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Review and Forecast of Apartment Marketplace for 2017-2018 for the Portland, OR Metro Area

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In January of 2018, Mark and Patrick Barry (well established Portland, Oregon real estate appraisers specializing in the appraisal of apartment properties) gave the commercial real estate community (CCIM group) a market update regarding the Portland Metro Marketplace. This article attempts to summarize their fact-filled market overview.

2017 History

In 2017, employment grew by 33,100 in the Portland Metro area alone. This was extraordinarily good news for the Metro Area and helped drive the unemployment rate down to 3.8%. In the last year Oregon experienced a job growth rate of 2.7%, which is the second fastest rate of job growth in the United States. This kind of job growth reflects the robust economic health of the state – and compared to a lackluster growth rate of .02% in West Virginia - you can understand why many real estate investors are attracted to the Portland Metro area.

Other key indicators driving successful real estate values in the Metro include:

- Record low interest rates
- Apt vacancy of 4.4%
- 2017 apartment valuations went up 16 – 21%
- Apartment sales priced closer to a 5 CAP rather than the 6 CAP seen in 2015 and 2016
- Tax reform bill retained 1031 exchanges

The last three years have been extraordinary in regards to rent increases and their parallel value increases. It is possible that this is the new normal, or we will return to a mean which is closer to a 3 – 5% annual rental increase, given the significant number of new apartments being delivered to the market place. At the end of the year (2017) the rental market slowed down, and rental specials became necessary to fill vacant apartment units. That slowdown turned again at the end of February 2018 as

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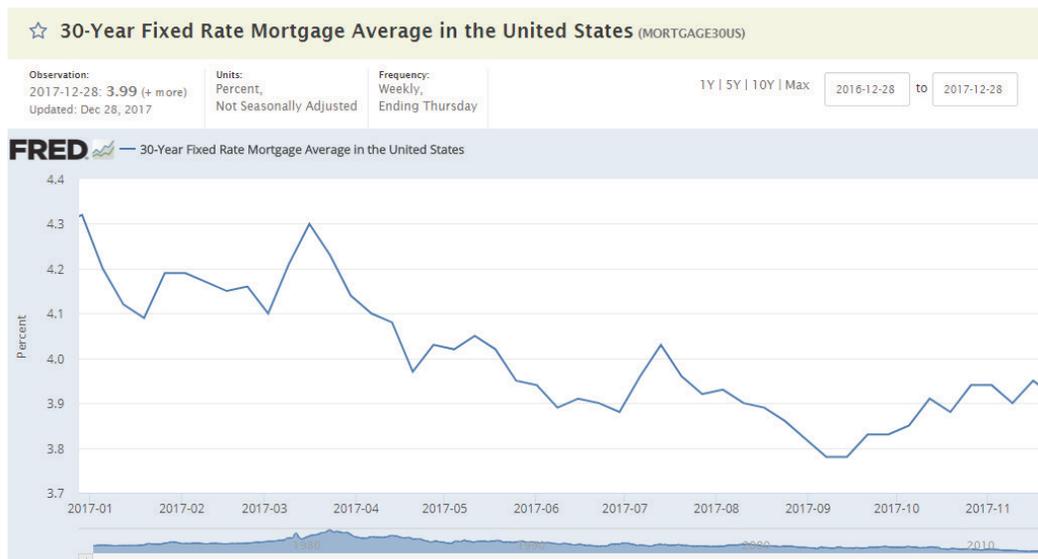


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more renters emerged from hibernation (after saving up the money to fund their moving expenses.) At the same time renters are buying homes. As millennials get married and have kids they are moving out of small apartments into homes.

Interest Rates

Interest rates are increasing, and banks are reluctant to fund long term fixed loans due to uncertainty over how much the Federal Reserve will be pushing interest rates. This may slow down the sale of apartments even more than the low rate of sales in 2017 as sellers may initially refuse to lower their prices to meet buyer underwriting standards.



Population Growth and Demand for Apartments

From a population standpoint, the Metro area has been adding about 41,000 new people a year for the past two years. Typically, 60% of these new people are interested in owning a home, with the balance split between apartments, assisted living units, and other shared housing opportunities. In the Portland Metro marketplace, we usually forecast annual demand for apartments between 5,000 and 6000 units. This is typically driven by immigration and job growth, as well as the maturing of the existing base of students matriculating from high school and college. The current demand for apartments is about 4,500 units per year.

New permit requests for 2018 have dropped off, but the pipeline for existing permits is huge (estimated at 32,000 units), however many of these units will never get built. In 2017, permits for 9500 and 10,000 units were issued, and six thousand permits were requested to beat the inclusionary zoning deadline at the end of 2016. There has also been a surge in requests for permits for properties that are less than 20 units because they can bypass the inclusionary zoning rules.

Operational Notes

Current Metro vacancy rates: Rates for 2018 are estimated at 4.4%, with rental softness in newer units and areas with high volumes of apartment construction.

Rents: Rent increase forecasts are significantly reduced for 2018, with estimates ranging from 2.2% to 5%, rather than the 10% of the last few years. Tenants have simply run out of money, and many apartments are offering concessions for brand new units that equal 4- 8 weeks of free rent and/or free wi-fi and TV's.

Expenses: Mark and Patrick expect the following property tax increases:

Property Taxes:

Clackamas County up 5%

Washington County up by 3 -5%

Multnomah County up 9 -10 % due to approved school bond

Utilities: Water filtration plant construction (\$500,000,000 cost) will cause significant per unit increases for the next 16 years to pay for bond measures.

Maintenance: Maintenance costs have been increasing significantly. There is a shortage of maintenance techs due to demand from construction projects and the need for staff at new and existing properties. This shortage has driven an increase in maintenance technician salaries. Additionally, the construction boom and the two hurricanes last year have created supply shortages that have spurred material price increases.

Where is Construction Occurring?

There are currently 11,000 units under construction, with a total of 46,379 units proposed.

Apartment Construction in Portland Metro Area

	Units		
	Prop.	UC	Total
North Portland	2,174	1,561	3,735
Close in East Portland	10,394	2,513	12,907
Close in West Portland	9,317	3,905	13,222
Suburban West	4,341	1,434	5,775
Suburban East	3,029	179	3,208
Suburban South	1,512	857	2,369
Clark County	4,312	851	5,163
Total	35,079	11,300	46,379

Politics: Portland Tenant Union are Strong

Homelessness and housing shortages of low income and market rate housing has a created political backlash. Tenant Unions are pressuring Portland City commissioners to create a system of rent controls, and this has encouraged the development of local ordinances that address inclusionary zoning of market rate housing units. Additionally, city ordinances have put a damper on value added redevelopment projects and apartment sales, and buyers are more interested in investing outside of the City of Portland.

Apartment Sales

Sales in Units:

2016: 285 sales

2017: 205 Sales

Sales in Dollar Volume:

2016: \$3,400,000,000

2017: \$1,400,000,000

2016 was an unusual outlier and reflected one of the regions most active years. Mark and Patrick Barry believe that we are getting back to a more normal market place and pace of sales.

Median Price per Unit:

- Median price per sq ft have hit record values
- Apartment values have more than doubled since 2010

The median sales price for older units is about \$140,000 per unit depending on fundamentals, but in some rare instances of location and income/expenses, some older units have sold for as high as \$231,000 per unit.

Portland Metro Median Price/SF by Quarter: 2008-2017



Unreinforced Masonry Buildings

These older unreinforced buildings may lose value. The City of Portland issued a report published in December 2017 - which included 200 + apartment buildings. These mostly brick buildings will need seismic retrofits, estimated at \$61 -\$75 per foot, though some one story buildings might cost as little as \$25 per foot. Total number of buildings in Portland that will need retrofits is estimated at 1,884. This could reduce property values on URM buildings by as much as 5%.

2018 - The Future

- The Urban Land Institute (ULI) has valued Portland as the 13th best overall real estate market in the USA
- Rental increases seem to be slowing down
- Vacancy rates are expected to be at 5 or 5.5% vacancy by end of 2018
- Expected 2% job growth – 24,000 new jobs for 2018
- In 2019, 1% or 12,000 additional jobs are forecasted
- Hyper supply - increasing vacancy rates, low absorption, low to moderate rent growth
- We are closing in on the end of the current growth cycle

2018 - Stability

- Interest rates will be up at least 50 points in 2018
- There is a projected slowdown in employment
- Population growth should remain stable
- Home ownership rates will keep going up

Apartment construction will complete the existing round of projects but new permit applications will be anemic with the huge number of permits already in the pipeline. In summary, the apartment marketplace has been very strong, with out of state demand pushing sales values. If job growth and immigration does not materialize in 2018, vacancy rates are sure to rise, and rents will drop to encourage renters to move in. New projects will continue to struggle to find tenants as millennials start changing course from apartment living to home ownership, attempting to achieve the American Dream.



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