SOUTHWEST MARKETS NEWSLETTER

27100 SW Parkway, W-3 | For Lease

JANUARY 2024

Southwest Commercial Markets

2023 was a slowdown year for all commercial markets. The steady rise in borrowing rates and capital requirements for investment put a damper on all facets of the markets. Most of the headlines during the year were dominated by predictions of a recession just over the horizon. The commensurate uncertainty in the economy's direction exacerbated the effect of rising interest rates.

Socioeconomic factors continued to define market outcomes. The fissures caused by these pressures began to widen in the past year. Work from home continues to decimate the office market nationwide. Online shopping buoys the industrial markets and deflates big-box retail. These adverse effects are amplified on the West Coat as the political doctrines pursued by the body politic in these cities and states have changed market dynamics faster than I can remember.

The evidence of these policies effect is the decline in population in these urban areas and a flight of high-income earners, in particular, to more friendly confines. Survey after survey of population studies points to this. The permissive attitude towards crime in Portland and Multnomah County have exacerbated the situation. Locally employers and employees feel unsafe in the urban core or on the mass transit system that serves it. This effect has had a profound impact on the values of office buildings in general, but in the urban core, the decline is bordering on the spectacular/apocalyptic. Recent sales of office buildings in the urban core point to values near levels of 1982 when I first started in the business. I can think of no asset investment class that has performed as poorly. The revenue consequences for the city of Portland and Multnomah County are profound. The board of Property tax appeals in Multnomah County will be very busy in the coming years.

This newsletter is meant to focus on the Southwest area outside of Multnomah County. But, I will also concentrate on the problems in the urban areas that have contributed to inflating values in the cities along the I-5 corridor. The flight of many office users to the suburbs has softened the effect of the remote work dynamic and the industrial properties in the outlying areas. Properties in the southwest market have far outperformed the corresponding industrial and office markets in Multnomah County. Washington and Clackamas counties have expanding tax bases and employment levels compared to their larger neighbor. I think most market participants would agree that the taxation and political climate in the urban area has been a boon to the outlying areas.

Stu Peterson, SIOR
Broker, Partner
503.972.7288
stu@macadamforbes.com
Bio

MACADAM FORBES
COMMERCIAL REAL ESTATE SERVICES

Industrial Markets

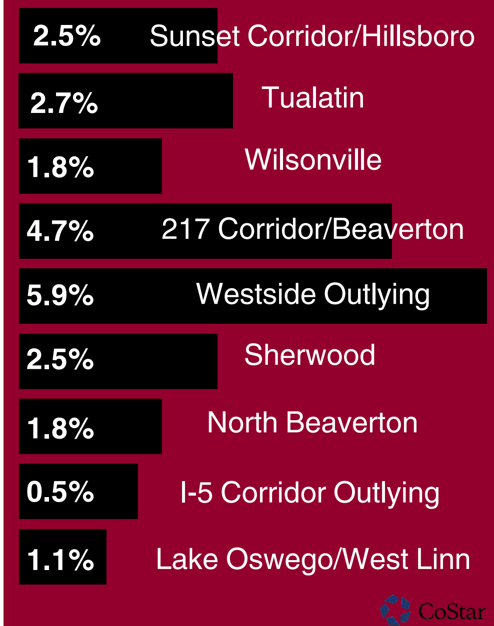
While 2023 certainly saw a slowdown in Industrial market activity, it nonetheless saw still more shrinkage in vacancies and, if anything, an increase in market rents. The combined markets of the I-5 and 217 corridors are as healthy as I can remember, and the table below illustrates that claim. The steady progression in the rents achieved by each new project constructed over the past three years is, by historical standards, astounding. In three years, rents for newly built space along I-5 projects have nearly doubled. I have been involved in many of these transactions, and there has been little pushback from tenants as alternatives for space are sparse or nonexistent.

This rise in industrial rents is not unique to this area. Nationwide industrial markets have been the shining star of commercial real estate. Macro factors, such as the onshoring of manufacturing and the displacement of consumer goods from retail shelves to warehouses because of online shopping, have served to swell the value of industrial properties. Land use policies of the State of Oregon have contributed to the dramatic rise in rates. The state's strict and uncompromising land use laws create an artificial shortage of industrial land and thus space for companies to choose from. More local companies than I have ever seen are desperate to find facilities to expand into and have run up against this lack of product to consider. This lack of land to develop and space available in the metro area has been a windfall for outlying cities along the I-5 corridor from Cottage Grove to the south Puget Sound region.

The Metropolitan Services District, which is supposed to oversee the process of providing land for housing and employment areas, seems blind to this issue. They continue to insist there is an adequate supply of industrial land in the tri-county region. They point to maps that show the industrial property in cities' urban growth boundaries as proof of this. As a "boots on the ground" participant in these markets, I can tell you this is not the case. While there are vacant sites this on the metro maps, it is years away from being developable. There are no services to this land, and the plans to provide them need to be formed and will take years to put in place. In many cases, these sites do not have a zone assigned to them, or if they do, the zones are so restrictive they only pertain to a handful of "desirable" businesses, and they will likely lie fallow for many years to come.

As of this writing, I can only point to 24 acres of industrial land south and west of Portland that is for sale and is developable, which seems unbelievable for a market of this size. In fact, south of Portland to the southern tip of Salem, I can only point to less than 200 acres of industrial property for sale and readily developable. If the macro and local economies ratchet up in 2024. It will squeeze this inventory of industrial property to the point where it will stymie growth and likely cost our region dearly in terms of jobs and affordability.

Industrial Submarket Vacancy



"This lack of land to develop and space available in the metro area has been a windfall for outlying cities along the I-5 corridor from Cottage Grove to the south Puget Sound region"

- Stu Peterson

MACADAM FORBES
COMMERCIAL REAL ESTATE SERVICES

As of 1/1/24, only 600,000 square feet of industrial space in the southwest metro area are scheduled to be delivered for the year. Over the period from 2020 to 2023, the average absorption of industrial space in this region has been more than twice that. As of this writing, between what land is under construction and what is tied up by Developers in the Southwest area, there is maybe three years of inventory in slow years and half that if the market heats up. Unlike other areas of the region, the Southwest markets are fueled by manufacturing companies. Their needs in terms of space are unique to the industrial markets. Heavy Power, increased lighting, parking, and often, climate-controlled facilities serve to distinguish their needs from ordinary warehousing uses. Yet, without developing the types of buildings suitable for warehousing, there would be no place for these companies to locate. City councils pressure their planning staffs to enact laws that exclude "undesirable" uses of industrial space (warehousing, for example). The intent is to have only favored employers located in their cities. In reality, it hinders all companies, including the type most favored.

Nearly all the industrial space provided for the SW region, certainly over 90%, in the past five years, has come from developers who provide multi-tenant business parks. These developers rely on financing to build these projects and shoulder the inherent risk in speculative development. Lenders will not loan on projects within restricted zones; thus, the land zoned in this manner lies fallow for years. An example of this effect has recently been exhibited in Sherwood. The city had a large area of industrial land earmarked for a very exclusive list of manufacturing uses. This land lay undeveloped for years despite having a premium location at the conflux of 124th and Tualatin Sherwood Road. The city leaders took it upon themselves to change the zoning. Immediately following this expansion of allowed uses, a 400,000 SF industrial park was developed by Trammell Crow that is now home to Lam Research, DW Fritz Automation, Nuance Systems, and MiTek, all advanced manufacturing companies. As of this writing, Schnitzer Properties and Mainlander Investment are delivering a 450,000 SF industrial park in this area that is scheduled for delivery in the spring of 2024. It has already landed a significant manufacturing company in Olympic controls well in advance of the completion of the development.

The point of this is to describe how our byzantine land use laws and indifferent local attitude toward development thwart goals that our state and local leaders strive for. The affordability of housing grabs so many of the local headlines that the shortage of industrial property is shunted aside and ignored. These shortfalls of available inventory for development are due to the bureaucratic hurdles that exist in our state. When Governor Kotek took office, she pledged to build 36,000 housing units annually. It was the cornerstone of her campaign. While this was an admirable goal, the conflagration of our system surely must be becoming apparent to her and those who support this goal.

The shortage of land and available space is good news for folks invested in real estate, as most of you reading this are. Lack of supply leads to higher values. However, in the macro/holistic sense, it is bad for our economic ecosystem. National recruiters tell me Oregon is far down the list and usually ignored when searching for sites for new facilities or corporate headquarters relocations. It is well known among site search firms that there are never large sites in our state that are readily developable. This is a significant hurdle to diversifying our economy and employment base. It makes the state more vulnerable to slumps in specific industries.

Year End SW Suburban Industrial Markets

Submarket	Asst Value	Vacancy Rate	Availability Rate	Available SF Direct	Available SF Sublet	Available SF Total	Market Rent/SF	Annual Rent Growth	Inventory SF	12 Mo Delivery SF	Under Constr SF	Under Constr % of Inventory	12 Mo Net Absorp Sf	Market Sale Price /SF
Sunset Corridor/ Hillsboro	$4.9B	2.5%	5.0%	911K	392K	1.3M	$1.20	3.3%	25.8M	293K	53.2K	0.2%	257K	$188
Tualatin	$2.4B	2.7%	2.6%	258K	80K	338K	$0.87	4.2%	12.8M	206K	18K	0.1%	36.9K	$186
Wilsonville	$1.4B	1.8%	9.8%	755K	84.1K	839K	$0.96	3.2%	8.6M	0	0	0%	(93.5K)	$159
217 Corridor/ Beaverton	$1.1B	4.7%	4.6%	227K	29.9K	251K	$1.05	2.9%	5.4M	0	0	0%	68.4K	$197
Westside Outlying	$513M	1.3%	5.9%	193K	9.8K	202K	$0.91	4.4%	3.3M	0	155K	4.7%	13.3K	$149
Sherwood	$404M	2.5%	2.4%	23.6K	30K	53.6K	$0.87	4.0%	2.2M	0	0	0%	5K	$180
North Beaverton	$371M	1.8%	1.8%	43.4K	0	43.4K	$1.10	3.7%	2.5M	0	0	0%	3.6K	$150
I-5 Corridor Outlying	$365M	1.5%	34.0%	543K	0	543K	$0.96	4.4%	1.1M	148K	445K	38.7%	488K	$229
Lake Oswego/ West Linn	$270M	1.1%	1.5%	19.8K	0	19.8K	$1.04	3.6%	1.3M	0	0	0%	(12.6K)	$203

CoStar

As you can see from this table, industrial vacancies in these submarkets are exceptionally low. No surprise here. This is in spite of what may have been the slowest year in the past ten in terms of activity. Despite the slow activity, rents in industrial space continued to firm up, and vacancies declined. There were bright spots as well. Lam Research, the largest employer in the south I-5 market, is doubling its presence. They have begun planning to expand on their existing campus and purchased 19 acres adjacent to it. In addition, Lam occupies well over half a million square feet in the area's industrial parks. Amazon is finishing their new building on I-5 in Woodburn, Oregon, and expects to employ 2000-2500 people eventually.

Undoubtedly, the best news is Intel's announcement of the Mod 4 facility on their existing campus in Hillsboro. The facility is 1.1 million SF, estimated to provide 2,000 more jobs, and represents one of Oregon's most significant capital investments in the state's history. Intel is the largest employer in the state of Oregon with 22,000 employees, who, as far as I know, all are in Washington County.

Year End SW I-5 Corridor Office Markets

Submarket	Asst Value	Vacancy Rate	Availability Rate	Available SF Direct	Available SF Sublet	Available SF Total	Market Rent/SF	Annual Rent Growth	Inventory SF	12 Mo Delivery SF	Under Constr SF	Under Constr % of Inventory	12 Mo Net Absorp Sf	Market Sale Price /SF
Wilsonville	$324M	2.8%	11.8%	141K	15.1K	156K	$2.55	2.2%	1.3M	0	0	0%	(4K)	$245
Sunset Corridor/ Hillsboro	$4.5B	5.4%	7.5%	991K	377K	1.4M	$2.25	1.6%	18.3M	0	0	0%	(359K)	$247
Lake Oswego/ West Linn	$301M	5.7%	7.4%	77.4K	6.1K	83.4K	$2.54	1.1%	1.1M	0	6.8K	0.6%	17.9K	$265
North Beaverton	$814M	5.7%	7.3%	235K	8.4K	244K	$2.33	1.5%	3.4M	0	0	0%	(29.3K)	$242
Westside Outlying	$148M	6.3%	6.3%	46.9K	0	46.9K	$2.02	0.7%	740K	0	0	0%	14K	$199
Sherwood	$46.5M	8.1%	9.0%	11.4K	7.4K	18.8K	$2.27	1.0%	208K	0	0	0%	(9.9K)	$223
Tigard	$1.1B	11.8%	14.9%	629K	95K	724K	$2.37	2.0%	4.9M	0	0	0%	(44.9K)	$234
Tualatin	$312M	16.0%	18.2%	233K	16.8K	250K	$2.48	-0.6%	1.4M	0	0	0%	(53K)	$227
I-5 Corridor Outlying	$12.4M	18.2%	26.1%	14.3K	0	14.3K	$2.40	1.7%	55K	0	0	0%	5.7K	$226
217 Corridor/ Beaverton	$569M	18.4%	19.6%	397K	142K	539K	$2.00	1.6%	2.8M	0	0	0%	(42.7K)	$207
Kruse Way	$836M	23.8%	22.7%	564K	75K	639K	$3.19	1.5%	2.8M	0	0	0%	(49.1K)	$297

CoStar

As you can see in the above, the office market it is not pretty compared to the SW Industrial markets. However, these statistics are downright bright when compared to the urban core. There is no overstating the effect work from home has had on the office market. While few companies have gone completely virtual over the last several years, they often renew their leases at substantial reductions in space. This is particularly true of professional firms, including insurance companies, financial services, accountants, engineers, and lawyers. In addition, the above stats do not show the large lots of hybrid space Nike has surrendered over the last several years in the sunset corridor. Much of this space is a hybrid between office and industrial space. Like many companies, Nike began allowing many employees to work from home during the Covid-19 scare. This practice became customary at Nike. As a result, they started not renewing leases in the Sunset Corridor. They are likely the most prominent office/flex space occupant in the corridor market. The surrendering of space by Nike has had a profound effect on this area's real estate. Lately, Nike has announced a great deal of workforce reduction, which will undoubtedly further adversely affect this submarket's vacancies and values. By my estimate, Nike has left 700,000 SF behind over the last three years in the Hillsboro and Beaverton flex and office markets.

The bellwether market in the SW region is the Kruse Way submarket. While the statistics above reflect vacancy rates of over 20% and negative absorption in 2023, its rents are stabilized and rising. It has been home to many firms most likely to allow their workers to work from home. As their leases renew, these firms decrease their footprint, and the absorption and vacancy statistics reflect this over the last several years. Offsetting this is the fact that this area is a favored destination for companies fleeing the urban core. This trend will likely continue over the next several years as leases expire in Portland. Several announcements of large leases in the Kruse way market will come in 2024, emphasizing this trend. I expect a solid recovery in this submarket in the coming year.

MACADAM FORBES
COMMERCIAL REAL ESTATE SERVICES

Looking Ahead in 2024

This year should bring lighter headwinds for most types of real estate. Even if the Fed overshot its mark in reigning in inflation and the economy slows down, I expect to see declining long-term borrowing costs buoying the values of most commercial real estate. At year-end, there was an increase in activity among industrial firms, and I expect that trend to continue into 2024. Vacancies in modern industrial space are even scarcer than the statistics reveal. Industrial Rents should climb. If 2023 was indeed a pause in industrial activity, and the market resumes its acceleration of the last decade, this rise in rental rates should be robust.

The office market in SW should stabilize at best. Many leases that have yet to expire were signed before the remote work dynamic took effect, and this will continue to be a drag. Migration from Portland and Multnomah County will persist, but many of those moving will also lessen their footprint. Kruse Way will rebound mainly due to the migration mentioned above, as it is a favored location for those leaving the urban areas.

Despite our flagship city's travails, I see some green shoots of hope. Portland is still the state's most recognizable region, and all of the state's denizens will benefit from a recovery from its current troubles. Recent elections have exhibited a return to the moderate. There also seems to be a change in the narrative realized by the loss of businesses and wealthy individuals and the threat to the revenue needed to deal with their problems. Things could change over time if the city can come to grips with the three-headed hydra of crime, homelessness, and the city's unreasonable taxation.

Please call if you have any questions about the content herein. Thanks for taking the time to read this, and cheers to a prosperous 2024.

Featured Listings

18280 SW 108th Avenue

4405 Turner Road

1980 SE 4th Avenue

Sherwood Commerce Center

Cobalt Industrial Park

MACADAM FORBES
COMMERCIAL REAL ESTATE SERVICES

2 Centerpointe Drive, Suite 500
Lake Oswego, OR 97035
503.227.2500
macadamforbes.com

Stu Peterson, SIOR
Broker, Partner
503.972.7288
stu@macadamforbes.com