

The Barry Apartment Report is a publication covering economic, financial, and valuation trends impacting apartments in the Portland, Oregon metropolitan area.

2012 Forecast - Strong Apartment Market to Continue

Current Portland Metro Trends

- Unemployment: 9.0%
- Job Growth: 1.2%
- Population Growth: 0.8%
- Portland-Salem CPI: 2.6%
- Apartment Construction A new construction cycle is starting; permits up 70% from 2010
- Apartment Sales: 2011 sale transactions up 25% from 2010
- Apartment Values: down around 10% to 15% from the peak in early 2008
- Apartment Income: Up 2% to 3% in 2011
- Apartment Vacancies: 3.3%

This issue of the Barry Apartment Report is based on the recent speech given by Mark D. Barry, MAI, Apartment Appraiser, with research and professional contribution from Phillip E. Barry, Apartment Broker.

In early 2011, there was optimism that we were on the road to a more rapid economic recovery. However, the expansion in Portland and the US slowed down in 2011. Issues that impacted the economy in 2011 were slower than expected job growth, the European debt crisis, a stalemate over the US debt, the Japanese earthquake, and US wage rates increasingly becoming more uncompetitive now that many jobs—not just manufacturing jobs—can be transferred to lower cost markets overseas.

So what is happening here?

Portland Economy: Good news in 2011 includes Intel starting a \$4 billion plant in Hillsboro, Vestas building a \$66 million headquarters project in the Pearl, Solorworld expanding to 1,000 jobs in Hillsboro, Damler adding 350 jobs, and 250 new jobs

at the Affiliated Computer Services call center in Tigard. However, the latest employment report shows that we added just 11,400 jobs over the last year, with a stubbornly high unemployment rate of 9.0%. From



6/11 Sale- \$279,356/Unit
132 unit Kearney Plaza Apartment
931 NW 11th Avenue, Portland

the peak in 2008 to the trough in early 2010 Portland metro lost 80,000 jobs. We are now three years into the recovery, with just 20,000 new jobs from the trough.

Apartment Construction: 2011 saw an obvious pickup in apartment construction. Permits have been issued for 1,559 new apartment units in the four county metro area for YTD 2011 through October vs. 1,100 in 2010, and an average of around 4,700 units per year for the metro area for the five years prior to 2009. Half of the 2011 apartment construction activity is in the close-in



90 Unit 20Pettygrove Apartments
NW Pettygrove St. at NW 20th, Portland

urban area, with 25% in Clackamas County, and the balance split between Washington and Clackamas Counties. **Holland Partners alone accounts for one third of the YTD 2011 permits!** This includes their 190 unit Living Green Apartments in Hillsboro and their 324 unit Brenchley Estates project in Wilsonville,

Single Family Market: The median sales price is \$217,800 as of October 2011, which is down 28% from the peak in August 2007. There are 6.8 months of inventory vs. 10.7 months a year ago. Single family construction is exceptionally slow. Permits were issued for just 2,456 new homes through October 2011 vs. 3,137 homes in 2010. This is in comparison with an average of 9,400 homes built per year from 2003 to 2007.

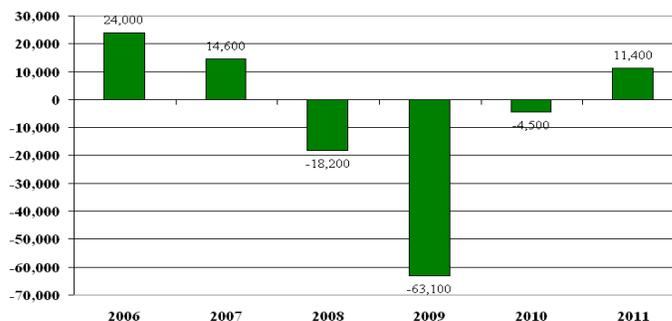


12/11 Sale- \$53,571/Unit
28 unit Court Louise Apt.
13059 SE Powell Blvd.

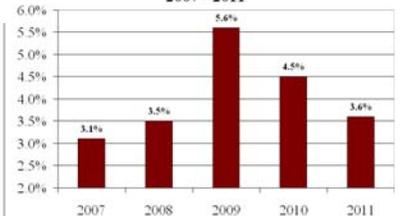
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PMSA Wage & Salary Employment Annual Change 2006 - 2011



Portland Area Apartment Vacancy Rates 2007 - 2011



Apartment Vacancies and Rental Rates: The US Census Bureau reports that the Portland area has a 3.1% apartment vacancy factor, or one of the lowest in the nation as of the end

of the third quarter. The Fall 2011 MMHA Apartment Report shows a 3.3% apartment vacancy factor. Of the 20 submarkets surveyed, **18 are showing an apartment vacancy factor of 4% or less.** While turnover rents are up around 8% over the last year, the actual income at most apartments we see is up between 2% and 5%. However, the actual income for more recent months shows some obvious improvement.

Apartment Expenses: The detailed MMHA apartment operating expense surveys show that overall operating expenses increased by around 8% from 2009 to 2010, though this may overstate the true increases. On site management, utilities, and turnover expenses show the biggest increases, while advertising expenses have declined. Portland voters turned down the \$548 million school levy by a razor thin margin, and averted a 9% increase in property taxes.

Apartment Values: It is often difficult to make a meaningful comparison on apartment value trends over selected periods due to significant physical and locational differences in the apartments which have sold. However, the Portland area showed about a 15% to 25% decline in apartment values from the peak of the market to the trough. Cap rates showed an increase from 6.1% in 2008 to 6.8% in 2009 and 2010. However, Co Star figures show a 6.86% median cap rate median cap rate for the first half of 2011, and 6.70% for the sales since July 2011. Thus, overall cap rates have come down about 15 basis points, though this can vary widely.



Apartment Sales Volume: In looking back, we can now see that 2006 to 2008 was the golden era for apartment brokers, with an average of around



6/11 Sale- \$113,636/Unit
44 unit St. Francis Apartments
526 NW 21st Avenue, Portland

\$960 million in apartment sales volume per year, and an average of 225 apartment sale transactions per year. This was the era of escalating values and easy credit, with many buy and flip investors. Our apartment sales volume was around \$285 million in 2009, with just 81 sales, and \$600 million in 2010, with 113 sales. Based on the apartment sales for YTD 2011, **we can expect around \$650 million in apartment sales, and 150 to 160 sale transactions.**



FORECAST FOR 2012

So where is our apartment market going in 2012? Some thoughts are as follows:

Economy: The economy is growing at a frustratingly slow pace and employment gains are not strong enough to bring down the unemployment rate quickly. The housing sector and cutbacks in public employment are a drag on the recovery. There are at least six reputable organizations that forecast employment figures for Oregon. If you assume that employment in the Portland area will grow consistent with the state, the median forecasts are for around **18,000 new wage and salary jobs here in the Portland metropolitan area in 2012, and 25,000 new jobs in 2013,** but that employment will not reach pre-recession levels until 2015.

Apartment Construction: Many developers are champing at the bit to get back in the game, and trying to get their project to make sense in light of low cap rates for investment grade apartments, and the amount of capital chasing after newer stabilized projects. Financing is more readily available, and the word is out that the apartment market is the place to be. **We expect to see permits for 2,000 to 2,500 new units in 2012,** with half of the construction activity in Multnomah County. While this is below the trend line of the five years ended in 2008, we will see double the apartment construction in 2012 that we saw in 2010. We expect that half of this apartment construction will have public sponsorship or participation.



209 Unit Block 49 Apartments
South Waterfront, Portland

Apartment Vacancies and Rental Income: Apartment vacancies should remain in the **3.0% to 3.5% range,** but start to increase in 2013 in conjunction with new units coming on line. **We need 5,000 to 7,000 new apartment units for the market to get back in balance,** and it will take developers three years to produce this much supply. In 2012, **apartment income will be up by 3% to 5%,** with this same trend continuing through 2014. **There will continue to be a shortage of apartments in 2012 and 2013** in conjunction with a better economy and slow apartment construction.

Apartment Values: Apartment values stabilized in 2011. **We expect that apartment values will remain stable in 2012** due to low interest rates, low vacancies, stable apartment income, and anticipation of better times in 2012. Everyone expects apartment income to increase. The real concern is that interest rates will also increase, with a corresponding increase in cap rates.

Apartment Sales Volume: In 2009 and the first half of 2010, we saw the lowest level of apartment sales activity over the last decade, with an obvious improvement

in the second half of 2010 and 2011. Apartment are clearly the favored asset class in Portland and across the nation. **In 2012 and 2013 we will be well on our way to seeing \$700 to \$800 million in apartment sales, and 175 to 200 apartment sale transactions per year.**



9/11 Sale- \$73,611/Unit
18 unit Kings Five Apartments
1684 8th Avenue, West Linn

Risks: The biggest risk facing the economy as well as the real estate market is the **sovereign debt crisis in Europe, and the risk of a double dip recession.** Also, an increase in interest rates, which usually translates into higher cap rates, could result in lower values. Also, some buyers of larger newer complexes have acquired the property in a bidding war, and low interest rates have encouraged investors to take more risk.

CONCLUSION: No one expects a sharp rebound in the economy, though the November national employment report of 120,000 jobs and 8.6% unemployment was encouraging. Unresolved problems



6/11 Sale- \$90,476/Unit
21 unit Chardonnay Apartments
2162 NW Everett Street, Portland

with huge deficits, high unemployment, and a tough single family market are issues of concern. We expect a slow recovery in 2012 and 2013, but we will have to wait until 2014 and 2015 for any significant economic recovery. Apartment construction

will pick up, which will result in very modest increases in apartment vacancies in 2013 and 2014.

The apartment market has everything going for it, with increasing rents, increasing income, low vacancies, financing which is readily available, relatively slow apartment construction, and good investor demand. In addition, the word is out that apartments are the place to be and are the favored asset class among investors, and Portland has one of the healthiest apartment markets in the nation. This will continue in 2012 and 2013. **I think we are going into a two to four year sweet spot in the market and the real estate cycle.** To sum it all up, I expect that the apartment market will be much stronger in 2012 and 2013 in conjunction with the low vacancies, a stronger economy, and only moderate increase in supply well below the trend line.



10/11 Sale- \$56,250/Unit
48 unit Royal Crest Apartments
11700 SW Allen Blvd., Beaverton

HEARD ON THE STREET

"In four to five years, we're going to overbuild the apartment market. The demand is going to support maybe a dozen new projects. And, of course, the developers are going to build 20." Jerald Johnson of Johnson Reid, LLC.

"In the past, I could borrow about 85% to 90% of the cost to build a new apartment. Now, I can borrow about 60%. Everyone is more risk sensitive, more risk averse." Dwight Unti, Tokala Properties.

"There is currently a shortage of 10,000 to 12,000 apartments." Brian M. Owendoff, Capacity Commercial Group.

"Oregon's economic expansion has been put at risk by external factors—most notably the sovereign debt crisis and the unfolding recession in Europe. The threat of a renewed global recession is uncomfortably high." Oregon Economic Review.

"We will see 25% to 35% rent growth over the next three years." Clyde Holland, Holland Partner Group.

"We're seeing the burden be higher on tenants to maintain their housing," said Elisa Harrigan, executive director of the Community Alliance of Tenants. "People's incomes aren't growing at the same rate as the rental price and government services are being cut. Things were bad before, but they're worse now."

"We could be on the cusp of seeing a dramatic rent increase." Bernard Gehret of Joseph Bernard Investment Real Estate.

"I wonder whether we'll say 2008 wasn't the real crisis—it was a warm up, but the real crisis was the sovereign debt crisis in Europe." Simon Johnson, MIT economist.

"Don't get rolled by the good times." T. Barry Brenneke, GMC Properties.

"While increasing rents would seem to be relatively easy with vacancy rates so low, a lack of qualified residents has some landlords nervous" said Craig McConachie, President of C & R Real Estate Services. "Delinquent rent and collection problems are plaguing class C apartment owners, as tenants struggle to find work and maintain income levels."

"I've been sitting back until I felt the time was right to get back in the marketplace," said Bob Ball, in conjunction with the announcement in December 2011 of his 177 unit The Parker Apartments to be built at NW 12th Avenue at Pettygrove. "If you have the right product and the right amount of land, I think the rents are there to support it."

"Real estate cycles tend to unwind very slowly, and this one shows no sign of being any different. It may take years because the run-up in housing prices was so extreme." Charles Royce, The Royce Funds.

The Barry Apartment Report

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Turn Back the Clock . . .



***1938**– The City Council held hearings to determine if the city should establish an agency to operate under the rules established by the U.S. Housing Act of 1937. The proposal was opposed by the Oregon Apartment House Association, the Portland Realty Board, the Portland Chamber of Commerce, and Portland Home Builders Association.



8/11 Sale– \$57,462/Unit
18 unit Rosewood Station Apartments
312-318 SE 160th Avenue, Portland

***1942**– The newly formed Housing Authority of Portland begins developing

affordable housing projects like Columbia Villa and Vanport City. WW II fills them with 100,000 workers, who built 20% of the US warships.

***1963**– HAP invited President John F. Kennedy to Portland to open the 180 unit Northwest Towers Apartments in northwest Portland, a federal housing project. HAP was forced to cancel his visit when the NAACP threatened to picket because of discrimination against blacks applying to rent apartments. Local leaders, including Senator Wayne Morse, labeled the NAACP's actions as "reckless."

***1995**– An abandoned dairy becomes Portland's first marquee infill development. The Belmont Dairy, with 85 apartments, is at 3340 SE Morrison Street.

2003– Bulldozers knock down the 462 unit barracks style Columbia Villa in anticipation of the 854 unit, \$150 million New Columbia.



8/11 Sale– \$46,471/Unit
34 unit Park Apartment
760 SE 10th Avenue, Hillsboro

***2007**– "Since the first quarter of 2006, nearly 90 eastside buildings underwent condo conversion. In the northwest and southwest parts of the city, there were over 30 condo building conversions between 2000 and 2005. Since the first quarter of 2006, at least 34 buildings have been converted!" *Phil Oester, Hendricks Partners in the Fall 2007 MMHA Apartment Report.*