CENTRAL OREGON COMMERCIAL REAL ESTATE: A REVIEW OF 2012 AND FORECAST FOR 2013

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For the second straight year, Central Oregon's vacancy rates in the industrial, retail and office markets all saw a drop, indicating a slow but steady recovery from the recent recession. Rental rates in the retail market held steady and in the industrial market we actually saw a slight uptick, but unfortunately our office rates are still stuck in first gear, and will probably continue in that slow mode for 2013.

The City of Bend recently announced plans for several new industrial and commercial endeavors, and we foresee at least the industrial projects commencing this year. Finally, with no change at the top in Washington D.C., we expect a sluggish, but upward regional economic rise.

The latest reports from the U.S. Commerce Department show that residential housing starts were up nationally in 2012 to the highest levels since 2008. Locally, we are also experiencing that trend. It's not hard to see this in action as you drive around Bend, particularly in NorthWest Crossing and other planned developments, where walls are going up and builders are getting busier.

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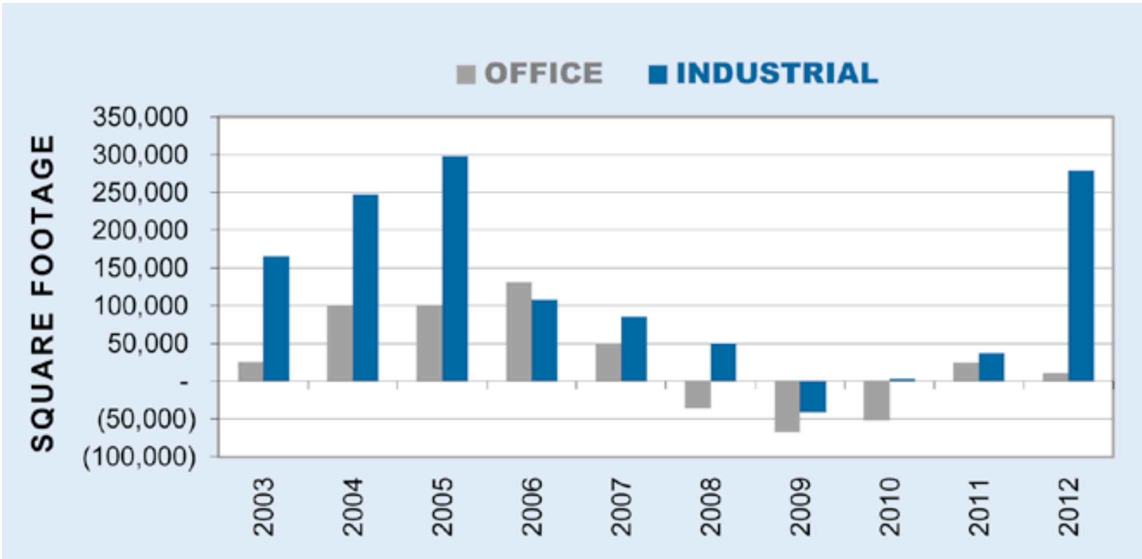
Figure 1: Bend office and industrial absorption by year



Historically, commercial real estate activity follows residential movement by about a year. We are optimistic that by the end of this year, there will be less inventory and thus, more construction in the commercial sector, which was already evidenced by the lack of residential development land, REO (bank "Real Estate Owned") properties, and quality investment grade opportunities for commercial buyers in 2012. The last year or two appeared to be the latest great land rush, with investors and solvent builders snapping up residential land developments for a fraction of the cost of the infrastructure, sometimes as low as $10,000 – $15,000 per finished buildable lot, when it can cost upwards of $25,000 per lot to get to that stage.

For 2012, 11,354 square feet of office space was absorbed in Bend, compared to almost 68,000 square feet in 2011. Prior to our two years of growth we experienced three years of negative absorption in the Bend office market, so we are continuing a slow but steady upward climb. The west side submarket was the only losing submarket, recording a negative 14,646, sq. ft. while the downtown area gained 10,433 sq. ft. and the Highway 97/3rd Street submarket gained 15,567 sq. ft. of new net occupancy.

The Bend industrial market also showed positive absorption for the year with a whopping 278,477 sq. ft. in 2012. Vacancy rates for the industrial sector dropped from 16.7 percent at the end of 2011 to 9.6 percent at the end of 2012. This followed a positive year in 2011 that saw over 37,000 sq. ft. absorbed after a two year period of negative absorption and greatly surpasses the 10-year average that has typically recorded over 100,000 sq. ft. of annual positive absorption. At this rate, with just under 389,000 sq. ft. of available industrial space on the market, there is only a 17-month supply of rental space available.

Will this hot leasing activity continue in 2013? It will likely not remain as brisk, but with all indicators pointing to improved housing starts, window makers, cabinet manufacturers, plumbers and electricians may be looking for more industrial square footage to expand their businesses.

The southeast and northeast submarkets recorded the majority of the net positive absorption of nearly 235,000 sq. ft., while the central area showed a gain of over 44,000 sq. ft. and the and west side again recorded slight negative absorption of 218 sq. ft.

Redmond's industrial market finally recorded a gain in 2012, after two years of negative net absorption, recording 36,489 sq. ft. of positive absorption, which is above Redmond's 10-year average of 29,000 sq. ft. of positive absorption. But putting that in terms of supply, there is a nearly 10-year inventory of available industrial space in Redmond, not a pleasant outlook for landlords.

OFFICE MARKET REVIEW

Again in 2012, and for the fifth year in a row in Bend, no significant new construction of office buildings was added to the inventory available for rent. For those of you keeping score, however, the additional 116,985 sq. ft. on our survey in 2012 was mainly the result of investor purchases from owner/users (or banks) that now qualify for inclusion, and an adjustment of some of the data obtained by our survey collectors. Our 2012 prediction of new office projects popping up in the next year or two will most likely be the latter time frame, even though there were some significant commercial land purchases this past year, as those buyers were mainly speculators sitting on cash and finding great bargains. We doubt any of those savvy developers would start an office project in 2013 with a 21 percent vacancy rate except those who procure tenants prior to starting construction. Our wish of a reduction in inventory with resulting vacancy rate decreases and rising rental rates did not materialize, but we hope to have better news at the end of this coming year.

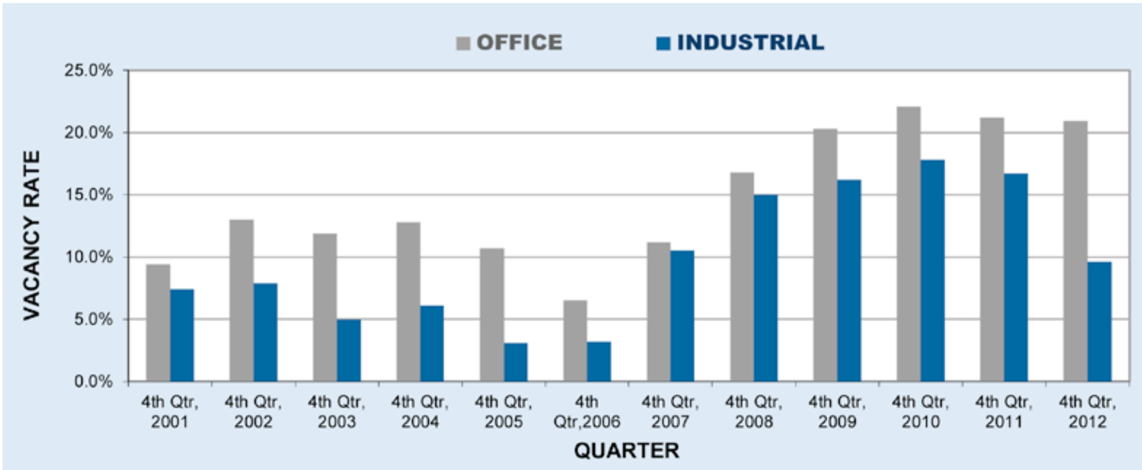
Look for another year of low office rental rates and enticing landlord incentives until the vacancy rate improves.

INDUSTRIAL MARKET REVIEW

At the end of 2011 we predicted that "there will again be improvement in the vacancy rates, possibly down to 15 percent, as little or no construction is slated for the year, and evidence of job creation is afoot, with falling unemployment rates and talk of new industry popping up in the area. Lease rates should stay level for the year."

Happily, we erred on the side of conservatism, as our end of year industrial vacancy rate of 9.6 percent dropped precipitously from the previous end of year 2011 rate of 16.7 percent. Lease rates did stay steady in 2012 but should be on the rise, and several new industrial projects are on the books for 2013.

Figure 2: Bend office and industrial vacancy by year



RETAIL MARKET REVIEW

The retail sector in Bend continues to shine. Our tourist based industry remains a model for other mid-sized MSAs (Metropolitan Statistical Areas), with recreation, sporting goods, restaurants and brew pubs the shining industries. Rents are on the upswing after several years of landlord concessions. The vacancy rate of 8.0 percent is the lowest since the second quarter of 2008 when we recorded a 6.8 percent figure. Since then, retail rates have been as high as 13.2 percent, recorded at the end of Q1 2009, and have fallen steadily since.

Several vacant downtown restaurant locations are backfilling, with rising rents and good stable operators moving into the previously dark spaces.

OUR PREDICTION FOR 2013

In 2013, expect to see a continued drop in industrial vacancy rates, two or three new buildings on the survey, and a slight rise in rental rates of between $0.40 and $0.45 per sq. ft.

The retail occupancy will also rise as consumer confidence gets stronger and tourism remains good. Retail rates should also continue to climb a bit.

We do expect a better office market, but that will depend on businesses feeling confident enough to expand, hire and absorb larger office spaces. We look for a one to two percent drop in vacancy and lease rates remaining stable. ■