

PORTLAND OFFICE MARKET

ANOTHER YEAR OF GROWTH

As 2019 concludes, Portland's office market reports another year of steady growth. Vacancy has compressed, from 10.9% at the end of 2018 to 10.0% this quarter. Rent growth has risen continuously, landing at \$30.39/SF, an increase of \$1.38/SF, or 4.8%, from last year. Each quarter of 2019 reported positive net absorption, with 142,548 square feet absorbed in the fourth quarter for an annual total of 648,930 square feet. This marks an increase of 181,164 square feet, or 38.7%, over the 467,766 square feet absorbed in 2018. The construction pipeline remains steady. While only 80,000 square feet of new construction completed in 2019, almost 1.0 million square feet of office space is currently under construction. Much of this construction is scheduled to complete in 2020. As the nation weighs the possibility of an economic downturn, the Portland office market continues to exhibit the growth patterns responsible for the longest real estate cycle in U.S. history.

URBAN CBD AND CLOSE-IN SUBMARKETS

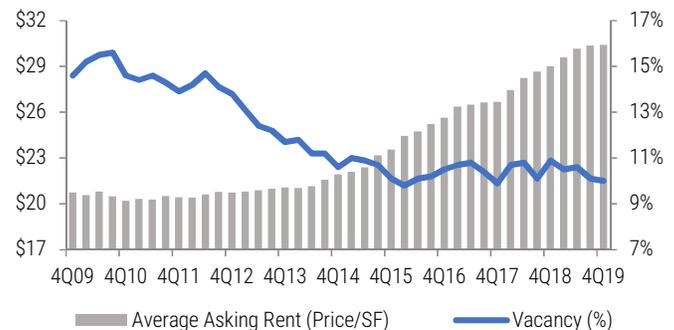
Portland's urban core, which includes Downtown Portland, the Pearl District, the Close-In Eastside and other densely populated neighborhoods, has grown rapidly during the current cycle. Out of the 997,428 square feet of new office space that is currently under construction, 842,142 square feet, or 84.4%, is being constructed in one of the five urban submarkets of the central city. In the past five years, 77.1% of all new office space, a total of 2.2 million square feet, was built here. In 2019, the average asking rent was \$34.44/SF, an increase of \$1.43/SF, or 4.3%, from a year ago. For Class A space, asking rents grew to \$37.80/SF, up \$2.02/SF, or 5.6%. Office tenants in Portland's urban center absorbed 275,714 square feet in 2019, while the vacancy rate decreased to 11.5% from 11.9% a year ago. These figures represent the combined statistics of the Central Business District (CBD), Close-in Northwest, Close-in Northeast, Close-in Southeast, Lloyd District and Johns Landing submarkets.

SUBURBAN WESTSIDE SUBMARKETS

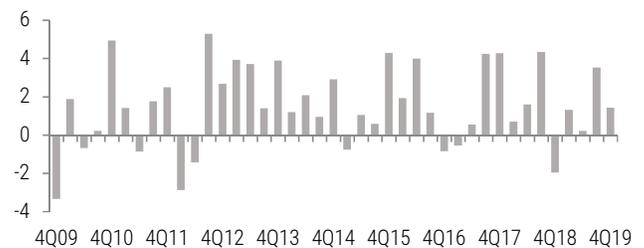
A comparison of the year-end statistics for the combined submarkets of Portland's Westside suburbs reveals their prodigious growth over the course of the current cycle. Vacancy rates for these submarkets remained high for many years, especially during the market's recovery from the great recession, when they exceeded 20.0%, and the highest vacancy rate recorded was 23.4% in 2010. Now, at the end of 2019, the vacancy rate is down to 10.0%. Additionally, rents are growing, although slower outside of the urban core, as asking rents were \$24.58/SF at the end of 2019, a 2.6% increase from last year. Class A asking rates grew to \$28.04/SF, up \$0.61, or 2.2%, over the same time period. Annual absorption for 2019 was positive 166,246 square feet.

MARKET ANALYSIS

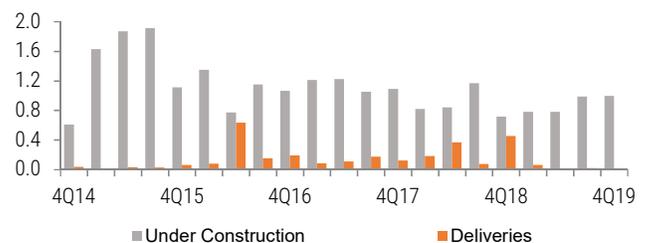
Asking Rent and Vacancy Rate



Net Absorption (SF, Millions)



Construction and Deliveries (SF, Millions)



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	12 Month Forecast
Total Inventory	61.0 MSF	60.9 MSF	60.8 MSF	↑
Vacancy Rate	10.0%	10.1%	10.9%	↑↓
Quarterly Net Absorption	142,548	352,591	-195,598	↑
Average Asking Rent	\$30.39	\$30.36	\$29.01	↑
Under Construction	997,428	987,488	714,749	↑↓
Deliveries	0	20,000	454,975	↑

THE GREAT EARTHQUAKE AND THE OFFICE MARKET

In 2015, the New Yorker published “The Really Big One,” an in-depth, Pulitzer Prize-winning article about the catastrophic earthquake predicted to hit the Pacific Northwest. Five years later, the article still resonates, as many are unsure of how to face this public safety crisis. Tenants of office buildings built between 1870 and 1960 with unreinforced masonry (URM) are at a severe risk, as their walls lack steel reinforcing bars that secure the structure during an earthquake. Retrofitting to secure these structures is extremely costly for landlords and offers no guarantee they will withstand the disaster. Many different levels of retrofitting exist, but for most URM office buildings, the recommended retrofits are estimated to cost between \$51/SF and \$69/SF. So, a landlord considering a retrofit of a 20,000-square-foot office building should expect to spend anywhere from \$1.0 million to \$1.4 million in order to meet the standards set by the city of Portland.

A database of all commercial unreinforced masonry buildings found in Portland is kept by the city government. The database currently tracks 21.8 million square feet of URM buildings, including 6.2 million square feet of office buildings, or up to 10.1% of all office space tracked by Newmark Knight Frank in Portland. This figure could be even higher, as the database does not track URM buildings in nearby suburban communities. Currently, few programs exist that assist landlords in retrofitting, and these are mostly tax breaks. Office tenants are likely to find their rents will increase to pay for these added costs. Keeping an

investment property profitable is extremely difficult when factoring in this expense; in similar situations, landlords have chosen to demolish old URM buildings and rebuild. In California, mandatory programs to retrofit have been implemented since the 1980s. A study by the city of Portland found that the Californian cities that offered the most assistance to property owners had the lowest demolition rates, while cities that provided less support had higher demolition rates. Demolition of older buildings may be an effective alternative to improve safety for occupants, but it may also destroy Portland’s historic character. It is hoped that landlords will make the best choices to ensure safety for everyone.

CAPITAL MARKETS

Office property sales totaled \$387.5 million for the fourth quarter, bringing the year-end total to around \$1.3 billion. This outpaced the \$1.1 billion reported in 2018 and broke the previous record of \$1.2 billion set in 2017. 250 Taylor, the largest transaction of the fourth quarter, is an under-construction office building that is 100% pre-leased to Portland’s publicly traded utility company, NW Natural, for 20 years. The sale of this asset, which is set to deliver in March 2020, resulted in a new price per square foot record. This reflected its location in an Opportunity Zone, as its associated tax advantages allowed investors to compress typical return requirements. Newmark Knight Frank brokered another of Portland’s largest transactions in 2019, the sale of the Power + Light Building for \$131.5 million.

SELECT LEASE TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
Square	Aspect on Sixth	CBD	Direct	~70,000
Lam Research Corporation	Pacific Financial Center	Tualatin	Direct	41,946
City of Portland	Jacobs Center	CBD	Lease Expansion	31,964
Campbell Global	Wells Fargo Center	CBD	Direct	17,520
Miller Consulting Engineers	Atrium West	217 Corridor	Direct	9,270

SELECT SALES TRANSACTIONS

Building	Submarket	Approximate Sale Price	Approximate Price/SF	Square Feet
250 Taylor	CBD	\$141.3 Million	\$786	179,685
Power + Light Building	CBD	\$131.5 Million	\$486	270,622
River Forum	Johns Landing	\$57.5 Million	\$274	209,597
Pacific Financial Center	Tualatin	\$14.0 Million	\$139	100,831
The Public Will Building	CBD	\$6.4 Million	\$363	17,655

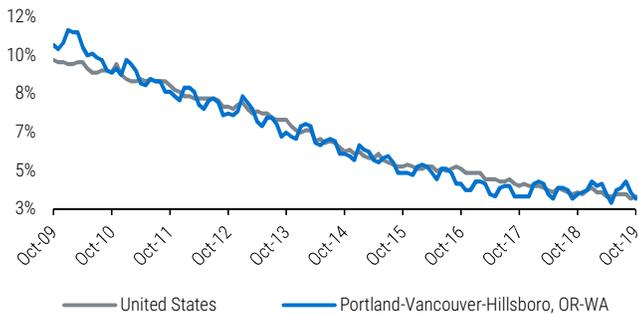
EMPLOYMENT OUTLOOK

The nationwide unemployment rate was 3.6% in November. As in the second quarter of this year, the current rate hovers at an all-time low. In Portland, the unemployment rate was even lower, ticking down to 3.5%. In November, the white-collar sectors of information, financial activities, and professional and business services grew by 4.3%, 3.3%, and 1.7%, respectively. Information was the fastest-growing sector, followed by construction, which grew by 3.8%.

Portland's office market will start the new decade on a high note. Many new construction projects are expected to complete in the urban close-in submarkets. The rising demand for suburban office space on Portland's Westside may spur more new construction or renovation there. As this real estate cycle continues, expect to see more rent growth in the first few quarters of 2020, while vacancy will continue to compress until more new construction projects are completed.

UNEMPLOYMENT RATE

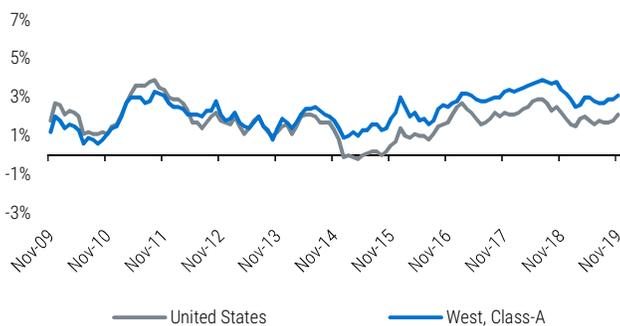
Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics

CONSUMER PRICE INDEX (CPI)

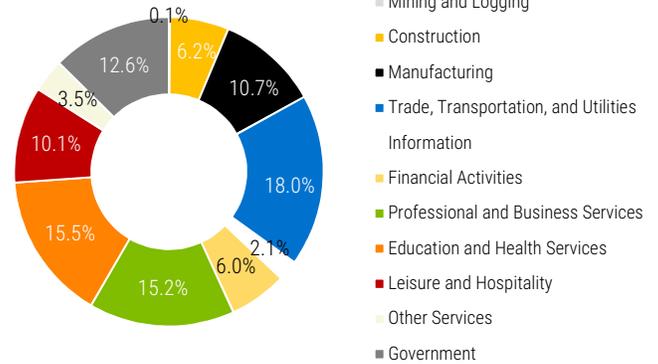
All Items, 12-Month % Change, Not Seasonally Adjusted,



Source: U.S. Bureau of Labor Statistics

EMPLOYMENT BY INDUSTRY

Portland, Nov 2019



Source: U.S. Bureau of Labor Statistics

PAYROLL EMPLOYMENT

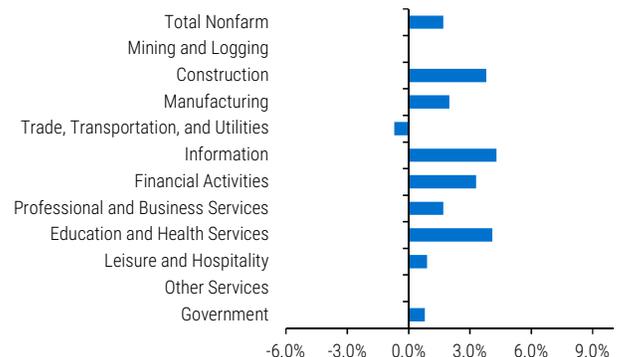
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

EMPLOYMENT GROWTH BY INDUSTRY

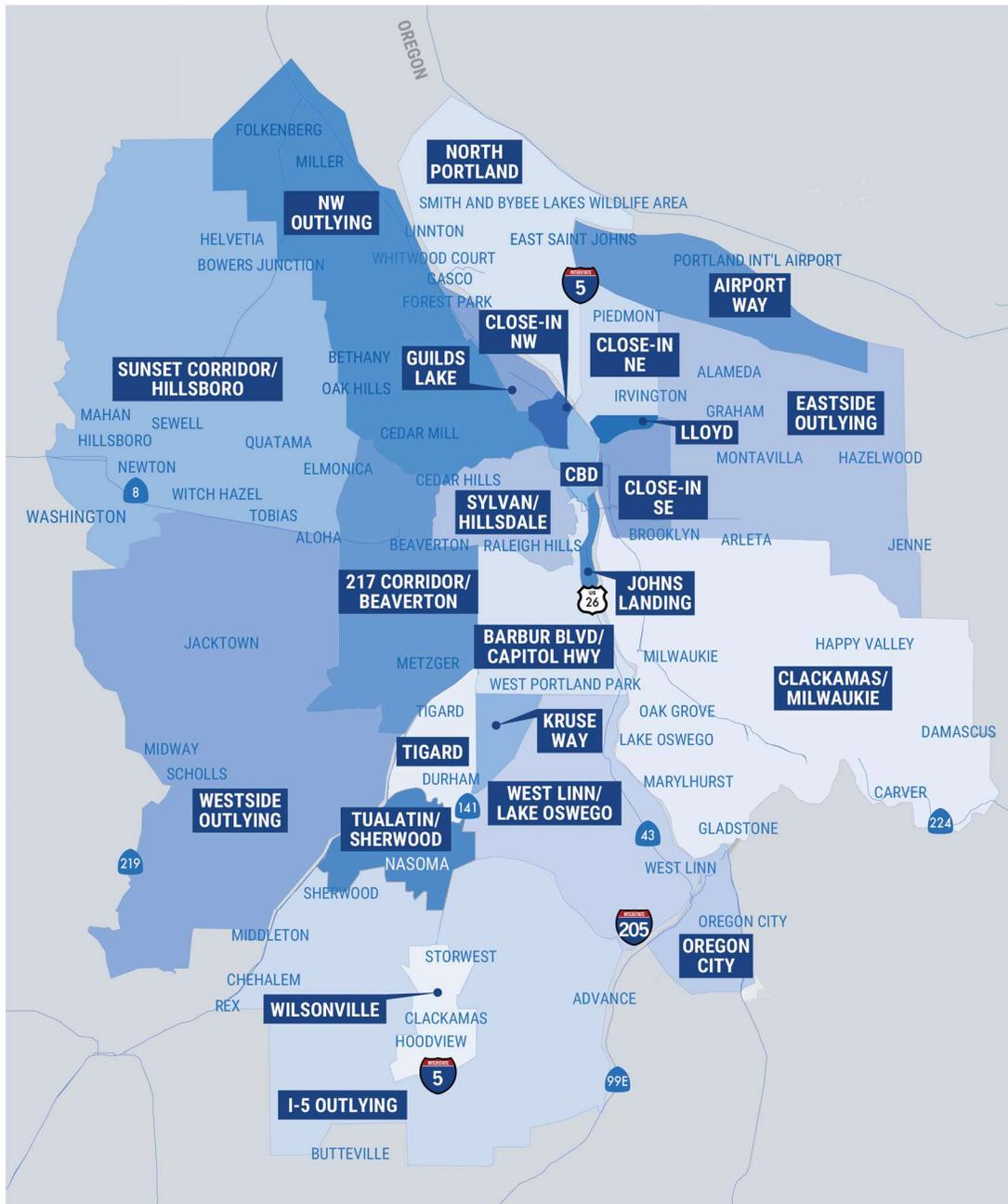
POR, Nov 2019, 12-Month % Change, Not Seasonally Adj.



Source: U.S. Bureau of Labor Statistics

SUBMARKET STATISTICS

	Total Inventory (SF)	Under Construction (SF)	Total Vacancy Rate	Qtr Absorption (SF)	YTD Absorption (SF)	Class A Asking Rent (Price/SF)	Class B Asking Rent (Price/SF)	Total Asking Rent (Price/SF)
CBD	23,506,400	465,349	12.2 %	46,456	84,323	\$37.93	\$33.24	\$34.74
Clark County (WA) Total	6,999,480	41,795	5.9 %	74,456	39,352	\$26.54	\$23.30	\$24.79
217 Corridor/Beaverton	4,904,271	0	9.9 %	10,535	9,174	\$27.92	\$18.72	\$23.66
Airport Way	892,764	0	12.8 %	-9,411	7,334	\$25.46	\$19.70	\$17.10
Barbur Blvd/Capitol Hwy	857,450	0	6.1 %	10,748	23,868	-	\$19.79	\$19.67
Clackamas/Milwaukie	1,432,370	9,940	2.4 %	-4,775	23,556	\$25.26	\$21.60	\$23.20
Close-In Northeast	518,939	0	5.8 %	8,901	13,358	\$34.67	\$27.50	\$30.98
Close-In Northwest	1,821,983	67,393	17.3 %	41,162	56,555	\$41.41	\$36.26	\$38.43
Close-In Southeast	2,826,392	189,000	9.2 %	7,840	25,543	\$36.14	\$30.98	\$31.67
Eastside Outlying	1,811,658	53,551	3.7 %	-8,141	132,975	-	\$20.24	\$20.22
Guilds Lake	105,196	0	0.9 %	-	31,855	-	\$24.00	\$24.00
I-5 Outlying	22,254	0	0.0 %	-	-	-	-	-
Johns Landing	1,381,062	0	10.2 %	5,298	-1,049	\$33.77	\$30.57	\$32.06
Kruse Way	2,495,785	0	14.1 %	10,267	-8,671	\$32.27	-	\$32.27
Lloyd District	2,199,354	120,400	4.8 %	-3,583	96,984	\$34.35	\$20.38	\$28.36
North Portland	144,300	0	10.9 %	442	-137	-	\$14.00	\$14.00
Northwest Outlying	27,740	0	14.6 %	-	-4,049	-	\$17.50	\$17.50
Oregon City	248,152	0	0.0 %	-	3,890	-	\$20.83	\$20.98
Sunset Corridor/Hillsboro	3,783,998	0	9.9 %	-64,855	86,319	\$24.44	\$23.80	\$24.15
Sylvan/Hillsdale	445,712	0	10.2 %	-2,676	-17,792	-	\$17.68	\$16.96
Tigard	2,423,566	0	8.1 %	9,934	34,788	\$28.38	\$19.83	\$23.54
Tualatin/Sherwood	916,638	0	16.7 %	4,128	13,588	\$26.84	\$24.39	\$25.48
West Linn/Lake Oswego	541,669	50,000	7.0 %	7,670	550	\$28.05	\$26.31	\$26.16
Westside Outlying	58,921	0	2.3 %	-	-	-	-	\$17.84
Wilsonville	559,773	0	1.5 %	-1,848	-3,384	-	\$16.45	\$16.45
TOTALS	60,965,827	997,428	10.0 %	142,548	648,930	\$33.96	\$27.13	\$30.39



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Newmark Knight Frank has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents. Newmark Knight Frank Research Reports are available at www.ngkf.com/research

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