



## Portland booming, but not at '04-'06 pace

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Like much of the rest of the nation, Portland's was a frenzied real estate investment market in 2004 and 2005. And although activity calmed in 2006, the market still saw in excess of \$1 billion in commercial transactions last year.

Through the third quarter of 2007, \$500 million in investment deals have been completed, even with the capital markets in flux. There's still strong activity in the pipeline, and it's possible 2007 will be another \$1 billion year.

The complexion of the Portland market has changed over the past 24 months. Although it's still a second-tier market, local and regional owners no longer dominate it. Every year, we see more deals by large institutional players – witness the recent Blackstone-Shorenstein transaction in excess of \$1 billion. Broadreach Capital Partners, Commonwealth Partners, GE Asset Management, JPMorgan, Prudential, Principal and Triple Net Properties have all increased their presence.

Why is Portland rising to the top of the second-tier market? Why are more national investors seeing it as an outstanding market?

Portland benefits from many of the same market constraints that protect real estate value in first-tier markets: limited land supply (ours occur due to the urban growth boundary), rising construction costs, and the necessary population and job growth to drive demand for space.

Additionally, we have an outstanding mass transit system and high quality of life – two factors that many large, first-tier markets no longer possess.

Although Portland experiences slightly less explosive rent growth than most first-tier markets, we also tend to suffer less severe downturns. Portland will see 6 percent to 8 percent rent growth across all product types in 2008.

Investors enjoy better investment pricing in Portland, particularly when compared to Seattle and San Francisco, the two largest West Coast markets. For the next 12 months, we expect investors to continue to see returns at least 15 basis points higher than those achieved in Seattle.

But there are still challenges in Portland.

Although there are more institutional deals, the reality of our market size limits the number of big transactions. Many institutional investors want and need to place \$20 million or more per deal, and, compared to larger markets, Portland just doesn't see many transactions of this size.

Capital market turbulence, due to the implosion of subprime lending, is pushing capitalization rates up 25 to 75 basis points, depending on product type. This cap rate movement hasn't had much of an effect on buyers of core, or completely stabilized, assets, as they still use little or no leverage. However, buyers of core-plus assets (those properties that have core characteristics but could benefit from some repositioning to gain more "pop" on the investor's exit) have been affected more significantly because they tend to require more leverage to make their deals economically feasible.

Lenders have tightened their underwriting requirements in response to this summer's turmoil, with loan-to-value ratios dropping from 75 percent to 60 percent. Lenders have also increased their spreads over the 10-year Treasury from 110 to 125 basis points to 175 to 225 basis points. These increased spreads have settled since early in the fourth quarter.

Investment deals that might have been rated "value add" are moving into the "core plus" category because value-add investors can no longer obtain the levels of leverage required to make their deals pencil out. Value-add properties, which we see in every product type, usually have a higher risk component than core and core-plus properties because of factors like high vacancy, significant deferred maintenance and the need for repositioning or redevelopment.

Additionally, smaller investors, such as 1031 exchange buyers and high net worth individuals, have seen interest-only financing dry up, effectively taking them out of the market.

Most recently, we've seen more "off market" deals. Some sellers are nervous about the capital market uncertainty, and as a result, we've seen several deals not go through the typical marketing and bid process. Instead, sellers are accepting unsolicited offers that may not be at the pricing levels they'd achieve through a competitive bid situation.

It's essential to understand why some recent deals – the Brewery Blocks, KOIN Tower and U.S. Bancorp Tower deals and Shorenstein's acquisition of the Equity Office Properties portfolio – achieved such eye-popping values. It's also important to remember our market isn't big enough to see more than one or two of these super-sized transactions each year.

The Brewery Blocks development is a multi-block asset, with significant underground parking, and the leading sustainable redevelopment in the nation. The size and quality of the project, multiple product types and cachet of the Pearl District all factored into top-of-the-charts pricing.

U.S. Bancorp Tower was an opportunity to purchase the central business district's largest Class A office tower in a location most people agree is in transition, and at a price well below replacement cost.

The ODS Tower was the first Class A, full-block high-rise office tower

Portland's a highly desirable second-tier market with solid market fundamentals – but the same forces that protect real estate values also serve to constrain our growth, ensuring we'll be a second-tier market for the foreseeable future. With only the PacWest Tower on the market, we likely won't see the Class A office transaction volume in 2007 we've seen over the past three years. We'll continue to see Class A office properties change hands – just not at the levels of 2004, 2005 and 2006.

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