# CENTER FOR REAL ESTATE

**QUARTERLY REPORTS**

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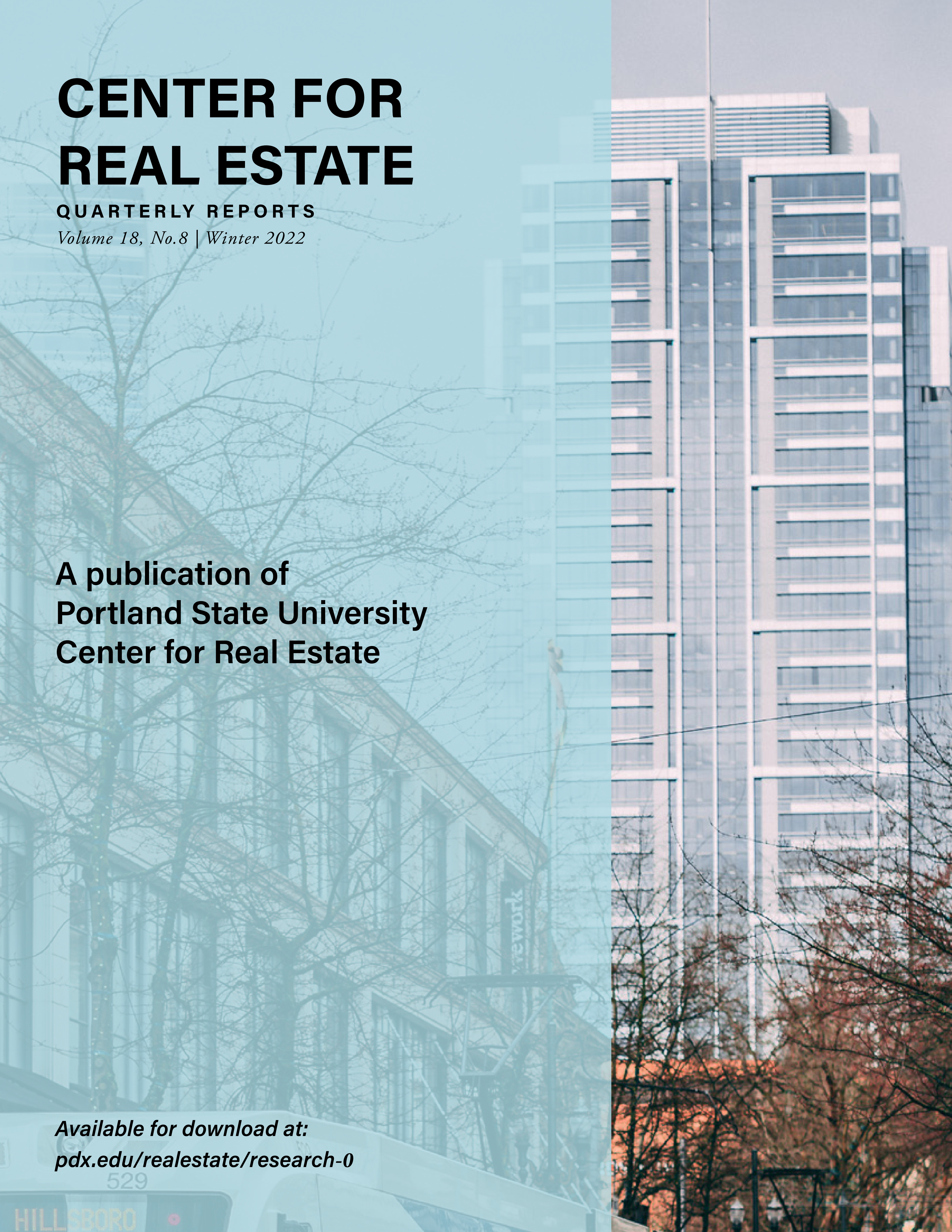


***Available for download at:***
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ECONOMIC OVERVIEW

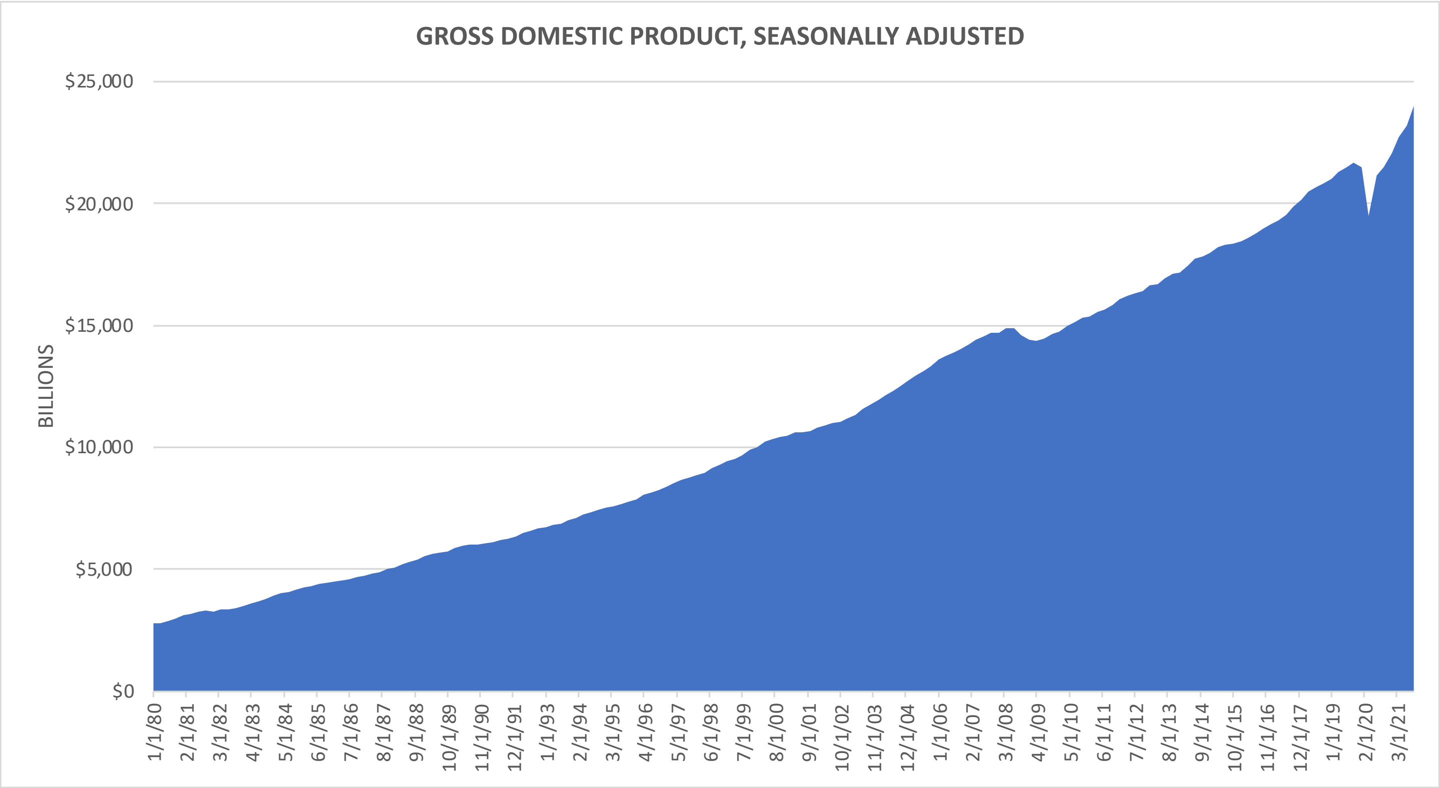
# Economic Analysis


## Jerry Johnson

Portland State University

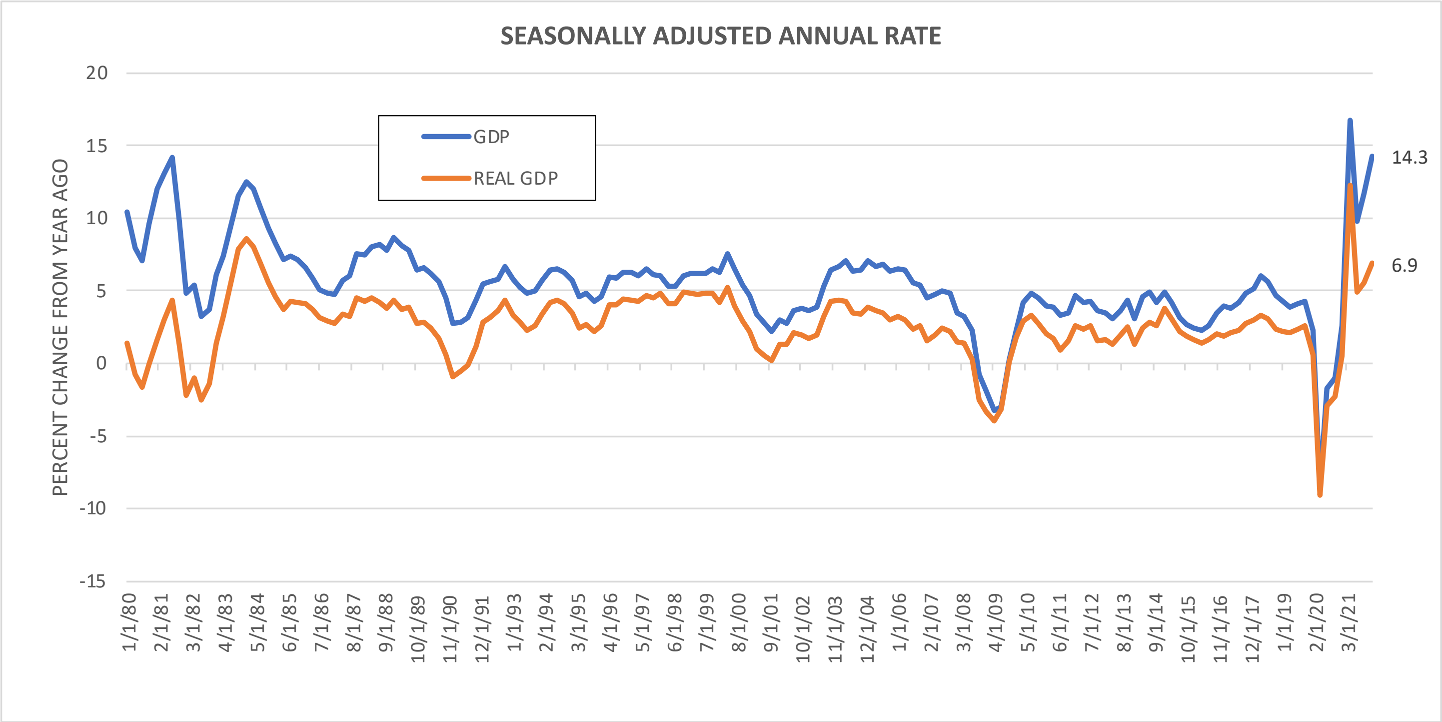

Jerry Johnson is an adjunct professor at Portland State University's Center for Real Estate. He is also the Managing Principal of Johnson Economics, a consultancy based in Portland.

The economic expansion continued through the fourth quarter of 2021, with gross domestic product approaching $24 trillion during the quarter. The increase was led by increases in private inventory investment, export, personal consumption expenditures, and nonresidential fixed investments. This was offset by decreases in government spending and increases in imports. The rapid spread of the omicron variant of COVID-19 resulted in renewed restrictions and disruptions in operations and the supply chain. Growth in retail trade was driven by inventory investment by motor vehicle dealers, while the increase in personal consumption was led by health care, recreation, and transportation.



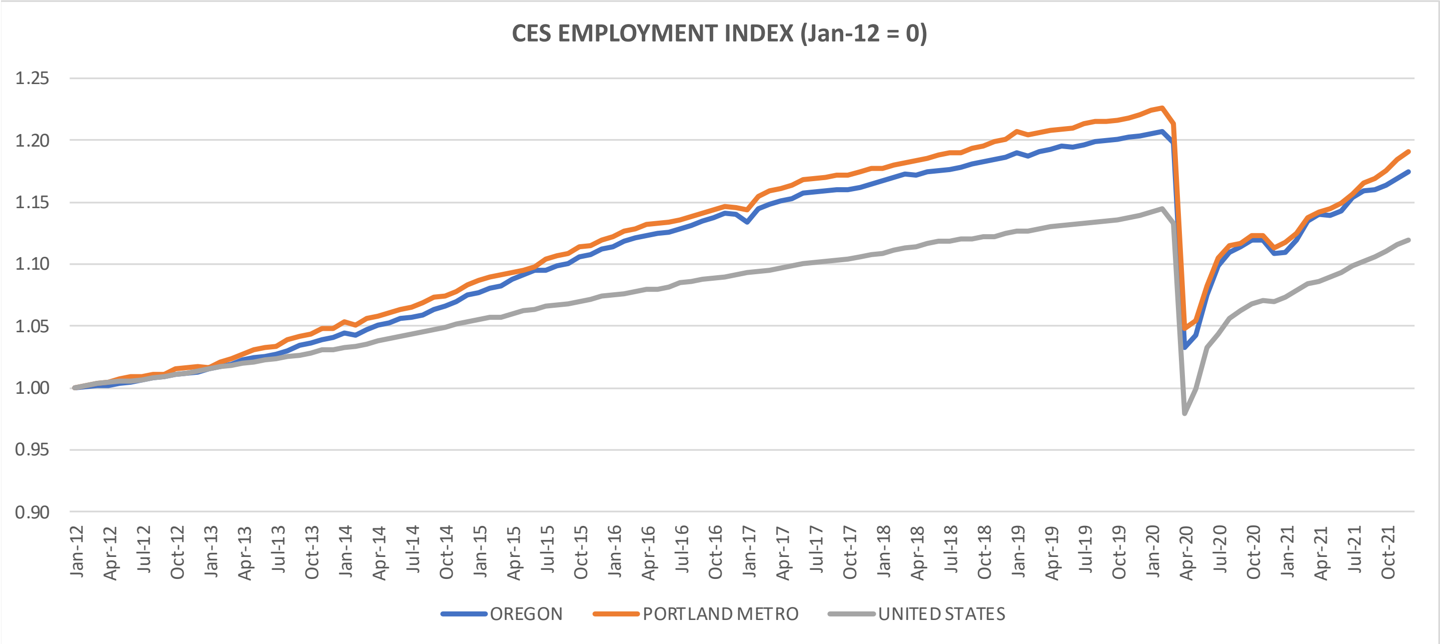

*U.S. Bureau of Economic Analysis*

GDP in current dollars increased at an annual rate of 14.3% during the fourth quarter, adding $790.1 billion to overall activity. Real GDP growth in the quarter was a more modest yet still robust 6.9%. The PCE price index increased 6.5% during the quarter, higher than the 5.3% increase during the third quarter. Excluding food and energy prices, the index increased 4.9%. Real GDP increased 5.7% in 2021 on average relative to 2020.

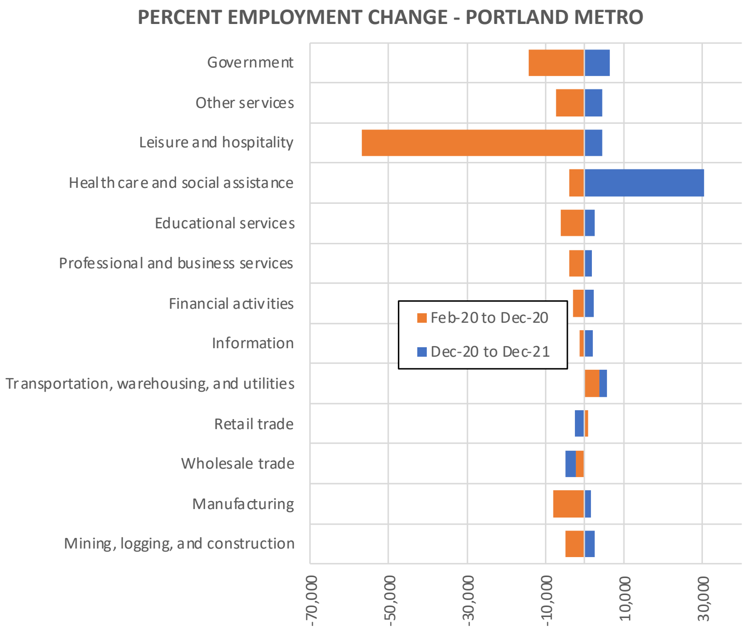



*U.S. Bureau of Economic Analysis*

While GDP growth has been robust, employment remains below pre-pandemic levels nationally as well as in Oregon and the Portland metro area. The state and metropolitan area continue to outperform the national average over the last decade, but the growth rate in the current cycle has followed national patterns.

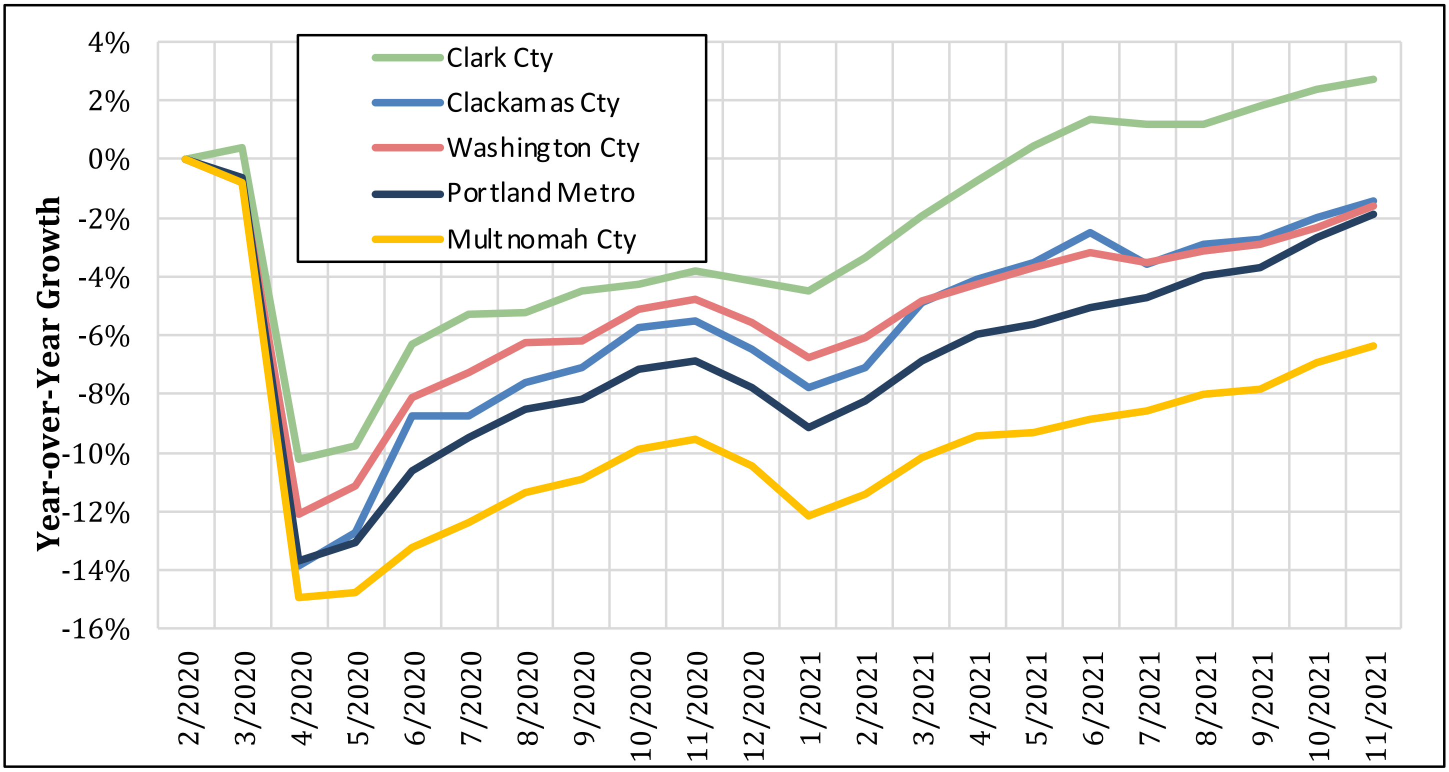



*U.S. Bureau of Labor Statistics, Qualityinfo.org*




Employment levels in the Portland metropolitan area remain well below pre-pandemic levels, with only 52% of the 106,000 jobs lost in 2020 recovered through 2021. Employment losses were most significant in the leisure and hospitality and government sectors, neither of which has yet regained their previous employment base. Health care and social assistance is the one major sector that has done well in terms of employment levels over the last two years. Transportation, warehousing, and utilities have also done well through the pandemic, buoyed by the rapid expansion of e-commerce.

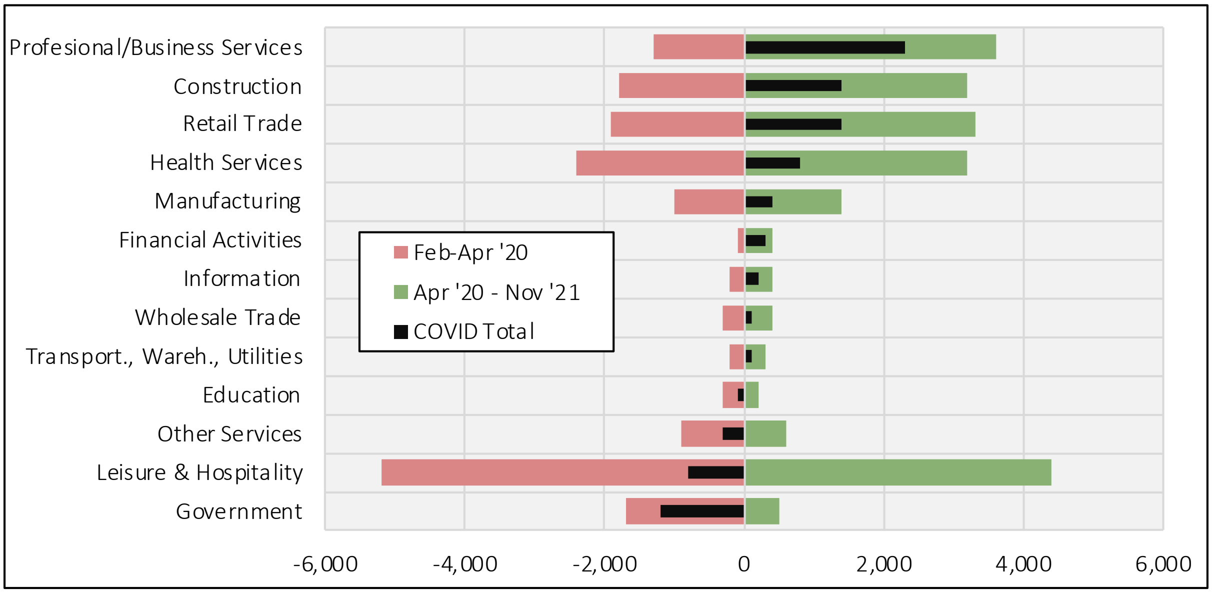
Clark County has been the brightest spot in the region during the pandemic, with the most limited initial impact as well as the strongest subsequent growth. After initially losing 10% of its jobs, the county's employment level was 3% higher than pre-COVID as of November 2021. The opposite is the case for Multnomah County, which saw the steepest initial loss (-15%) as well as the weakest subsequent growth – currently 6% below pre-COVID employment.




*SOURCE: OR Employment Department, WA Employment Security Department, US BLS, JOHNSON ECONOMICS*

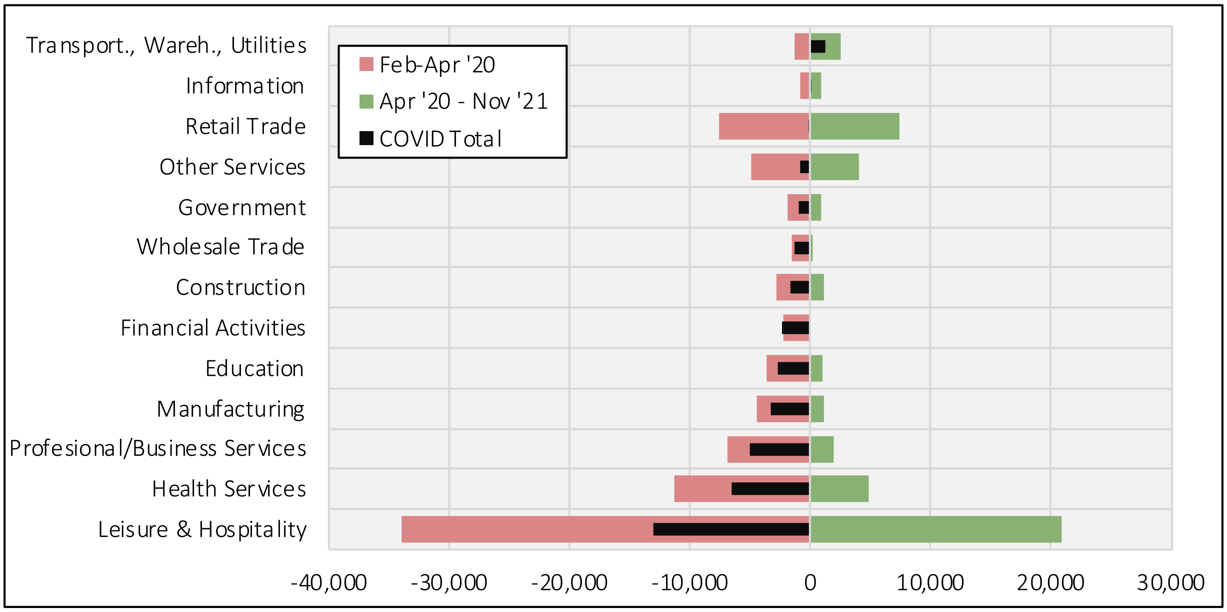
The strength of Clark County is primarily due to continued growth in professional and business services. This was the industry that drove the county's strong growth in the last decade, helped by multiple headquarter relocations. This industry has attracted many young high-wage earners, which has benefitted the county's apartment market. The public sector is responsible for most of the employment that remains lost from the early part of the pandemic.

**CHANGE IN EMPLOYMENT DURING COVID-19 BY INDUSTRY SECTOR, CLARK COUNTY**




*SOURCE: WA Employment Security Department, JOHNSON ECONOMICS*

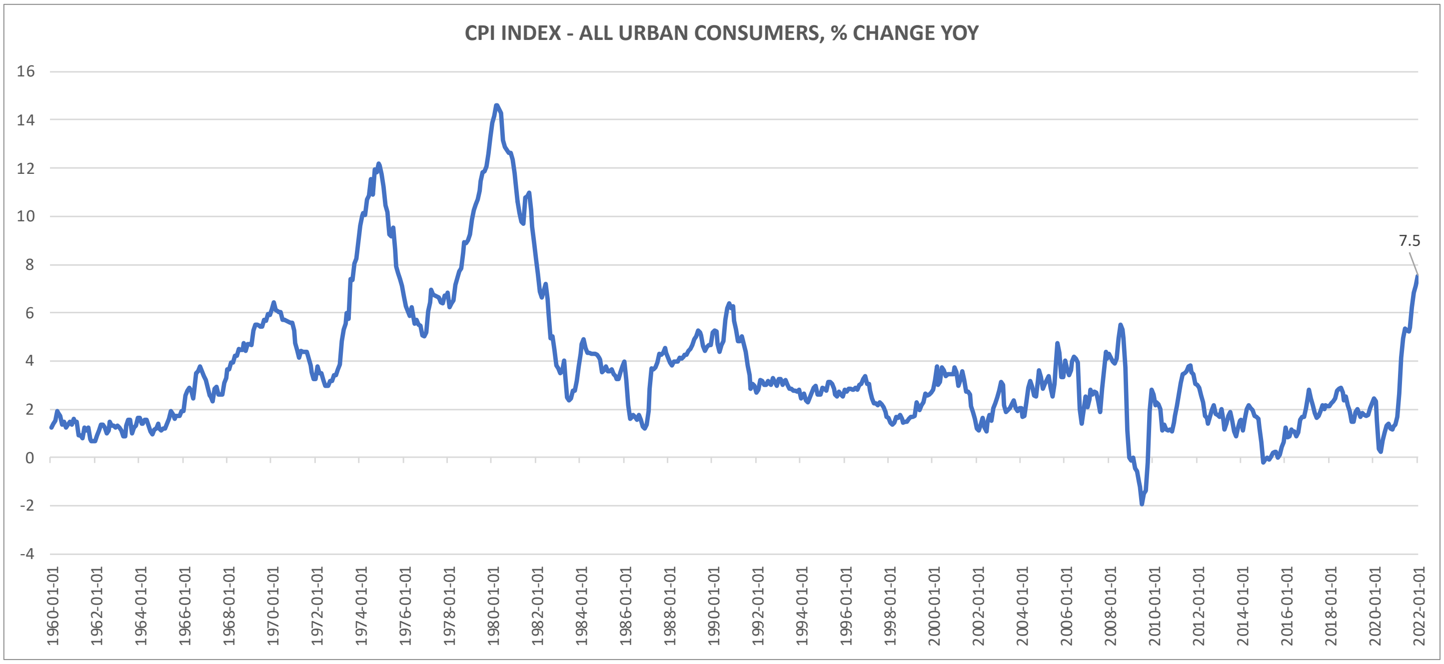
**CHANGE IN EMPLOYMENT DURING COVID-19 BY INDUSTRY SECTOR, MULTNOMAH COUNTY**




*SOURCE: OR Employment Department, JOHNSON ECONOMICS*

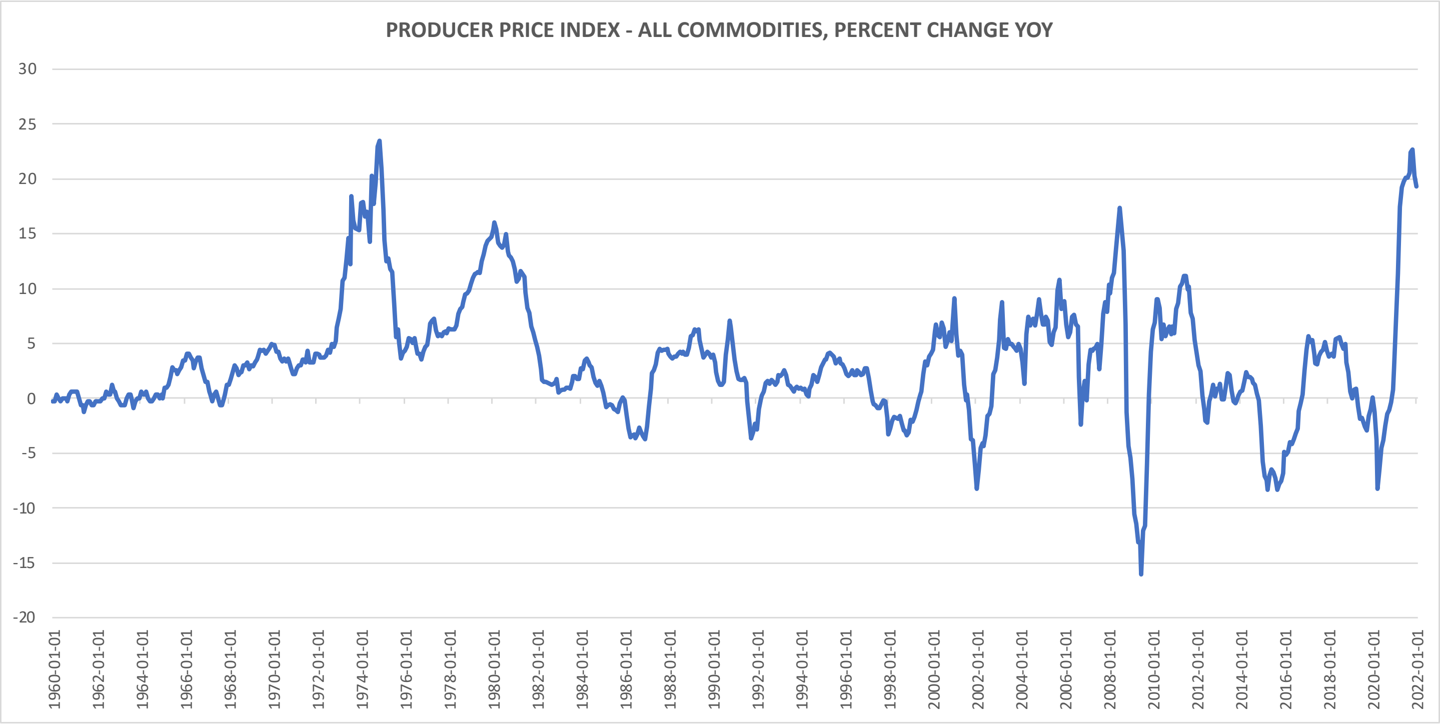
The picture is very different in Multnomah County. A large share of the downtown office workers – most of whom belong to the professional/business service industry – have yet to return. County-wide employment in this industry remains 6% below the pre-COVID level. Their absence continues to hurt the restaurant industry (leisure/hospitality), which remains 23% below the pre-COVID level.

Inflation continues to be an area of concern, with the most recent Labor Department report indicating that consumer prices climbed 7.5% in January year over year. This reflects the largest rate of growth in the CPI since 1982.

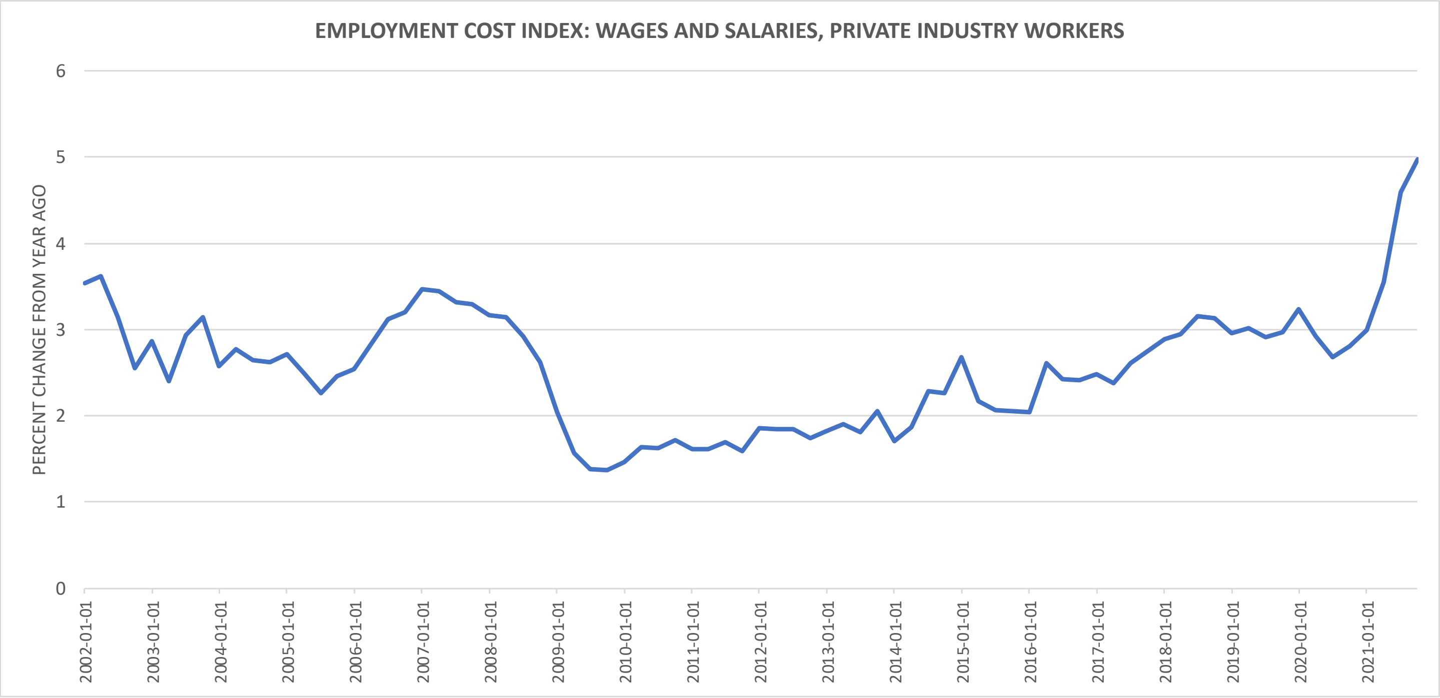



*U.S. Bureau of Economic Analysis*

The rate of inflation has now been above 5% for eight consecutive months. Producer prices are also showing sharp increases, which is expected to continue to place inflationary pressure on pricing. The producer price index, which measures inflation at the wholesale level, grew 9.7% in January of 2022, following two consecutive months at 9.8%. Core inflation, excluding food and energy, was up 6.9% on average over the last twelve months. Commodities were up almost 20%, a level not seen since the 1970s. Employment costs are also rising rapidly, fueled by labor market tightness, and fed by the inflationary cycle.

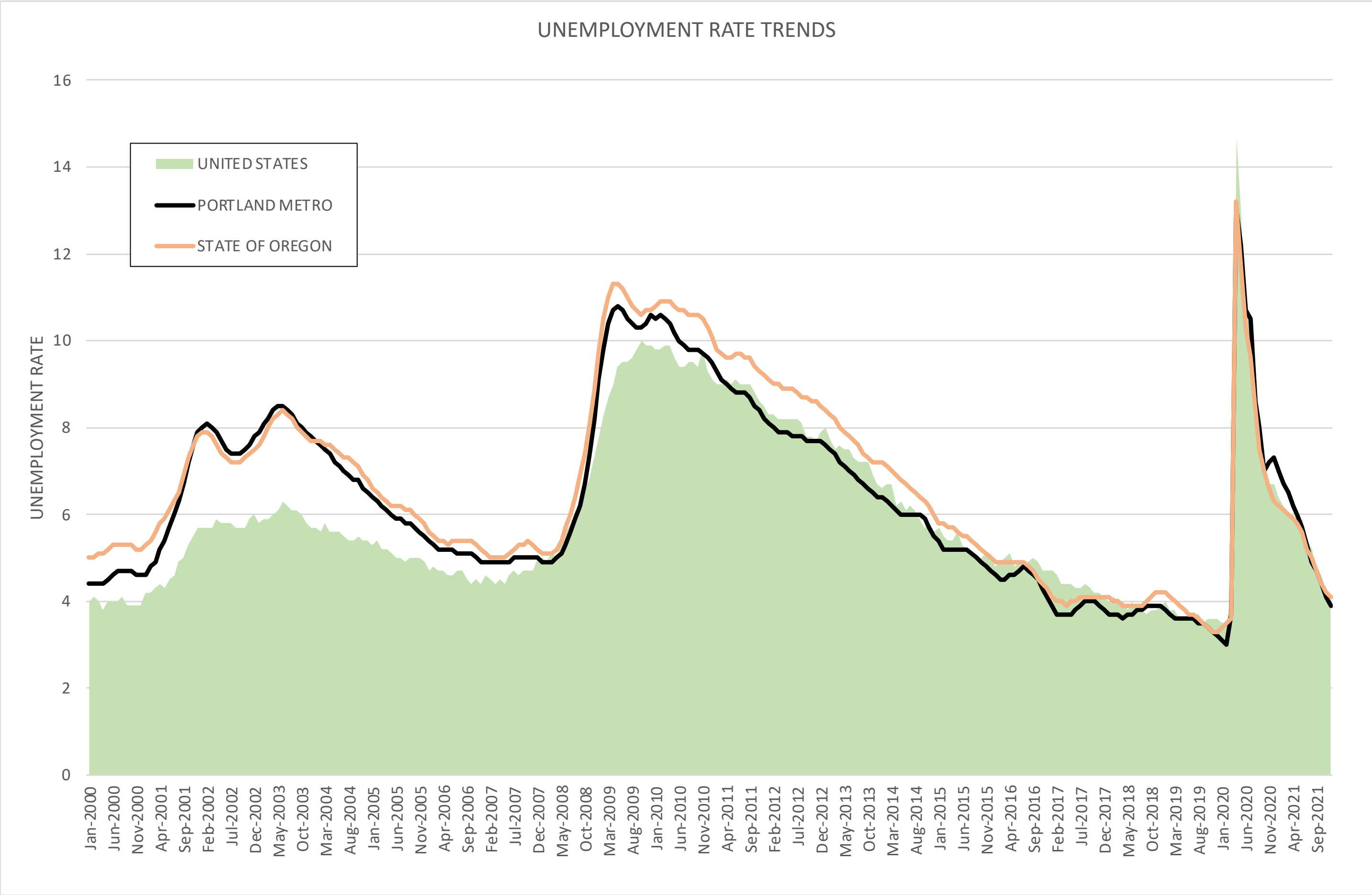



*Federal Reserve Bank of St. Louis*




*Federal Reserve Bank of St. Louis*

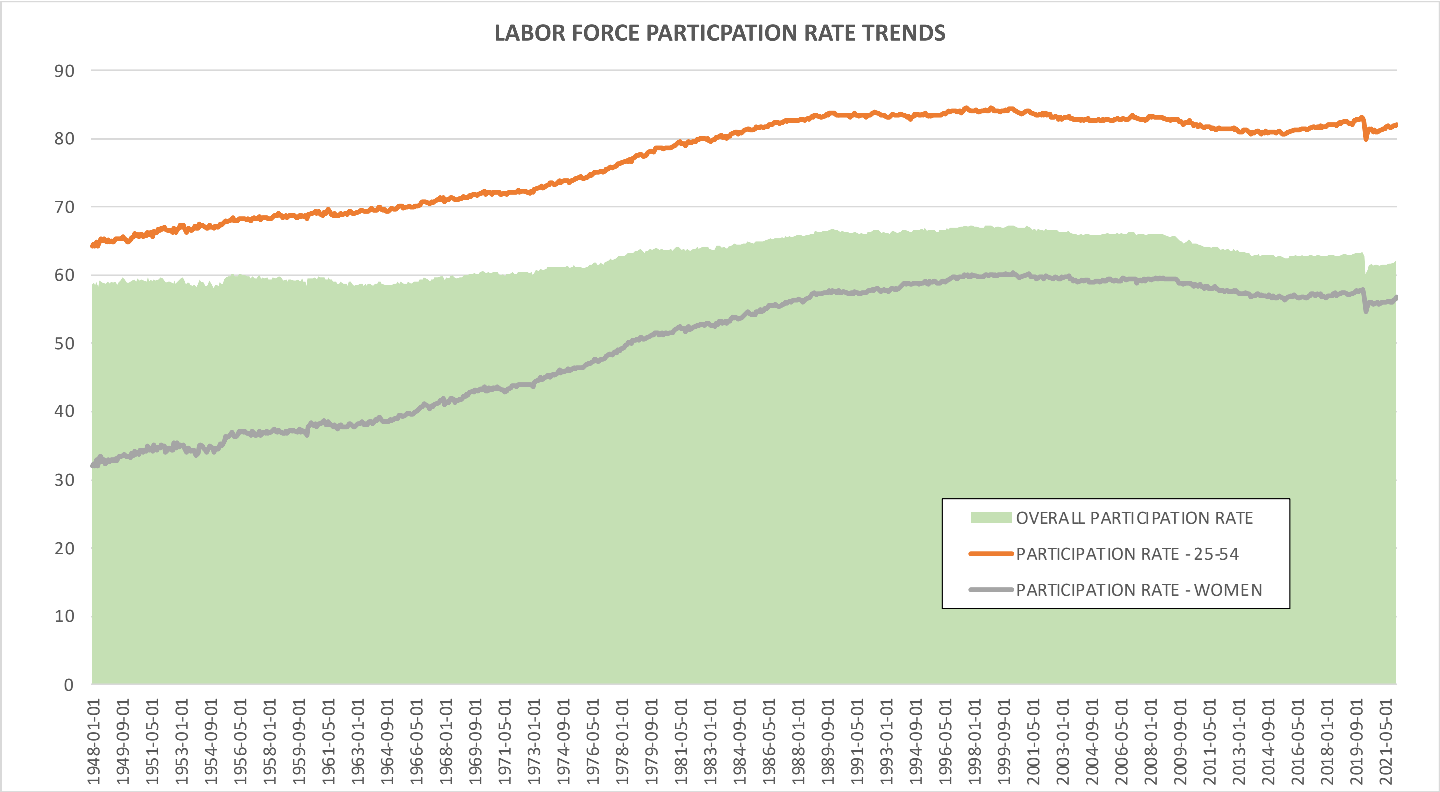
While employment remains below pre-pandemic levels, the unemployment rate at the national and local level has dropped below 4.0%. The drop in unemployment reflects a sharp recovery of lost employment in the early months of the pandemic, as well as a significant drop in the labor force participation rate.




*SOURCE: State of Oregon Employment Department*

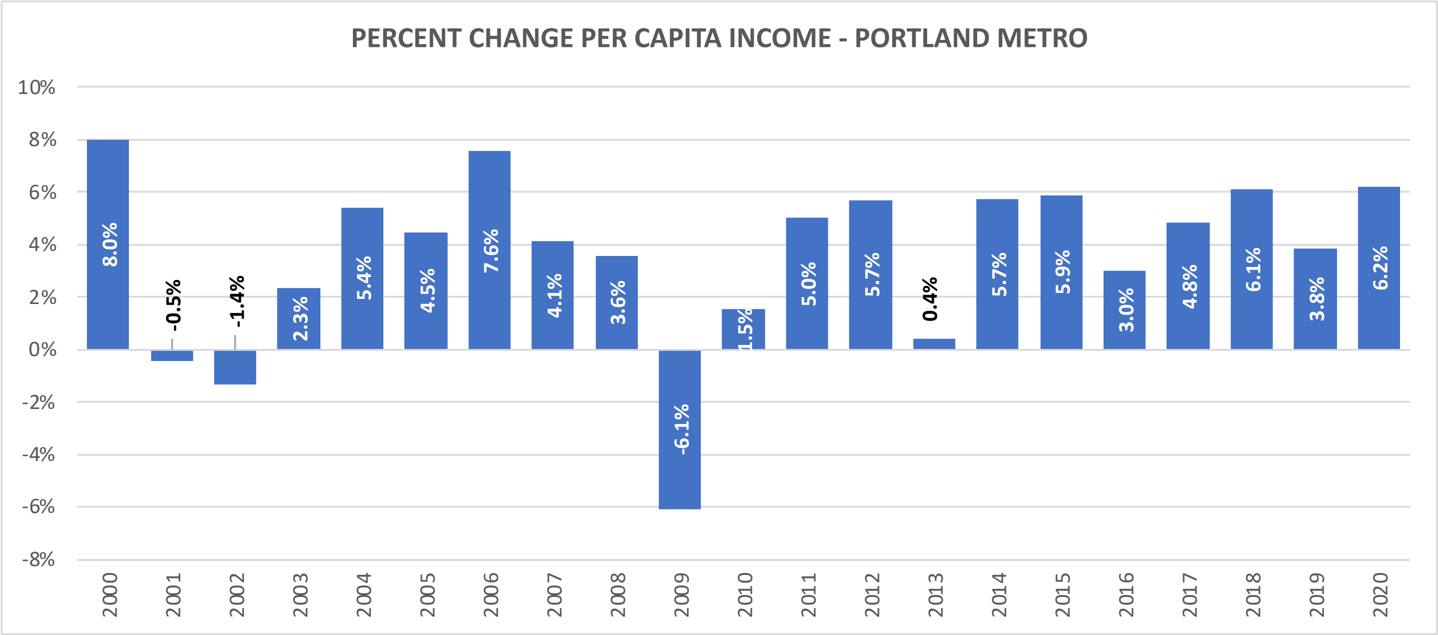
Goldman Sachs estimates that that roughly 5.0 million persons have exited the labor force since the start of the pandemic. This is likely an overstatement, as it includes an assumption of normal labor force growth. Population growth has been unusually low during the pandemic, with net international migration dropping significantly.

The Bureau of Labor Statistics (BLS) calculates the national labor force participation rate from the Current Population Survey (CPS). This is a monthly survey of approximately 60,000 households. The CPS survey indicates that losses in the labor force are concentrated in the 25-29 and 45-49 age cohorts, and most are women. When we look at the participation rates over time, the pattern for women and prime labor force (25-54) appears to be consistent with the overall pattern.



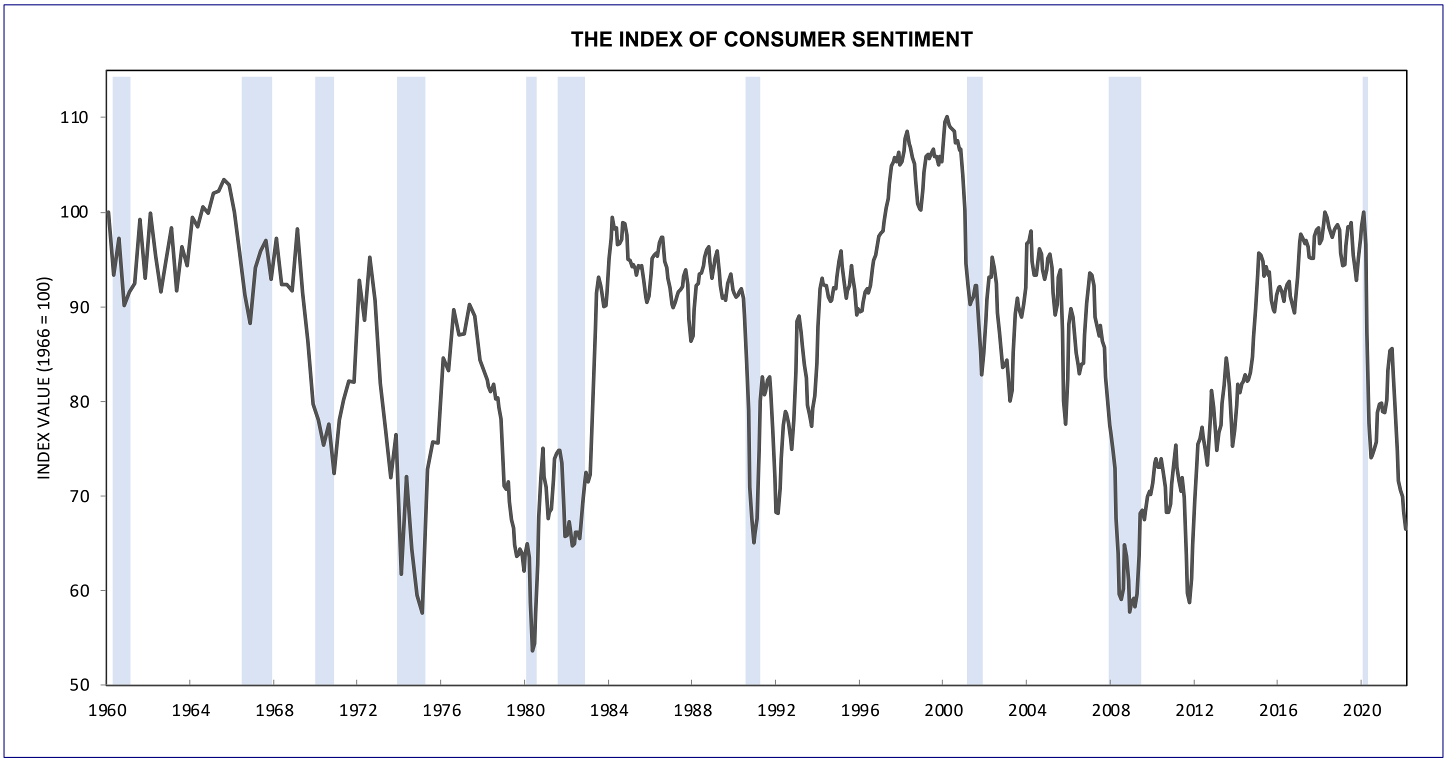

*SOURCE: Federal Reserve Bank of St. Louis*

The tight labor market has begun to be reflected in employment costs, with average wage and salary levels in the Portland metro area up 8.6% in 2020. While wage levels are up significantly, placing inflationary pressure on prices, that same inflation has offset the wage gains with buying power up only modestly when adjusted for inflation. We have more money, but it is not worth as much.



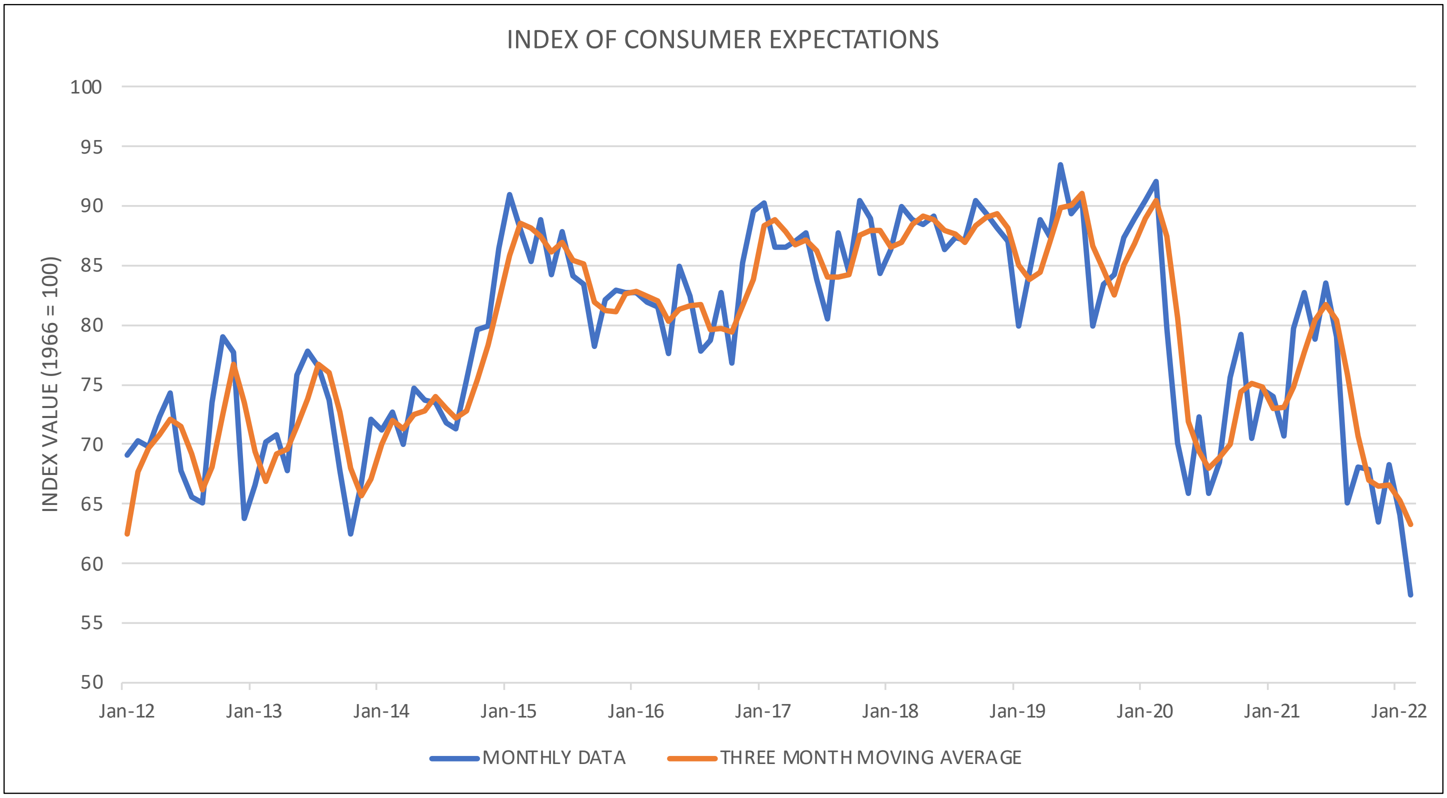

*SOURCE: Bureau of Economic Analysis*

Inflation and the increasing acceptance that the pandemic is likely to be endemic have contributed to an erosion of consumer confidence. The University of Michigan's Index of Consumer Sentiment has seen a sharp drop in the last few months, reaching its worst level in a decade. The recent declines have been driven by weakening personal financial prospects, to a large extent related to rising inflation. The survey also reflected lower confidence in the government's economic policies. The decline in February reflects the opinions of households with incomes greater than $100,000. This is notable as the index tends to rise in expansion cycles, and sharp drops have often preceded recessions in the past.




*SOURCE: University of Michigan*

A similar pattern is seen in the Consumer Confidence Index, which is published monthly by the Conference Board. The index reflects consumers' short-term (six month) outlook for the performance of the overall economy. This index is an important component of the broader consumer confidence index. Expectations in this index are currently at the lowest point in the last decade.




*SOURCE: Conference Board*

02

MARKET ANALYSIS

# Will the City of Portland's Charter Reform be Democratic?


**Gerard Milder**

Portland State University

Gerard Milder is an Associate Professor in the School of Business at Portland State University.

What would you think if you ran for City Council, won 50% of the vote, your two opponents won 40% and 10%, respectively, and yet all three of you were awarded a city council seat…? You would have the same council seat as both opponents, even though you received five times as many votes than one of them. That sounds completely unfair, yet that is what the City of Portland's Charter Review Commission is proposing.

In November 2022, City of Portland voters will vote to change the city's form of government, with the key proposal moving from the current discredited commission form of government to a city manager form of government. This welcome change promises greater coordination between the various city bureaus and better bureau management, as most city commissioners have little city management experience.

While this change is long overdue, the Charter Review Commission has also proposed elections to City Council that include ranked choice voting and multi-member districts which are unrealistic and undemocratic. The Commission should drop this proposal in favor of a simpler City Council election method – 12 city councilors elected from 12 equal population districts using our existing primary process.

The Charter Review Commission adopted as a goal to increase the number of minority voices on City Council. In their early deliberations, for example, they recognized that turnout is greater at general elections in November, particularly among racial and ethnic minorities. They also recognized that Portland doesn't have that many geographic concentrations of racial and ethnic minorities that would promote election of minority candidates to the City Council. The irony of this goal is that the current City Council is 40% Black and 20% Latino in a city that's overwhelming white and non-Hispanic.

The Commission's negative view of low-turnout primary elections in May led them to adopt ranked choice voting, where voters list their preferences 1st, 2nd, 3rd, 4th, etc. among the City Council candidates, with ballots for lowest ranked candidates transferring to one's second or third choice. Depending upon the other elements of the reform, this method would create "instant primaries" in November, when minority turnout is highest.

The problem with ranked choice voting is that most voters have limited information when they vote. They might have good knowledge of some of the candidates on the ballot, but no voter is aware of the merits or positions of all the candidates in a five- or 10-person race. By contrast, the current primary election system helps voters focus on serious candidates after eliminating fringe candidates in the primary. Hence, the advocates of ranked choice voting are promoting an election system with less voter information and deliberation.

Compounding this error, the Commission proposes “multi-member districts”, in which several people from a single district would be elected. In the current proposed format, three people would be elected from each of four districts for a total of 12 City Councilors. The Commission was persuaded by arguments that most European parliaments use multi-member districts along with proportional representation, so that smaller parties are represented in proportion to their total vote.

The problem with multi-member districts that the Commission proposes is that candidates with very small number of votes would receive the same council seat as more popular candidates with two, three or even five times the number of votes. Unlike proportional representation parliaments, where votes determine the number of elected party representatives, city elections are non-partisan and there’s no mechanism to add weight to more popular representatives.

This proposed system will elect more fringe candidates. And while many on the Commission believe this will enhance minority and progressive voices on the Council, multi-member districts could just as easily bring obstructionist, right-wing representatives on the Council.

Some of the interest in multi-member districts by the Commission is self-serving as several are past or future City Council candidates. For example, the commission is chaired by activist Candace Avalos, who lost a 2020 City Council election to Carmen Rubio by 68% to 9%. Under the proposed revision, Ms. Avalos would have earned a Council seat equivalent to that of Commissioner Rubio, as well as the third-place fringe candidate with even fewer votes.

The Commission’s multi-member district proposal also ensures that Council races will be held in gigantic districts with populations of 161,000, much larger than the cities of Hillsboro, Beaverton, and Gresham. Large districts will increase the cost of campaigning and reduces the opportunity of neighborhood representation and grass roots democracy.

The shame of Commission’s proposal is that a desperately needed reform of our commission form of government is being held hostage to a weird and undemocratic scheme for electing a city council.

# 03

COMMERCIAL MARKET

# Office Market Analysis


## Anthony Bertenelli

Portland State University


Anthony Bertenelli is a Master of Real Estate Development (MRED) candidate at Portland State and a Society of Industrial and Office Realtors (SIOR) real estate student fellow.

## EMPLOYMENT

Aggregate employment levels remain a problem within the Portland metropolitan area ("MSA"). The unemployment rate in the Portland MSA was 3.4% in the fourth quarter. This was down from the fourth quarter 2020 rate of 7.1%, a steep 52.1% year-over-year ("YOY") decline. Month-over-month within the quarter showed incremental progress. For example, the unemployment rate fell 2.9% from October to November 2021 alone, from 3.5% to 3.4%. Non-government hiring across the MSA rose by over 10,300 jobs in the fourth quarter. These results also mirror the same trends seen on the national and Oregon state level. The Oregon unemployment rate dropped each month in the fourth quarter from 4.7% on September 1, 2021, to 4.1% on December 31, 2021.

Employment recovery by sector in the MSA also showed strong gains with those industries heavily affected by the COVID-19 pandemic showing fast bounce-back growth. The leisure and hospitality industries devastated in 2020 saw gains of more than 1,000 jobs YOY with retail – as well as construction, manufacturing, and wholesale trade – gaining more than 3,000 new hires in October 2021 alone. The only sector which saw job losses in the fourth quarter of 2021 was government employment, which saw a seasonally adjusted loss of 5,600 jobs. Most of this loss occurred in public schools amid the expiration of pandemic government assistance programs.

Despite these strong statistical gains and recent spurts in new hiring, the employment numbers for all of 2021 in the MSA are grim. Across Oregon, the economy is more than 30,000 jobs below the peak employment watermark in February 2020, the start of the pandemic. Public school teaching and staff shortages are so acute statewide that there are 9,000 fewer school related employees today than in the fourth quarter of 2019. To make matters worse, employers across Oregon and especially within the MSA are reporting severe staffing shortages and extreme difficulty in filling open positions.

This has been particularly acute in the hospitality, education, transportation, retail, and service industries. For example, the Oregon Restaurant and Lodging Association currently has 23,000 open positions employer members cannot fill. The Oregon Employment Department reported that a whopping 100,000 jobs listed on its website in the fourth quarter



went unfulfilled, a staggering 131% increase YOY from 2020.

The employment outlook within the MSA going into the first quarter of 2022 does not offer much optimism. Employers battered by pandemic losses cannot offer the wage increases many potential employees are demanding. The expiration of special pandemic "hazard" pay rates also acts as a psychological deterrent or pay cut for many seeking jobs in the most crippled service sectors such as hospitality and retail. Ironically, wages across Oregon and especially within the MSA have risen more than 17% since the start of the pandemic, or more than $7,500 per year for the average Oregon employee, but these numbers are not attracting new job seekers into the local markets. In fact, the overall gains in unemployment rates are more a consequence of the declining labor participation rate than actual real net employment growth. In the fourth quarter, Oregon's labor participation rate fell to just 61.5%, slightly lower than the decline at the national level of 63.4%.

**OFFICE MARKET**

The MSA ended the fourth quarter of 2021 with an overall office vacancy rate of 14.6%, rising forty basis points since the end of the third quarter of 202, and more than 190 basis points YOY. The key weakness in the MSA office market is once again the Central Business District ("CBD") which ended 2020 with nearly 20% of all available space empty, or a rate of 19.2%. The office vacancy rate in the CBD continues to increase, up eighty basis points from the end of the third quarter 2021 and more than 370 basis points YOY.

Outside the CBD, the MSA saw somewhat better news. Overall office space showed a minor positive net absorption in the fourth quarter; yet it showed high negative net absorption overall for the entirety of 2021, a negative 1,823,413 square feet. New leasing within the MSA for the entire year was just 2.72 million square feet, higher than in 2020, but far lower than pre-pandemic levels in 2019. The pricing for Class A office properties declined 2.9% YOY, down to an average $29.92 per square foot.

The highest-Class A rates within the MSA are all suburban properties. For example, the rate in Lake Oswego is $35.87 per square foot, up 8.7% YOY, with some landlords asking for more at select "hot" suburban properties. In contrast, some Class A office spaces in the CBD are sitting empty at just $20 per square foot, or less.

As expected, all the major new leases signed in the MSA for Class A office space are in the suburbs. The largest new MSA leases signed in the fourth quarter of 2021 were for 366,000 square feet by ZoomInfo in the Vancouver Waterfront Terminal, and 82,500 square feet in the Amber Creek development in Hillsboro. Both are new projects. The only bright spot from a leasing perspective within the CBD is the signing for 28,762 square feet for a new supermarket in the Northwest District.

With a current negative absorption rate across the MSA, and especially within the CBD, the news only appears worse for Class A office property owners. More than 735,132 square feet of new Class A is currently under development with 160,000 square feet at the new Ritz-Carlton hotel and office complex being built in the CBD. While this new total MSA Class A office development inventory total is below the historic five-year average for the MSA, just 38% of this total, or 466,181 square feet, has been pre-leased. Still, employers from outside Oregon are looking at the relatively inexpensive prices of Class A space in Portland compared to Seattle, Los Angeles, San Francisco, and other comparable cities and taking a decidedly "wait-and-see" approach, given all of Portland's recent public image troubles. Nevertheless, new Class A office space continues to hit the market without much current leasing interest. For example, the new 67,000 square feet Class A office building developed by Sturgeon Development Partners in the Slabtown neighborhood of Portland has received interest from Apple and Google. However, it still sits empty without a single tenant since its completion in October 2020.

### SUBLEASE MARKET

One major headwind creating trouble for property owners of all types in the MSA and especially the CBD is the strong subleasing market for every genre and variety of real estate. While subleasing signs are most visible in empty retail storefronts, efforts by existing lessees to exit their space commitments by passing along savings to sublessees is stifling demand for new leases from primary lessors across all property types. While subleasing can avoid complete lessee rent defaults and provide property owners with some income in the event of the failure of a tenant business, subleasing decreases new potential net income to lessors by allowing the leasing of existing space below the current lease rate by new occupants. This situation means new tenants sign new subleases at lower per square foot rates than other space held in lessor inventory without any net impact on existing property absorption rates. The fact is that many of these subleases offer space that is completely built-out, down to furnishings and artwork on the walls, which makes the situation more competitive for lessors with empty space to lease.

**SUBMARKET STATISTICS**

| Submarket | Total Inventory | Direct Vacancy Rate | Total Vacancy Rate | Total Availability Rate | Q4 2021 Total Net Absorption | YTD Total Net Absorption | Q4 2021 Leasing Activity | YTD Total Leasing Activity | Total Rental Rate |
|---|---|---|---|---|---|---|---|---|---|
| CBD | 28,638,568 | 17.5% | 18.9% | 25.7% | -146,785 | -1,147,370 | 92,005 | 840,020 | $28.81 |
| Pearl District/Chinatown | 3,169,147 | 22.9% | 24.8% | 31.6% | 50,745 | -136,951 | 40,316 | 191,343 | $26.51 |
| **Downtown** | **31,807,715** | **18.0%** | **19.5%** | **26.3%** | **-96,040** | **-1,284,321** | **132,321** | **1,031,363** | **$28.71** |

The size of the MSA sublease market is huge. Of the ten largest leases signed in the CBD within the last six months of 2021, five were subleases. More than 1.6 million square feet of all types of commercial space was offered for sublease in the first quarter of 2021, with more than 1.47 million still available on the last day of 2021. The sublease market is mostly small business owners seeking to avoid their rental obligations due to pandemic disruptions. Huge blocks of Class A office, retail, and other types of space were offered by major employers. For example, Comcast put up 56,000 square feet of Class A office space for sublease in Beaverton.

Other cities are reporting slowly declining subleasing activity which matches the experience in Portland. Seattle lost 377,000 square feet of Class A office from its subleasing market between the second and fourth quarters of 2021. San Francisco lost 289,000 square feet of Class A office over the same time period. But with a high negative absorption rate of nearly 1.8 million square feet of Class A office in the MSA in 2021, nearly 750,000 square feet of new Class A office is currently under construction and joining these properties in 2022. Further, more than 1.4 million square feet of Class A office and other properties is currently available for sublease. Because of this, property owners and especially spec developers of Class A properties will likely see bleak times in 2022, specifically with respect to prices per square foot and the terms new tenants will demand.

## RESOURCES

Market trends portland office - kidder mathews. (n.d.). Retrieved February 3, 2022, from https://kidder.com/wp-content/uploads/market_report/office-market-research-portland-2021-1q.pdf

# 04

COMMERCIAL MARKET

# Industrial Market Analysis

## Antwon Ali

Portland State University

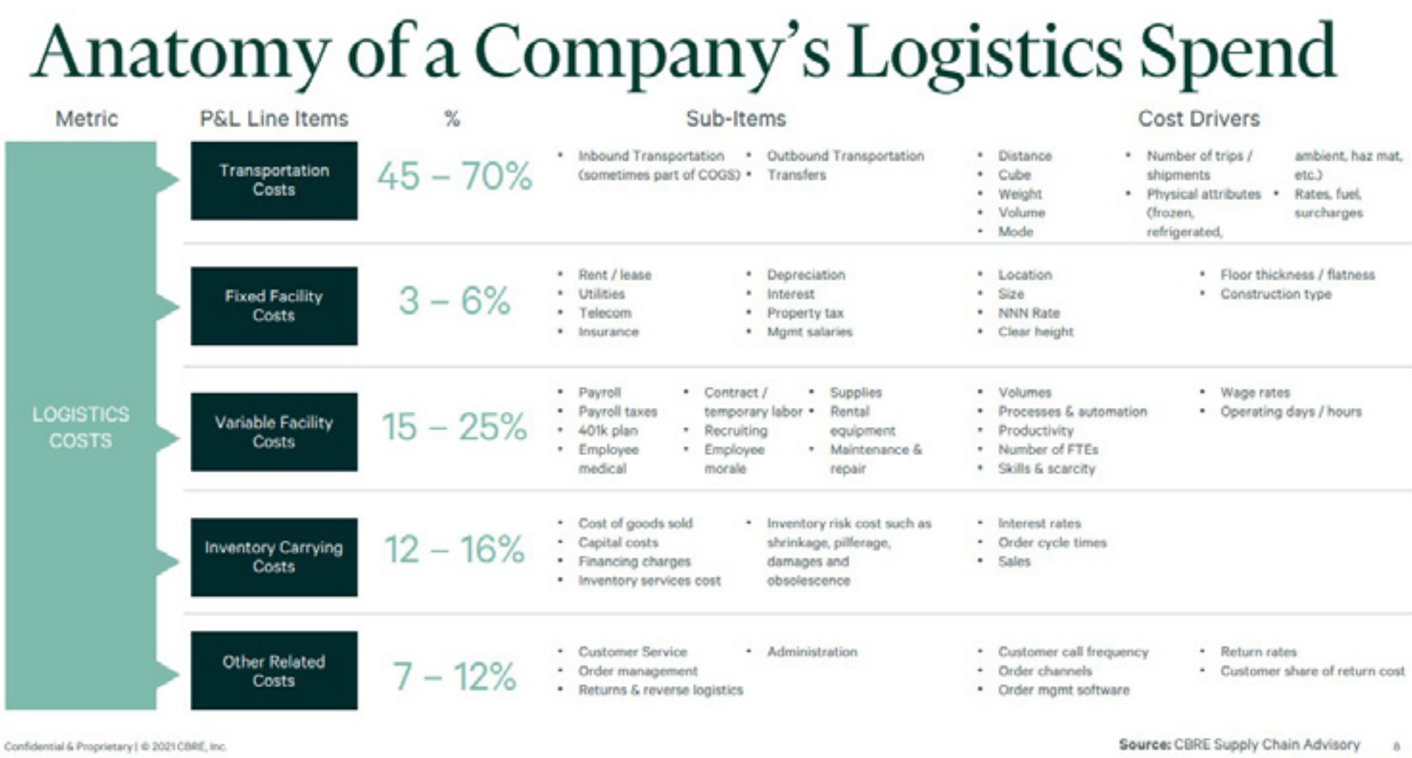
Antwon Ali is a Master of Real Estate Development (MRED) candidate at Portland State and a Society of Industrial and Office Realtors (SIOR) real estate student fellow.

## INDUSTRIAL SECTOR

The industrial sector continues to be the star of the real estate industry with total returns in double-digit territory over the past cycle, according to the National Council of Real Estate Investment Fiduciaries (NCREIF). With ever-increasing tenant demand for more space, the industrial sector shows no signs of slowing as companies continually battle for space and proximity to their customer base. As a result, supply/demand imbalances continue to fuel pricing and returns to record-breaking heights. The size of buildings are growing as companies expand and seek to maximize square footage and building efficiency. E-commerce growth has been one of the most notable contributors to recent demand. With continued strong tenant demand and pricing pressure, the industrial sector appears poised for continuing growth.

## LOGISTICAL DEMANDS

Companies are currently competing to secure industrial space near their customer base. CBRE's Anatomy of a Company's Logistics Spend shows why.

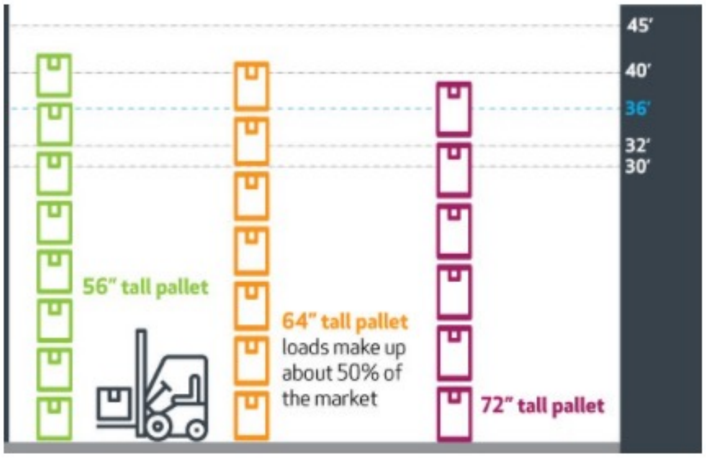


Transportation costs make up a whopping 45% to 70% of all logistic costs, with many cost drivers that are unpredictable and pose a risk to the company's bottom line. In contrast, fixed facility costs account for only 3% to 6% of total logistics costs, with cost drivers that have a relatively lower risk. Companies are identifying ways to control and reduce transportation costs. The best way is to be as close to your customer base as possible to mitigate major transportation cost drivers. It becomes more cost-effective to increase fixed facility costs by paying a rent premium for the correct location.

Furthermore, companies are expected to begin to focus more on reshoring. A May 2020 survey by McKinsey and Company found that 93% of logistics executives plan to increase resilience in their supply chains. Nearshoring and reshoring could play significant roles in those efforts. The NAIOP article All Eyes on Supply Chain also highlights how labor costs factor in reshoring. According to a 2019 report from IVEMSA, a Mexican manufacturing back-office services provider and shelter company, labor costs in Mexico are about $4 per hour compared to roughly $4.95 in China. Naturally, it is significantly cheaper to transport goods from Mexico than China.

Portland's industrial sector continues along the same vein as the national industrial sector, with supply chain woes leading companies to get closer to their customers. They are increasing their logistical reliance on warehousing as consumers expect fast delivery. According to Capacity Commercial Group's Industrial Market Outlook for Portland Q4 2021:

> "…supply chain constraints will continue through 2022. With major ports such as Los Angeles and Long Beach experiencing ongoing congestion, smaller to mid-sized ports such as Portland have benefited from some of these supply chain issues, leading to increased demand for warehouse space from retailers and logistics service providers. The Port of Portland has seen a large increase in TEU processing as the Port added weekly container services with MSG and SM Lines. The increased port activity places Portland at 15th in the country for top Port of containerized cargo."




*In a building with a 36-foot clear height, a user will be able to rack one pallet position higher. Fifty-six inch pallets require 37 feet clear before they can gain another pallet position.*

## BUILDING GROWTH

Industrial buildings in Portland, and in general, are getting larger and taller. The article Go Big or Go Home by Mark Childs discusses the evolution of building square footage by analyzing the current construction pipeline. Childs states:

"We are showing around 5M SF under construction, and close to 6M SF planned beyond that. Just a few years ago, building a speculative 200k SF building was rare. If you had enough land, you built a few buildings larger or smaller than 100k SF each. Now, most sites are covered by one building, with some sites having two or three buildings only because the site configuration won't allow one large building. The average building size currently under construction is close to 250k SF, and while the data is still a little sketchy, the average size for the buildings planned will probably be a little larger."

Tenant absorption rates are increasing due to forecasted long-term demand. Tenants are stockpiling inventory to ensure sufficient supply as demand continues to rise and there is no clear-cut path to end the supply chain woes. Thus, there is a demand for larger spaces. Portland has also seen its clear heights rise. In interviews, multiple local industrial brokers have said that clear heights have consistently gotten taller to accommodate tenant demands. They stated that 10 years ago, the typical clear heights were 24 to 26 feet. Today the standard clear height ranges from 30 to 36 feet in the Portland metro area. An article by Method Architecture explains how clear heights add to a building's efficiency. The article states, "the efficiencies in utilizing more cubic space rather than a larger footprint" maximizes the volume of the cube.

## E-COMMERCE

According to CBRE's U.S Industrial & Logistics Market National Update, companies are leasing space at record levels to handle the significant increase in e-commerce sales. There was a record estimated 432.1 million square feet absorbed in 2021. Also, the increased demand from e-commerce and the need for safety stock to counter supply chain disruptions will further push up asking rents and keep vacancy rates at record lows. This is despite a large amount of new development in 2022. A typical rule of thumb in the industry is that a $1 billion increase in sales requires 1 million square feet of industrial space. CBRE projects that e-commerce sales will reach 33% of all retail sales by 2032. In light of these projections, there remains significant new demand potential.

In his article, Mark Childs explains the effects of e-commerce on the Pacific Northwest and Portland:

> "Why the shift? The Amazon effect. As I've shared before, the basic concept is that the largest 100 retailers have to compete with home delivery, so they are expanding their one or two national warehouses to the six to eight range, with at least one landing in the Pacific Northwest. And when they land, it is usually in the 100k to 500k square foot range. One would expect them to land in the Seattle area, the larger market, but that has happened so much that they are basically out of land. New, large developments have been pushed down to the Centralia/Chehalis area, and while this locale has the land, they don't have any employees to staff them. Plus, the Kent Valley has become very expensive. A 20k SF lease in the Portland area that would be in the $0.70 shell and $0.25 NNN range is a $1.10 shell and $1.00 NNN range in the Kent Valley."

Like the rest of the nation, Portland's industrial assets have benefitted from the rise in consumer demand and lack of available warehouse supply.

## CONCLUSION

There is no clear end in sight for industrial rent growth. Compared to transportation spending, the logistic spending companies are incentivized to pay rent premiums for locations closer to their customer base. As tenant demands shift, buildings are growing larger and larger as warehousing is becoming more popular due to inefficiencies in the supply chain and other factors. E-commerce sales are projected to rise steadily over the next 10 years and make up 33% of retail sales by 2032. There is considerable upside for Portland's industrial rent growth. According to CBRE's 2021 U.S Industrial & Logistics Market report, national annual asking rents rose to a record $9.10 per square foot, 11.0% higher than a year ago. Rent growth is expected to remain at double-digits for the foreseeable future.

The Kidder Matthews Fourth Quarter 2021 Portland Industrial Market report shows leasing activity climbed 15.6% year over year from 9.9 million square feet in 2020 to 11.4 million square feet in 2021. The most active submarket clusters for the year were the Southeast and I-5 Corridor, with 35.8 million square feet and 29.4 million square feet. Rent growth in Portland's industrial market shows no sign of slowing down.

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05

COMMERCIAL MARKET

# Retail Market Analysis


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## INTRODUCTION

As signs of a stable economy shine on the horizon, the Portland retail market must be prepared for the shift in people, preference, and possibilities that emerge from the pandemic. Oregon's relatively affordable cost of living has attracted an influx of new white-collar residents to its metropolitan area. The shift from place-based to web and e-commerce purchasing during the pandemic may be an indicator of long-term consumer preference shift. These changes invite and challenge us to rethink if, where, and how place-based retail can exist in this new environment.

As Portland's market continues to rebound from pandemic induced lows, local population growth in the fourth quarter of 2021 was more than 250% the national average. This growth can be attributed, in part, to the shift to remote work during the pandemic. According to CoStar, many migrants from more expensive cities have transitioned to Portland. The decision of many employers to adopt telework or hybrid models as an option for its employees is likely to lead to these high-income earners making Portland home.

## INCOME

The Portland metro area's median household income is exceeding pre-pandemic levels and demonstrating greater growth than the national median income (see Table 1). According to the Bureau of Labor Statistics, Oregon's unemployment rate has shrunk to one-third the rate at the start of the pandemic, closing the fourth quarter at 4.1%. The dropping rate can be attributed, in part, to a decrease in labor force participation. The 61.9% labor force participation at the end of 2021 was a 1.4% decline from the closing of 2019.

The decrease in unemployment and increase in median household income are promising signs that the greatest economic challenges are behind us. Apart from malls and downtown Portland, all submarkets continue to appear stable and are meeting or exceeding pre-pandemic numbers in terms of market rent per SF, market sale price per square feet, and sales volume.

**TABLE 1: Q1 2019 TO Q1 2023 MEDIAN HOUSEHOLD INCOME**

| Period | Portland | United States |
|---|---|---|
| 2023 Q1 | $91,570 | $74,998 |
| 2022 Q4 | $90,588 | $74,292 |
| 2022 Q3 | $89,322 | $73,322 |
| 2022 Q2 | $87,892 | $72,201 |
| 2022 Q1 | $86,159 | $70,941 |
| 2021 Q4 | $84,135 | $69,437 |
| 2021 Q3 | $82,235 | $68,084 |
| 2021 Q2 | $80,249 | $66,648 |
| 2021 Q1 | $77,989 | $64,859 |
| 2020 Q4 | $77,682 | $64,582 |
| 2020 Q3 | $77,499 | $64,623 |
| 2020 Q2 | $77,704 | $64,947 |
| 2020 Q1 | $78,746 | $65,888 |
| 2019 Q4 | $78,439 | $65,712 |
| 2019 Q3 | $77,882 | $64,888 |
| 2019 Q2 | $77,286 | $63,988 |
| 2019 Q1 | $76,512 | $62,967 |

*Source: Kidder Mathews*

## VACANCY

Locally, vacancy rates remain lower than the national average, but the hit to the Portland retail market was a dizzying blow. Portland average vacancy rates have increased 0.90% since Q4 2019, while the national average has increased 0.11% during that same period (see Table 2). Historically, strip malls have been the lowest performing locations for place-based retail. However, since the start of the pandemic, older malls and "those that lost department-store tenants" have claimed this unfortunate title, according to the Wall Street Journal. Locally, vacancy rates have doubled in commercial business districts, skyrocketing from 2.6% in Q4 2019 to 5.3% in Q4 2021. According to CoStar's forecast, vacancy in the commercial business district will stabilize around 5% well into the future. This perhaps could indicate a shift to the in-consumer preference for suburbia that was exacerbated by the pandemic.

**TABLE 2: Q1 2019 TO Q1 2023 VACANCY**

| Period | Mall | Power Center | Neighborhood Center | Strip Center | General Retail | Other Retail | Portland | U.S. |
|---|---|---|---|---|---|---|---|---|
| 2023 Q1 | 7.4% | 3.9% | 4.9% | 5.4% | 2.9% | 1.9% | 3.9% | 4.3% |
| 2022 Q4 | 7.4% | 4.0% | 4.9% | 5.5% | 2.8% | 1.9% | 3.9% | 4.3% |
| 2022 Q3 | 7.5% | 4.0% | 5.0% | 5.5% | 2.8% | 2.0% | 3.9% | 4.4% |
| 2022 Q2 | 7.6% | 4.1% | 5.1% | 5.6% | 2.8% | 2.1% | 4.0% | 4.5% |
| 2022 Q1 EST | 7.5% | 4.2% | 5.1% | 5.7% | 2.8% | 2.5% | 4.0% | 4.6% |
| 2022 Q1 QTD | 7.3% | 4.2% | 5.2% | 5.7% | 2.9% | 3.8% | 4.1% | 4.6% |
| 2021 Q4 | 7.4% | 4.2% | 5.4% | 5.4% | 2.9% | 4.1% | 4.1% | 4.6% |
| 2021 Q3 | 7.4% | 4.0% | 5.6% | 5.6% | 2.8% | 3.1% | 4.1% | 4.8% |
| 2021 Q2 | 6.8% | 4.4% | 6.1% | 6.3% | 3.0% | 3.1% | 4.3% | 5.1% |
| 2021 Q1 | 6.1% | 4.7% | 6.0% | 6.0% | 2.8% | 2.1% | 4.2% | 5.2% |
| 2020 Q4 | 5.1% | 4.2% | 5.9% | 5.4% | 2.9% | 2.1% | 4.1% | 5.1% |
| 2020 Q3 | 4.0% | 3.9% | 5.9% | 5.7% | 2.6% | 2.5% | 3.8% | 5.0% |
| 2020 Q2 | 3.0% | 2.5% | 5.9% | 4.9% | 2.4% | 2.0% | 3.6% | 4.8% |
| 2020 Q1 | 2.6% | 2.0% | 5.6% | 4.5% | 2.3% | 2.1% | 3.3% | 4.7% |
| 2019 Q4 | 2.6% | 1.9% | 5.2% | 4.1% | 2.3% | 1.2% | 3.2% | 4.5% |
| 2019 Q3 | 2.9% | 2.0% | 5.0% | 4.7% | 2.1% | 1.2% | 3.1% | 4.5% |
| 2019 Q2 | 2.4% | 2.3% | 4.8% | 4.9% | 2.2% | 0.3% | 3.1% | 4.5% |
| 2019 Q1 | 2.4% | 2.4% | 4.7% | 4.3% | 1.9% | 0.3% | 2.9% | 4.5% |

*Source: Kidder Mathews*

## DELIVERIES AND CONSTRUCTION

The limited increase of new construction will likely offset some of the impact the pandemic has had on the retail market. According to CoStar, over the last four years less than 500,000 SF of new real estate has been built each year.

E-commerce behemoth Amazon has joined retail giants Nike, Adidas, and Intel in developing a significant real estate footprint across state lines from its home base. In addition to Amazon's $2.8 billion investments across Oregon's office and industrial sectors since 2015, facilities in both Canby and Woodburn have been identified as upcoming sites. Nike continues to host one of the largest campuses in the United States, and Intel is completing its 1.5 million square foot expansion of its previously 2.2 million square foot campus. Currently, there is about 656,000 square feet of construction in process at varying stages.

**TABLE 3: TOP 5 UNDER CONSTRUCTION FOR 2021**

| Property | Submarket | Square Feet | Delivery Date |
|---|---|---|---|
| SW Cedar Hills Blvd. | North Beaverton | 140,000 | 1Q 2023 |
| Happy Valley Crossroads East | Clackamas/Milwaukie | 61,998 | 4Q 2022 |
| 11941 N Jantzen Dr | Hayden Island/Swan Island | 54,562 | 2Q 2022 |
| Milltowner I | North Beaverton | 50,500 | 1Q 2022 |
| 13645 NW Cornell Rd | North Beaverton | 30,000 | 3Q 2022 |

*Source: Kidder Mathews*

## SALES AND LEASES

Typically, the multi-family, office, and industrial sectors have drawn greater investment than retail has in Portland. An indication of the retail sales potential is highlighted in CoStar's fourth quarter report, which says, "Trailing year volume is $797 million, versus the historical average of $573 million." Triple net assets selling essential goods, including personal protective equipment, sold for above average sale prices as risk tolerance shrunk among investors. Average sales per square foot increased 13.22% from the fourth quarter of 2020 to the four quarter of 2021, with average pricing around $236 per square foot.

**TABLE 4: TOP 5 LEASE TRANSACTIONS FOR 2021**

| Property | Submarket | SF | Landlord | Tenant |
|---|---|---|---|---|
| 119431 N Jantzen Dr | Hayden Island/Swan Island | 54,000 | Watmull Proper-ties Corporation | Floor & Décor |
| 10174-10176 SE 82nd Ave | Clackamas/Milwaukie | 40,000 | 82nd & Orchards, LLC | JoAnn Fabrics |
| 2913-3009 NE 72nd Dr | St. Johns/Central Vancouver | 30,000 | Fourth Plain Port-land Shopping Center | O'Reily Auto Parts |
| 9600 SE 82nd Ave | Clackamas/Milwaukie | 29,000 | Gryphon Investors | Home Goods |
| 10400 NE Fourth Plain Blvd | Orchards | 26,000 | | Kaspar Sandblast-ing |

*Source: Kidder Mathews*

**TABLE 5: TOP SALE TRANSACTIONS FOR 2021**

| Property | Submarket | SF | Sale Price | Buyer |
|---|---|---|---|---|
| 8840 SW Can-yon Rd | Sylvan/Hillsdale | 51,817 | $21,000,000 | Kuni/Bullock Marital Trust |
| 10174-10176 SE 82nd Ave | Clacka-mas/Milwaukie | 74,263 | $15,150,000 | Westwood De-velopment |
| 9009 SW Hall Blvd | Tigard | 50,808 | $9,635,000 | U.S. Micro PC |
| 5240 SE 82nd Ave | Clacka-mas/Milwaukie | 44,000 | $9,100,000 | William Gan-der |
| 3600 SW Hall Blvd | North Beaverton | 24,775 | $8,240,000 | William Gan-der |

*Source: Kidder Mathews*

Rent growth in Portland has experienced a -0.3% dip year over year, compared to the national market's 3.0% growth during the same period. Local Power Centers command rents of $27.33 per square foot, $3.17 per square foot higher than the national average. The national index for malls at $30.67 per square foot outpaces the local average of $23.17 per square foot, according to CoStar. Despite the waning rent growth, the Portland market experienced a total of 75,265 square feet of net absorption. The third and fourth quarters of 2021 mark the first consecutive quarters to report positive net absorptions since the end of 2018. Malls continue to trail behind with average pricing of $23.17 per square foot.

**RETHINKING LLOYD CENTER**

To many, Lloyd Center was an economic and cultural hub. It evokes emotional responses in op-ed columns and at dining room tables. Today, it remains a shadow of what it once was, economically and culturally. When Lloyd Center opened its doors in 1960, it was an outdoor mall serving as an alternative to the retail market downtown. Thirty years later, Pioneer Place opened its doors as an indoor mall. In response, Lloyd Center made the executive decision to become enclosed.

Randy Gragg, architectural critic for the Oregonian, vehemently disagreed with the design. In a 1991 article he wrote, "with more development in the area likely, the suburban orientation of Lloyd Center will encourage a sterile, car-choked, suburb-in-a-city, rather than a bustling extension of downtown." He went on to say, "the storefronts and windows facing the streets have been cinder-blocked shut and stuccoed over. All but one street-level pedestrian entrance forces you to troop through a department store."

Tom Kilbane of Urban Renaissance Group (URG), the developer spearheading the revitalization of Lloyd Center, appeared to agree with Gragg's view. Kilbane shared that although the vision for Lloyd Center's future has not been determined, the thought of reopening the street grid (north to south) and increasing street-level pedestrian entrances is appealing to the development firm. URG also believes that the current retail footprint is too vast.

Current NOI at Lloyd Center is negative, with a 50% vacancy rate. Because of this, URG's focus for the next three years will be stabilization. It is not currently recruiting anchor tenants and is unlikely to sign five-year leases. As URG works to develop a 15-year vision of the Lloyd Center, they claim that they are committed to listening to the community. Some combination of residential, retail, event space and office are likely to make up what was once the largest mall in the country.

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06

RESIDENTIAL MARKET

# Multifamily Residential Report


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**The Portland metropolitan area in this report is defined as Vancouver, Beaverton, Gresham, Hillsboro, Milwaukie, Lake Oswego, Oregon City, Fairview, Wood Village, Troutdale, Tualatin, Tigard, West Linn, Battle Ground, Camas, and Washougal.*

## INTRODUCTION

As we head into 2022, the multi-family sector remains a strong asset class within the Portland metro area. Portland still offers the second most affordable rents when compared to the 11 west coast metros; only Fresno, California offers more affordable rents. Portland's affordability continues to drive in new residents, but that could be slowing down due to rapidly rising rents fueled by sustained demand and an oncoming lack of new construction.

The vacancy rate has returned to pre-pandemic levels except for the downtown core. Capitalization rates for multi-family housing remain below 5% for the Portland metro area, and after a record-breaking sales year, new players continue to enter the market as the fundamentals remain strong. We can see the first results of the inclusionary zoning era within the City of Portland, and developers are getting creative. The suburban markets saw the strongest rent growth, and they remain an attractive opportunity as demand has been increasing in most of these areas. The trend of renters seeking large unit sizes and more open or green space remains an ongoing phenomenon. With over 9,000 units being absorbed in the metro area for 2021, how will the multi-family supply keep up with the demand?

## DEVELOPING IN A CHALLENGING CLIMATE

The City of Portland and the State of Oregon have instituted new regulations on developers and property owners in a very unhealthy way, which may disrupt the overall Portland metro economy. New regulations such as statewide rent control and inclusionary zoning coupled with the City of Portland's notoriously slow permitting processes has practically brought new development to a halt within the city limits.

Inclusionary zoning only affects the City of Portland. At its most restrictive level, it requires developers of projects with 20 or more units to either commit 20% of the building to be affordable units or pay a fee in lieu. In return for including affordable units or paying the fee, additional FAR and height limits are granted. While the additional FAR is attractive in many instances, requiring the affordable units or paying the fee lowers the profitability of the project. When this is compounded by rising land values, new projects simply become unfeasible. Developers remain skeptical about paying the fee in lieu because there is not much information on where the funds will be allocated.

Despite the current climate, developers are thinking outside the box. Portland-based developer Solterra is currently building a beautiful and unique LEED designed, 90,000 square-foot, 104 unit building at 1130 NE Alberta Avenue. The project is called Cascada and will be a combination hotel and apartment building. The Building of Development Services application was approved for the housing units to be used as “Co-Living/ Lodging”. The developer on their website describes the units as flexible accommodations where residents can stay for a day or a year. The units will feature full-size kitchens, essentially making the building an upscale version of an extended-stay hotel. The building appears to be circumventing the goals of the city and the purpose of inclusionary zoning which is to provide more affordable units. Solterra was not available for comment, and opinions expressed are solely of the writer.

Another example that will be commonplace is developers only building 19 units on separate parcels to avoid triggering the inclusionary zoning ordinance. Northbound 30 Collaborative located in the Northwest neighborhood is an example of this. The developer divided their larger parcel into eight 5,000 square-foot lots and on each lot will sit a 5-story 18-unit building. This will be a mass timber project that features open spaces between buildings. Like Cascada, it will be ecologically sustainable, but not equitable.

Once a building finishes construction and its initial lease-up, its rents are at its highest for 3-5 years until new product comes online. When new product is added, older products filter down with lower rents until the building needs a renovation. Then, rents go back up temporarily but not quite to their original amounts. Ultimately, the property then filters downward again. If there is steadily new product coming available, then older product will filter down and build up the affordable housing stock for the city. If new production stops while supply is low and demand is high, price competition will occur, which is counteractive to the City’s goals of providing more affordable units.

The City of Portland has disrupted the natural cycle of developers filling the multi-family needs of the city. For the time being, many 19-unit or less properties will be built, and some developers will find interesting ways to circumvent the policy. However, mid-rise development will be put on hold, which works against the density increases the city is trying to create. The lack of development will continue to decrease supply and increase rents as renters compete over remaining inventory. On a positive note, the elimination of single-family zoning will provide the city and the metro area with a growing tri- and quadplex stock.

### CAP RATES

Coming off a record-breaking sales year, cap rates continue to tighten as the Portland metro improved from 4.6% to 4.5% from the fourth quarter of 2021 to the first quarter of 2022. The suburban cities of Hillsboro, Tigard, Wilsonville, Beaverton, and Clark County continue to have slightly stronger cap rates than the urban core as remote work drives renters to look for larger units and more green space. For buildings with at least 20 units, no Portland submarket with a decent amount of multi-family properties exceeds a 5% cap rate.

Single-family home pricing has skyrocketed in the Portland metro area, slowing the ability of Millennials and Gen-X households to make the move from renters to home ownership. Gen-X and Millennials aged 25-45 are considered the largest labor pool in the United States but continue to struggle with the transition to home ownership due to high pricing; lack of new inventory; high debt to income ratios; and the growing generational mentality to have flexible employment, which enables them to move around frequently. These factors ensure that multi-family projects remain desirable in this market. As demand continues and the rate of new supply drops, rents will continue to rise as renters compete for the limited availability in the market. Insufficient future supply could be fatal if prices rise too high and Portland is no longer is known as the affordable west coast destination, pushing renters to look for other markets.

### SALES ACTIVITY

In 2021, the total volume of sales ($3.7 billion) and average sales price per unit ($285,000) both broke records. Sales continue to trade as a few buildings that recently leased up have changed hands. The Heather Lodge was completed in Happy Valley in April 2021 and was sold for $71 million to The Randall Group based in Portland. It is a 178-unit, 4-story property built on 4.3 acres offering studios and 1- , 2- , and 3-bedroom units.

At the time of sale, it was fully occupied and achieved a sale price per unit of $398,876. Portland continues to remain an attractive market for larger or institutional investors as we have seen annual sales average $1.5 billion over the past five years. Table 1 shows notable sales over the past 4 months. Two new to market investors include Canadian REIT Rise Investment Trust, and Starwood REIT based out of Miami.

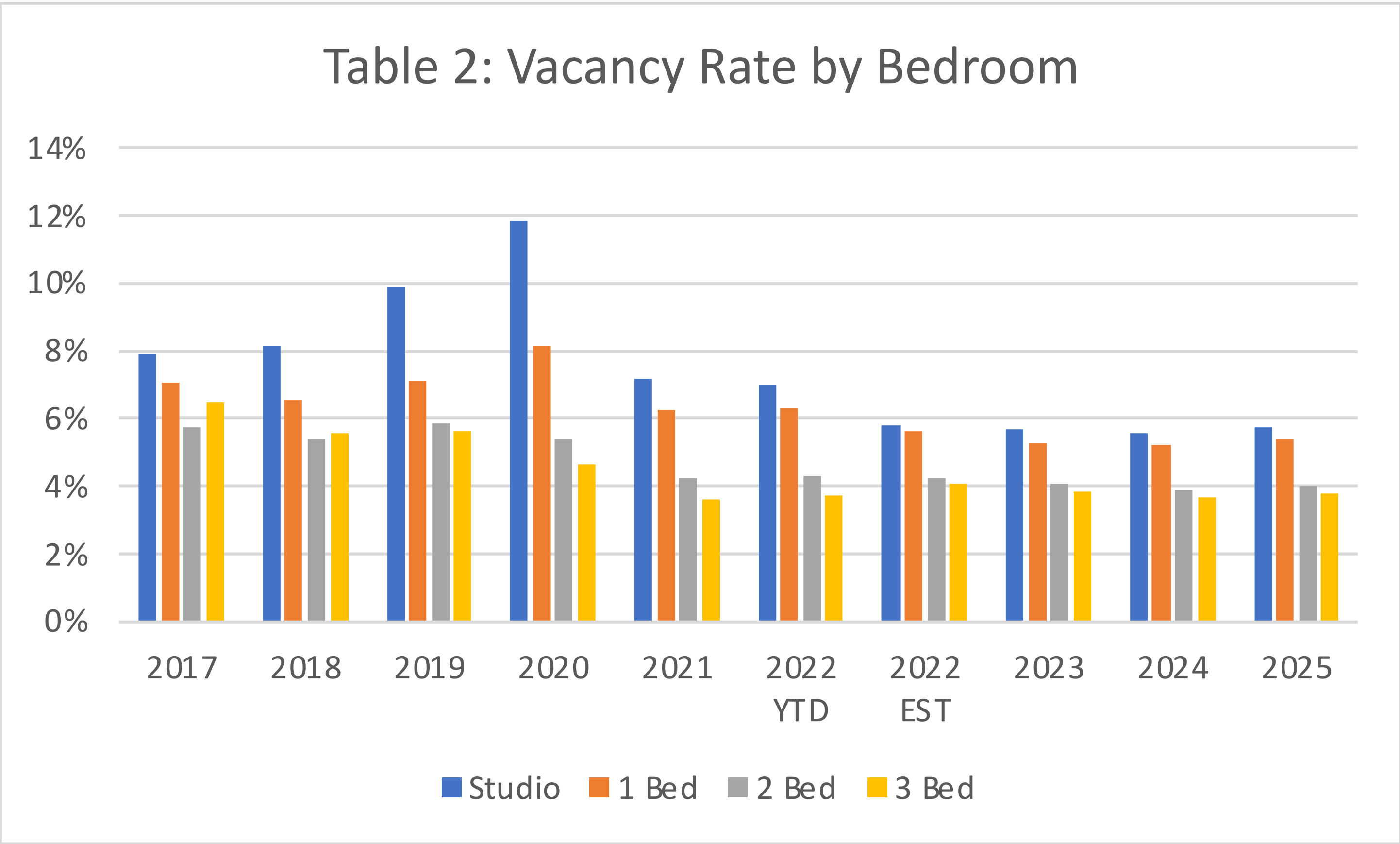
**Table 1: Notable Sales Last 4 Months**

| | Apartment Name | Buyer | Seller | Sales Price ($ Million) | Sale Date | Vacancy at Sale | Units | Sale Price Per Unit | GBA (SF) |
|---|---|---|---|---|---|---|---|---|---|
| 1 | Kado NW | The Wolff Company | Holland Partner Group | $80.60 | Dec-21 | 4.3% | 196 | $411,224 | 228,305 |
| 2 | Revere Apts | The Wolff Company | Fore Property Company | $78.50 | Dec-21 | 9.5% | 693 | $372,038 | 160,458 |
| 3 | 10th @ Hoyt | Rise Properties Trust | Prometheus Real Estate Group | $75.50 | Dec-21 | 5.6% | 178 | $421,348 | 194,044 |
| 4 | Verso | Brookfield Real Estate Income Trust | Rembold Companies | $74.00 | Dec-21 | 4.0% | 172 | $430,223 | 165,000 |
| 5 | Heather Lodge | The Randall Group | Fore Property Company | $71.00 | Jan-22 | 0.0% | 178 | $398,876 | 150,000 |
| 6 | Q21 | Fairfield Residential | Rosan | $65.00 | Dec-21 | 0.0% | 166 | $391,566 | 130,000 |
| 7 | Lakemont Ridge | T Barry Brenneke Company | Urban Form Development | $42.00 | Nov-21 | NA | 131 | $320,611 | 475,000 |
| 8 | Union Park | Coast Equity Partners | Timberland | $34.50 | Nov-21 | 2.0% | 120 | $287,500 | 109,000 |
| 9 | Our Heroes Place | ColRich | Prestige Development | $25.35 | Dec-21 | 7.2% | 49 | $517,347 | 44,838 |
| 10 | Arbor Heights | Kennedy Wilson | Cigna Investments | $120.75 | Dec-21 | 3.0% | 348 | $346,983 | 285,260 |

## VACANCY AND ABSORPTION

The market has almost returned to pre-pandemic vacancy numbers, and the urban core is the only remaining area that has not fully rebounded. Within the urban core, Southeast and Central Northeast submarkets have the lowest vacancy rate of 5.4%, followed by Southwest at 7.4%; Northwest & Northeast at 8.9%; Downtown/CBD at 9.2%; and North Portland at 9.6%. Southwest has seen excellent absorption, as many renters want to be in the core but out of downtown. OHSU's expansion also brought new jobs to the area and helped fill units.

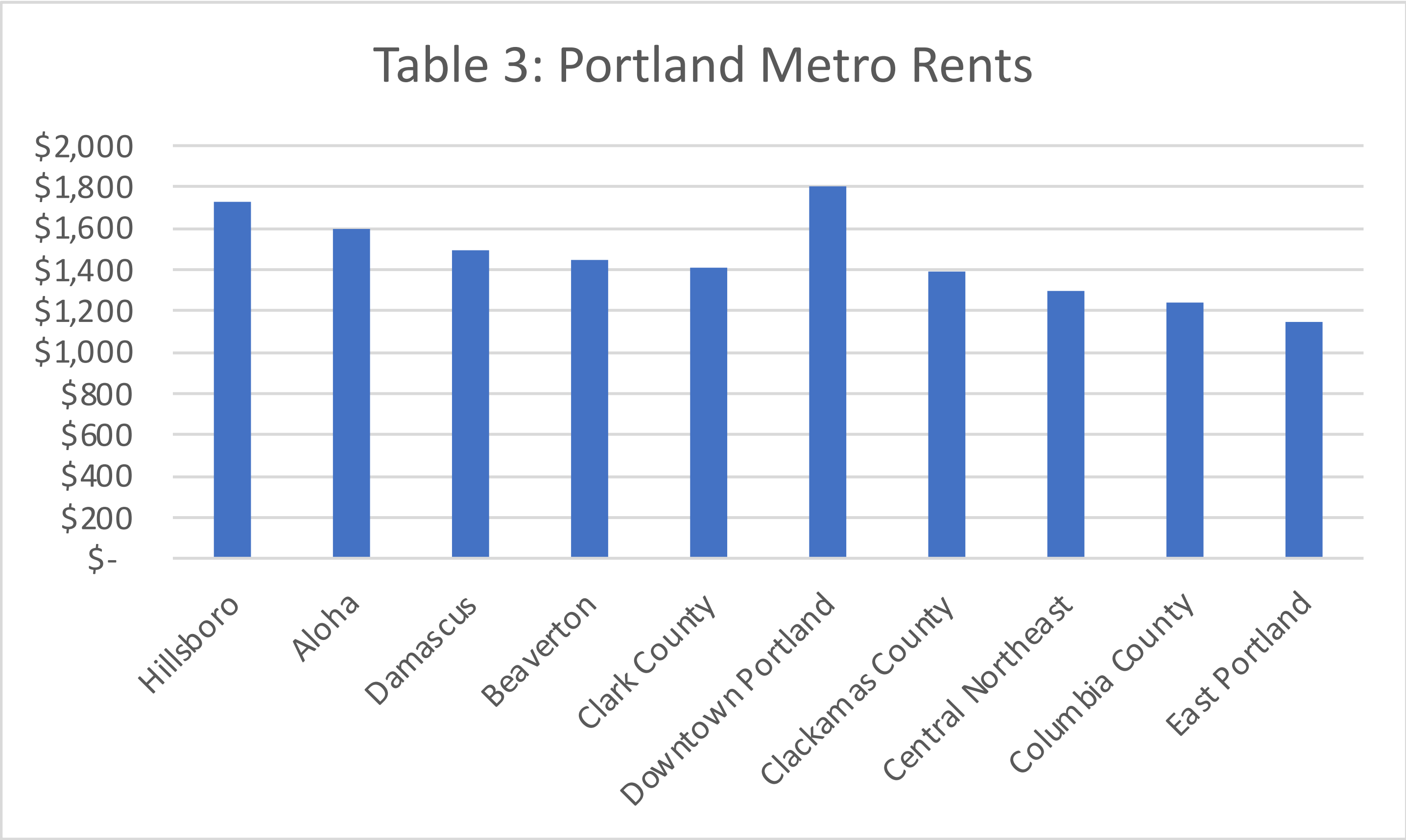
The North and Central Eastside neighborhoods provide more affordable options for renters interested in an urban lifestyle but are priced out of the Downtown core. Portland neighborhoods that have appreciated over the past decade provide young professionals with trendy living options at prices they can afford. Meanwhile, the suburbs like Hillsboro and Beaverton benefit from the presence of Intel and Nike. These submarkets have been consistently receiving the most institutional interest other than Vancouver. Absorption for 2021 was the highest in Vancouver at 1,761 units. Outside of the urban core, Gresham saw 614 units absorbed beating out cities like Beaverton and Hillsboro. CoStar estimates that 45% of the Portland metro's residents are renters as homeownership remains out of reach for them.




When looking at unit mix, 2- and 3-bedroom units have the lowest vacancy in the market, with studios having the highest vacancy. Table 2 shows vacancy by unit type. During the pandemic, when studio vacancy was abnormally high, 2- and 3-bedroom units were inversely being absorbed. The demand for these units is a result of lack of construction of 2- and 3-bedroom units, as well as a shift in renters' preferences to desire larger units. While studios remain desirable to some, developers should be aware of their tenant mix and not overload studios.

**RENTS**

According to the Apartment Investors Journal published by Norris & Stevens, "As of the first quarter of 2022, average rent levels in Portland have reached $1,520 per month, reflecting year-over-year growth of 9.1%." Table 3 shows monthly rents and annual rent growth of submarkets within the Portland metro.




Downtown rents have grown by well over 5% year-over-year, but companies will need to continue to commit workers to the urban areas for this trend to continue. Tech and apparel sector office leases have been the bright spot of downtown activity over the past year, but the central business core remains a shell of its pre-pandemic form. The upcoming departure of the Umpqua Bank headquarters will deal another significant blow to central Portland in the coming months.

**SUPPLY**

Portland metro area construction peaked in 2018 when 14,000 units were delivered, part of a 30% increase in supply over the last decade. During this time, developers delivered an average of approximately 8,500 units each year, while only 4,000 units are under construction for 2022. Net absorption is approximately 9,300 units per year, so it appears that a shortage is coming fast. Prior to the pandemic, investors feared that too much product was coming to market and slowed down investment.

After the initial shock of the pandemic, tenants started moving to Portland for its affordability compared to the other major west coast markets. The expansion of remote work is playing a factor in the relocations to Portland as well. As Portland city officials instituted aggressive regulations, developers have gone to seek projects elsewhere creating a vacuum of limited supply and rising rents and land prices, counteracting the City's plan to make more affordable units available. Table 4 shows some of the new development.

**Table 4: Under Construction**

| Property | City/Submarket | # of Units | Owner | Expected Delivery |
|---|---|---|---|---|
| West End District Apts | Beaverton | 424 | Sisters of St Mary of Oregon | Q1 2022 |
| The Quarry | Hillsboro | 352 | Katerra | Q2 2022 |
| Alta Art Tower | Goose Hollow | 314 | Wood Partners | Q1 2022 |
| South Waterfront 45 | SW (Waterfront) | 291 | Caim Pacific | Q3 2022 |
| Modera Morrison | Central Eastside | 247 | Mill Creek Residential Trust | Q2 2023 |
| Skylar Grand | Central Eastside | 170 | Fairfield Residential | Q3 2022 |
| Overland | Tigard | 219 | Greystar | Q4 2022 |

## LOOKING FORWARD

Despite the ongoing pandemic, the multi-family market in the Portland metro area has recovered and is arguably the metro's strongest asset class. Steady job growth coupled with affordable west coast living has kept the Portland metro a desirable place to live. The Vancouver submarket has led the way in year over year rent growth, vacancy decline, construction starts, cap rates, and sales. Vancouver will continue to remain attractive for investors as Oregon's rent control bill and Portland's inclusionary zoning don't affect this part of the metro area.

There is still desire from consumers to live in transit-oriented communities within Portland's metro area, but due to the city's logjam with permits, developers will start seeking out projects along these transit corridors within the suburbs. The City of Portland should continue to see more sales as once empty buildings now fill new residents at higher rents and with less concessions. The southwest waterfront, which was at one time considered a failure, has stabilized as consumers enjoy being close to, but not in the downtown core.

The City of Portland should find ways to incentivize new companies to relocate downtown to fill the vacancies in both the office and multi-family buildings. New supply will be the biggest segment to watch. If developers don't deliver enough properties, rents will rise, and the market will risk losing current residents.

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# 07

RESIDENTIAL MARKET

# Housing Production, SROs, and Project Turnkey

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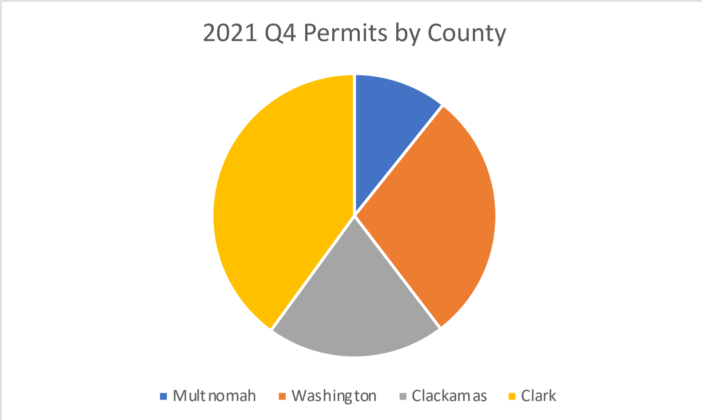


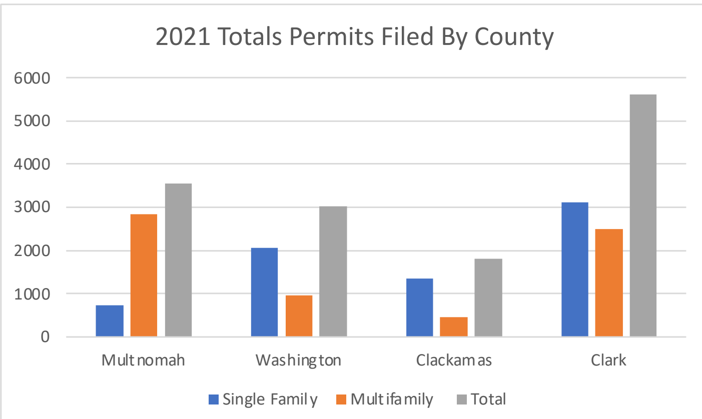


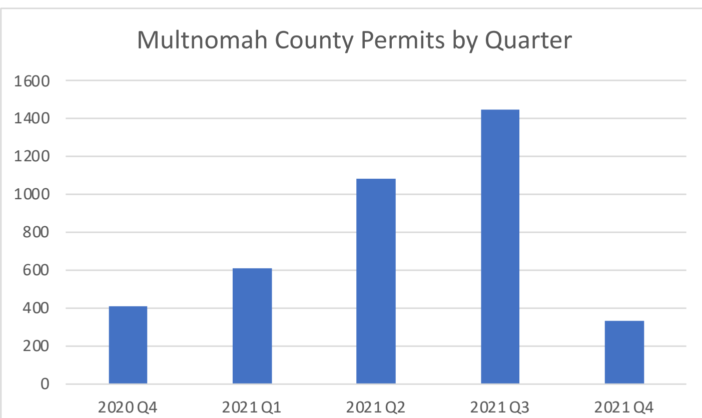


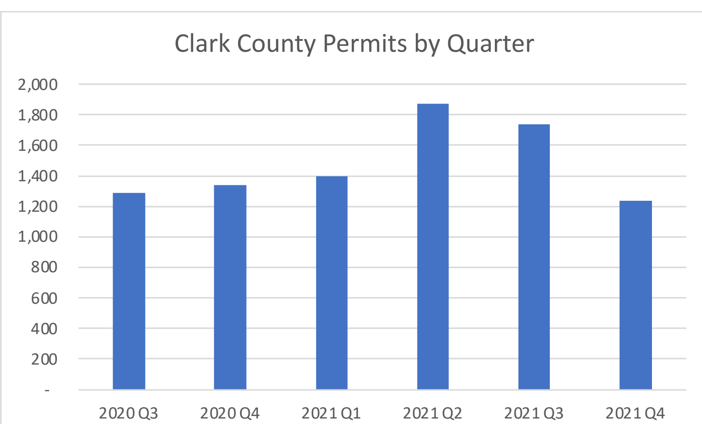


## LOCAL HOUSING PRODUCTION 2021 Q4

By in large, 2021 closed out with a much stronger overall performance than 2020. Total housing permits filed has increased 28.2% since the fourth quarter of 2020 in Multnomah County and 24.4% in Clark. Year-over-year change in Washington and Clackamas has decreased slightly, by 2% and 10% respectively. As has been the case for most of the year, Clark filed the most permits in the fourth quarter of 2021, accounting for 40% of the area's growth. Following Clark is Washington with 29%, Multnomah with 20% and Clackamas with 11%.

Despite a steady increase in the fourth quarter of 2020, Multnomah permits filed plummeted in the fourth quarter of 2021, down from 1,448 to 331. Oddly, 16% of those permits were for multi-family and 84% were for single-family. In fact, HUD reported zero multi-family permits filed in October and November of 2021. This is quite a dramatic reversal from July, which had the most activity since 2019 (752 multi-family permits filed). While overall production is up from the year prior, the fourth quarter of 2021 ended on a low note for Multnomah.

Continuing an impressive development streak, Clark closed out 2021 with its strongest year yet with approximately 5,609 totals permits filed. Of those total permits, 55% were for single family homes and 45% for multi-family, demonstrating significant demand and a strong performance for both asset types. Considering its ample development pipeline, quick absorption times and low vacancies, it is likely that Vancouver's production will continue eclipsing Portland for the foreseeable future.

## PORTLAND'S HOUSING CRISIS

In October 2015, Portland City Council declared a state of emergency to help address the city's growing homeless and housing affordability crisis. This allowed the city to access additional federal funding, which led to the creation of a department called the Joint Office of Homeless Services. Since the start of the declaration, the Joint Office has spent $286.4 million; however, the problem still feels as dire as ever. While an official tally has not been conducted since the start of the pandemic, most experts agree that COVID-19 has only made the situation worse.

There are many root causes of homelessness that have made it an almost insurmountable challenge to overcome. Historically, the deinstitutionalization of mental health facilities, disinvestment in public housing, and the dismantling of the welfare system under President Reagan have all been major contributing factors. Bloomberg CityLab also identifies a modern form of homelessness that took rise in the 1980s, charactered by mass incarceration, drug epidemics, and a lack of affordable health care.

These factors, combined with rapidly increasing housing costs and lagging wages, have created the crisis we now face today. But what many people don't realize about modern homelessness is that its origins can be traced back to the removal of America's most naturally affordable housing supply: single room occupancies. Interestingly, this once-in-a-century pandemic has presented a unique albeit fleeting opportunity to bring them back.

## HISTORY OF SINGLE ROOM OCCUPANCIES (SROs)

As America's industrial cities started booming around the turn of the century, everyday workers migrated to these urban hubs to participate in their economies. This migrant workforce, comprised of laborers, seafarers, immigrants – many of them women – all thrived off the flexibility that the short-term rental of beds and rooms offered. But as America started to suburbanize and become more family values oriented, SROs and their residents fell into disrepute.

Throughout the 1960s and 1970s, the majority of inexpensive hotels and SROs used by low-income residents were converted to office, luxury condos, or tourists' hotels. The few that remained languished alongside urban decay, further solidifying their reputation as problematic and undesirable. By the mid 1990s, most planners and city officials agreed that SROs led to "maladjustment" and were considered a public nuisance. Yet they failed to replace the SRO units that were lost with an alternative. While official records were not kept in Portland, housing nonprofit Northwest Pilot Project found that from 1978 to 2015, Downtown lost nearly 40% of its rentals (about 2,000 units) that were affordable to minimum wage earners. Many of these units were SROs.

## PROJECT TURNKEY: HOTEL CONVERSION AS THE 21ST CENTURY SRO

Soon after the pandemic devasted the hotel industry in the spring of 2020, government officials took advantage of a rare opportunity: use pandemic emergency funds to convert struggling hotels into supportive and affordable housing. In March 2020, California established Project Roomkey to provide non-congregate shelter options for people experiencing homelessness during the pandemic. As the pandemic assistance funds were scheduled to end in late 2020, Project Homekey was established as its continuation, with a focus on creating permanent low-cost housing by repurposing hotels, motels, vacant apartments, and other underutilized commercial real estate.

In November 2020, after wildfires in Oregon displaced more than 4,000 households, lawmakers passed their own version of this initiative called Project Turnkey. Modeled off Project Homekey's success, Project Turnkey also uses grant money to acquire hotels and motels to use as emergency housing during the pandemic, with intentions to convert them into a permanent supply of transitional, supportive, and affordable housing units.

Between November 2020 and August 2021, Project Turnkey was able to acquire and convert 865 new housing units in Oregon, at the average cost of $87,700 per unit. That's over 60% less the average cost of a new affordable housing unit, which is around $226,000 per unit. For the Turnkey properties located in the metro area, the cost per unit ranges from $91,000 to $101,800, while average cost per unit for affordable housing can range from $350,000 to $450,000. Turnkey was able to convert 865 hotel rooms into housing units in approximately seven months, while the design, permitting, financing and construction timeline of a new affordable complex can take anywhere between two to four years.

Of course, in many ways this is an unfair comparison. New affordable units are higher quality, longer lasting, and will better serve larger households than SRO style housing. But hotel conversion and new construction serve different purposes in the ongoing effort to provide housing for vulnerable populations. For example, converted hotels and SROs have proven especially effective at helping unsheltered people transition out of homelessness and into more permanent housing situations.

In November 2021, Help USA published a literature review outlining how SROs have reduced homelessness among single adults and have had positive impacts on residents by improving mental health, increased housing stability, and increasing job retention. All around the country, especially in New York and California, discussions about reintroducing SRO supportive housing are underway. But the extent to which they are effectual will all depend upon if they can act before the economics of conversions change in the future.

### CONCLUSION

For the last half century, the common narrative about SROs is that they are undignified at best and criminal hubs at worst. But the heart of that narrative was informed by class bias, social prejudice and varying degrees of xenophobia and racism. There was the misunderstanding that a housing type that met the needs of vulnerable people was responsible for the issues that already exist in these populations. We have learned the hard way that simply removing the housing type doesn't make the problem go away; rather, it makes it worse. By shedding our preconceived notions about SROs, we should continue to think creatively about how we can repurpose underutilized real estate into the housing we desperately need in a post-COVID world.

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# 08

RESIDENTIAL MARKET

# Ownership Housing Market

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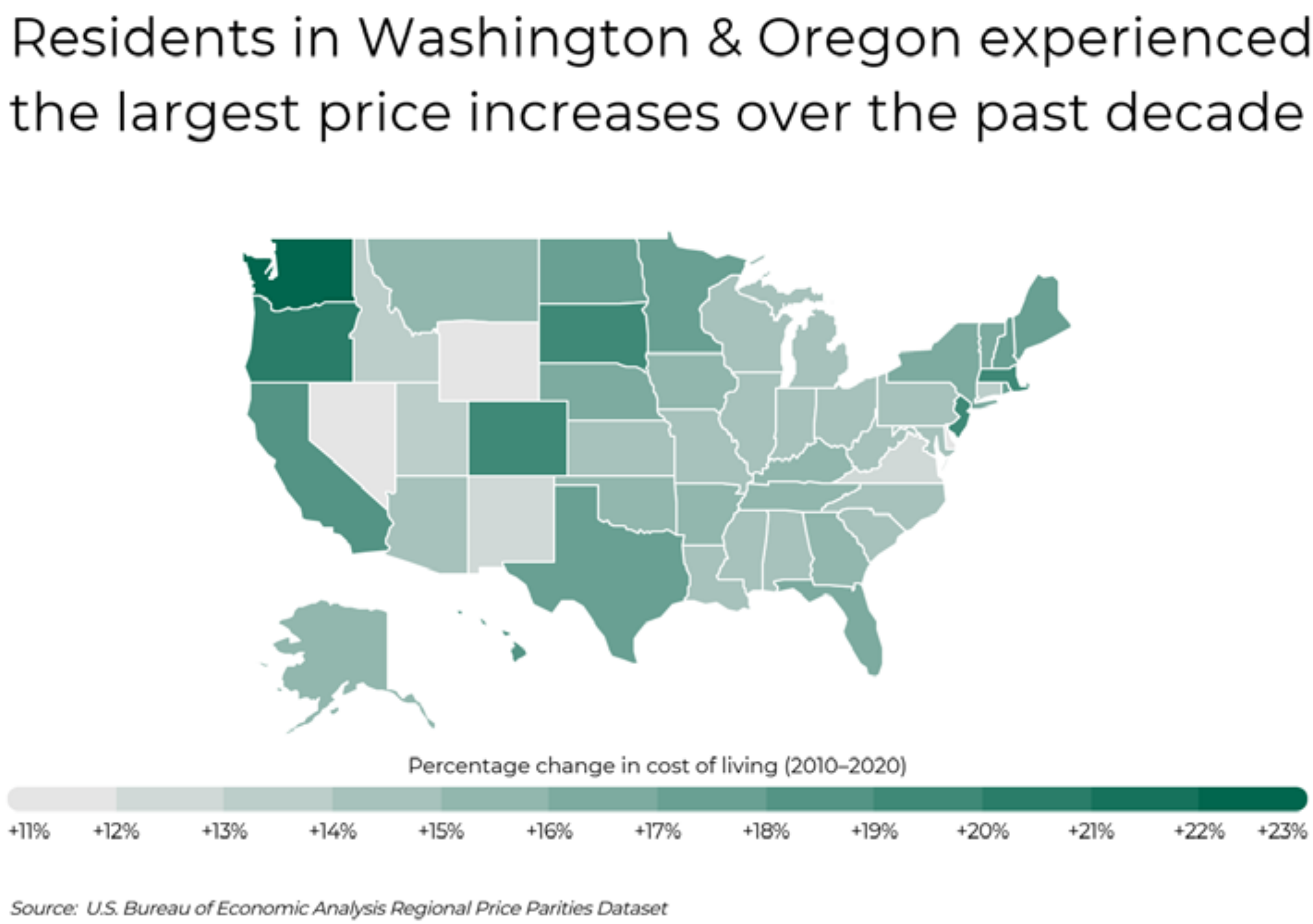
The cost of living in Portland has significantly increased over the past decade. According to The Filterbuy Report, from 2010 to 2020, Oregon and Washington had the largest housing price increases in the United States. Living costs increased 23% in the Seattle metropolitan area and 22% in the Portland metropolitan area. These were the first and third largest increases in the U.S., respectively. The average cost of living in the past decade increased 5.7% in the city of Portland and 12% in the city of Seattle. During the same period, the cost of housing increased 30.5% in Portland and 52.3% in Seattle.




**PORTLAND**

In January 2021, the Portland metropolitan area's median sales price was at $460,000. This increased 11.1% to $511,000 by January of 2022 after hitting a high in August 2021 of $524,900. With the increase in median sales price, the number of homes sold in the Portland metro area is decreasing. In June 2021, total sales were at 3,498 compared to 2,616 in December 2022. The number of active listings in July 2021 was at 3,180. This decreased to average listings of 1,554 in December 2022, a 51.1% decline.

The number of active listings in 2021 shows that the inventory in the metro area is not meeting the demands of the increasing population. In December 2019, there were 3,904 active listings, the lowest of any month that year. Today, that number has been cut by more than half. Portland is ranked in the top three cities with the fastest increasing median home price but has less than half of the number of homes for sale compared to 2019. This is making it very difficult for residents to buy or rent a home.

### SEATTLE

According to Redfin, the median selling price for homes in Seattle was $729,500 during in the fourth quarter of 2020. In May 2021, median home prices hit a record high $816,500, and by the fourth quarter of 2021 prices had decreased to $765,000, a year-over-year increase of 4.9%. In December 2021, the number of homes sold was 962. This was a 5.7% decrease from a total of 1,020 homes sold in December 2020. The highest number of home sales recorded was in June 2021 at 1,561.

The number of listings in the Seattle area decreased significantly from December 2020 to December 2021. In December of 2020, there was an average of 413 listings each month, according to Norda. In December of 2021, that number decreased 64.7%. This pattern is not just in Seattle and Portland. Redfin reported that due to homeowners taking advantage of low mortgage rates and a lack of construction, the national inventory has hit the lowest level in history. To make matters worse, the population in Seattle increased by 19% since 2010. If the demand for homes doesn't decrease or new supply increase, there is no sign of change in 2022.

### HOW BUYERS ARE RESPONDING

With the current lack of inventory, potential homebuyers have two options. One option is to fight and suffer through bidding wars, compete for homes far above market price, or settle for homes they don't imagine themselves living in. The other option is to move to a smaller city with a less competitive market. With where the market stands today, finding a less competitive market seems like the safer and more affordable option. The proliferation of remote working also allows workers flexibility on where they live and has enabled this trend.

Bend has become a very popular city for those who are trying to flee the Portland metropolitan area. In 2010, Bend's population was around 76,700, according to World Population Review. Today, the population is 108,824, reflecting an increase of 42%. This increase in population led to the fourth biggest increase in living costs of small metros in the U.S. The rate of home ownership in

Bend is around 60%, with the majority being married couples. In December 2020, the median sales price was $540,618. By December 2021, this increased 31.3% to $710,000. There are now more bidding wars, offers on single-family homes, and less inventory than ever before.

As of 2020, Wenatchee, Washington had a population of 34,741. From 2010 to 2020, it had the third the biggest increase in living costs in small metros. In December 2020, the median cost of single-family homes was $363,950. By December 2021, the median price increased 21% to $439,000. This was only an 8.8% increase from 2010, smaller than the increases in larger cities, but still sizeable. According to Redfin, homes in Wenatchee are selling for 4% above listing price.

## CONCLUSION

Workers with high paying jobs have shown their preference is to work at home at least some of the time. This incentivizes these people to move to a smaller city with lower demand, more affordable prices, and a higher perceived quality of life. Unfortunately, this has driven up the market in many smaller cities. Home builders are not able to supply enough inventory for the demand on homes and are actually starting to lose business, according to the New York Times.

Small city construction had a 15.7% annual growth rate in 2021, according to the National Association of Home Builders. As people continue to leave, the demand in small cities will continue to rise along with the price of homes. This is great for sellers, who can take advantage of the lack of inventory and sell significantly above market value. In contrast, it has made things very difficult for buyers. Workforces in smaller cities have difficulty competing for scarce housing inventory against households with higher wages, and this can lead to displacement. Many people are still struggling due to the economic effects of the pandemic. If inventory does not increase, many of these people will not become homeowners.

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# 09

HOUSING INSIGHTS

# Rental Assistance in Oregon: The New ERA

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Throughout the pandemic, housing programs nationwide have faced many challenges while attempting to deliver federal, state and local rental relief funds. Regional politics, as well as the logistical hurdles of processing thousands of applications, are two of the main challenges. Much of the funding allocated to Oregon is exhausted, and we're now entering a new phase of rental assistance.

With COVID-19 and geopolitics creating uncertainty in financial markets, we're left wondering what the next 24 months will look like for the state of Oregon. This Quarterly article will reflect on the past two years, the current issues we face, and what can be done to ensure financial stability for both housing providers and tenants.

## A LOOK AT THE PAST 24 MONTHS

Under the CARES Act of March 2020, Oregon was granted $204 million in Federal Emergency Rental Assistance (referred to as "ERA 1"). These funds were part of a nationwide plan to deliver relief to struggling renters who were experiencing financial hardship because of the pandemic. In December 2020, Oregon passed House Bill 4401 which arranged $150 million to be distributed by Oregon Housing and Community Services ("OHCS") through the Landlord Compensation Fund ("LCF").

The two major sources of rent relief funding were accessible in different ways. Federal ERA 1 funds were to be applied for by tenants on their own behalf, with help from localized Community Action Agencies ("CAA's"). The LCF differed in the fact that funds could be applied for directly by a housing provider, and implementation of the LCF was designed to alleviate some of the administrative burden being cast on already strained tenants. However, faced with the choice between using one funding source or the other, many housing providers preferred to take advantage of the ERA 1 program due to the lackluster terms of repayment in the initial release of the LCF (only $0.80 on the dollar).

A testament to the lack of desirability felt among housing providers, the first round of LCF funding earmarked only $40 million for distribution, which is 20% less than of the projected demand. In June 2021, Senate Bill 278 updated the distribution terms of the LCF. The most notable change was an increase to 100% of uncollectible rent to be covered (and a retrospective adjustment applied to those previously awarded funds through the program). With a boost in popularity resulting from these changes, all $150 million in the LCF was allocated and distributed by the end of 2021.

The Oregon Emergency Rental Assistance Program ("OERAP"), which distributes the Federal ERA 1 funding, suffered significant logistical challenges in processing applications and distributing funds in a timely manner. After initializing in early 2020, nearly 18 months later in August 2021, only $8 million (4.37%) of the total $183 million that was applied for had been delivered to tenants. This extreme slowdown was blamed on many issues, including software malfunctions caused by the Allita 360 system in place – as well as the decentralized approach of using local CAAs to gather and process applications. These local agencies did not have the staff capacity to handle such an enormous volume of applications, and the decentralized nature of each office caused inconsistencies and inefficiency in processing power. In addition to the slow pace of dispersal, during 2021 OHCS reportedly sent out hundreds of "bad checks" due to an accounting error in applying routing numbers.

## A LOOK AT THE PRESENT

After such a painfully slow start, a few key changes helped get things back on track. During 2021, the U.S. Treasury issued a statement that any state deemed unable or unwilling to obligate or pay out at least 65% of their federally allocated funds by September 30, 2021 would potentially become ineligible for subsequent rounds of rental assistance funding. At the time, nearly all states had yet to surpass this threshold, and this authoritative "threat" inspired a renewed sense of urgency. By the end of the year, Oregon was reportedly among the top five states in the nation in terms of funds allocated and distributed, with nearly all its remaining ERA 1 assistance depleted. The major difference in pace was made up through the introduction of Public Partnerships, LLC, a third party specializing in processing assistance applications. With dozens of extra hands now onboard, the OERAP program has been able to issue nearly $2 million each day in assistance payments.

On December 13, 2021 Oregon lawmakers held a special legislative session which discussed the status of the emergency rental assistance programs and the looming threat of eviction for many tenants due to nonpayment. Key outcomes achieved by this meeting included the passing of Senate Bill 5561, which authorized an additional round of funding, consisting of $100 million in new rental assistance. The bill also granted OHCS $5 million to help facilitate a quicker turnaround time for processing, and an additional $10 million for the recently created Landlord Guarantee Program ("LGP"). The LGP is a much smaller source of assistance that was specially formed in response to the lagging distribution of funds from the OERAP program.

Senate Bill 278 introduced a 60-day "safe harbor" clause. This protected tenants who submitted an application for assistance from being evicted due to nonpayment. However, after 60 days passed (90 days in Multnomah County), many residents and housing providers did not receive any assistance. Coupled with the end of the nationwide eviction moratorium, this delay put tenants at risk of being evicted at no fault of their own. In order to ease this situation, the LGP (administered through Home Forward) would send qualified housing providers up to 60 days of rent to help bridge the gap and prevent eviction. The December 13th special legislative session produced Senate Bill 891, which eliminated this 60-day safe harbor clause altogether, and extended tenant eviction protections throughout the duration of their wait for funds, or at the longest, September 30, 2022.

**THE NEW ERA**

Currently, we are entering a new phase of rental assistance funding, ushered in by newly appointed state allocations and the promise of federally-backed American Rescue Plan Act funding ("ERA 2"). These sources will provide $156 million for the state of Oregon, which is to be distributed by September 2025. At the beginning of 2022, OHCS curiously put a pause on the collection of new rental assistance applications for nearly a month, citing the need to "catch-up" on several backlogged commitments, as well as anticipating the exhaustion of all remaining funds on hand. The web portal reopened on January 26, 2022 with access to the new sources of relief funds. It utilizes the improved centralized approach that I covered in detail in the Fall 2021 Quarterly.

In mid-January 2022, President Biden tapped director Margaret Salazar of OHCS to be the new regional HUD administrator for the northwest region (covering Alaska, Idaho, Oregon, and Washington.) Salazar's final day with

OHCS was on February 4th, which concluded a five-year term. Her replacement Andrea Bell will likely face immediate challenges as the newly acting agency leader. With Salazar's departure also came the news of an official audit of the state's rental assistance program conducted by the Secretary of State, as urged by many lawmakers due to the disorganization and issues with processing and funding applications. An official audit plan is expected to be drafted during the second week of February and will be released to the public soon after.

For those who have been most affected by the pandemic, paying rent has been a financial burden. Initially, the system of distribution for rental assistance broke down, causing severe backlogs. With the new phase of ERA coming soon, renters and property owners should be increasingly optimistic.

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10

HOUSING INSIGHTS

# An Update on Evictions in Oregon


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The pandemic has lasted longer than anticipated since the original COVID-19 emergency rental assistance bills were passed. While many thought the pandemic would be a one-time event, it has unfolded much more like a story. Each chapter reveals new twists, victories, fallbacks, and solutions. In the last few months, we have continued to see households teeter on the brink of financial, employment, and housing insecurity. The Oregon Legislative Assembly passed SB 891 in December, extending safe harbor periods and providing additional emergency rental assistance funds. With the extension of relief funds, we could see a flatter and more prolonged series of eviction ripples, rather than a wave of evictions.

For example, at the beginning of December, many of the 90-day safe harbor terms from the first round of eviction protections had ended. Multnomah County had reported a spike at 70 cases filed per week. However, we can see the impact that the legislation has had. According to Becky Straus, managing attorney of the Oregon Law Center's eviction prevention project, "Since the passage of SB 891, eviction cases have slowed to about 30 to 40 per week. Of those, roughly 40% are 'set over,'" (Multnomah County, 2022). This means that the tenant has proven they have applied for rent assistance. About a third of cases are dismissed entirely.

Still, a concerning 22% of cases are resulting in default. That could be for many reasons, including transportation barriers, technology access issues, or the tenant having already moved out of their home. "Those are very disappointing, preventable outcomes for tenants who should have been able to access the rent assistance available to them," said Straus. This shows how legislation is stemming the tidal wave of evictions that could have occurred. It also shows how much we can still improve.

According to data collected directly from Multnomah County, there were 225 evictions filed in October, 273 in November, 283 in December, and 225 in January (Multnomah Circuit Court, 2022). In our previous article, we had covered that there were as many as 915 filings in September of 2021. That said, in 2019 Oregon landlords had filed 5,898 evictions, or 491 per month (EvictionLab, n.d.). We see that our rate of eviction had a brief spike, which policy has controlled into a steady stream. However, we are still not at pre-pandemic levels, so it is possible that our eviction wave could still happen.

The Oregon Department of Housing Community Services (OHCS), which processes tenant applications for rental assistance, stopped accepting applications from December 1, 2021 to January 26, 2022. This delay was to process a backlog of application and ensure that there would still be enough funds left to allocate to all applicants (McCarthy, 2022). This left tenants uncertain at the holidays about whether they would be able to apply for assistance in the future. It was not a good look for the state from a public relations standpoint, as they have already been accused of mishandling emergency rental assistance applications.

Meanwhile, today's economy is different from the early days of the pandemic. Inflation is high, and companies are begging for workers rather than laying them off. Apartment rental rates and vacancies have increased to pre-pandemic levels (CoStar, 2022). Perhaps in the beginning of the pandemic, a landlord could have worked with a tenant who was out of work and couldn't pay rent. After all, everyone was out of work, the banks were being flexible about mortgage payments, and there was quite a bit of empathy and a general feeling of being in this together. But today, a landlord could easily fill a vacancy at market rent. He or she may have a mortgage of their own to pay now and would be perhaps less inclined to be lenient and more likely to begin the eviction process.

On February 28, 2022, back rent became due for the first wave of emergency rental assistance applicants (Cline, 2021). Note that there are some programs that do not require repayment. What percentage of people will be able to pay this amount? If you already had no savings, and your new job only pays you enough to live paycheck to paycheck, where will this back rent come from? For the majority of the working class, rent is their number one expense each month. According to CoStar, the average asking rent in Q4 of 2021 for Portland was $1,461 (CoStar, 2022). But how long were people out of work? Figure 1 below shows how long U.S. workers were unemployed for. It also shows the percent of rent this accounted for using average rents in Portland to estimate the total back rent since February.

While many people were covered by unemployment benefits and additional pandemic relief funds, there were small business owners, freelancers, gig workers, people with limited access to technology, and people with

**FIGURE 1**
**ACCUMULATED RENT BURDEN OF US WORKERS**

| Duration of unemployment | | Average Portland area rent by weeks unemployed |
|---|---|---|
| Less than 5 weeks | 37.0% | $1,826.25 or less |
| 5-14 | 24.6% | $1,826.25-$5,113.50 |
| 15-26 | 38.4% | $5,478.75-$9,496.50 |
| 27+ | 12.5% | $9,861.75+ |

Source: US Bureau of Labor Statistics

language barriers who might have been out of work but unable to claim unemployment.

What are implications of this coming repayment period? Luckily, SB 282 puts protections in place that help to keep this dark time from being a permanent shadow on an individual's financial future. The bill disallows reporting late payments to credit agencies and makes it illegal for future landlords to deny renting based on COVID-19 related evictions or collections (City of Portland, 2021). This begs another question: what incentivizes people owing back rent to pay the balance? They could keep these thousands of dollars of outstanding debt today with fewer consequences that typically incentivize debt repayment.

We have yet to see evictions en masse due to continued rounds of policy changes. The non-payment of rent will likely continue to extend much further into the future than any of us would have believed. The below quote perhaps summarizes our situation best in our extended pandemic:

> "Every extension of the moratorium has made things more complicated and more uncertain. Our Legislature has intervened three times, and each time they have made the situation more complicated and more uncertain for renters and housing providers," (Wheeler, 2021).

Naturally as the pandemic continues and more laws are passed, this creates more nuance, more regulation, and more tenants and landlords jumping through hoop. As the legal environment becomes increasingly complex, people will have to slog through more sets of laws, programs, and exceptions until the individual must by necessity become an expert in the law or hire counsel to interpret it for them. This complexity places an extended burden of education on renters and landlords alike to avoid legal missteps and keep up with changing circumstances.

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11

HOUSING INSIGHTS

# The Portland Housing Bond and Metro Housing Bond: Goals, Progress, and Outcomes


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## INTRODUCTION

My November article examined income-restricted housing production through Vancouver's Multifamily Tax Exemption and Portland's Inclusionary Housing and explored emerging policy tools for grappling with the affordability crisis. This article examines bond programs, which are another strategy for supporting metropolitan affordable housing development. From Los Angeles's $1.2 billion Proposition HHH to Denver's Affordable Housing Fund, cities are increasingly turning to bond financing to stimulate the delivery of affordable units. In November 2016 and November 2018, the City of Portland and Metro (Portland's regional government) initiated two new bond programs, known as the Portland Housing Bond and Metro Housing Bond.

This article will be organized into four sections. The first will provide a brief description of the programs' origins, considering questions around how bond programs are structured in general and why they are necessary as a policy tool.

Section two will analyze Portland's programs specifically, laying out the goals of the bonds and their framework for delivering affordable units.

The third section offers a status update on program outcomes, addressing questions like: How many projects are underway? Where are they in the construction process? What percentage of funds have been allocated? And how do these outcomes align with the programs' stated goals?

The final section will examine project costs in the region, comparing bond project budgets to recent multifamily projects to better understand the variance between affordable and market-rate production. Overall, I find that affordable bond projects are more expensive to produce on a per unit and per bedroom basis when compared to market-rate housing. The analysis concludes with considerations around how we may best deploy public funds to support affordable development.

## BOND PROGRAMS: AN EMERGING POLICY TOOL

Cities are implementing housing bond programs for three reasons. The first is that many metropolitan regions throughout the country are struggling to manage deepening housing unaffordability. Stagnant wages, a lack of housing production, and an unequal distribution of economic growth all contribute to this pressing issue. As a result, 48% of renter households are cost burdened, meaning they spend over 30% of their income on housing costs, and 24% of all renters are severely cost burdened (housing costs exceed 50% of income). Moreover, Black and Hispanic renters are more likely to be cost burdened than White renters. In 2019, a full-time worker earning the average renter's wage could only afford a two-bedroom apartment priced at the HUD-designated fair market rent (FMR) in only 10% of counties across the U.S. Further, they could only afford a one-bedroom apartment at FMR in 40% of U.S. counties. Because affordability challenges are especially pronounced in dense urban markets and these regions can leverage significant public funds, cities are increasingly turning to bond programs to create income-restricted housing.

The second reason cities are deploying this policy tool pertains to affordable housing finance. Market-rate multifamily development generally utilizes just two key capital sources: private equity and debt. The amount of debt an asset can take on is directly linked to the amount of income the property generates. The relationship between debt and income generation is the why affordable housing finance is often more complex than market-rate development. Because affordable developments offer below-market rents, these projects cannot leverage the debt required to fully finance the property. The lower the target income the property will serve, the larger the gap between debt and a fully financed project.

In response, a number of public and private resources have been developed to facilitate affordable production; they include private and public grants, government loans, Section 8 vouchers, tax credits, and inclusionary zoning fees. The most widely used resource by developers is the Low Income Housing Tax Credit (LIHTC), which was created in 1986. Nonetheless, even affordable projects financed with both conventional debt and LIHTC may not generate the necessary sources of capital to finance a project. Federal programs like the HOME and Community Development Block Grant (CDBG) are, therefore, frequently incorporated into a capital stack. According to the Terner Center's April 2021 report, however, inflation adjusted funds for HOME declined from $2.4 billion in 2000 to $1.36 billion in 2020. CDBG funding fell from $7.2 billion to $3.4 billion over that same period. Gap financing programs like these – heavily sought after and facing troubling funding cuts – can often make the difference between a project moving forward or not.

The third reason driving local bond initiatives is that voters are throwing their weight behind creative strategies to promote rental affordability. Alex Shwartz notes that until recently, cities have rarely issued general obligation (GO) bonds to produce and preserve affordable housing. GO bonds, unlike revenue bonds, are backed by the government and covered via property tax, income tax, and other general revenue sources. Significantly, many states and cities require voters to approve GO bond issuance via public referenda. Voters in the Portland area have recently passed two such initiatives to implement this policy tool and mobilize public dollars for affordable production.

### PORTLAND'S BOND PROGRAMS: PROGRAM GOALS, ADMINISTRATION, AND FRAMEWORKS

This section analyzes the Portland area's two bond programs, paying specific attention to their goals, administration, and frameworks. Please refer to Figure 1 for a side-by-side comparison of both programs.

*Figure 1 - Program Comparison*

| **Bond Program** | Portland Housing Bond | Metro Housing Bond |
|---|---|---|
| **Administering Entities** | Portland Housing Bureau (PHB) | Home Forward (Multnomah County)<br>Washington County<br>Clackamas County<br>City of Portland<br>City of Hillsboro<br>City of Beaverton<br>City Gresham |
| **Year Approved** | 2016 | 2018 |
| **Geographic Focus** | City of Portland | Metro's jurisdiction |
| **Total Funding** | $258,400,000 | $682,082,545 |
| **Unit Goals:**<br>**Total Income-Restricted**<br>**30% AMI or below**<br>**PSH Units**<br>**Family-Sized Units** | <br>1,300<br>600<br>300<br>650 | <br>3,900<br>1,600<br>-<br>1,950 |
| **Priority Communities** | Populations of color;<br>Families with children;<br>Homeless households;<br>Households at risk of displacement | Populations of color;<br>Families with children;<br>People living with disabilities;<br>Homeless households;<br>Households at risk of displacement |
| **Priority Locations** | Areas with little or no affordable housing;<br>High opportunity areas<br>Gentrifying neighborhoods | Areas with little or no affordable housing;<br>High opportunity areas;<br>Gentrifying neighborhoods |
| **Services Component** | Service plan required | Not required |
| **Equity in Contracting** | 30% of Construction Costs | 20% of Construction Costs |

*a. The Portland Housing Bond*

In November 2016, Portland voters approved the city's first ever housing bond, commonly known as the Portland Housing Bond. Administered by the Portland Housing Bureau (PHB), the initiative dedicated $258.4 million in public funds to support affordable housing development throughout the city. PHB manages the allocation process, awarding funds to developers pursuing projects in alignment with the program's goals (see below). Development activities include new construction, redevelopment, and acquisition projects. The Bond Oversight Committee, composed of five individuals appointed by Portland city commissioners, monitors bond progress and reviews financial metrics.

The Policy Framework, the bond's guiding administrative document, identifies a number of goals for funded projects.

(1) Unit production: The total production goal is 1,300 permanently affordable homes for families at or below 60% of Area Median Income (AMI); subgoals include delivering 600 affordable units for families earning at or below 30% of AMI, 300 permanent supportive housing units, and 650 family-size units (2 or more bedrooms).

(2) Priority Communities: Priority communities include populations of color; families with children, particularly among immigrant and refugee communities; intergenerational households; and households experiencing homelessness or at imminent risk of becoming homeless.

(3) Location priorities: Locations of particular interest include areas with little or no affordable housing; neighborhoods at high risk of gentrification; and high opportunity areas with access to education, food, transportation, health services, greenspace, and employment opportunities. As part of this goal, the Policy Framework also emphasized striking a balance of investments throughout the city, rather than targeting one neighborhood in particular. Unlike the Metro bond, funding is restricted to the City of Portland.

(4) Services: To best serve each property, PHB will develop a culturally appropriate service plan in collaboration with regional partners, agencies, and community partners. Regular programming from a homeless service agency, for instance, would meet this target goal. Importantly, bond funds cannot be used for services so developers must identify sustainable funding sources to ensure continued execution of the service plan.

(5) Equity in Contacting: PHB's equity in contracting target is for 30% of construction costs to be utilized by certified Disadvantaged/Minority/Women/Emerging Small Business/Service-Disabled

Veteran (DMWESB-SDV) contractors. All bond projects target 20% for DMWESB-SDV utilization for professional services, including architects, surveyors, and engineers.

In selecting these specific goals, the bond program aims to further citywide community goals around preventing displacement, advancing racial equity, and ending homelessness.

*b. Metro Housing Bond*

In November 2018, voters in the three-county region voted in favor of the country's first regional housing bond. Metro, Portland's metropolitan planning organization (MPO), administers the housing bond, amounting to just over $680 million. Allowable projects include the construction of new affordable housing and the conversion of existing market-rate housing to affordable developments. Eligible costs include new construction, acquisition, rehabilitation, construction of community amenities, site work, and predevelopment costs, including third-party reports.

Funds may not be deployed for market rate housing, operating costs, ongoing rental assistance, or rehabilitation of existing income-restricted housing. All projects receiving bond proceeds will record a restrictive covenant or regulatory agreement restricting rents for a minimum of 60 years, or 30 years for conversion projects where the buildings are 10 years or older. Like the Portland Housing Bond, the Metro Housing Bond is overseen by a community oversight committee in charge of monitoring investment outcomes, reporting to Metro, and evaluating local implementation strategies.

The Metro Housing Bond policy framework identifies a number of production goals. Within 5-7 years, the program aims to produce 3,900 income-restricted units. Half of those homes (1,950) are intended to accommodate families via two-, three-, and four-bedroom units. Lastly, 1,600 homes are to be reserved for individuals earning at or below 30% AMI. Unlike the Portland Housing Bond, there is no expressed permanent supportive housing goal, though local jurisdictions are encouraged to implement them as part of their strategy (see below).

As a result of its regional scope, the Metro Housing Bond funds are distributed to seven participating jurisdictions "based on [the] assessed value of property in each of the three counties." The "Local Implementation Partners" are: Clackamas County, Washington County, Home Forward (Multnomah County), and the Cities of Portland, Hillsboro, Beaverton, and Gresham. Each partnering entity is expected to draft a local implementation strategy, detailing the locale's goals for the bonds, their application process, and the project selection criteria.

Eligible developers must submit proposals to a participating jurisdiction, which reviews applications, and with Metro's co-approval, distributes bond funds. Figure 2 identifies local jurisdiction production targets, including 30% AMI and family units, as well as funding allocations. The City of Portland received the biggest distribution of bond funds at just over $211 million, followed by Washington County and Clackamas County at over $116 million. As expected, production targets align proportionally with funding allotments.

*Figure 2 - Metro Housing Bond Local Jurisdiction Goals*

| Entity | Unit Production Targets | | | |
|---|---|---|---|---|
| | Total Units | 30% AMI Units | Family Units | Funding Available |
| **Beaverton** | 218 | 89 | 109 | $31,140,595 |
| **Clackamas County** | 812 | 333 | 406 | $116,188,094 |
| **Gresham** | 187 | 77 | 93 | $26,756,995 |
| **Hillsboro** | 284 | 117 | 142 | $40,657,081 |
| **Multnomah County (Home Forward)** | 111 | 46 | 55 | $15,879,123 |
| **Portland** | 1,475 | 605 | 737 | $211,056,579 |
| **Washington County** | 814 | 334 | 407 | $116,465,532 |

Like the Portland Housing Bond, Metro is guided by a set of core values around target populations and locations of particular interest. Other policy goals of note include racial equity, equity in contracting, and the efficient distribution of funds.

(1) Target Populations: Metro's target populations closely align with those of the Portland Housing Bond. Specific communities include: communities of color; families with children and multiple generations; individuals living with disabilities; seniors and veterans; households experiencing or at risk of homelessness; and households at risk of displacement.

(2) Target Project Locations: Target locations for Metro bond projects are neighborhoods that have not historically included sufficient supply of affordable homes; high opportunity areas with access to transportation, employment, education, nutrition, and parks; and changing neighborhoods where communities of color live and are at risk of being displaced.

(3) Equity Goals: An awareness of how social equity intersects with housing affordability is central to Metro's framework. One of the bond's core values is leading with racial equity, which Metro writes should influence decision making around: community engagement, project location, tenant screening and marketing, and culturally responsive services.

(4) Equity in Contracting: Metro requires all participating jurisdictions to establish an equity in contracting goal of 20% for construction trades. Jurisdictions can exceed this goal in their local implementation strategy; the City of Portland, for instance, has an equity in contracting goal of 30% for the Metro bond.

(5) Efficient Use of Funds: To guarantee long-term and maximized benefits, Metro also commits to the efficient use of public dollars. That said, in Metro's 2020 Annual Report, the regional government identified a number of reasons why development costs may exceed market-rate averages. Factors identified include: targeting family-size units; goals for equitable contracting; and nationwide trends in higher per-unit soft costs for affordable projects compared to market-rate.

**BOND PROGRAM OUTCOMES: STATUS UPDATE**

This section provides a status update for the Portland Housing Bond and Metro Housing Bond. Particular attention will be paid to the allocation of funds, where projects are situated in the construction process, the locational distribution of projects, and alignment with the production goals detailed above.

*a. Portland Housing Bond Status Update*

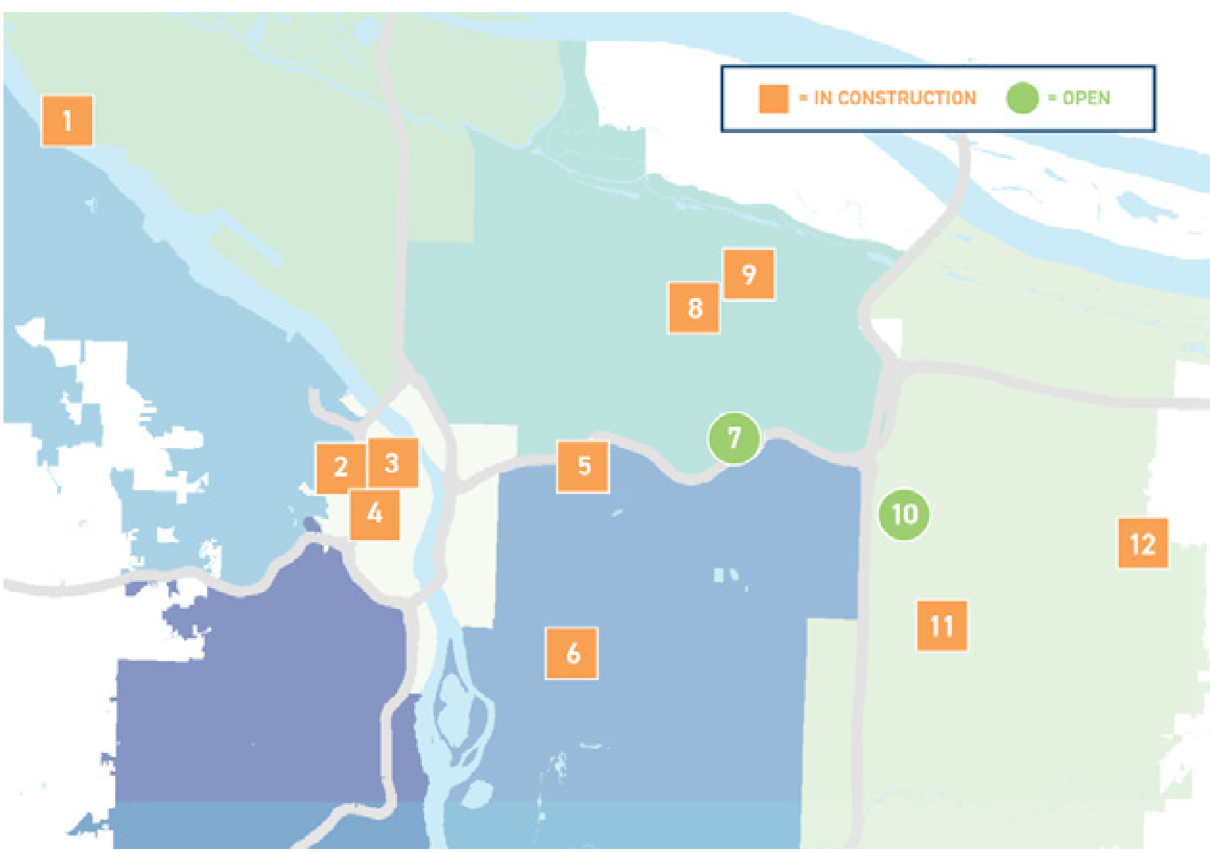
As seen in Figures 3 and 4, the Portland Housing Bond has supported 12 projects in the City of Portland, totaling 1,490 units of affordable housing. Two projects, East Burnside Apartments and The Ellington, are open, while 10 others are still in the development process. A total of $228 million has been allocated to support affordable housing projects across the city, with an average of $19 million per project. The smallest award, allocated to The Joyce, was over $7.1 million. The Ellington received the largest award at $47 million, which provided 100% of the acquisition and redevelopment costs for the site. The total development cost for all 12 projects amounts to just under $510 million, meaning that bond financing accounts for roughly 44% of the total investment in affordable projects.

Regarding project location, three developments are situated in downtown Portland, four in Northeast Portland, three in Southeast Portland, one in North Portland, and one in Outer East Portland. PHB's 2020 Progress Report shows that 82% of new units will open in high opportunity areas and 25% of total units are in areas at high risk for gentrification. The largest project is PHB and Home Forward's The Ellington, a 263-unit market-rate conversion and redevelopment project. The smallest, at 50 units, is sponsored by Community Development Partners (CDP) and the Native American Youth and Family Center (NAYA). Known as Hayu Tilixam, the development is focused on delivering culturally specific housing options for the indigenous community.

*Figure 3 - Portland Housing Bond Project Information*

| Project Name | Sponsor | Location | Status | Unit Count |
|---|---|---|---|---|
| Cathedral Village | Related Northwest and Catholic Charities | North Portland | In Construction | 110 |
| Emmons Place | NHA | Downtown Portland | Pre-Construction | 144 |
| The Westwind | CCC | Downtown Portland | Pre-Construction | 100 |
| The Joyce | CPAH | Downtown Portland | Pre-Construction | 66 |
| Anna Mann House | Innovative Housing | Northeast Portland | Pre-Construction | 128 |
| 3000 SE Powell | Home Forward | Southeast Portland | Pre-Construction | 206 |
| The Ellington | PHB and Home Forward | Northeast Portland | Open | 263 |
| Hayu Tilixam | CDP and NAYA | Northeast Portland | Pre-Construction | 50 |
| Las Adelitas | Hacienda CDC | Northeast Portland | In Construction | 142 |
| East Burnside Apartments | PHB | Southeast Portland | Open | 51 |
| Crescent Court Apartments | Related Northwest | Southeast Portland | In Construction | 138 |
| Stark Family Housing | Edlan & Co and Human Solutions | Outer East Portland | Pre-Construction | 93 |

*Figure 4 - Portland Housing Bond ProjectsMap*



How do these projects align with the Portland Housing Bond's goals? Figure 5 shows the bond's production goals compared to the target outcomes once all projects have been completed. According to PHB, all policy targets, including the number of total units, deeply affordable units, Permanent Supportive Housing (PSH) units, and family-sized units, will exceed the program's goals. Significantly, 100% of bond projects include multiple PSH units and two-thirds have partnered with service agencies, including NAYA and the Immigrant and Refugee Community Organization (IRCO), that will provide on-site programming.

*Figure 5 - Portland Housing Bond Production Goals and Outcomes*

| | Goal | Outcome |
|---|---|---|
| Total Units | 1,300 | 1,490 |
| Units at 30% AMI | 600 | 628 |
| PSH Units | 300 | 313 |
| Family-size Units | 650 | 691 |

*b. Metro Housing Bond Status Update*

Figures 7 and 8 below reflect the Metro Housing Bond's progress in the region. As of Portland Housing Bureau's November 17, 2021 press release, participating jurisdictions had allocated funds to 32 different projects. Three projects are complete (comprising 170 units), eight are actively under construction (comprising 755 units), and 23 are in pre-construction (comprising 2,234 units). This corresponds to a total of 3,519 bond-supported units, 90% of the program's 3900-unit goal. Moreover, the program has achieved 69.4% of its 1,600-unit goal for units affordable to households earning at or below 30% AMI and around 75% of its 1,950-unit goal for family-sized units.

Regarding financing and allocations, of the $620 million specifically reserved for affordable housing development, jurisdictions have allocated $330 million of the total bond amount. With an average award size of $10.3 million, the smallest award amounted to $1.7 million and the largest just exceeded $29 million. The total development cost for all 32 projects is $1.26 billion, meaning that Metro's bond financing accounts for roughly 26.3% of the total investment in affordable projects.

While slightly out of date, Metro's 2020 Annual Report identified the additional financing sources benefiting these bond-supported projects. LIHTC equity provided 33.6% of funds, permanent debt and other loans provided 31.9% of funds, sponsors provided 7% of contributions, and grants yielded 0.5%.

At the time of the report, all but one project was financed in part with LIHTC. The low percentage of grant funding suggests that bond financing took the place of other federal and state programs typically used for gap financing. These include CDBG, HOME, and Housing Trust Fund (HTF) funds. The relatively low percentage of debt is explained by the program's goals around deep affordability and a proportional decrease in operating income. That financial limitation heightens the need for bonds as gap financing.

The program is on track to exceed goals both cumulatively and at the local level (explored in Figures 8 and 9). Metro explains that this positive result is, in part, due to the federal government's expansion of financing through 4% LIHTC. Metro also cited as contributing factors the low interest rates leading to greater leveraged debt and unanticipated early action by implementation partners, thereby minimizing delays and construction cost escalation.

*Figure 7 - Metro Housing Bond Project Information*

| Project Name | Sponsor | Location | Status | Eligible Bond Units |
|---|---|---|---|---|
| 5020 N Interstate | CDP and Self-Enhancement | Portland | Pre-Construction | 64 |
| Albertina Kerr | Gerdin Edlan | Gresham | In Construction | 147 |
| Albina One | Albina Vision Trust and Edlan & Co | Portland | Pre-Construction | 94 |
| Aloha Housing Development | Bridge Housing | Washington County | Pre-Construction | 82 |
| Aloha Quality Inn | HAWC | Washington County | Pre-Construction | 54 |
| Basalt Creek | CPAH | Washington County | Pre-Construction | 116 |
| Dekum Court | Home Forward | Portland | Pre-Construction | 147 |
| Findley Commons | Home First and Do Good Multnomah | Portland | Complete | 35 |
| Fuller Road Station | GSA, GRES | Clackamas County | In Construction | 99 |
| Garden Park Estates | Innovative Housing | Portland | Pre-Construction | 117 |
| Goldcrest | Bridge Housing | Washington County | Pre-Construction | 75 |
| Good Shepherd Village | Caritas and Catholic Charities | Clackamas County | In Construction | 142 |
| Hattie Redmond | Home Forward | Portland | In Construction | 60 |
| HollywoodHUB | Bridge | Portland | Pre-Construction | 201 |
| Maple Apartments | CDP and Hacienda CDC | Clackamas County | Pre-Construction | 171 |
| Meridian Gardens | Central City Concern | Portland | Pre-Construction | 85 |
| NE 74th & Glisan | Related Northwest, Catholic Charities, and IRCO | Portland | Pre-Construction | 137 |
| Nueva Esperanza | Bienestar | Hillsboro | Pre-Construction | 150 |
| PCC Killingsworth | Home Forward | Portland | Pre-Construction | 84 |
| Plaza Los Amigos | Reach | Washington County | Pre-Construction | 113 |
| Powelhurst Place | NHA | Portland | Pre-Construction | 65 |
| Riverplace Phase 2 | Bridge Housing | Portland | In Construction | 176 |
| Rockwood Village | CDP and Hacienda | Gresham | In Construction | 47 |
| Saltzmann Road | Home First | Washington County | Pre-Construction | 55 |
| Scholls Ferry Apartments | Wishcamper | Beaverton | Pre-Construction | 164 |
| Terrace Glen | Related Northwest | Washington County | Pre-Construction | 144 |
| The Mary Ann | Reach | Beaverton | Complete | 54 |
| Tigard Senior Housing | NHA | Washington County | Pre-Construction | 58 |
| Tistilal Village | NAYA Family Center | Portland | Pre-Construction | 58 |
| Valfre at Avenida 23 | DCM Communities | Washington County | In Construction | 36 |
| Viewfinder | CDP | Washington County | Complete | 81 |
| Webster Road | HACC | Clackamas County | In Construction | 48 |

Regarding the regional distribution of projects, 15 are in Multnomah County, 13 are in Washington County, and four are in Clackamas County. The largest property funded in part by the bond is Bridge Housing's recently announced 201-unit project located in the Hollywood neighborhood of NE Portland. The smallest is Home First's Findley Commons, a 35-unit permanent supportive housing property for formerly homeless veterans. Figure 8 details how these projects tie to local jurisdictions.

*Figure 8 - Metro Housing Bond Projects Map*

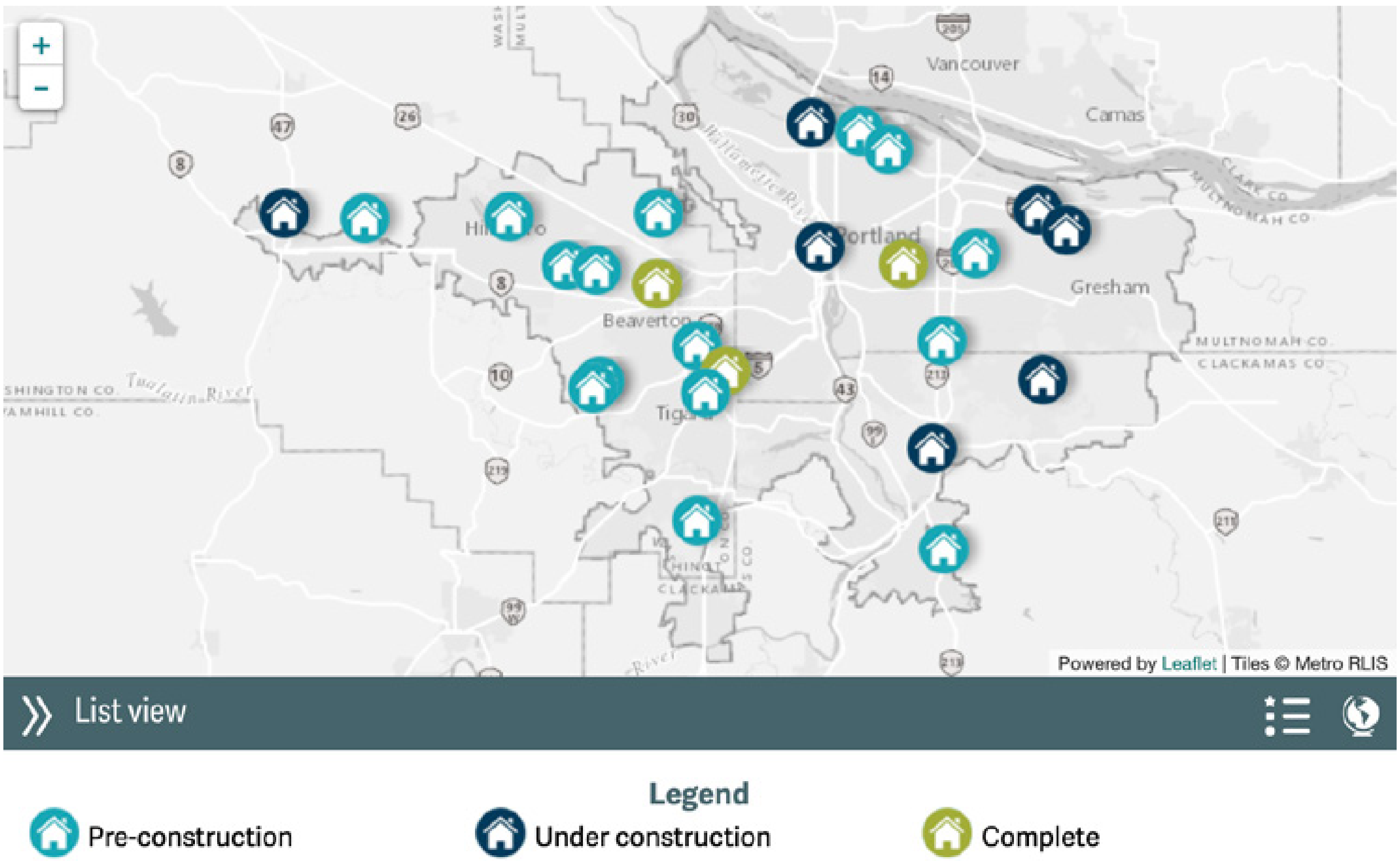



Figure 9 shows how successful local jurisdictions have been in reaching their individual unit production goals. Four entities (Beaverton, Gresham, Home Forward, and Washington County) have already met or surpassed their goals. Portland has reached 70% of its goal, and Clackamas County and Gresham have reached over 50% of their goals.

*Figure 9 - Metro Housing Bond Local Jurisdiction Production Goals and Outcomes*

| Entity | Unit Production Targets | Bond-Supported Units | % of Goal |
|---|---|---|---|
| Beaverton | 218 | 218 | 100% |
| Clackamas County | 812 | 460 | 57% |
| Gresham | 187 | 194 | 104% |
| Hillsboro | 284 | 150 | 53% |
| Multnomah County (Home Forward) | 111 | 291 | 262% |
| Portland | 1,475 | 1,032 | 70% |
| Washington County | 814 | 814 | 100% |

## DEVELOPMENT COST ANALYSIS: AFFORDABLE BOND PROJECTS AND MARKET-RATE

This article's final section provides a comparative cost analysis between affordable bond projects and recent market-rate projects. To do so, I have calculated the development costs per unit and per bedroom for both property types. For the market-rate properties, I selected eight of the highest selling properties from Q3 2021 in the Portland metropolitan area, including developments from Portland, Wilsonville, Hillsboro, Beaverton, and Vancouver. See Figure 10. Because the development budgets are not available for these properties, the purchase price will be used. The goal of this property selection is to gain insight into the upper-end of the market-rate multifamily market. Moreover, in order to examine comparable physical projects, all properties have undergone either construction or substantial rehabilitation in the last six years.

*Figure 10 - Highest Selling Market-Rate Projects in Portland Metro from Q3 2021*

| Project Name | Sponsor | Location | Year Built / Renovated | Unit Count |
|---|---|---|---|---|
| Seven West at the Trail | Greystar Real Estate Partners | Beaverton | 1996 / 2017 | 423 |
| Zera @ Reed's Crossing | MG Properties | Hillsboro | 2020 | 324 |
| Avana One Zero Nine | Greystar Real Estate Partners | Vancouver | 1994 / 2015 | 387 |
| Arc Central | St. Regis Properties | Beaverton | 2019 | 230 |
| Anthem PDX | The Wolff Company | Portland | 2020 | 211 |
| Bridge Creek | TIAA-CREF | Wilsonville | 1989 / 2017 | 315 |
| Ella | The Wolff Company | Portland | 2015 | 199 |
| Sky3 Place | The Wolff Company | Portland | 2017 | 196 |

Figure 11 reflects developmental costs for all of the Portland Housing Bond and Metro Housing Bond projects, as well as selected market-rate projects. The average development cost for a Portland Housing Bond project is around $42.5 million, which corresponds to $352,145 per unit and $250,017 per bedroom. The most expensive property is the 206-unit 3000 SE Powell in Southeast Portland at just over $87 million. The least expensive is the recently completed, 51-unit East Burnside Apartments project.

Metro Housing Bond projects cost, on average, $39.39 million to develop, meaning $405,132 per unit and $251,706 per bedroom. HollywoodHUB in Northeast Portland's Hollywood neighborhood has the highest total development costs at $98.8 million; it will deliver 201 units once complete. The Findley Commons has the lowest cost at $7 million and will provide 35 units. Between the two bond programs, then, the Portland Housing Bond is projected to see slightly higher total development costs. Additionally, although the Portland Housing Bond has lower costs per unit compared to the Metro Housing Bond, they have nearly identical costs per bedroom.

The average sales price for the selected market-rate projects was $92 million, double the development costs of both bond programs. The sales price per unit and per bedroom, however, are much more closely aligned with the affordable projects. The market-rate projects saw a per unit cost of $328,221 and per bedroom cost of $218,088. The most expensive market-rate properties from Q3 2021 thus cost $23.9K less per unit then the Portland Housing Bond and $76.9K less per unit then the Metro Housing Bond. Regarding per bedroom costs, the market-rate properties cost just over $30K less per bedroom than the bond programs. Ultimately, then, these market-rate projects are seeing lower costs per unit and per bedroom.

*Figure 11 - Cost Comparisons - Avg Cost Per Unit & Avg Cost Per Bedroom*

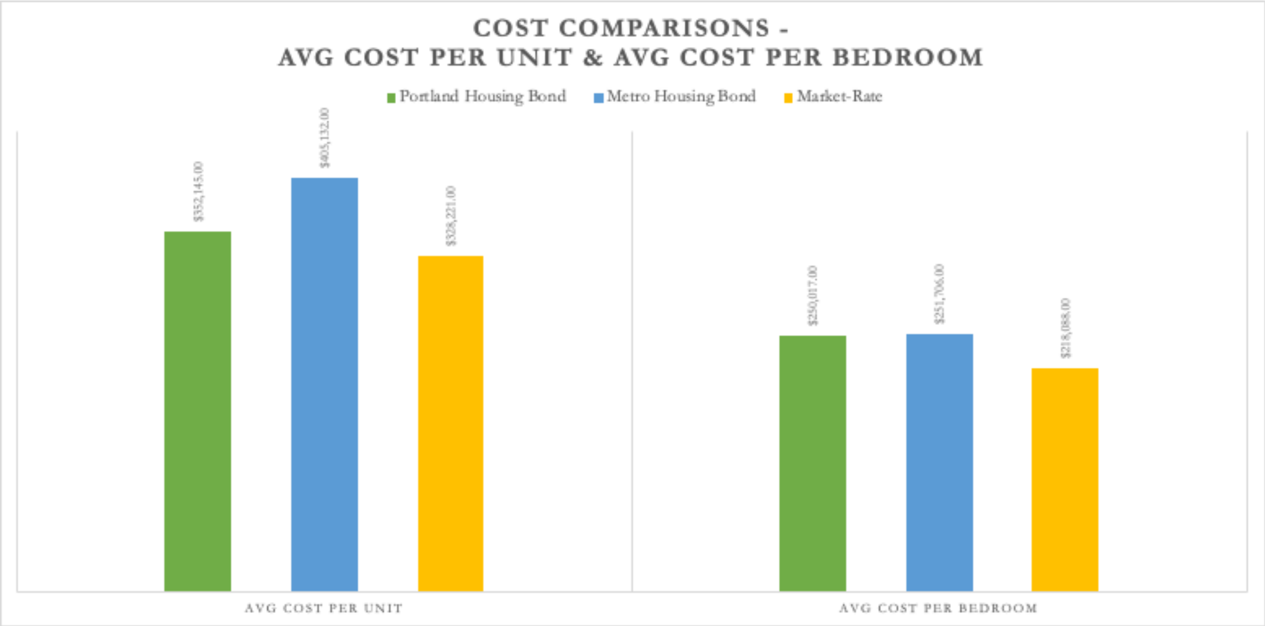


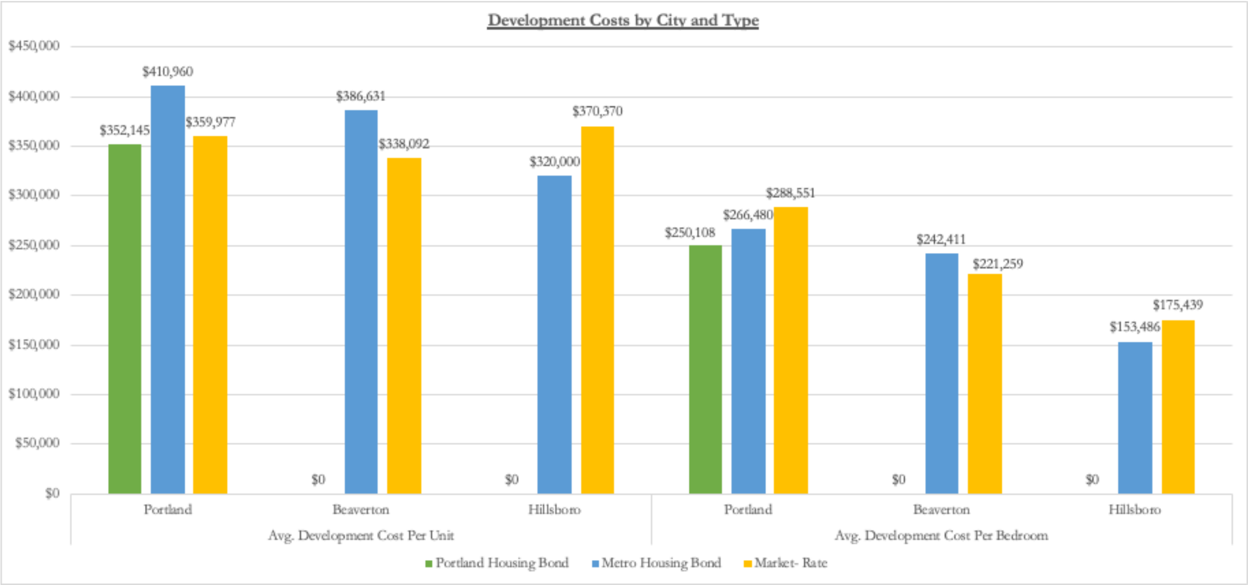

*Figure 12 - Cost Comparisons - Avg Cost Per Unit & Per Bedroom % Difference than Market Rate*

| Avg Cost Per Unit % Diff than Market Rate | | | Avg Cost Per Bedroom % Diff than Market Rate | | |
|---|---|---|---|---|---|
| Portland Housing Bond | Metro Housing Bond | Market Rate | Portland Housing Bond | Metro Housing Bond | Market Rate |
| +7.3% | +23.4% | - | +14.6% | +15.4% | - |

Figure 13 offers a city-specific examination of cost per unit and cost per bedroom for Portland, Beaverton, and Hillsboro. Because the Portland Housing Bond was limited to the city of Portland, that program does not offer any data in Beaverton and Hillsboro. Note, too, the limited data included here for market rate projects – Portland had three projects represented, Beaverton had two, and Hillsboro just one. Nonetheless, a few interesting observations may be drawn.

First, in the Portland Area, market-rate projects actually saw the highest cost per bedroom, though the Metro Housing Bond saw the highest per-unit costs. Second, Beaverton's market rate projects saw lower per-unit and per-bedroom costs. Lastly, Hillsboro, a one-to-one comparison between the market-rate Zera at Reed's Crossing and Metro Housing Bond's Nueva Esperanza, saw higher per-unit and per-bedroom costs for the market-rate project.

*Figure 13 - City Comparisons Cost Per Unit and Cost Per Bedroom*




The high cost of affordable housing development is not new to the industry or to the region. Even Metro admits that certain facets of affordable housing production drive up costs. In particular, Metro notes that affordable housing development is widely known to generate higher per-unit soft costs as a result of combining public and private financing and complying with a greater number of regulatory requirements. Contracting requirements are also cited as a contributing factor: "the program's priority focus on advancing racial equity was made with an understanding that prioritizing equitable contracting and workforce diversity may mean additional costs."

The authors go on to add that any project relying upon federal funding will trigger prevailing wage requirements. What's more, while not mentioned by Metro, green building standards and the need to incorporate office and community space for services are also frequently noted as a source of higher per unit costs. Lastly, because the bond programs both target family-size units, which drive up hard costs, this analysis has intentionally included costs per bedroom.

As a final note, we should be mindful of the significant limitations of this type of direct property comparison. For instance, while cities may see similar development costs, every parcel is positioned differently, resulting in unique developmental challenges, amenities, and land costs. Likewise, every project has distinct design elements and construction quality. I did not account for building type in the project comparisons above – garden style walk-ups, five-story structures, and high-rise construction are tied to very different hard costs largely due to the need for elevators and structural reinforcement.

I also did not account for in-unit amenities, like stainless steel appliances, balconies, patios, or high-speed internet. A 2015 study on affordable housing costs writes that "comparing costs between different kinds of projects is difficult and complex – and often misleading." With this in mind, it is useful to think of these cost comparisons as demonstrative of the high-cost of affordable housing development in general, rather than yielding any insight into how much housing projects should cost in specific locales.

## CONCLUSION

The Portland Housing Bond and the Metro Housing Bond have stimulated an incredible amount of affordable development for the region. These programs are partly responsible for Portland seeing one of the largest per-capita investments in affordable housing in the entire U.S. As gap financing tools at the federal level face fierce competition, voter-backed bond programs can and should be deployed to bridge the gap between a theoretical project and a financially viable one. The integration of green building elements, commitment to living wage contracting jobs, delivery of deeply affordable and family-sized units, and engagement with local service partners all generate additional benefits for our communities. Indeed, these are high quality developments that address many issues which affect our communities. They are also, importantly, proving very successful at accomplishing program goals.

Having said that, entities must be transparent about the costs to develop affordable housing and carefully oversee programs to ensure the most cost-effective allocation of funds. Should new construction projects be prioritized, or should locales encourage conversion projects, in which an existing property is adapted for affordable housing? The Ellington, which was financed through the Portland Housing Bond, provides an insightful example of this strategy; at just over $178,000 per unit, The Ellington was able to convert 263 units at nearly half the average per unit development costs of the other bond projects. How do complex requirements (e.g. green building, equity in contracting, etc.) complicate and thus disincentivize affordable housing development? Or, alternatively, should we collectively accept that affordable housing is delivering projects that meet a variety of social needs, albeit at a higher cost? If financial resources like these are truly precious, we need to constantly evaluate how we can stretch them the farthest. Seeking answers to these types of questions will help us do so.

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12

HOUSING INSIGHTS

# Middle Housing and Updates on HB 2001


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## INTRODUCTION

Oregon House Bill 2001 was passed in 2019 to expand housing choice and ultimately lower the cost of housing for Oregon residents. The bill implements a change to city zoning codes to allow for middle housing on all land previously zoned for single-family homes. Middle housing is best explained as housing assets that are more dense than single-family homes but less dense than mid-rise or high-rise buildings. According to the bill, cities with more than 25,000 residents must allow for 2-4 units on these lots. Cities with more than 10,000 residents must allow duplexes.

This bill was passed in the face of rising housing costs, inflexible urban growth boundaries and long-term concerns about the availability of new housing market supply. HB 2001 was not without its controversies which continue as the deadline approaches to implement the zoning changes. The bill universally changes all single-family zoning in the designated cities of Oregon without indicating flexibility for communities who wish to selectively apply zoning code changes to certain neighborhoods.

This study will look at the current state of zoning code implementations with an emphasis on stakeholders' feedback. It will also examine the conflicts that lay ahead as the State of Oregon drastically changes the way it regulates residential land. With an overview of the current market conditions in Oregon and a review of middle housing testimony by local leaders, this paper will examine the benefits that Oregon hopes will come and what challenges may lie ahead.

The Housing Market

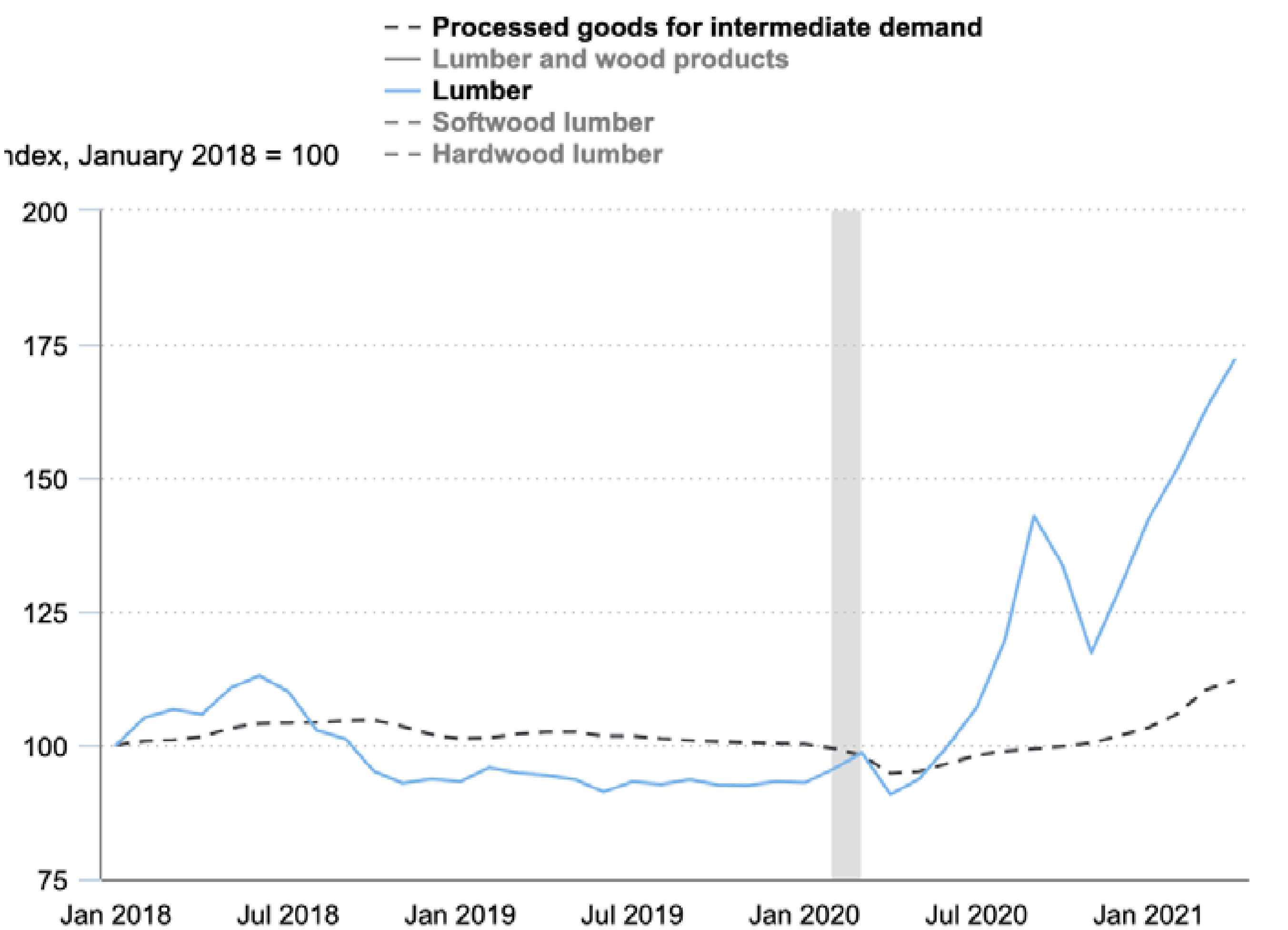
The Oregon housing market has experienced strong growth in recent years. Most markets within Oregon are currently sellers' markets with housing prices continuing to increase, multifamily rents increasing, and vacancies continuing to decline. Portland's year-over-year rent growth has reached 8.9% compared to a 10-year average of 4% annual growth. Salem's vacancy rate is currently 2.3% with rents remaining lower than other markets in Oregon, while Eugene's 1.5% vacancy rate has been bolstered by local population growth. Sales in every Oregon market have increased along with price per units. This is a positive sign for many investors, and capital markets have responded by compressing cap rates to record lows, reaching near 4.5% in Portland. However, this is not good news in the short term for rents, and it is a cause for concern for the entire market in the long term.

The inability of new supply to keep up with record demand is an underlying cause for increasing rents, decreasing vacancies, and increased property values. This is down from the annual average of 8,600 units delivered over the last ten years. Similar trends across

Oregon led to an alarming trend in the housing market. Oregon's increasing population and decreasing new supply has caused the values of multifamily assets to increase. Increasing demand is a positive force in the market. However, markets need increasing supply to drive down rents and allow renters to remain in the market. In addition, the market needs new real estate investment to compete with larger corporations, REITS, and investment groups.

The two main reasons that new deliveries have slowed in Portland are rising construction costs, which affect the entire state of Oregon, as well as the Portland-specific inclusionary housing policies implemented in 2019. Construction costs continue to rise, posing a threat for new construction projects to be profitable. Lumber prices have hit a record high, increasing 24.4% in December 2021, while lumber volatility reached a 75-year high, according to the Bureau of Labor Statistics. The cost of building materials increased by 15.9% in 2019, and the average cost of commercial development projects increased by 23.1% between August 2020 and August 2021 according to a JLL report.

**Producer Price Index for selected commodities, January 2018–April 2021**




Click legend items to change data display. Hover over chart to view data.
The vertical line at February 2020 represents the start of a recession, as determined by the National Bureau of Economic Research. When this chart was published, the NBER had not yet determined an endpoint for that recession.
Source: U.S. Bureau of Labor Statistics.

## MIDDLE HOUSING

Middle housing refers to residential properties with medium density, typically duplexes, triplexes, townhouses, courtyard buildings, multiplexes, and other arrangements. Middle housing allows renters to live in smaller developments, and it allows developers to construct multifamily properties smaller than typical urban multifamily properties. Middle housing is less costly to build than mid- and high-rises. It can be created by converting an additional dwelling unit ("ADU") such as a detached garage into a residential unit. Daniel Parolek, author of *Missing Middle Housing: Responding to the Demand for Walkable Urban Living* explains that "Because of their simple forms, smaller size, and Type V construction, Missing Middle building types can help developers maximize affordability and returns without compromising quality." Middle housing allows owners of single-family lots to change the existing use and create multifamily housing on their property without the significant investment needed to develop a midrise building, or the land required for garden style multifamily complexes.

## IMPLEMENTATION OF HB 2001 AND CITY RESPONSES

Oregon has been in the process of implementing HB 2001 for over two years as of this publication. As the deadline for code adjustments looms over cities, the results have indicated a mix of reactions from larger cities and a nearly universal embrace of this bill from smaller cities. As seen in the appendix, most small cities have made the necessary zoning changes while larger cities are still in the process of deciding the direction of their city codes. This distinction is likely due to the difference in densities between smaller and larger cities. Smaller cities see their capabilities to expand their existing housing supply, while larger cities are less inclined to focus on population growth at the expense of their single-family inventory. Also, smaller cities typically have more to gain by population growth and would be inclined to take advantage of the infrastructure benefits outlined in HB 2001. By comparison, some larger cities have grown to their capacity and would see less impact from eliminating single-family zoning. The Oregon Legislative Assembly required cities failing to meet the July deadline to implement an alternative "development model code," creating a strong incentive to accept the legislative mandate.

The most succinct summary of the challenges coming from larger cities would be the 2020 letter published by the Oregon League of Cities (OLOC) regarding HB 2001. The OLOC is a political organization of city leaders throughout Oregon designed to advocate for legislative action based on individual city needs. Their vision is that "All Oregon cities effectively govern, provide municipal services, and freely exercise their home rule authority," and their focus has been for maintaining local control over city decisions rather than statewide actions such as HB 2001.

The OLOC letter was written on behalf of nine large Oregon cities including Eugene, Salem, and Beaverton and includes clear opposition to HB 2001. They urge the state government to revisit their approach to the legislation and lay out numerous points which all focus on allowing flexibility on a city by city basis. These cities refer to HB 2001 as a "whittle away" approach. This is due to language within the bill that allows middle housing on land which is, "zoned for residential uses that allow for the development of detached single-family dwellings," rather than lots zoned exclusively for single family.

The OLOC's concern is that because many zoning codes technically allow single family houses to be built, any lot with this potential is now subject to middle family zoning. These parcels include lots with higher density and mixed commercial zoning codes which allow for single family. The OLOC claims this approach fails to provide cities with flexibility, taking issue without how HB 2001:

> "Fails to provide a path for cities to retain middle housing strategies that are already working… does not expressly allow cities to define different areas within their jurisdiction in which middle housing can be regulated in different ways… and removes flexibility and severely limit cities' ability to use tools such as minimum lot size, maximum density, planned unit developments, and unit maximums per lot."

The OLOC letter goes on to propose an alternative approach which focuses on cities deciding their own criteria for lots that should be designated for middle housing. The components of their alternatives include, "Promotion of racial equity and desegregation," wherein cities would be allowed to rezone land to middle housing in a manner that "promotes racial equity and reduces historic segregation by race, ethnicity and income by providing the opportunity for a wider range of housing types to be built in areas zoned for residential use." The OLOC advocates for local jurisdictions having the authority to set standards and expectations on zoning adjustments and land designations to avoid potential conflicts.

The OLOC letter indicates how cities may handle compliance. The primary focus of their critique is focused on the centralized nature of HB 2001 and how the minimum requirements push compliance across all cities. Their criticism identifies an issue with cities that allow single-family along with other potential uses on a site that may not be compatible with middle housing options. However, the alternative option that focuses on racial equality lacks explanation as to how individual zoning designations would increase access to housing options for people of color. Also, it seemingly allows for cities to pick and choose the areas that would be the focus for housing density increases over others. Without further understanding of this idea, the OLOC proposal suggests differences in zoning in areas with higher populations of BIPOC residents in the apparent effort to lower housing costs in those areas. If this is the intended value behind the flexible option of the OLOC letter, it creates a clear risk of further segregation as areas with middle housing becoming ostracized compared to areas without middle housing. This proposal appears to endorse zoning rules that correlate with racial characteristics of neighborhoods.

Portland has embraced the changes made in HB 2001 and made clear their approval of zoning changes to encourage density in all residential land. In September 2021, the Portland city government announced the Residential Infill Project Part 2 ("RIP 2"). This project adopts the zoning changes in HB 2001 and clears the way for additional multifamily units that were part of Senate Bill 458. RIP 2 will be implemented by July 1, 2022 in order to meet the state deadline as the city has stated that adopting the model development code is not compliant with Portland's zoning policies. City Council hearings are planned in Spring 2022, but it is doubtful that anything will change Portland's plan to adopt these codes. The city has stated that RIP 2 will allow for several middle housing options, including triplexes, fourplexes and cottage clusters, on R10- and R20-zoned properties. RIP 2 will revise the constrained site overlay zones in compliance with middle housing requirements and create an expedited land division process for the creation of new middle housing.

During this debate, the Portland region has been dramatically impacted by the rising demand for housing as supply fails to keep up. Rising construction costs and inclusionary housing policies have diminished the incentive for new large multifamily projects. The hope is that middle housing will enable Portland to pursue a new avenue of housing creation to lower rents. The Portland CBD has a number of small single-family lots that would be difficult, though not impossible, to add further density. However, Portland's sprawling city limits encapsulate many neighborhoods of less dense areas with room to add housing stock. With their clear intents on easing the expansion of their UGB, the City of Portland's embrace of HB 2001 is expected, and there is a clear potential for the new housing options to have a positive impact on the market. Portland is also the target location of the Missing Middle Housing Fund, a nonprofit organization which aims to bolster innovation in missing middle techniques by launching a competition to reward developers of innovative projects.

Outside of Portland, many of Oregon's larger cities are showing more hesitation on the matter, and their city leaders have made their attitudes clear. Many of these cities echo the sentiments of the OLOC letter but for their own reasons. The City of Beaverton, which signed the OLOC letter, expressed its desire to keep local control of zoning codes. Beaverton has historically expressed an interest in increasing density and expanding middle housing options before HB 2001 was passed. The City established the Beaverton Housing Options Project to help determine where and how these housing types will be allowed.

Those efforts were stalled, according to Beaverton community development director Cheryl Twete, to determine if the initiative was in compliance with HB 2001 and whether Beaverton residents would accept higher density. Beaverton associate planner Rob Zoeller expressed a concern with the impact of single-family markets as land demands rise and residents are priced out of buying the existing single-family inventory. Mark Haas, a state senator from Beaverton, voted no on the bill. While the City has demonstrated a desire to pursue increased density, members of the community have taken issue with the state-mandated control of zoning codes rather than identifying neighborhoods for increased density themselves.

The City of Troutdale, with just over 16,000 residents, responded to HB 2001 with a strongly worded message on its website making clear that the Troutdale city council was largely opposed to HB 2001 and supporting the message of the OLOC. The website stated, "There are still possibilities for legal challenges to the law, and there may also be legal protections for some established neighborhoods." The city council issued a letter of disapproval immediately following the passage of HB 2001 in 2019. During the legislative debate regarding HB 2001, Troutdale mayor Casey Ryan publicly disagreed with the sentiment that single family neighborhoods enforce segregation, noting, "Maybe at one point neighborhoods were formed to keep people out, but that's not going on anymore."

Eugene, the second most populous city in Oregon, is currently in phase two of a four-part plan in amending their zoning code to meet HB 2001 standards and has largely expressed a desire to see increased density in their city. Code writing will start in the spring, and then city staff will bring the changes to City Council for adoption. Principal planner Terri Harding has expressed the city's intent to comply with the minimum standards of HB 2001 and anticipated furthering measures to increase density beyond state guidelines. Harding expressed an interest in incentivizing higher density projects with measures such as not requiring off-street parking for properties with an affordable unit or for triplexes near a transit option.

Albany, a city of 50,000 residents just outside of Salem, adopted a mixed approach to HB 2001, ultimately embracing the bill. In November 2021, the city rolled out its Expanded Housing Options

Project, which aims to improve housing choice and implement zoning changes in compliance with HB 2001. According to the City, members of the community – including small families and older adults – need housing options with smaller footprints, and middle housing can be that solution. Anne Catlin, a City of Albany senior planner, made her support of increased density clear. Catlin states, "Through zoning without realizing it, we did actually restrict the types of housing units that could be built… A lot of communities, not just in Oregon, are trying to get back to more varieties of housing types." However, this view was not universal in the city as Former Mayor Sharon Konopa viewed HB 2001 as irresponsible and claimed that "[HB 2001] takes away cities' authority over the character of their neighborhoods and basically punishes single-family neighborhoods." Konopa served until 2020 before losing reelection to Alex Johnson II, who publicly stated his support for new housing options to increase affordability.

HB 2001 provided $3.5 million to the Department of Land Conservation and Development to assist local governments with planning and zoning processes, as well as infrastructure plans which are necessary for many cities to increase density. The money targeted smaller cities with inadequate resources to independently plan and implement these changes. Most large cities, such as Portland, Eugene, Bend and Wilsonville, were awarded with grant money. For example, Eugene was awarded $145,000.

## OUTLOOK

The earlier analysis published on this subject focused on the technical impacts of HB 2001 and how middle housing serves as an opportunity to increase housing supply, decrease rents and property values, and create new opportunities for smaller investors. While these points remain true, the political fallout of cities struggling with reduced autonomy is an increasingly important subject and has become a test case for further implementation of similar legislation in other states.

HB 2001 presents a contradictory look at legislative autonomy: does the right of a city to decide its zoning code outweigh the right of a landowner to decide what ought to be built on that property? HB 2001 universally overhauled Oregon's zoning codes by mandating that all individual city codes with single-family zoning must be expanded to allow increased density, effectively ending single-family zoning in these cities. This new state policy reverses practices that were historically handled at the city level and challenges local planning departments to redesign their cities.

A look at the record of public comments, legislative actions, and popular press in Oregon shows that many cities that oppose HB 2001 have also engaged in their own density increases and are struggling to embrace a statewide approach rather than a local one. Nearly every city in Oregon has publicly announced their plans to amend zoning codes to comply with HB 2001. Only a few cities, like Troutdale, have taken a more aggressive approach to engage in legal battles against the state legislature over the issue. The legislature's actions beg the question of whether cities should have the authority to decide which parts of their city density ought to increase in. However, the nature of HB 2001 and its universal approach to the zoning code changes prevents cities from focusing density on lower-income areas.

The changes in zoning codes do not prohibit or dissuade the development of single-family homes but do change the potential uses for all land. Cities that desire single-family neighborhoods have no authority to prevent investors from purchasing and converting plots of land to convert into multifamily development. Construction of middle housing can start a domino effect in which neighboring owners sell their property to investors, and neighborhoods are largely converted from single family to multifamily properties. This outcome may be extreme but demonstrates the potential impact of taking away legal authority for cities to create single-family neighborhoods. On a market level, a potential conversion of a sizable number of single-family units creates the likelihood of new single-family development to compensate for this change. In this scenario, consumer preferences for single-family homes dominate the preferences of lawmakers.

Ultimately, HB 2001 could have a dramatically large or surprisingly small impact on housing in Oregon. A common fear for some Oregon residents is that this bill will put an end to single-family housing, which has become a strawman argument against the bill. This change in zoning code opens all single family lots within the selected cities to potentially convert to multifamily housing, but this is solely at the discretion of the owner. The bill creates more flexibility for landowners to choose highest and best use for their property, which is ultimately the goal of all developers and landowners. At the same time, city officials – many who show a clear desire to increase density throughout their cities – fear the loss of control over their own zoning regulations.

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