



## Apartment rents have nowhere to go but up in 2015

by Cliff Hockley, CPM, CCIM

*Executive Director, Sperry Van Ness | Bluestone & Hockley*

As tall tower cranes have become a fixture in the Portland skyline, many are wondering how many units will be added to the Portland metro area in the next few years. According to the spring 2015 Barry Report (published by Patrick and Mark Barry Appraisers) somewhere between 12,000 - 16,000 units will be built between 2015 and 2016. Typical annual demand is between 3,000 and 4,000 units per year. That translates into a likely surplus of apartment units in 2016.

### Given the increased supply, what is forcing rents up?

Increased demand for rentals is driven by demographic changes, population growth, and job growth. The low rate of

apartment vacancies, at the 3% mark across the Portland Metro marketplace, is evidence of this.

**Demographic changes.** The millennials have exited college, moved out of their parents' home and are populating central urban areas of major cities. They have created significant apartment demand in the metro Portland area.

Note: Developers and investors need to use caution as they continue to race ahead. Within five years, 50% of this cohort is looking to live in a suburban environment. (According to Trulia's chief economist Jed Kilko in a blog he posted on January 22, 2015 <http://read.bi/1Ff3PHo>



**Steve Morris**

*steve.morris@svn.com*



**Rick Funk**

*rick.funk@svn.com*



**Becky Potter**

*becky.potter@svn.com*



**Kevin Wingate-Pearse**

*kevinsp@svn.com*



**Julie Richard-Schutrop**

*julie.richard@svn.com*

### Sperry Van Ness

Bluestone & Hockley

9320 SW Barbur Blvd, Suite 300

Portland, OR 97219

503.222.3800

900 Washington St, Suite 800

Vancouver, WA 98660

**Population growth.** Since 2010, an estimated 116,168 people have moved to the Portland metropolitan area. This reflects a 5.2% growth rate from 2010 – 2014, which is the 20th-fastest in the country among large cities in the United States, and fourth-fastest outside the Sun Belt.

<http://bit.ly/1FGrlc7>

**Job Growth.** Portland has gained jobs more rapidly than Seattle, San Francisco and most other major U.S. metro areas in the past year. Portland's employment base expanded 3.1% from June 2013 - June 2014, the area's fastest annual growth rate in nine years. According to state workforce economist Christian Kaylor, the past year marked only the second stretch since the mid-1990s that job growth exceeded 3% in Portland.

**Cost of construction.** In 2010, the cost of building a two bedroom one bath apartment unit with a washer/dryer hookup was approximately \$90 – 95,000 per unit. Today that cost ranges from \$125,000 - \$165,000 for wood frame apartment buildings up to five floors. The cost of construction is significantly greater for buildings over five floors

due to the higher cost associated in building with concrete and metal. A recent appraisal completed by Barry and Associates for the construction of a “high end” five story elevator-served building priced out at \$230,000 per unit all in (system development charges, soft and hard costs and developer profit.) A number of factors account for the increased costs of construction:

**Increased land prices.** Land prices that were down to \$10,000 a unit during the recession are now averaging closer to \$20,000 a unit for multifamily units, with some deals coming in at \$30 – 40,000 a unit (which was once prerecession pricing for townhouse unit land.)

**Code changes.** There have been many code changes in the last six years. In 2012 the Oregon Structural Specialty Code was revised using the framework of the international building code. This had many implications. First of all, new multifamily properties are now required to install fire suppression sprinklers. Additionally, there are more

complete requirements for handicapped accessibility, seismic resistance, and stricter codes regarding air flow into buildings. These new requirements have increased building costs significantly.

**Lack of enough labor.** The 2014 - 2015 construction boom has created increased demand for construction labor creating a lack of contractors and laborers available to complete projects. This labor shortage has increased the cost and supply of labor. Commercial increases have averaged 4.4% over the last two years. According to Brian Frank, President of Keyway Construction, a construction company that specializes in the construction of midrise wood frame apartment communities, the cost for labor across all trades has increased about 5% due to a shortage of experienced tradespeople.

**Increased material costs.** The cost of construction materials have been increasing as well. More importantly, there are more materials needed to complete the construction of apartments and homes in order to comply with code changes. Brian Frank of Keyway Construction



**Sperry Van Ness**®

BLUESTONE & HOCKLEY

pointed out that the cost of materials has risen about 5% this year. The combination of labor and materials brings the total increase in apartment construction costs in the last 8 – 12 months of 10%.

<http://on.wsj.com/1HVYaa6>

**Increased permit costs.** Every year there are typically some increases in permit fees to offset the operation of the permit center staff who manage the permitting and inspection requests. Patrick Barry of Barry and Associates noted recently that system development and permit costs were approaching \$20,000 per unit in the Portland Metro area, with a recent smaller project actually costing \$25,000 a unit.

**Increased systems development charges.** System development charges increase annually. The Portland Parks and Recreation Department, led by Commissioner Amada Fritz, recently proposed residential increases in parks-related fees for units over 1,700 square feet in the city center and over 700 square feet outside of the city. The proposed increases follow a sliding scale based on unit size which may increase fees up to 52% for outer city units

more than 2,200 square feet. Commercial increases in this proposal are budgeted to increase 113% to 281%.

**Increases in operating expenses.**

Water and sewer bills, property taxes (with bond measure increases) and regular maintenance are making properties more expensive to manage and are also forcing investors to increase property rents. Appraisers have recently noted that outside of new apartments, in which taxes are the biggest expense, utilities are leading the way. Typical utility costs are \$70 - \$100 per unit per month. New apartments are being taxed at around \$1,500 - \$2,500 per unit.

**The bottom line**

Rent increases will continue to go up in the next 24 months as a response to continued robust demand and job growth. Additionally, the cost of construction is forcing developers to increase their asking rates in order to meet all of the economic needs for their projects.

**There are two kinds of rent to consider:**

Rents for newly constructed properties will continue to be strong ranging from \$2.50 - \$2.75 per foot, even reaching as high as \$3.00 per foot for very small units, but significant concessions will be needed to fill these properties. Also, as more of these new properties lack parking we will see some shift of tenants to properties that have a parking component. Well located, well maintained older product rents are in the \$1.50 per foot range, while further outside the metro area rents are ranging closer to \$1.00 per foot. "Value add" properties, which have been substantially upgraded, are nearing the \$1.75-2.00 per foot mark.

We expect to see rents for existing properties continue to increase from between 4-7% each year over the next two years, as existing multifamily housing adjusts to the increasing demand in the marketplace.

In summary, rents have nowhere to go but up in 2015.

*For more MarketWatch articles, go to [www.svnbluestone.com/news](http://www.svnbluestone.com/news)*



**Sperry Van Ness**

BLUESTONE & HOCKLEY