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CENTER FOR REAL ESTATE

Quarterly Report

Volume 6, Number 2

Spring 2012

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SHIFTING DEMOGRAPHICS: REAL ESTATE INVESTMENT IMPLICATIONS

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Heitman LLC

This article is based on a presentation at the Portland State University Center for Real Estate's 7th Annual Real Estate Conference, Portland, Oregon, May 30, 2012

My topic is really the future. Since the future is a long time, I decided to do two things to corral it. First, I'm looking into the middle distance—20 years out. And second, I've focused around demographics.

That's because there is much about the demographic future that is already in place. Let's be clear. People who are 20 today will be 40 in 2030. Ten year olds, like my daughter, will be 30!

I've taken some of the known information and tried to extrapolate from it to identify factors relevant to commercial real estate. For one, demographics have economic implications—for instance, population growth or decline can shape the economic prospects of a metropolitan area or a country. For another, there are spatial

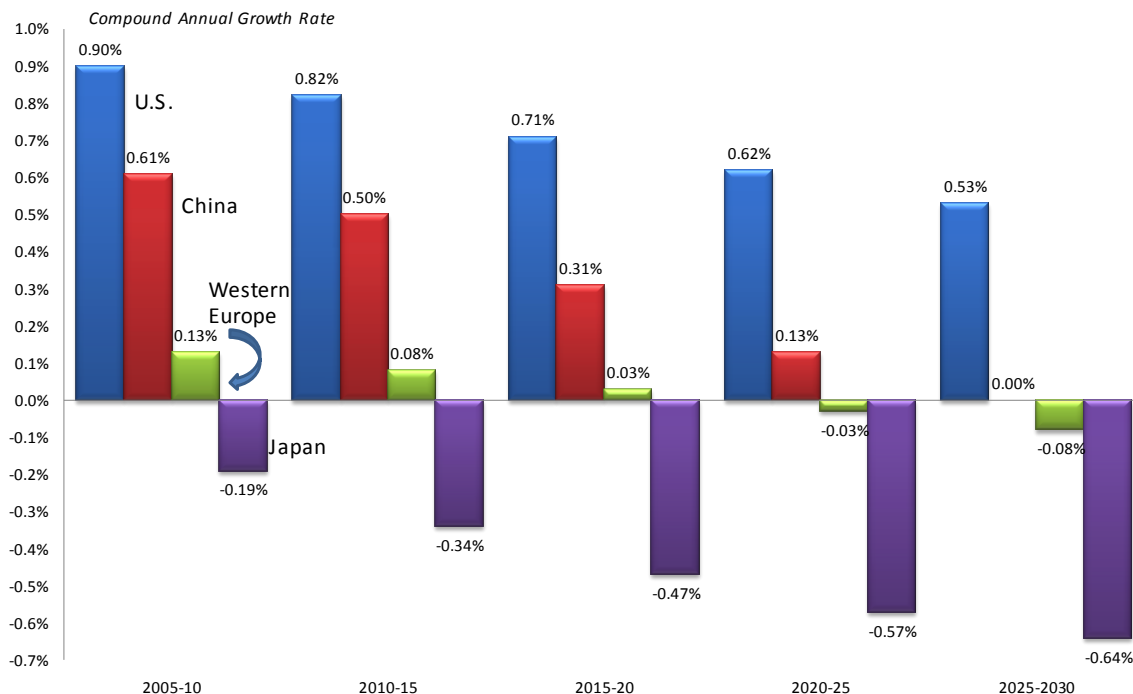
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implications of demographic trends. A key one that will affect real estate space demand relates to the spatial preferences of members of the echo boom, Generation Y, or the so-called “baby boomlet.” Let me begin with some context.

U.S. POPULATION: A GLOBAL AND HISTORICAL CONTEXT

The U.S. is a bastion of population stability, especially relative to China, where China’s economic potential is being undermined by social issues related to population structure. In particular, China is ageing at a rapid pace. The conventional wisdom is that China can fix its ageing problem by abolishing or relaxing the one-child policy. However, this is an erroneous conclusion. Whatever impact the imposition of the one-child policy might have had in 1979-80 when it was implemented, it no longer has any effect. Chinese birth rates are low and will remain low because of socioeconomic and related factors such as improved standard of living, urbanization, changes in educational attainment of women, and alterations in the social mosaic, such as changes in marriage and divorce patterns. Fewer Chinese are marrying and more are divorcing. The important investment conclusion is that China will continue to focus on exports to further increase their foreign exchange holdings. In that sense, think of China as a country saving for retirement.

Population Growth 2005-2030



Source: United Nations; Heitman Research

Across the world, fertility rates vary by age structure, cultural factors, government policies, and cost of living. In these areas, the United States holds a unique advantage globally among developed countries in terms of its high replacement level birth rate. Put simply, it is much less expensive to have children in the U.S. than in much of the developed world. This places the U.S. head and shoulders above the rest of the developed world and many countries in the developing world in terms of population growth. Unlike the 46 percent of the world's population that currently lives in countries with a below replacement birth rate, America is powerfully unique in having a replacement level birth rate of 2.1 children per woman, which is the number needed for a stable population. Immigration is the icing on the cake and further bolsters America's strong profile. And it is not just their numbers that are positive but also the fact that many of them are pursuing the American dream, a feature unique to the United States. In the 1980s, Japan was presumed to bury America. Now it is China, yet China faces a population time bomb that rivals Japan. Thus, it seems that the next century will again be the American Century. Let's now consider the population distribution of the United States.

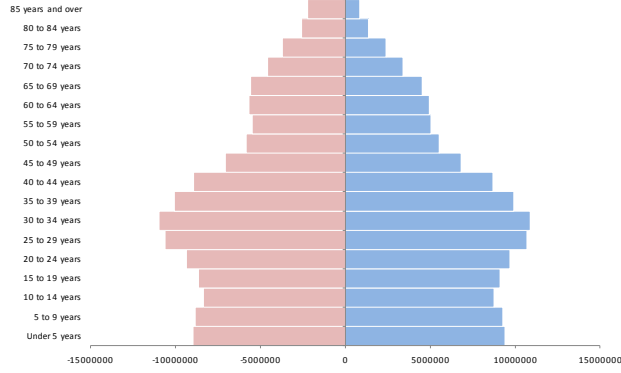
POPULATION DISTRIBUTION

You probably remember seeing a population pyramid. It's the distribution of the population by gender and age. From the 1950s through the 1960s, the U.S. population distribution looked much like a pyramid. Then, it shifted with the advent of the baby bust. In many ways, the shift reflected the impact of the birth control pill, which came on the market in 1960. The pill gave women and couples control over fertility that no prior generation had experienced, so it's no coincidence that the birth rate dropped by 1964, bringing the Baby Boom to a close.

Now, the age and gender distribution today is hard to describe as a shape. The change reflects longer life span. For example, today there are more than 500,000 women aged 85 or older versus half that number 20 years before. The population distribution diagram also shows the evening out that immigration has brought. While fertility dropped, immigration swelled.

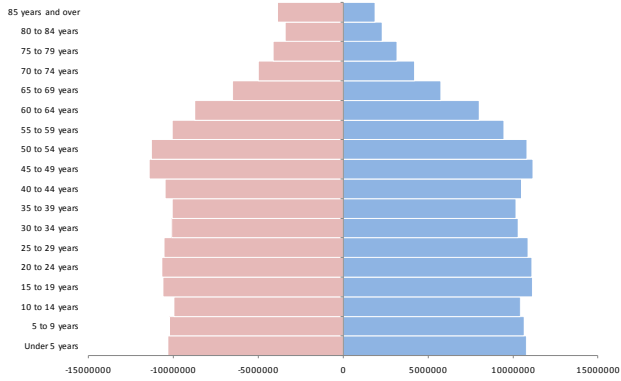
Ask a well-informed person to draw the population pyramid they would expect in 2030 and they're likely to make it look V-shaped, narrow at bottom and wide at top, or the inverse of the 1950s' pyramid. While we will still have many younger people, we are also filling up the older age groups.

Population by Age and Gender
U.S. 1990



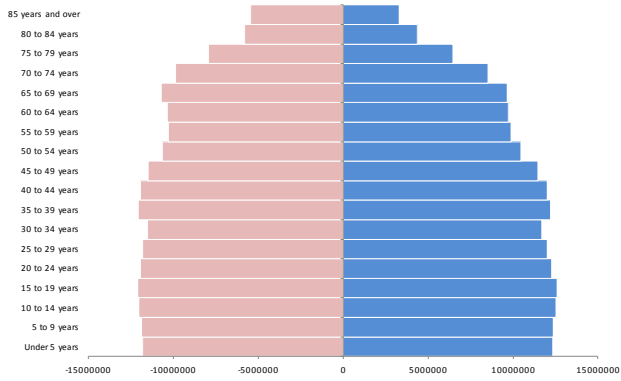
Source: U.S. Bureau of the Census; Heitman Research

Population By Age and Gender
U.S. 2010



Source: U.S. Bureau of the Census; Heitman Research

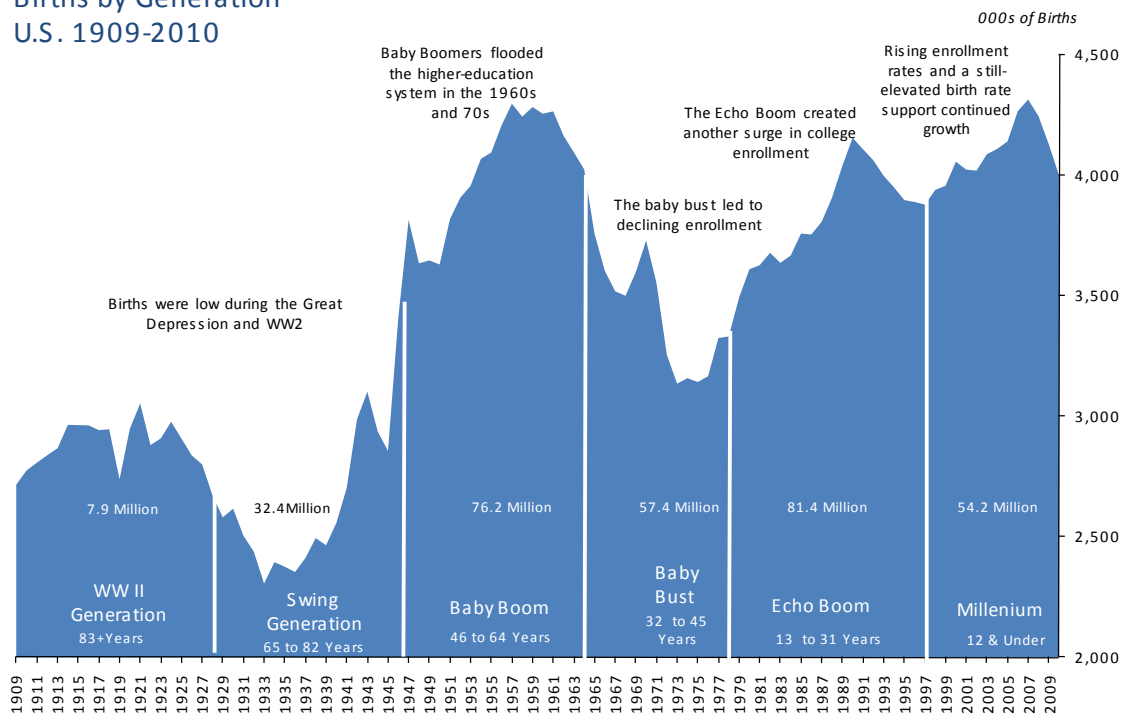
Population by Age and Gender
U.S. 2030



Source: U.S. Bureau of the Census; Heitman Research

Finally, it’s hard to speak of demographics without mentioning generations. This chart below shows the dates of birth and the number of births per year. Members of the World War II Generation—born between 1909 and 1926—are now more than 80 years old and are the parents of many Baby Boomers. The swing generation—born between 1927 and 1945 are made up of many who lived through the Great Depression and had their lives shaped by World War II and the boom that followed. The Baby Boom is made up of 76 million born people born between 1946 and 1964. These Boomers are now between 46 and 64 years old. Many are facing retirement and the youngest are entering middle age. Generation X, also known as the Baby Bust, is a much smaller group of 46 million people born 1965 to 1976. They are now 34 to 45 years old and were the first Internet generation. Generation X was followed by the Echo Boom, also known as the baby boomlet or Generation Y. People in this group—born between 1977 and 1998—represent a boom that is even bigger than the Baby Boom. Children born after 1998 are what are known as Millennials. Children born after 1998 are what are known as Millennials.

Births by Generation
U.S. 1909-2010



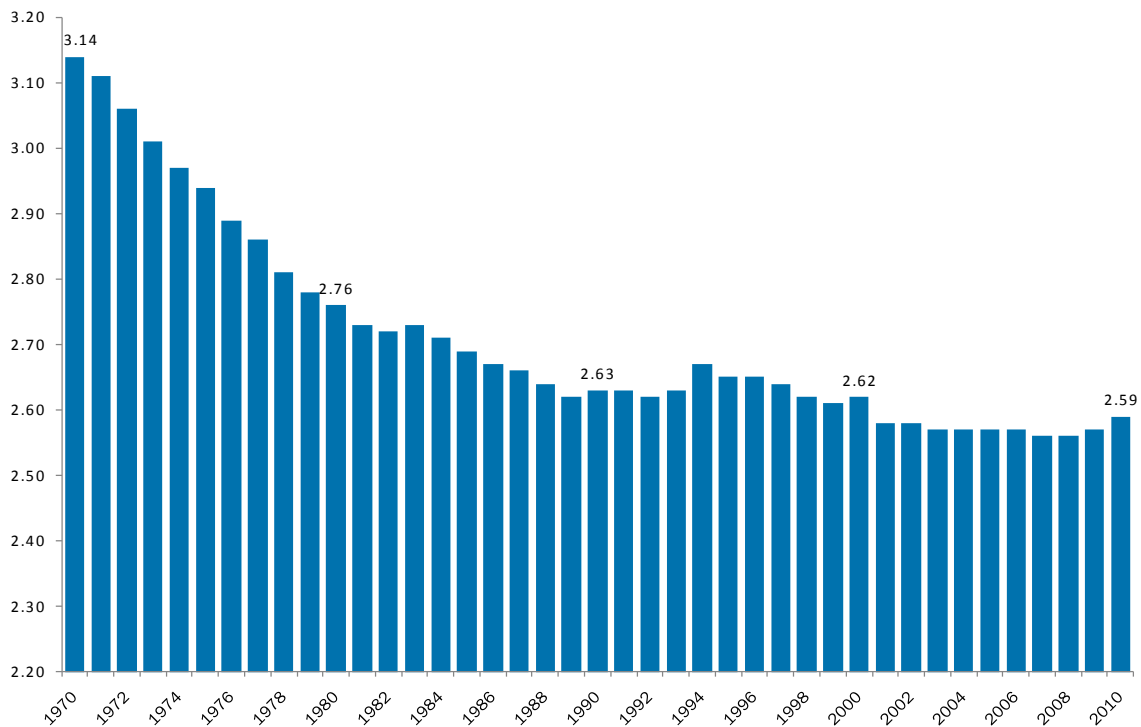
Source: National Center for Health Statistics, US Census Bureau; Heitman Research

Notice the boom/bust nature of the number of births. That pattern has shaped our lives. However, the pattern shouldn’t be extrapolated into the future. Indeed, there is no reason to predict a dramatic uptick or decline in births. With fertility expanded by science, women in Generation X women and Echo Boom women are

having children. In fact, there were more births last year to women over 35 than to teenagers.

While U.S. population is growing, household size has been shrinking over the past 40 years, as shown in the chart below. At the same time, the number of single person households has risen steadily to more than 30 million households. All this means that the number of households has been increasing and is likely to increase.

Persons Per Household
U.S. 1970-2010



Source: US Census Bureau; Heitman Research

INVESTMENT STRATEGIES

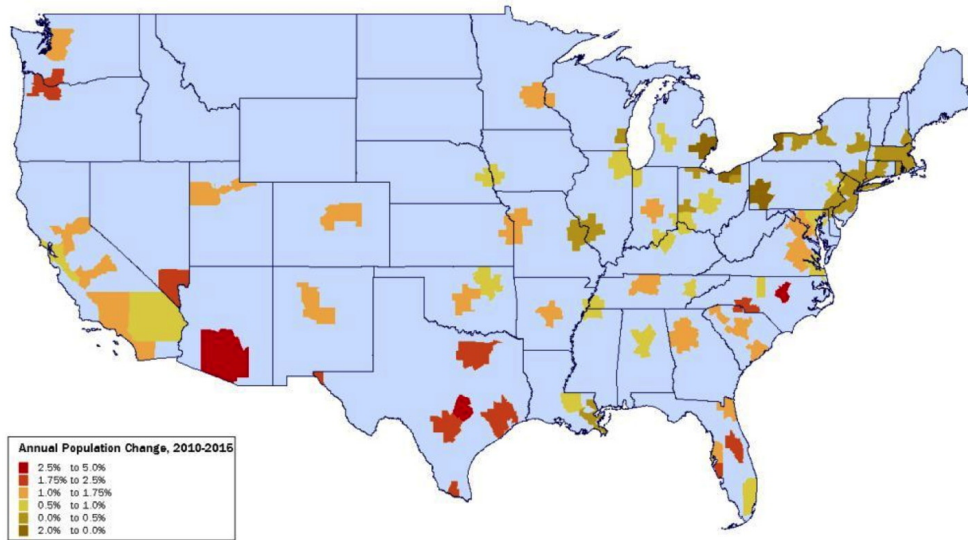
Now that we've review the major trends in the US and global demographic patterns, let's now think about real estate investment strategies that would fit those patterns.

Build a strategy around demographic best bets

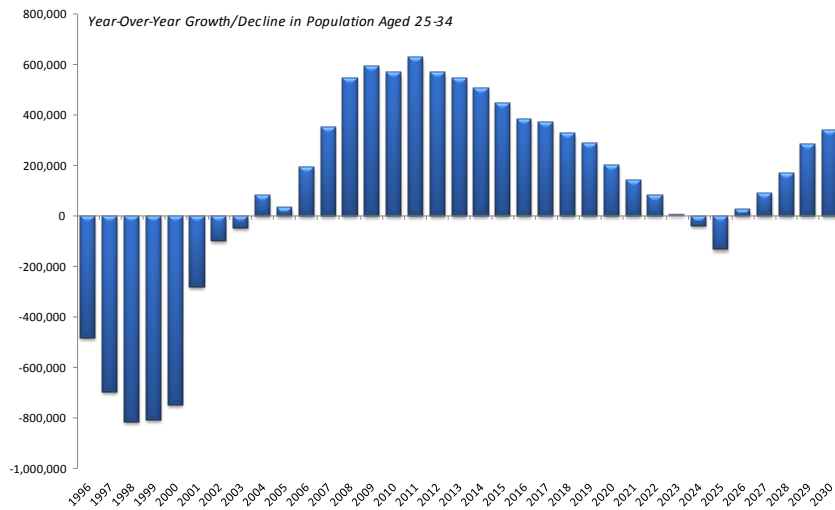
First, one would want to focus on faster growing metropolitan areas in states like Texas, Florida, Georgia, and smaller states in the Mountain West and Southeast. The Sunbelt continues to be the fastest growing region of the country, but the

Southeast is growing faster now than the Pacific Coast. Second, metropolitan areas with highly educated populations will continue to be attractive places to invest. This includes university cities like Austin, Texas, but also places like Portland, Oregon. Your state continues to grow faster than the United States as a whole and seems to attract highly educated young people.

Population Growth
U.S. Top 50 Metropolitan Areas 200-2015



Annual Change in the Age Group Most Likely to Rent Apartments
1995-2030



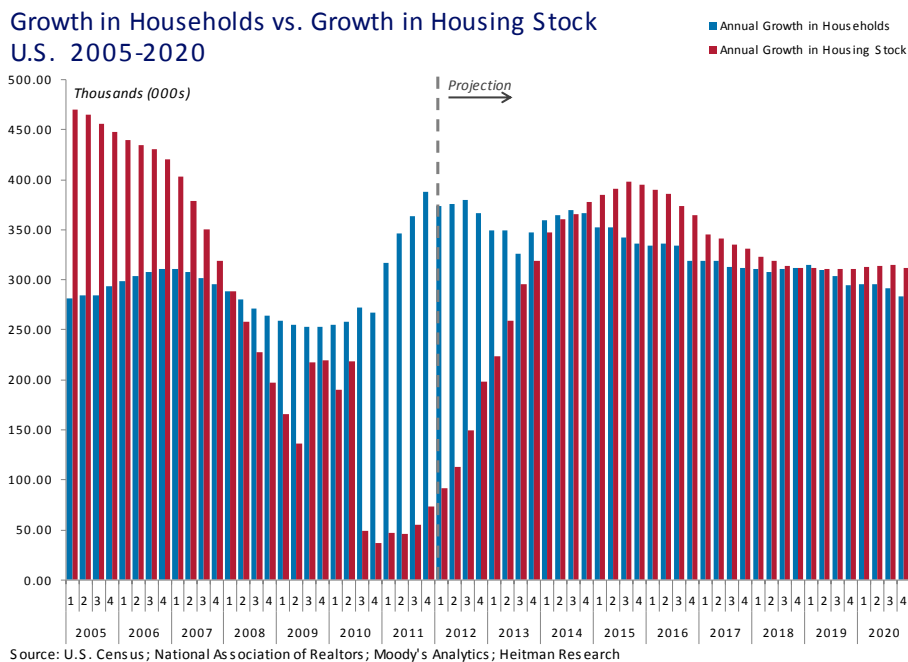
Source: U.S. Bureau of the Census; Heitman Research

Demographic trends toward smaller households and the migration of young people favors the development of apartments and student housing. Portland and Seattle are key target markets in the United States for apartment growth.

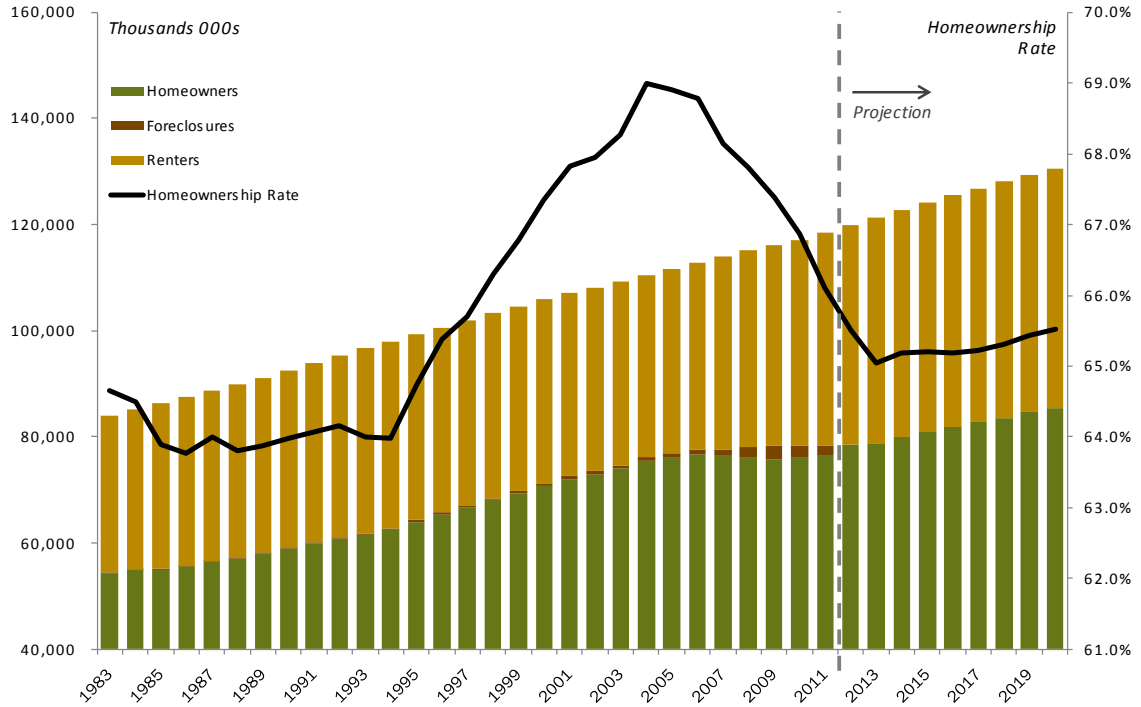
Beyond demographics: Apartment supply has not kept up with demand

At the same time that we are seeing rising demand for apartments, the demand for apartments hasn't kept pace with that anticipated demand. The credit crisis in 2007 and 2008 made it very difficult for apartment developers to get their projects financed and out of the ground. As a result, we are seeing some rapid increases in rents that will make apartment development attractive for several years to come.

This pattern of rising apartment demand has been aided by the fall in home prices and decline in homeownership. Young potential home buyers have been put off by the decline in home prices that they see their older peers experience. They see themselves as being in a more safe position as renters. And for those households who owned homes with high loan-to-value mortgages, they see themselves underwater and questioning why they should continue to make mortgage payments. And as the recession has led to unemployment and mortgage defaults, many households find themselves with damaged credit and unable to buy homes in the near future. As a result, even though home prices have probably bottomed out, the U.S. housing crisis is not over and the demand for apartment living will probably remain high for several years.



Renter-Occupied vs. Owner-Occupied Households U.S. 1983-2020

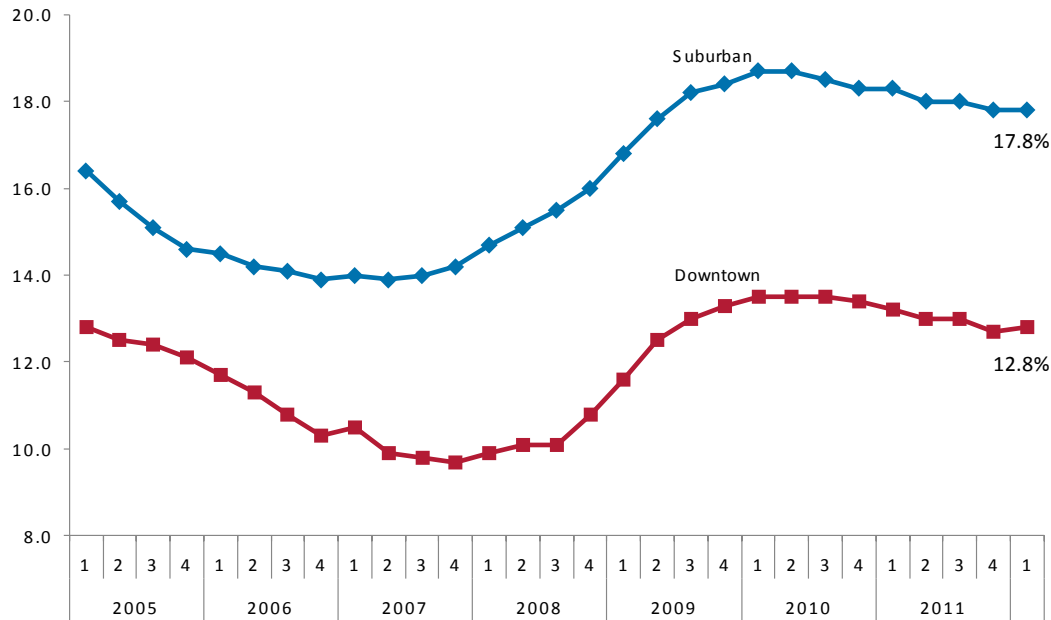


Source: U.S. Census; Mortgage Bankers Association; Moody's Analytics; Heitman Research

Office markets: Downtowns doing better than suburbs

Turning now to the office market, we are seeing improving conditions in the last two years, as the economy shifts from recession to recovery. Office markets look considerably stronger in downtown office markets, reflecting the absence of empty speculative office buildings and the preference by talented employees for Central Business District locations.

Office Vacancy: Downtown vs. Suburbs
U.S. 2005-2012



Source: CBRE Econometric Advisors; Heitman Research

Retail markets

Retail markets are affected by both demographic trends and technology trends. Retailers will want to locate where people live and newer, higher quality retail will outperform older retail outlets. However, the performance of traditional retail is being overshadowed by electronic commerce.

The market share for E-commerce is growing by 30 basis points year-over-year and this trend is continuing. The retail bookstore, Borders, closed its stores in 2011, as did the video retailer, Blockbuster. That was expected. What wasn't expected was how well in-store retailers would respond online. The shake out helped retailers step up their game and realize the complementary nature of online and in-store.

There seems to be a weird focus on grocery anchored centers as a safety zone that is free from much online competition. This assumption does not make sense to us given frailty of the income stream in grocery anchored centers. Grocery store anchors tend to be beat up by competition and their small shops are closing when leases are up without much in the way of replacements. As a result, investors need to be cautious and look for newer and higher quality assets when investing in grocery anchored centers.

THEMES FOR THE NEXT 20 YEARS

What conclusion should we draw from this demographic picture of the world?

First, we believe that the U.S. population show grow in a steadier pattern than we have experienced in our post-war history. We expect the U.S. to break out of its boom and bust pattern as fertility remains at replacement levels, immigration adds to our overall population, and our population distribution won't be much affected by past baby booms.

Second, ageing of the population is a global issue, but one that is more critical for Europe, Russia, China, and Japan. Certainly, the U.S. population will continue to age, but we also see a rise in younger population groups resulting from immigration and fertility. This leads to our conclusion that other major economic powers will decline, while the U.S. will continue to grow.

Third, the continued importance of immigration and the higher fertility rates for immigrants in the U.S. population means that the US population will become more diverse. We are already seeing that in the increasing diversity in California and Texas, as well as the higher levels of African-American, Hispanic, and Asian-American ethnicity in younger population cohorts, compared to older Americans.

Real estate investors need to pay attention to these demographic trends. Among the product types, we see increasing demand for apartments and offices in downtown markets, but less so for retail outlets. Among metropolitan areas, we see continued population growth in the Mountain West, Southwest, and Southeast, particularly in university towns and cities. High amenity cities, such as Portland, appear attractive to highly educated adults and that should give confidence to investors in those communities. ■

HOUSING MARKET ANALYSIS

EVAN ABRAMOWITZ

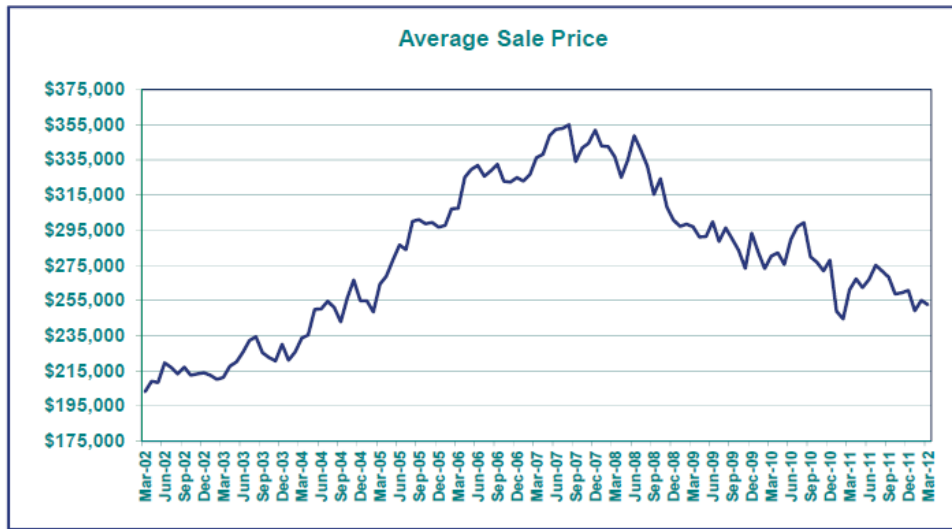
Joseph Bernard Investment Real Estate
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National housing market statistics reflect slightly increasing median-existing home prices for all housing types over the past year. The median price was \$156,600 in February, up 0.3 percent annually from February 2011. Median prices in the western United States increased by 3.1 percent to \$195,300. Over the same period, the Portland metropolitan area experienced a decrease in median sales prices, but double-digit increase in sales volume. The median sales price in December 2011 was \$216,600, which has decreased 6.2 percent since December 2010 and the number of transactions in the metropolitan area increased by 10.3 percent year over year.

The chart below illustrates the average sales price for homes in Portland over the past ten years. The current average sold price is approximately \$255,000, which is similar to 2004 levels.

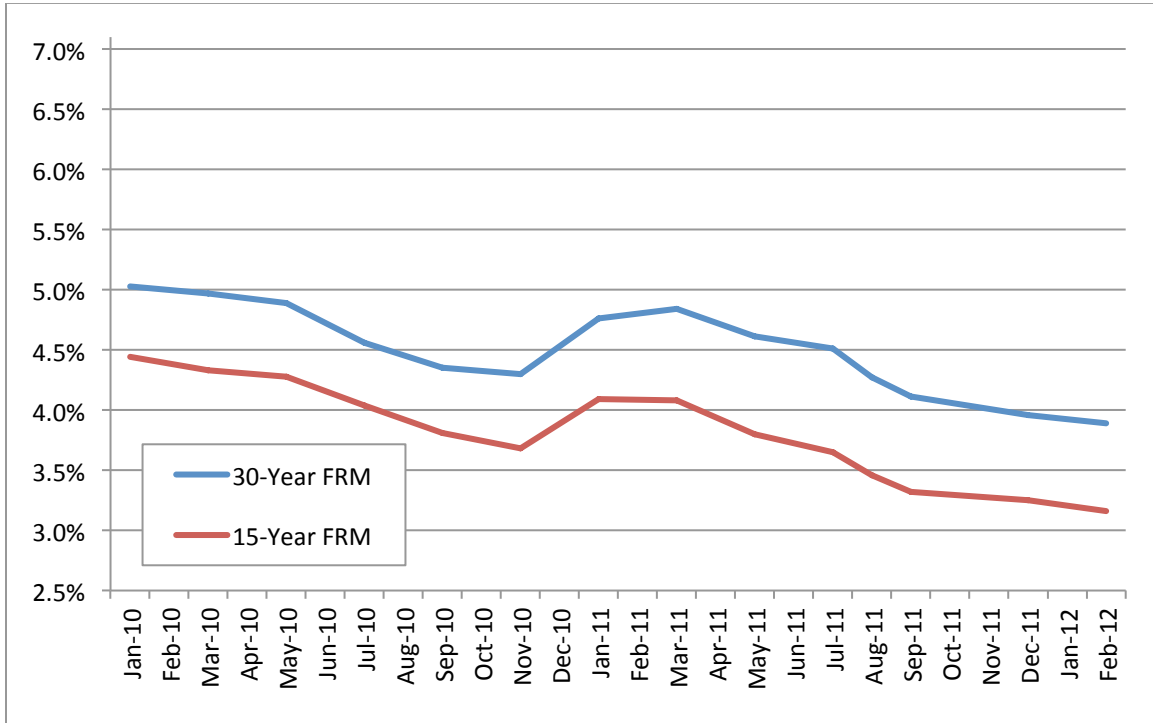
■ Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

Figure 1: Average Sales Price in Portland, 2002-2012



The National Association of Realtors reports the number of existing home sales in February 2012 was a seasonally adjusted rate of 4.59 million homes sold nationally. This was a 0.9 percent decrease from January, which was seasonally adjusted to 4.62 million.

Figure 2: Single Family Mortgage Interest Rate



Source: Freddie Mac

Mortgage interest rates had been steadily decreasing since the first quarter of 2011 and are now at nearly 60-year lows. The national average commitment rate for a 30-year conventional, fixed-rate mortgage was 3.89 in February, down from 3.92 percent in January; the rate was 4.95 percent in December 2011.

First time home buyers constituted 32 percent of homes in February, down from 33 percent in January. They have decreased from 34 percent in February 2011. Investors purchased 23 percent of homes in February, unchanged from January.

Table 1: Median Home Values of Existing Detached Homes

| | U.S. | West | Portland Metro Area |
|------------------------------------------------|-----------|-----------|---------------------|
| February 2011 Median Sales Price | \$158,700 | \$201,350 | \$208,250 |
| February 2012 Median Sales Price | \$157,100 | \$195,300 | \$211,000 |
| % Change in Median Sales Price | 0.1% | 3.1% | -1.3% |
| % Change in Number of Sales Feb 2011- Feb 2012 | 9.4% | 6.1% | 17.5% |

Source: National Association of Realtors

Standard & Poor's Case-Shiller Index for Portland was 129.96 through January 2012. The represents a decrease of 2.1 percent from December 2011, and a year-over-year decrease of 4.3 percent. Portland is now close to July 2004 levels and a new low since the peak in July 2007. Case-Shiller's 20 city composite index is down 3.8 percent compared to the same time last year. The index data shows that in 17 of the 20 major U.S. metropolitan cities, home prices decreased from the previous month.

Of the 20 cities tracked, Denver, Detroit, and Phoenix were the only markets to post a year over year gain at growth rate of 0.2, 1.7 percent and 1.3 percent respectively.

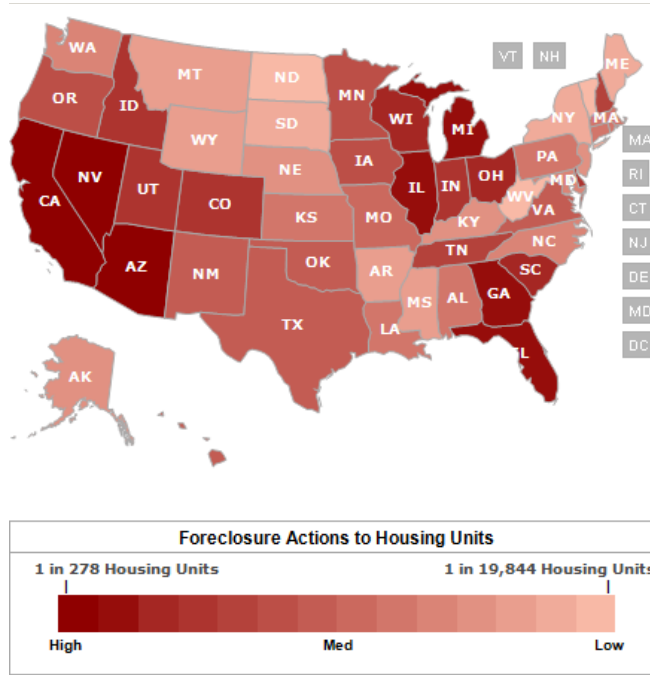
Foreclosure filings were reported on 206,900 U.S. properties in February, a 2 percent decrease from November and a 9 percent decrease from February 2011, the lowest annual decrease since October 2010. The filing figures include default notices, schedule auctions and bank repossessions.

"February's numbers point to a gradually rising foreclosure tide as some of the barriers that have been holding back foreclosures are removed," said Brandon Moore, CEO of RealtyTrac. "Although national foreclosure activity was pushed lower by decreases in a handful of larger states, 21 states posted annual increases in foreclosure activity, the most states with annual increases since November 2010.

"The foreclosure and mortgage settlement filed in court earlier this week will help pave the way to a properly functioning foreclosure process by providing a clear roadmap for necessary foreclosures," Moore continued. "That should result in more states posting annual increases in the coming months. Not surprisingly, many of the biggest annual increases in February were in states with the more bureaucratic judicial foreclosure process, which resulted in a larger backlog of foreclosures built up over the last 18 months in those states."

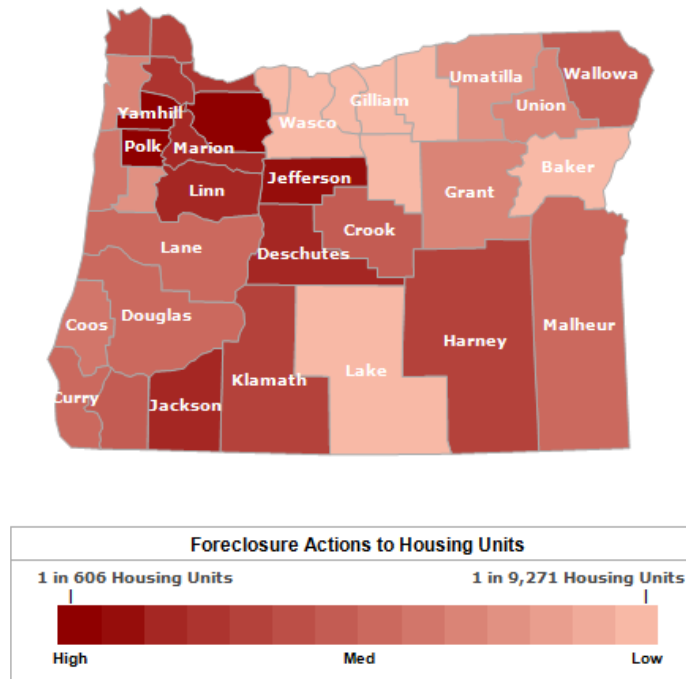
During February 2012 Oregon reported 1,752 foreclosure fillings, which is a 27.8 percent decrease from the previous year. Multnomah County had the state's highest level of activity in February 2012 with 383 homes, and a 21.6 percent increase from January. In the U.S., one in every 637 homes received a foreclosure filling while one in every 956 homes in Oregon received a foreclosure filling during February 2012.

Figure 3: Foreclosure Rate Heat Map, February 2012



Source: RealtyTrac

Figure 4: Foreclosure Rate Heat Map-Oregon, February 2012



Source: RealtyTrac

According to RealtyTrac, the ten states that ranked the highest in foreclosure rates in February 2012 were Nevada, Arizona, California, Ohio, Georgia, Michigan, Florida, South Carolina, Wisconsin and Illinois. Of these states, Nevada posted the nation's highest state foreclosure rate, with one in every 278 housing units receiving a foreclosure filing in February 2012. In California one in every 283 housing units and in Arizona one in every 312 housing units filed for foreclosure during February 2012.

Table 2: Building Permits Issued, Year to Date, in thousands

| | Single Family | | | Multi Family | | |
|------------------------------------|---------------|--------|----------|--------------|--------|----------|
| | Feb-12 | Feb-11 | % Change | Feb-12 | Feb-11 | % Change |
| United States | 64.6 | 53.0 | 22% | 34.3 | 20.4 | 69% |
| Oregon | 0.85 | 0.77 | 10% | 0.41 | 0.18 | 131% |
| Portland-Vancouver-Beaverton OR-WA | 0.63 | 0.47 | 35% | 0.33 | 0.14 | 140% |
| Salem OR | 0.04 | 0.04 | -12% | 0.00 | 0.06 | -97% |
| Eugene-Springfield OR | 0.04 | 0.05 | -7% | 0.03 | 0.02 | 127% |
| Bend OR | 0.07 | 0.07 | 9% | 0.00 | 0.00 | 0% |
| Corvallis OR | 0.02 | 0.01 | 114% | 0.04 | 0.03 | 33% |
| Medford OR | 0.04 | 0.03 | 26% | 0.00 | 0.01 | -83% |

Source: National Association of Home Builders

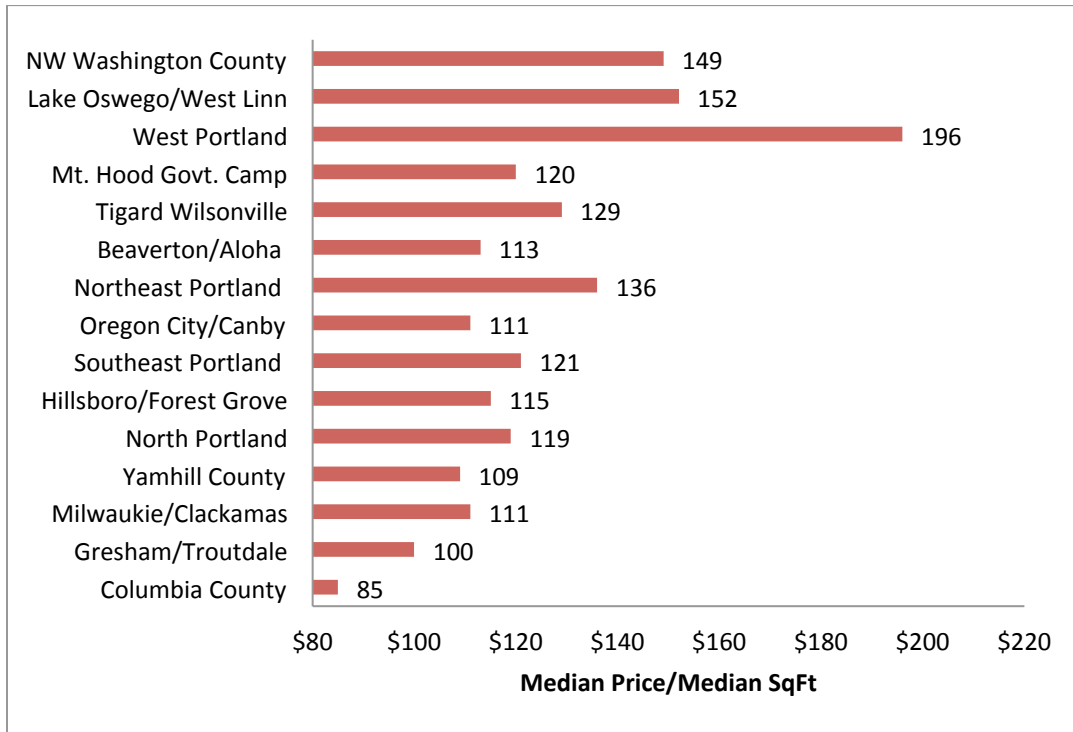
Single family building permits have increased sharply thus far in 2012 in the US and Oregon. The Portland, Corvallis, and Medford markets increased more than the US average for single-family with Corvallis increasing 114% over this time last year. Multifamily new construction has increased sharply in the US and even more in Oregon. Portland and Eugene increased at 127% and 140% over the previous year which significantly outpacing the nation at 69%.

PORTLAND

The number of Portland metropolitan area home sales increased significantly, 68.5 percent year over year and 70.8 percent since the previous quarter. Buyers closed on purchases of 4,908 homes, a sharp increase from previous first quarter data. There were 391 new properties sold, the most in a first quarter since 2008. First quarter 2012 increased 87.98 percent from last quarter and 62.9 percent year over year.

Median prices for the first quarter were at \$231,270, which represents an 11.44 percent decrease over the previous quarter and a 3.71 percent increase annually. Sales price to original list price continue to come closer together, with average sales taking place at 98.04 percent of the original list price. This is a 1.96 percent increase annually from 96.08 percent. Sellers in the Portland area have had their homes on the market for an average of 58 days before closing, reflecting a 35 day decrease from first quarter 2011 and a 3 day increase from the previous quarter.

Figure 5: Single Family Price per Square Foot, New and Existing Detached Homes, Portland Sub Markets



Source: RMLS

Figure 6: Median Sales Price & Number of Transactions, Existing Detached Homes, Portland Metro (excluding Clark County, WA)

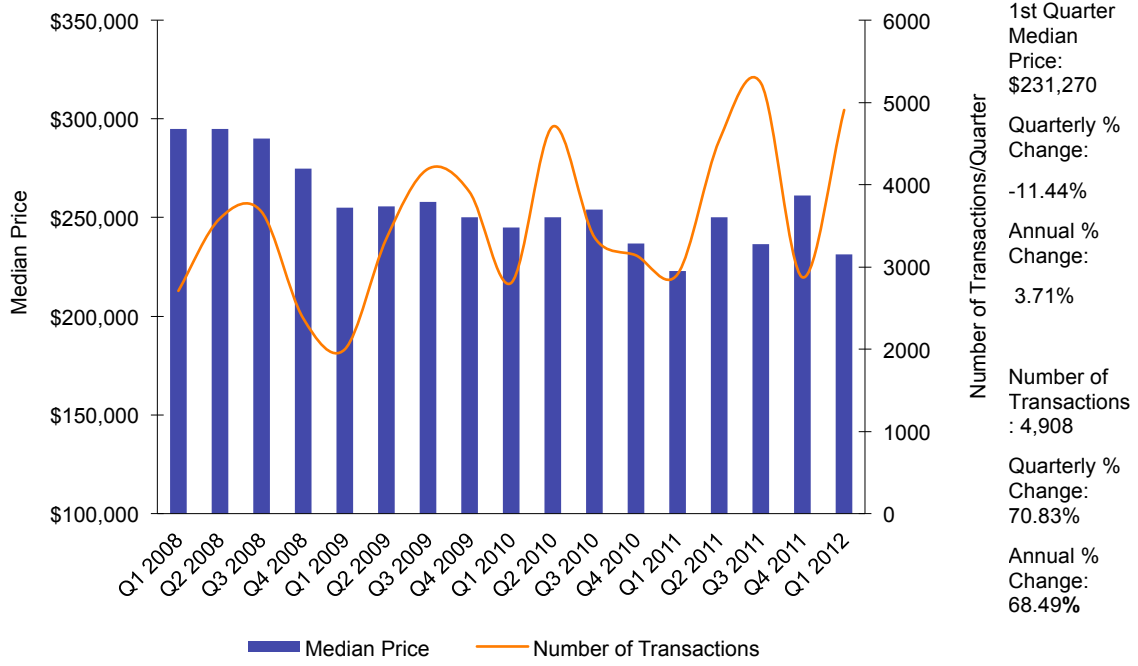


Figure 7: Sale Price/Original List Price & Average Days on Market, Existing Detached Homes, Portland Metro (excluding Clark County, WA)

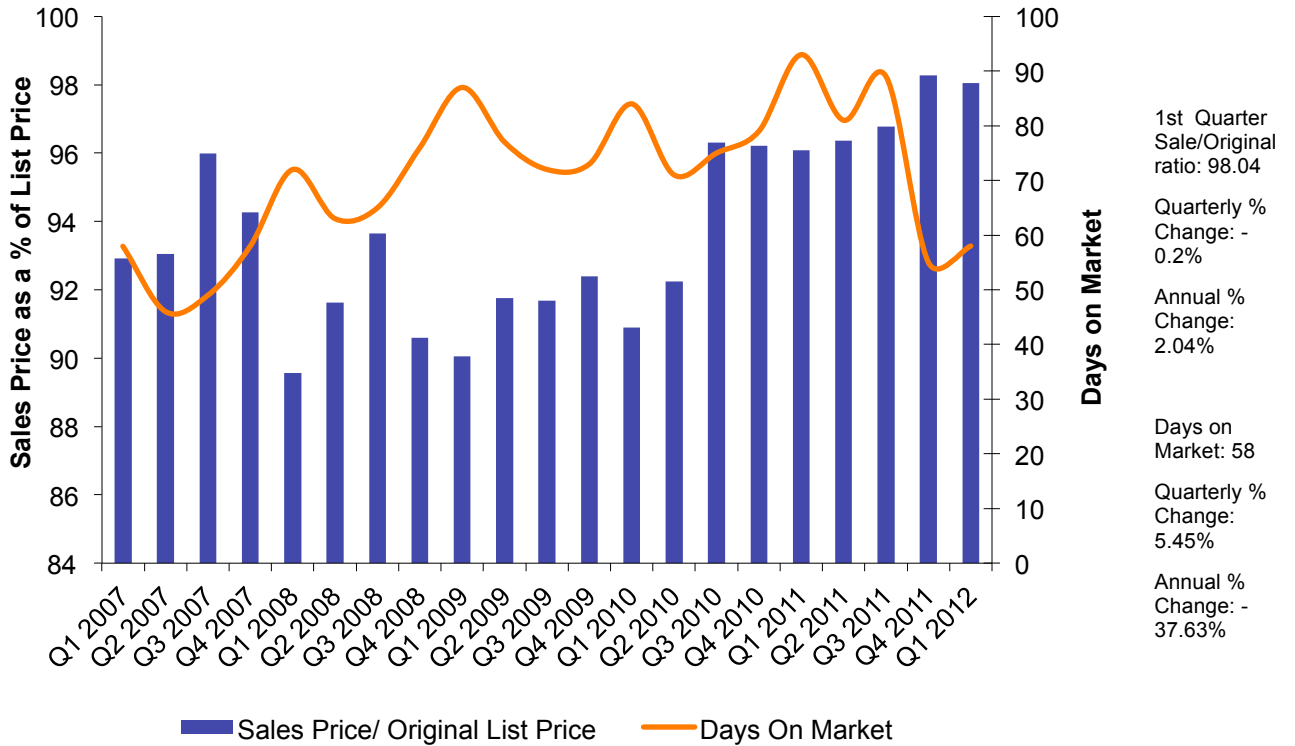
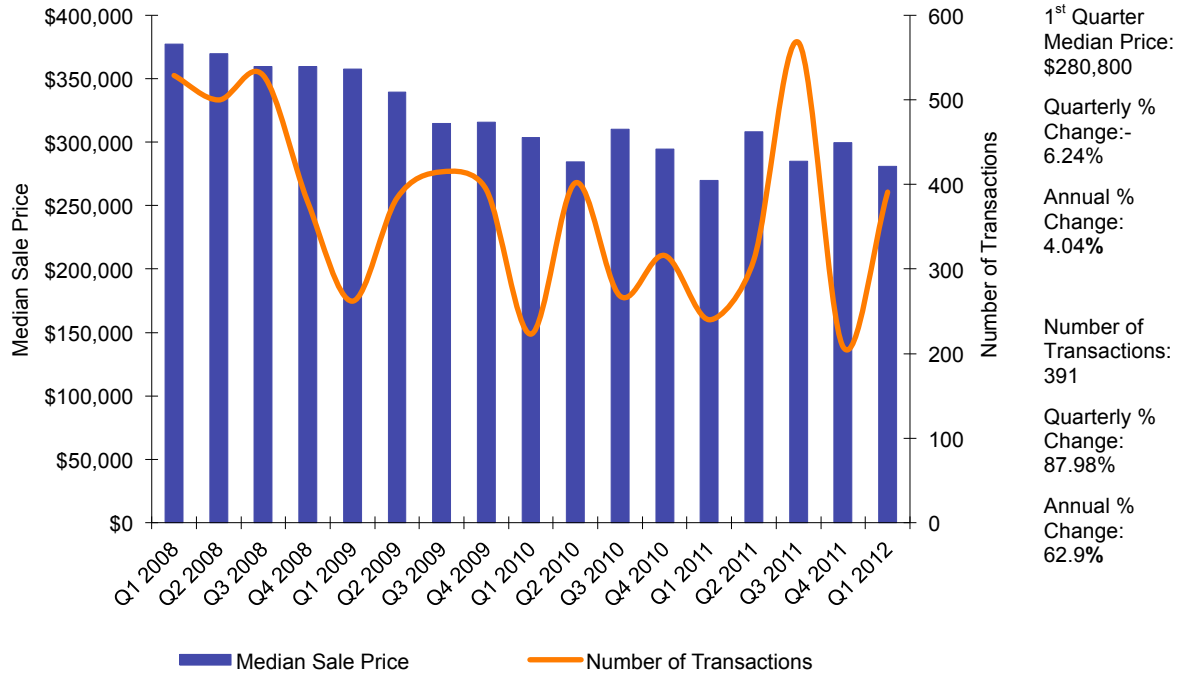


Figure 8: Median Sales Price & Number of Transactions, New Detached Homes, Portland Metro (excluding Clark County, WA)



VANCOUVER

Vancouver’s median home price was \$162,900 resulting, very similar to the \$162,600 reported in the last quarter. The median price decreased 9 percent over an annual basis. The number of homes sold in first quarter increased by over 9 percent to 733 from the fourth quarter of 2011, and a large increase of 44.5 percent year over year. In addition, the number of days on the market decreased to 58 from 63 in the previous quarter and 102 in first quarter 2011.

Figure 10: Median Price and Annual Appreciation Existing Detached Homes, Vancouver

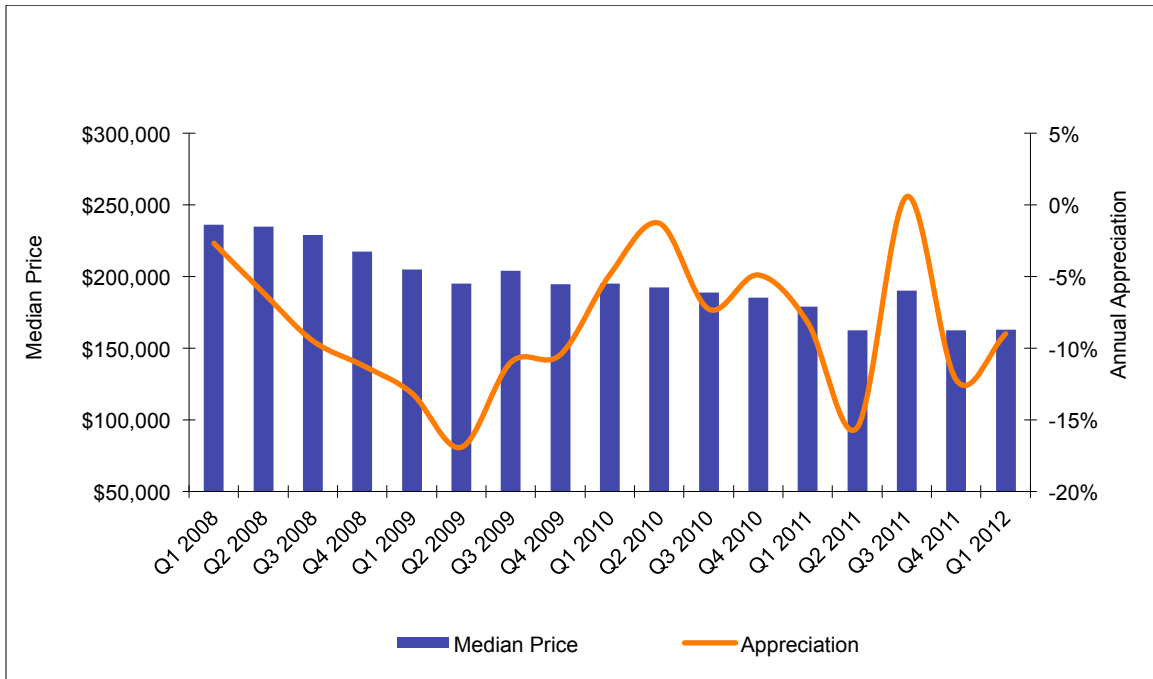
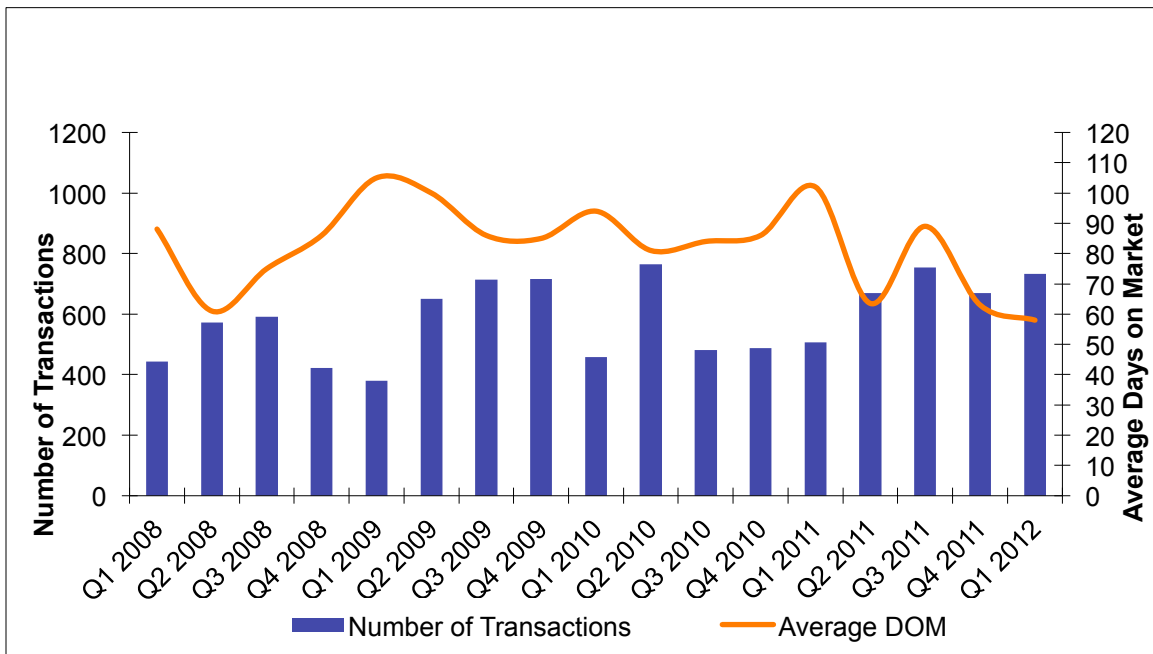


Figure 1: Average Days on Market and Number of Transactions Existing Detached Homes, Vancouver



In the Vancouver suburbs, the median home price was \$200,492, which was an 11 percent decrease from the first quarter of 2011, and a 3.8 percent decrease from the previous quarter. Similarly to the Vancouver city data, there was increase in the number of transactions and decrease in days on market in first quarter 2012. The number of transactions increased 21 percent from last quarter to 544 and increased 49 percent year over year. Properties were on the market an average of 73 days which was up slightly from last quarter when it was 67, but a sharp decrease from 120 in first quarter 2012.

Figure 12: Median Price and Annual Appreciation Existing Detached Homes, Clark County (excluding Vancouver)

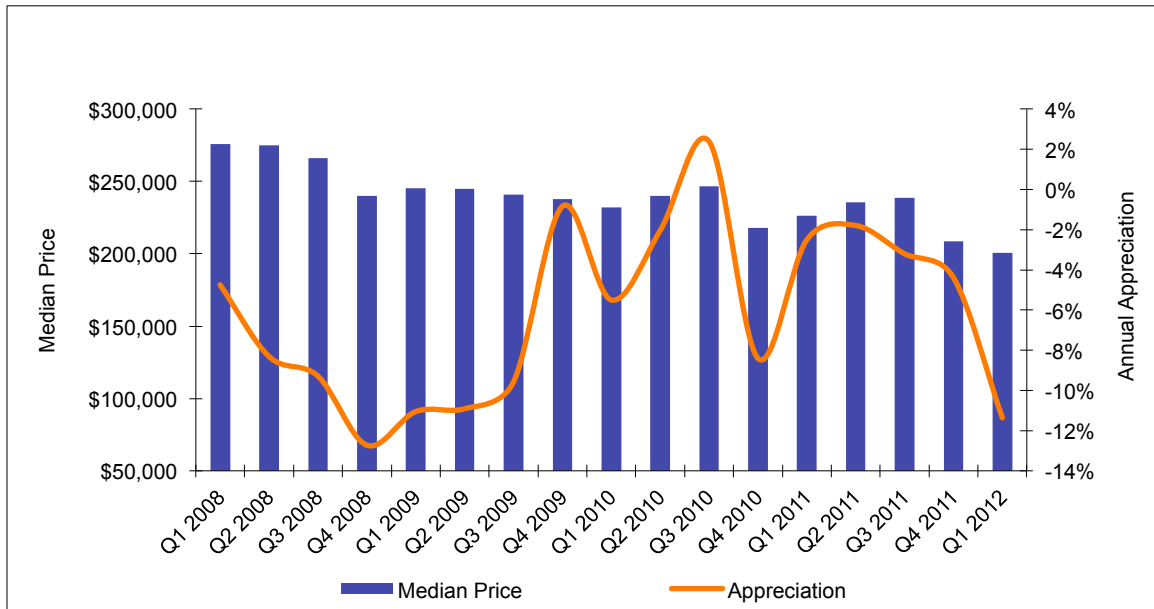
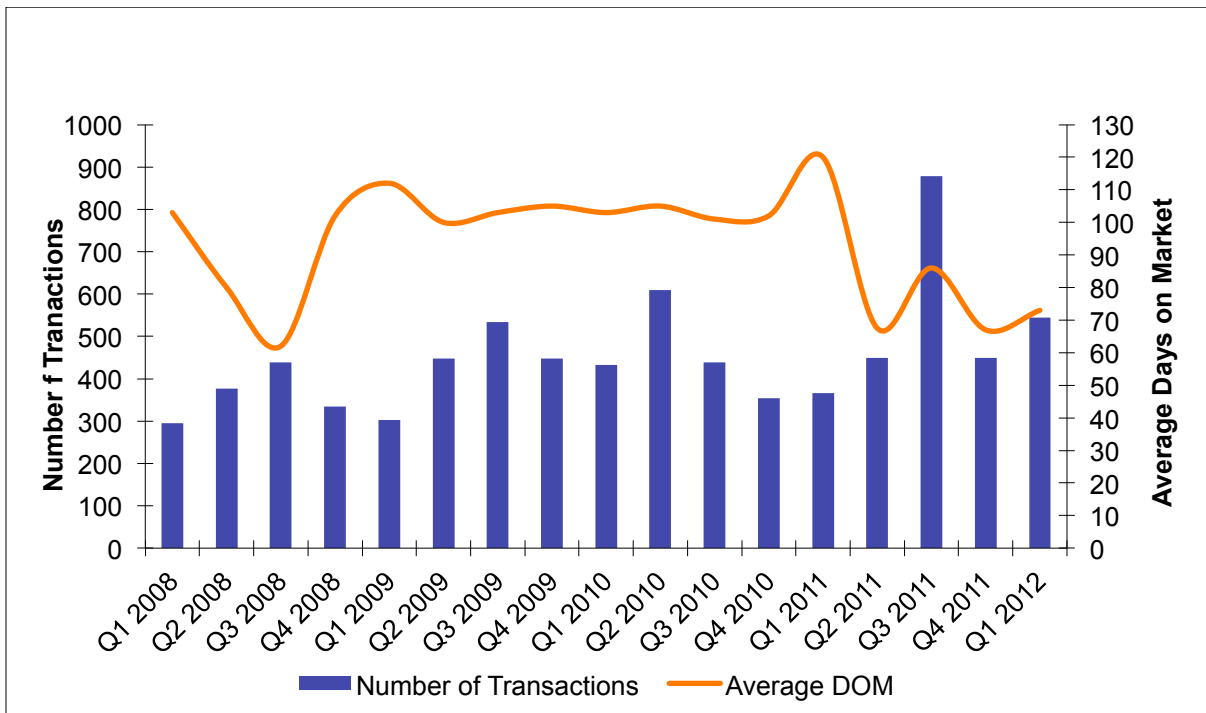


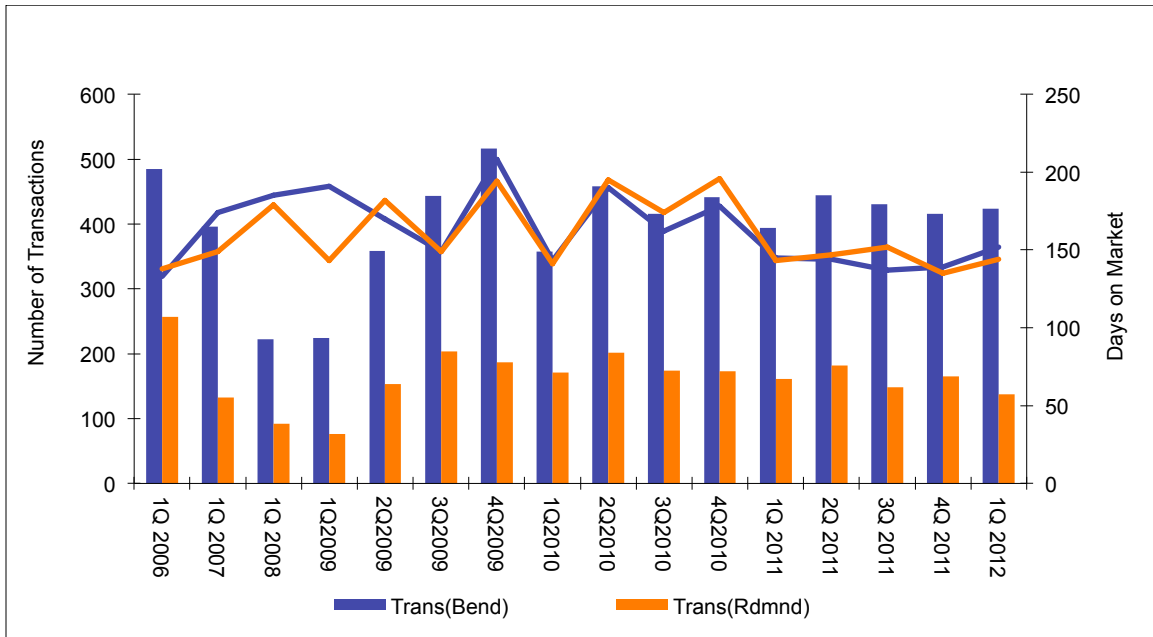
Figure 23: Average Days on Market and Number of Transactions Existing Detached Homes Clark County (excluding Vancouver)



CENTRAL OREGON

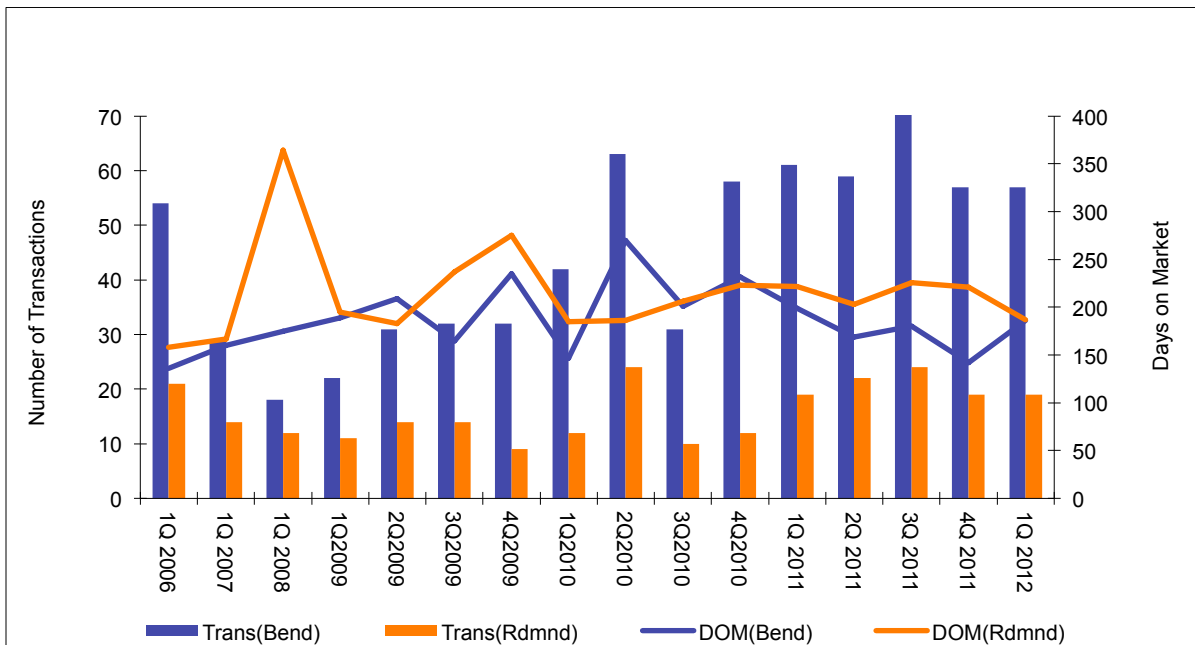
Bend home sales less than one acre increased 1.9 percent to 424 while Redmond’s decreased 17.0 percent to 137 in the fourth quarter on homes sold less than one acres. On the other hand, sales volume for homes on 1-5 acres remained the same in Bend and Redmond at 19 in Redmond and 57 transactions in Bend. For homes on less than one acre, the average number of days on market increased slightly from 139 (in the fourth quarter 2011) to 152 (in the first quarter 2012) in Bend and also increased from 133 to 144 in Redmond. In Central Oregon’s reports, the housing stock is separated by lot size, properties under one acre and those between one and five acres. Price per square foot data is provided to control for lot size between both categories.

Figure14: Number of Transactions and Days on the Market, Single Family Under 1 Acre, Bend and Redmond



Source: Central Oregon Association of Realtors

Figure 15: Number of Transactions and Days on the Market, Single Family 1-5 Acres, Bend and Redmond



The median home prices for the Bend and Redmond markets increased during the first quarter of 2012. The Bend market increased 6.7 percent to \$194,750, and Redmond market increased 3.2 percent to \$127,500 from the previous quarter for homes less than one acre. Both markets decreased on homes 1-5 acres as the Bend market decreased 12.9 percent to \$291,895, while the Redmond market decreased 32.7 percent to \$185,000. Over the past year the Bend market under and acre increased by 10.9 percent and the Redmond market increased 6.7 percent for home sales under an acre. For sales 1-5 acres, Bend increased 21.4 percent while Redmond has decreased 26.0 percent since first quarter of 2011.

Figure 16: Median Single Family Price and \$/SqFt Under 1 Acre, Bend and Redmond

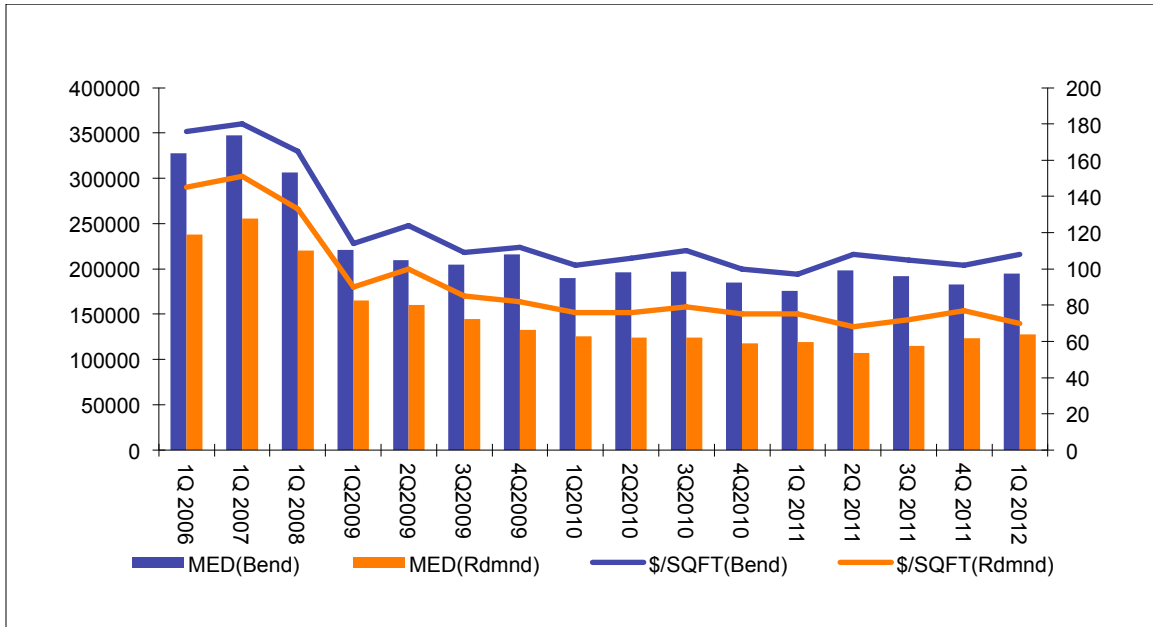
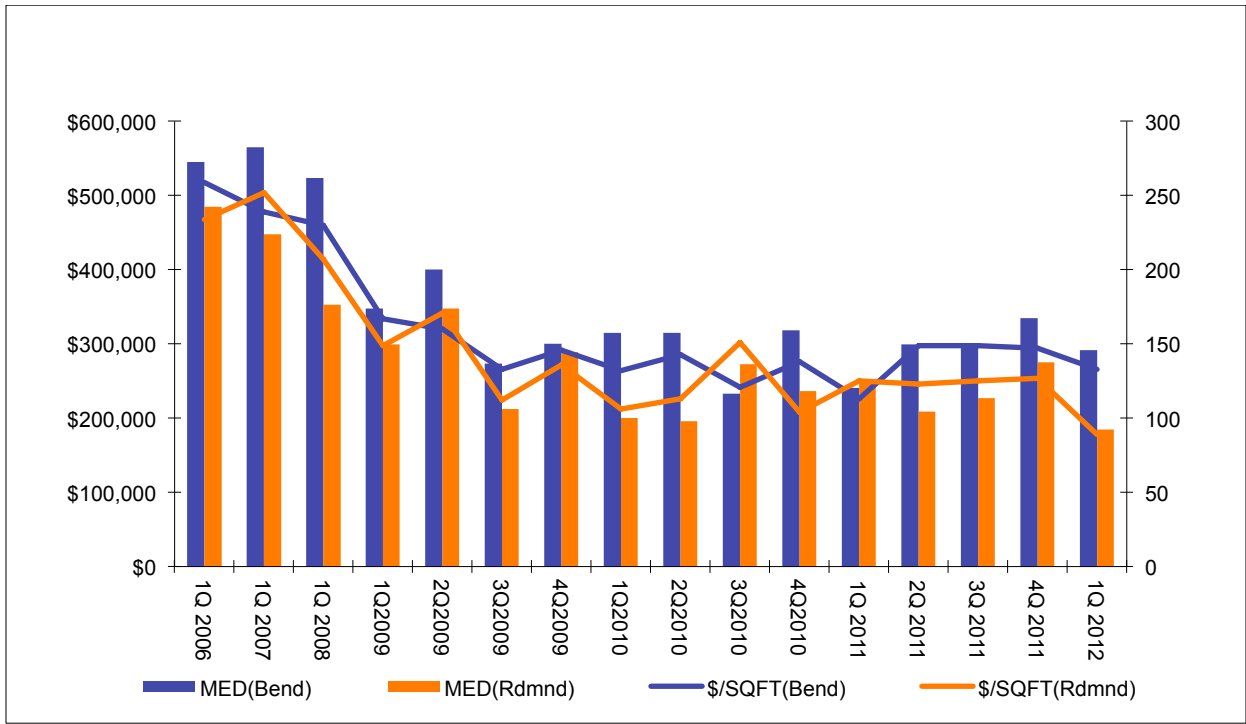


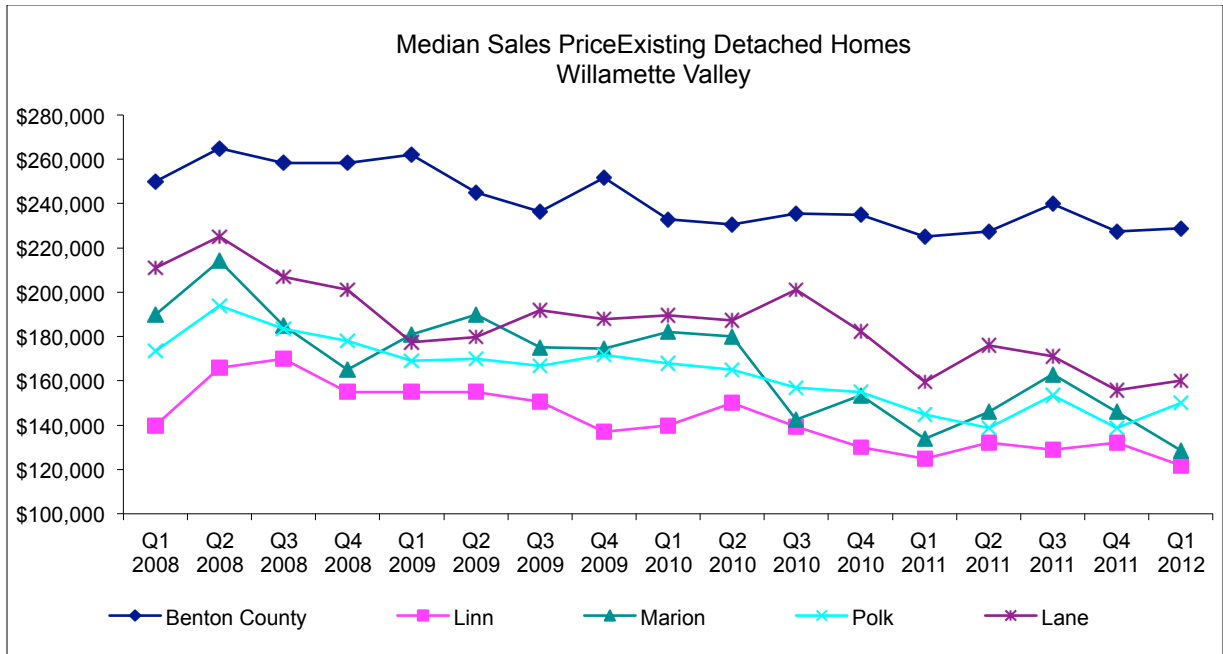
Figure 17: Median Single Family Price and \$/SqFt, 1-5 Acres, Bend and Redmond



WILLAMETTE VALLEY

Marion County prices decreased 3.9 percent since the first quarter of 2011 to a median sold price of \$128,500. Linn County and Eugene / Springfield decreased year over year by 2.5 percent and 4 percent respectively. Polk County increased 3.6 percent over the past year to a median price of \$149,900.

Figure 19: Median Sales Price Existing Detached Homes, Willamette Valley



Source: Willamette Valley MLS

SALEM

Salem’s housing market again experienced annual depreciation of 6.9 percent year over year in the first quarter while the number of days on the market decreased. The median sale price decreased to \$144,000 and the number of transactions also decreased from the fourth quarter of 2011. The number of transactions increased slightly from the previous year from 336 to 343, but decreased from the fourth quarter of 2011 from 394. The average number of days on market decreased sharply from 188 in the fourth quarter to 108 in the first quarter of 2012.

Figure 20: Median Sales Price and Annual Appreciation, Existing Homes, Salem

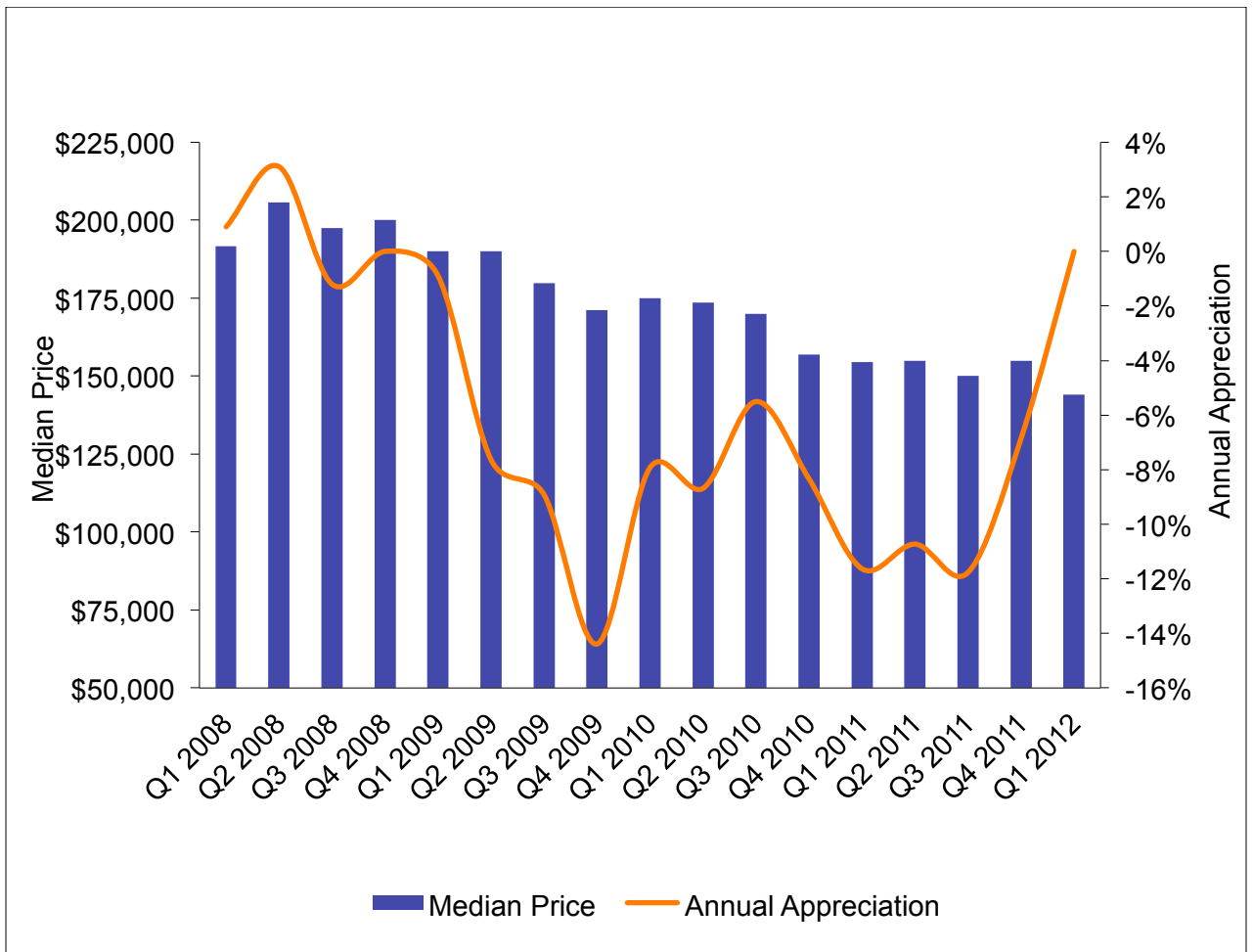
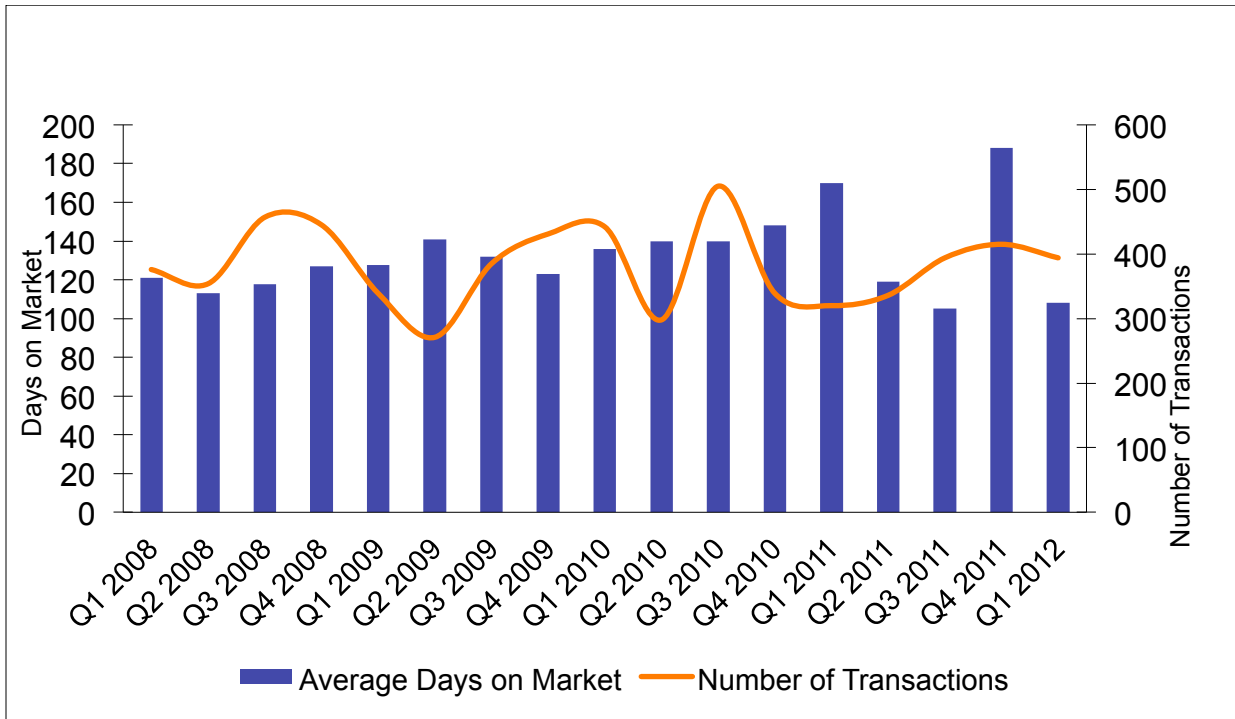


Figure 21: Average Days on Market and Number of Transactions, Existing Homes, Salem

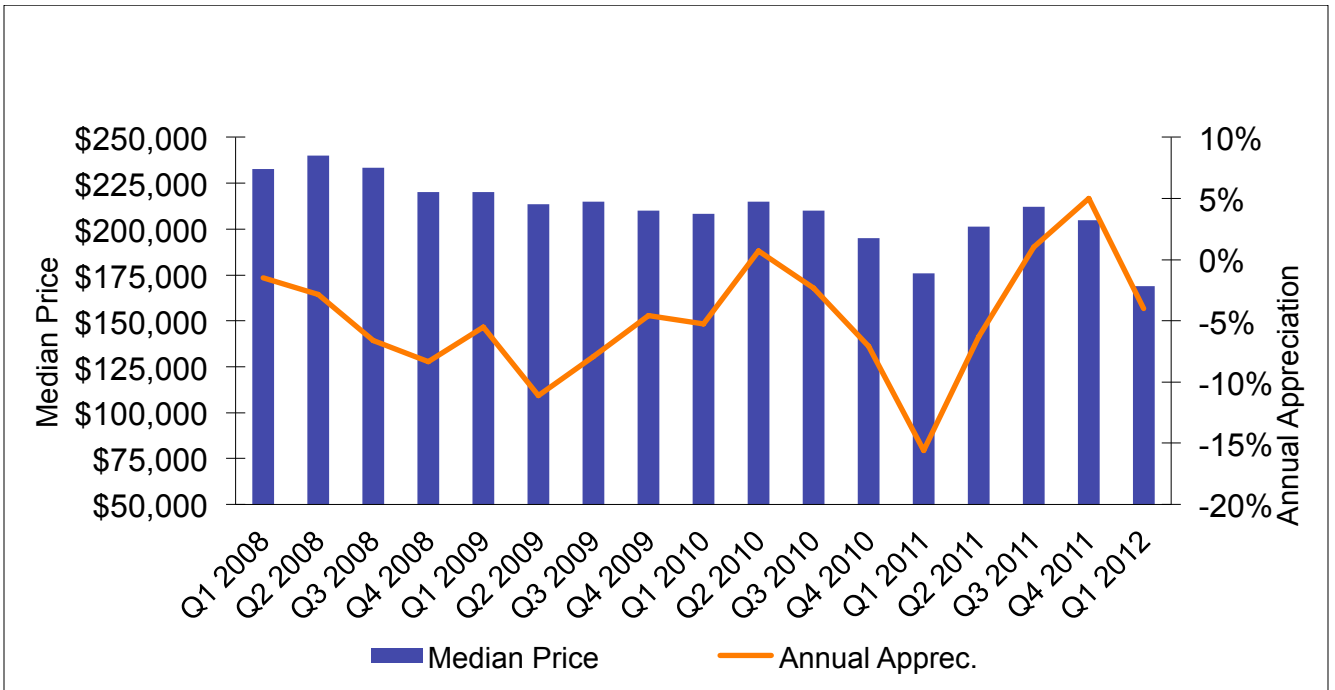


EUGENE/SPRINGFIELD

Home prices in the Eugene/Springfield area decreased 17.5 percent from the fourth quarter of 2011 to \$168,900. Values decreased 4 percent since the first quarter of 2011.

Lane County prices increased 2.7 percent from the previous quarter to a median price of \$160,000. They increased slightly year over year from \$159,500 in first quarter of 2011. ■

Figure 22: Median Price and Annual Appreciation Existing Detached Homes, Eugene/Springfield



Source: RMLS

MULTIFAMILY MARKET ANALYSIS

EVAN ABRAMOWITZ

Joseph Bernard Investment Real Estate
Oregon Association of Realtors Student Fellow
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The apartment market in Portland remains strong, but vacancies have begun to inch upwards and rent growth is slowing. According to the Spring 2012 Metro Multifamily Housing Association report, Portland had a 3.72 percent vacancy rate, which remains among the lowest vacancy rates in the US. Strong rental demand has persisted as fewer buyers are drawn to the single-family market. According to the 2012 Barry Report: “The apartment market has everything going for it, with increasing rents, increasing income, low vacancies, financing which is readily available, relatively slow apartment construction, and good investor demand.” The report projects stronger performance in the market in 2012 and 2013 and forecasts that we are entering a “two to four year sweet spot in the market and the real estate cycle.”

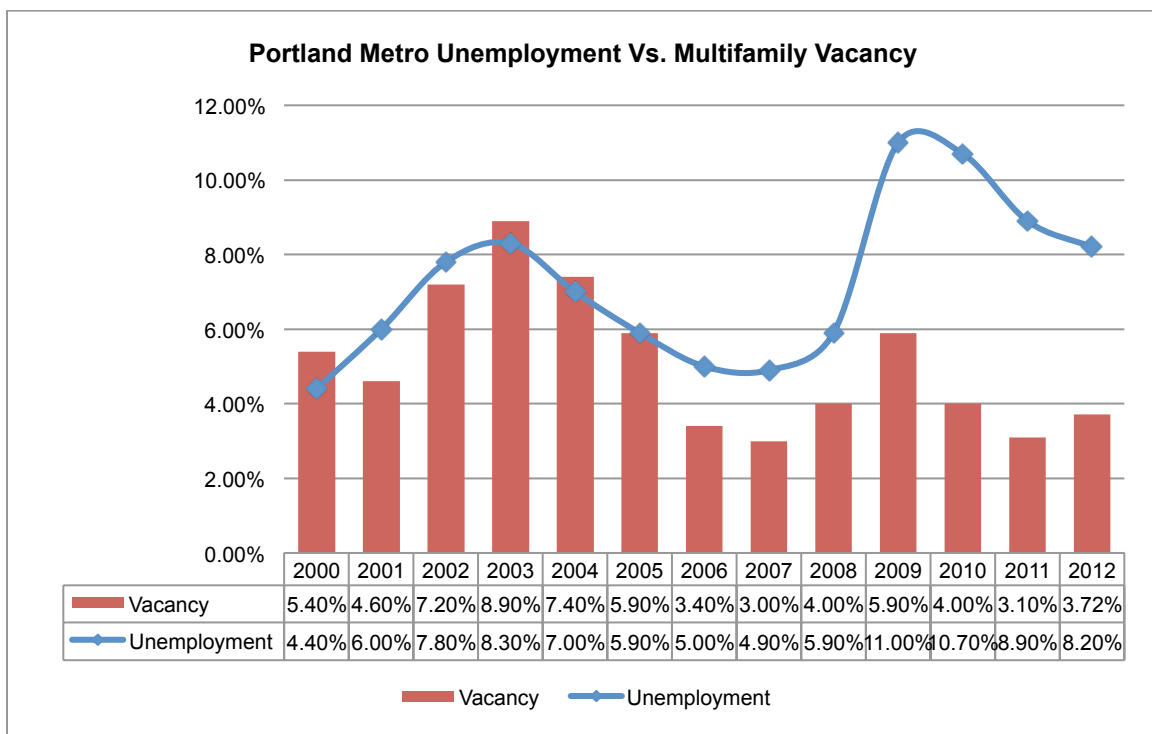
On the supply side, construction for multifamily in 2011 increased significantly from 2010, but is still below historical figures. In 2011 permits were issued for 1,696 units in the three county metro area, compared to 1,100 in 2010, according to the Barry Report. From 2004-2008 an average of 4,700 units came online annually. Half of the units being built are in the close-in areas where vacancy is lowest. The high demand for rentals is expected to persist over the next several years and absorb the new construction projects. It is expected that new construction will continue to ramp up, as more projects are approved in the coming year. Until these projects are delivered in 3-4 years, vacancy rates are projected to remain low and market conditions should remain strong for property owners.

■ 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.

Although the current and future state of the local and national economy is uncertain, people need somewhere to live. With more and more potential single-family buyers opting to rent instead of own, the demand for apartments continues to be strong. In first quarter 2012 nationally, revenue increased by an average of 5.8 percent since first quarter 2011 and effective rents increased by 4.6 percent according to MPF Research, a Carrollton, TX real estate research firm. Occupancy climbed 1.2 percent year over year to 94.9 percent in first quarter 2012.

Unemployment rates are positively correlated with vacancies as shown in the chart below. Locally, the vacancy rate has been declining with the unemployment rate since 2009. In 2009 the vacancy rate was 5.9 percent and the unemployment rate was 11 percent and in April 2012 the vacancy rate is 3.1 percent and the unemployment rate is 8.2 percent.

Figure 1: Unemployment and Multifamily Vacancy, Portland Metropolitan Area

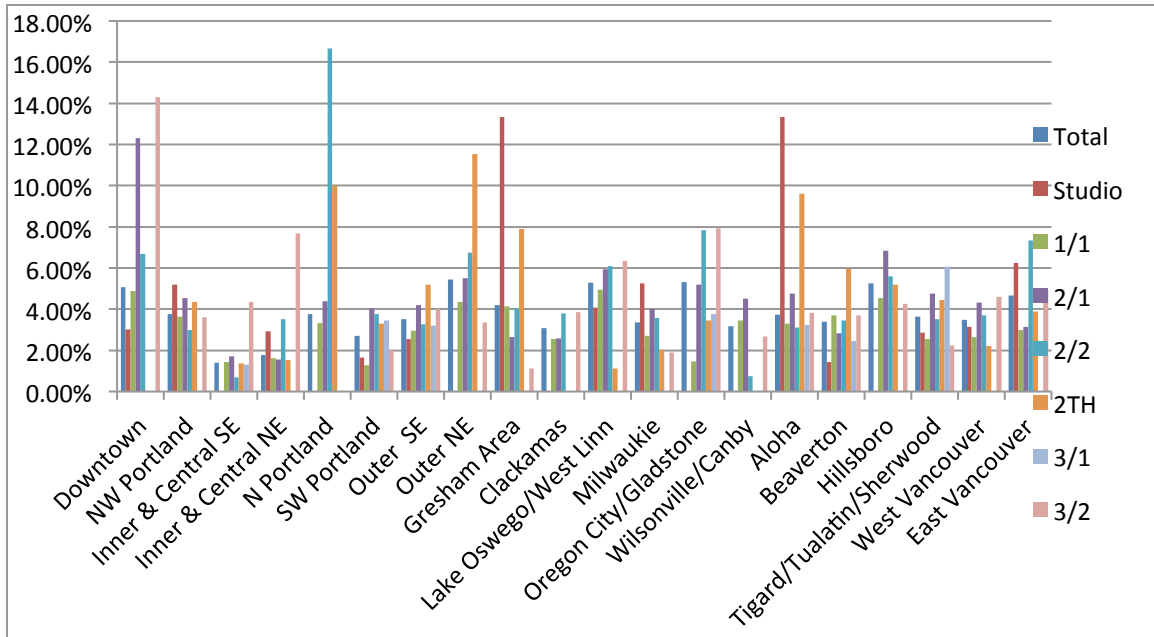


Source: MMHA, Oregonian

These market factors have driven vacancy rates in historically undersupplied Portland to among the lowest in the nation. The highest overall vacancy submarket was 5.44 percent in Outer Northeast and the lowest was Inner & Central SE at

1.4 percent. The highest vacancy rate among studios was Gresham Area and Aloha at 13.33 percent, while six submarkets reports 0 percent vacancy for studios. The highest vacancy rate for 1 BD, 1 BA was Lake Oswego / West Linn at 4.93 percent, while the lowest was SW Portland with 1.26 percent. For 2 BD, 1 BA the highest vacancy was Downtown Portland at 12.03 percent and the lowest was Inner & Central NE at 1.55 percent. Ten submarkets had a 0 percent vacancy rate among 3 BD, 1 BA, but many of these were based on less than 100 units surveyed, as 3 BD / 1 BA units are relatively unusual. North Portland reported 0 percent for 3 BD / 2 BA, while Downtown Portland had a 14.29 percent vacancy rate for 3 BD / 2 BA.

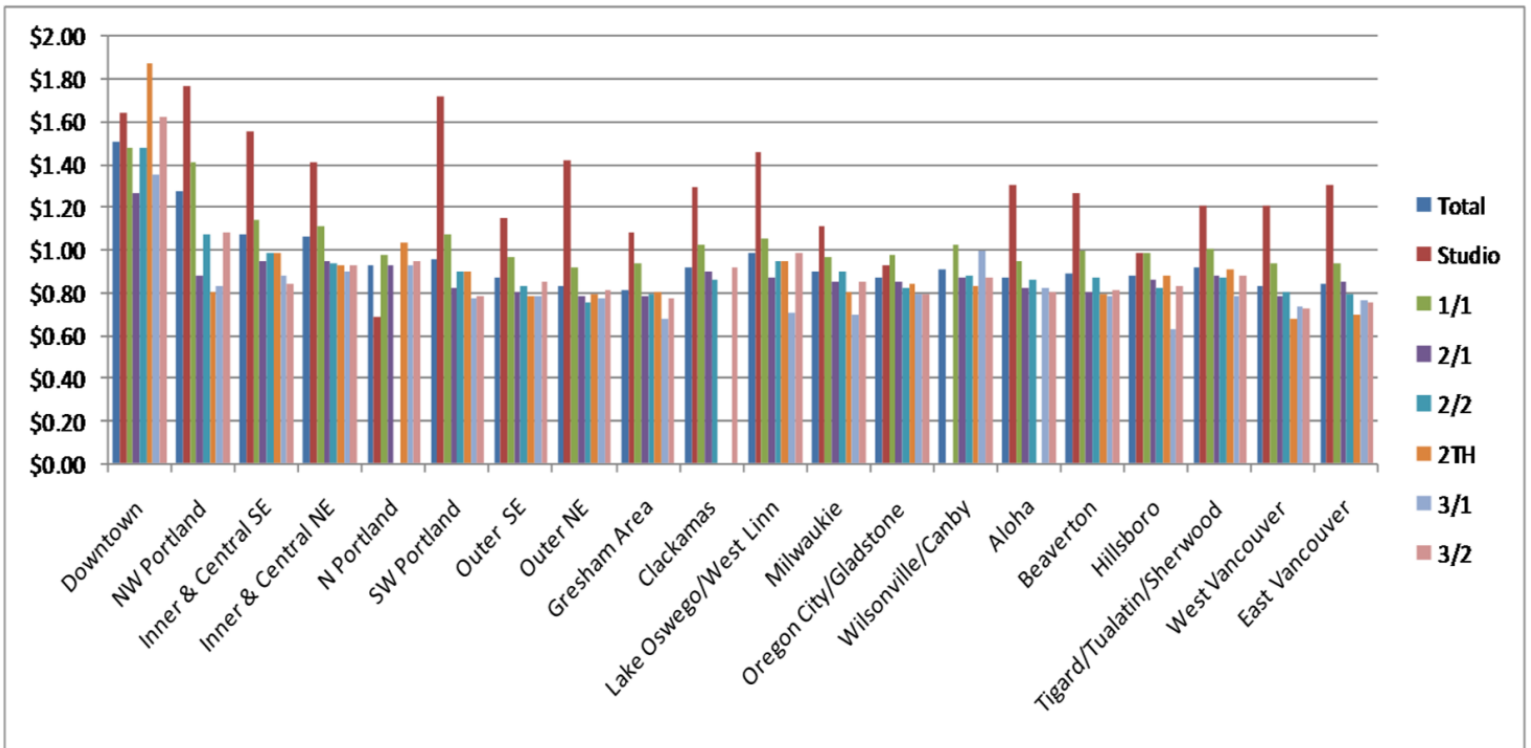
Figure 2: Vacancy Rates by Submarket 2012 Portland Metropolitan Area



Source: MMHA

The submarket with the highest overall rent/SF is downtown Portland with a \$1.66 average, followed by NW Portland at \$1.44. The lowest overall rent/SF is shared between Outer NE, Oregon City / Gladstone, and West Vancouver all at \$0.85 per square foot. The highest rent/SF for studios was NW Portland at \$2.04 and the lowest was Oregon City / Gladstone at \$0.68. The highest rent/SF for 1 BD, 1 BA was downtown at \$1.61 and the lowest were West Vancouver and Outer Northeast at \$0.93. The highest rent/SF for 2 BD, 1 BA was downtown at \$1.56 and the lowest was \$0.81 in Outer Northeast.

Figure 3: Rent / SF by Submarket 2012 Portland Metropolitan Area



Source: MMHA

In this high demand market, investors are aggressively seeking quality, well-located properties. Apartments are viewed as a relatively safe investment to gain a higher return than bonds, or conventional Treasuries. Several 100+ unit, Class A, institutional quality properties traded in the first quarter of 2012, at below-market cap rates. These major sales transactions included La Salle (\$77 million) in Beaverton, Center Pointe (\$34 million) in Beaverton, The Domaine at Villebois (\$30 million) in Wilsonville, and Parkside (\$16 million) in Gresham. Institutional buyers aggressively pursued core close-in properties in the second quarter, and are paying a premium. Several of the transactions have resulted in cap rates between 4 and 5 percent.

Figure 4: Major Sales Transactions, 1st Quarter, 2012, Portland Metropolitan Area

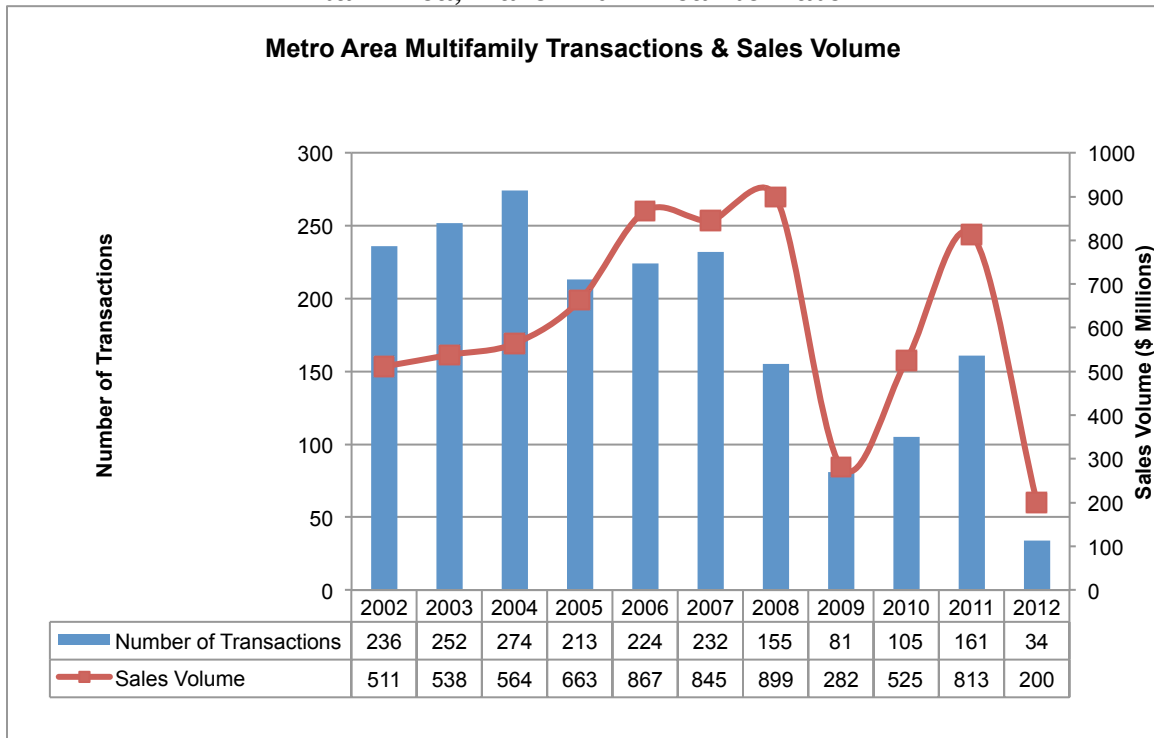
| Q2 2012 Major Sale Transactions | | | | | |
|---------------------------------|-------------------------|---------------|-------|------------|-------------|
| Building | Buyer | Price | Units | Price/Unit | Submarkets |
| La Salle | Waterton Associates LLC | \$ 77,200,000 | 554 | \$ 139,350 | Beaverton |
| Center Pointe | Sequoia Equities Inc. | \$ 34,325,000 | 264 | \$ 130,019 | Beaverton |
| Domaine at Villebois | The Carlyle Group | \$ 30,400,000 | 274 | \$ 110,949 | Wilsonville |
| Parkside | Crossbeam Holdings | \$ 16,450,000 | 225 | \$ 73,111 | Gresham |

Source: Costar

The majority of the product in Portland is Class B and C quality properties based on location and condition of the building. 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.

The number of transactions and sales volume has rebounded nicely since 2009. In 2011 there were 161 transactions and \$813 million in sales volume compared with 105 transactions and \$525 million in 2010. This is 65 percent more transactions and 64 percent increase in sales volume. Through the second week of March in 2012, the apartment is on pace to close fewer deals than 2011 but on track as far as sales volume. Experts are projecting that the increases in sales volume and transactions will continue to be strong in 2012 and the next several years.

Figure 5: Multifamily Transactions and Sales Volume, Portland Metropolitan Area, March 2012 Year to Date

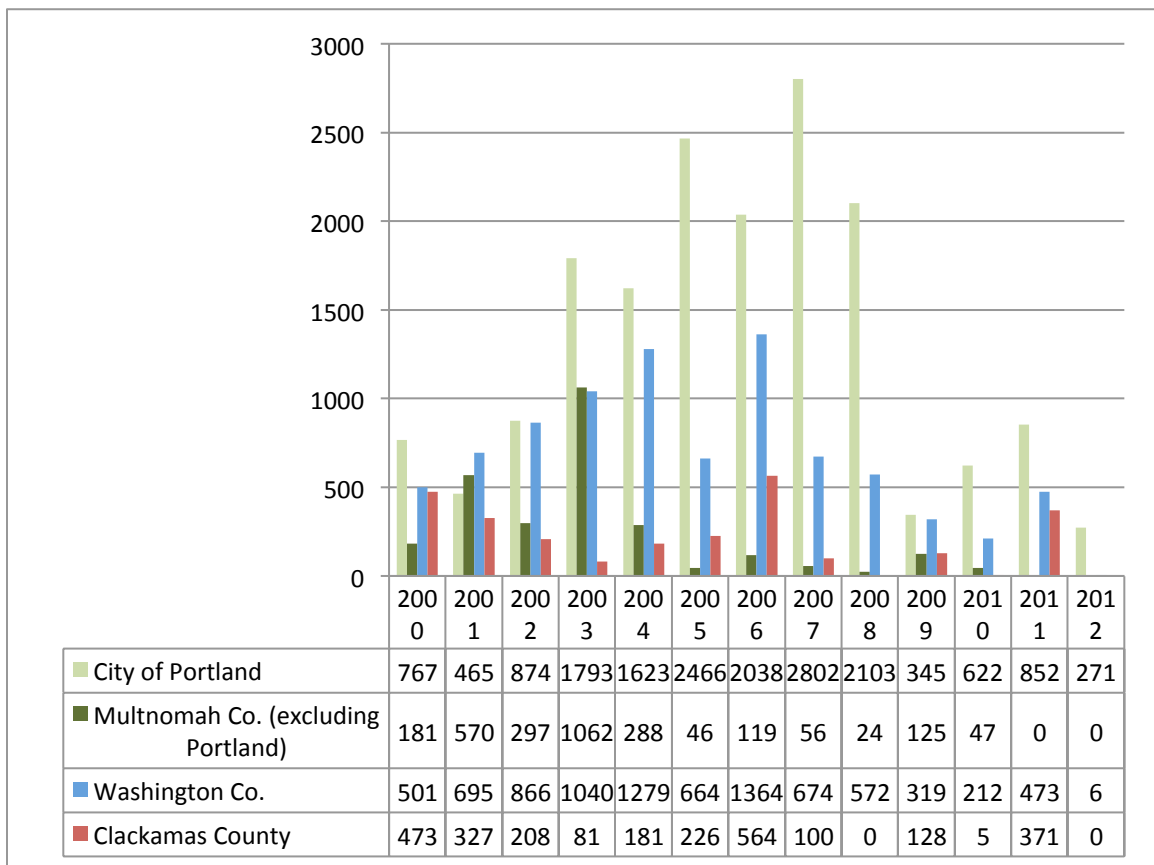


Source: Costar

Through the first two months of 2012, multifamily building permits have carried over from the momentum in 2011 within the City of Portland. Permits have been issued for 271 multifamily units built in the City, which is on pace to surpass the 2011 numbers for Portland. In 2012, there are 21 new apartment projects with 2,619 units slated to open. Many new developments are planned for close-in Portland including 20 Pettygrove (90 units), Prescott Apartments (155 units), Hollywood Apartments (47 units), 41st & Tillamook (41 units), SE 33rd and Division (31 units), and NE Garfield and Failing (33 units). Developers are clearly favoring the core locations, as there have been zero permits issued in the rest of Multnomah County, Clackamas County, and only six units in Washington County. New development for multifamily rebounded in 2011 with a total of 1,696 units built. However this number is still significantly lower than 2003-2008.

Factors contributing to the current lag in new construction include the weak economy, difficulty obtaining financing, and the current gap between replacement cost and market value. New construction is ramping up but still below the number of units to achieve “normal” vacancy levels. In light of the microscopic vacancy rate in the metropolitan region and lack of new construction, many real estate professionals and would argue that the market is experiencing a shortage in apartments this year. In order to get back in balance the market needs 5,000-7,000 apartment units, and it will take developers three years to produce this supply, according to the Barry Report. This shortage will be felt first within the urban core and later in the suburbs, where there is slightly more inventory available.

Figure 6: Multifamily Building Permits Issued, February 2012 Year to Date



Source: US Census

Experts predict a spike in number of transactions and sales volume as a result of owners and investors positioning their portfolios to capitalize on the further rent growth projected and persistent low vacancy in the market. The Barry Report asserts that with the current strong market conditions, sales volume of \$700-\$800 million and 175-200 transactions per year in 2012 and 2013 are possible. ■

OFFICE MARKET ANALYSIS

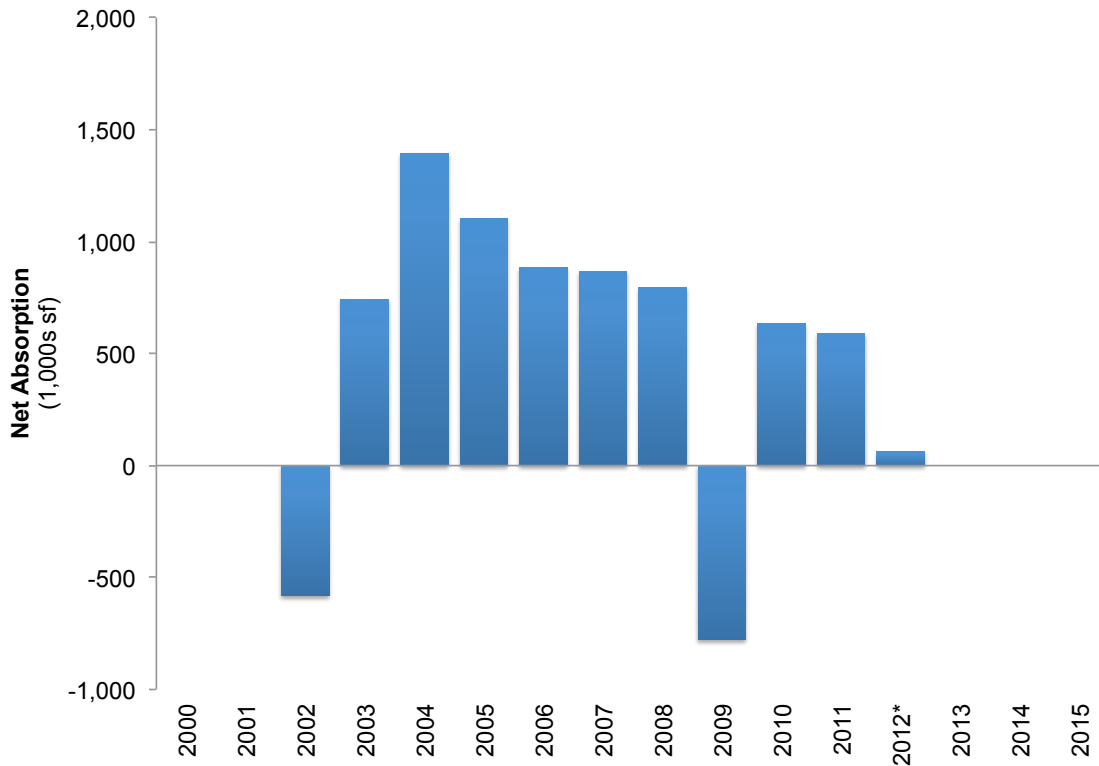
KYLE BROWN

RMLS Fellow, Master of Real Estate Development Candidate

Oregon's economy has shown encouraging signs in the first quarter of 2012. The year began with national jobless claims well below 400,000, and consumer spending showing modest growth in February. Amid growing confidence in a recovery, the Portland office market has shown increased activity with the first quarter of 2012 marking the eighth consecutive quarter of positive absorption. Tenants in CBD and suburban markets who have downsized in the past few years are beginning to look for longer-term leases. Cautiously optimistic that the market is gaining strength, owners are beginning to push back on tenant's request for longer leases and concessions.

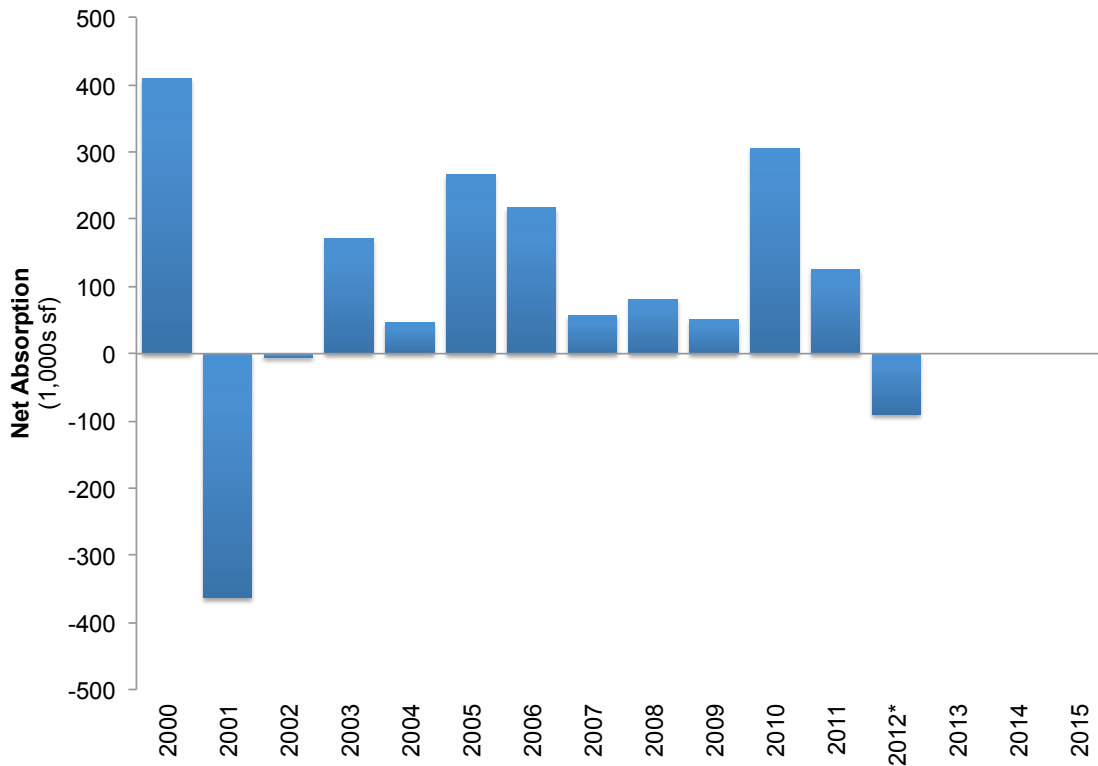
■ Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

Figure 1: Overall net absorption, Portland office market



*Year-to-date
 Sources: Grubb & Ellis; Jones Lang LaSalle

In the office market Jones, Lang, Lasalle reports a 30 basis point drop in market-wide vacancy from 14.3 percent to 14 percent in the first quarter, with approximately 64,000 square feet of net absorption overall. Increased tenant demand in the suburbs has begun absorbing excess space. Cushman and Wakefield notes that half of the top twenty leases signed in the first quarter were in suburban markets, likely due to large concessions by landlords to rent excess vacant space. Suburban markets like Kruse Way will continue to struggle this year, as tenants mixes were largely comprised of financial and personal service providers.

Figure 2: Class A overall net absorption, Portland office market

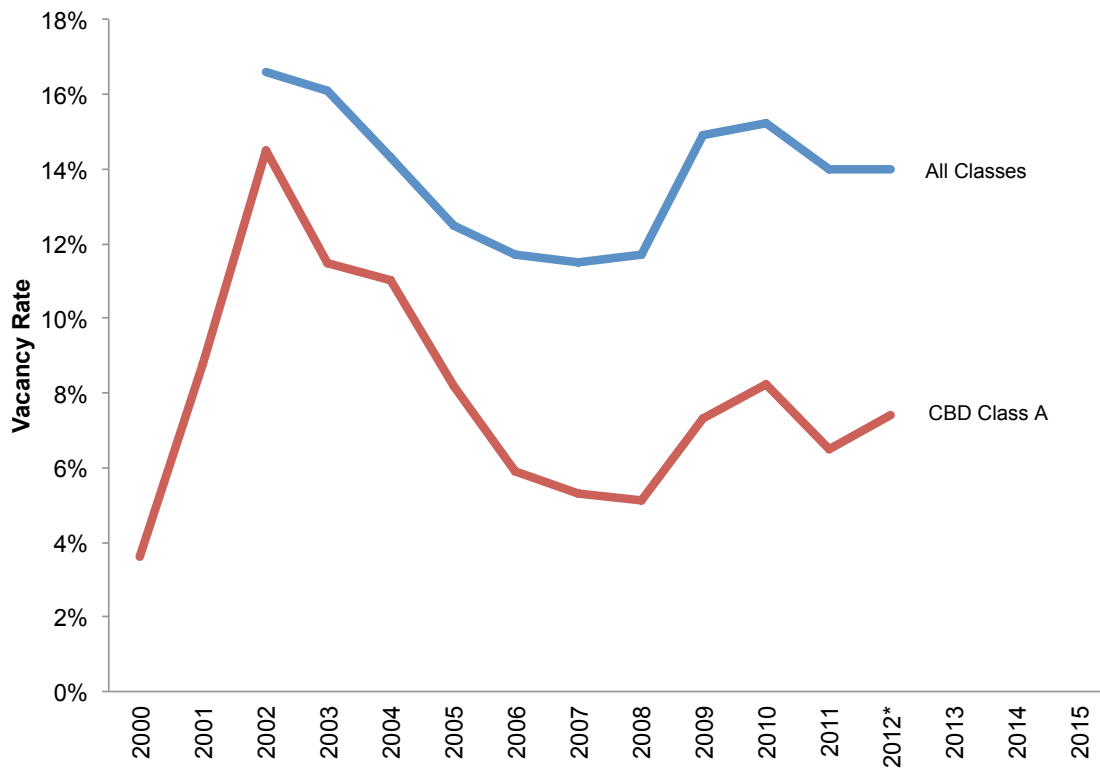
*Year-to-date

Sources: Grubb & Ellis; NAI Norris, Beggs & Simpson

In 2011, Portland had one of the lowest Class A CBD vacancy rates in the nation, with a direct vacancy of 6.5 percent according to Grubb & Ellis historical data. Since the 3rd quarter vacancy has begun to increase, maintaining 6.5 percent in the 4th quarter, and growing in the 1st quarter of 2012 to 7.4 percent. This growth can be confirmed by all major brokerages. The driver behind this trend is the consolidation of a number of large law firms, which has freed up a number of full floor spaces.

Availability in CBD Class A buildings is on the rise. Large occupiers relocating, or consolidating space has allowed for more full-floor availabilities. The FBI's move from the Crown Plaza to the Columbia/Airport Way submarket, and as mentioned previously, Vestas Wind Systems consolidating multiple locations to the Meier & Frank building will likely keep positive absorption low.

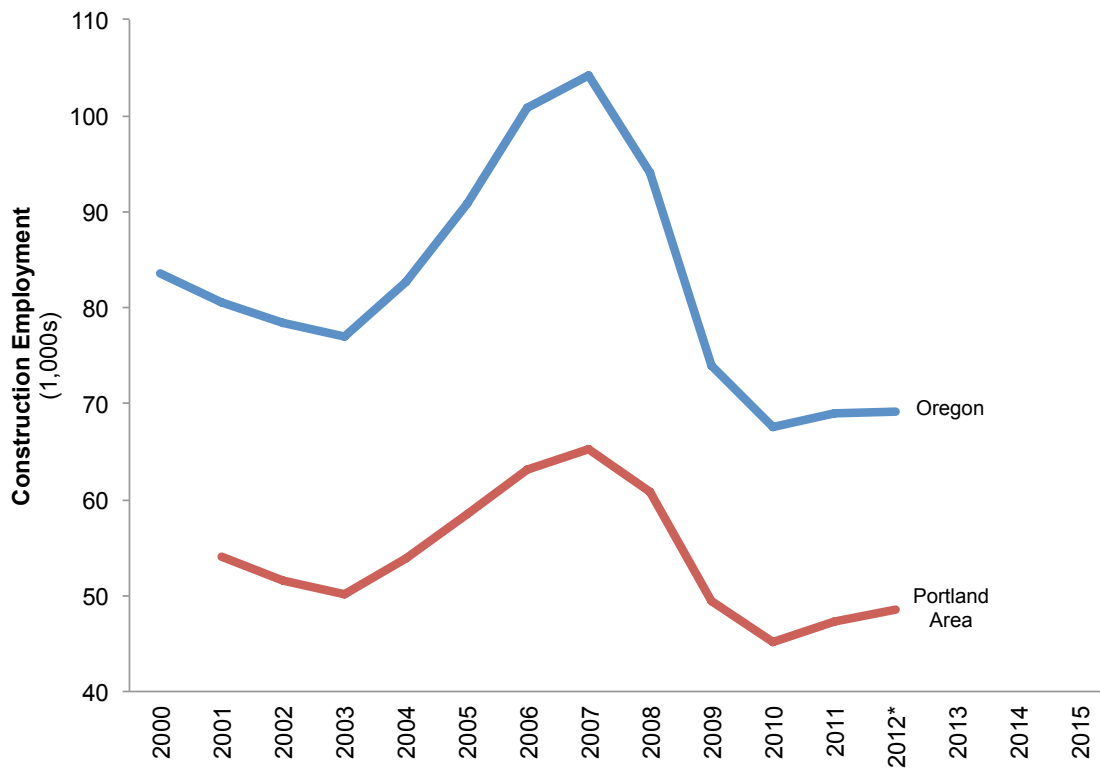
Figure 3: Vacancy rates, Portland office market



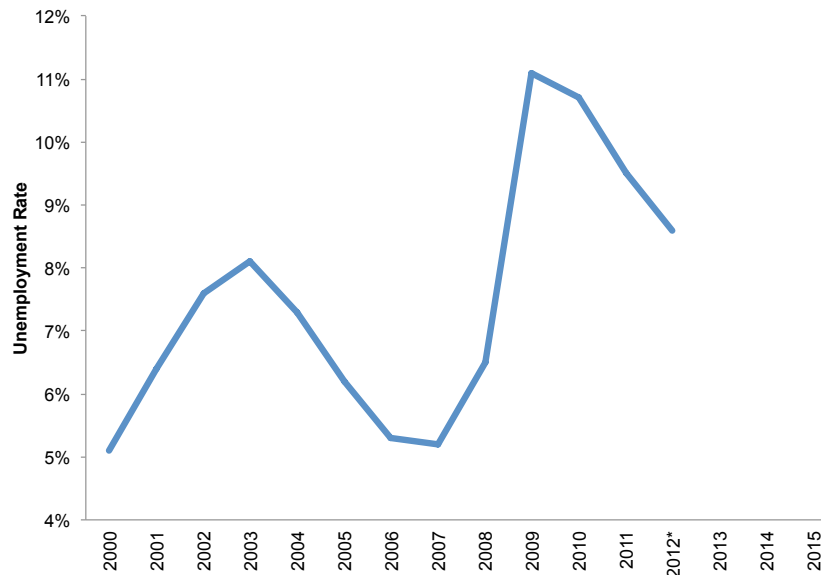
*Year-to-date

Sources: Grubb & Ellis; Jones Lang LaSalle; NAI Norris, Beggs & Simpson

Figure 4: Construction employment, Portland area and Oregon statewide



*Year-to-date
 Sources: Oregon Employment Department

Figure 5: Unemployment rate, Oregon

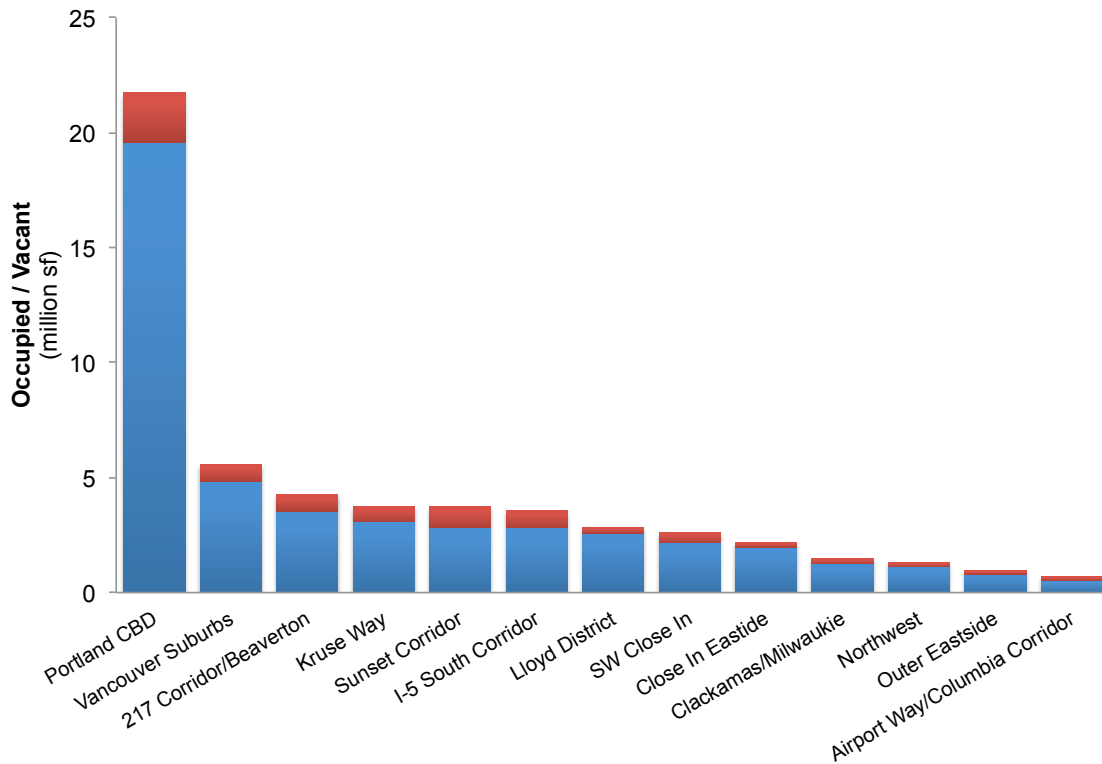
*Year-to-date

Sources: Oregon Employment Department

Portland's economic recovery has continued its slow positive growth. Unemployment continues to improve, but Oregon is not expected to recover all of the jobs lost during the recession until the end of 2014. The current unemployment rate in the Portland Metropolitan Statistical Area is 8.1 percent, compared with 8.8 percent in Oregon, and 8.3 percent nationwide. One year ago, Portland Metro unemployment was at 9.5 percent. Patricia Raicht with Jones, Lang, LaSalle notes a recent study by Arizona State University ranking Portland's job growth 12th among the 26 largest metro areas in the U.S.

Construction employment has held steadily around 48,000 jobs, and there has been little or no completed construction or speculative office development delivered to market in the 1st quarter 2012. We can expect some churn in the 2nd quarter as the newly renovated Meier & Frank building will deliver over 170,000 square feet to the market. Vestas Wind Systems will begin vacating various office spaces around the city to fill this new space with 400-500 employees.

We can expect to see continued slow growth in construction jobs over 2012 with significant projects such as the Target at the Galleria breaking ground, and multiple multifamily projects in various stages of approval and construction. There are grounds for cautious optimism with renewed talk again of developing the Conway Blocks, the Burnside Bridgehead, and TMT Development's talk of bringing the Parkwest project back to realization.

Figure 6: Submarket inventory, occupied and vacant

Source: Jones Lang LaSalle

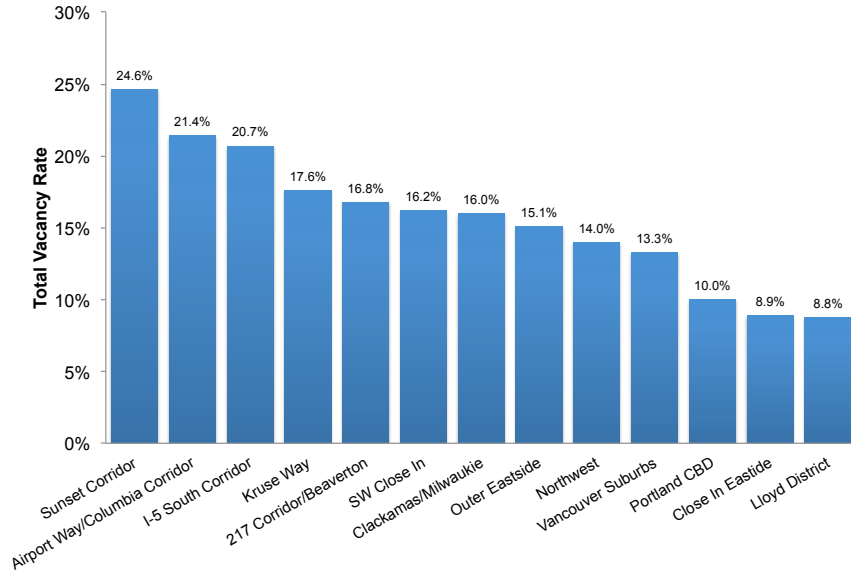
Suburban markets have seen some improvement. One explanation for the improvement in is the high demand for high end Class A space, while the supply of such properties in the CBD has dwindled, forcing tenants which might otherwise have located in a downtown location to consider a peripheral location. At this point, very little new supply is in the pipeline.

Financing remains tight for developers and while many projects are currently being pitched to fill this niche, few have been able to move forward. Despite the apparent demand for Class A space, most brokerages reported moderate or no increase in asking rents in the Central City. However, brokerage data was split as Cushman Wakefield reported healthy increases in Class A asking rents for both CBD and suburbs, both in the +\$.50 range. This split represents the first compelling signs of a stabilization in rents since the recession.

Although Jones, Lang, Lasalle captures different data and market areas than we have previously followed, rankings of vacancy by submarket show few dramatic shifts from the fourth quarter of 2011. Despite positive absorption in 2011, the major submarkets of Sunset Corridor and Kruse Way remain strong renter's markets at

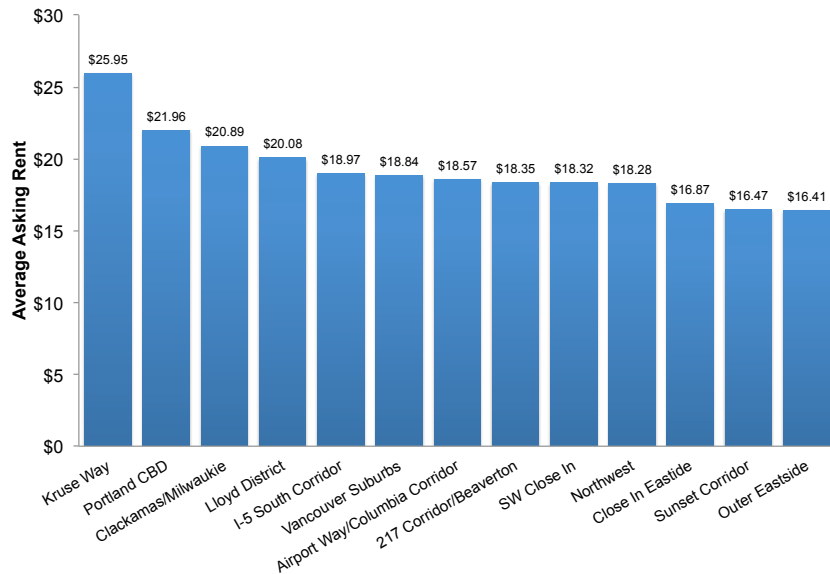
with vacancies just below 20 percent. The Eastside submarket continues to be the strongest outside the central city.

Figure 7: Submarket vacancy rates

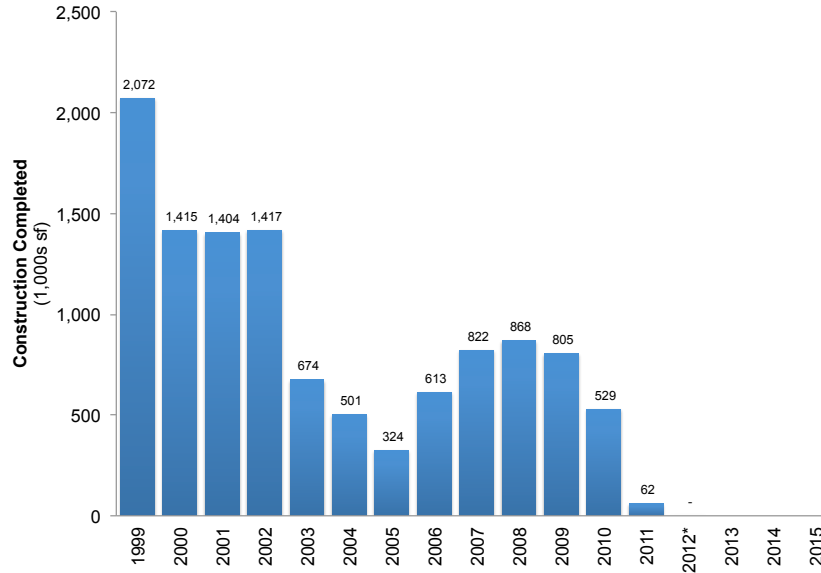


Source: Jones Lang LaSalle

Figure 8: Submarket average asking rents



Source: Jones Lang LaSalle

Figure 9: Office construction completed, Portland

Source: Colliers International

Table 1: Major lease transactions, first quarter 2012

| Lessee | Property | Submarket | Square Feet |
|----------------------|---------------------|------------------------|-------------|
| Iberdrola Renewables | Brewery Blocks II* | CBD | 57,082 |
| Klarquist Sparkman | World Trade Center* | CBD | 30,675 |
| Clear Channel | Triangle Pointe | 217 Corridor/Beaverton | 25,859 |
| NBC Studios | 2127 NW 26th Ave. | Northwest | 20,500 |

* Renewal

Sources: CB Richard Ellis; Cushman & Wakefield; Grubb & Ellis; NAI Norris, Beggs & Simpson

While indicators continue to paint a mixed picture moving forward, the first quarter of 2012 continues to present encouraging signs of a recovery. In particular, continued positive net absorption numbers and drops in vacancy for suburban markets suggest that constraints on new supply across submarkets have had metro-wide effects. While asking rent data is inconsistent across brokerages, mixed results show the first hints of a halt to the steady decreases in rent of the past two years.

Along with the sustained strong performance for the Class A market, these indicators will be important to watch in order to gauge demand in a market that appears to be led by tenants who desire high quality space in the Central City. Moving forward, there may be opportunities in place for developers who are able secure credit. ■