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# office market analysis

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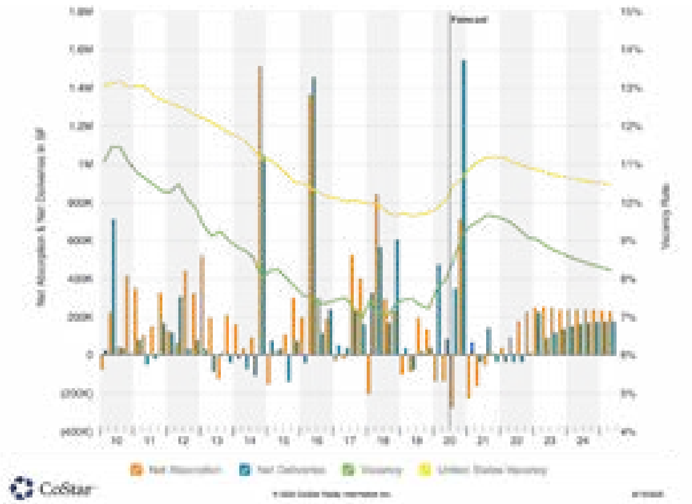
**It's been five months since Governor Kate Brown issued a state-wide "Stay at Home" order, and there's still much speculation on the impacts of the COVID-19 pandemic on the Portland office market. Prior to the outbreak, the local office market was exhibiting exceptionally high sales volume and investment appeal due to competitive rates (relative to other West Coast metropolitan areas) and sustained employment growth. However, "it is [now] anticipated that leasing activity will slow and absorption will pause as tenants delay moving during the outbreak" [1].**

### TABLE ONE: NET ABSORPTION, NET DELIVERIES AND VACANCY




## DELIVERIES

Office deliveries in the Portland Market have been volatile throughout the past decade. There have been periods of relatively low activity, followed by periods of booming growth (late 2014, mid 2016), as well as extended periods of negative net deliveries. In Q2 2020 alone, there was approximately 85,000 SF of net office space deliveries added to the market. However, there's expected to be an estimated 1.5 million SF of net office space delivered by the end of 2020. This influx of new supply in 2020 represents the largest annual market growth in Portland over the past decade. However, the COVID-19 pandemic is putting these new property owners in a predicament when it comes to finding tenants.

The top deliveries expected by the end of 2020 include the built-to-suit office expansions at the Nike Headquarters in Beaverton and the Adidas Headquarters in the Overlook neighborhood in North Portland. Combined, these office expansions account for approximately 1.4 million SF.[3]

## ABSORPTION

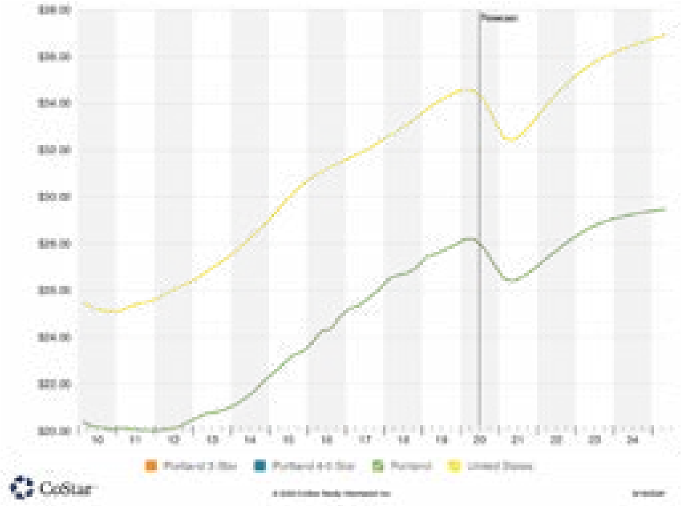
As you can see in Table 1, absorption dropped into the negative territory (approximately -130,000 SF) in Q2 2020. It should be noted that this was mostly attributable to activity in the CBD, most notably the City of Portland returning to their owned building. This effectively negates the absorption gains we saw in Q1 2020.[3]

While the negative absorption by the City of Portland was premeditated, there are several industries that are contributing the negative absorption due primarily to the effects of COVID-19. Two prominent types of tenants that are being negatively affected and forced to downsize are in the travel and tourism industry (such as AirBnB and Vacasa), as well as tenants in the coworking space industry (such as WeWork), all of which have been vacating office property in the Portland area. Travel and tourism has been hit especially hard initially when Governor Kate Brown announced her 'stay-at-home' order; however, even in the first phase of re-opening, there is still a sense of unease associated with traveling where people are choosing to cancel or postpone trips, whether for busines or pleasure.

Shared workspaces are also struggling, as many of the facilities were not designed with social distancing regulations in mind. Additionally, many workers were either laid off or furloughed, or are simply opting to work out of their homes instead of risking their health by exposing themselves to conditions in a shared working environment. Another reason co-working spaces were so quick to feel the effects of COVID-19 is because of the short-term leases that are common in that industry. Traditional office space leases are generally on the order of 10 years, so the effects of COVID-19 will likely not be felt for some time.

As with most market conditions, it's hard to accurately determine the long-term effects of COVID-19 with regards to absorption. "Although the economy has seen improvement in employment and other measures of activity since the initial collapse, the U.S. economy remains a long way from returning to pre-crisis levels of full employment."[4] Fortunately, most of the new deliveries in the Portland market are built-to-suit at corporate headquarter facilities, so it's unlikely those properties will be vacated in the near future. The next 6 months will give us a much better picture of office market absorption in the Portland Metro market.

#### TABLE TWO: MARKET RENT PER SF



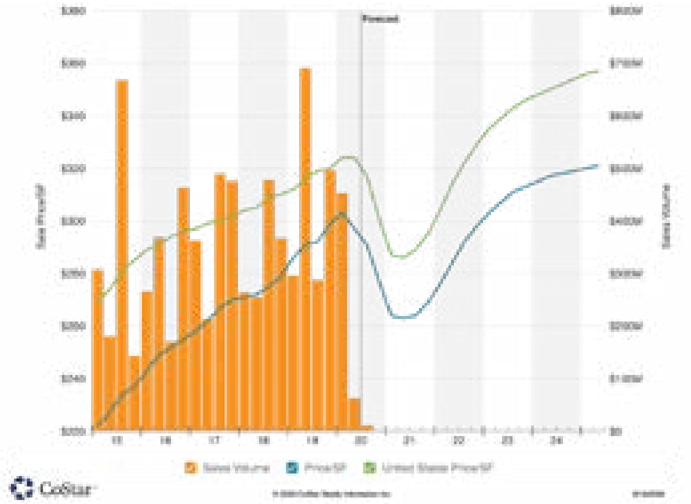

## VACANCY

The 2020 boom in office market deliveries, coupled with decreasing leasing activity, is expected to have a significant impact on vacancy rates going forward. At the end of Q2 2020, the available vacancy rate for the Portland office market was estimated at 7.9%, compared to the United States available vacancy rate of 10.1%1. Over the next year, the local available vacancy rate is expected to rise to a peak of 9.7%, the highest it's been since the end of 2012, but still lower than the national rate. The fact is that while companies have continued to operate while coping with the 'stay-at-home' order, "some business leaders are learning that the bulk of their operations can be done with a fully remote workforce".[5] This is especially true for a number of businesses that are experiencing significant revenue losses due to COVID-19  In many cases, the only option for some businesses to stay in operation will be to give up their traditional office space as a means of reducing their overhead expenses, and shift to a utilizing a remote working environment.

## LEASING

Market rents for office properties throughout the country have been steadily growing over the past nine years. Portland's local office market has followed the same general trend as the entire United States, but has consistently been approximately 20% below the national rate. These relatively low rates have acted as an incentive for national investors to focus on the Portland Market as an investment opportunity. In Q2 2020, when the effects of COVID-19 showed their initial impact on the office market rents, the average rental rate for office property in Portland and the United States was $28.17 per SF and $34.50 per SF, respectively. Due to the high supply and low demand for office space, rents are expected to be held stable, or maybe slightly decrease, over the next 2-4 years. In order to further stimulate leasing activities, property owners have begun offering concessions to attract office tenants. One effective concession is offering free rent, which averaged 10 months on all office leases executed throughout the United States in Q2 2020 alone, a 13.7% increase from Q1. Another effective concession is increasing tenant improvement allowances, which rose by 5.1% between Q1 and Q2 nationwide[6]. Shortening lease durations is also a way to attract tenants, as it decreases the risk of the lessee during times of economic volatility.

**TABLE THREE:**
**SALES VOLUME & MARKET SALE PRICE PER SF**




## SALES

The Portland metropolitan area has been an attractive investment opportunity over the past decade due to low vacancy, a dynamic economy, and consistent growth of property values. "Portland office investment reached $450 million in Q1 2020, the highest first-quarter sales volume of the past 10 years, but investment fell sharply after Oregon's stay-at-home order was issued on March 23rd."[1] Sales volume dropped to approximately $60 million in Q2 2020, an 86% decrease quarter-over-quarter, and the worst quarter since 2011. With regards to price per square foot, Portland office space is currently selling at an average of $297, which is below the national average of $324 per square foot. Due to the inherent risks of buying during volatile economic conditions, and the tenant-favorable leasing opportunities, the sales price for office space across the country is expected to continue to decrease for at least the next year.

## CONCLUSION

It's speculated that the dense nature of the CBD will become less attractive for office tenants in the future, and the relatively open, suburban options will become more sought after by potential office tenants.

High supply and decreasing demand will lead to increase in vacancy. In order to cope with this, property owners are expected to maintain rental rates at their current levels, but include additional concessions such as free rent and shorter lease obligations in order to incentivize leases.

While the Q2 data has given us more clarity on the short-term effects of COVID-19, there still remains significant uncertainty on the long-term effects given that the pandemic is ongoing, and expected by many to increase in severity in the coming fall and winter months. "The second half of 2020 will set the tone for what a recovery may look like and how a global pandemic may forever change how we view office space."[7] Existing lease commitments will likely mask the longer term impacts, with emerging location and space usage patterns becoming more clear when lease renewals come up.

## SOURCES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