
OFFICE MARKET ANALYSIS

KYLE BROWN

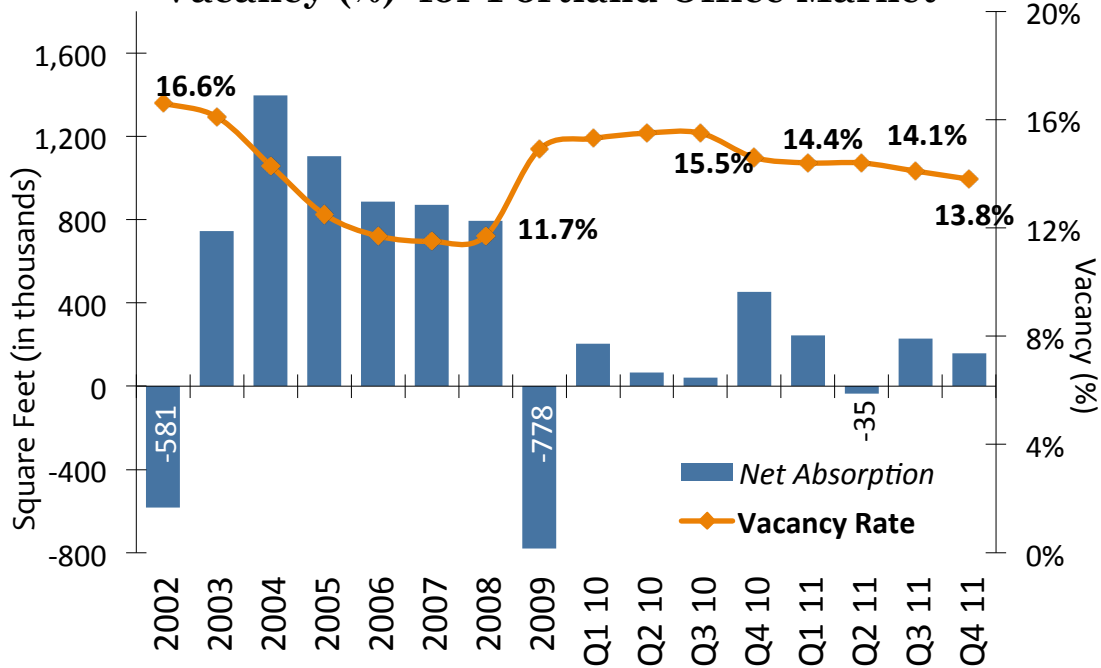
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Amid some encouraging signs nationally, the Portland office market has maintained its stability, with the CBD meeting modest expectations in the fourth quarter of 2011. Local indices show evidence of a decline in vacancy and modest absorption throughout the year. The pressure on the central city Class A market that continued for most of the year has begun to level out, as high-end users return underutilized space to the market.

Portland's economic recovery has slowly gained traction with the unemployment situation starting to improve, and year-over-year increases in professional and financial services offsetting losses in government jobs. Oregon's unemployment rate has held steady over the last few quarters ending in December at 8.9%, but still above the national average of 8.3%. Having entered the recession late, job recovery has also been slow to get a toehold, leaving Oregon trailing other states with its resurgence. As could be expected, the Portland MSA has seen greater growth in employment relative to smaller cities and rural areas in Oregon. Grubb & Ellis reports that Portland ranks 5th in "over-the year" employment growth for large metro areas, dropping from 9.8% to 8.4% (Figure 2).

In the office market Grubb & Ellis (G&E) reports a 30 basis point drop in market-wide vacancy from 14.1 percent to 13.8 percent in the fourth quarter, with 157,000 square feet of net absorption overall. Tenant demand in the suburbs grew substantially in 2011, with six of the ten largest leases being signed in the suburban markets and Vancouver. Overall vacancy rates in the suburbs have remained somewhat stable, with the Washington Square/Kruse Way submarket stabilizing around 20%.

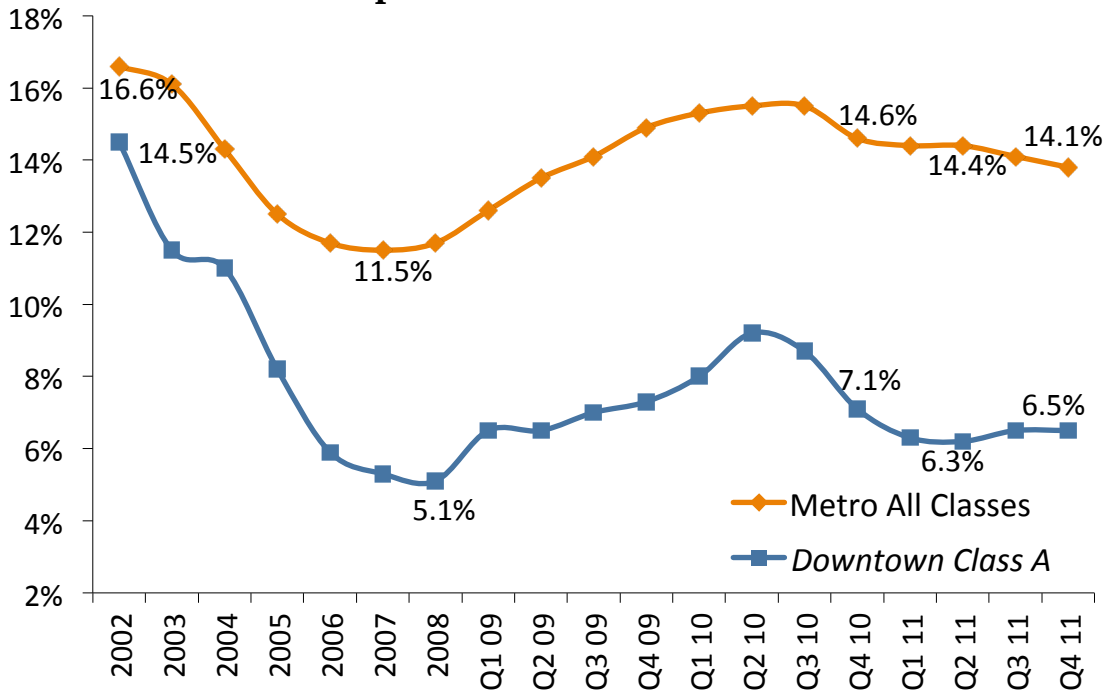
Figure 1: Overall Net Absorption (SqFt) and Vacancy (%) for Portland Office Market



Source: Grubb & Ellis, Office Quarterly Reports

Steady leasing in the Vancouver submarket registered over 235,000 square feet of net absorption. The signing of PeaceHealth, Nautilus, and LionBridge Technologies helped to cut its vacancy rate by nearly half over 2011. Overall the year ended on a positive note, but the pace and scale of recovery is highly segmented by location. For cost-sensitive tenants in suburban markets this is good news; tenants may be able to realize significant rent cuts when renewing leases, and new tenants may be able to negotiate incentives and larger tenant improvement allowances.

**Figure 4: Office Vacancy (%)
Metropolitan All Classes & CBD Class A**



Source: Grubb & Ellis, Office Quarterly Reports

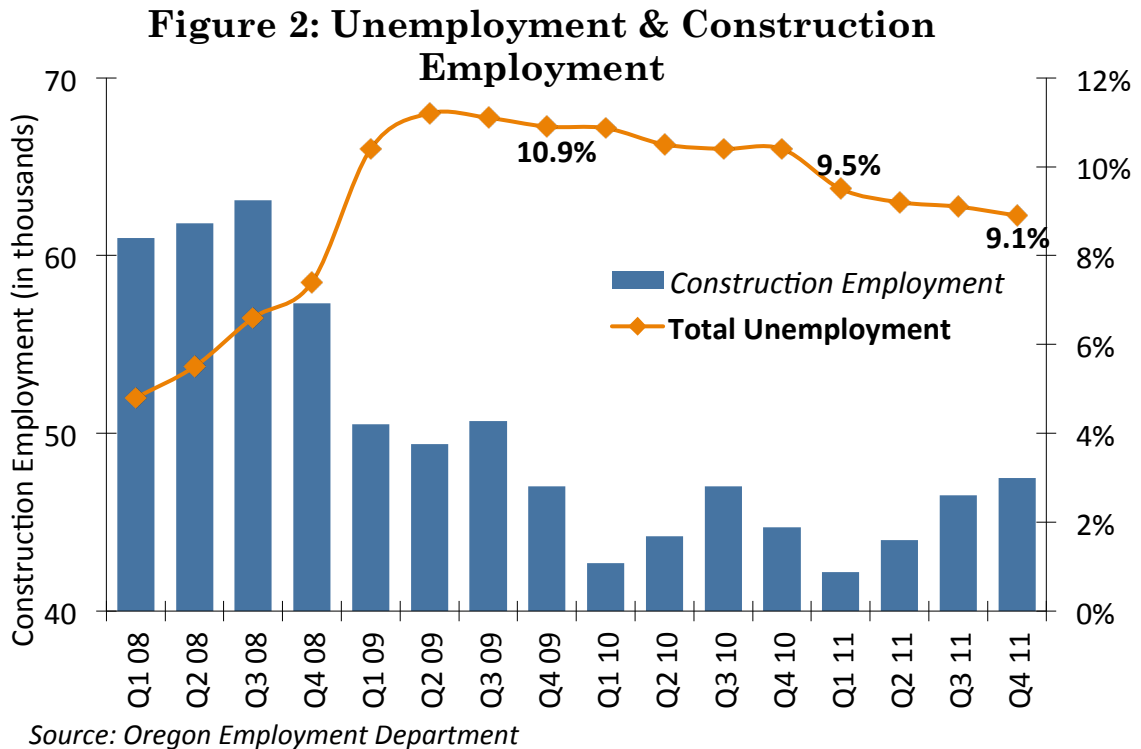
Table 1: Office Market Vacancies and Asking Rents, Q4, 2011

	CB Richard Ellis	Cushman & Wakefield	Grubb & Ellis	Norris, Beggs & Simpson	Median
Market-Wide Vacancy	14.5%	13.5%	13.8%	16.7%	14.2%
Previous Quarter	14.9%	12.4%	14.1%	17.2%	14.5%
Fourth Quarter 2010	16.4%	16.1%	15.5%	17.7%	16.3%
Fourth Quarter 2009	15.4%	15.9%	14.1%	17.1%	15.7%
CBD & Downtown Vacancy	9.7%	9.1%	9.1%	12.9%	9.4%
Previous Quarter	9.7%	9.6%	9.3%	12.8%	9.7%
Fourth Quarter 2010	10.3%	11.6%	10.7%	12.1%	11.2%
Fourth Quarter 2009	10.0%	11.7%	9.8%	11.1%	10.6%
CBD Class A Vacancy	-	6.5%	6.5%	N/A	6.5%
Previous Quarter	-	-	6.5%	9.2%	7.9%
Fourth Quarter 2010	8.9%	10.5%	9.4%	11.8%	10.0%
Fourth Quarter 2009	3.8%	6.4%	5.1%	5.4%	5.3%
CBD Class A Asking Rents	-	\$26.56	\$26.19	N/A	\$26.38
Previous Quarter	-	\$24.54	\$25.99	N/A	\$25.27
Fourth Quarter 2010	N/A	\$26.34	\$27.03	N/A	\$26.69
Fourth Quarter 2009	N/A	\$25.79	\$25.86	N/A	\$25.83
Suburban Vacancy	19.1%	18.1%	-	23.2%	19.1%
Previous Quarter	19.9%	17.0%	17.0%	23.2%	18.5%
Fourth Quarter 2010	20.8%	20.2%	17.8%	23.9%	20.5%
Fourth Quarter 2009	20.3%	19.9%	17.4%	20.2%	20.1%
Suburban Class A Vacancy	N/A	-	-	N/A	N/A
Previous Quarter	N/A	-	19.8%	N/A	19.8%
Fourth Quarter 2010	N/A	-	-	-	-
Fourth Quarter 2009	N/A	16.3%	15.2%	17.0%	16.3%
Suburb Class A Asking Rent	N/A	\$21.16	\$22.30	N/A	\$21.73
Previous Quarter	N/A	\$22.95	\$21.79	N/A	\$22.37
Fourth Quarter 2010	N/A	\$22.56	\$22.40	N/A	\$22.48
Fourth Quarter 2009	N/A	\$24.04	\$23.84	N/A	\$23.94

Source: CB Richard Ellis, Cushman & Wakefield, Grubb & Ellis, and Norris Beggs & Simpson Quarterly Reports

Vacancy rates above include subleases except those reported by CBRE, and NBS, which report direct vacancies. CBD figures include close-in neighborhoods, except Class A figures reported by CBRE. All rents are full service. All other suburban figures include Vancouver.

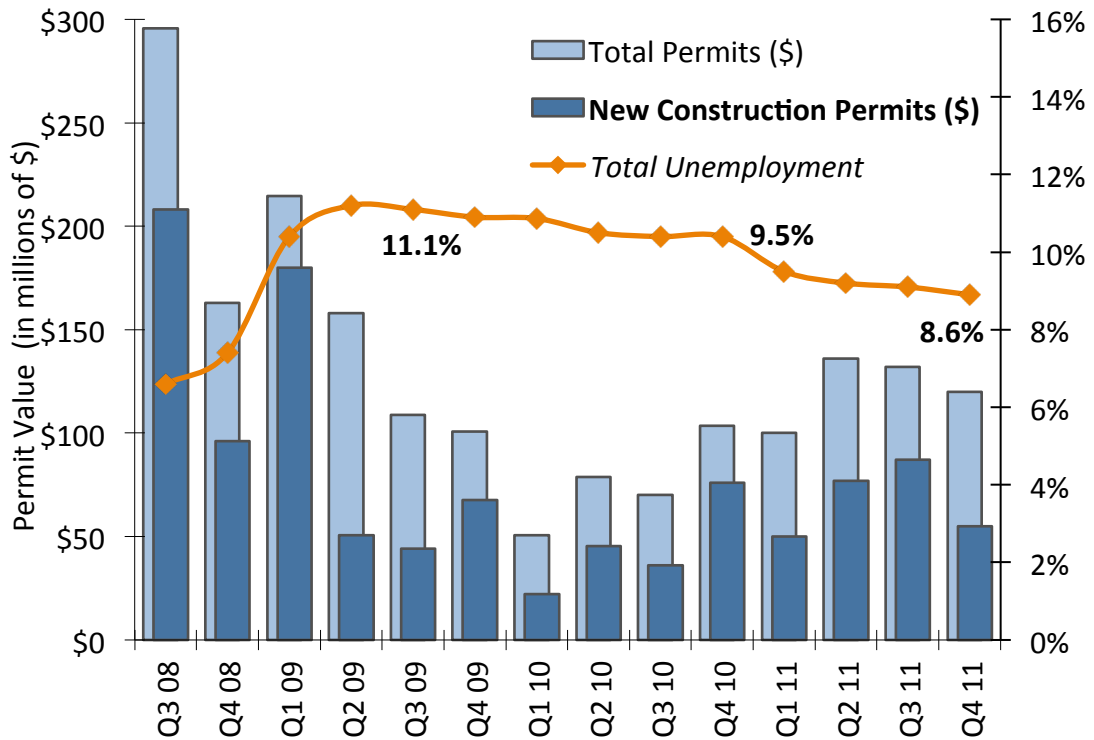
Although construction employment numbers have grown steadily over 2011, seen in Figure 2, completed construction remains severely constrained with just 62,000 feet delivered during the year, as seen in Figure 7. Construction in the CBD has essentially stopped and new projects are on hold pending more favorable financing options and the market tightening further.



Construction had faster growth than any other sector in 2011. The 3,500 additional jobs over the year demonstrated a growth rate of around 5 percent. Oregon’s growth in 2011 placed it fifth in states that track construction jobs. Oregon would need to continue this rate for 10 years to reach 2007 construction employment numbers.¹

¹ Source: Oregon Labor Market Information System (OLMIS)

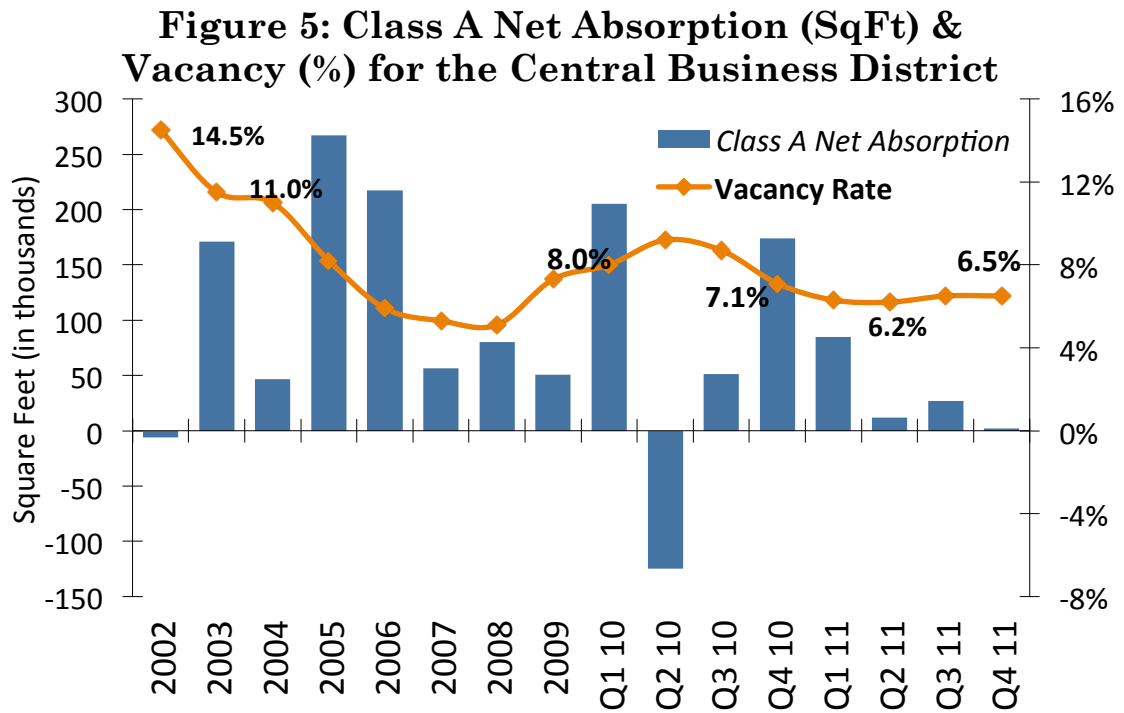
Figure 3: Portland Construction Permits & Metro Unemployment



Source: Portland Development Services and Oregon Employment Department

Over the year, metro-area employers added 14,200 jobs for a gain of 1.5 percent. That increase exceeds 1.1 percent job growth for Oregon as a whole. Many rural counties remain stalled in double-digit unemployment.²

² Source: Read, Richard. "Portland-area unemployment drops to 8.6 percent, lowest in three years", The Oregonian, January 26, 2011



Source: Grubb & Ellis, Office Quarterly Reports

Occupiers in the CBD Class A market absorbed just over 125,000 square feet in 2011, close to the area’s historic average. Q4 showed an exceptionally low demand of just over 2,000 square feet. Lacking an abundance of major office tenants, Portland’s average lease size came in just under 7,000 square feet for the metro area.

Table 2: Total Vacancy for Select Suburban Submarkets

Submarket	Market Size (SqFt)	4Q 10 Vacancy	1Q 11 Vacancy	2Q 11 Vacancy	3Q 11 Vacancy	4Q 11 Vacancy
Wash. Square/Kruse Way	6,187,668	19.7%	19.2%	20.7%	20.5%	19.2%
Sunset Corridor	4,321,964	25.5%	24.5%	24.6%	23.2%	21.9%
SW/Beaverton/Slyvan	3,530,939	17.0%	16.3%	16.1%	15.8%	16.8%
Eastside	2,855,826	8.6%	10.6%	9.0%	9.2%	10.8%
Johns Landing/ Barber Blvd.	1,759,476	17.7%	15.7%	14.2%	14.4%	14.6%
Tualatin/Wilsonville	1,676,855	32.0%	32.5%	33.1%	33.4%	34.3%

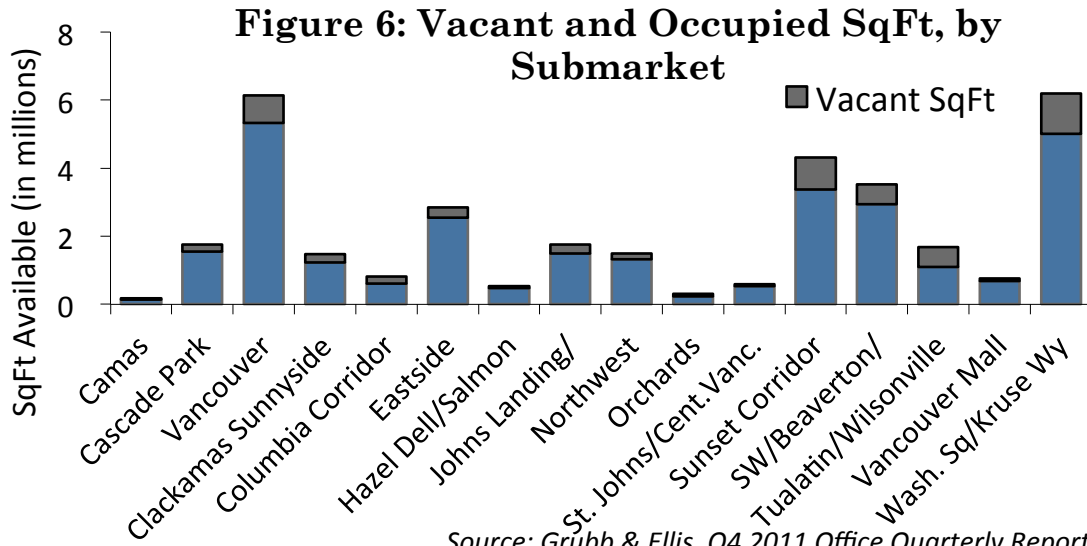
Source: Grubb & Ellis, Quarterly Statistics Reports

**Table 3: Suburban Office
Submarkets,
Ranked by Vacancy Rate**

Submarket	4Q 11 Vacancy
Tualatin/Wilsonville	34.3%
Camas	25.4%
Columbia Corridor	24.0%
Orchards	23.4%
Sunset Corridor	21.9%
Wash. Sq/Kruse Wy	19.2%
SW/Beaverton/Sylvan	16.8%
Clackamas Sunnyside	16.6%
Johns Landing/Barbur Blvd	14.6%
Vancouver	13.1%
Hazel Dell/Salmon Creek	12.4%
Northwest	11.9%
Cascade Park	11.3%
Eastside	10.8%
St. Johns/Cent.Vanc.	9.7%
Vancouver Mall	9.3%

Source: Grubb & Ellis Office Report, Q4 2011

Rankings of vacancy by submarket from Grubb and Ellis (Table 3) show few dramatic shifts from the first quarter. Tualatin/Wilsonville remains at the top of the list, climbing 230 basis points to a striking 34.3 percent vacancy. Despite positive absorption in the past year, the major submarkets of Sunset Corridor & Washington Square/Kruse Way remain strong renter's markets at around 20 percent vacancy. The Camas submarket dropped 150 basis points to 25.4 percent vacancy to end 2011. The Eastside submarket climbed 220 basis points to hit 10.8 percent, losing its rank in 2011 for lowest vacancy to Vancouver.



Although only 62,000 feet were delivered to the market in 2011, the key factor to remember is that demand for space can grow much faster than space can be built. This applies specifically to Portland’s downtown office market, and may help excess vacancy be absorbed in suburban markets in 2012 and beyond. As certain markets in San Francisco and Seattle begin taking off, this should mean good news for Portland. If Portland can continue to improve at a modest pace it will gradually drive rents and ultimately spur new construction.

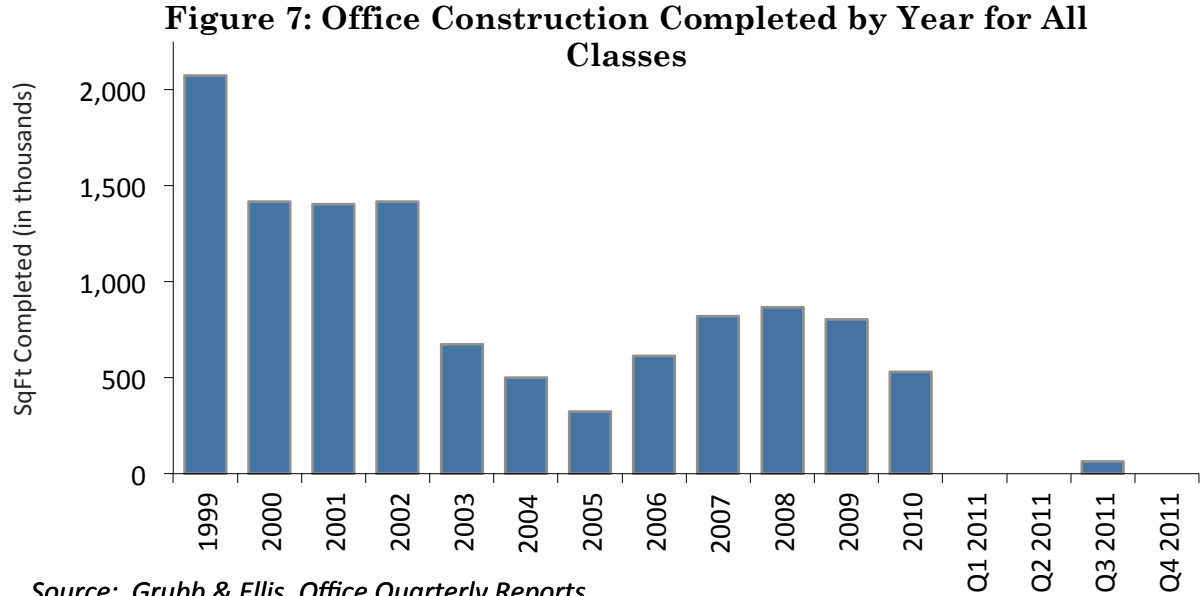


Table 4: Major Lease Transactions, 4th Quarter, 2011

Lessee	Property	Submarket	Size (SqFt)
HDR, Inc	Congress Center*	CBD	48,111
DeLap LLP	Kruse Woods Way	CBD	20,922
Everest Institute	Plaza West Bldg	217 Corridor/Beav.	20,646
Columbia Sportswear	Cornell Oaks-Summit	Sunset Corridor	24,073

Source: CB Richard Ellis, Cushman & Wakefield, Grubb & Ellis, and Norris Beggs & Simpson Reports, *renewal

Oregon's economic recovery has translated into a moderate improvement in demand for office space. While not a banner year, 2011 provided market stabilization and slow but steady tenant growth in most submarkets. Although some tenants began planning for future growth, most will continue to continue move forward cautiously. Continued global recessionary concerns cause uncertainty, but forecasts for downtown Class A property continue to be positive. The CBD will continue to be one of the strongest in the country as Class A vacancy approaches 6

percent, and rental rates increase. Suburban markets will continue to stabilize. Continuing to watch the construction pipeline for speculative projects will be a key indicator. And on a positive note, it was announced in December that in late 2013 construction will resume on the proposed 27-story Park Avenue West office building downtown. There are no confirmed tenants for Park Avenue West at this time. ■