houses every other month, and buying things they clearly didn’t need, is now 12 percent higher at the net level.

So, the notion that US consumer was going to hide in caves and never come back again has clearly not held up; and the consumer is giving the US economy a very strong footing. Going back to the chart, if you look at the per capita expenditure; a lot of my colleagues have objected to my optimism on this analysis saying “well the population growth and the size of the economy propels retail sales, so there’s no evidence of real health.” On the other hand, on a per capita basis, we up about 9 percent, which gives us a strong footing.
HOUSING

Housing, which was the culprit of the credit crisis, had an even bigger impact. If you take a look at all of our recession and growth periods going back to 1954, you can see that housing is not usually a tremendous reason for the crisis or the recession, with the exception of the 1973–75 period, which then was followed by an expansion period, in which housing was a big driver.

If you average out all the recessions and recovery periods, by this point along the current recovery, housing would typically contribute 39 percent to economic output. In this recovery, it’s contributed, up to now, only 16 percent. So it had a much bigger impact on the way down and a much weaker impact on the way back. This is about to change.

Everything you are hearing about a single family housing market now coming back is real; it’s not a head fake; it’s sustainable. And the reason for that is shown on the graph below. You can see that the 11 or so percent jump in prices is pretty broad based; you can see that we’ve got a long way to go from the prior peak, but also sales have improved by 10 percent on a year to year basis; this is across the country.
Single-Family Housing and Condo Market Improving with Brighter Outlook

Median Home Prices

$250  Single-Family  Condo
$225
$200
$175
$150

Existing Home Sales

650  Single-Family and Condo
550
450
350
250

Home Sales (000s)


Y-O-Y Change
+11%  +10%

* Through April
Sources: Marcus & Millichap Research Services, National Association of Realtors

Single-Family Home Construction vs. Household Formation

Single-Family Home Construction  Household Formation

2.4
1.8
1.2
0.6
0.0

Single-Family Home Completions (millions) and Household Formations (millions)


* Forecast
Sources: Marcus & Millichap Research Services, U.S. Census Bureau
And why it’s sustainable is shown on the lower graph. It shows household formation in red versus single family housing construction shown in blue. Look at the period after 2001 or so, where the blue (the construction) was way outpacing household formation; that’s the easy credit, that’s the credit bubble, that’s the oversupply basically resulting in the credit crisis.

But now look at the reverse, in the last four years, household formation has way outpaced construction. So the market has found its balance. All the other head fakes that we saw earlier were happening too early; the recovery wasn’t sustainable. This is giving us the foundation for a sustainable for-sale housing recovery, which is an important, very important, ingredient coming into the national economic scene over the next two to four years.

**CORPORATE PROFITS & COMMERCIAL REAL ESTATE**

So all the notion of terrible job creation, disappointing employment numbers are somewhat true. We added about 2.2 million private sector jobs in the last 12 months, that should be closer to 3 million at this point of a recovery, it’s being held back. But the good news is that if you look across the spectrum of the US economy, every major sector is adding meaningful number of jobs. Professional and business services almost 600,000 jobs in the last 12 months. Trade, transportation and utilities 428,000 jobs, that’s the industrial market basically recovering. Leisure and hospitality about 400,000. Education and healthcare, which are higher paid jobs, about 373,000.

Even construction jobs are now positive to the tune of 154,000 jobs. That’s the linkage back to the for-sale housing because construction is slowly coming back. We are beginning to see some commercial construction in some markets. And manufacturing added about 70,000 jobs, because our exports have been a big contributor to the economy. So the news is pretty good, if you look at the diversity of where the jobs are being created, it’s relatively good in terms of the 2.2 million jobs, but it is disappointing from where we should be. Why is that?

Corporate America, having cleaned up its balance sheet, having survived the downturn, having really cut expenses, has now shown tremendous profit growth. Just as I shared with you how far ahead retail sales are than the prior peak, corporate profits are 22 percent higher than they were in the 2006 third quarter peak. So the corporate side of the ledger has also improved dramatically.

In the graph below, the red line is corporate investment in plant equipment and software; it’s a precursor to hiring; it’s an indication of how aggressive companies are being about expansion. And you can see the red line coming out recession very strong, but in the last few quarters, it’s actually slowed down – that’s the uncertainty in the market place; that’s the ongoing question marks about the logjam in Washington, about taxation, about regulation, about Europe. We haven’t heard too much about Europe in the last few months, but it’s there. The debt crisis is still there, it didn’t go away. So that hesitation is what’s keeping corporate America back from engaging into a full scale expansion mode.
Now for commercial real estate, all of this has been relatively good news. The apartment market almost fully recovered to prerecession metrics. As the home ownership rate was falling—from 69 percent, now down to 65 percent—every point drop in the home ownership was putting over a million households back in the rental pool. It’s no wonder that the apartment market has performed so well; plus really favorable demographics.

Outside of apartments, you are now beginning to see a steady but meaningful recovery in occupancies across all property types. The office market is a little bit of a mystery. You saw those professional business service jobs leading the job creation—600,000 jobs—so where is the net absorption?

Well, companies had so much excess space, that so far, any demand has basically been satisfied through excess space, whether it was burning through sublease space, or just excess space that companies were sitting on. Now going forward, you are beginning to see a much tighter correlation between job creation and space demand. Companies are beginning to realize this is the bottom of the cycle, and as your leases are expiring, you are probably going to be a little bit more aggressive about space consumption and lock in the lease rate for the next three to five years. However, there are structural changes in our society—technology, conservative attitudes toward space consumption. So, the two kind of outweigh each other. But if you look ahead, for both office and industrial, 2013 and 2014, I think, are going to be a period of much more rapid recovery in occupancies. And so far, construction is way out
there, so we don’t have an oversupply problem. The surprising performer, in terms of sectors, has been retail. We just came out of International Council of Shopping Centers meetings and the attitudes were great. But, more importantly, the reinvention of what’s going on with retail is quite spectacular. Once Circuit City fell, for example, everybody thought Best Buy would do extremely well. But online retailing is absolutely changing the landscape, and retailers are having to react to that. Or what’s happening in terms of life style centers, or older malls, that are basically having to be completely reinvented or go through reuse. But retail is coming back a lot faster than most people expected.

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![Core Inflation vs. 10-Year Treasury](chart.png)

**INTEREST RATES**

One of the things that we benefitted tremendously from is interest rates. Of course, the Fed has been extremely accommodative. This has been the lubricant of not just the real estate market coming back, but also the broader economy.

I think we are in a period of continued accommodative stance, but the party’s got to end at some point. Generation-low interest rates are something we should all take advantage of in terms investment decision, value added investment; it’s a great safety net toward risk. But it is a major driver of why the market has come back as well as it has over the past three to four years.
I don’t think we have any kind of a reason to believe interest rates are going to spike any time soon, because there is very little inflation pressure, as you can see. Both housing and wage pressure—the biggest components of inflation—have not been at a level that should cause alarm. But a year from now, I think we will have a different attitude toward inflation pressure, and therefore interest rates. I think we have another 12-month window of this incredibly opportunistic interest rate driven time, but I don’t think it’s going to go much beyond that.

For the commercial real estate industry, in terms of investment, you can see the trading volume of the 4 major property types pretty much collapsing from about $500 billion in 2007 down to $90 billion or so in 2009. I am happy to announce, on behalf of all of our colleagues, we are just wrapping up our group therapy in the brokerage industry, because that was really something, you could not have predicted.

But the market has come back, we are 15 percent to 20 percent below the prior peak, but we are coming back much faster than anybody anticipated. This has been really dominated by institutional capitalism. Blake Eagle (as summarized in his article in the current issue of the Quarterly) was talking about the role of institutions. They really pounced with a great strategy, smart money, picking off the low hanging fruit, high quality assets in the best metros in 2009 and 2010 when the market was frozen. Some of those are the astute investors that Blake was talking about. Really
showed just how astute they were; if we only had a time machine. So those first movers really took advantage of the market place.

Having analyzed this in every which way under the sun, in terms of where we are in the cycle and so on, our conclusion—and this has got nothing to do with the fact that I come from a research shop in a brokerage firm—is that it is not only a time to sell but it’s a great time to buy. [Laughter]

In case any of you fall for that, our team is here with some listing agreement forms right there towards the back wall, we’ll meet you after the show. [Laughter]

But, you know it’s kind of awkward, because what I say, I actually believe that. If you look at the landscape across the country, product types, quality, size and so forth, there is more opportunity in the market place today than there ever was because we have at least that strong footing I talked about in terms of the consumer and corporate America that gives us some level of assurance that the recovery is sustainable; there is very little in the supply underway, and then you have these incredibly low interest rates. So where are those opportunities and how is it going to play out? Let’s go back to the graphs.

LOOKING FORWARD

If you look at what’s happened so far, apartments are fully recovered, pricing wise, back to prerecession levels. The office market is 15 percent below peak. This is on an average basis, and I know averages are misleading. Single tenant retail, which is of course a safety play for a lot of private investors, is pretty much on par with where it was before the recession, so fully recovered. Multi-tenant retail is down about 10 percent, and industrial is down about 15 percent. So just from this very simple way of looking at it, really office, maybe multi-tenant retail and industrial are the opportunistic places. But even within apartments, if you take a look at where the capital has flown and where the herd of investors have gone, they have left a lot of the market still untapped. And I’ll talk about that. These ingredients are the reasons that the investors are, right now, feeling so good.

One of the things that we publish is a commercial real estate investor sentiment, much like a consumer sentiment, that we have been tracking since 2004. And in the first quarter of 2013, we hit an all-time high in that index. And you can see the red line shows the index. Our community, the commercial real estate community, is very accurate in predicting where the whole economy is going to go and where capital flows are going to go. Look at in 2005 and 2006, when things were going very well, the market was still climbing, the commercial real estate investor sentiment began to fall. So we were sensing that there was some trouble in the woods. And in 2009, we start to see a serious increase in the sentiment. So it’s been very accurate. This is an indication of future capital flows into the sector. But where is that capital flow going to go?
REAL ESTATE OVERVIEW & OUTLOOK

U.S. CRE Average Price Trends

CRE Investor Sentiment Index Points to Further Rise in Capital Flows Into the Sector

*Annualized preliminary estimate
2012 investor sentiment index: 171; 1Q 2013 investor sentiment index: 174
Includes all apartment, office, retail, and industrial sales $1 million and greater
Sources: Marcus & Millichap Research Services, CoStar Group, Inc., M&M/NREI Investor Survey
If you look at this metric—this is cap rate movement among the four major property types, cut through primary, secondary, and tertiary markets. This graph tells a few stories.

One story is that cap rates in primary markets have recompressed very close to prerecession levels. Another story is in secondary markets, the green line, which are coming back pretty fast. The cap rates have compressed because of institutional capital pressure coming into the primary markets and class A assets, for the most part. As those cap rates have compressed, now capital is looking to go elsewhere.

A year, or year and a half ago, our institutional clients wouldn’t even hear the word “secondary market.” Today, they are calling us for secondary market opportunities and in their planning going forward. Tertiary markets, a little bit different, lenders are still very cautious about tertiary markets. But again, a year from now, I think the tune will change. A year from now, that green line will be substantially lower than it is today, more so than the blue line or the red line. But look at the spread that’s still there in the market place, versus 2006–07, where the market was not really distinguishing much by quality. So the good news is that there is still discipline in the market place, the question is: Two years from now, is that spread going to go away and are we going to head into another potentially dangerous situation?
You would think that we wouldn’t, but then again I think the real estate busi-
ness also suffers from long-term memory loss; and that could be the reason why we
keep on repeating some of these things that we seem to go through.

One of the most important indicators when people really object to why com-
mercial real estate is an asset class is the spread between cap rates and interest rates
today. If you look at the 10 year Treasury versus the composite cap rate of all prod-
uct types going back to 1990, you can see that anytime the spread was wide—1992,
1998, 2002 in particular—you would want to go back in time and buy more commer-
cial assets. Today, that spread is wider than it’s been since 1990. And again, the
power of locking in that low interest rate as a safety net for a five to seven year hold
is a tremendous factor.

PORTLAND FORECAST
One of the things that we are not used to here in Portland is not being one of the
leading job creators. If you look at the blue line, which is Portland; in the early
2000s, we were outpacing the national average job creation by a very comfortable
margin. And what’s happened is that the recession was very tough on Portland, we
lost over 80,000 jobs. And the recovery has been somewhat disappointing, not be-
cause we are doing any worse than the national average, but because we are used to
be doing so much better than the national average.
Here’s one of the challenges, and I thought about this a lot. Look at the Silicon Valley, which of course is so technology oriented. And, in some ways, so is Portland. Silicon Valley has reinvented its technological orientation over the past 15 to 20 years pretty rapidly. You now have a whole different landscape of technology related jobs and companies that are driving that economy.

Portland has been slower to reinvent in that regard even though it still has a lot of high technology jobs and still benefits from tremendous trade, business professional service job orientation, financial services and so on. So we are in great shape from the stand point of economic diversity, but the technology sector in particular hasn’t really adapted as quickly as the Silicon Valley in being the forefront of what is now the technology industry, versus the 1990’s and the early 2000’s. That is one of the reasons why we are doing pretty much as well as the national average. But I think that is about to change. We’ve added about 15,000 jobs in the last 12 months; going forward, for the next 12 months, I’m expecting over 20,000 jobs in Portland. I think the turning point is really the second half of 2013.
Looking at the housing market, we certainly didn't have anywhere near the crisis in for-sale housing as any other markets did. But it's an important indicator. Today, as we sit, home prices are just about 50 percent higher than they were in 2000. So the real estate market here on the for-sale housing side still is healthy and still is a contributor. And the expectation is that it will continue to do so.

If you look at the apartment market, Portland is one of the best apartment markets in the country. It is a subject of discussion among just about every one of my institutional client tours around Chicago, New York, and Boston, where so much of the capital allocation decisions are made. And it's definitely on the radar screen as one of the best apartment markets. Part of the challenge, though, is the depth of the market. Portland is somewhere between a major metro and a secondary metro. I would not consider Portland a secondary metro, but it also has a hard time competing with the San Francisco Bay Area or Los Angeles or other true major metros. So part of the capital allocation challenge is that kind of in-between primary and secondary metro status. But construction is pretty well in check, our absorption levels are picking up, our vacancies are four percent here in the Portland apartment market, which is a little bit better than the national average.

So it's not surprising that the cap rate movement has been pretty dramatic and pretty similar to the national average. Part of the reason why, in the later period of this graph, we are not seeing the same kind of rapid drop in the cap rate is because of that size issue and the pool not being big enough for more institutional capital to
flow into Portland. But the private investors here in Portland, in terms of investing in apartments, are extremely active. And the market has improved substantially.
From a retail perspective, we are trailing the national average a little bit. We had a lot of construction happen just similar to the national scene prior to the recession. Then we kind of had another wave of constructions come online in 2011. That’s part of the reason our vacancies are stubbornly high. But again, I think retail would reinvent itself very fast.

From an investment perspective, you see Portland has done quite well in terms of cap rates of retail product coming back down and offering a spread. If anything, these cap rate analyses are telling us that there is a story to sell about Portland: There is a cap rate spread, there is an improving job picture, and there is a very favorable vacancy supply demand picture.

On the office market side, Portland is outpacing the national average by quite a bit and shows up as one of the best markets across the country. Again, construction is not a problem at all, vacancy is pushing down to about 12 percent versus a national average of around 16 percent. I anticipate this to continue. By the end of 2014, I think we are approaching the 10 percent benchmark here in Portland.
And the cap rates have shown that. We are well below the national average during the recovery. The national average is beginning to come down now because a lot of investors are now moving into office, as the opportunity play pushing the cap rates down. So the overall Portland commercial real estate economic picture is extremely positive. I expect it to stay that way. Think about the next four to five years: We are going to add 120,000 jobs in the next 5 years (as predicted by most forecast entities in our own work). An additional 200,000 people will be added to the Portland population base. And nearly 50,000 of those people will be in the important age category of 18 to 34 years old. This is a very important indicator, not just for Portland, but for the broader economy.

If you look at one of our most favorable advantages across the globe, is that the US is the only developed country where we had 80 million baby boomers come through the system. You might recognize some of those baby boomers—Bill Gates, the late Steve Jobs, and Michael Dell. (You might question Michael Dell, does he still belong up there with those others given what’s happened to Dell.) But nevertheless, these types of minds in the baby boom generation changed everything, both in terms of innovation and size. Unlike Japan, which are losing population; or Western Europe, which is losing population, we have another 80 million people wave coming through the system that are children of those baby boomers. They are going to inherent something like 42 trillion dollars of wealth over the next 3 decades. And that gives us a tremendous advantage. Now how are they going to manage that money, I have no idea.
THE INSTITUTIONALIZATION OF THE U.S. COMMERCIAL REAL ESTATE MARKET

Blake Eagle
National Council of Real Estate Investment Fiduciaries

Thank you very much. Good morning. It is a great pleasure and honor for me to be here today. I truly mean that. I want to commend Portland State University for recognizing Real Estate as a needed field of study and then finding the resources to both provide education as well as engage in real estate.

The real estate industry around the world uses more capital than any other sector of any other economy, and it is one of the most under researched industry in the world. The more than we know, the more that we can learn, the more that we can understand the more the efficiency of the markets will evolve. And, we will be able to use less capital in a more efficient way, making capital more available for other economic activities. So, this is a wonderful cause that Portland State University has undertaken, and I take my hat off to every one of you in this room that is a sponsor of the program because it is critically important that the real estate industry sup-
port and promulgate real estate education and research. So I take my hat off to all of you this morning.

My role here today is to address what has been the impact of institutional capital on the real estate market. I will start out by defining for us:

- What is an institutional investor?
- Who are the institutional investors that have participated in the U.S. markets?
- How many dollars have been invested?
- What has been the impact on the marketplace?
- What is the total institutional capital invested in Portland real estate?

“What is an institutional investor? It is an entity that pools up capital for investment. The sources of the institutional investor's capital can come from savers, depositors, policyholders, shareholders, investors, contributors, and donors. It depends on the type of institutional investor and where it gets its capital. It highly specializes in investment. They don’t make products or offer services. They invest capital. Most institutional investors spread their capital across the entire spectrum of investment opportunities that exists in both of the debt and equity markets, the primary and secondary markets, public and private markets, and today as we know it, domestic and international markets.

There are, for the purpose of this discussion, three categories of institutional investors that play heavily in the real estate market: (1) financial intermediaries, (2) real estate investment trusts (REITs), and (3) private investment funds.

With respect to financial intermediaries, they are the banks, insurance companies, the thrift institutions, the credit unions. For a couple hundred years now, they have been providing most of the real estate credit to the industry. From everyone from construction and development loans, to bridge loans, gap loans, down to residential and commercial first mortgages. They are spread lenders; they are not equity investors. They borrow capital at one rate and lend the capital at a higher rate. The spread between the two rates is enough to cover operating expenses, provide them with a profit and compensate them for the risk undertaken given the type of loan that they might make. I don’t need to tell you the impact they have had on the real estate market because they have been here for a couple hundred years. Basically, their impact is the quality and standards of underwriting depending on where we are in a particular cycle.

The next category is the REITs, this is a corporation or trust or association that does nothing but specializes in real estate. They don’t do anything else. REITs were created by Congress in the 1960s and the purpose of the enabling legislation was to encourage both and small and large investors to invest in real estate. The real estate capital markets had historically been capital deficient particularly when it came to equity. REITs were to fill that void. Most of the REITs you know of today, the
names of which you are familiar, are public companies. But, there are a lot of REITs that operate in the private market that invest in real estate just as well. I sit on the board of one of the big ones.

REITs invest primarily in equities and most of them favor operating properties as their investment. There is a small category of REITs that specialize in mortgages. There is a third category or REITs that do both mortgages and equities. They are called hybrid REITs. Ninety+ percent of REITs are in the equity business. They are tax exempt, as you know, provided they pay out ninety percent earning to their shareholders. Even though they have been around for a lot of years, it took 30 years and 2 volatile real estate cycles before the market recognized the validity of the REIT and its ability to provide capital to the marketplace. During the early years, no one had ever even heard of them. It wasn't until 1990 that they really took off and grew.

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<th># Equity REITs</th>
<th>Market Cap</th>
<th># Other REITs</th>
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</tbody>
</table>

In 1971, there were 34 REITs with a market cap of $1.5 billion, which is not even measurable in real estate terms. In 1998, there were only 75 REITs, with only $2.3 billion. In the late 1980s, we went through a horrible real estate crash with excess capital, overbuilding, markets came down. There was a need to recapitalize a considerable amount of real estate, particularly real estate in the hands of large developers. The only place they could go for capital for recapitalization was in the public market. The private market and the intermediaries didn’t have any money or didn’t want to invest. This is when the REIT industry took off. In 2000, you have 189 REITs with $138.7 billion of assets and in 2012, we have an industry with a market cap of $603.4 billion and the equity REITs are about $550 billion. That is $550 billion in equity that wasn’t there 23 years ago. And it has had a significant impact on the marketplace as you will see.

Private investment funds, as they have been defined, are single purpose investment trusts. They are sponsored and set up to fund a particular purpose, mostly for the public good: retirement, education, scientific research, and philanthropy. They are generically known as pension funds, endowment funds, and charitable foundations. Like the REITs, they are tax exempt and they are true portfolio investors. They in-
vest in accordance with a strategic plan that is put together to achieve the objectives for what the institution was set up for, in the first place. I work for the Frank Russell Company and we advise pension funds for many years. We help them to develop their asset allocation models. Then, help them set up an investment objective for each one of the asset classes in which they have allocated capital. Then, we would help them find and hire their investment managers to monitor their performance. That’s what an institutional investor in this category is all about. They diversify across asset classes and diversify across investment managers. Totally this group holds about $13 trillion of assets; pretty huge pool of money. They could buy off the government debt. Pension funds make up of $11 trillion of that total. And the pension fund capital is the largest single pool of investable capital in the world.

With respect to real estate, private investment funds spread their capital across three different categories of strategies: Core, Value Added, and Opportunistic. Core investing is buying and investing in operating properties. Value-added is looking at properties that need some kind of refurbishing and redevelopment or repositioning. It’s a higher risk and therefore higher expected return. And finally, last but not least, it the opportunistic strategy which takes on the development risks at the beginning of a cycle or looks to buy distressed real estate at the end of a cycle.

Pension funds are the biggest pool of investable capital in the world. In 1970, zero dollars were invested in real estate. So, stop and think about that. Real estate is the oldest form of investment known to mankind. There was a time a human being’s wealth was measured by how many acres they owned or how many animals they owned. Here was the biggest pool of capital and they were not participating in the largest capital market in the world. Today, they have $500 billion, maybe $550 billion, invested in real estate equity.

So between the REITs and the pension funds and their partners of endowment funds and charitable foundations, they have put in about a trillion dollars’ worth of equity in the real estate markets in the past 40 years. That is an incredible amount. It has had a significant amount of impact on the marketplace.

For one, institutional investors have legitimized real estate as an investment asset class. Number two, it requires professional management, and thereby enhancing real estate industry related professionalism to which Portland State University and its education and research programs are making a big contribution. Thirdly, it forced and promulgated transparency; something that the real estate industry abhorred in the early days. Operators preferred to keep their data to themselves. However, if institutional capital was to come into the market, and the industry wanted capital, then, the operators would have to make the information more available. Fourthly, it requires measurement. Institutional investors, pension funds, endowments, and charitable foundations must report the returns on their assets on a quarterly basis to their underlying constituents and/or their trustees and beneficiaries, a the case may be.
Institutional investors changed the perception of real estate investment. When they first looked at real estate, they saw it as a deal driven, fee motivated, tax oriented, over-leveraged, over promoted sector of the economy that was too risky and too entrepreneurial that they couldn’t get a quantitative handle on the market place.

Once institutional investors entered and recognized at what benefits that real estate might offer them, they began to realize that it was number one, a portfolio diversifier. It is required that they spread their capital across assets in such a way to spread risk. Also, real estate could be seen as a very good inflation hedge. At the time, when they just entered the market inflation was a big concern to portfolio investors. Thirdly, when you looked at an operating property without leverage, it produced a pretty good stream of income. It competed well with the dividend side of preferred stocks and competed well with the bond market. Real estate investment offered something the bond market didn’t and that was the potential of capital growth because in many ways, a piece of commercial real estate is a portfolio of leases wrapped up in a bundle of commodities. The commodities, steel, brick and mortar, have prices that rise in periods of inflation. So, in a relatively short time, real estate became accepted as an asset class with the institutional investors, right alongside equities, fixed income and money market securities.

With capital flowing in from institutional investors, the industry was enhanced in professionalism. We saw a new industry evolve called real estate investment management or real estate portfolio management. This was an entity or business that offered to institutional investors:

- Research driven investment strategies
- Asset management and portfolio management
- Leasing, market value accounting, investment reporting
- Valuation, performance measurement
- Portfolio monitoring
- Periodic buy/sell/hold analysis.

They are really and truly investment operators versus deal makers, promoters or developers. Not making fun or degrading any of those professions. This just simply added another professional level to the industry that did not exist before. Today there are more than 300 real estate investment portfolio management organizations in the country; many are, I’m sure, familiar to some of you in the audience. The original sponsorship came out of the insurance industry, commercial banks, Wall Street, registered investment advisors, and developers are even in the business. As strange as it may sound sometimes, some of the biggest real estate developers offer real estate management services to the institutional investor. There are real estate brokerages that are engaged in the business and even some of the public REITs offer private real estate management to institutional investors. The total assets that are under professional managers are at $500 billion to $550 billion in equity that was mentioned before. What separates the professional management industry from other segments of the industry is that they are paid on the basis of the assets under
management and they get extra compensation for beating benchmarks or indexes, whatever the case may be, as opposed to being compensated for transactions.

Institutional investors also require information on a timely basis and a reliable basis. They want their information to be able to be verified by third-party independent objective evaluators, such as the university systems with their real estate centers around the country. The reason they demand this information is that they are mandated to make intelligent and informed investment decisions. They must monitor and track their results and they like to, on a periodic basis, undertake a buy/sell/hold analysis to ensure they are holding onto the property for any other reasons other than making the optimal return out of the asset class. They want information at every level; property level, investment level, and market level. They want it in every form possible; operating expenses, transaction prices, rental rates, vacancy ratios, absorption rates, construction rates, amount of inventory and more. Otherwise, the capital wouldn't flow and the industry would be short the equity capital it has earned. But it has responded and resulted in more market transparency.

The transparent part of the industry evolved out of organizations forming to respond to the needs of the institutional investors. The first one was NCRIEF to respond to performance measurement. But today there are a number of well-known and recognized private companies that are in the real estate information business, such as CBRE Econometrics, REIS, Costar, Portfolio Property Research, and Moody's. These companies all engage in real estate economic forecasting, looking at markets and submarkets, as well as the national market on a macro basis on supply and demand and inventory, and where the economy's demands for real estate are going to be; a map, if you will, of the future prospects of the marketplace. Real Estate Capital Analytics came out about five years ago and now provides transaction data to the market across the spectrum so you get prices on what real estate is trading for; cap rates and discount rates. Appraisal firms, such as Atlus Real Estate Research Corporation, provide valuation data to the marketplace, which is very important. In private real estate, we must assess the market every quarter and we need information to make the process work. Wall Street engages in public analysis of public companies. They have research analysts that are devoted to the public real estate market.

One piece of the information being made available on a constant basis is the difference between the public and private market placing; the premium or the discount, whatever the case may be. This is valuable information for the marketplace. Most recently, we've had a new entrance into the information business. The British firm Income Property Data provides portfolio information to the industry.

With all this information, academia took notice and began to really start look at real estate as a field of study. The information providers make the data available to the academic world, on a very reasonable, if not free, basis. This enriches the literature of the industry, if you will, and brings in the third party credibility as it tests the data within the laboratories of the academic community to see how valid it is. This has spawned and expanded the interest in academia for further research and education-
al resources such as Portland State University. Furthermore, we are also seeing real estate degree programs on the rise.

As mentioned before pension funds require performance measurement and they need to have their assets valued on a regular basis for two reasons. One, to keep their constituents and sponsors informed, and secondly, they want to know how they are doing against other asset classes; How is real estate doing against other asset classes? How is my real estate doing against other managers? How is my portfolio doing against other pension funds? So, it is the constant measuring of performance and comparative analysis to deal with where we stand in the mix and how we may be able to improve our performance is what performance measurement is all about.

National Council of Real Estate Investment Fiduciaries (NCREIF) was founded in 1981 to answer the question of performance in private real estate. This is an industry association made up of real estate investment managers (over 45 big institutional investors), plan sponsors (such as CalPERS, and the General Motors retirement plan), accountants, appraisers, academics and consultants. They all get in a room and decide on how to set the rules for performance measurement; the data that is required and how the calculations will be set.

The NCREIF’s mission is to collect data, calculate it, and publish. No statements made. It simply is a data repository, data manager, and publisher of what the data tells us. In 1977, when the NCREIF Property Index (NPI) started, there were 256 properties worth $550 million worth of market value. Critics said that it was hardly a representative cross section of the real estate industry. Today, the number of properties is at 7,181 with a market value of $329.1 billion. During the life of the index, over 9,000 properties have been sold with a market value in excess of $150 billion. There is history in the database of over 17,000 properties with millions of data points that can be researched down to the nth degree. This never would have happened if institutional capital had not come into the marketplace. You may be interested to know the total return in the 35 years of NCREIF history of the income properties in the portfolio index. On an unlevered basis, the return is 8.8 percent, income 7.1 percent, and the capital growth at 1.55 percent. This stacks up, on a long term basis, very competitively with the stock and bond markets.

As a result of institutional investors and diversifying their real estate holdings, we now publish a Timberland Index, a Farmland Index, an Open-End Diversified Core Equity Index (ODCE), an all Open-End Fund Index, and a Transaction Based Index. Furthermore, in working with counterparts in Europe and Asia to link up our respective databases, we hope to create a Global Property Index within a year that can be sorted to determine the impact of return of different countries over different periods of time. This is all a result of the over trillion dollars of institutional capital that has come into the marketplace in the last 40 years.

So, in summary, real estate today is an established investment asset class. Investors can participate in the public market, private market, or both, as many of them do. Investors can look to professional real estate managers, who operate in an envi-
The environment of highly accountable fiduciary responsibility. There are all kinds of information out there, on both the market level and the investment level, to provide you with what you need to make intelligent decisions. It isn't fully free yet, but it's no longer an arm and a leg and it's not held back, it's available for those that want to use the information.

Last but not least, I thought you'd be interested to know that there are 142 properties in NCREIF index that are located here in the Portland market. So, Portland is clearly on the radar scope of the institutional investment manager and the capital.

<table>
<thead>
<tr>
<th>Property Type</th>
<th>Number of Properties</th>
<th>Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apartments</td>
<td>26</td>
<td>$1,437.0 million</td>
</tr>
<tr>
<td>Industrial</td>
<td>86</td>
<td>834.1 million</td>
</tr>
<tr>
<td>Office</td>
<td>19</td>
<td>810.1 million</td>
</tr>
<tr>
<td>Retail</td>
<td>11</td>
<td>1,008.1 million</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>142</strong></td>
<td><strong>$4,089.3 million</strong></td>
</tr>
</tbody>
</table>

This breaks down to 26 apartments, 86 industrial properties, 19 office buildings and 11 shopping centers.

That is my story and I am sticking with it. Thank you very much.
THE STATE OF THE ECONOMY

ANGELA GUO

Portland State University

Moderate growth continued in the United States economy through the second quarter of 2013, though forecasters had anticipated an acceleration of the economy from the sluggish start to 2013. While on a national level, the country reported progress, some metropolitans struggled to change their negative economic currents.

In July, Detroit filed the biggest-ever city bankruptcy and sought protection from all its creditors, sending shudders throughout other cities and states who also carry large long-term debts. The spotlight of this Detroit crisis is focused on how the city will deal with approximately $9.2 billion debt in unfunded retirement benefits (out of $18.2 billion total debt). Michigan constitutional provisions protect government pension benefits, but a judge will have to rule whether and how federal bankruptcy law trumps the rights of Detroit’s pensioners, and whether the city filed too hastily for bankruptcy. The decision from this could have ripple effects on how other cities will go about potentially filing for bankruptcy, but most importantly, in determining how to tweak current programs and state laws regarding public sector pensions.

THE U.S. AND WORLD ECONOMY

On a national scale, economic indicators underscore the restrained optimism as the U.S. continues to recover from the recent recession. Economists remain hopeful, yet realistic, and have altered their earlier more aggressive forecasts for 2013. Figure 1 outlines the tempered U.S. economic growth projections. GDP is projected to grow

- Angela Guo 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.
slightly and remain around 2.4 percent a year over the coming years. Gross fixed investments may decrease due to higher interest rates. Exports are not growing particularly fast, but are forecasted to be slightly above imports.

**Figure 1: Annual economic growth, actual and forecasts, 2012–2017**

<table>
<thead>
<tr>
<th></th>
<th>2012&lt;sup&gt;a&lt;/sup&gt;</th>
<th>2013&lt;sup&gt;b&lt;/sup&gt;</th>
<th>2014&lt;sup&gt;b&lt;/sup&gt;</th>
<th>2015&lt;sup&gt;b&lt;/sup&gt;</th>
<th>2016&lt;sup&gt;b&lt;/sup&gt;</th>
<th>2017&lt;sup&gt;b&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>2.2</td>
<td>2.5</td>
<td>2.3</td>
<td>2.4</td>
<td>2.4</td>
<td>2.4</td>
</tr>
<tr>
<td>Private consumption</td>
<td>1.9</td>
<td>2.1</td>
<td>2.2</td>
<td>2.1</td>
<td>2</td>
<td>2.1</td>
</tr>
<tr>
<td>Government consumption</td>
<td>-1.7</td>
<td>-2.8</td>
<td>-0.7</td>
<td>-0.1</td>
<td>0</td>
<td>0.1</td>
</tr>
<tr>
<td>Gross fixed investment</td>
<td>8.7</td>
<td>6.6</td>
<td>7.9</td>
<td>6.5</td>
<td>6.5</td>
<td>6.4</td>
</tr>
<tr>
<td>Exports of goods &amp; services</td>
<td>3.4</td>
<td>1.6</td>
<td>3.5</td>
<td>3.8</td>
<td>3.8</td>
<td>3.7</td>
</tr>
<tr>
<td>Imports of goods &amp; services</td>
<td>2.4</td>
<td>0.9</td>
<td>3.2</td>
<td>3.4</td>
<td>3.5</td>
<td>3.5</td>
</tr>
<tr>
<td>Domestic demand</td>
<td>2.1</td>
<td>1.9</td>
<td>2.5</td>
<td>2.3</td>
<td>2.4</td>
<td>2.4</td>
</tr>
<tr>
<td>Agriculture</td>
<td>-3.7</td>
<td>2.1</td>
<td>2</td>
<td>2.5</td>
<td>2.9</td>
<td>2.9</td>
</tr>
<tr>
<td>Industry</td>
<td>3.2</td>
<td>2.5</td>
<td>2.8</td>
<td>3</td>
<td>2.5</td>
<td>2.4</td>
</tr>
<tr>
<td>Services</td>
<td>2</td>
<td>1.9</td>
<td>2.5</td>
<td>2.2</td>
<td>2.4</td>
<td>2.4</td>
</tr>
</tbody>
</table>

<sup>a</sup> Actual; <sup>b</sup> Forecasted
Source: Economist Intelligence Unit 2013

The Gross Domestic Product grew from 1.1 percent in the first quarter to 1.7 percent in the second quarter, the United States Bureau of Economic Analysis reports. The U.S. Commerce Department attributes the rise in GDP to personal consumption expenditures and business investments, particularly in buildings, and an upturn in exports.

This initial second quarter GDP reporting reveals that the U.S. economy is on the road to recovery as it grows more robust. This steady growth is to continue over the rest of the year and into 2014. The Economist Intelligence Unit projects annual growth of about 2.5 percent through 2017. Figure 2 shows the forecasted growth of U.S. GDP through 2014.
Figure 2: Gross domestic product, annualized, 1993–2014

Source: Bureau of Economic Analysis and Wall Street Journal Economic Forecasting Survey
Figure 3: Gross domestic product, forecasted, selected countries, 2013

Figure 4 shows that the emerging economies of Brazil, Russia, India and China (BRICs) report slowing in their growth. These countries observed rapid growth since the 1990s and this year, account for more than half of the world’s GDP based on purchasing power, according to the International Monetary Fund (IMF). The Economist concludes that after such economic expansion, growth rates in all the BRICs have dropped and are likely not to be repeated.

China, in particular, slowed to a 7.6 percent increase in the second quarter of 2013, which is the slowest growth since early 2009, and is estimated to remain at this level for the remainder of the year. For the second half of 2013, the Wall Street Journal reports that China’s GDP may continue to slow to 7 percent. On the other hand, the International Monetary Fund predicts China’s 2013 GDP will increase to 7.8 percent. China’s GDP has stayed under 8 percent for five straight quarters, which indicates to the world that as China shifts from real estate investment and to a consumption based economic model, growth will be slower.
With the growth in the U.S. GDP, the employment is anticipated to see similar improvement. The U.S. Bureau of Labor Statistics reports that the total nonfarm payroll employment increased by 195,000 in June 2013, and the unemployment rate was unchanged at 7.6 percent, which brings the preceding 12-month average to 182,000. Industry sectors that reported the most growth in June were in leisure and hospitality (+75,000), professional and business services (+53,000), retail trade (+37,100), and education and health services (+13,000).

In June 2013, the majority of jobs in leisure and hospitality were in food services and drinking places (+51,700), while the professional and business services sector employment growth consisted of management and technical consulting (+8,400), temporary help services (+9,500), and computer systems design and related services (+7,300). Within retail trade, building material and garden supply stores (+8,500) and motor vehicle and parts dealers (+8,300) led growth and in education and health services, the ambulatory health care services sector (+12,600) continued to add jobs.
The U.S. unemployment rate continued to slowly decline, according to the Bureau of Labor Statistics. As seen in Figure 5, U.S. unemployment hovered between 4 percent and 6 percent from the mid-1990s until the recession that began in late 2008 when it spiked to 10 percent in October of 2009. Since then, the unemployment rate has dropped gradually and by June 2013, stood roughly at 7.6%. While the decline in unemployment has been viewed as a sign of an improving economy, a portion of the decline in unemployment has been attributed to a large number of individuals leaving the work force.

Despite the sluggish employment growth, consumer spending increased by 0.4 percent, while inflation rates hover just under 2 percent for the first half of 2013 (Figure 6). Inflation rates are forecasted to stay below 2.5 percent through 2015.

**Figure 6: United States inflation trend, Consumer Price Index**

In July 2013, the chairman of the Federal Reserve Ben Bernanke hinted that the Fed plans on slowing its $85 billion-a-month bond buying program. Soon thereafter, Bernanke seemingly backtracked, saying that Fed monetary policy would be “highly accommodative for the foreseeable future.”

The stock market showed a continuation of gains from a dip in the early 2009. The Standard & Poor’s 500 stock index indicates a general upward trend since then. For the first time, the S&P 500 neared 1,700 and S&P Total Returns (which accounts for dividend reinvestment) was close to 3,000 at the end of July, 2013. (Figure 8).
Figure 8: Standard & Poor’s 500 stock index, 5-years

Standard & Poor’s elevated its long-term outlook on the U.S. credit rating to "stable" from “negative,” citing the economic resilience, receding fiscal risks, and monetary credibility of the U.S. The U.S. still holds an AA+ status—which is one notch below the AAA score that the U.S. held until 2011.
Mortgage rates, which are closely tied to 10-year Treasury yields, have begun to climb. Conventional 30-year fixed rate mortgages rose from 3.45 percent in April to 4.52 percent at the end of July 2013. The Fed, however, has concerns that the increase in mortgage rates may potentially harm the recovery of the housing market.
Figure 10: Trade and U.S. dollar, July 2013

<table>
<thead>
<tr>
<th>July, 2013</th>
<th>Trade balance</th>
<th>Current-Account Balance</th>
<th>Currency Units, per $</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>latest 12 months ($bn)</td>
<td>latest 12 months ($bn)</td>
<td>% of GDP</td>
</tr>
<tr>
<td>United States</td>
<td>-721.8 (May)</td>
<td>-425.7 (Q1)</td>
<td>-2.8</td>
</tr>
<tr>
<td>China</td>
<td>+271.3 (June)</td>
<td>+217.2 (Q1)</td>
<td>+1.9</td>
</tr>
<tr>
<td>Australia</td>
<td>+9.6 (May)</td>
<td>-51.1 (Q1)</td>
<td>-3.3</td>
</tr>
<tr>
<td>Japan</td>
<td>-73.1 (May)</td>
<td>+55.9 (May)</td>
<td>+0.9</td>
</tr>
<tr>
<td>Canada</td>
<td>-11.9 (May)</td>
<td>-62.3 (Q1)</td>
<td>-3.1</td>
</tr>
<tr>
<td>Sweden</td>
<td>+10.7 (May)</td>
<td>+37.5 (Q1)</td>
<td>+7.4</td>
</tr>
<tr>
<td>Switzerland</td>
<td>+26.3 (Jun)</td>
<td>+88.7 (Q1)</td>
<td>+12.3</td>
</tr>
<tr>
<td>Britain</td>
<td>-168.1 (May)</td>
<td>-96.7 (Q1)</td>
<td>-2.8</td>
</tr>
<tr>
<td>Euro Area</td>
<td>+165.7 (May)</td>
<td>+235.8 (May)</td>
<td>+1.6</td>
</tr>
<tr>
<td>Germany</td>
<td>+249.3 (May)</td>
<td>+246.0 (May)</td>
<td>+6.4</td>
</tr>
<tr>
<td>Belgium</td>
<td>+8.8 (May)</td>
<td>-8.7 (Mar)</td>
<td>-0.6</td>
</tr>
<tr>
<td>France</td>
<td>-82.0 (May)</td>
<td>-53.9 (May)</td>
<td>-1.9</td>
</tr>
<tr>
<td>Netherlands</td>
<td>+56.0 (May)</td>
<td>+85.1 (Q1)</td>
<td>+8.9</td>
</tr>
<tr>
<td>Italy</td>
<td>+29.4 (May)</td>
<td>+3.9 (May)</td>
<td>+0.4</td>
</tr>
<tr>
<td>Spain</td>
<td>-26.4 (May)</td>
<td>+0.1 (Apr)</td>
<td>+0.6</td>
</tr>
</tbody>
</table>

Source: The Economist

Finally, the U.S. Dollar appears to be weakening in China and in the European Union, even as most of Europe has been dragging down the world economy as they weather the recession (Figure 10). In Australia and Japan, however, the dollar is gaining strength as export of goods is projected to outweigh U.S. imports.

OREGON AND THE PORTLAND AREA

The State of Oregon reported a similar job growth trend to the nation for the month of June. The largest increase in nonfarm payroll employment (seasonally adjusted figures) were in Leisure and Hospitality (+1,700), Professional and Business Services (+800), and also Manufacturing (+700). (Figure 11)

Figure 11: Oregon job growth, nonfarm payroll employment, seasonally adjusted, thousands

<table>
<thead>
<tr>
<th>Sector</th>
<th>Jun-13</th>
<th>May-13</th>
<th>Jun-12</th>
<th>Change From</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>72.4</td>
<td>73.1</td>
<td>69.5</td>
<td>-0.7</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>175.9</td>
<td>175.2</td>
<td>172.2</td>
<td>0.7</td>
</tr>
<tr>
<td>Trade, Transport and Utilities</td>
<td>319.7</td>
<td>321.7</td>
<td>316.5</td>
<td>-2.0</td>
</tr>
<tr>
<td>Financial Activities</td>
<td>91.9</td>
<td>92.1</td>
<td>90.1</td>
<td>-0.2</td>
</tr>
</tbody>
</table>
The Portland-Vancouver-Hillsboro MSA had its majority of growth in Leisure and Hospitality (+3,600), Construction (+3,500), Manufacturing (+1,700) and Professional and Business Services (+1,500), as seen below.

**Figure 12: Portland-Vancouver-Hillsboro MSA, nonfarm payroll employment, not adjusted for seasonality**

<table>
<thead>
<tr>
<th></th>
<th>March 2013</th>
<th>April 2013</th>
<th>May 2013</th>
<th>June 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Non-farm Employment</td>
<td>1,018,500</td>
<td>1,026,000</td>
<td>1,034,200</td>
<td>1,040,700</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>8.0%</td>
<td>7.2%</td>
<td>7.1%</td>
<td>7.5%</td>
</tr>
<tr>
<td>Mining and Logging</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
<td>1,100</td>
</tr>
<tr>
<td>Construction</td>
<td>46,700</td>
<td>47,200</td>
<td>48,800</td>
<td>51,300</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>113,200</td>
<td>113,600</td>
<td>114,100</td>
<td>115,800</td>
</tr>
<tr>
<td>Trade, Transportation, &amp; Utilities</td>
<td>193,700</td>
<td>194,100</td>
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Source: Jones Lang LaSalle IP, Inc. and Oregon Employment Department

The region experienced a year-over-year employment gain of approximately 28,600 jobs, which is the largest since the great recession began. In percentage terms, the metro labor market expanded by 2.8% in the past 12 months, which is well ahead of the U.S. average of 1.7%.
Oregon’s unemployment rate typically treads above the national rate and in June was 7.9 percent, slightly higher than the national rate (Figure 13). Portland-Vancouver-Hillsboro MSA has observed persistent growth in employment in recent years and, although more volatile than both the national and state unemployment rates, had unemployment diminish to 7.3 percent in June which is slightly lower than the national level on a seasonally adjusted basis.

In this improving economic climate with steady employment expansion and increasing consumption, the outlook for Oregon and the Portland metro region remain strong. With predictions of the high technology sector growing attracting educated and talented individuals to move to the state, the commercial office and residential markets are expect to see slowly improving demand.
RESIDENTIAL MARKET ANALYSIS

Evan Abramowitz

RMLS Student Fellow
Master of Real Estate Development Graduate Student

The Portland market is one of the hottest in the nation as investors experienced returns of more than twice the national average for flipping houses. According to a report from the Salem Statesman Journal, buyers who purchase an Oregon home and fix it up are reselling it for about 20 percent more than the original purchase price, compared to the national average of 9 percent.

According to RealtyTrac, there were 949 single-family home flips in the first half of 2013 in Oregon. The average purchase price was just under $190,000. And when homes were resold again a few months later, sellers banked an average of more than $37,000 in profit.

According to CoreLogic, in April 2013 Oregon ranked fifth in the nation in price appreciation at 15.5 percent annually. Only Nevada, California, Arizona, and Hawaii rated higher.
Existing-home sales improved in May and remain solidly above a year ago, while the median price continued to rise by double-digit rates from a year earlier, according to the National Association of Realtors.

Total existing-home sales, which are completed transactions that include single-family homes, townhomes, condominiums and co-ops, rose 4.2 percent to a seasonally adjusted annual rate of 5.18 million in May from 4.97 million in April, and is 12.9 percent above the 4.59 million-unit pace in May 2012.

Lawrence Yun, NAR chief economist, said the recovery is strengthening and to expect limited housing supplies for the balance of the year in much of the country. “The housing numbers are overwhelmingly positive. However, the number of available homes is unlikely to grow, despite a nice gain in May, unless new home construction ramps up quickly by an additional 50 percent,” he said. “The home price growth is too fast, and only additional supply from new homebuilding can moderate future price growth.”

Existing-home sales are at the highest level since November 2009 when the market jumped to 5.44 million as buyers took advantage of tax stimulus. Sales have stayed above year-ago levels for 23 months, while the national median price shows 15 consecutive months of year-over-year increases.

Total housing inventory at the end of May rose 3.3 percent to 2.22 million existing homes available for sale, which represents a 5.1 month supply at the current sales pace, down from 5.2 months in April. Listed inventory is 10.1 percent below a year ago, when there was a 6.5 month supply.

The national median existing-home price for all housing types was $208,000 in May, up 15.4 percent from May 2012. This marks six straight months of double-digit increases and is the strongest price gain since October 2005, which jumped a record 16.6 percent from a year earlier. The last time there were 15 consecutive months of year-over-year price increases was from March 2005 to May 2006.

Single-family home sales rose 5.0 percent to a seasonally adjusted annual rate of 4.60 million in May from 4.38 million in April, and are 12.7 percent higher than the 4.08 million-unit pace in May 2012. The median existing single-family home price was $208,700 in May, up 15.8 percent above a year ago, the strongest increase since October 2005 when it jumped 16.9 percent from a year earlier.

Existing condominium and co-op sales slipped 1.7 percent to an annualized rate of 580,000 units in May from 590,000 in April, but are 13.7 percent above the 510,000-unit level a year ago. The median existing condo price was $202,100 in May, which is 11.8 percent above May 2012.

Regionally, existing-home sales in the Northeast rose 1.6 percent to an annual rate of 650,000 in May and are 8.3 percent above May 2012. The median price in the
Northeast was $269,600, up 12.3 percent from a year ago. Existing-home sales in the Midwest jumped 8.0 percent in May to a pace of 1.21 million, and are 16.3 percent higher than a year ago. The median price in the Midwest was $159,800, up 8.2 percent from May 2012. In the South, existing-home sales rose 4.0 percent to an annual level of 2.09 million in May and are 16.1 percent above May 2012. The median price in the South was $183,300, which is 15.0 percent above a year ago.

Existing-home sales in the West increased 2.5 percent to a pace of 1.23 million in May and are 7.0 percent above a year ago. With the tightest regional supply, the median price in the West was $276,400, up 19.9 percent from May 2012.

Mortgage interest rates are still hovering at nearly 60-year lows. The national average commitment rate for a 30-year conventional, fixed-rate mortgage was 3.41 percent in April, up from 3.34 percent in January; the rate was 3.91 percent in April 2012.

First-time buyers accounted for 28 percent of purchases in May, compared with 29 percent in April and 34 percent in May 2012. All-cash sales were at 33 percent of transactions in May, up from 32 percent in April and 28 percent in May 2012. Individual investors, who account for many cash sales, purchased 18 percent of homes in May; they were 19 percent in April and 17 percent in May 2012.

The four counties in the Portland metro area have added 9,000 residential homes or apartment units since 2010. The April 2013 issue of Portland monthly highlighted residential real estate trends in Portland. The data was provided by Construction Monitor and the images were built by the Metro Data Resource Center.
Median Home Values of Existing Detached Homes

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<td>May 2013 Median Sales Price</td>
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<td>% Change in Median Sales Price</td>
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<td>% Change in Number of Sales Mar 2012- Mar 2013</td>
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<td>2.5%</td>
<td>27.8%</td>
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Standard & Poor’s Case-Shiller Index for was 152.37 through April 2013. The represents an increase of 2.5 percent from April 2013, which was the largest one month gain in the 12-year history of the index, and a year-over-year increase of 12.1 percent. Portland was at 148.62 in April, which is a 2.1 percent increase from March, and up 12.9 percent compared to the same time last year. The index data shows that in April 19 of the 20 major U.S. metropolitan cities, home prices increased from the previous month, with only Detroit remaining unchanged.

Foreclosure filings were reported on 442,117 U.S. properties during the first quarter, a decrease of 12 percent from the previous quarter and a decrease of 23 percent from the first quarter of 2012. Foreclosure activity is at the lowest level since the second quarter of 2007.
During the first quarter of 2013 Oregon reported 7,879 foreclosure filings. “Although the overall national foreclosure trend continues to head lower, late-blooming foreclosures are bolting higher in some local markets where aggressive foreclosure prevention efforts in previous years are wearing off,” said Daren Blomquist, vice president at RealtyTrac. “Meanwhile, more recent foreclosure prevention efforts in other states have drastically increased the average time to foreclose, which could result in a similar outbreak of delayed foreclosures down the road in those states.”

According to RealtyTrac, the ten states that ranked the highest in foreclosure rates in March 2013 were Florida, Nevada, Illinois, Ohio, Georgia, Arizona, Washington, Maryland, South Carolina, and California. Of these states, Florida posted the nation’s highest state foreclosure rate, with one in every 104 housing units receiving a foreclosure filing in the first quarter of 2013, more than three times the national average. In Nevada, one in every 115 housing units and in Illinois one in every 147 housing units filed for foreclosure during the first quarter of 2013.

Single family building permits have increased sharply thus far in 2013 in the US and Oregon. The state and all major Oregon markets increased more than the US average for single-family with Bend increasing 74 percent since the same quarter last year. Portland saw a 34 percent increase, Eugene grew 40 percent, and Medford grew 25 percent. Multifamily new construction has increased sharply in the US and even more in Oregon. Portland increased by 138 percent with over 3,050 permits for new units in the metro area through June 2013.
Building permits for new private housing, quarterly
Oregon, statewide

Building permits for new private housing, quarterly
Portland-Vancouver-Beaverton MSA
Building permits for new private housing, quarterly
Bend

Building permits for new private housing, quarterly
Eugene-Springfield
PORTLAND

Buyers closed on purchases of 7,175 homes. The number of transactions in second quarter 2013 increased by a significant 78.2 percent from last quarter, and increased 34.3 percent annually. Median prices for the first quarter were at $326,273 which represents a 12.3 percent increase over the previous quarter and a 19.4 percent increase annually.

The data comparing sales price to list price was red hot in second quarter and number of days on the market increased slightly as well. Properties sold at an average price of 99.0 percent of the original list price. Sellers in the Portland area have had their homes on the market for an average of 16 days before closing, which was far less than 41 in the previous quarter.

There were 308 new properties sold, compared to 291 in first quarter, and a 21.4 percent decrease from second quarter 2012. The new properties sold at a median price of $332,346 which was a 3.3 percent increase from first quarter. New home prices increased from second quarter 2012 by 8.6 percent.
Number of transactions
Portland metro, new detached homes

Median sales price
Portland metro, new homes
Number of transactions
Portland metro, existing homes

Median sales price
Portland metro, existing homes
VANCOUVER

In Vancouver, the median home price in second quarter 2013 was $227,100, which increased 27 percent year over year. This was a 0.4 percent decrease from the previous quarter. The number of homes sold in second quarter increased by over
93 percent from the previous quarter to 1,185, and by 27.3 percent annually. The number of days on market decreased by 52.9 percent from the previous quarter to 24, down from 50 last year at this time.

In the Vancouver suburbs median home price during the second quarter of 2013 was $275,900, a 6.6 percent increase from first quarter 2013 when it was $258,800. The number of homes sold in first quarter was up 65.7 percent increase from the first quarter of 2013 at 880, and increased by 36.6 percent year over year. The number of days on the market decreased to 33 from 74 in the previous quarter and 56 in second quarter 2012.

Number of transactions
Vancouver, existing homes

![Graph showing number of transactions from 2003 to 2014, with a peak of 1,185 in 2014.](image-url)
Median sales price
Vancouver, existing homes

Days on market
Vancouver, existing homes
Number of transactions
Clark County, excluding Vancouver, existing homes

Median sales price
Clark County, excluding Vancouver, existing homes
CENTRAL OREGON

At 670 transactions, second quarter Bend home sales of less than one acre are up 26.7 percent since the same period last year. At 191 transactions of less than one acre, Redmond is up 1.6 percent over last year. For larger properties—homes on 1-5 acres—transactions are up 12.5 percent in Bend and up 24.1 percent in Redmond.

The number of days on the market for every market in Central Oregon has decreased since last quarter and the previous year. Properties less than an acre spend nearly five months on the market before sale. Larger properties average eight months in Bend and nearly one year in Redmond.

For sales under an acre, the median home prices for Bend and Redmond both increased since the second quarter of 2012. The median price in Bend market increased 28.4 percent to $267,300, while Redmond increased 39.3 percent to $171,000. Results are improved in the market for larger properties: the median price in Bend is up 41.9 percent, and the median price is up 63.9 percent in Redmond. Measured on a price-per-square-foot basis, the median price of properties of 1-5 acres is up 17.1 percent in Bend, and up 53.9 percent in Redmond.
Number of transactions
Bend, under 1 acre

Median sales price
Bend, under 1 acre
Days on market
Bend, under 1 acre

Median sales price, $ per square foot
Bend, under 1 acre
Days on market
Redmond, under 1 acre

Median sales price, $ per square foot
Redmond, under 1 acre
Marion County increased 2.6 percent from the previous quarter to a median sold price of $160,000. Linn County increased 7.3 percent over the past year to a median price of $145,000.
**SALEM**

Salem’s housing market increased 10.1 percent since the first quarter of 2013 with a median sold price of $165,000. At the same time, the number of transactions increased 40 percent to 522, and the number of days on the market has dropped from 116 days in the first quarter of 2013 to 84.
Number of transactions
Salem, existing homes

Salem, existing homes

Median sales price

$250,000

$200,000

$165,000

$150,000

$100,000
Home prices in the Eugene/Springfield area increased 27.3 percent since the previous quarter. However, at a median price of $244,400, the year-over-year median price is up 41.9 percent. There were 908 transactions in the second quarter of 2013. The median number of days on the market for sold transactions was 24.
Median sales price
Eugene-Springfield, existing homes

Days on market
Eugene-Springfield, existing homes
MULTIFAMILY MARKET ANALYSIS

Evan Abramowitz
RMLS Student Fellow
Master of Real Estate Development Graduate Student

The strong market fundamentals persist in multifamily, but the new construction is coming. For now Portland remains one of the tightest markets in the nation with a vacancy rate of 3.55%. Both local and national investors are seeking to position equity, and have been drawn to the market conditions that make apartments an attractive, low-risk investment. However, with thousands of units in the planning, permitting, or construction phases, there is concern that the market could become overbuilt. According to appraiser Mark Barry: “Many developers are chomping at the bit to get back in the game. In 2013, we’re in a sweet spot. When we get into 2014 and 2015, the apartment market will be more in balance. It will no longer be a landlord’s market.”

The Barry’s forecast that rent increases will subside after mid-2013 and will flatten out over the next two years as landlords compete for tenants. They predict that apartment vacancies will increase to 4% to 4.5% by the end of this year and possibly as high as 5.5% by the end of 2014. This will result in a shift from a landlord’s market to a more balanced market over the next 18 to 24 months.

Evan Abramowitz is a valuation analyst with Colliers International. He is currently working towards the Master of Real Estate Development degree through Portland State University’s School of Business where he is an RMLS Student Fellow. 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.
Multifamily construction has been ramping up, but still below 2004-2008. In 2012 there were multifamily building permits issued for 2,687 units in the tri-county area. In 2011 permits were issued for 1,696 units in the three county metro area, compared to 1,100 in 2010, according to the Barry Report. From 2004-2008 an average of 4,700 units came online annually.

The high demand for rentals is expected to persist over the next several years and absorb the new construction projects. Strong fundamentals including low interest rates, low vacancy rates, and increasing rents have spurred new projects, as developers work to capitalize.

Axiometrics, a leading provider of apartment data and market research, reports that effective rent growth remained steady during February, at a rate of 3.53%, but that the pace of rent growth has been slowing in recent months. February's effective rent growth rate was the lowest since August 2010. Occupancy remained strong nationally with an average rate of 94.13% in February. This rate is up 35 basis points (bps) from February 2012 and 71 bps from February 2011.

“A pattern has emerged this year, as effective rent growth for Class A properties has really slowed down, Class B rates have remained relatively steady, but Class C rates have continued to increase,” said Ron Johnsey, president for Axiometrics. “Rents had been pushed so much at the upper end of the market it was inevitable we would begin to see a slowdown in growth for Class A properties, but we may also be seeing some impact from new properties coming online in certain markets. As new deliveries increase later this year and next, the trend could become even more pronounced.”

Unemployment rates are positively correlated with vacancies as shown in the chart below. Portland currently has an unemployment rate of 7.0 percent, which is lower than the state average of 7.9 percent and the national average of 7.3 percent.
These market factors have driven vacancy rates in historically undersupplied Portland to among the lowest in the nation. The highest overall vacancy submarket was 5.7 percent in Hillsboro and the lowest was Inner & Central SE at 2.85 percent. The highest vacancy rate among studios was Hillsboro at 14.3 percent. The highest vacancy rate for 1 BD, 1 BA was Hillsboro at 6.9 percent, while the lowest was Outer SE with 1.95 percent. For 2 BD, 1 BA the highest vacancy was Downtown at 5.56 percent and the lowest was West Vancouver at 1.8 percent. Eight submarkets reported a 0 percent vacancy rate among 3 BD, 1 BA, but many of these were based on less than 100 units surveyed. Inner SE and Inner NE reported 0 percent for 3 BD / 2 BA, while Oregon City / Gladstone had a 12.6 percent vacancy rate for 3 BD / 2 BA.
The submarket with the highest overall rent/SF is downtown Portland with a $1.88 average, followed by NW Portland at $1.37. The lowest overall rent/SF is shared between Outer NE at $0.85 per square foot. The highest rent/SF for studios was Downtown at $1.96 and the lowest was Wilsonville / Canby at $0.82. The highest rent/SF for 1 BD, 1 BA was Downtown at $1.96 and the lowest was Outer Northeast at $0.92. The highest rent/SF for 2 BD, 1 BA was Downtown at $1.55 and the lowest was $0.82 in West Vancouver.
In Portland, approximately 70 percent of the apartments were built in the 1970s. These properties are often in the 8-60 unit range, have varying levels of deferred maintenance, and many sell in the $50,000-$80,000 per unit range depending on rents, location, condition, and other factors. In the second quarter of 2013 the sold price per unit was $68,300. The average number of units sold per property was 40 in second quarter 2013 and 37 in the first quarter of 2013.

There have been two deals with a sales price over $10 million in the second quarter of 2013. The Cyan (338 units) in Downtown Portland sold for $95.5 million and Green Leaf Springs (266 units) in Northeast Portland sold for $16.1 million.

In 2012 there were 162 transactions and $541 million in sales volume compared with 161 transactions and $813 million in 2011. As of July 2013, there have been 170 transactions and $326 million in volume year to date. Due to the solid market fundamentals, apartments remain the favored asset class of investors in Portland and throughout the nation. Experts are projecting that the increases in sales volume and transactions will continue to be strong in 2013 and over the next several years.
Through May 2013, multifamily building permits have increased within the metro area compared to 2012. Permits have been issued for 1,119 multifamily units built in the City, which is on pace to surpass last year’s total of 1,612. According to the Barry Report there are 8,000 new units projected in 2013 and 2014 with half of these slated for Multnomah County. Washington County has already surpassed 2012 for the number of new units this year at 942 units through May.

In the April 2013 MMHA Report Mark and Patrick Barry astutely observed a number of trends that have emerged in new apartment construction:

- Currently there are twice as many units under construction as units that have been recently completed.
- Almost three times as many units have been proposed as recently completed.
- Close-in east Portland accounts for almost 1/3 of the proposed units.
- Very little activity in market rate apartment construction in East Multnomah County area.
- Average size is approximately 50 units in urban east side and 100 units in urban west side.
• In the suburbs, most projects under construction or recently completed are over 150 units.

Figure 5: Multifamily Building Permits Issued, May 2013 Year to Date

Source: US Census

Mark and Patrick Barry predict that despite the uptick in new apartment construction, the market will not become overbuilt. They emphasize the projected population growth of 25,000-30,000 per year and that the new units will be delivered in intervals. They expect that some neighborhoods will experience slow absorption, higher vacancies, and possible concessions until there is sufficient time for the new units to be absorbed.
OFFICE MARKET ANALYSIS

GEOFF FALKENBERG
Oregon Association of Realtors Fellow

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 it 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.

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

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<th>Building/Address</th>
<th>Submarket</th>
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<td>I-5 South Corridor</td>
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### Construction Completed

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<tr>
<td>2009</td>
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<tr>
<td>2010</td>
<td>529</td>
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<td>506</td>
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<tr>
<td>2012</td>
<td>62</td>
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<tr>
<td>2013*</td>
<td>11</td>
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<tr>
<td>2014</td>
<td></td>
</tr>
<tr>
<td>2015</td>
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</table>
The second quarter saw the year’s only delivery, a 10,916 square feet 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.
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.
INDUSTRIAL MARKET ANALYSIS

GEOFF FALKENBERG
Oregon Association of Realtors Fellow

During the month of April the Portland area added 900 new jobs in construction and manufacturing alone. This does translate over to the industrial market, adding some much needed growth pressure to the market. Despite the upward pressure Colliers International is reporting that the Portland industrial market experienced a net absorption of negative 522,075 square feet. Kidder Matthews and CBRE are in the same ballpark with negative 690,716 SF and 257,514 SF, respectively. NAI Norris, Beggs, & Simpson is reporting slightly differently with positive 326,432 SF of absorption. Jones Lang LaSalle is reporting that 184,892 SF of industrial space was delivered last quarter, while Newmark Grubb Knight Frank is reporting zero deliveries last quarter and 34,625 SF delivered on the year.

For the first time in 3 years, vacancy has ticked upward and net absorption has turned negative. Vacancy is up a to 6.8 percent, a 4 basis point increase from last quarter, but still down 2 basis points from a year ago. Rents are up in Class A and B, and holding steady in Class C. The average asking rent stood at 46.2 cents per square foot at the close of last quarter, as reported by Colliers International.
The loss in vacancy and absorption is due to downsizing and market timing. Portland’s largest lease signed last quarter was Georgia-Pacific, downsizing from 600,000 SF to 402,450 SF. This alone contributed much to the market’s negative movement. GI Joe’s Distribution Center was sold this last quarter, but the 300,000 SF will not be absorbed until 1Q 2014. On July 1st both DHL and Bridgestone-Firestone signed new leases that will absorb a total of 409,000 SF of Rivergate Corporate Center 2.
### INDUSTRIAL MARKET ANALYSIS

**Q2 2013 Sale Activity of Noto**

<table>
<thead>
<tr>
<th>Property Address</th>
<th>Location</th>
<th>Size (SF)</th>
<th>Date of Sale</th>
<th>Sale Price</th>
<th>Price Per SF</th>
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<td>9805 SW Boeckman Road</td>
<td>Wilsonville</td>
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<td>$35.93</td>
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<td>3725 SW Hooken Avenue</td>
<td>Beaverton</td>
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<td>21101-21149 SW 115th Avenue</td>
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<td>48,000</td>
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<td>3777-3783 SE Naat Road</td>
<td>Milwaukee</td>
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<td>2117 NE Oregon Street</td>
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<td>2747 NW Rogers Circle</td>
<td>Troutdale</td>
<td>22,500</td>
<td>Jun 2013</td>
<td>$3,750,000</td>
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</tbody>
</table>

**Source:** Kidder Matthews

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**Industrial Absorption and New Construction (SqFt)**

- **2005:** 1,068
- **2006:** 3,330
- **2007:** 3,814
- **2008:** 3,054
- **2009:** 2,749
- **2010:** 1,098
- **2011:** 1,358
- **2012:** 2,582
- **2013 YTD:** 723
- **(277)**

**Source:** Colliers International Quarterly Reports
Despite the large variance in reporting between the major reporting companies on deliveries and absorption the overall consensus is that deliveries are low and absorption has turned negative. The I-5 corridor was the highlight of last quarter. NGKF is reporting a total net absorption of 283,540. The Sunset Corridor comes in second with 245,151 SF of net absorption, while Rivergate was the main drag on the Portland market with a negative 285,393 SF of net absorption. Again, much of the negative activity is due to downsizing during resigning (at least firms are staying in the market) and leases signed after the end of the quarter (absorption to be registered later).
Overall Industrial Net Absorption (SqFt) and Vacancy (%) for Portland Market

Source: Colliers International
Even though absorption has tipped towards the negative and 2Q was the first quarter since 2010 that vacancy increased, the markets have held steady on lease rates. All in all the movements in absorption and vacancy could be considered ‘lingering’ more than moving in a negative direction. Usually, in this environment of single digit vacancy and modest movement in absorption we would anticipate rental rates to go up and a push for new development. This has yet to materialize due to lack of anticipation in demand growth beyond a slow and steady pace. As the overall job and product demand market continues to incrementally improve, demand for more industrial product will continue to remain pinned up.

In the last year Portland’s economy has added 23,500 new jobs, at a rate of 2.3% growth, as compared to the national average of 1.6. The industrial market has experienced 3 consecutive years of positive absorption and vacancy decline as a result of this growth. Despite the fact that the growth run in the industrial market flattened and even reversed a bit last quarter, rents continue to grow ever so slightly and sentiment is that growth of the industrial market will continue as recent leases signed turn into absorption in the following 3 quarters. Also, as China begins to transition beyond a developing economy their interest rates will rise, exchange rate will flatten, and disposable income will increase, this may increase demand for American products, adding the potential of sustained future growth to the Portland industrial market.
In January of this year the payroll tax cut expired and retailers were apprehensive that this would further hinder the slow climb out of the Great Recession. But, during the second quarter of this year retail has begun to see spending near pre-recession levels. On the surface this is great news for retailers, but a closer look at the numbers and how they stack, reveals that there will continue to be a changing and challenging road for retailers and those who supply retail space.

Between 2005 and 2012, electronic sales of core retail goods reached 7%, a near doubling of sales during that time period. In particular, the electronic sale of books, music and video has seen the largest increases. In the year 2000, e-sales of these items stood at about 11.9%, by 2009 this number had dramatically increased to 54%. These goods are uniquely suited for e-commerce as there is no qualitative difference for an album or film bought in a physical or digital format.
Surprisingly, e-sales of appliances and computers has seen a dramatic increase during this same time period, rising from 10.1% to 28.8%. This is a second type of change that retailers are becoming familiar with. Customer are beginning to search online to highlight a few brands of stove or laptop, and then go to a brick and mortar store to turn nob, and return home to purchase the item at a discounted rate; turning Best Buys into showrooms for Amazon.com in the process. Target has taken on the strategy of in store price matching of products sold on Amazon to combat the show room effect.

Though the retail market is experiencing a monumental shift in how consumers acquire retail items and that retailers like Barnes and Noble and Tower Records have thus far felt this change most bluntly, the market is still in the midst of the sea change. Currently e-commerce is experiencing 7.2% growth while brick and mortar retailers are experiencing an accumulated 3.8% growth (excluding automobiles). Keeping in mind that total retail volume, excluding automobiles, stands at $3.94 trillion and e-commerce holds 6.5% of this market; it will be quite some time until e-commerce could come to dominate even a quarter of the total market.

As the E-commerce and wealth distribution sea change winds its way through the national economy we see both similar signs of change and growth in the Portland MSA. Retail vacancy is holding strong at 5.5% (Norris & Stevens). Net absorption, though shrinking, remains positive at 85,625 SF (Norris & Stevens). Deliveries in the 2nd quarter are up at 33,949 SF (Norris & Stevens) with new construction currently at 141,793 SF (Norris & Stevens). Leading lease rates to rise to $15.96 per square foot (Kidder Matthews).
Norris, Beggs, and Simpsons are reporting the most bearish figures on the Portland MSA retail market with vacancy at 6.2% and absorption at less than 30,000 SF, vs. the more bullish reports of Norris & Stevens and Kidder Matthews with vacancy in the mid 5% range and absorption around 85,000 SF. In either case though, absorption is up and vacancy is down. During the 2nd quarter the market saw the departure of Kmart from two locations totaling 218,159 SF and the arrival of Orchard’s Hardware to two locations. Despite the company’s June filing of bankruptcy and selling off of California locations to Lowe’s, Orchard’s does plan to maintain the Portland area locations under their own brand and management.
Kidder Matthews is reporting market area rent rates at $15.96/SF, which is in the ballpark of what both Norris & Stevens and CoStar are reporting of $16.06/SF. Reporting agencies are in agreement that rents are rising and vacancy continues to decrease. This is somewhat anomalous in regards to national trends as retailers work vigorously to adapt. Though the net affect in Portland may look like a reprieve, the continuing struggle between tenants’ income stream and rent has sent many upstart restaurateurs packing as locals like Matchbox Lounge, Basa Basa, and Yaw’s Top Notch have recently closed doors. Also, as available space stays relatively flat and rents rise landlords are beginning to pull back on offers of free rent and T.I. allowances. Of various shopping center types large neighborhood and community centers are maintaining a strong vacancy level of 9.6%, while unanchored strip centers are struggling with a vacancy level of 12.4% and slow absorption.
Over the past four quarters a total of 352,192 SF of new retail space has been added to Portland, with 33,949 SF added last quarter. Currently, 141,793 SF is under construction. In particular Kruse Village will bring 65,000 SF of shopping to Lake Oswego. This is being developed by Gramor, who will be busy developing a $30 million in the Cedar Mill neighborhood and $50 million retail center in Sherwood, as well as another development at 118th and Cornell that will break ground in August.
Norris, Beggs, and Simpson reports that 4 of the 7 major submarkets experienced negative absorption with the Eastside having the worst of it at negative 45,816 SF. The Southwest, though still in the negatives, continues to rebound. The Sunset corridor fared best last quarter with 61,223 SF.

The latest absorption is the new downtown Target. The new 89,000 SF Target in the old Galleria is a hallmark of the change in living patterns as more and more people move to urban centers. Target has brought 200 new jobs to the CBD and retail shopping until 10pm Mon-Fri. Also moving to downtown locations are Nike, Microsoft, H&M, and Sephora.
Cap rates continue to remain relatively low as both vacancy and availability slowly decrease. The most noteworthy sale transaction in this last second quarter is the purchase of the remaining 40% interest in the Lloyd Center Mall by Cypress Real Estate Investment Management for $148 million.
The Portland retail market continues to grow at an uneven and measured pace. Market forces regarding online shopping availability and wealth distribution have taxed retailers as they face the struggle between cash flow and rent levels while vacancy is down, absorption up, and construction flat. For large retailers who can learn to guide customers to their stores via an online presence, market share will grow. For small retailers who can bring value through experience and align themselves with large anchors, good things will continue to happen.