MACADAM FORBES
COMMERCIAL REAL ESTATE SERVICES

Market News
4th Quarter 2018

Portland Market Snapshot

Industrial

VACANCY	RENTAL RATE
3.7% from 4.0% 4Q2017	**$0.73** from $0.70 4Q2017

Office

VACANCY	RENTAL RATE
6.6 % from 6.8% 4Q2017	**$26.94** from $26.09 4Q2017

Retail

VACANCY	RENTAL RATE
3.0% from 3.8% 4Q2017	**$21.84** from $21.11 4Q2017

Are we there yet?

The long-sustained economic recovery has been an exciting time, putting Portland on the map for national investors. From that exposure, Portland has reaped the benefits of a booming commercial real estate market. Speculation over the last eighteen months has created micro-introspection of market blips with attempts to predict when the market will turn. However, not all good things must come to a crashing end. Analysts are anticipating a soft landing, or market correction. For investors, understanding the early indicators and the timing of their effects can help drive future investment decisions.

WHERE ARE WE NOW?

- After topping out near 10% in mid-2010, Portland's industrial vacancy rate fell steadily to 3.1% in mid- 2018, even with significant new construction.
- Portland's office vacancy rate reached 11% in 2010, but recovered to 6.5% in mid-2018.
- Portland's unemployment rate stood at 11.4% in June of 2009 and fell to a low of 3.1% in mid-2018.
- Rent growth in the office and industrial sectors has been substantial, driving pricing increases to all-time highs
- Current Portland industrial cap rates are at 6.1 % versus a national rate of 6.9% Office cap rates are 6.3% and the national rate is 6.6%.

Portland's Cap rates have consistently trended below the U.S. national average, due primarily to the limited amount of institutional grade investments. There continues to be significant investor demand in the Portland market due to our fundamentals including job growth, population growth, and the relative affordability compared to other west coast cities.

WHERE ARE WE GOING?

Cap rates are typically based on a spread over alternative investment returns, most commonly benchmarked by the yield on the 10-year Treasury Bond. As 10-year yields have been virtually non-existent, the spread has compressed, and cap rates have been on a steady decline in recent years. With the Fed altering their course and slowly raising interest rates, the yield on the 10-year has also been increasing, as high as over 3% in 2018. As a result, lenders have also begun raising interest rates, leading to an increase in the cost of capital available to investors. Although there hasn't been an immediate correction in cap rates, the longer-term trend of rising interest rates and 10-year yields will have a meaningful impact on when cap rates begin to rise, and thus negatively impact real estate values.

WHEN WILL WE GET THERE?

Further compounding the topic of real estate values is the length of the recovery/ expansion over the past 10 years. One metric that we are keeping an eye on is the yield curve, or the difference between the interest rate of a longer-dated bond and a shorter-dated bond. As of the end of 2018, the yield curve has flattened and is predicted to invert, meaning it costs more to borrow money now than it does in the long term. The result of this trend is that the economy is showing signs of slowing, and may even predict that the next recession is coming sooner than later.

WELCOME TO 2019

Population 4.26 million
Unemployment 4.1%

The last ten years of economic growth have been an amazing ride, even with the occasional bumps and crazy turns.

PwC and the Urban Land Institute have released their Emerging Trends In Real Estate 2019 report, of which we have identified key landmarks and points of interest to help you navigate your commercial real estate journey for 2019, and beyond. The more information you have, the fewer surprises there will be around the bend.

Issues to Watch

Source: PwC and the Urban Land Institute

INSURANCE

The evidence of floods, wildfires, and violent storms in 2018 indicates that the risk has been intensifying. That means that property/casualty insurers and reinsurers are experiencing massive payouts, and they will be pricing this into premiums going forward.

ROAD WORK AHEAD

INFRASTRUCTURE

The American Society of Civil Engineers provides details on the shortfall in investment in key assets that affect business. By 2025, the United States sacrifices $3.9 trillion in GDP and $7 trillion in reduced business sales due to congestion and delays along the supply chain adding greater costs of doing business. Additionally, there is the added event risk that comes along with potential catastrophic failure in roads, bridges, dams, and transit systems.

DO NOT ENTER

CYBERSECURITY RISK MANAGEMENT

This has affected governments, retailers, and utility systems, and extends deeply into the property sector. The "internet of things" is turning common building components and systems into gateways to cyberspace.

COMPLACENCY

One key risk toward the end of economic cycles is the supposition that expansion will persist well into the future. Although a decline in real estate transactions is currently happening, cap rates not only have trended low but also are convergent. At current cap rates, risk premiums are so thin it is likely that many deals are pricing risk too cheaply. That mispricing becomes apparent once recession strikes—and that is not a question of if, but rather when.

LABOR

Uncertainty surrounding changing immigration policies may have negative economic consequences and long-term weakening of our national growth potential. Emerging Trends has addressed the consequences for the labor markets in previous years. Now, the impacts on demand growth going forward include the reduction in the baseline for real potential GDP growth to less than 2 percent annually beginning in 2023.

> "The past year was marked by strong U.S. economic growth, supported by a burst of fiscal stimulus from federal tax cuts and spending increases. That, in turn, underpinned profit growth and the Federal Reserve's decision to dial up its campaign of short-term interest-rate increases. Most private economists expect U.S. growth to slow in 2019, in part because the initial impetus of fiscal stimulus is set to wane, meaning slower profit growth and more calls for a pause in Fed interest-rate increases."
>
> – WALL STREET JOURNAL

Expected Best Bets

Source: PwC and the Urban Land Institute

INDUSTRIAL Development

Warehouse/distribution vacancy is at a historic low. While ports and hub cities still play key roles, infill opportunities give "last mile" break-bulk sites—even multi-story properties—a chance for development.

Garden APARTMENTS

While the multifamily sector registered an overall NCREIF total return of 6.38 percent, the garden apartment component was near a double-digit total return at 9.33 percent. Pricing for garden complexes reflects a higher-yield 5.7 percent cap rate, compared with 4.9 percent for mid-to-high-rise properties. The strong move toward secondary and tertiary markets, and the return of interest to suburban assets bode well for these multifamily assets.

QUICK-FLIP VALUE-ADD DEALS

It's all about timing, both the institutional and entrepreneurial realms see late-cycle opportunity. The window of opportunity is narrow—the ability to execute by 2020 is key. The geographic focus needs to be in markets where assets have not yet been priced to perfection. This is not low-hanging fruit by any definition; but for yield-oriented investors with turnaround expertise, such deals are right in their wheelhouse.

REDEPLOYMENT OF Obsolescent RETAIL ASSETS

Many shopping center properties are not going to come back as successful retail assets. But while few have been reduced in price to mere land value, many are well below replacement cost and have good locations for alternative uses. If a site is sufficiently large, mixed use is a great option for close-in suburbs looking to exploit maturing millennials' desire to enter their next life-cycle phase. There is also an opportunity to turn the tables on the e-commerce trend that fostered the obsolescence by redevelopment into distribution facilities.

> "The Millennial effect on CRE: The first phase is millennials moving to the suburbs for larger, more affordable homes and access to schools, so adequate single-family and multifamily housing will be necessary. Retail follows rooftops, so retail development to meet the new residents' requirements will follow. Finally, you may begin to see more emphasis on employment centers as residents decide they want to work closer to where they live."
>
> – PWC AND ULI EMERGING TRENDS IN REAL ESTATE 2019

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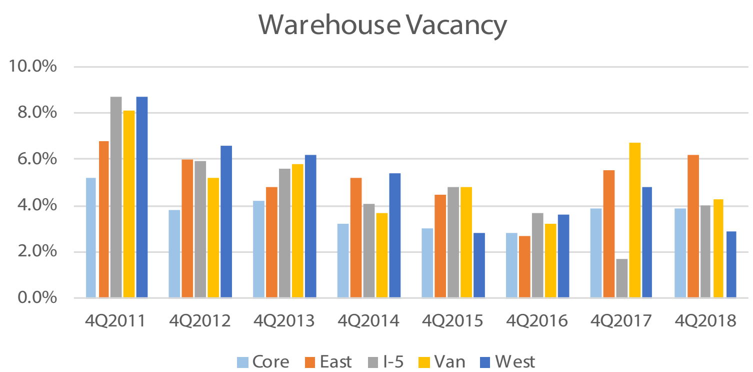
Market News
4TH QUARTER 2018

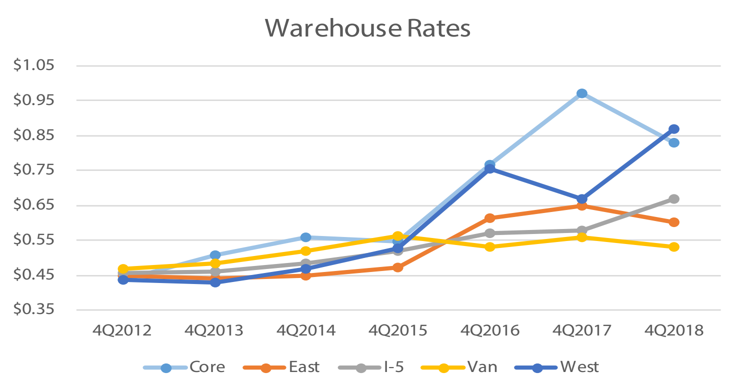
PORTLAND INDUSTRIAL

The Portland industrial market remained strong and active through the fourth quarter of 2018. The vacancy rate dropped to 3.1% in the fourth quarter, with warehouse product types dipping to 2.9%. Average rental rates across product types increased 6.4% from the previous quarter with the Portland average for warehouse at $0.67/SF and flex at $1.09/SF.

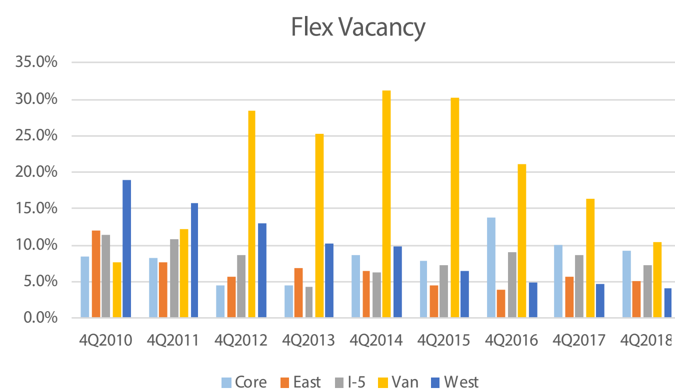
Nine new industrial buildings were completed in the fourth quarter totaling nearly 1.5 million SF. Across the market, net absorption was positive 2,319,645 SF suggesting a continued need for additional industrial inventory. There are still 51 buildings in the construction pipeline that could add over 3 million additional square feet in the next few years. The largest delivery of buildings and square footage is expected to be in Northeast Portland.

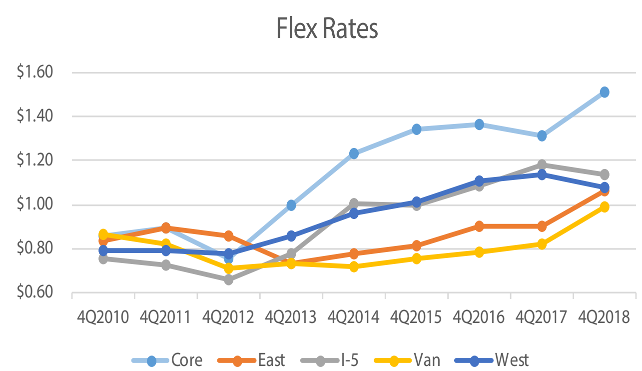
WAREHOUSE





FLEX





Industrial Sales-Previous Quarter

Total Volume	# of Transactions	Average Cap Rate
$151,001,135	24	6.53%

Core:
Downtown, Close-In Northwest, Close-In Northeast, Close-In Southwest, Close-In Southeast

East:
Hollywood, Gateway, Airport, Milwaukie, Clackamas, Gresham

I-5:
Tigard, Lake Oswego, Kruse Way, Tualatin, Wilsonville, Sherwood

Vancouver:
Vancouver, Hazel Dell, Salmon Creek, Five Corners, Mill Plain, Ellsworth, Camas

West:
Beaverton, Hillsboro, Aloha, Cornell

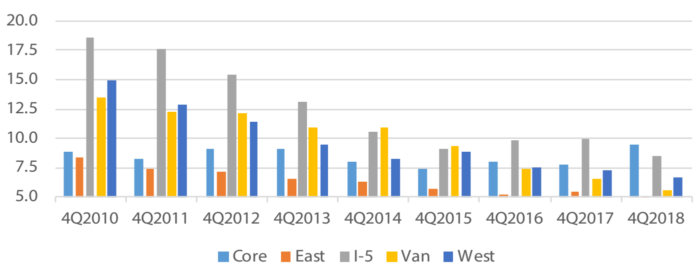
Source: CoStar Property

PORTLAND OFFICE

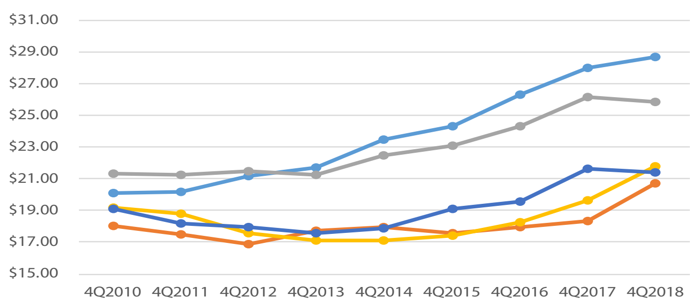
Vacancy rates across the Portland office market have remained steady throughout 2018, ending the year at 6.6%, a 0.2% decrease from fourth quarter 2017. Class C product types continue to have the lowest vacancy rate, dropping to 3.7%. Net absorption was positive 351,195 SF across Portland, with both CBD and suburban markets recording positive absorption.

Average rental rates increased 4.2% from the previous quarter, with the average CBD rate at $31.74/SF, and the suburban market at $21.98/SF.

Office Vacancy



Office Rates



Office Sales-Previous Quarter

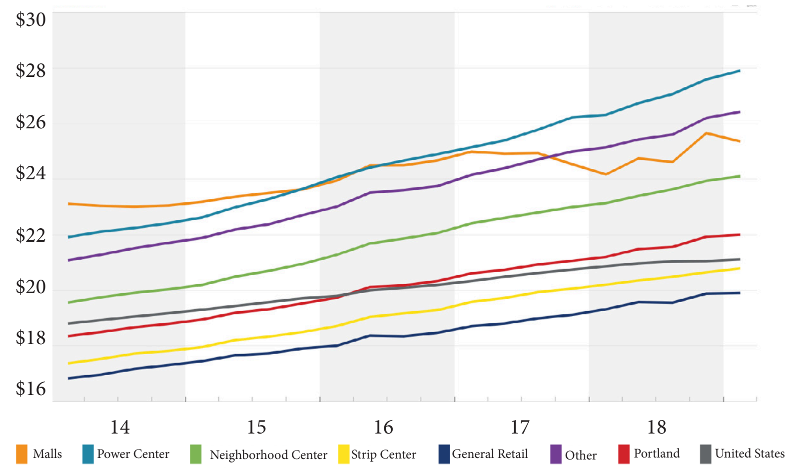
Total Volume: $273,292,000

# of Transactions: 9

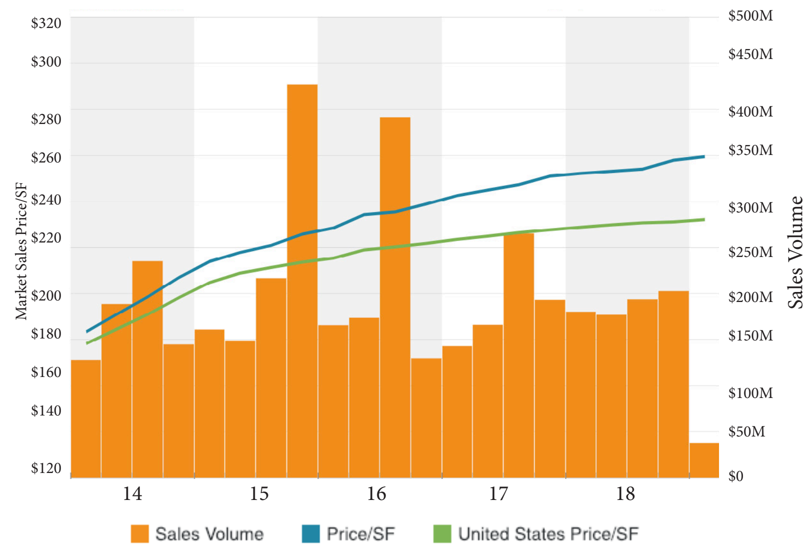
Average Cap Rate: 6.59%

PORTLAND RETAIL

Asking Rent per SF



Sales Volume & Price per SF



Retail Sales-Previous Quarter

Total Volume: $150,710,000

# of Transactions: 15

Average Cap Rate: 6.68%

Core:
Downtown, Close-In Northwest, Close-In Northeast, Close-In Southwest, Close-In Southeast

East:
Hollywood, Gateway, Airport, Milwaukie, Clackamas, Gresham

I-5:
Tigard, Lake Oswego, Kruse Way, Tualatin, Wilsonville, Sherwood

Vancouver:
Vancouver, Hazel Dell, Salmon Creek, Five Corners, Mill Plain, Ellsworth, Camas

West:
Beaverton, Hillsboro, Aloha, Cornell

Source: CoStar Property

Market News
4th Quarter 2018

Locally owned by active brokers since 1978, Macadam Forbes continues to grow into a market leader in office, industrial, investment, retail, and land/development transactions throughout the Portland metropolitan area and beyond.

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