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CONTENTS

THE STATE OF THE ECONOMY

SPENCER WEILLS
Portland State University

The United States economy in 2017 continued the steady growth since the Great Recession. The country is now in the longest economic expansion since the 1990s and the third longest in the nation's history. Real gross domestic product (GDP) increased at an annual rate of 2.6 percent in the fourth quarter of 2017 according to the Bureau of Economic Analysis realizing a 2.3 percent increase for the year compared to 1.5 percent in 2016.

The stock market continued the strong growth of 2016 through the entirety of 2017 adding over 5,000 points to the Dow Jones Industrial Average for the year. Tax cuts passed by the federal government are expected to add to corporate profits in 2018 and will likely sustain the growth seen in 2017 through 2018, barring unforeseen events.

Unemployment fell to a 17 year low of 4.1 percent in the fourth quarter of 2017 nearing the low point of 3.8 percent reached in 2000.

While equities markets and corporate profits experienced significant growth in 2017, real average hourly earnings in the U.S. rose by only 0.4 percent for the year while the Consumer Price Index (CPI) grew by 2.1 percent, effectively leaving US workers with a lower standard of living than at the end of 2016.

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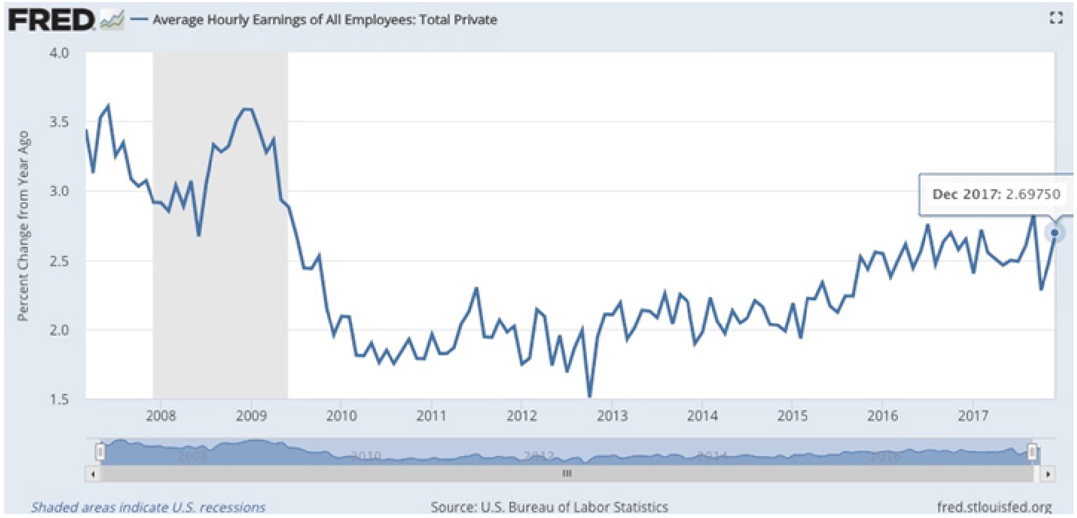
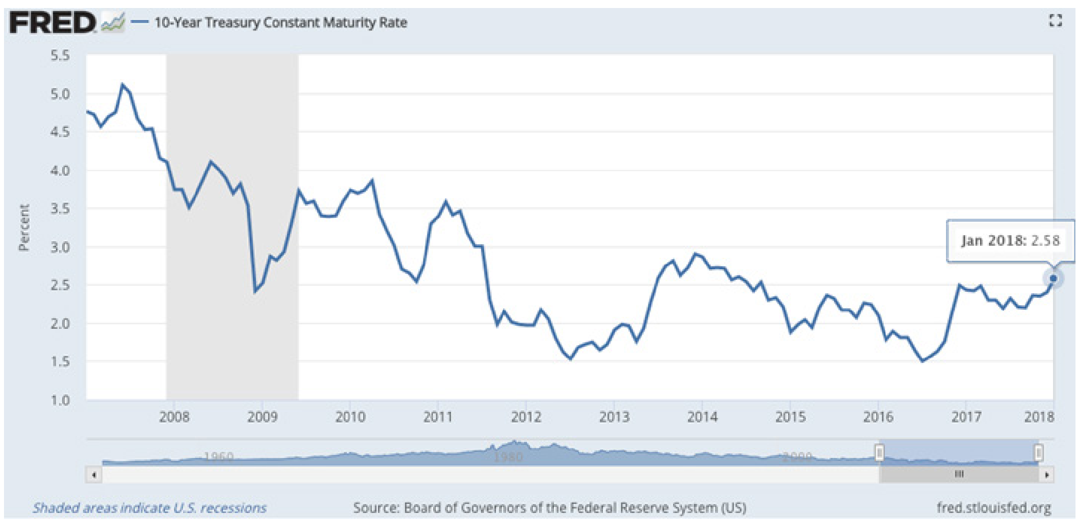
US ECONOMY



Additionally, a weaker dollar combined with increased government borrowing due to the tax legislation's reduction in tax revenue is starting to put upward pressure on U.S. Treasury yields, increasing the burden of government debt. The yield on the 10-year note pushed up at the end of 2017.

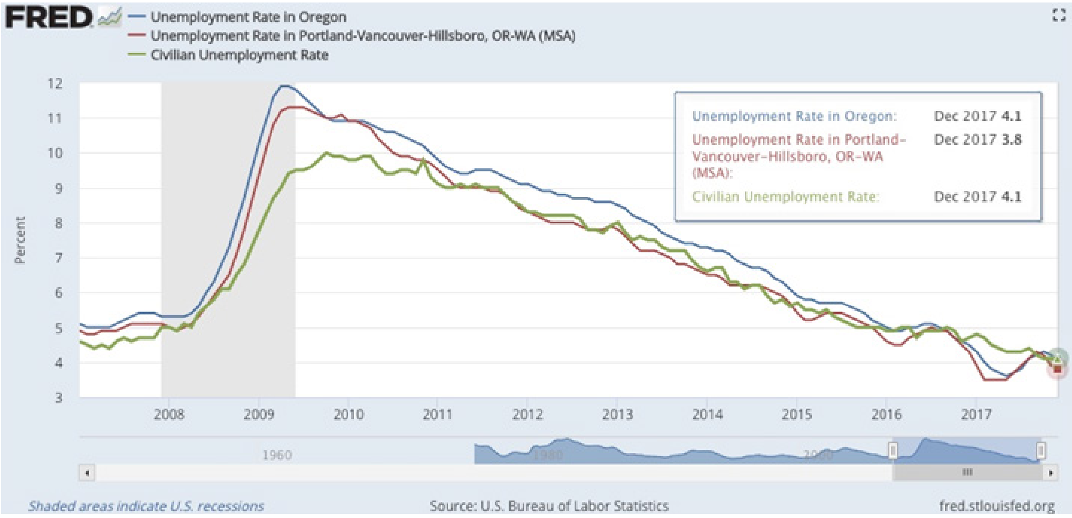


OREGON ECONOMY

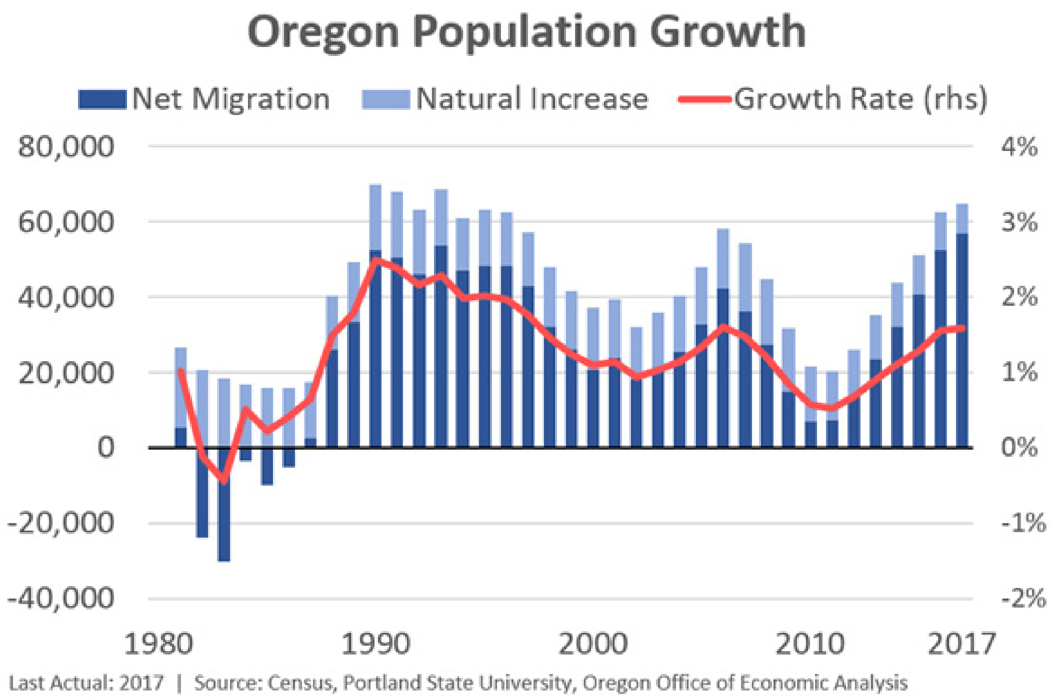
Oregon's economy continued is strong growth in the fourth quarter of 2017. The unemployment rate dropped to 4.1 percent after rising to 4.3 percent in October from a low of 3.6 percent in May 2017.

Over the same period, Oregon's labor force has grown due to a significant population growth. The labor force has grown from a low of 1.9 million in 2013 to a high of 2.14 million at the end of 2017, an increase of 240,000 people in just over four years. Over the same period, Oregon's GDP grew from $196 billion to $226 billion, a 15 percent increase.

OREGON ECONOMY



Oregon's population has been growing in the range of 1-2 percent for the last 20 years but an interesting note that is demonstrated by the chart below from the Oregon Office of Economic Analysis is that a significant majority of the population growth comes from migration. New migrants to Oregon tend to be younger, which lowers the average wage but also supplies the human capital for sustained growth.



PORTLAND ECONOMY

Looking around the city it is easy to see that Portland's economy has been booming. The Portland metro area's unemployment was at 3.8 percent at the end of 2017, just below the national average.

Rents have risen roughly 27 percent in the city in the last four years according to Kidder Mathews multi-family report and cap rates have fallen for all property types.

One worrying note that Christian Kaylor from the Oregon Employment Department spoke to at a recent Columbia Corridor Association meeting is that incomes in the Portland area are becoming increasingly stratified with the average income in the west side of Portland now at $104,000 annually and average income on the east side of $44,000. Kaylor points out this disparity and concentration of income categories in different parts of the city can be detrimental to social mobility and community engagement.

LEGISLATIVE CHANGES

The tax bill enacted by congress in the fourth quarter of 2017 will have significant on real estate professionals. The reduction of the mortgage interest deduction from $1 million to $750,000 may put downward pressure on housing prices in the Portland area. With interest no longer being deductible on a home over $750,000, the home price that a potential buyer can afford may be reduced.

In addition, the elimination of state and local tax deductions over $10,000 may impact high tax states, such as Oregon and specifically a significant number of Portlanders who pay higher taxes.

The biggest win for real estate investors is the changes to pass-through income reporting. Many real estate investors structure their companies as pass-through entities and report their income on their personal taxes. The new legislation allows pass-through entities to deduct up to 20 percent of their qualified business income.

While there was discussions about eliminating 1031 exchanges (a tax code provision that allows investors to roll profits from a real estate sale into another investment without paying taxes on them) the final version of the bill left the benefits of the exchanges intact.

AFFORDABLE HOUSING AND INCLUSIONARY ZONING IN PORTLAND

DENIZ ARAC
Portland State University

Over the last 20 years the City of Portland has evolved from a trendy, quirky destination to a desirable place to live and work. Over the last few years Portland has been getting even more national attention and was ranked fifth on Forbes "Coolest Cities" in 2017.[1] Reasons for Portland's recent national attention include a lower cost of living than major West Coast cities, fulfilling and available jobs, easy access to the outdoors, a young educated workforce, public transportation and a thriving food and drink scene.

These claims have been backed up by net migration numbers, between 2012-2014 the net migration to the state was 66 people per day, increasing the population of the Portland MSA to approximately 2.39 million.[2-3] The increase in population has also magnified deeper issues in the Rose City such as an increase (and a much more apparent) homeless population, middle-income wage stagnation, and what we will focus on, housing affordability.

The city was referenced in the TV show "Portlandia" as the place "Where young people go to retire", but nowadays this romantic notion is just a catchy line that is said when people talk about how things used to be.

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This paper will concentration on the development regulation of inclusionary housing (IH). First, we will dive into how we got to the point where the city felt it was necessary to introduce an affordable housing requirement in multifamily projects. This section will include the mechanisms enacted to enforce the IH regulations that commenced in 2017. Second, we will look at the immediate impact the IH regulations had on development and permitting at the city and on construction. Lastly, we will detail a few of the unintended consequences the IH has brought, or could bring going forward, in this development cycle and beyond.

HOW DID WE GET HERE?

As was mentioned above, Portland's net migration has been about 66 people per day for a few years. Within the Portland city limits, the population of Portland has increased from 583,799 residents to 639,863, between 2010-2016, nearly a 10 percent increase over that span.[4] With Portland's local economy being fueled by manufacturing, tech, and food/drink industries, the days of reliance on the timber industry are over. Of those 639,863 residents, approximately 47 percent of the adults have a bachelor's degree. Of the new migrants, about 62 percent are young and college-educated[2]. The young, college-educated demographic that is showing up to Portland in bunches is used to, and desires, different living arrangements then the generations before them.

The unemployment rate in Portland has also been trending in the right direction with unemployment a little below 4 percent at the end of 2017, which is about 8 percent lower than 2010, as shown in Figure 1.[5] With these current numbers, the Portland MSA (which includes Vancouver to Hillsboro) is projecting approximately 260,000 new residents and 140,000 new jobs by 2035.

If we look at the living arrangements in the City of Portland, 53 percent of the housing is owner-occupied. That leaves a large percent of the population as renters. If we drill deeper into the factors for the lack of owner-occupied housing units, we do not need to go much farther than looking at home prices in the Portland metro area. By the end of 2017, the average year-over-year Portland home value has increased 5.6 percent, to $373,500.[6] This is $167,000 over the national average. The average income per household in the Portland MSA from 2016 was $68,676.[7] When you factor the average home prices with the average household income, and consider that two-thirds of the new migrants are young and college educated (who typically are tend toward with ownership later in life), all signs pointed towards more renters. With this new migration, the vacancy rate in Portland hit an all-time low in 2015 at below 4.5 percent, as shown in Figure 3. The corresponding rent in January of 2015 was around $1.28 per square foot.[8]

If we recap, the Portland market in 2015 has constant increase of population (especially the young, college-educated demographic), relatively high housing prices, vacancies at an all-time low and a very low unemployment rate. Multifamily developers and investors recognized the solid fundamentals of the Portland market and started getting their projects teed up.

Fast forward two years later to 2017 and rents peaked at $1.51 a square foot, or almost an 18 percent increase in two years. Approximately 10,500 units were put online in 2016 and 2017 combined.[9] With the median income of Portland households growing but being relatively stagnant compared to rent and housing prices, the issues of housing affordability was magnified and worsened. At this point the City of Portland decided to step in.

CITY'S RESPONSE

The City of Portland set out to make a program that could increase the supply of affordable housing by utilizing the private developer's appetite for adding housing supply to the Portland market.

Below shows a few key steps the city took to achieve the IH legislation that is in effect today.

Oct, 2015	• City Council delacres a housing emergency for a period of one year
Feb, 2016	• Oregon Legislature passed Senate Bill 1533, which allowed local governements to enforce IH requirements on multifamily structures • Started developing framework of the IH Program with a panel of experts
Sep, 2016	• City Council extended the housing emergency for another year • IH Program reccomendations due
Nov, 2016	• Zoning code amendments were reccomended for the IH program
Dec, 2016	• City Council voted to approve the IH program
Feb, 2017	• Title 30.01.120, the IH Program, of the Portland City Code and Charter was enforced and managed by Portland Housing Buerau (PHB)

On February 1, 2017, title 30.01.120, or the Inclusionary Housing program, was put into effect. Any projects submitted to the city for permitting before this date were vested, and not subject to the new inclusionary housing regulations. The main details of the program are as follows for projects that include 20 or more units.[10]

Option 1:
20 percent of the units must be at or below 80 percent of the AMI (Area Median Income produced by HUD). Projects outside of the Central City District only need to achieve 15 percent. The financial incentives for the developers include a 10-year property tax exemption on all units if the FAR (floor-area-ratio) is greater than 5:1 and only on the affordable units if less, waived Construction Excise Tax, exempt from parking requirements and FAR Bonuses.

Option 2:
10 percent of the units must be at or below 60 percent of the AMI. Projects outside of the Central City District only need to achieve 8 percent. The financial incentives for the developers are the same as Option 1 and include SDC (System Development Charges) exemptions of the affordable units. The SDC savings are waived during the permitting process.

Option 3:
The affordable units can be transferred from the original site (sending site) to another new development (receiving site). The number of units are based off the sending sites total number of units and there are two options. The first is 20 percent of the sending sites total number of units can be transferred to the receiving site, but they must be at 60 percent AMI. The second is, 10 percent of the sending sites total number of units can be transferred to the receiving site, but they must be at 30 percent AMI. The financial

CITY'S RESPONSE

incentives are similar to option 2. Other key requirements include; must be within one-half mile of the sending site or have a higher Combined Opportunity Map score and receiving site must receive Certificate of Occupancy within three years of sending site's building permit issuance.

Option 4:
Units in an existing building (receiving site) can be designated to be affordable to exempt the proposed project (sending site) from the requirements. 25 percent of the sending site's total number of units would need to be affordable in the receiving site at 60 percent AMI, or 15 percent at 30 percent AMI. The financial incentives are FAR bonuses and exemption from the parking requirements.

Option 5:
The distribution mix of affordable units can be based of bedrooms rather than units to provide less number of affordable units, but the same number of bedrooms and larger affordable units.

Option 6:
A fee-in-lieu of affordable units can be paid based off Figure 5.[11]

All projects, not exclusive to any of the options, must maintain the affordable units as affordable for a period of 99 years and the owner must provide annual documentation regarding tenant income and rents for the affordable units.

At the same time the IH program was being crafted, the City Council passed a renter protection policy that required landlords to pay a relocation fee between $2,900 and $4,500 for tenants they evict without cause or vacate because of a rent hike more than 10 percent.[12]

THE MARKET'S RESPONSE

The following permitting analysis is mainly based off of the Bureau of Planning and Sustainability's "Six Month Review of Inclusionary Housing Zoning Code Program" and the update, the "One Year Review of Inclusionary Housing Zoning Code Program" by Senior Economic Planner, Tyler Bump.

There was to be expected a rush of applications to the city because any developer, even considering a multifamily project with over 20 units, would benefit financially from being exempt from the new IH program. What everyone, including the city, wanted to see is how the market would respond after the predictable lull of permit activity directly after the implementation of the IH program.

Prior to the IH program going to effect in February 2017, it is estimated that 19,000 units were submitted to the City of Portland, which vests the applicant's rights for a period of 3 years.[13] After one year, of these 19,000 units, there are approximately 10,000 units still in the development pipeline. Around 5,000 units of the original 19,000 have moved along the permit process and are in review or approved to issue.[14] This means that about 4,000 units represent projects submitted that were not complete or withdrawn. These are mainly made up of the projects that developers submitted as placeholders—in case they decided to move forward with a project, they would be vested a pre-IH. There are close to 10,000 units currently under construction in the Portland metro area.[15] The number of units that are currently vested or under construction represent about two years of development activity, which is down about two years of activity from the initial 19,000 units, but is still under the forecasted amount of housing that will be needed as Portland continues to grow.

THE MARKET'S RESPONSE

In the year since the IH program had been enforced, 17 projects included the IH requirements. Five were with public financing. The other twelve were privately financed and represented 565 market rate units and 89 affordable units. Of the 89 affordable units, 69 chose Option 1, while 20 chose Option 2. The publicly financed projects represent 353 units at varying income levels at or below 80 percent. It is worth noting that all of the projects were outside of the Central City.

To forecast farther out than one year, one can look at the Early Assistance Review activity—52 appointments have been completed that incorporate affordable housing into their projects. This shows that developers and investors still feel confident about the Portland's market fundamentals and are willing to work within the IH program.

One important factors to note is that rents in Portland have softened due to the sudden increase of new housing supply. Landlords are offering more concessions and new marketing strategies to fill their vacancies. Also, labor and material escalation for construction have been trending in an upward direction, which is another reason development activity can slow.

THE UNINTENDED CONSEQUENCES

The program is only one year in, and because of the amount of pre-vested multifamily projects, we still do not know the ultimate effect the IH program will have on the City of Portland. The following section is dedicated to the unintended consequences and the effects they could have on the market in Portland.

The 19-Unit Building Boom

The IH program doesn't mandate developments that are under 20 units. Because of this, it was thought that there would be a steep increase in multifamily projects permitted between 15-19 units. One year in, and the data does not show that this has been the case, as shown in Figure 6. There have only been 5 permits issued between 15-19 units, totaling 83 units in the year since the IH program was enforced. The previous year saw 8 permits and 145 units issued. The fact of the matter is that these developments are more of a product of their land size and zoning. Unless you are in a high density residentially zoned area, you would not be able to put over 20 units on a site because that determination is made by the size of the lot.

New Project Style

An effect of the IH program, that has already been seen, is the creativity of developers to avoid the IH mandate. There have already been a few permits at the city that have multiple buildings in a development, instead of one larger building, to stay under the 20-unit threshold. Although building two separate building does add costs to a project, those costs may still be less than any of the IH options.

Shift to the Suburbs

The latest multifamily boom has been centered around the Central City, and justified by the premium in rents. Multifamily development in the suburbs only boom when the rents can support the construction costs and returns needed for investments. Up to this point the increase in construction costs have been too great and not been able to support suburban multifamily development. The IH program has certainly slowed the number of projects being submitted for permit in the City of Portland, which will only increase the rents in Portland once the new deliveries have been absorbed and landlords gain leverage. Looking ahead to 2018 and beyond, if the IH program remains in its current form, the increase in Central City rents will start its creep into the suburbs. As the Central City prices residents out, the residents could shift to the suburbs. Just as what happened in the Central City, more incoming migrants to the suburbs increases the demand on the

THE UNINTENDED CONSEQUENCES

existing housing supply. In turn the rents will start to increase, which would then justify investments for new multifamily projects in the suburbs.

Industry Effects

As the IH program starts to shape the development scene in Portland, many industries that have been booming over the last four years could see dramatic effects. First, is the construction labor market. By all accounts, there is a labor shortage in Portland for many trades.[16] Many contractors are having to turn down work, as they cannot perform the projects because of their current pipeline. The rippling effects the IH program could have on the development pipeline could cause a potential labor surplus with many of the same companies turning down work now, having to let go many of their workers due to too little or no projects in the pipeline. Of course, there will still be projects outside of multifamily to be built, but the sheer amount of multifamily projects during the current cycle have forced contractors to increase their number of employees and emptied out union halls. Unless there is an uptick in new projects into the development pipeline, the future could be bleak for some contractors.

Second, is the design industry. There have already been significant layoffs at local architecture firms due to the decrease in developers bringing new multifamily projects to their doors. Many firms had to increase their staff to support the influx of developers looking to have their projects vested pre-IH regulations. Since that day has come and passed, many of the local firms realized that they could no longer support all that staff that was brought on to help facilitate the multifamily boom. We could see reorganizations at more firms if the IH program remains as it is now.

Decreasing Land Value

One stakeholder that has not yet been mentioned is the land owners. To determine the feasibility of a project, the land value of a project can be determined by working backwards from the feasibility analysis of the developer. The developer estimates all costs to build a project, including financing and returns needed to get that financing from investors and debtors, and the residual value is how much a developer can pay for land. This cycle has seen record high land prices because the increases in rents have been able to support it. The IH program, and the set aside affordable units, reduces the net operating income of a project, which effectively reduces the amount the developer can pay for the land. Many projects that were feasible at these record high land values are no longer feasible, unless the market rate units can subsidize the gap of missing income. With rents already softening and more concessions being provided, the burden of the affordable units will be too great for most developments to be feasible. A land owner who is not following the cities policies would likely not realize that the land they own just decreased in value overnight. The recent sales comparisons are no longer valid due to the change of development policies by the city.

CAPITALISM AND CREATIVITY

Even with the IH program, the fundamentals of Portland are still attractive to local and out-of-market investors. Now we will get to see the creativity of the market in terms of living with the IH policies. We touched on one, which is building separate buildings to stay under the 20-unit threshold, but the city has seen an increase in Early Assistance meetings to discuss working within the IH policy. Though not backed up by statistics yet, you could see a decrease in apartment size, to increase the number of units to subsidize the affordable units. Co-housing has become one of the buzz words in the real estate industry, and there is potential to get creative with how rooms and units are classified. Although it does come down to the City’s determination if your project is exempt from the IH policies.

CAPITALISM AND CREATIVITY

The IH program can be amended, and likely will to some degree, if the goals of the program are not achieved. According to a study by the Urban Land Institute, "Economics of Inclusionary Zoning", the key takeaway from the study was that to have an IH program that is effective, there must be a sustained level of market-rate development in the local market.[17] Another key point was that the development incentives must align with market conditions to be effective. One year in, it appears that the incentives are not aligned with the market conditions, and the City of Portland development pipeline beyond 2019 will not be enough to reach the stated goals of the IH program.

Even though the immediate situation does look grim, the developers in the city should look at it as an opportunity. An opportunity to collaborate with the city to work within the program, and an opportunity to improve on the program. An opportunity to inject new life into the multifamily sector that has become mundane and sterile. An opportunity to, once again, be a city that does things a little "weird" and to bring the charm back to Portland.

The fact is, Portland is going to continue to increase its population and housing will be built. In the United States, there are 886 jurisdictions in 25 states, with an inclusionary housing program.[18] The ultimate success or failure of the IH program in Portland will be the balance of incentives to mandatory requirements to keep the development pipeline full. This will be the job of the City of Portland to listen, learn and implement concepts and practices from the business community, and other jurisdictions, to really make any meaningfully changes to the current housing situation. On that note, Mayor Ted Wheeler has said that in March, City Council will be looking at revamping or adding to the incentives structure to promote more development and bring more affordable units online. The City of Portland's slogan is "The City That Works", and now that inclusionary housing in Portland is here to stay, the City has an opportunity to really show that the catchy slogan is more than just a soliloquy.

Figure 1 - Unemployment in Portland

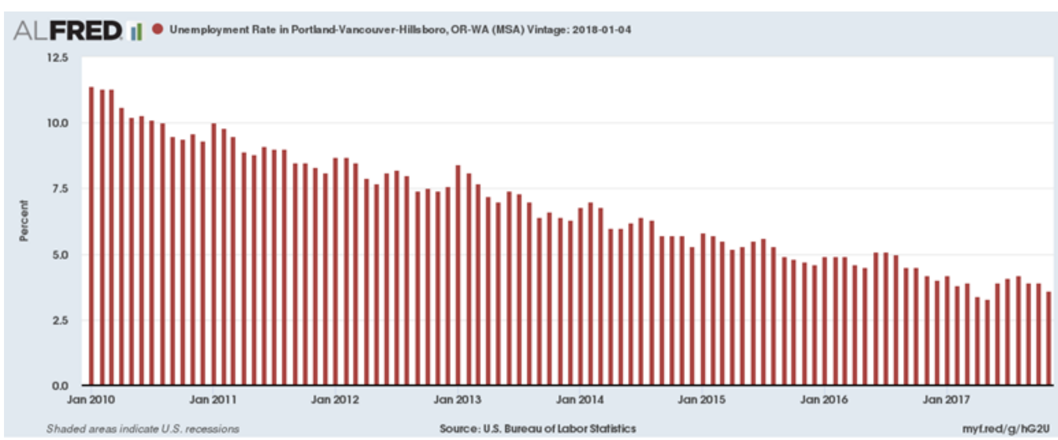

Figure 2 - Average Income in Portland

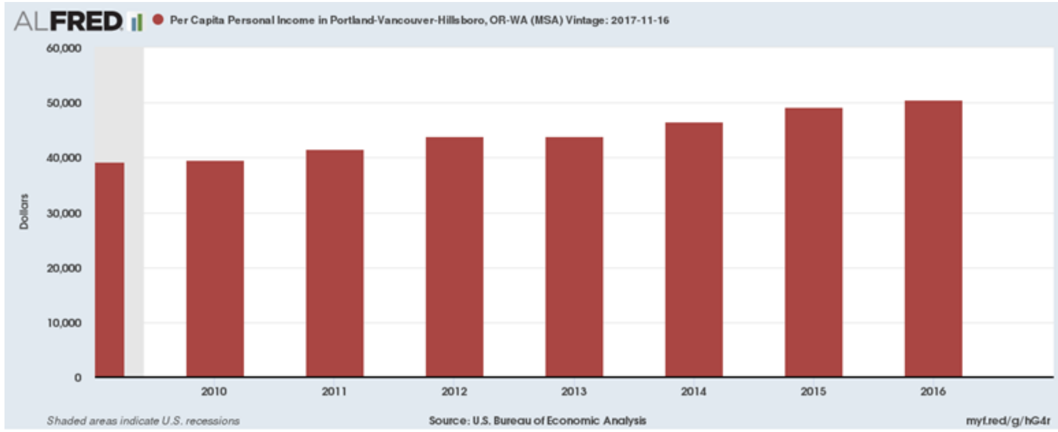

Figure 3 - Vacancy Rates in Portland - Costar

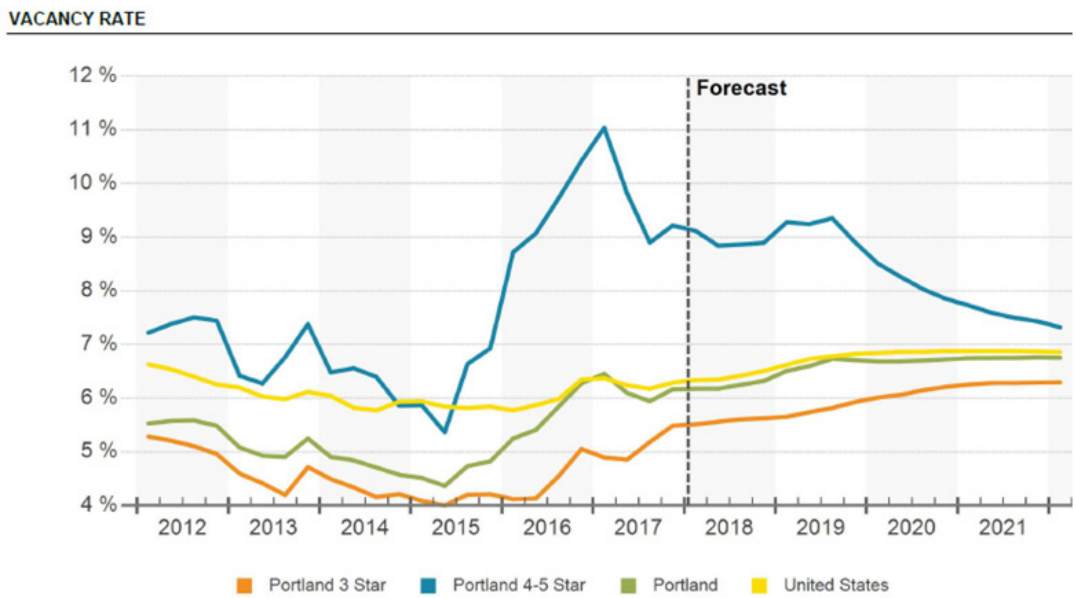

Figure 4 - Rents in Portland - Costar

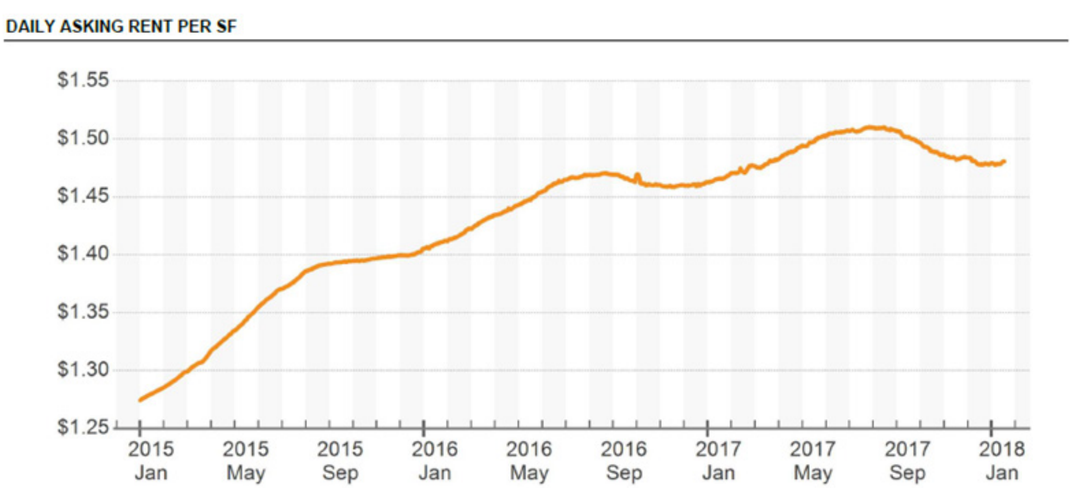

Figure 5 - Fee-in-lieu Schedule

Within Central City Plan District

Zone/FAR		Fee per GSF
3.0/4.0	*Base FAR*	$27.39
3.0/4.0	*Base with Bonus FAR*	$28.57
5.0/6.0	*Base FAR*	$28.57
5.0/6.0	*Base with Bonus FAR*	$28.99
8.0	*Base FAR*	$28.99
8.0	*Base with Bonus FAR*	$29.81
9.0	*Base FAR*	$29.81
9.0	*Base with Bonus FAR*	$29.42
12.0	*Base FAR*	$29.42
12.0	*Base with Bonus FAR*	$29.85
15.0	*Base FAR*	$27.39
15.0	*Base with Bonus FAR*	$28.57

Outside Central City Plan District *(before December 31, 2018)*

Zone/FAR	Fee per GSF
CN1, CO1, CO2, CM, CS, CG, CX plus EG1, EG2, EX and R3, R2, R1, RH and RX zones	$19.50

Outside Central City Plan District *(after December 31, 2018)*

Zone/FAR		Fee per GSF
CM1	*Base FAR*	$23.83
CM1	*Base with Bonus FAR*	$25.79
CM2	*Base FAR*	$25.79
CM2	*Base with Bonus FAR*	$26.50
CM3	*Base FAR*	$26.03
CM3	*Base with Bonus FAR*	$28.58

GSF= Gross Square Feet

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RESIDENTIAL MARKET ANALYSIS

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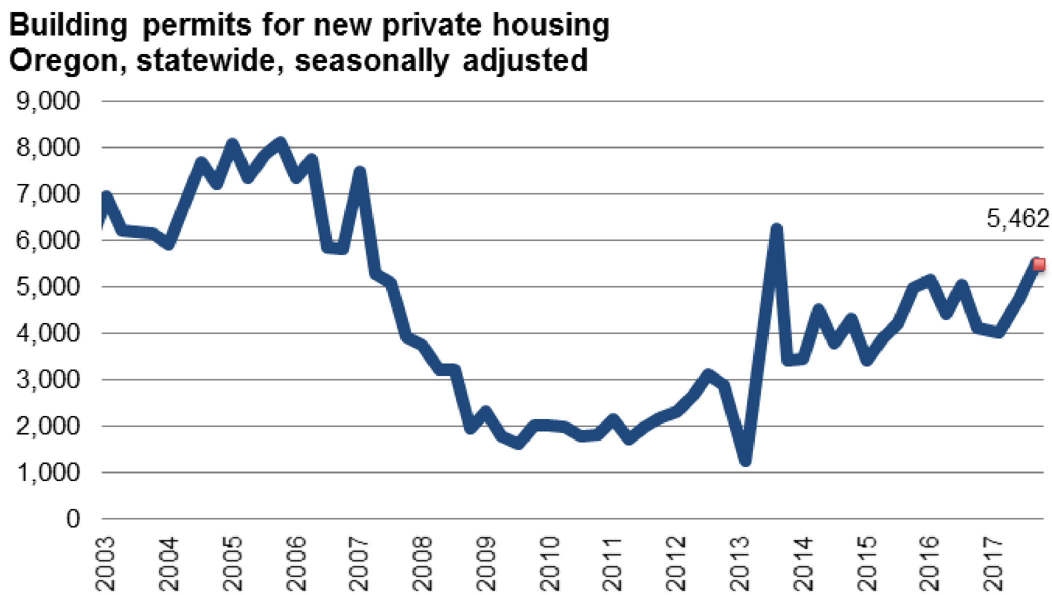
The fourth quarter typically is characterized by fewer transactions, lower prices, and longer periods of time these houses remain on the market due to the seasonal shift. The fourth quarter of 2017 revealed consistency—fewer transactions across the board from Vancouver to Portland and down to Southern Oregon, up to 15 percent lower selling prices and a generally longer time on the market.

While the data revealed consistency across the board for the fourth quarter in comparison with the third quarter, there was a noticeable increase in these market stats from the fourth quarter of last year. This quarter saw higher selling prices, and higher transactions than previous winters, except for in Portland. It is noteworthy to mention that while permits released for new single-family homes within the Portland sector decreased, the number of new-home transactions that occurred was a 3.38 percent increase over the previous quarter, while the average sales price was settling slightly lower than the quarter prior. This could be a reflection of the continually rising construction costs, which is pushing builders to all but abandon anything not high-end, resulting in an influx of high-end single-family homes on the market. Considering past winter seasons, the new single-family homes being built are significantly rising in price.

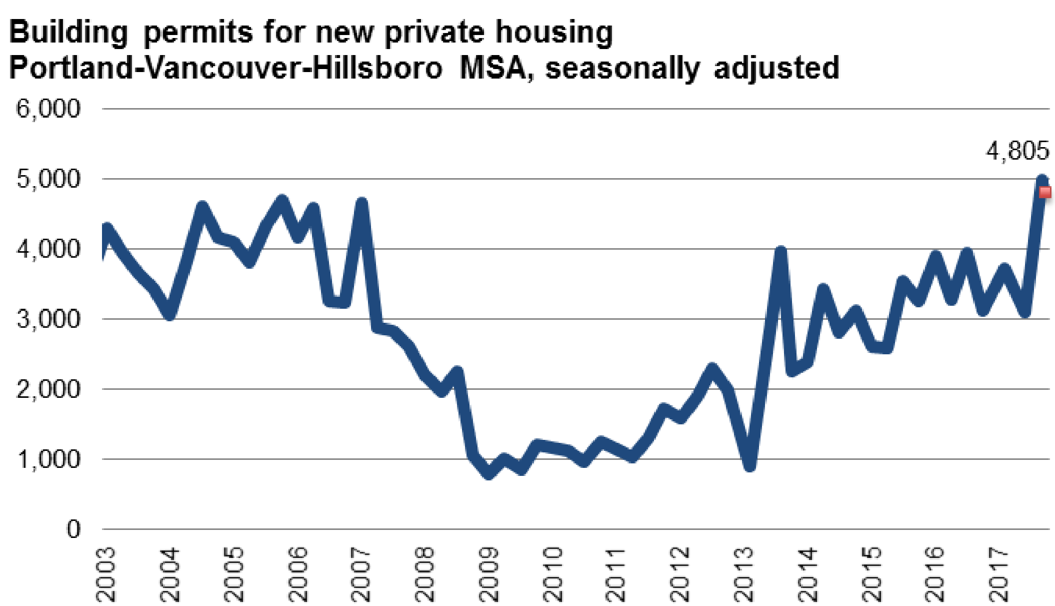
Jennifer Volbeda is a candidate for the Masters in Real Estate Development degree and currently works as a tenant coordinator/ project engineer for Harsch Investment Properties within the retail portfolio. Any errors of omissions are the author's responsibility. Any opinions are those of the author solely and do not represent the opinions of any other person of entity.

LOCAL PERMITTING

In the fourth quarter of 2017, there were 5,462 building permits for new private housing units issued in total across the state of Oregon. This is 1.17 percent fewer permits than were issued in the prior quarter yet 33 percent more than were issued in the fourth quarter of 2016.

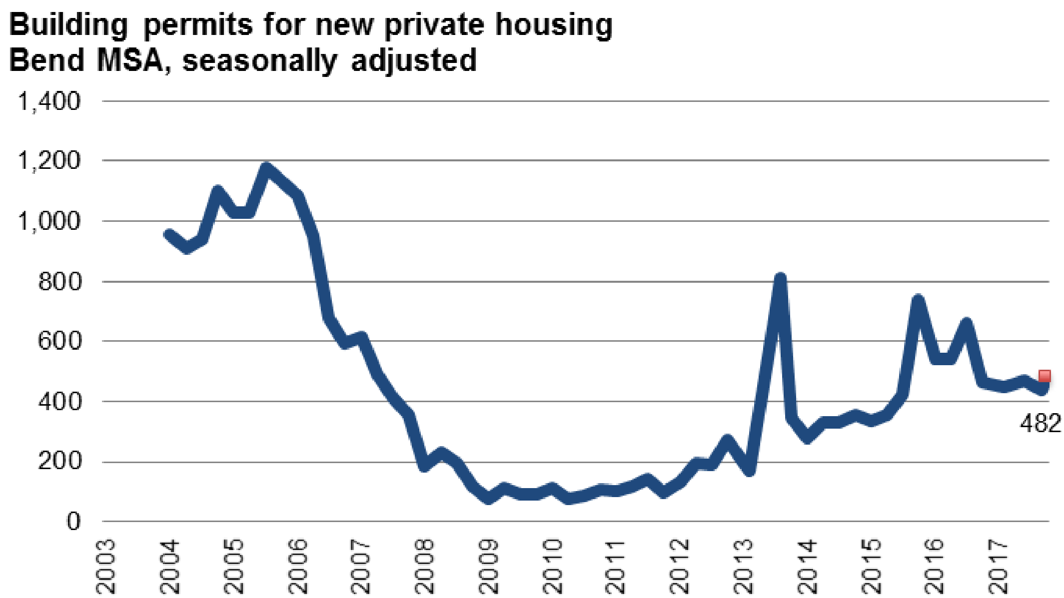


There were 4,805 permits for new private housing units issued in the Portland-Vancouver-Hillsboro Metropolitan Statistical Area (MSA) in the fourth quarter of 2017. This represents a 3.67 percent drop in permits compared to the third quarter of 2017, and a 53.51 percent increase in year-over-year permitting. The Portland market accounted for 88 percent of the new statewide permits this quarter.

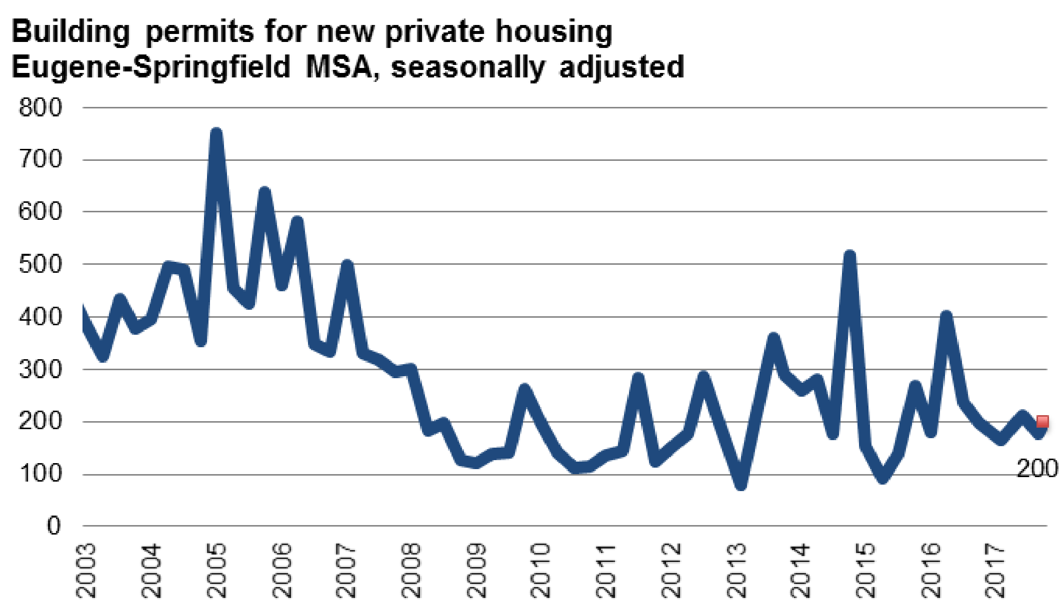


LOCAL PERMITTING

Bend MSA permitting rate increased to 482, a 9.30 percent rise compared to last quarter, but a decrease of 3.67 percent compared to the fourth quarter of last year.

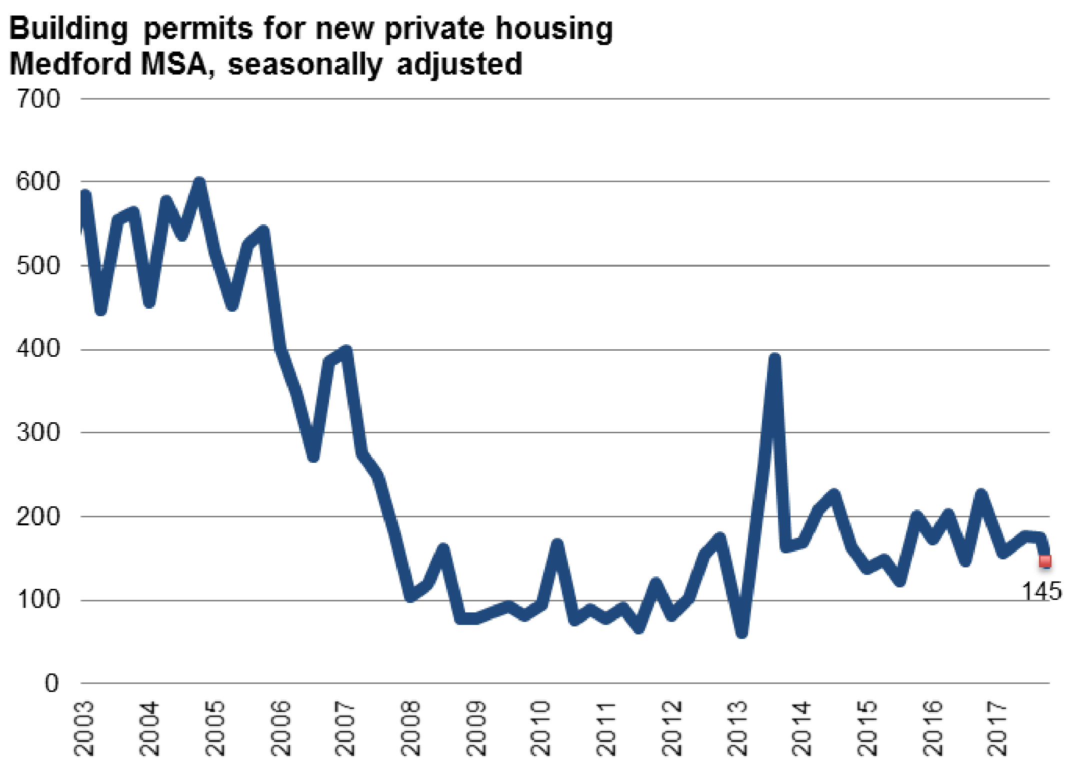


The Eugene-Springfield MSA's fourth quarter permitting increased to 200 permits resulting in a 13.64 percent increase from last quarter. The increase of permits in the Eugene market is first behind Bend in the state; with these two being the only two providing an increase in the fourth quarter. The Eugene market displayed a significant growth from last quarter, however, this represents only a 0.50 percent increase over the quarter from the fourth quarter, 2016.



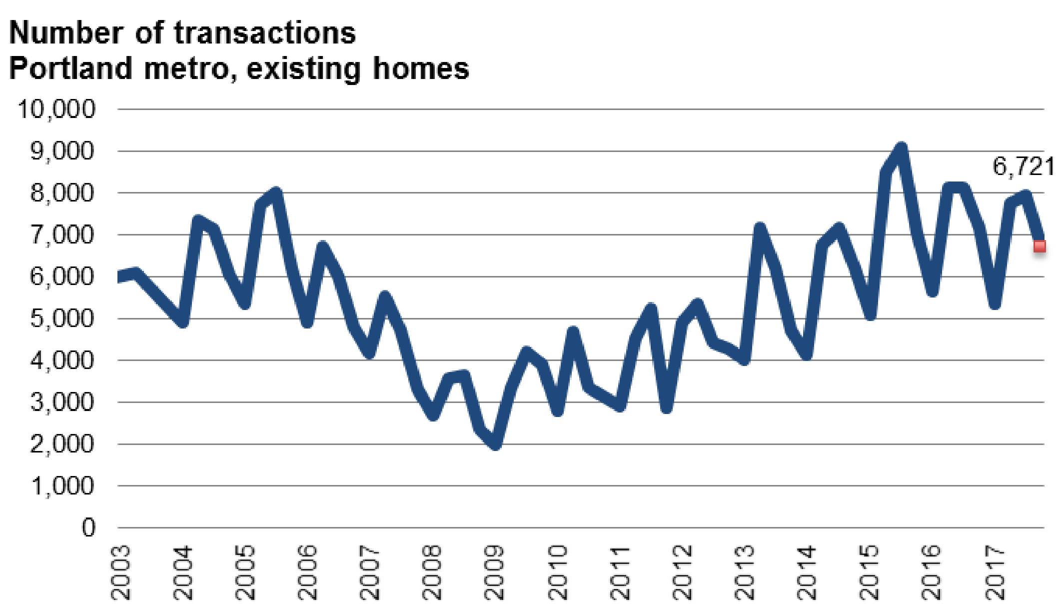
LOCAL PERMITTING

The Medford MSA saw yet another quarter of decreased permits in the fourth quarter; 145, or a 16.67 percent drop. Dissimilar to the other regions, Medford saw significant downward movement compared to same quarter last year, represented by 35.84 percent decrease compared to the previous year quarter.

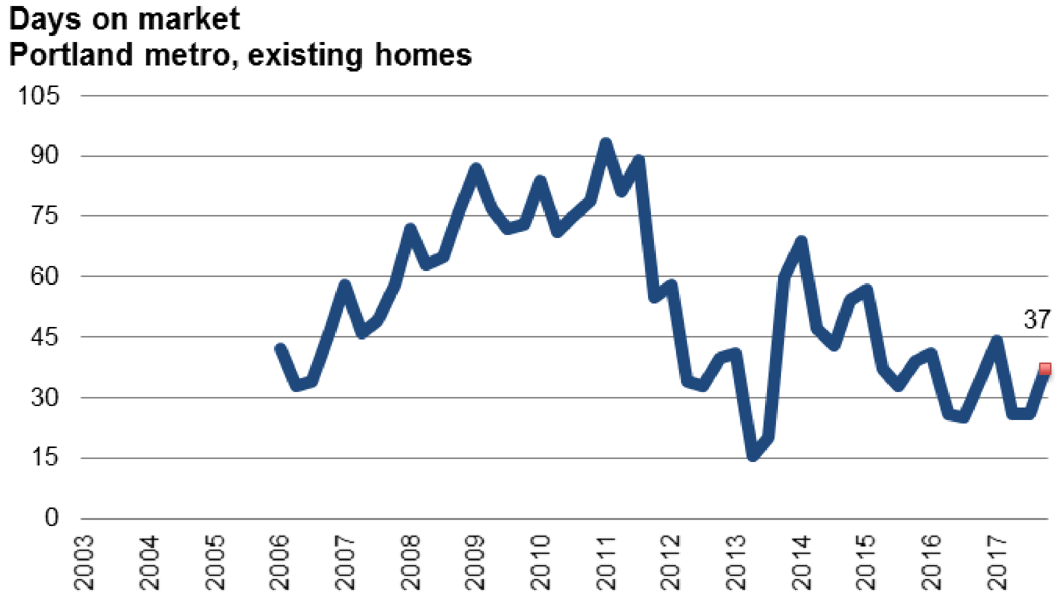


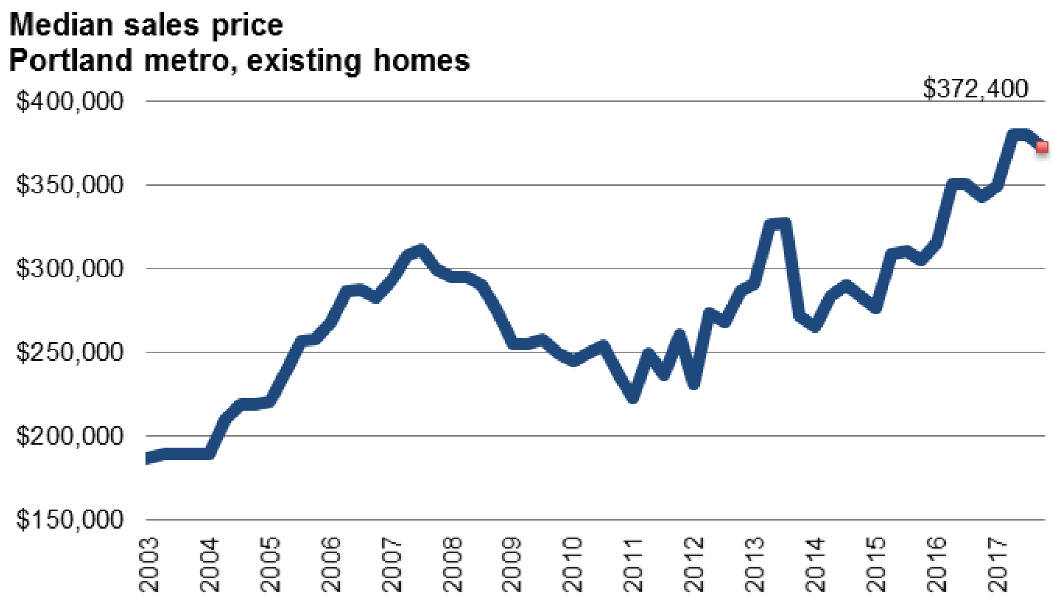
PORTLAND TRANSACTIONS

The fourth quarter displayed signs of a slightly cooling market from the previous few quarters for existing home sales in the Portland market: 6,721 transactions with a median sale price of $372,400. This represents a 6.24 percent drop in sales over the same quarter last year. Median sale price for existing homes increased 8.43 percent over the same quarter last year. The average days on the market for existing homes increased from 26 days to 37 days since last quarter. Homes are selling around asking price.



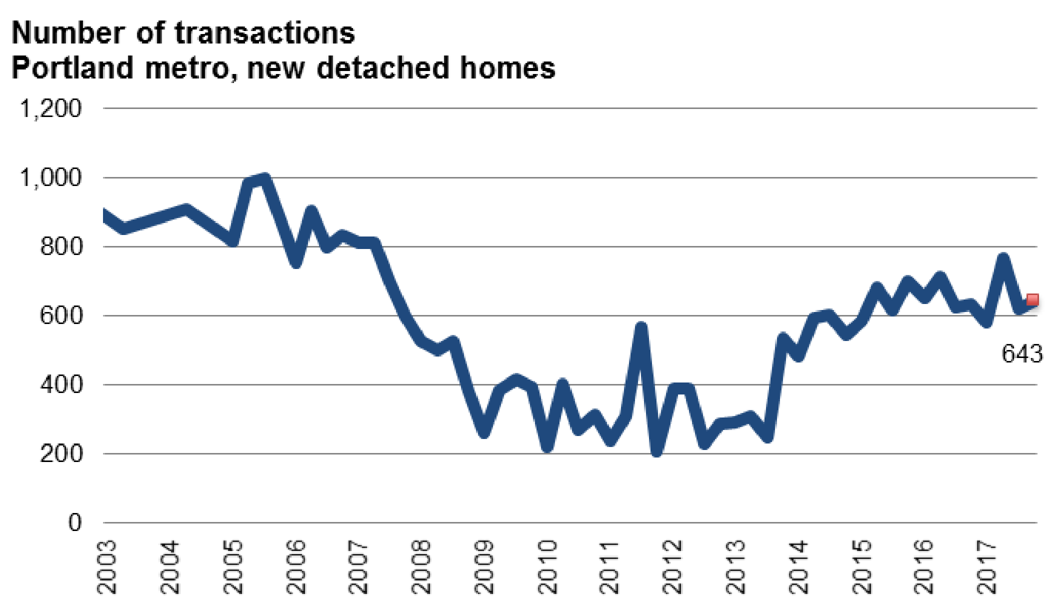
PORTLAND TRANSACTIONS



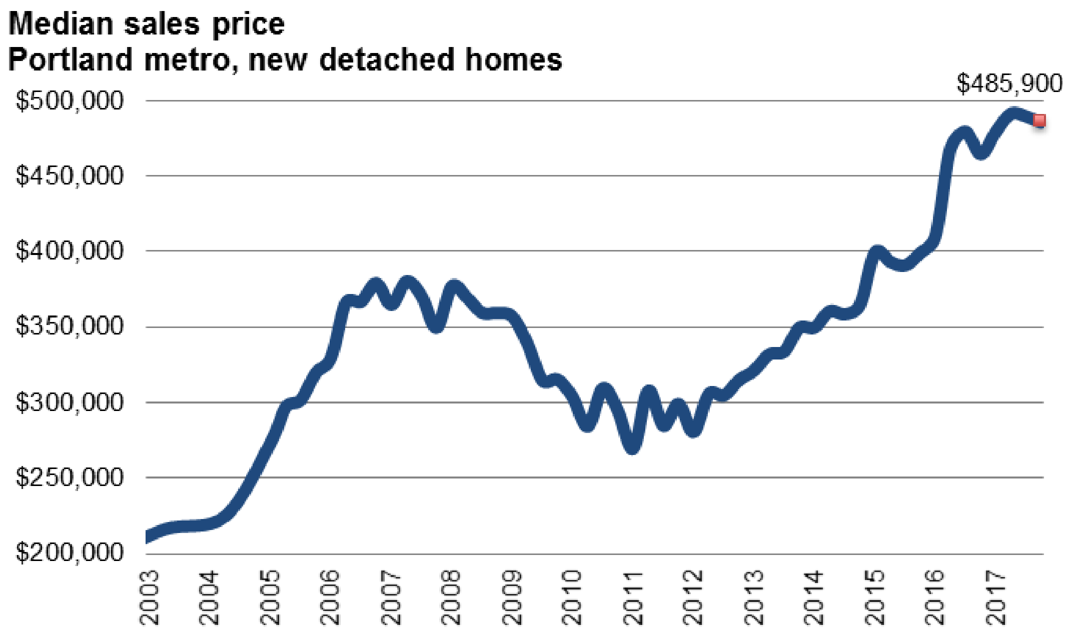


PORTLAND TRANSACTIONS

The number of transactions that occurred for new homes in Portland increased from 622 to 643, which is a 3.38 percent increase from quarter three, along with a 1.42 percent increase compared to quarter four of last year. The new home median sale price in the fourth quarter saw a continued decrease compared to the last two quarters. The third quarter had a median sale price for new homes at $489,946 compared to $485,900 in the fourth quarter, a decrease of 0.83 percent. Comparing the fourth quarter to the same quarter last year, new home prices have increased by 4.49 percent.



PORTLAND TRANSACTIONS

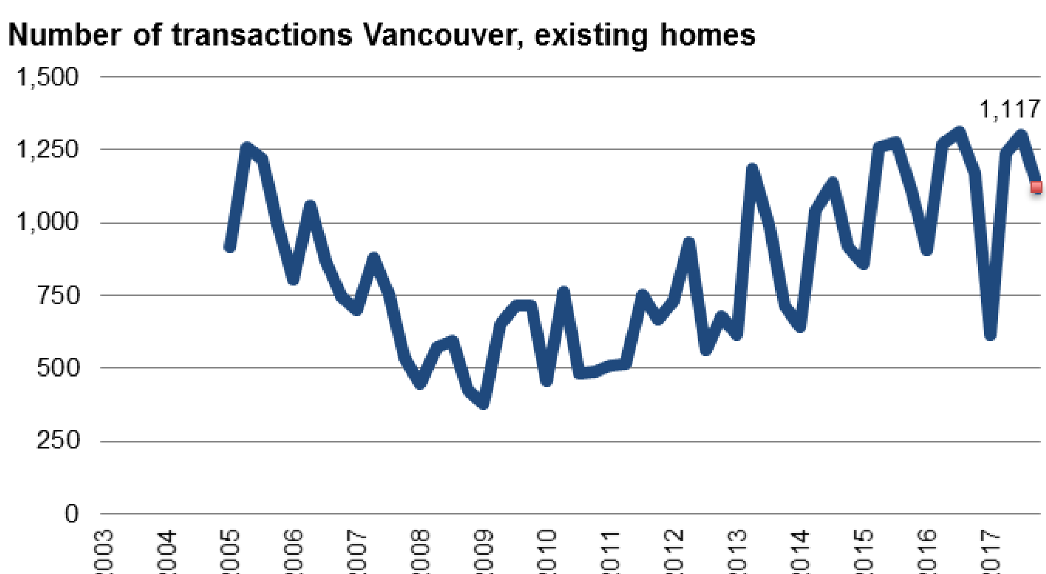


VANCOUVER AND CLARK COUNTY TRANSACTIONS

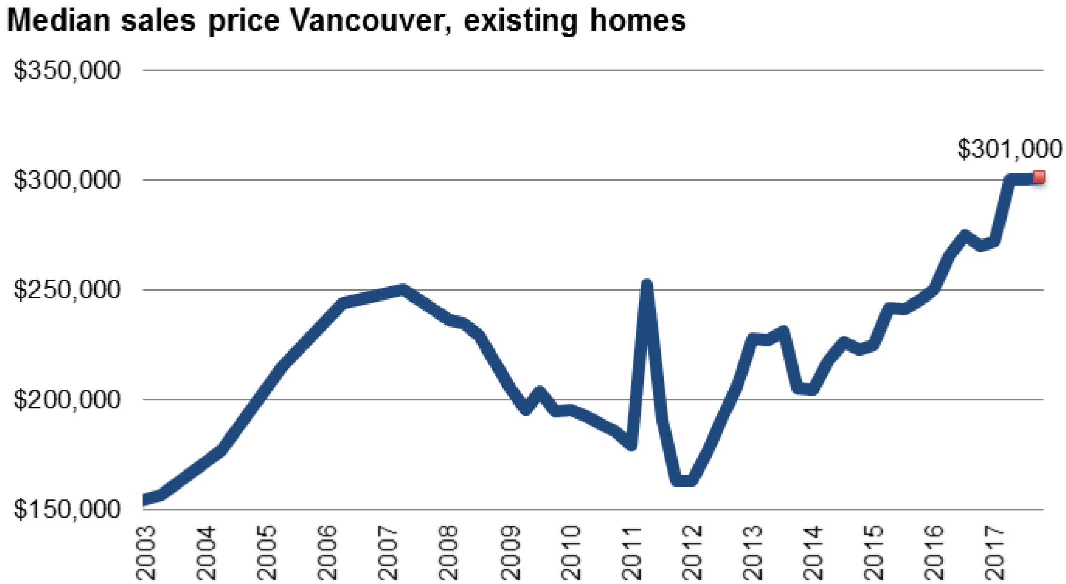
Like Portland, Vancouver experienced a decreased number of transactions of home sales this quarter compared to last quarter. Vancouver experienced a 14.27 percent decrease in transactions of existing homes compared to last quarter. Vancouver's transactions decreased by 4.53 percent. Clark County transactions were also down 12.08 percent compared to last quarter, yet 7.44 percent higher compared to the same quarter last year.

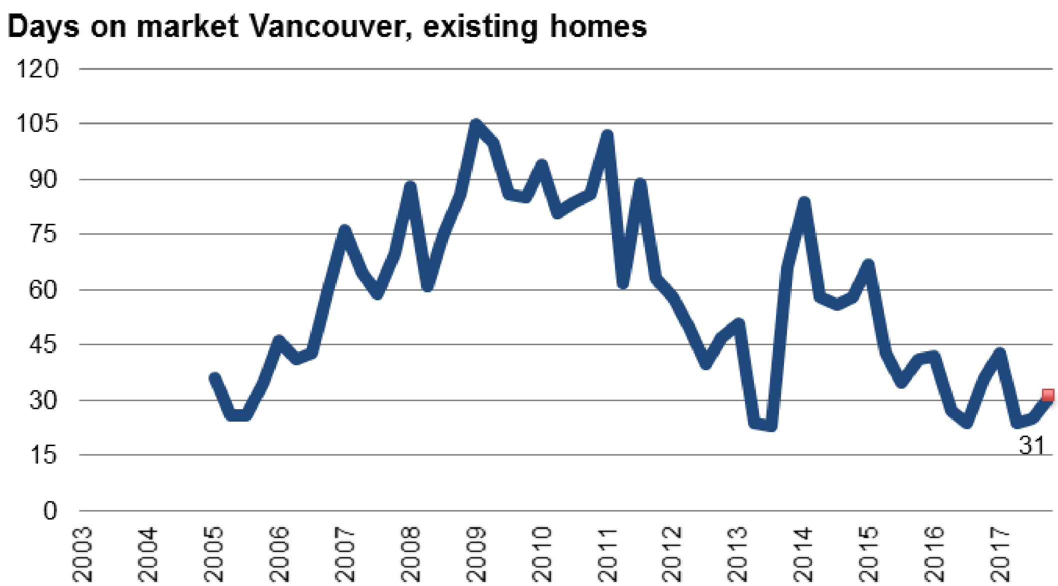
Average days on market began increasing again this quarter for both Vancouver and Clark County, but is a reduction compared to the fourth quarter last year. The average days on market for Vancouver was 31, which is 24 percent increase from last quarter, and a 13.89 percent drop from the fourth quarter in 2016. Clark County saw an average of 42 days on the market, which is 27.27 percent increase from last quarter, and an 8.7 percent decrease from this quarter last year.

Transactions for existing homes within Vancouver decreased from 1,303 to 1,117 with a median sales price of $301,000. Clark County, excluding Vancouver, saw transactions decreased from 1,002 to 881 with a median sales price of $350,000.



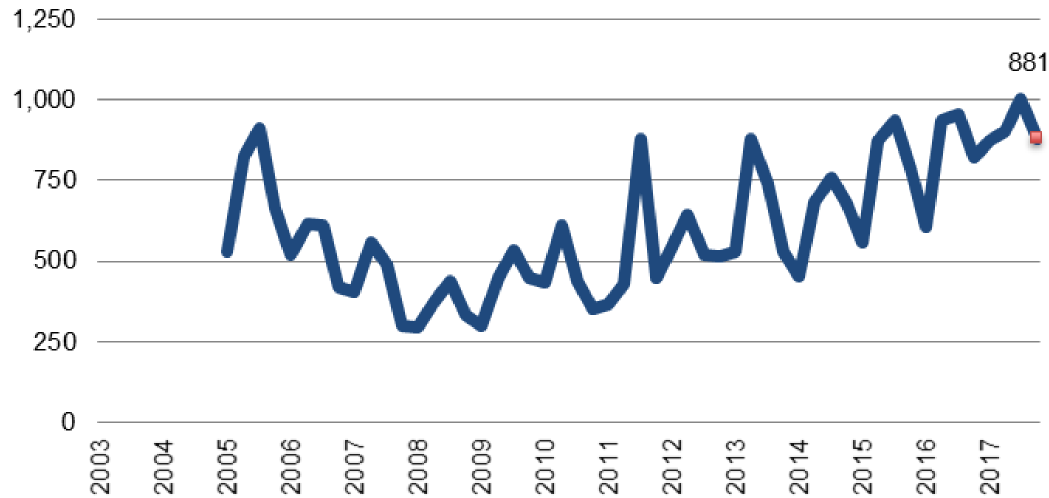
VANCOUVER AND CLARK COUNTY TRANSACTIONS



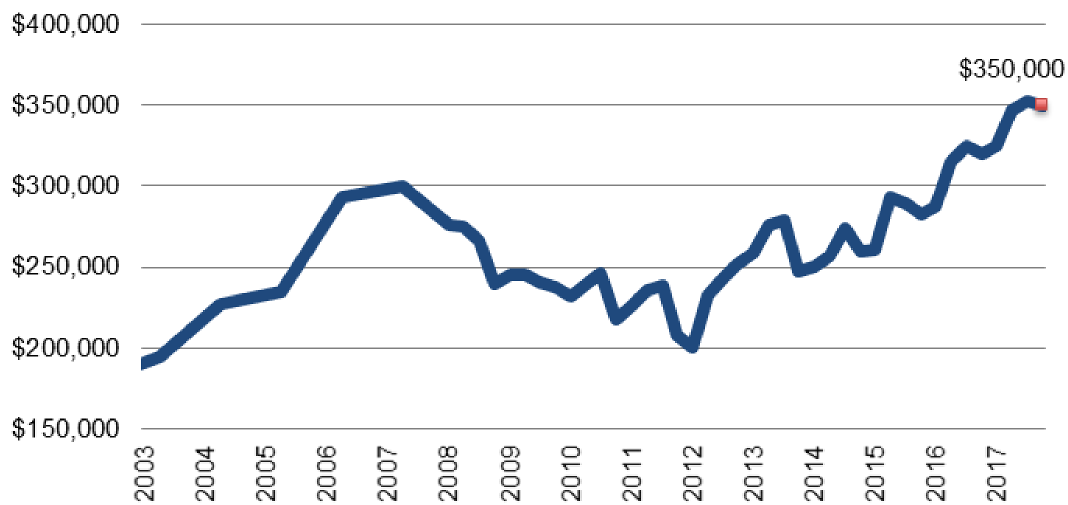


VANCOUVER AND CLARK COUNTY TRANSACTIONS

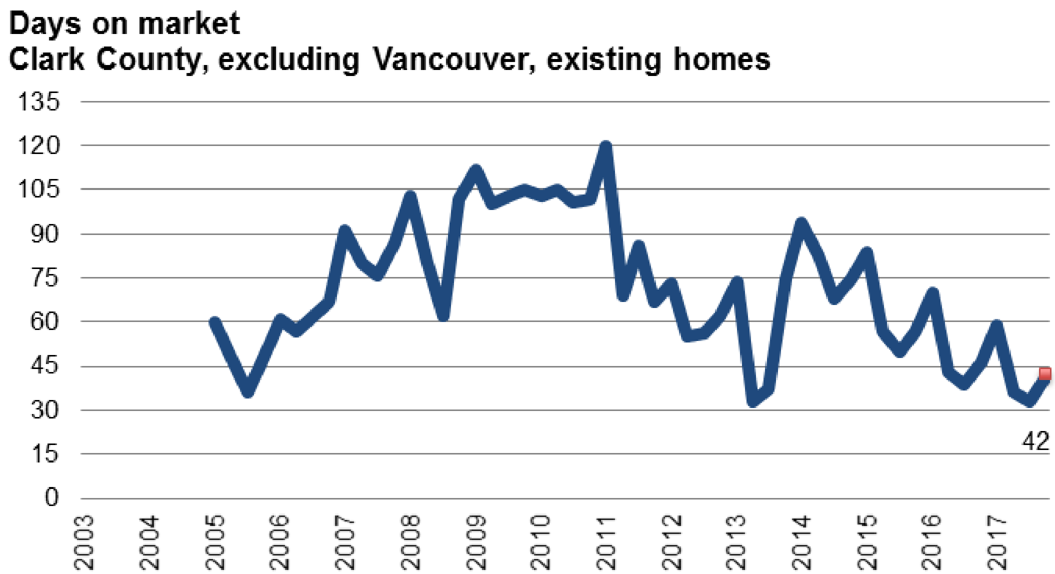
Number of transactions
Clark County, excluding Vancouver, existing homes



Median sales price
Clark County, excluding Vancouver, existing homes



VANCOUVER AND CLARK COUNTY TRANSACTIONS



CENTRAL OREGON TRANSACTIONS

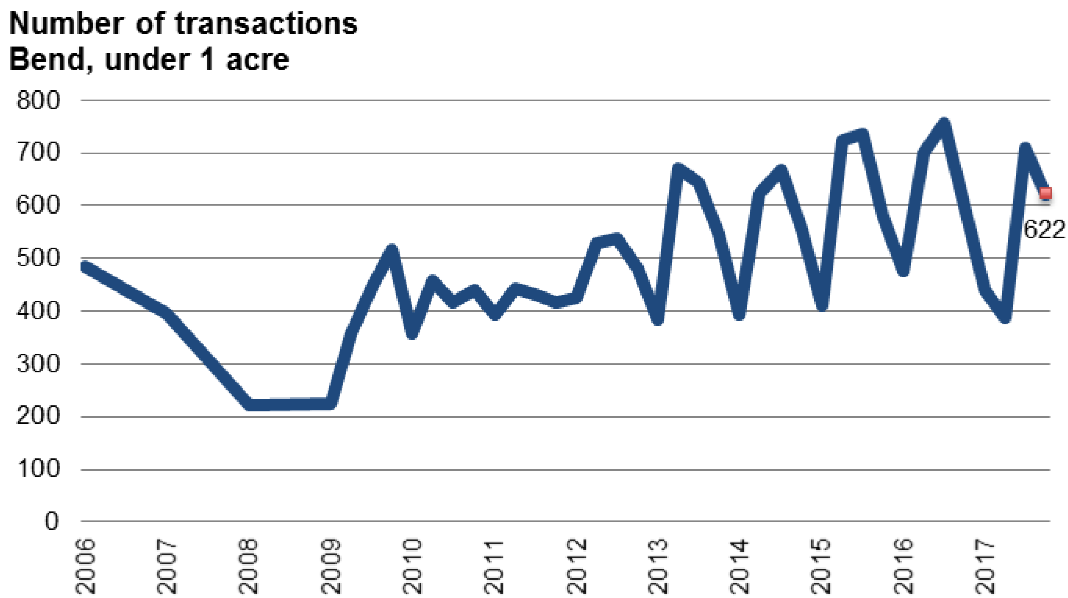
Central Oregon saw a decrease in activity, very similar to the statewide continuation of downward trends from the previous quarter. Bend saw a decrease in transactions of 12.39 percent compared to last quarter, with a 3.84 percent increase compared to the fourth quarter last year. Redmond experienced a 20.88 percent decrease in transactions compared to last quarter as well as a 15.63 percent decrease when compared to the same quarter last year. Bend transactions under one acre finished at 622, with median sales price of $464,000 and 106 days on the market.

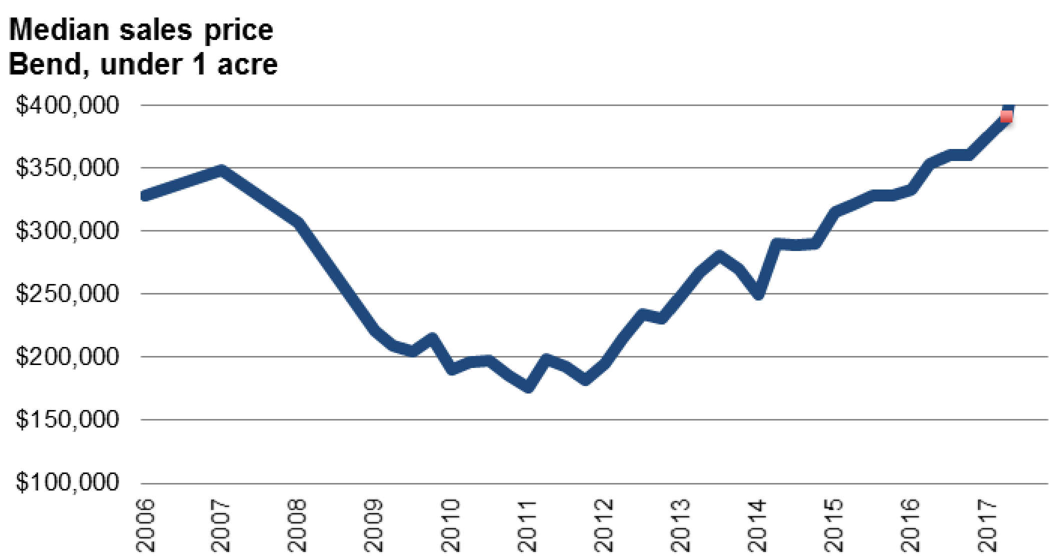
Median home prices in Central Oregon began to drop this quarter and last from previously significant increase seen last quarter. Bend began experiencing slightly cooling of median sales price at a 3.53 percent decrease from to last quarter, but a 28.89 percent increase compared to the fourth quarter last year. Redmond saw a 3.36 percent decrease in home prices compared to last quarter, but a 23.92 percent increase compared to the same quarter last year.

There was a general increase of average days on market from last quarter. Bend's average days on the market increased from 100 last quarter to 106. Compared to the same quarter last year, there was a 6.19 percent decline. Redmond saw a slight increase of 2.97 percent in average days on the market compared to last quarter, with 0.97 percent increase from this quarter last year.

Redmond saw a decrease of transactions from 273 to 216. The median sales prices decreased to $316,000 from $327,000. Days on the market increased from 101 to 104.

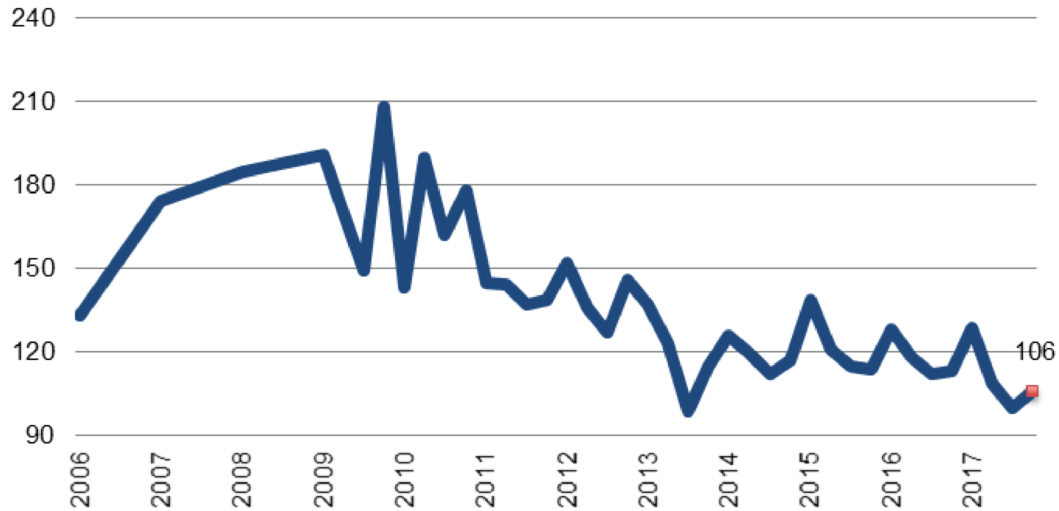
CENTRAL OREGON TRANSACTIONS



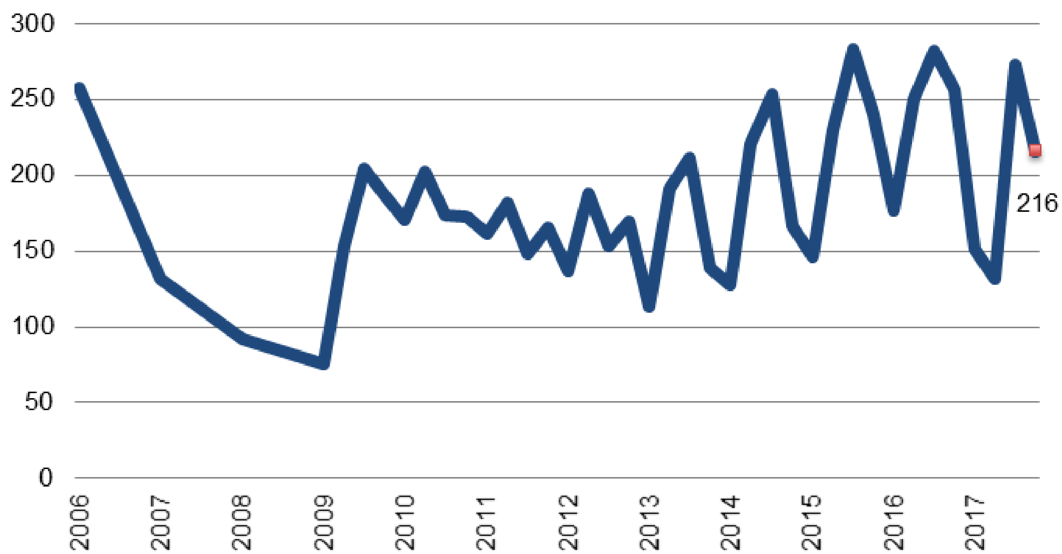


CENTRAL OREGON TRANSACTIONS

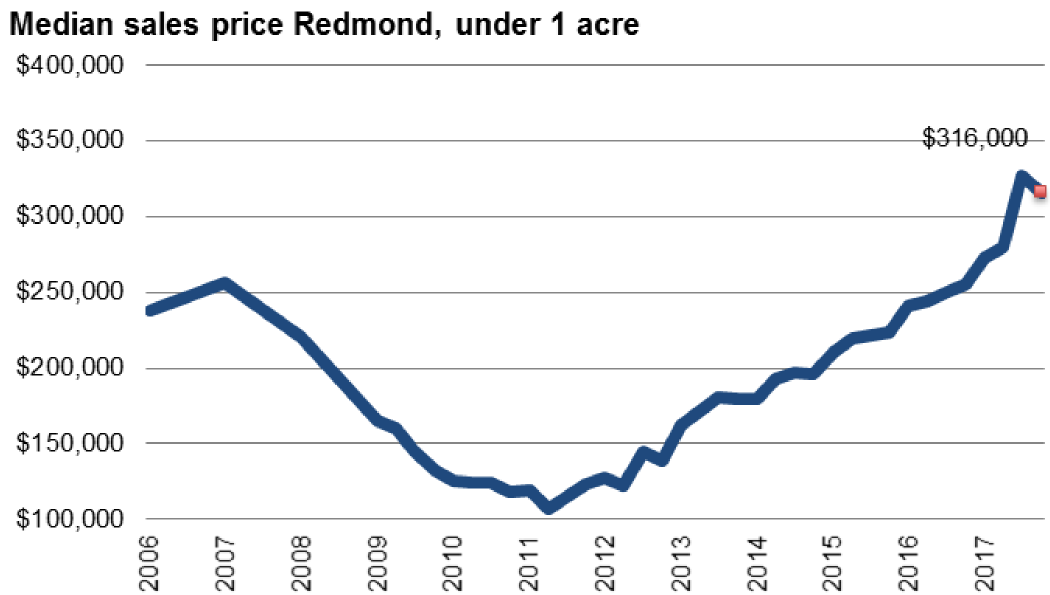
Days on market
Bend, under 1 acre

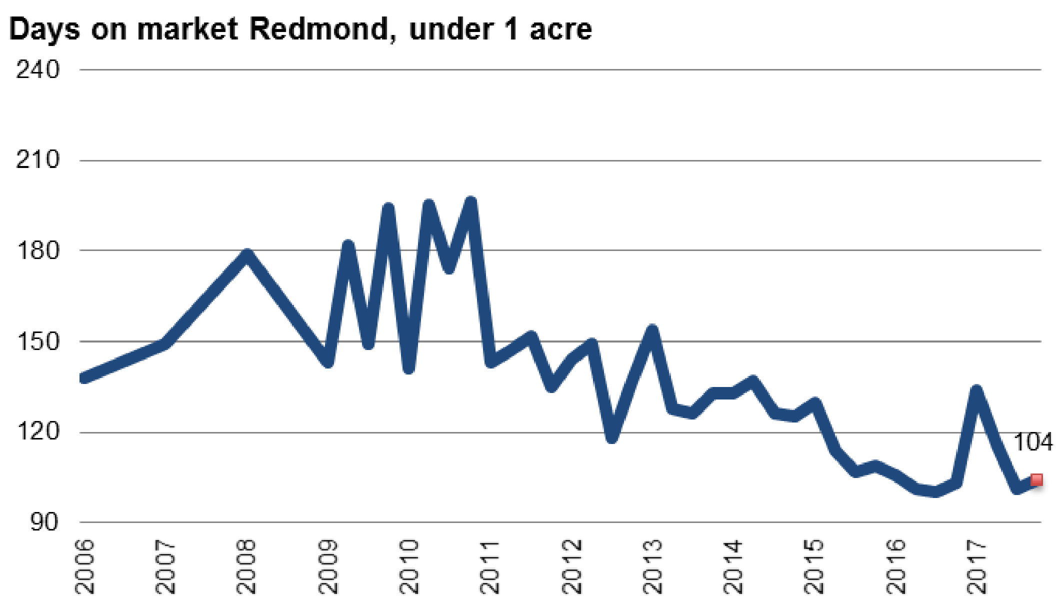


Number of transactions Redmond, under 1 acre



CENTRAL OREGON TRANSACTIONS





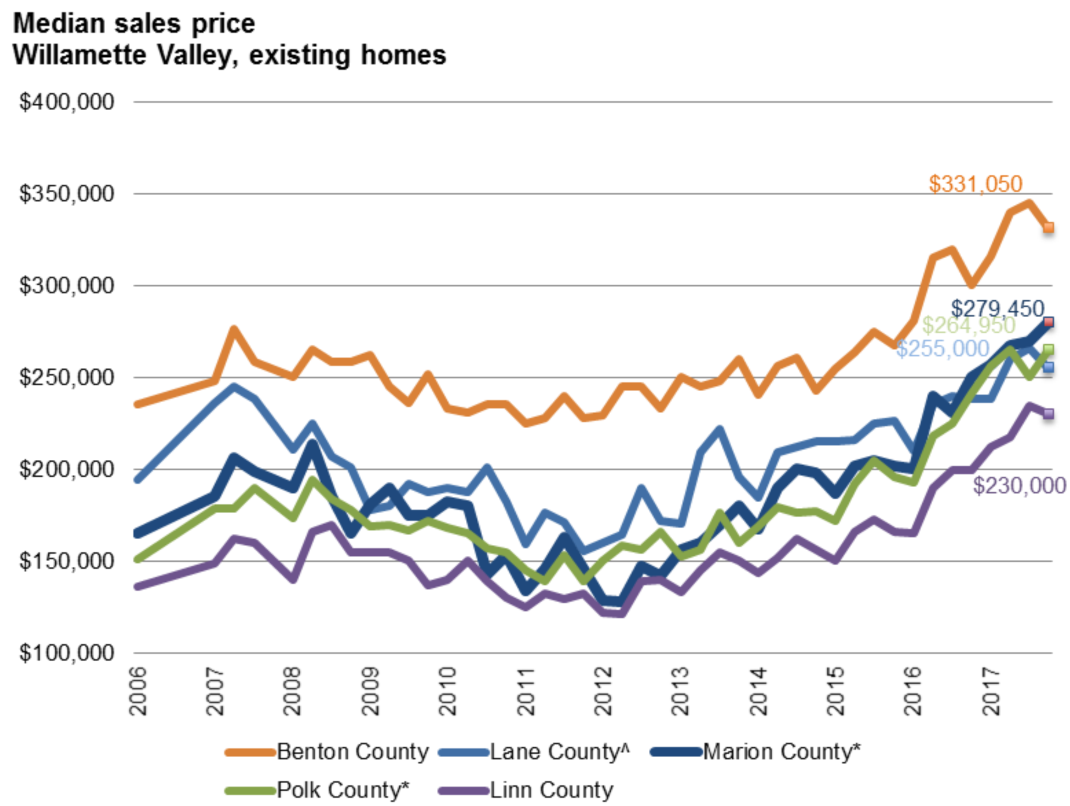
WILLAMETTE VALLEY TRANSACTIONS

The decrease in median sale prices seen across Oregon was not followed in Polk County or Marion County. Benton County, Lane County and Linn County, however, did experience the overall drop in price when compared to the previous quarter and an increase from the last quarter of the previous year. Data for the Willamette Valley counties including Salem is provided by Willamette Valley MLS.

- Benton County: $331,050 median price, a 4.03 percent decrease from the third quarter and a 10.35 percent increase year-over-year.
- Lane County (excluding Eugene): $255,000 median price, a 4.14 percent decrease from the third quarter and a 7.03 percent increase year-over-year.
- Marion County (excluding Salem): $279,950 median price, a 3.69 percent increase from the third quarter and an 11.98 percent increase year-over-year.

WILLAMETTE VALLEY TRANSACTIONS

- Polk County (excluding Salem): $264,950 median price, a 5.98 percent increase from the third quarter and a 9.94 percent increase year-over-year
- Linn County: $230,000 median price, a 1.96 percent decrease from the third quarter and a 15.17 percent increase year-over-year.



^Excluding Eugene *Excluding Salem

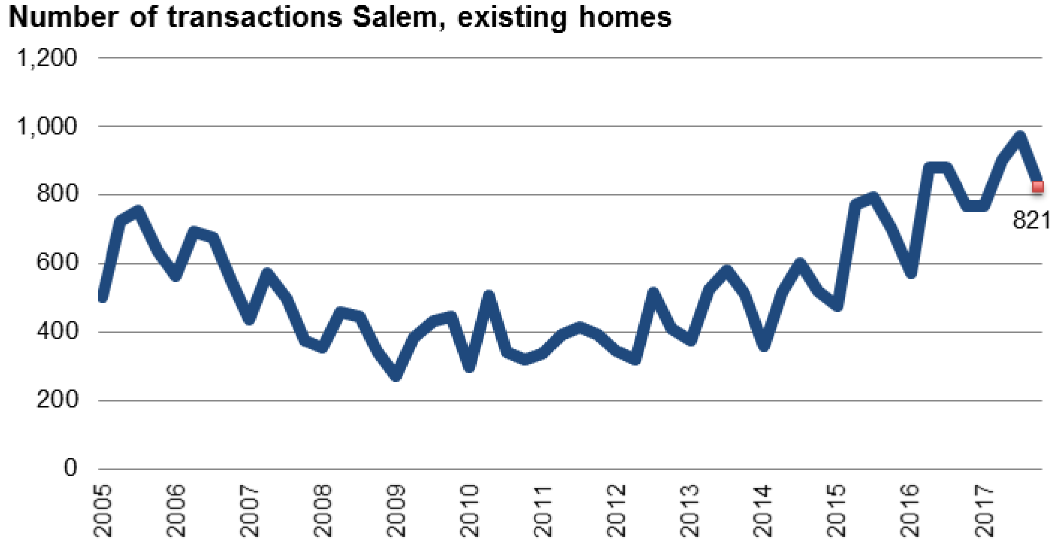
SALEM TRANSACTIONS

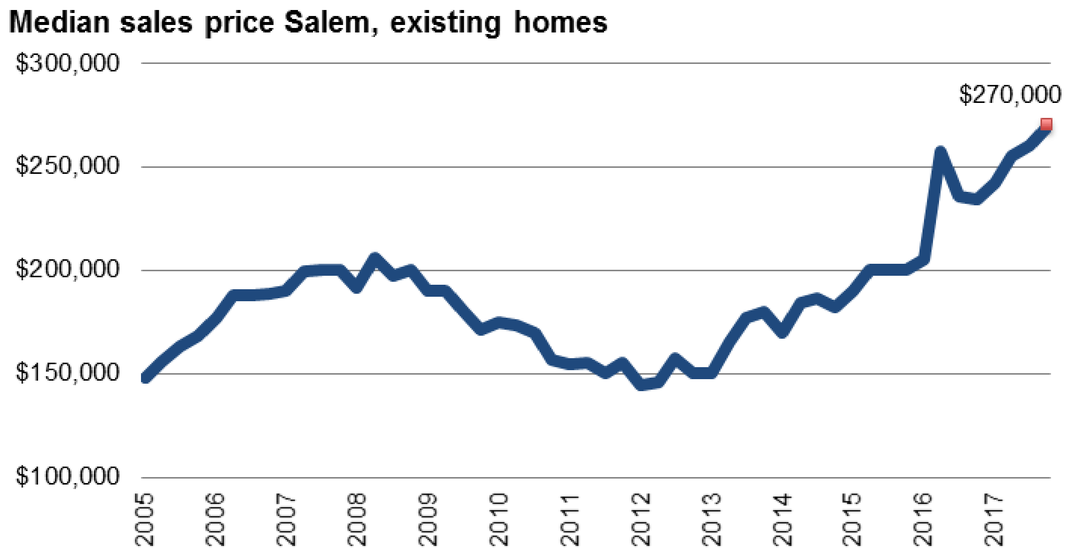
Transaction volume in Salem was consistent with the decrease statewide of last quarter's trend. Also, like the statewide trend, the transaction activity decreased by 15.53 percent compared to last quarter; additionally, that volume represents a 6.90 percent increase compared to the fourth quarter of last year.

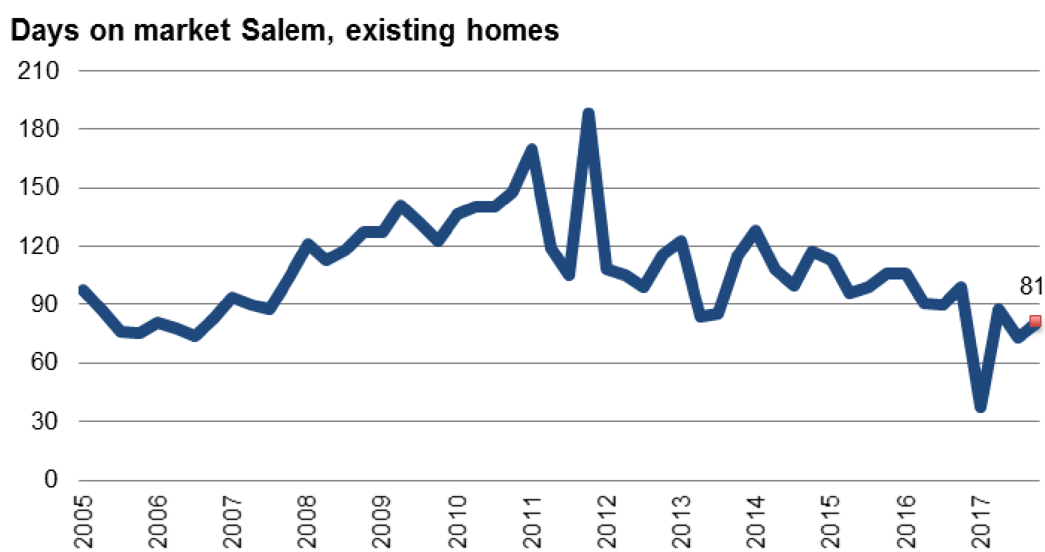
The median home prices rose from $260,000 last quarter by 3.85 percent up to $270,000 in the fourth quarter. When compared to the same quarter last year, this increase in price represents a 15.38 percent increase.

Average days on the market also declined when compared to a year ago from 99 days to 81 days.

SALEM TRANSACTIONS





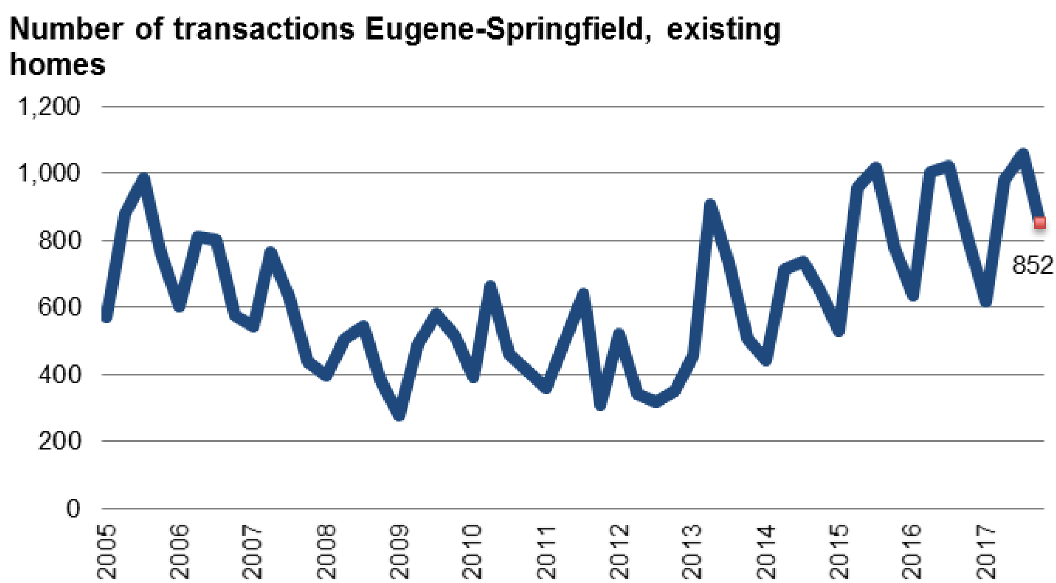


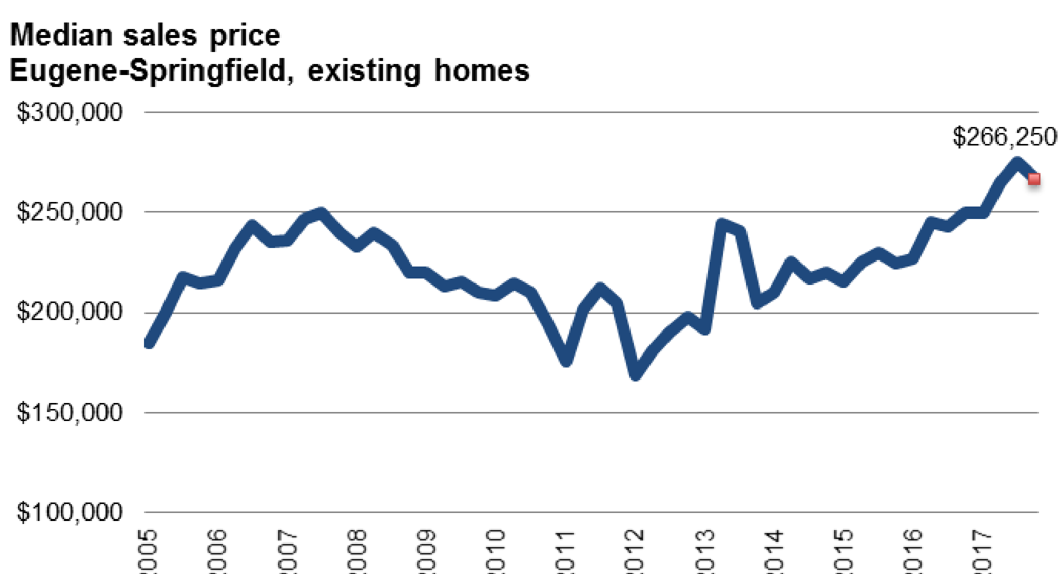
EUGENE–SPRINGFIELD TRANSACTIONS

Like many other areas of the state this quarter, Eugene-Springfield experienced a decrease in sales volume from last quarter. Transaction counts decreased 19.70 percent from 1,061 to 852 last quarter, with an increase of 4.93 percent compared to the same quarter last year.

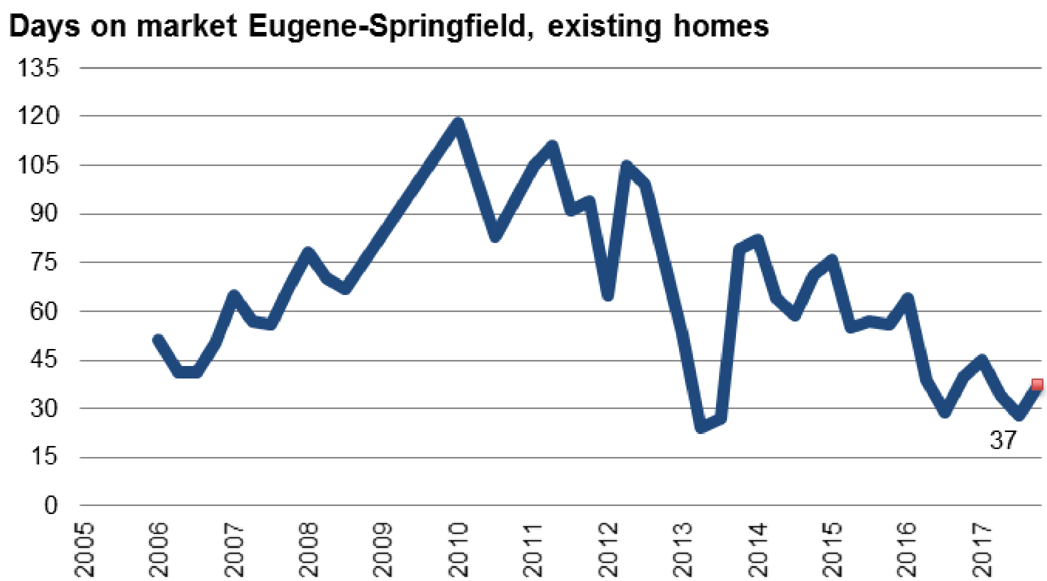
Median sale price began decreasing from $275,000 last quarter to $266,250 this quarter, which was a decrease of 3.18 percent. When compared to the same quarter in 2016, there is a 6.54 percent increase in sale price. Average days on market rose an additional 9 days this quarter compared to last, from 28 back up to 37 days on average. This represents a 32.14 percent increase compared to last quarter and a 7.50 percent decrease compared to the same quarter last year.

The urban growth boundary in the area recently grew to include an additional 969 acres to promote significant job growth. Yet no new land is available to provide single-family housing for the proposed density growth. There is concern over what this allocation of land will do to the median price of homes as well as the days on the market. There is concern whether there will be a sufficient supply of multifamily units to satisfy the expected demand for 15,000 additional units over the next 15 years.





EUGENE–SPRINGFIELD TRANSACTIONS



SOUTHERN OREGON TRANSACTIONS

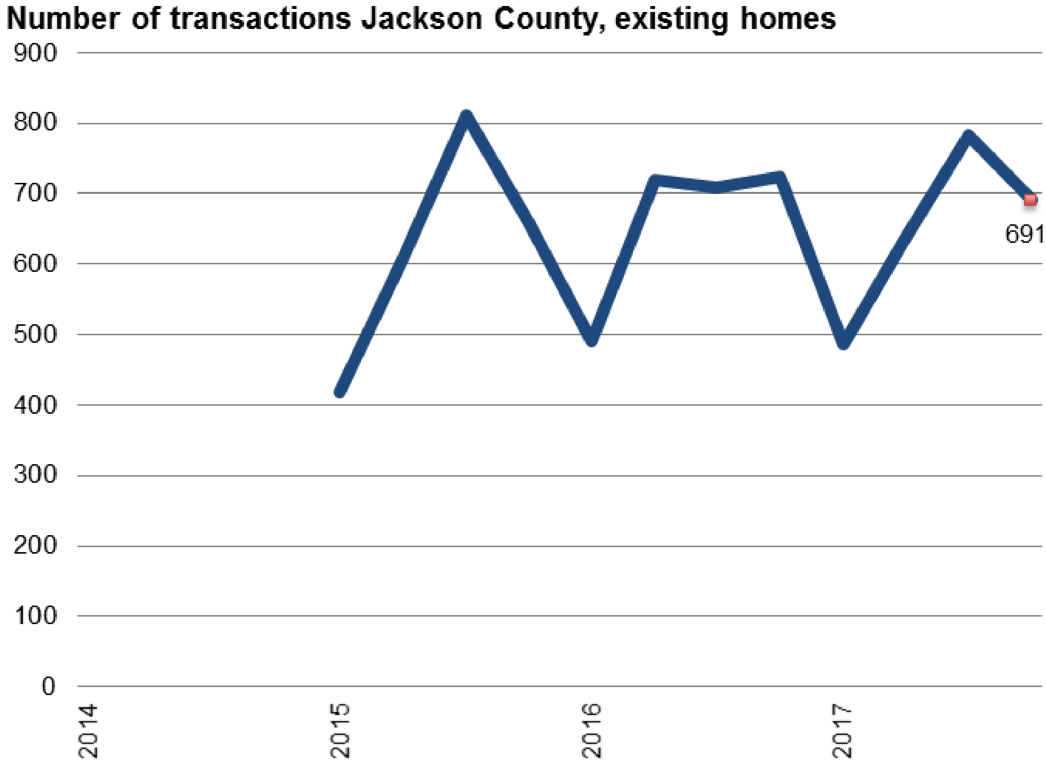
Trends in Southern Oregon were similar to the trends across the state: fewer transactions compared to last quarter, from 782 to 691 for Jackson County. Compared to the fourth quarter last year, Jackson County saw a 4.96 percent drop in transaction volume while Josephine County saw only a 1.71 percent increase.

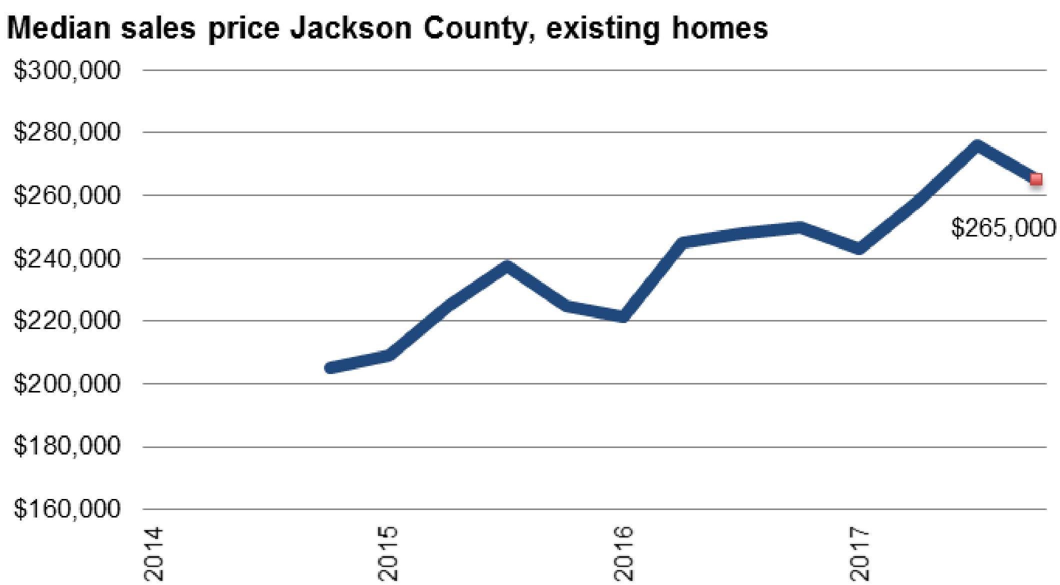
The median home price in Jackson County decreased from $276,250 in the third quarter to $265,000; however the fourth quarter is still an increase compared to the fourth quarter of last year, a 6 percent rise in price. Average days on the market experienced an increase compared to last quarter for both Jackson County and Josephine County; Jackson County with a 5.88 percent increase and Josephine County with a 16.67 percent increase.

Transactions for existing homes in Josephine County dropped from 190 to 178 in the fourth quarter, with the median sale price decreasing from $236,250 to $229,750.

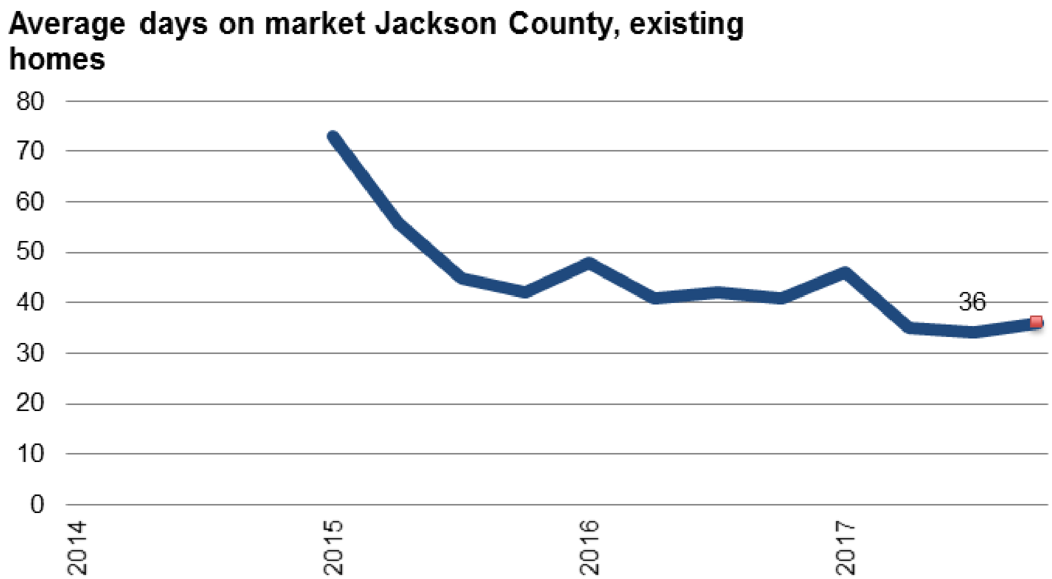
Data for Southern Oregon is provided in rolling three-month groupings, and the most recent dataset available for this region covers the October 1st to December 31st, 2017 time period. The following figures display the data for Jackson and Josephine County.

SOUTHERN OREGON TRANSACTIONS

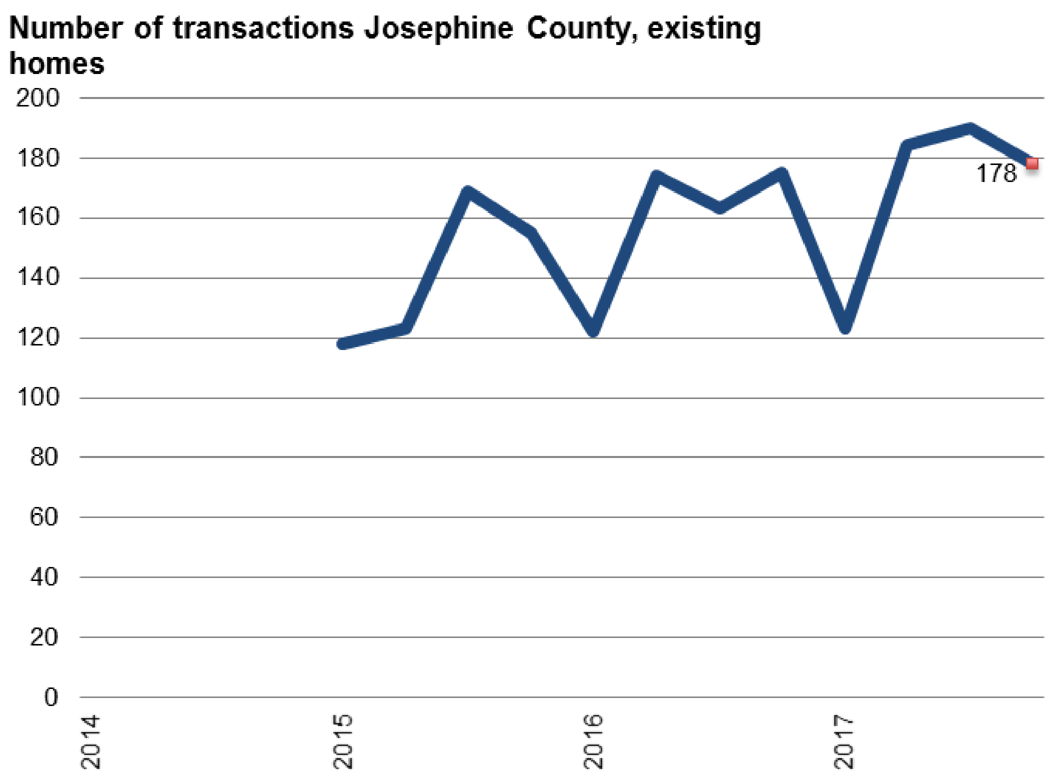




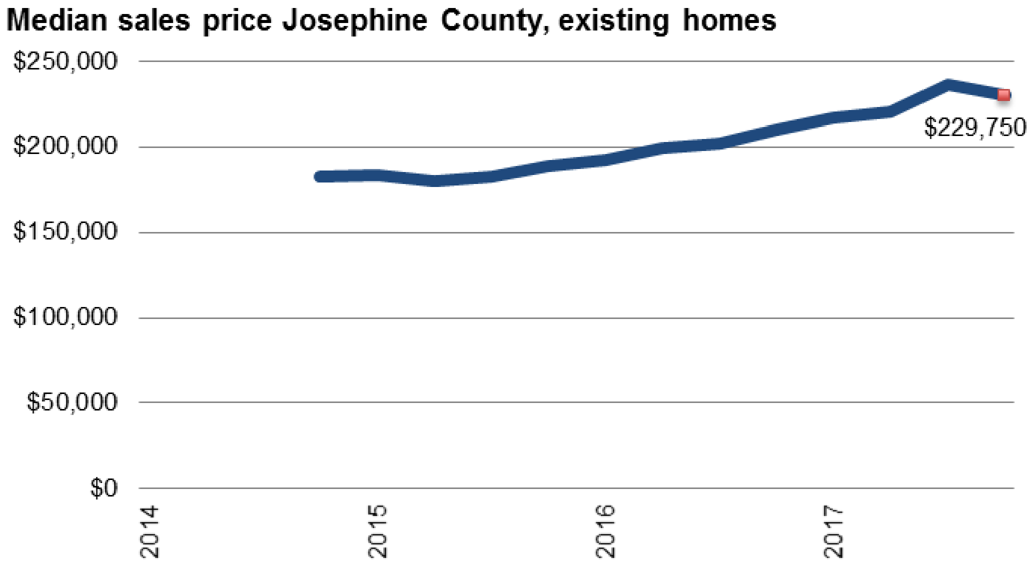
SOUTHERN OREGON TRANSACTIONS

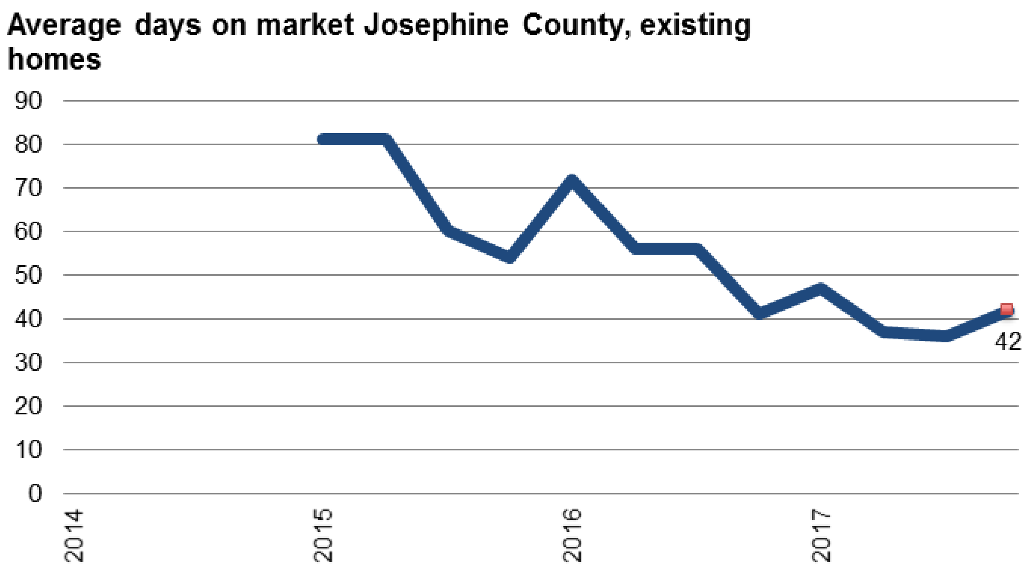


The following figures display the data for Josephine County:



SOUTHERN OREGON TRANSACTIONS

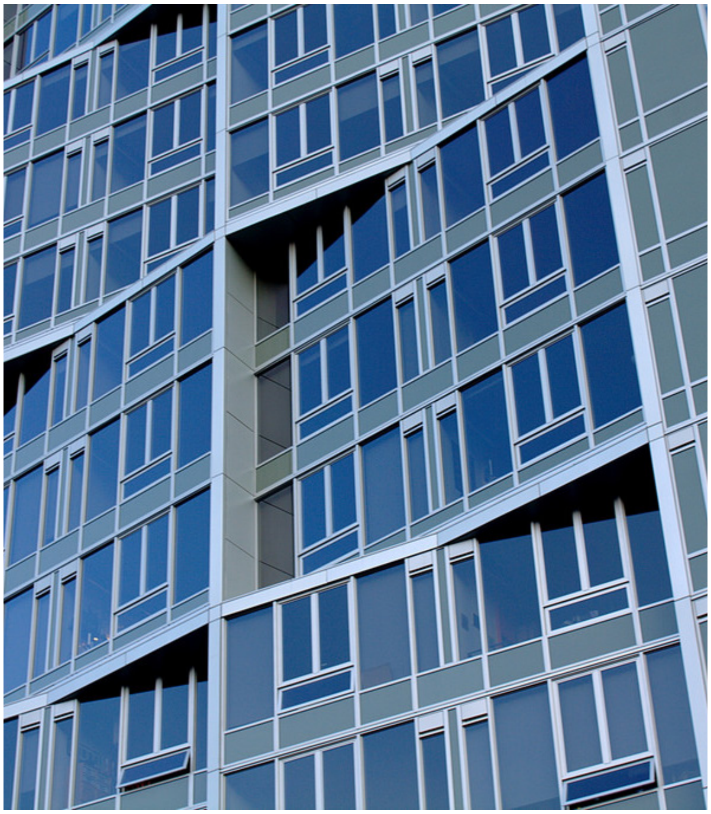




MULTIFAMILY MARKET ANALYSIS

SYDNEY BOWMAN
Portland State University

Portland continues to enjoy solid foundations of a healthy economy. The overall economic mood seems to be that the Portland multifamily market in 2018 will be a continued trajectory of 2016 and 2017, but tempered. At the same time, the public seems to be bracing for the next recession as we march into the eighth year of sustained growth in the real estate cycle.



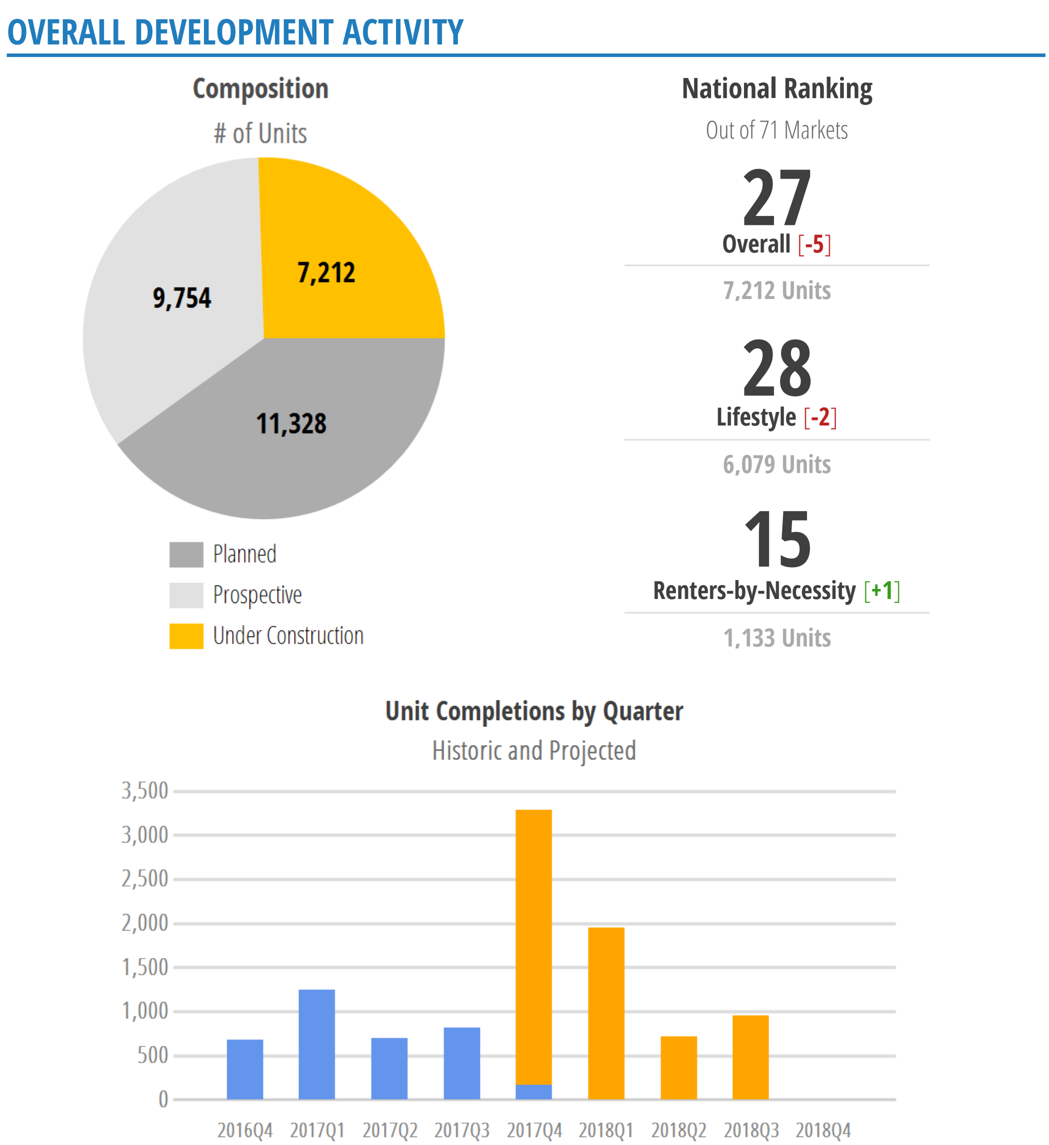
Sydney Bowman is a candidate for the Masters in Real Estate Development degree and currently works as a commercial real estate investment sales broker for CBRE. She was awarded the SIOR Fellowship at the Portland State University Center for Real Estate. Any errors of omissions are the author's responsibility. Any opinions are those of the author solely and do not represent the opinions of any other person of entity.

Portland State UNIVERSITY

AFFORDABILITY AND NEW CONSTRUCTION

No multifamily report would be complete without the discussion of the affordable housing situation in Portland. The onset of inclusionary zoning which went into effect February 1, 2017, requires developers to include rent restricted affordable units in projects of at least 20 units or pay a fee. According the Daily Journal of Commerce, approximately 19,000 multifamily residential units were in the development pipeline prior to that date. Most of the new construction of apartments easily seen around the city today came out of this rush to make the application deadline, although many of these permits will expire and will never come to fruition. To date, there have been six privately financed projects since inclusionary zoning has gone into effect. This equates to 60 affordable units and 406 market rate units.[1] Some have voiced concern that due to this dip in apartment deliveries, the lack of product will be felt in coming years as the low supply will cause rents to skyrocket once more—exacerbated by the continued in-migration to the area.[2]

Figure 1: Portland Development Activity



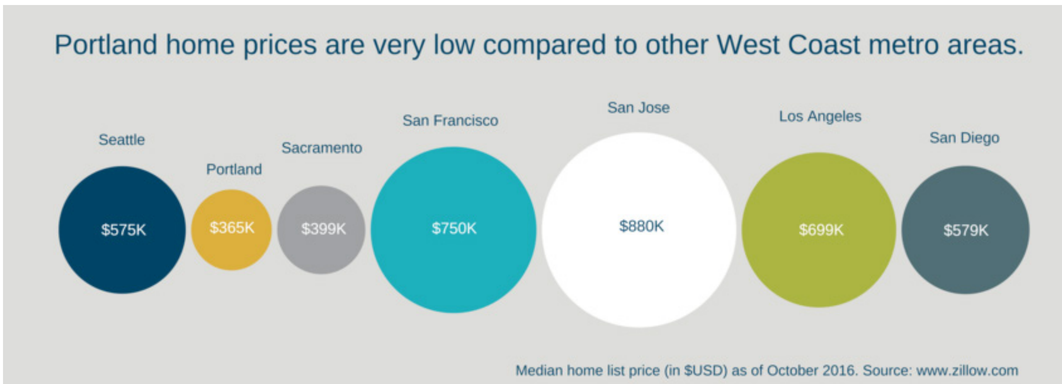
Source: Yardi Matrix

AFFORDABILITY AND NEW CONSTRUCTION

Portland, was once recognized as one of the most affordable big cities on the West Coast. Nevertheless, Portland caught up with the rest of the West Coast in 2015, experiencing the highest annual effective rent growth in the nation.[3] More recently, 2017 rents have climbed only 1.9 percent, as reported by Realpage.[4]

This has occurred during a period of increased new construction in the higher rent echelon. In a report by Yardi Matrix, of the 830 apartment properties (of all class types) surveyed in December 2017, 12.7 percent are currently offering concessions. This number jumps up to 39.4 percent for apartment type Class A. Yet still, many Portlanders are unable to afford rent, mostly in part to income levels not able to keep pace with rent growth.[5]

Figure 2: Portland's Affordability



Source: www.zillow.com, oregonmetro.gov/snapshot

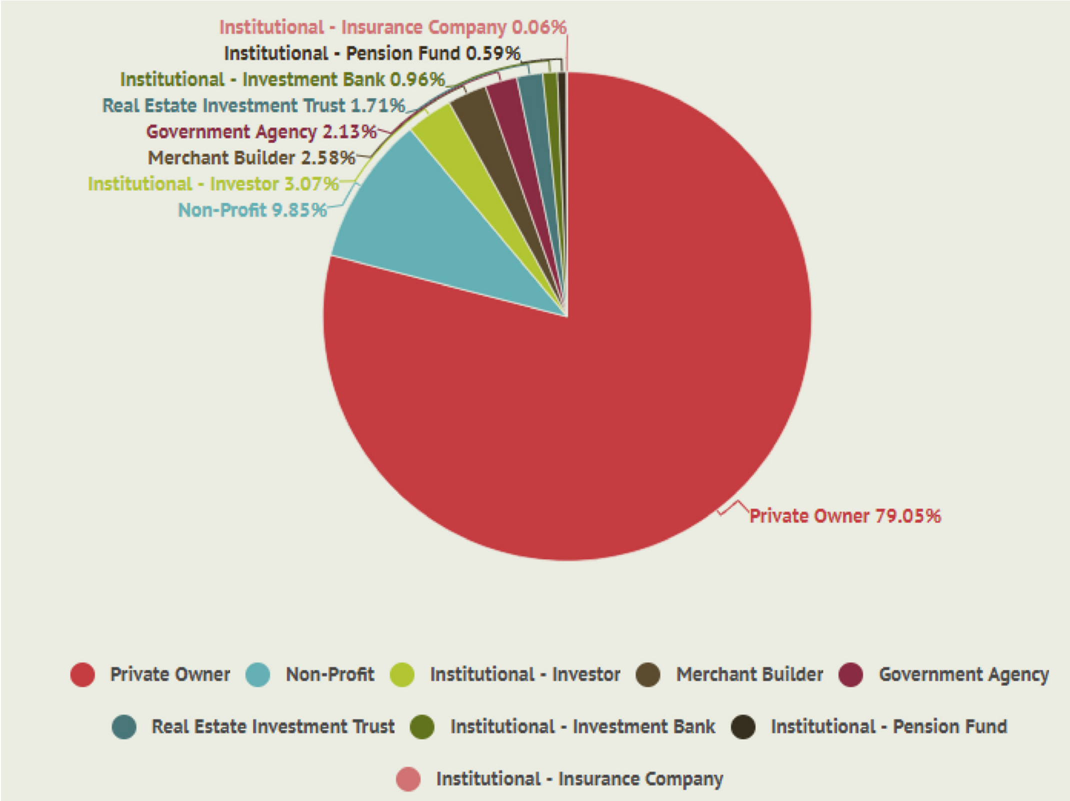
MARKET METRICS

According to the Multifamily Northwest's Fall 2017 Apartment Report, Portland's overall rent per square foot is $1.57, which equates to an average of $1,127 for a studio up to $1,150 for a 2-bedroom, one-bathroom apartment. Costar's Multifamily Portland Market Summary reports that the average vacancy rate is 6.1 percent with vacancy being highest in the urban core due to the new deliveries. This contrasts to the suburbs, which are maintaining higher occupancy.

Sales volume reached a record high of nearly $3 billion in 2016, thanks to the strong presence of institutional and value-add investors, but achieved less than half of that figure, a total of $1.49 billion in 2017.[6] In 2016, there were 210 transactions of properties valued one million and above, where 2017 declined to 164 transactions. Portland saw an average 5.5 percent CAP rate in 2017 for all apartments above one million dollars in Clark, Multnomah, Clackamas and Washington counties. The median price per unit was $155,000. Although Portland has recently entered into the spotlight for outside investors looking to invest, the majority of owners and investors are still local private owners.

MARKET METRICS

Figure 3: A Breakdown of Portland Apartment Ownership



Source: https://www.multihousingnews.com/post/top-10-apartment-owners-in-portland/

As mentioned in a presentation by the Northwest Economic Research Center at the CREW Forecasting breakfast this January, interest rates are expected to rise three times in the next year by 0.25 basis points. Investors continue to use debt to purchase existing multifamily product as it is available, however lenders are trending towards the conservative.

In 2017, investors and property owners in Multnomah County became increasingly nervous due to the recently implementation of relocation fees and capped rent increases. In turn, this has caused tertiary markets in Vancouver, Salem, Newberg and McMinnville in neighboring counties to look more and more attractive.

A recent notable project is Modera Belmont, a 200-unit urban apartment building in the Buckman Neighborhood which broke ground in the first quarter of 2017 and achieved certificate of occupancy January 12th, 2018. Developed by Mill Creek, Modera Belmont is already 7 percent occupied and is the only apartment in Portland to offer a virtual reality gaming room as an amenity

FORECAST & TRENDS

Two trends to watch in the Portland area is the expansion of the CLT (cross laminated timber) industry, especially with the Katerra's new domestic CLT manufacturing facility breaking ground July 2017 in Spokane, WA. Katerra also recently launched a 12-story multifamily high-rise CLT project in Portland.[7] One notable CLT project is Framework, a 60 unit multifamily project, which is currently underway in the downtown Pearl district. The other hot topic surrounds Portland's 1,884 unreinforced masonry buildings. City officials and property owners are working together to find a solution of how to seismically prepare these old buildings before it is too late.[8]

Overall, the 2018 Portland multifamily market is to remain stable with some momentum shifting from apartments to civic projects and condominium developments, which are on the rise. The tax reform legislative is anticipated to smile on commercial real estate owners and construction costs are to remain high.

ENDNOTES

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OFFICE MARKET ANALYSIS

RILEY HENDERSON
Portland State University

The national office landscape ended the year strong with most of the major metrics showing positive improvements across the board. The economy has been strong, leading businesses to expand and increase their office footprint. The national vacancy rate remained unchanged at 9.4 percent, which is across all office classes. Rental rates increased 2.2 percent in the quarter to $25.15 per square foot nationally. Tech companies continue to take down large amounts of office space; the two largest leases signed nationally in the fourth quarter are by Amazon for 738,902 square feet of space in Seattle and Dropbox for 736,550 square feet of space in San Francisco. Additionally, Apple opened their new campus in 2017 taking up 2,800,000 square feet at their custom designed Apple Park.

Locally the Portland office market continued its strong performance on the back of two previous quarters of solid market growth. The biggest unknown in the office market this year has been the amount of new construction in the development pipeline. But as some of that space starts to hit the market, the early signs are positive that the deliveries may not have as large of an impact on the market as previously thought.

Riley Henderson is a Masters of Real Estate Development candidate through a joint program of Portland State University's School of Business Administration and School of Urban Studies and Planning. In addition, Riley is a commercial broker with NAI Elliott specializing in office leasing. He is the 2017 Oregon Association of Realtors Fellowship recipient. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

Portland State
UNIVERSITY

The Portland metropolitan area's third quarter at-a-glance:

- Colliers notes that 2017 started off rocky but the market quickly recovered and has not looked back since. They report that 780,000 square feet was absorbed over the year. With 1.15 million square feet of office product currently under construction, they predict most of it will be absorbed over 2018 and into early 2019 assuming we see about the same amount of absorption in 2018 as we did in 2017. They note some recently announced leases in speculative projects that may be early indicators of a strong leasing market in 2018.
- In JLL's fourth quarter report, the Portland office vacancy rate has remained under 10 percent going on four years in a row. In another sign of the recent strength of the market, JLL states that the sale of CBD office properties has surpassed $1 billion in total volume in a year for the first time. The largest sale of the quarter was the trading of the Wells Fargo Center for $188 million. Looking into next year, the biggest challenge to the market as reported by JLL is not so much the coming deliveries but challenges with finding experienced workers in a very tight labor market as the economy nears full employment. This may slow down office expansion.
- Wrapping up the year, Kidder Mathews highlighted the strong sales activity through the year. They report that the average price per square foot of sales jumped up 25 percent to end the year at $276 per square feet There is an appetite for stabilized properties and investors seeking yield through the repositioning of existing properties. They highlight the sale of the U.S. Customs building. Purchased for $4.74 million, the developer Vista Investment Group repositioned the building and leased the entire property to WeWork. They sold the building in 2017 for $30 million, which equates to $448 per square foot.

VACANCY

The Portland office market vacancy ended the year below 10 percent, which should make investors feel good about the performance of the market in 2017. The lowest reported vacancy rate was by Kidder Mathews at 7.0 percent and the highest market vacancy rate was 9.9 percent according to JLL. The expectation for vacancy rate is that this is the lowest it will hit this cycle. However, in previous quarters the vacancy rate has been projected to rise but it seems that firms are predicting the rate to be more stagnant than rise precipitously. This is in part due to the strong leasing activity seen in the last quarter of the year.

Table 1: Total Vacancy Rates by Brokerage House and Class, Fourth Quarter 2017

Brokerage	Total	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Colliers	9.2%	9.8%	8.6%	11.6%	9.7%	-
JLL	9.9%	9.5%	8.8%	10.8%	9.4%	-
Kidder Mathews	7.0%	8.8%	-	-	-	6.7%

Source: CBRE, Colliers, JLL and Kidder Mathews

RENTAL RATES

Once again, rental rates trended upward in the fourth quarter to end the year on a positive note. The average rental rate was in the mid to high $20 per square feet range. This has been a strong year for rental rate growth. According to CoStar, rates have increased 3.3 percent from the end of the third quarter.

So long as vacancy remains low, landlords should continue to have the ability to incrementally raise rates in the coming year. However, the office landscape is expected to become increasingly competitive. The expectation is that landlords will increase their incentive packages rather than lower rates at first. If the glut of new construction substantially effects the market, expect to rental rates to stay stable for the near to mid-term as investors use larger incentives to lure tenants. Longer term, if the incentives are not working to fill buildings, rates will start to drop towards the end of 2018.

Table 3: Average Direct Asking Rates ($/sf FSG) by Brokerage House and Class, Fourth Quarter 2017

Brokerage	Market Average	CBD	CBD Class A	CBD Class B	CBD Class C	Suburban
Colliers	$25.87	$30.86	$34.15	$29.83	$24.50	-
JLL	$29.23	$33.67	$36.28	$32.63	$26.11	-
Kidder Mathews	$25.88	$30.61	-	-	-	$23.42

Source: CBRE, Colliers, JLL and Kidder Mathews

ABSORPTION AND LEASING

Leasing activity in the quarter continued a strong streak resulting in year-to-date net absorption somewhere between 558,000 square feet and 781,000 square feet depending on who is reporting. Colliers reports there were four leases above 30,000 square feet in Portland's CBD signed this quarter.

Amazon signed the biggest lease in the month at the under-construction Broadway Tower. This 83,955 square feet lease adds to their presence in the area as they occupy a majority of the newly renovated Oregonian Building across the street from Broadway Tower.

Over the course of the year two large companies signed leases to relocate their headquarters. NW Natural signed a lease for the 250 Taylor project although that is just getting underway and occupancy is not projected to be until 2020. Autodesk signed a lease at the Towne Storage building taking the entirety of that adaptive reuse development. In total they took down 100,022 square feet on 17 SE Third Avenue to relocate from Kruse Way. With more new speculative office hitting the market, Portland may see some other large leases signed in 2018 by companies who have been unable to find large contiguous space options in our previously supply constrained market.

Table 4: Net Absorption (in square feet) by Brokerage House and Market Area, Fourth Quarter 2017

Brokerage	Overall	CBD	Suburban
Colliers	303,853	221,206	-
JLL	249,016	(32,907)	-
Kidder Mathews	300,144	206,240	24,064

Source: CBRE, Colliers, JLL and Kidder Mathews

ABSORPTION AND LEASING

Table 5: Net Absorption (in square feet) by Brokerage House and Market Area, Year to Date

Brokerage	Overall	CBD	Suburban
Colliers	778,485	396,529	-
JLL	588,861	162,244	-
Kidder Mathews	834,761	410,385	384,680

Source: CBRE, Colliers, JLL and Kidder Mathews

Table 6: Notable Lease Transactions, Third Quarter 2017

Tenant	Building/Address	Market	Square Feet
Amazon	Broadway Tower	CBD	83,995
Ioavation	US Bancorp (plaza)	CBD	62,033
Oregon State University	Meier & Frank Building	CBD	39,500
Adpearance	Field Office – West	CBD	30,865

Source: CBRE and Colliers

SALES TRANSACTIONS

The appetite for CBD properties in the year was very strong from institutional buyers. This pushed up the total sales volume above $1 billion for the first time as noted by JLL. The year also saw a few records set on a price per square feet basis, as investors were willing to pay a premium for stabilized assets. The Oregonian Building, Pearl West and the Weiden & Kennedy Building all traded this year above the $500 per square feet threshold. Each transaction set a new record for price per square foot.

In addition to the appetite for stabilized assets, investors believe in the Portland office market long term as value-add properties also made up a significant portion of the sales volume in the year.

The fourth quarter saw the sale of the Wells Fargo Center. Kidder Mathews reports that the building was only 57 percent leased at the time of sale and was in desperate need of upgrades which the new owner plans to do. They see a lot of potential in a major renovation and reposition of that very notable asset.

The attention on Portland's office market from institutional capital is expected to remain in the coming year. As the new developments deliver to the market and get leased up, developers will be looking for exist strategy's hoping long-term ownership groups will take them out. As long as the strong underlying fundamentals of the market remain, the expectation is that there won't be a shortage of buyers as evidenced by the record setting sales in 2017.

SALES TRANSACTIONS

Table 7: Notable Sales Transactions, Fourth Quarter 2017

Building/ Address	Buyer	Seller	Market	Price	SF	Price/ SF
Wells Fargo Center	Starwood	Wells Fargo	CBD	$188,000,000	884,941	$212.44
400 SW Sixth Ave	SteelWave	Felton Properties	CBD	$68,000,000	208,477	$326.18
William Barnhardt Center	Consolidated Tomoka	National Financial Realty	Sunset Corridor	$39,750,000		$187.62
US Customs House	Vista Investments	Eastern Real Estate	CBD	$30,000,000		$448.20
Captain Couch, Merchant & Norton House	NBP Capital	Swift	CBD	$19,000,000		$215.67

Source: CBRE, Colliers and CoStar

DELIVERIES AND CONSTRUCTION

There has been a substantial amount of office development undertaken in the year as developers turned their attention to the market for opportunities. Until this recent development wave, the office market had been starved for new properties and companies looking to expand had few options for large spaces. This month saw some of the new construction hit the market. The largest project delivered was the Leland James developed by Cairn Pacific and Capstone Partners. This project in Northwest delivered 118,000 square feet and was 28 percent preleased at the time of delivery. Another smaller sized office project delivered in the month was Twelfth and Morrison developed by Menashe Properties. This project contains 62,381 square feet and according to Colliers was 54 percent preleased at delivery.

The sentiment among brokerage houses seems to have changed from slightly pessimistic to mildly optimistic about the market's ability to absorb the large amount of construction in the pipeline. The large office leases signed to date on speculative developments is lifting expectations that the market can absorb the new product efficiently without a large hit to vacancy or rental rates.

DELIVERIES AND CONSTRUCTION

Table 8: Notable Development Projects Under Construction, Fourth Quarter 2017

Building/ Address	Developer	Market	SF	Delivery Date
Field Office	Project^	NW Close-In	330,208	Q1 2018
Clay Pavillion	Killian Pacific	SE Close-In	75,000	Q1 2018
Custom Blocks	Capstone Partners/ Premium Property USA	Central Eastside	71,594	Q1 2018
Heartline	Security Properties	CBD	70,702	Q1 2018
Redfox Commons	L&L Investment Partners	Guilds Lake	60,000	Q2 2018
9North	Williams & Dame/ Miller Global	CBD	202,168	Q3 2018
Waterfront Block 6	Gramor	Vancouver CBD	77,000	Q3 2018
Broadway Tower	BPM Real Estate - Office	CBD	177,800	Q4 2018

Source: Colliers and CoStar

INDUSTRIAL MARKET ANALYSIS

SPENCER WEILLS
Portland State University

Portland's industrial real estate market absorbed 2.74 million square feet for the year in 2017 and rents continued rising in the fourth quarter to a high of $0.66 per square foot according to Kidder Mathews, continuing a trend of strong growth.

The fourth quarter saw a slight increase in vacancy rates up to 3.6 percent according to Capacity Commercial Group. Vacancy has risen the last two quarters after hitting a low of 3.2 percent in the second quarter of 2017. The vacancy rate increase was driven by a delivery of 730,000 square feet of new space and a net absorption of 67,000 square feet according to JLL. In contrast, several other brokerages reporting negative absorption for the quarter.

JLL reported 3.57 million square feet under construction at the end of the fourth quarter, a 400,000 square feet increase from the third quarter, demonstrating developers' bullish outlook on the 2018 market.

The strongest sub-market for leasing activity for the fourth quarter of 2017 was Rivergate. The Rivergate District is at the north end of the east bank of the Portland Harbor and the west end of the Columbia Corridor. This sub-market saw 981,000 square feet leased in the fourth quarter according to Kidder Mathews. With container service returning to Terminal 6 after a year and a half break, this sub-market looks poised to continue its strong 2017 performance into 2018.

Rivergate sub-market (image courtesy of Port of Portland)

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VACANCY AND RENTS

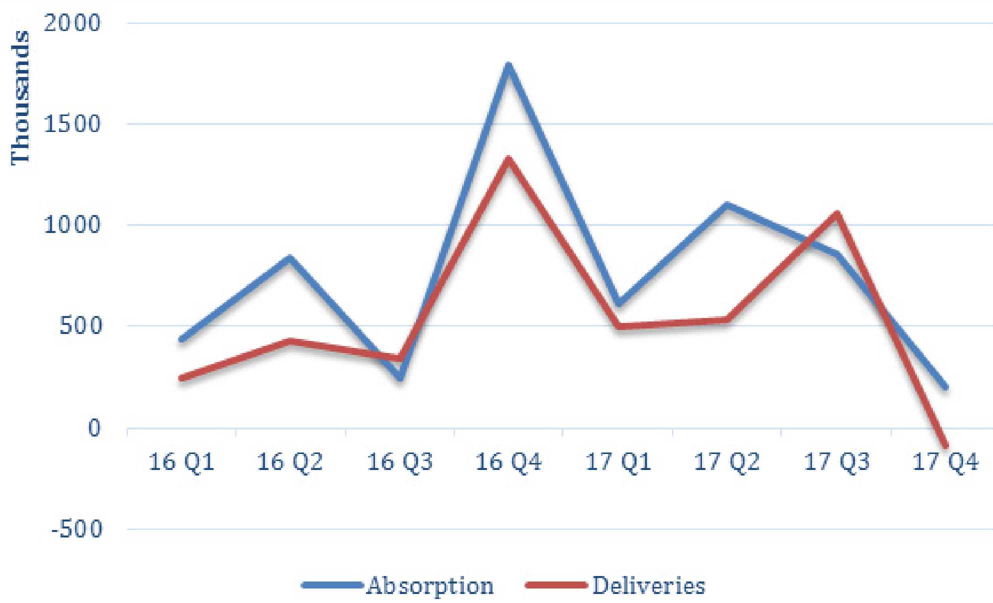
Industrial rents in Portland continued growing in the fourth quarter of 2017 while vacancy continued to rise slightly following increasing supply. Industrial rents have risen by 40 percent over the last eight quarters.

Growth in Industrial Rents and Vacancies Over Last Eight Quarters

	Vacancy (%)	Rent ($/SF)
Kushman Wakefield	3.9	0.71
JLL	3.8	0.62
Kidder	3.6	0.66
Mathews		
Average	3.8	0.66

ABSORPTION AND DELIVERIES

After a peak in fourth quarter of 2016, absorption and deliveries have dropped but demand still remains strong.



Data courtesy of Capacity Commercial Group

LEGISLATIVE CHALLENGES

Portland's industrial market will face a serious land availability problem in the near future if policymakers do not step in to address the situation. The Regional Industrial Site Readiness report classifies industrial land in Portland in three tiers based on the estimated time required to entitle the land for development based on environmental criteria and infrastructure accessibility.

1. Tier 1 property is estimated to have a 6 month entitlement period,
2. Tier 2 is 7-30 months, and
3. Tier 3 is greater than 30 months.

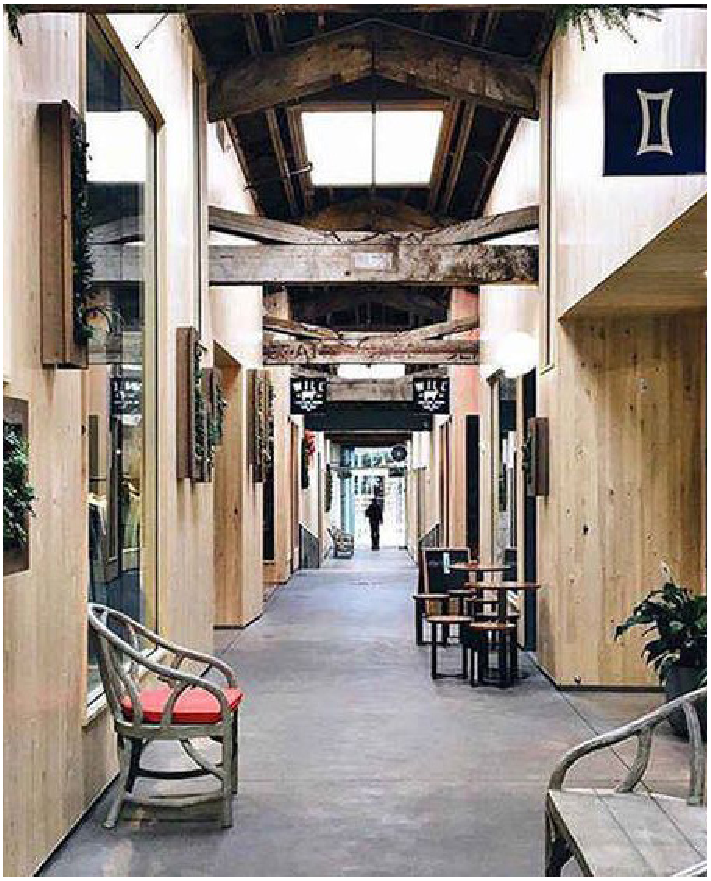
An entitlement period greater than six months makes development difficult as it requires speculation of future market conditions and increases project implementation time thus raising costs.

Portland Business Alliance reassessed the properties identified in the 2014 report in June of 2017, finding that of the 47 identified industrial sites remaining in the region, only 10 of them are classified as Tier 1. Of those 10, seven already have development agreements executed. Additionally, there are zero available Tier 1 sites over 100 acres. This scarcity will likely continue the trend of accelerating rents and has the potential to force smaller, local businesses out of the Portland market. Portland's policymakers will need to address this issue in 2018 for Industrial Real Estate in Portland to remain viable.

RETAIL MARKET ANALYSIS

RILEY HENDERSON
Portland State University

As 2017 came to a close, the national retail landscape outlook was positive. The year had been filled with hundreds of stories predicting the end of retail in what is commonly known as the "retail apocalypse." A quick Google search for the term "retail apocalypse" brings up many stories over the past year from publishers like The Wall Street Journal, Forbes and the Business Insider. The premise of the "retail apocalypse" is that online sales led by Amazon will increase to a point that traditional "brick and mortar" shopping channels are forced to close due to their sales being captured by online retailers. While it is true that there have been some high profile closings in 2017 including Macy's, Sears, Kmart and Gymboree among others have closed thousands of stores combined, it does not highlight all the new concepts and stores filing that space. With the headlines claiming the end of retail and the high profile closings, it is easy to believe that the retail market and the real estate the retailers occupy is in serious trouble. But a closer look at the retail landscape nationally paints a different picture.



In the fourth quarter of 2017, net absorption was positive. A total of 34 million square feet was leased across the nation. This follows three straight quarters of positive absorption in 2017. So despite the large spaces going dark, leasing activity is strong and retailers continue to

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take down more space than they are giving back. With the strong net absorption, vacancy rates decreased and rental rates increased in the final quarter of the year. The vacancy rate ended at a healthy 4.5 percent and rental rates averaged $16.45 per square foot for an increase of 3.89 percent in rental rates year over year.

Nevertheless, sales activity did lag behind 2016 numbers. Through the first three quarters of the year, sales volume in 2017 was $4.8 billion dollars less than 2016. Despite the drop in total sales volume, some investors may have captured additional value during sales as cap rates compressed by an average of seven basis points (bps) in the last year to end at 7.04 percent.

Looking closer to home, the Portland market closely mirrored the national retail market. Net absorption for the quarter was positive, a total of 560,766 square feet was leased. These strong numbers are in spite of the large departures in the market including the Macy's in downtown. Additionally, Fred Meyer announced it would close its location at 82nd Avenue and Foster during the fourth quarter.

Vacancy rates have decreased in the year, ending at 3.8 percent. Rental rates trended upwards and ended the year at an average of $19.34 per square foot. As with the national market, the only thing down in the year is total sales volume. Cap rates have trended higher in the year but are still 26 bps lower than the national average, ending at 6.78 percent.

Heading into 2018, the market should remain healthy. Currently there are 958,376 square feet of retail under construction. Many of the large projects in the market are either build-to-suit or have significant pre leasing. Cedar Hills Crossing is expanding its footprint and Sunset Lanes will take 44,000 square feet of that project. Additionally, there are 38,000 square feet related to a 24-Hour Fitness project at Gladstone Crossing, which is set to deliver in early 2018. The lack of speculative retail space will keep inventory and vacancy rates low, which should put continued upward pressure on asking rates.

VACANCY

The fourth quarter brought the year-end vacancy rate in Portland down to 3.8 percent. This is a strong finish for the market. Over the summer, the market slowed down with a vacancy rate of 4.3 percent at the end of the third quarter.

Portland is not expected to get a large amount of new retail construction in 2018. There is a possibility of some big box retailers closing in the year but overall the vacancy rate should hold around its current level heading into the New Year.

VACANCY

Table 1: Portland Retail Vacancies by Submarket, Fourth Quarter 2017

Submarket	Q4 Vacancy Rate	Q3 Vacancy Rate	Change from Previous Quarter
CBD	9.3%	9.4%	(0.1%)
Clark County/ Vancouver	5.1%	6.3%	(0.8%)
I-5 Corridor	4.8%	6.0%	(1.2%)
Lloyd District	2.5%	7.6%	(5.1%)
Northeast	3.1%	4.7%	(1.6%)
Northwest	2.9%	3.1%	(0.2%)
Southeast	3.3%	3.8%	(0.5%)
Southwest	3.0%	3.7%	(0.7%)
Sunset Corridor	3.4%	3.1%	0.3%
Total	3.9%	4.3%	(0.4%)

Source: Kidder Mathews

Table 2: Portland Retail Vacancies by Product Type, Fourth Quarter 2017

Property Type	Q4 Vacancy Rate	Q3 Vacancy Rate	Change from Previous Quarter
Malls	1.9%	3.8%	(1.9%)
Power Centers	2.8%	4.0%	(1.2%)
Shopping Centers	6.6%	7.2%	(0.6%)
Specialty	0.0%	0.0%	0.0%
General Retail	2.6%	2.7%	(0.1%)

Source: Kidder Mathews

ABSORPTION AND LEASING

Absorption over the last year has been up and down. Heading into the fourth quarter, year-to-date absorption was negative 48,773 square feet. However, the fourth quarter experienced positive net absorption to end the year at 214,242 square feet.

Kidder Mathews reports that there were 160 leasing transactions in the quarter for a total of 455,517 square feet of retail space. They report that in the Hillsboro submarket, Marshalls and Sierra Trading Post opened locations for a total of 43,214 square feet. Additionally; H Mart opened their doors at the former Zupan's market on Southeast Belmont in Portland.

ABSORPTION AND LEASING

Table 3: Portland Retail Absorption, Fourth Quarter 2017 and YTD.

Submarket	Q4 2017 Net Absorption	YTD Net Absorption
CBD	11,805	(186,649)
Clark County/ Vancouver	137,808	(21,749)
I-5 Corridor	46,103	90,104
Lloyd District	75,363	(79,329)
Northeast	60,279	53,329
Northwest	(2,321)	(6,460)
Southeast	151,685	175,296
Southwest	39,096	57,095
Sunset Corridor	(33,771)	(27,814)
Total	486,047	214,242

Source: Kidder Mathews

RENTAL RATES

Once again, rents increased in the final quarter of the year to finish at an average of $19.43 per square foot, NNN. Kidder Mathews reports that this is a 6.3 percent increase year-over-year. This level of rent growth betrays the narrative that retail is in an "apocalypse.". Close-in retail is on average more expensive. The CBD has the highest average rate at $22.69 per square foot, NNN. The lowest reported submarket is Southeast with an average rent of $18.36.

With a relative lack of supply in the market, Landlord's will continue to have the upper hand. This has allowed a steady increase in rents quarter after quarter but it remains to be seen how long this steady rent growth can be sustained.

DELIVERIES AND CONSTRUCTION

A total of seven retail projects were delivered to the market this quarter which added 53,2287 square feet to the market—38,000 sq. ft. will be occupied by Restoration Hardware at their new concept store at NW 23rd and Glisan and 36,000 square feet will be occupied by 24 Hour Fitness at their new Gladstone Crossing location.

Kidder Mathews notes that there are 16 retail projects under construction with retail component of 10,000 square feet or larger.

Table 4: Notable Retail Developments, Fourth Quarter 2017

Building/Address	Market	SF	Delivery Year
Cedar Hills Crossing Community Center	North Beaverton	128,652	Q2 2018
Cedar Creek Plaza	I-5 Corridor Retail Market	70,000	Q3 2018
The Union at St. Johns	Rivergate	80,000	Q1 2018
The Waterfront Vancouver	Clark County	28,528	Q2 2018

Source: CoStar and Kidder Mathews

SALES TRANSACTIONS

If there was a week spot in the retail market in 2017 it was the overall number of sales transactions. The total sales volume for 2017 was less than in 2016. Through three quarters of 2017 there were a total of 40 sales transactions, which represented more than $40 million and an average price per square foot of $160.07. In contrast, during the same time frame of 2016 there were a total of 57 sales transactions, representing $598 million with an average price per square foot of $186.80. The decrease in price is reflected in an increase in cap rates year-over-year. Cap rates in 2017 ended at 6.78 percent which is 24 bps higher than 2016.

Despite the increase in cap rates, well-positioned properties with long-term national tenants are trading at rates below six percent. Kidder Mathews highlights two such properties including a 7-Eleven in Vancouver that sold at a 5.58 percent cap rate and a Walgreens on East Burnside in Portland that sold at a cap rate of 5.51 percent.

Over the course of the year there were a few large transactions but the bulk of sales were from smaller single tenant properties. The largest transaction of the year was by Kimco Realty Corporation. They purchased the 732,542 square feet Jantzen Beach Center for $131.8 million. Additionally Division Center at 11908 SE Division sold for $33 million or $270.49 per sq. ft. and Martinazzi Square in Tualatin sold in early 2017 for $16 million or $319.31 per sq. ft.