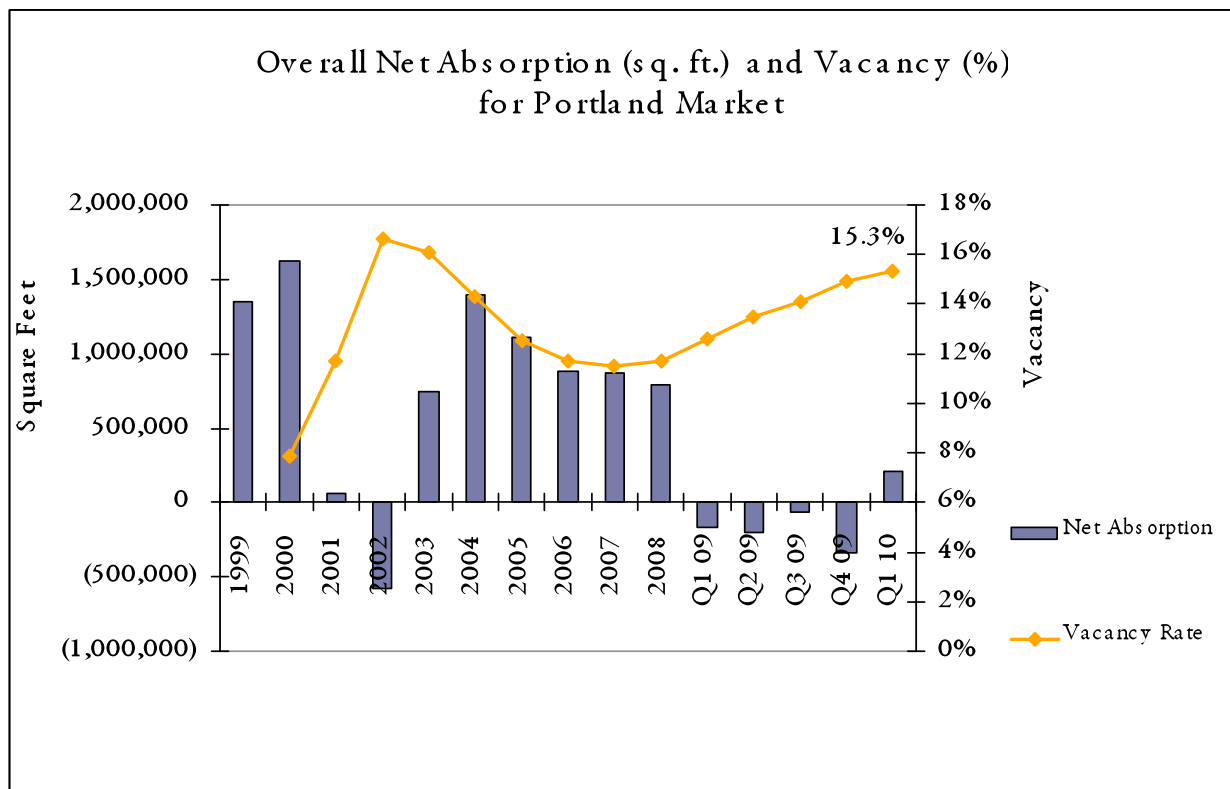


Office Market Analysis

Kyle Smith, Regional Multiple List Service [RMLS] Fellow
& Certificate of Real Estate Development Graduate Student

Portland Office Market

Grubb & Ellis reports that the market-wide office vacancy rate moved up to 15.3 percent during the first quarter, even though there was positive net absorption of 204,936 square feet. The CBD Class A submarket was responsible for almost all of the demand in the overall market, which is a continuation of the general trend toward leasing higher quality spaces while rents and incentives are favorable toward tenants.



Source: Grubb & Ellis Office Quarterly Report - First Quarter 2010

Net absorption is positive for the first time since 2008 while overall vacancy rates continue to increase

Norris, Beggs & Simpson (NBS) reported similar positive net absorption numbers, but differed from Grubb & Ellis on vacancy rates. NBS has total market vacancy at 18.0 percent, with the central city submarkets at 12.0 percent and the suburban submarkets at 21.9 percent. Colliers International also reported significantly different data with 11.8 percent total vacancy but with 53,075 square feet of negative net absorption market wide.

OFFICE Q1-10	CB Richard Ellis*	Cushman & Wakefield*	Grubb & Ellis	Norris, Beggs & Simpson	Median
Market-Wide Vacancy	-	-	15.3%	18.0%	16.7%
Previous Quarter	15.6%	16.6%	14.9%	17.5%	16.1%
First Quarter 2009	12.8%	13.5%	12.6%	14.7%	13.2%
First Quarter 2008	10.7%	11.3%	11.3%	12.5%	11.3%
CBD and Downtown Vacancy	-	-	10.4%	12.0%	11.2%
Previous Quarter	10.3%	12.1%	10.4%	11.8%	11.1%
First Quarter 2009	8.0%	10.2%	8.3%	10.5%	9.3%
First Quarter 2008	8.4%	8.9%	7.9%	10.2%	8.7%
CBD Class A Vacancy	-	-	8.0%	7.9%	8.0%
Previous Quarter	7.7%	7.8%	7.3%	7.2%	7.5%
First Quarter 2009	5.5%	8.3%	6.5%	6.2%	6.3%
First Quarter 2008	5.7%	6.1%	4.7%	6.2%	5.9%
CBD Class A Asking Rents	-	-	\$25.88	N/A	\$25.88
Previous Quarter	27.47	\$25.61	\$25.54	N/A	\$25.61
First Quarter 2009	\$26.89	\$27.62	\$27.02	N/A	\$27.02
First Quarter 2008	\$26.89	\$26.02	\$25.76	N/A	\$26.02
Suburban Vacancy	-	-	18.9%	21.9%	20.4%
Previous Quarter	20.3%	21.0%	18.5%	20.5%	20.4%
First Quarter 2009	17.2%	16.7%	15.7%	17.1%	16.9%
First Quarter 2008	12.8%	13.6%	13.4%	15.3%	13.5%
Suburban Class A Vacancy	N/A	-	24.4%	24.2%	24.3%
Previous Quarter	N/A	22.8%	21.1%	23.1%	22.8%
First Quarter 2009	N/A	18.3%	17.3%	17.5%	17.5%
First Quarter 2008	N/A	13.9%	12.7%	N/A	13.3%
Suburban Class A Asking Rents	N/A	-	\$22.98	N/A	\$22.98
Previous Quarter	N/A	\$23.44	\$23.40	N/A	\$23.42
First Quarter 2009	N/A	\$22.95	\$23.20	N/A	\$23.08
First Quarter 2008	N/A	\$24.33	\$24.37	N/A	\$24.35

Source: CB Richard Ellis, Cushman & Wakefield, Grubb & Ellis, Norris, Beggs & Simpson Quarterly Reports and Statistical Reports - First Quarter 2010

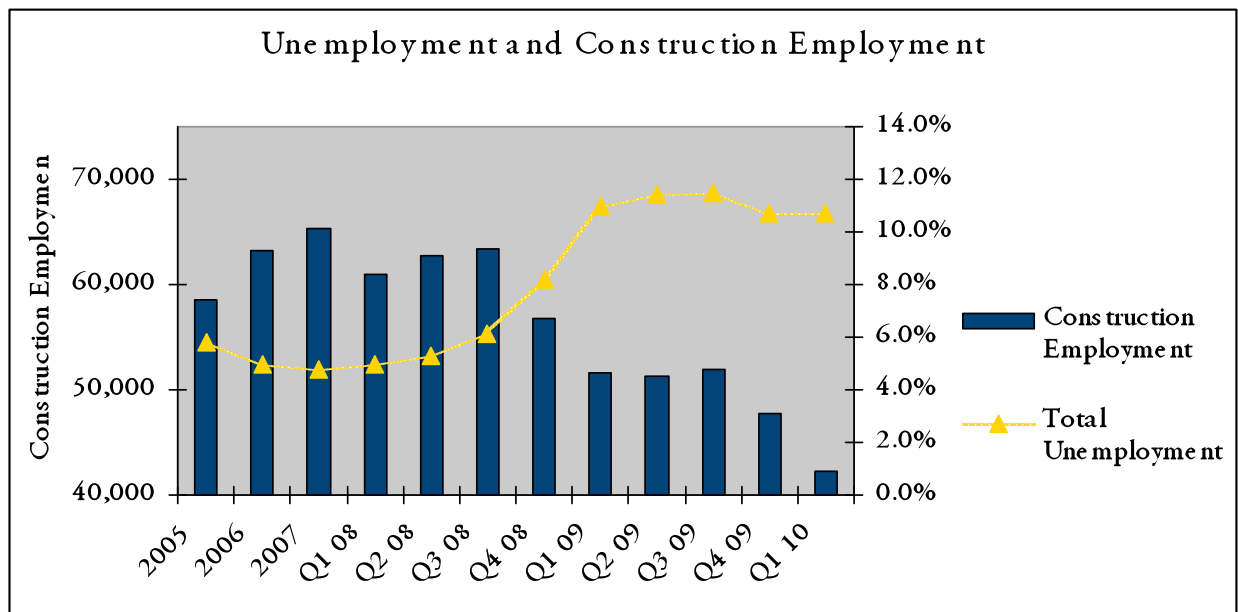
*CB Richard Ellis and Cushman & Wakefield first quarter reports were not complete at time of publishing

According to the summary chart above, the CBD Class A vacancy rate median of 8.0 percent remains lower than the overall CBD vacancy rate which remained relatively stable at 11.2 percent. The suburban market has the opposite relationship, with Class A continuing to have higher vacancy rates than the overall suburban market. Class A vacancy rose 150 basis points to 24.3 percent while market wide vacancy is 20.4 percent.

The seasonally adjusted unemployment rate for March was 10.6 percent in Oregon, which is down from the 11.0 percent December 2009 rate. The Portland metropolitan area’s seasonally adjusted unemployment rate was 10.7 in March after fluctuating to 10.9 and 10.2 in January and February respectively. An estimated 133,227 residents were unemployed in the metropolitan area, which is 9,862 more than December 2009 but only 992 more than March last year.

There are indications that Oregon’s economy is improving. One of these is the continued rise of The University of Oregon Index of Economic Indicators.¹ The index rose 1.6 percent in January and another 0.3 percent in February. The index has been steadily rising since its low in July of 2009 of 84.0. It was 88.7 in February, which is the most recent data published.

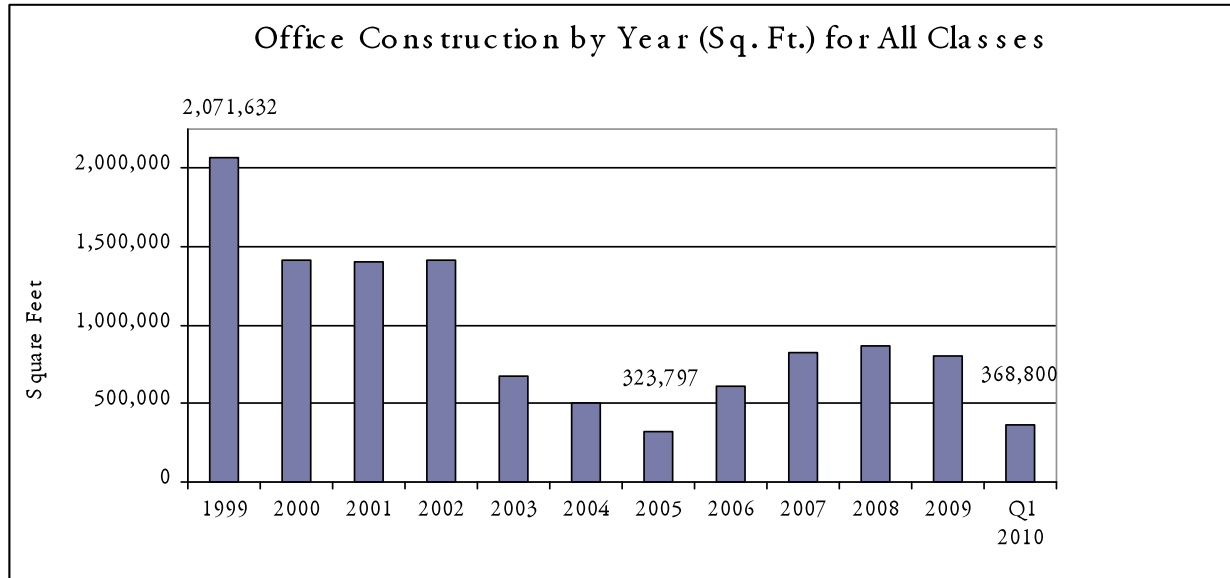
The Oregon Employment Department reported that construction employment in the metropolitan area is down 14.4 percent from March 2009 with 7,100 fewer people employed. Construction employment was 42,300 in March of 2010. Nonresidential construction has had the steepest decline at 19.6 percent over the same time period.



Source: Oregon Employment Department

Metropolitan area unemployment level remains stable and construction employment falls to a historic low

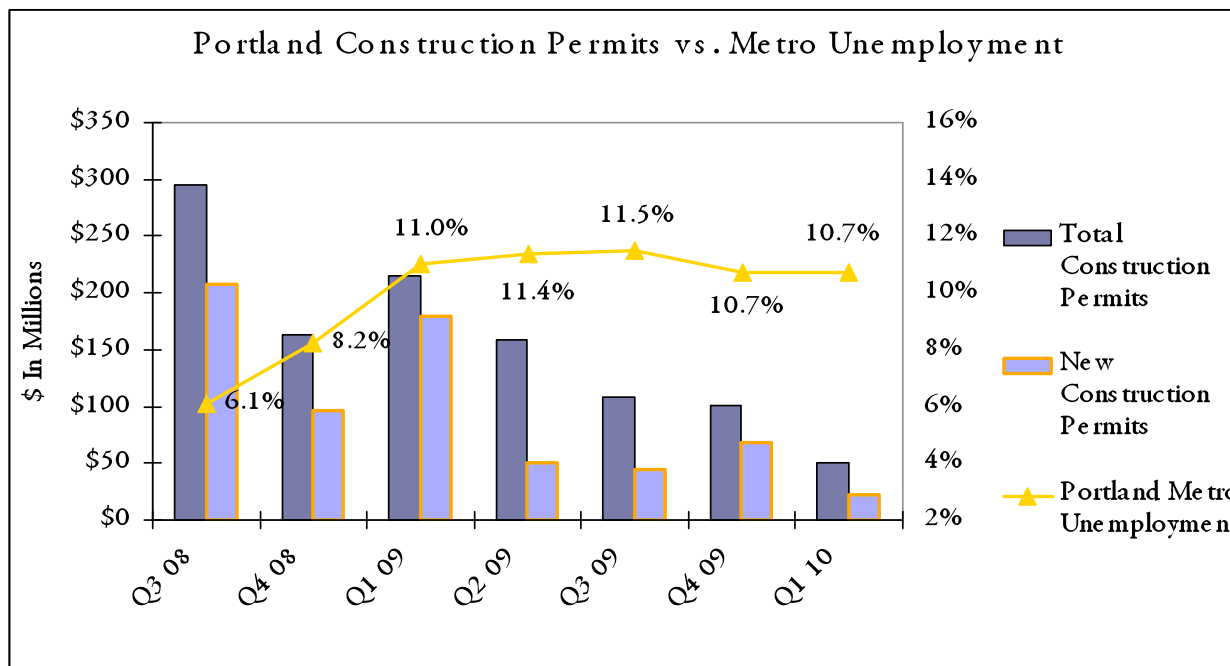
¹ “University of Oregon Index of Economic Indicators”, University of Oregon College of Arts and Sciences, February 2010



Source: Grubb & Ellis Office Quarterly Report - First Quarter 2010

Delivery of First and Main causes YTD first quarter spike in new space

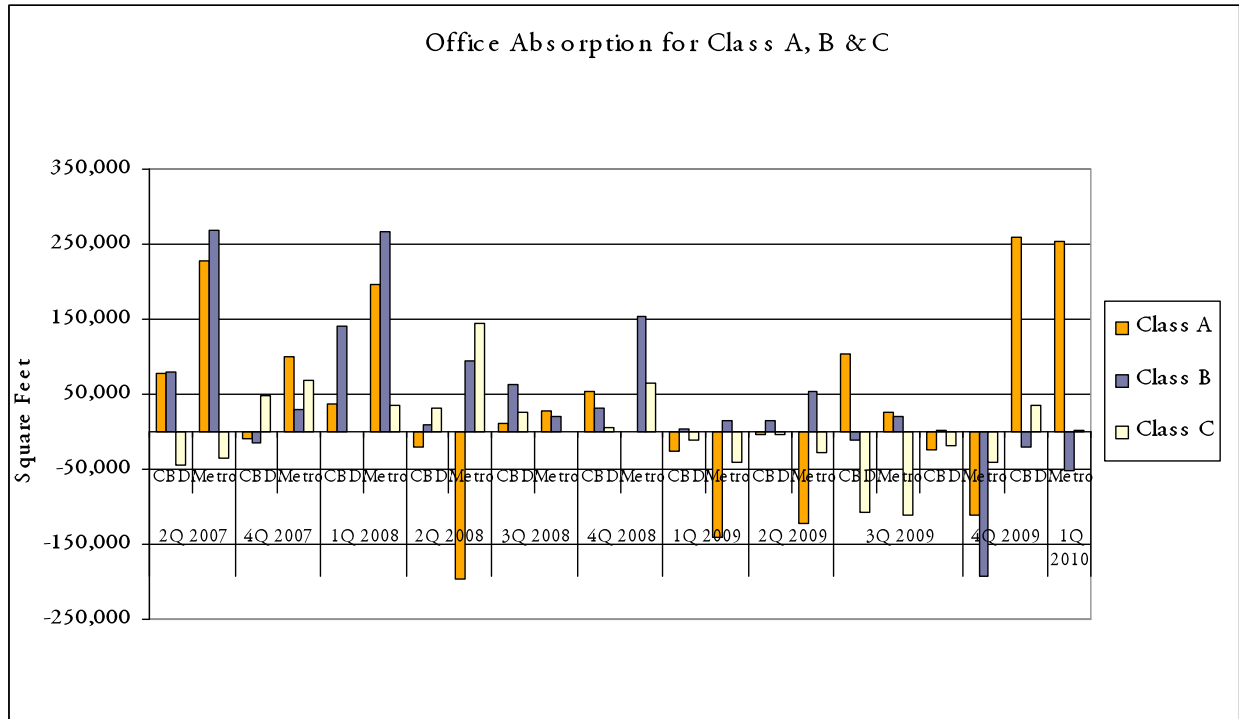
New commercial construction permits issued in Portland decreased by \$45.5 million to \$22.3 million during the first quarter and the value of all construction permits declined about 50 percent from \$100.6 million during the fourth quarter to \$50.6 million during the first. The dollar amount and quantity of both new and total construction permits in Portland is at a historic low.



Source: Portland Bureau of Development Services, Oregon Employment Department

Commercial construction permits continued to decrease during the first quarter

Now that First & Main is delivered to the market, there is very little in the office construction pipeline. According to Colliers International, there is only one multiple tenant construction project underway, a 70,020 square-foot Class A facility located in Wilsonville.² Providence Health Services is also constructing a 238,000 square foot administrative building on the Eastside. They will be both the owner and user of that facility.



Source: Grubb & Ellis Office Quarterly Report - First Quarter 2010

Large positive net absorption for CBD Class A office space fueled by GSA

CBD Trends

Grubb & Ellis reports that CBD Class A vacancy ended the first quarter of 2010 with an 8.0 percent vacancy rate which is an increase from the 7.3 percent vacancy rate posted during the fourth quarter. The CBD office market has been impacted by the federal stimulus project for renovating the Edith Green/Wendell Wyatt building. The renovation has created federal demand for Class A office space downtown which has help to offset weaker demand in the market as a whole. Congress has approved the \$133 million Edith Green/Wendell Wyatt Federal Building Renovation & Rehabilitation Project. According to Grubb & Ellis, The General Services Administration (GSA) executed six leases for over 280,000 square feet in the CBD during the first quarter of 2010. The First & Main building, which was completed earlier this year, accounts for 250,000 of the 280,000 total square feet of GSA leased space. The renovation of the Green/Wyatt building will substantially reduce the building’s energy and water consumption, and will incorporate numerous green building features. The most unique features are the 200 foot tall vegetated fins which will shade the western façade. The CBD vacancy rate increased during the first quarter partially because of the 368,800 square feet that was delivered to the market when First & Main was completed.

² “The Knowledge Report”, Colliers International, First Quarter 2010



Green/Wyatt Federal Building

The Port of Portland has moved from its Old Town office space at 121 NW Everett St. into its new headquarters built on top of the recently completed parking garage at Portland International Airport. The office space will house 478 workers, in large open spaces broken up by low-walled cubicles. The facility does not have traditional executive offices. The structure has 205,000 square feet of office space on three floors and can hold 3,500 cars in the seven floor parking garage.⁴ The additional parking capacity more than doubles the number of covered spaces at PDX.⁵ Construction costs for the garage were \$156 million and the office space was \$85 million, bringing the total project costs to \$241 million. The strategic goal of the project was to consolidate the 238 employees at the airport terminal building and the 240 employees at its Old Town headquarters under the same roof to speed decision making.⁶ It is the first time both operating segments of the port will be located in the same

The Portland office market has seen less volatility than other cities during the recession. Cushman & Wakefield reported that downtown Seattle office buildings had a 21 percent vacancy rate at the end of the fourth quarter in 2009. Cushman and Wakefield reported that the Portland CBD vacancy rate was 12.1 percent during the same period.³ This difference in volatility is part of why Grubb & Ellis recently ranked Portland's office market as the fourth best in the country. In its Office Trends Report for the first quarter of 2010, Grubb & Ellis stated that the downtown office market has now stabilized. They forecasted that vacancy will begin dropping during 2010 and that the large concessions currently offered will be reduced and that rental rates will begin a slow ascent upward.



Green/Wyatt Federal Building renovation

³ "Overall Office Summary", Cushman & Wakefield, Fourth Quarter 2009

⁴ "Port of Portland design driven by efficiency", Daily Journal of Commerce, April 2, 2010

⁵ "Port of Portland spending on HQ, airport parking nearly complete", The Oregonian, March 18, 2010

⁶ "Airport Building pushes green limits", Portland Tribune, May 14, 2009

office. The Port estimates that consolidating its two offices will save approximately \$3 million per year in costs which were previously duplicated.⁷ The Port of Portland sold its 160,000 square foot former headquarters to Washington Real Estate Holdings LLC for \$29 million⁸ in December of 2007. The new owners have executed a lease with Northwest Evaluation Associates to occupy 107,000 square feet of the vacated space with approximately 300 employees of the educational testing service. The vacated space at the airport terminal building will also be leased to other organizations.



New Port of Portland headquarters at PDX

Sustainability played a large factor in the Port of Portland building design. The building has a sewage treatment facility which can treat up to 2,500 gallons per day of sewage generated by the building. This treated water is then used to flush toilets and urinals throughout the office building structure. There is a moving sidewalk that connects the headquarters to the airport that has motion sensors that turn it off when not in use. The Daily Journal of Commerce reports that this is the

first motion activated moving sidewalk in the nation. Energy needs were also given consideration. Heating and cooling come from 300-foot deep geothermal wells and building temperature, artificial lighting and solar lighting are all adjusted automatically to maximize efficiency via monitors that respond to internal and external environmental conditions.

Near the old Port headquarters, a \$30 million renovation of an historic warehouse into Class A office and retail space at Third and NW Glisan has been forced into foreclosure. The Portland Business Journal reported that the project known as Soho 321 has been placed in receivership and the Multnomah County Circuit Court appointed a receiver to manage the property until the auction takes place. The seven-story, 89,000-square-foot building⁹ was being developed by JBH Company whose president, Blaine Hoggard agreed to the receivership to ensure completion of the project.¹⁰ The foreclosure suit was filed on behalf of the lender and subcontractor, Total Mechanical Inc. for defaulting on loan terms and non-payment of construction liens respectfully. Work on the project stopped in September of 2009 and JBH Company's attorney, Stephen Werts told the Portland Business Journal that, "the goal is to get the building done." Problems for the project started in

⁷ "Port of Portland spending on HQ, airport parking nearly complete", The Oregonian, March 18, 2010

⁸ "Airport Building pushes green limits", Portland Tribune, May 14, 2009

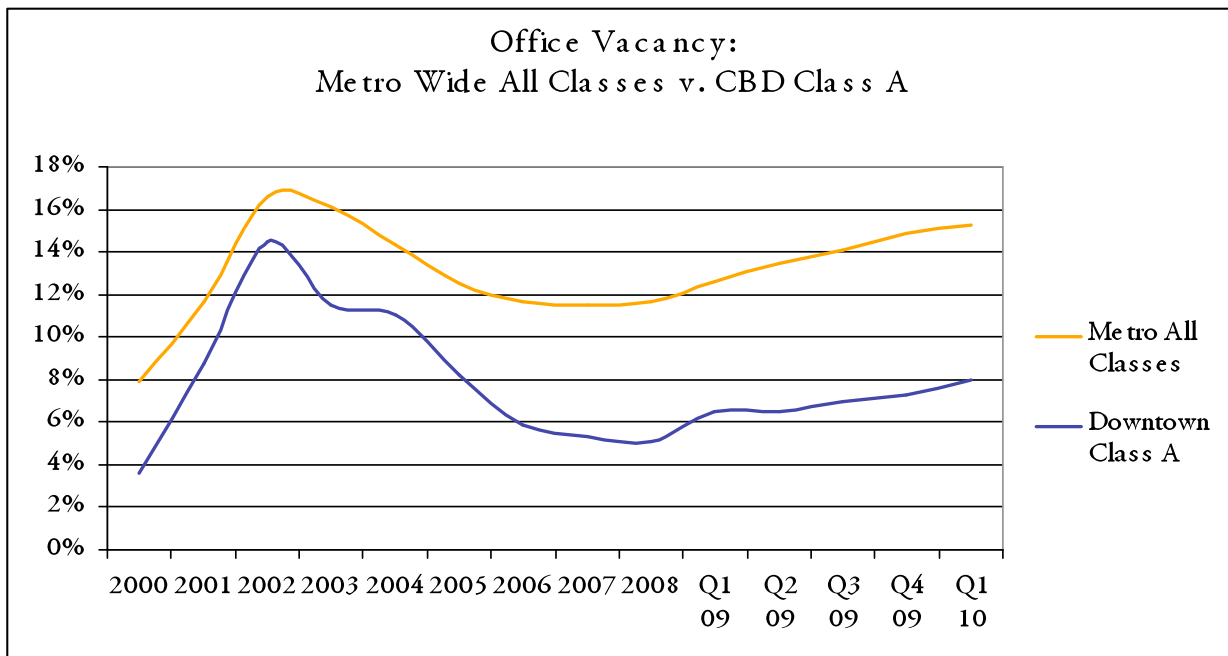
⁹ "Northwest Renovations", Northwest Construction, February, 2009

¹⁰ "Soho 321 foreclosed", Portland Business Journal, January 29th, 2010

January of 2008 when Ensequence Inc. opted out of the lease which was signed in March, 2007 for five floors or approximately 65 percent of the building's space. Ensequence Inc. is an interactive television firm which currently has offices in the U.S. Bancorp Tower in downtown Portland. Ensequence attorney, Jim Baumgartner stated that his client was within its legal rights to exit the lease. JBH Company does not share this opinion and sued Ensequence for over \$27 million in damages. The case is currently pending. CB Richard Ellis is the brokerage company for Soho 321 and is marketing the space at an asking rent of \$25 per square foot.

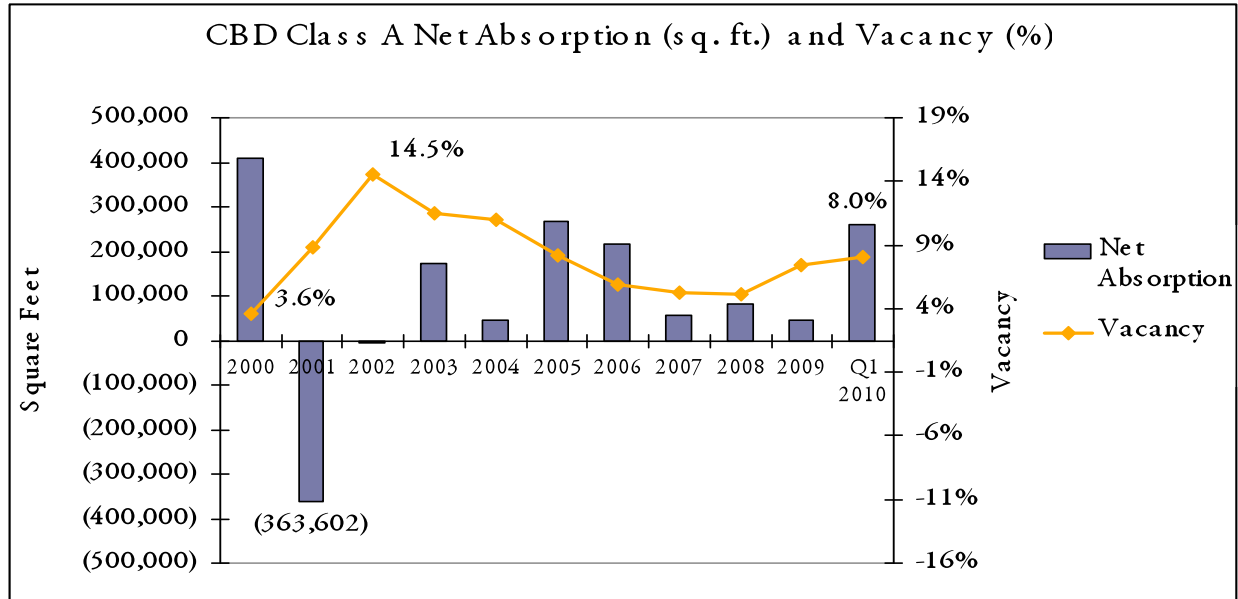


Soho 321 renovation rendering



Source: Grubb & Ellis Office Quarterly Report – First Quarter 2010

Metropolitan area and CDB Class A vacancy rates continue to increase



Source: Grubb & Ellis Office Quarterly Report – First Quarter 2010

Suburban Trends

Vacancy in the suburbs remained flat during the quarter at a 20.4 percent median rate as shown in the brokerage report summary at the beginning of the office report. Class A asking rents continued to decline and dropped almost \$0.50 per foot during the fourth quarter.

Camas now has the highest vacancy rate, replacing the Tualatin/ Wilsonville submarket at the number one spot according to Grubb & Ellis. The Eastside and Hazel Dell/Salmon Creek submarkets continue to have the lowest vacancy rates at 7.8 and 7.1 percent respectively. Submarkets which experienced declines in vacancy rates were the Eastside, Johns Landing/Barbur Blvd., Northwest, St. Johns/Central Vancouver and Vancouver Mall, which had rates drop by 0.8, 0.8, 0.4, 0.7, 0.5 percent respectively.

Suburban Office Submarkets Ranked by Highest Percent of Vacancy		
Submarket	Rank	Vacancy Rate
Camas	1	41%
Cascade Park	5	25.1%
Vancouver	8	17.2%
Clackamas Sunnyside	12	11.9%
Clark Co. Outlying	11	14.1%
Columbia Corridor	4	25.4%
Eastside	16	7.8%
Hazel Dell/Salmon Creek	17	7.1%
Johns Landing/Barbur Blvd	10	14.3%
Northwest	13	10.5%
Orchards	7	20.3%
St. Johns/Central Vancouver	15	9.5%
Sunset Corridor	3	28.1%
SW/Beaverton/Sylvan	9	16.6%
Tualatin/Wilsonville	2	29.2%
Vancouver Mall	14	10.3%
Washington Sq/Kruse Way	6	21.1%

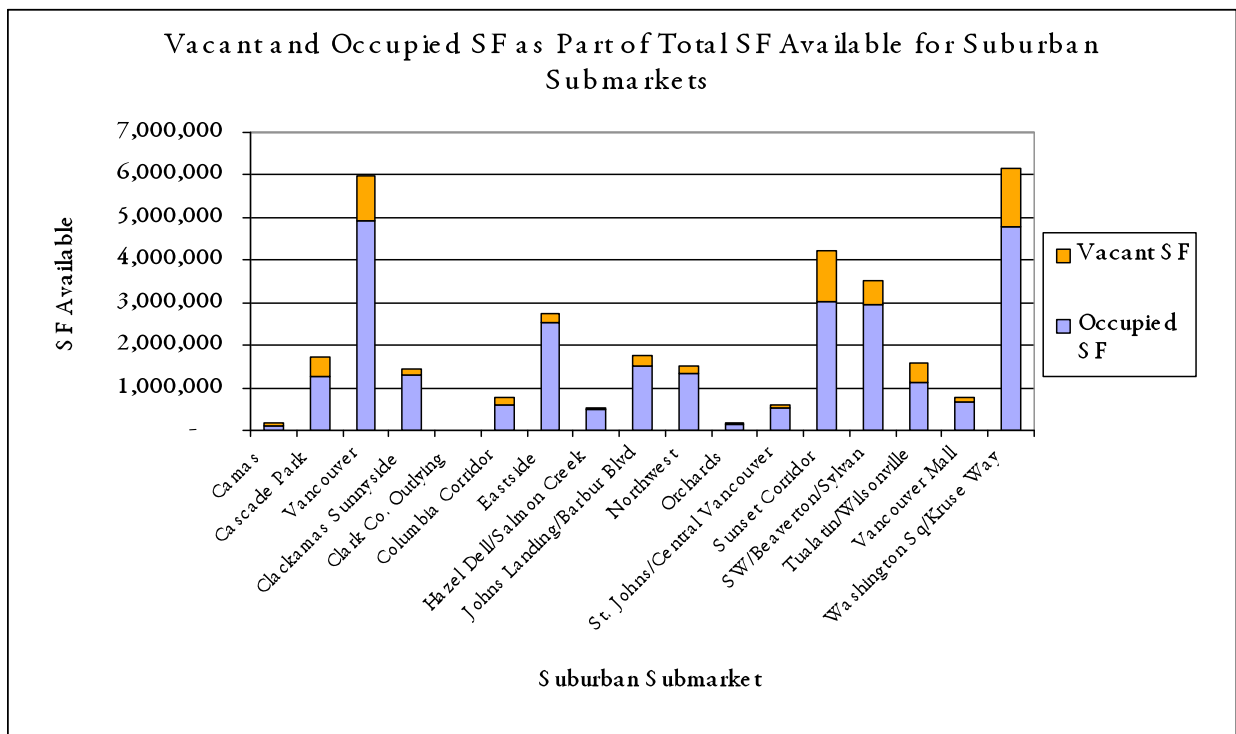
Source: Grubb & Ellis Office Quarterly Report – First Quarter 2010

Total Vacancy for Select Suburban Submarkets

Submarket	Current Market Size (Sq. Ft.)	1Q 09 Vacancy	2Q 09 Vacancy	3Q 09 Vacancy	4Q 09 Vacancy	1Q 10 Vacancy
Washington Square/Kruse Way	6,140,468	16.3%	19.6%	20.6%	21.1%	21.9%
Sunset Corridor	4,213,199	25.3%	25.6%	27.4%	28.0%	28.1%
Beaverton	3,530,939	16.5%	16.8%	15.8%	16.5%	16.6%
Eastside	2,735,967	7.6%	7.4%	7.4%	8.6%	7.8%
Johns Landing/ Barber Blvd.	1,758,613	13.9%	14.5%	14.8%	15.1%	14.3%
Tualatin/Wilsonville	1,595,175	26.1%	26.9%	27.9%	28.3%	29.2%

Source: Grubb & Ellis Office Quarterly Report- First Quarter 2010 Statistics

In its Office Trends Report for the first quarter, Grubb & Ellis are forecasting continued vacancy problems throughout the year in the suburban markets. The forecast also includes a continuation of large concession packages, strong competition for tenants, and low or decreasing lease rates.



Source: Grubb & Ellis Office Quarterly Report – First Quarter 2010

Tualatin/Wilsonville, Sunset Corridor and Camas post highest vacancy rates in the metropolitan area

In March The Oregonian published a feature highlighting vacancies in the suburban office market and the 14 major office buildings in the Portland metropolitan area which are totally vacant. These 14 buildings account for over one million square feet of empty space which could house approximately 4,000 employees¹¹. The largest examples are Kruse Oaks III (Lake Oswego) with 108,454 SF and InFocus (Wilsonville) with 131,848 SF. The largest concentration of completely vacant office buildings is located in the Hillsboro area called Silicon Forest, which never fully recovered from the high-tech sector downturn and dot-com crash. According to the article, Oregon lost one out of every ten technology manufacturing jobs during 2009. These job losses dropped Oregon's employment level in technology to 1996 levels and had a major effect on both real estate values and the area's office market. One example of the effect on real estate is the portion of the AmberGlen Business Center which recently sold for 40 percent of its previous sale price.



Kruse Oaks III interior and exterior

Despite numerous new leases signed during the first quarter of 2010, the Washington Square/Kruse Way submarket's vacancy increased from 21.1 percent to 21.9 percent during the first quarter of 2010, with a negative net absorption of 40,180 square feet according to Grubb and Ellis.¹² Kruse Way used to have one of the metropolitan area's lowest vacancy rates, which was as low as 3.7 percent during the first quarter of 2006.¹³ Historical data from Colliers International illustrates the timeline of the vacancy run up in Kruse Way. In 2006, the vacancy rate went from 3.7 percent at the beginning of the year to 10 percent by the end. This was approximately the time the mortgage-backed securities market became distressed. Then during the fourth quarter of 2008, while the overall US economy was weak, the vacancy rate rose from 15 percent to 23 percent. Referring to a general trend of downtown relocation for smaller class A office space, Gordon King, a commercial broker at Colliers, told the Daily Journal of Commerce that, "companies' relocations to downtown Portland will likely trigger a third wave."

Kruse Way's 2.3 million square feet of Class A office space, which was built from 1981 to 2009, was attractive to many companies for reasons which include the area's close proximity to Interstate 5 and housing options in Lake Oswego for employees.¹⁴ The City of Lake Oswego has acknowledged the impact. The economic development manager for the City of Lake Oswego told the Daily Journal of Commerce, "The vacancies on Kruse Way have affected the city in terms of employment and spending in our

¹¹ "Vacant office buildings dot Portland suburban areas", The Oregonian, March, 20, 2010

¹² "Office Trends Report", Grubb & Ellis, First Quarter 2010

¹³ "Leases pump up hard-hit Kruse Way", Portland Business Journal, April 2, 2010

¹⁴ "Kruse Way no longer the belle of the ball", Daily Journal of Commerce, April 14, 2010

retail areas. We're doing whatever we can by way of marketing and working with prospective tenants to fill that space."

The submarket vacancy rate has changed substantially and has been affected both by new, un-leased office buildings like Kruse Oaks III and large tenants such as Lime Financial Services, Textron Financial, Northwest Evaluation Associates and SAIF Corporation exiting the area. There has been no new office construction in the area since Kruse Oaks III was completed in spring of 2009.

Major Lease Transactions Q1 2010

Lessee	Property	Submarket	Size (SF)
General Services Administration	First & Main	CBD	250,279
Citicaster Co.	4949 SW Macadam	John's Landing	29,992
Alpha Broadcasting	Pacwest Center		27,439
Black and Veatch	Kruse Woods V	Kruse Way	25,116
Hampton Management Co.	9600 Building		24,056
Kryptiq Corp.	Amberglen Business Center	Sunset Corridor	22,721
Indian Health Services (GSA)	Machine Works	CBD	19,431

Source: Norris, Beggs & Simpson, Grubb & Ellis Office Report – First Quarter 2010

Lease volume within all central city and suburban submarkets was low during the quarter, despite the GSA's large lease in the CBD. Colliers International reported that there were leases signed for a total of 863,138 square feet with an average size of 3,319 square feet.¹⁵ If the GSA lease at First & Main is excluded, the average transaction size drops to 2,315 square feet. Colliers also reported that there are a large number of leases which are set to expire over the next six to 18 months. Because of this, Colliers expects that leasing activity will increase during future quarters.

¹⁵ "The Knowledge Report", Colliers International, First Quarter 2010