



## How condos almost ruined redevelopment

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In the last 10 to 15 years, Portland has seen a metamorphosis in its traditionally industrial neighborhoods, as redevelopment of structurally or functionally obsolete buildings into multi-tenant, multi-use facilities became an attractive opportunity for entrepreneurs. Even recently, many of those obsolete buildings were purchased and demolished to make way for condominium projects and coffee shops.

But as history predicts, the pendulum seems to be swinging back toward commercial redevelopment, and new opportunities for industrial redevelopment are emerging.

The previous redevelopment model for core industrial buildings was simple. Developers sought multi-story buildings with vacant floors or single-story buildings with non-functional floor plans and architecturally inconsistent additions; buildings with existing windows or windows that had been filled in or covered with metal; or buildings with multiple entrances on different streets.

These properties were often located in what was then Portland's newly created "EX" zone, which allowed mixed-use development, or in "IG1" or "IG2" general industrial zones near EX zones.

Redevelopers could buy properties for \$30 to \$60 per square foot and invest like amounts, bringing their total investments to \$70 to \$100 per square foot. After allowances for redevelopment costs, the properties could be leased for 55 cents to 80 cents per square foot, triple net, per month. The capitalized investment values of the properties were often 20 percent to 30 percent more than the total project costs. Redevelopers were creating value while creating a profit.

Just as important to this model were the users who leased the spaces. They included small manufacturers, importers and exporters, ad agencies, Web designers, carpenters, manufacturer representatives, caterers, local retailers and home design suppliers that flocked to these types of facilities. These users fueled the evolution of the Northwest Portland Industrial District and then spread to inner Southeast Portland, the Hawthorne District and North Mississippi Avenue.

Redevelopments of industrial properties – like the former Beaver Sales building in Southeast Portland, the General Tool & Supply building in the Pearl District and the former Northwest Marine facility in the Guild's Lake Industrial Sanctuary – proved this type of redevelopment could be successful. A recent large-scale example is Cathedral Park Place in St. Johns, a 280,000-square-foot single-tenant building that now has over 60 different lessees.

But in the last several years, Portland's condo boom pushed the price of EX-zoned buildings from as low as \$50 per square foot to as much as \$250 per square foot. Additional factors – such as low interest rates, easy underwriting for condo projects, and investments fueled by 1031 exchanges – helped fuel this explosion in value. Buildings that would have once been excellent candidates for redevelopment were instead purchased and torn down. Many redevelopers that had been buying one or two buildings a year to redevelop found themselves priced out of the market. Not only could they not create any investment value from the purchase of these properties at their new market values, they couldn't capitalize rent at the necessary rate. Redevelopers found themselves pushed to the sidelines.

Some well-located buildings, like the Jasco Block at 2001 N.W. 19th Ave., were still redeveloped. But because the purchase values of such properties were so high, rental rates around \$20 per square foot, triple net, were demanded – rates similar to those of the central business district and far out of reach for the previous tenants of redeveloped properties.

But things change. Portland's oversupply of condos and the declining demand have reversed the land price surge in the EX, IG1 and IG2 zones. Although some apartment developers are still pursuing opportunities, their pro forma for land is one-third to one-half of what it was only six or eight months ago. Additionally, tighter underwriting requirements have left many building owners, who didn't sell their properties within the last year, facing a different market than they'd anticipated.

The market for these buildings with redevelopment potential is in a period of transition.

Although the rental rates for small industrial spaces have continued to increase over the last several years, they don't justify the market value that many owners had projected for their buildings six months ago. Like it did when the dot-com bubble popped, speculative value has come out of the market. A return to sound investment criteria has redevelopers anticipating the ability to again create "development value." As with most periods of economic transition, opportunity for profitable redevelopment should follow.

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