INDUSTRIAL MARKET ANALYSIS

George S. McCleary

Owner, MRE Properties
RMLS Fellow, Master of Real Estate Development Candidate

Market fundamentals gained positive momentum in the third quarter of 2012, marking a slow but steady climb out of the recession for industrial/flex properties. Vacancy has remained relatively flat, with rates at just one tenth of a percent below the second quarter of 2012. Some submarkets have dropped a full percentage point or more. Positive net absorption is reported by all major brokerage houses, on pace to surpass or meet 2011 levels.

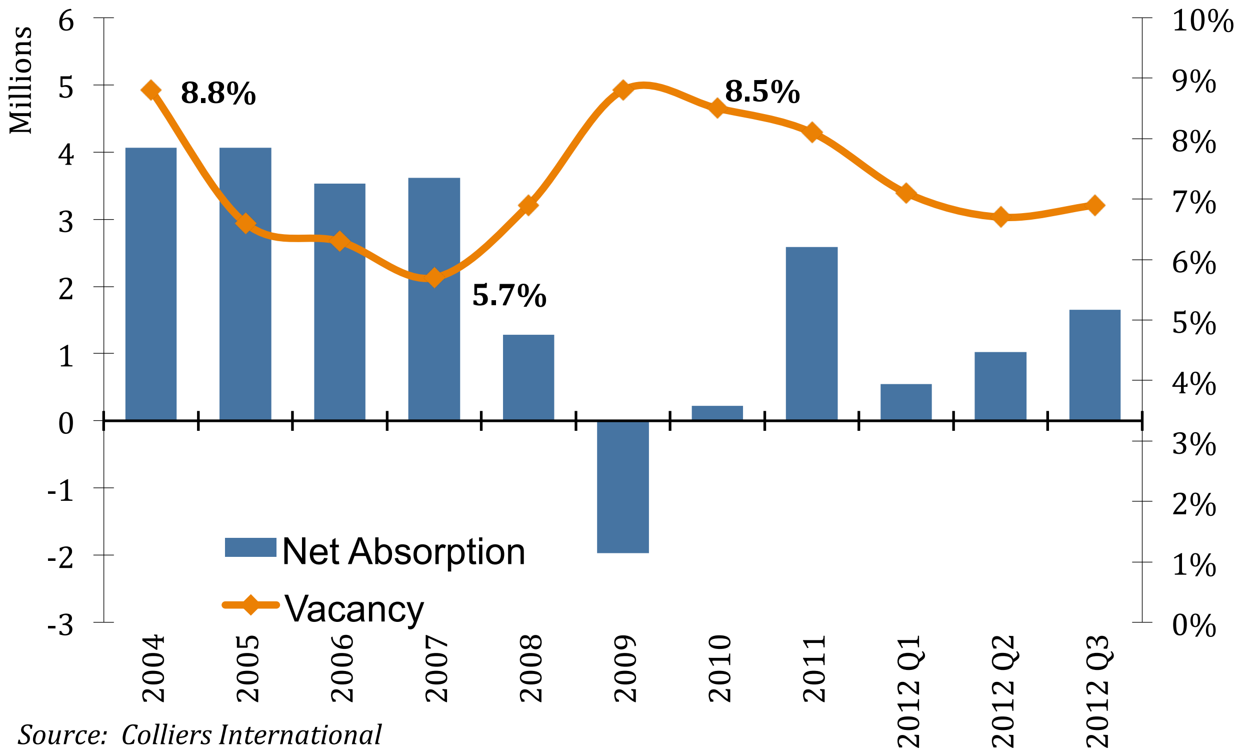
Economically, Oregon appears to be improving. The U.S. Bureau of Labor Statistics reports that Portland added 17,800 jobs during the past year, an increase of 1.8 percent. At this point the metro area has regained 45,800 of the 82,800 jobs lost since hitting bottom in late 2009. This is due in part to jobs added in manufacturing. CBRE reports that 500 jobs were added in August, split evenly between durable and non-durable goods. This is the sixth consecutive month of growth, with an average of 1,200 jobs added per month.

Rents are generally still not supportive of speculative construction, as has been the case for the past four years. Developers have constructed facilities, but nearly all development has been built-to-suit. This is expected to continue through the fourth quarter, with market fundamentals eventually arriving at levels that support speculative development.

■ George S. McCleary is the owner of MRE properties specializing in commercial real estate investment and development of urban infill properties. He is enrolled in the Master of Real Estate Development program at Portland State University and is an RMLS Fellow in the program. Any errors or omissions are the author's responsibility. Any opinions expressed are those of the author solely and do not represent the opinions of any other person or entity.

2012 is currently on pace to surpass 2011 in terms of overall net growth, reports Grubb & Ellis. This positive outlook is expected to last through the end of the year into 2013, with continued robust demand and strong export growth.

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



Source: Colliers International

Colliers reports that despite positive net absorption of 140,339 square feet, the delivery of 381,975 square feet of new product outweighed leasing activity and led to a 13 basis point uptick in vacancy to 6.9 percent. This is reportedly a result of subdued activity in the B and C class market. While this data differs somewhat with that of other brokerage houses, the consensus appears to be that vacancy is relatively flat, with other metrics moving in a more positive direction. Since 2009, market vacancy has steadily decreased, and net absorption has steadily risen. Most agree that this flattening of the vacancy rate will be a temporary plateau as the rate slowly drops.

Class A space continues to drive current leasing activity. Current vacancy is disproportionately weighted towards class B and C space, presenting challenges in the quarters to come, reports Colliers International.

Table 2: Major Industrial Transactions, 3rd Quarter, 2012

Tenant	Property	SqFt	Submarket
Vetris	Leveton Corporate Campus	140,000	Tualatin
Communications Test Design	Birtcher Center	124,154	Fairview, OR
Pomegranate Publishing	Southshore Corporate Park	84,192	Gresham, OR
KGP Logistic	29899 SW Boones Ferry	77,000	I5 South Corridor
Comcast of Tualatin Valley	10831 SW Cascade Ave	43,363	217 Corridor
Rexel Taylor	20121 SW 95th Pl	41,000	I5 South Corridor
Boxes and Foam	10100 SW Allen Blvd	36,000	Portland

**Source: NAI Norris Beggs & Simpson, CB Richard Ellis, and Kidder Matthews Industrial Quarterly Reports*

Vetris signed a lease for 140,000 square feet at the Leveton Corporate Campus in Tualatin. Suburban markets like Tualatin and Hillsboro fared well in the third quarter, with positive net absorption and below-market vacancy rates. This trend is expected to continue through the end of the year.

Major Sale Transactions

Buyer:	Building:	Price:	Submarket:
Watumull Properties Corporation	10965 SW Commerce Circle, Building A	$8,044,400	Southwest I-5
Summit Properties Inc.	7431 and 7451 NW Evergreen Parkway	$6,900,000	Southwest Sunset
Watumull Properties Corporation	Summit Portal Way Building	$4,835,000	North/Northeast

Source: C

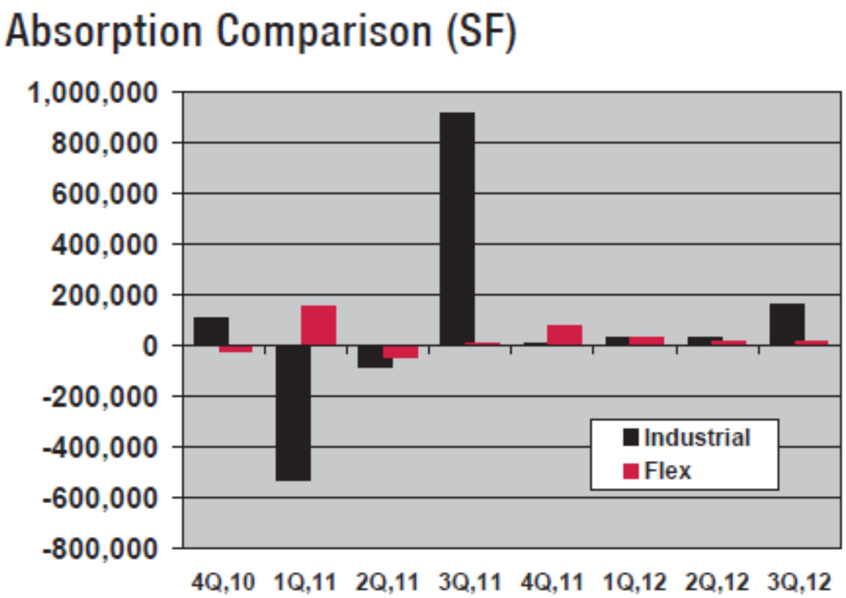
Source: NAI Norris, Beggs & Simpson

SALES ACTIVITY

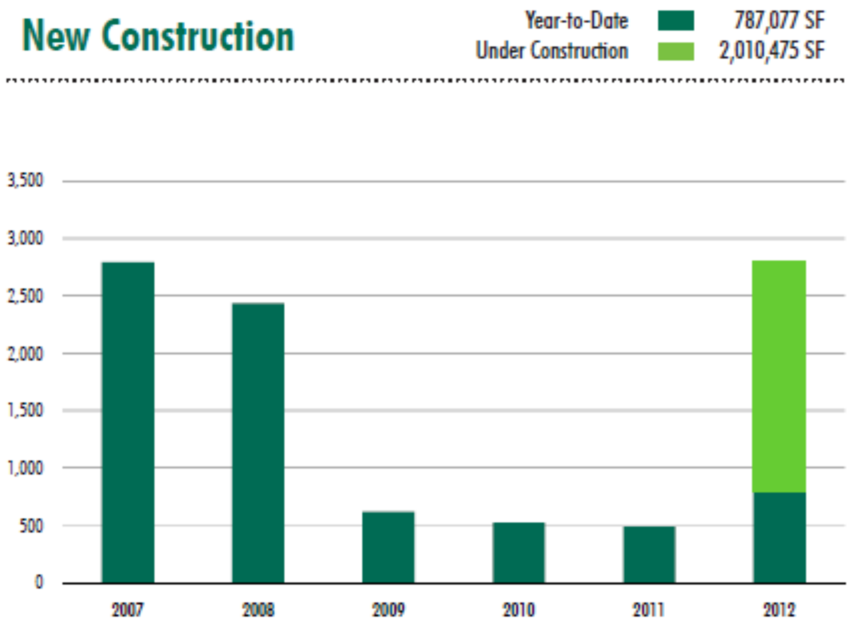
PROJECT	CITY	SALES DATE	SALES PRICE	PRICE/SF	TRANSACTION TY
Oregon Commerce Parks Portfolio	Various	08/10/2012	Undisclosed	N/A	Investm
Tuatalatin Corporate Center	Tutalatin	08/13/2012	$25,150,000	$82.19	Investm
Summit Portal Way Building	Portland	07/02/2012	$4,835,000	$57.43	Investm
Columbia Commerce Park - Bldg IV	Portland	08/03/2012	$4,590,000	$24.44	Investm

Source: Colliers International

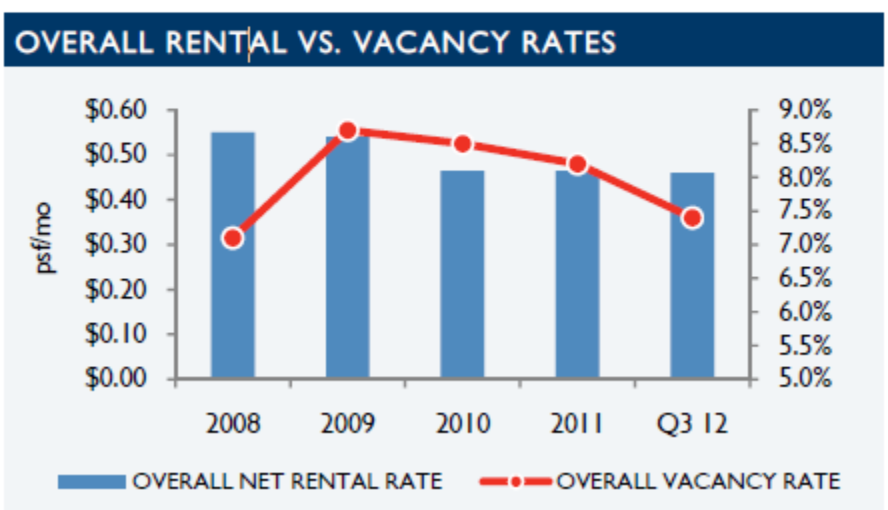
The 1.2 million square feet Oregon Commerce Park portfolio was acquired in August by Washington Holdings from International Airport Centers at an undisclosed price. Sales activity was slower in the third quarter in comparison with other quarters, with Colliers reporting only 16 properties sold in excess of $500,000. Total transaction volume was $55.2 million, down from previous 2012 quarters.



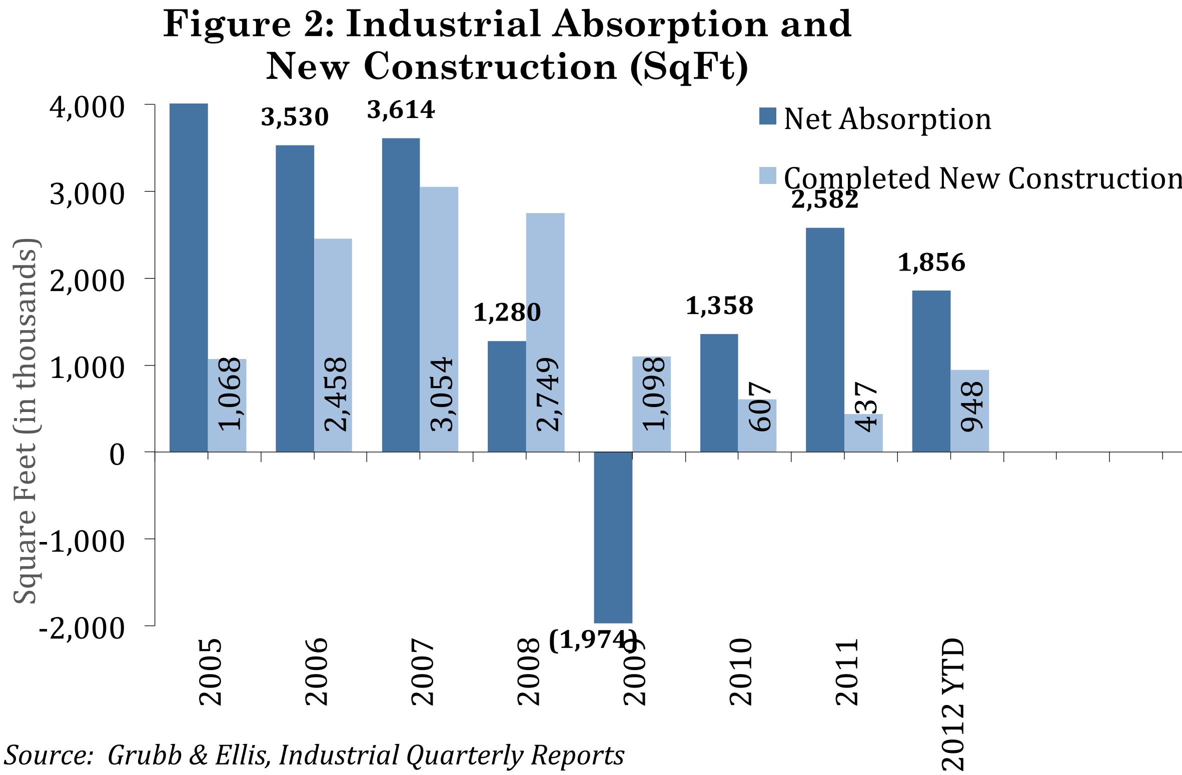
Source:Norris, Beggs & Simpson



Source: CBRE



Source: Cushman & Wakefield

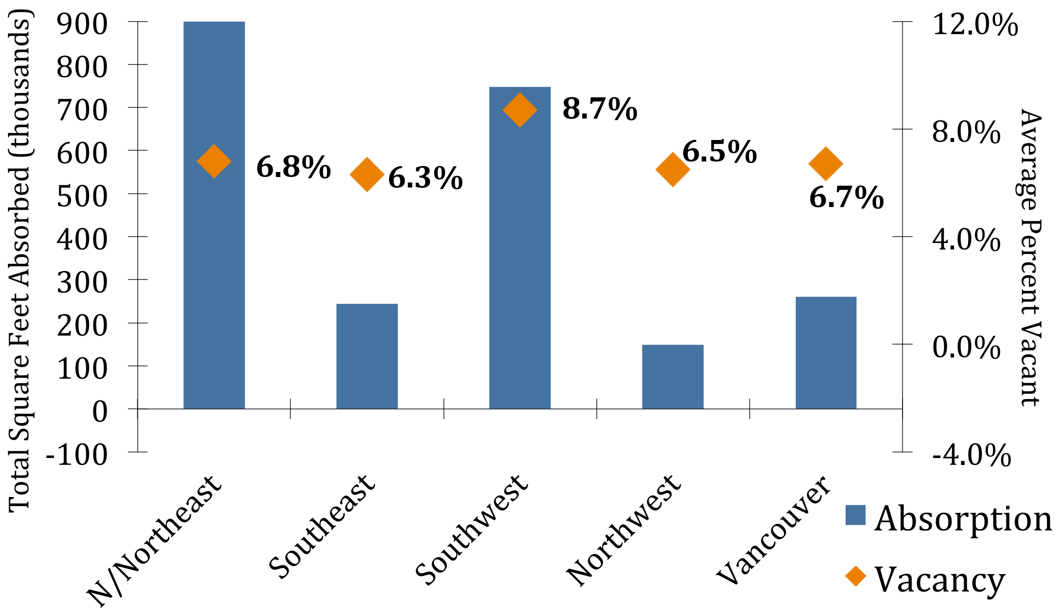


Source: Grubb & Ellis, Industrial Quarterly Reports

Portland has enjoyed its ninth consecutive quarter of positive net absorption since the third quarter of 2010. The tightening supply of large, quality warehouse and distribution space will have positive implications for increasing rates and renewed construction activity, reports Colliers International. Additionally, there is a shortage of developable land for industrial projects, and any large site will require a minimum of 18 months to be ready to build.

Cushman and Wakefield predict that this shortage of developable land will likely lead to the redevelopment of existing properties. This, combined with the urban growth boundary and the robust demand for class A space should lead to renovation of existing class B and C spaces as the market tightens.

Figure 3: Submarket Vacancy and Overall Absorption, Q3 2012



Source: Cushman and Wakefield, Q3 2012 Industrial Quarterly Report

Rental rates for industrial space are ranging from $.032 to $.045 for a shell, with an office surcharge of $0.70/sf to $0.80/sf. Tigard/Lake Oswego, Airport Way, Northeast Portland and Vancouver are achieving the highest rates, while Swan Island, Macadam and Camas submarkets achieve the lowest. Kidder Matthews reports that the Hillsboro market has seen a rise in rents as a result of demand from contractors for warehouse space near the Intel Ronler Acres expansion project. The Rivergate submarket has not stabilized, reports Kidder Matthews, as much of the activity in recent years has been driven by local businesses. Outside companies have been reluctant to move in, due to minimal supportive services and a relatively small employee base. It is predicted that continued tightening of the market will lead to higher occupancy in Rivergate as cost savings is factored into future leases.

Most of the new construction in the pipeline is build to suit, with very little speculative construction. Kidder Mathews reports that NRA has increased only 1.2 percent since the third quarter of 2009. Absorption is likely to continue to surge, with downward pressure on vacancy rates. Many questions remain with regards to the national and local economies leading most firms to believe that the outlook is one of slow, steady progress. ■