

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

2011 Forecast - Strong Apartment Market Despite A Weak Economy

Current Portland Metro Trends

- Unemployment: 10.7%
- Job Growth: -0.5%
- Population Growth: 0.8%
- Portland-Salem CPI: 1.6%
- Apartment Construction: Dead; at record low levels
- Apartment Sales: Sales volume down 55% from 2005-2008, but up 85% for 2010 vs. 2009
- Apartment Values: down around 15% to 25% from the peak in early 2008; stable for 2010
- Apartment Income: Flat
- Apartment Vacancies: 4.0%

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

A year ago, there were high hopes that our economy had hit bottom, and that by this time we would be well on the road to recovery. There was great optimism when we added jobs in April, May, and June. The recovery slowed down in the summer, but has picked up some steam the last two months. Issues impacting the Portland economy are a lack of any job growth, high unemployment, slow single-family sales, and a relatively high foreclosure rate. So what is happening here?

Portland Economy: Good news in 2010 includes Intel planning a \$4 billion plant in Hillsboro, Vestas deciding to move forward with a \$66 million headquarters project in the Pearl, IBM announcing that they will add 600 jobs in Beaverton, and Daimler announcing they will continue

manufacturing trucks at their Swan Island plant. This Intel plant will be the largest construction project in the history of Oregon. In addition, that latest employment report



12/10 Sale- \$227,642 Unit
123 unit 2121 Belmont Apartment
2121 SE Belmont Street, Portland

shows that we added 6,700 such jobs in Oregon in October, and 6,300 jobs in November. Portland added 2,700 jobs in October, but the November job figures were flat. However, we have actually lost 4,500 wage and salary jobs in the metro area over the last year, and our unemployment rate is a stubbornly high 10.7% vs. 10.6% a year ago.

Apartment Construction: 2010 will go down as the slowest year for apartment construction since the early 1960's. Permits were issued for just 737 apartment units in the four county metro area for YTD 2010 through November vs. an

average of around 4,000 units per year for the previous ten years. **Apartment construction is dead!**

Single Family Market: Home values fell by 8.5% in 2008, 9.8% in 2009, and 2.5% in 2010. The median sales price is now \$233,000, with 10.2 months of inventory. Home sales are down, with 2010 the slowest in a decade. Single family construction is exceptionally slow. Permits were issued for just 2,900 new homes through November 2010 vs. 2,669 homes in 2009. This is in comparison with an average of 9,400 homes built per year from 2003 to 2007.

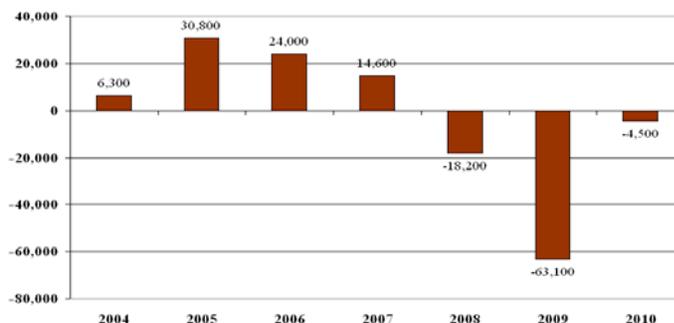
Apartment Vacancies and Rental Rates: The US Census Bureau reports that the Portland area has the second lowest apartment vacancy factor in the nation as of the end of the third quarter. The MMHA Apartment Report shows a 4.0% apartment vacancy factor as of the Fall of 2010. Rents were reported to have dropped by 1.0%. Apartment vacancies are under 5.0% in 18 of the 20 submarkets surveyed, with only Wilsonville and E. Vancouver showing vacancies over



10/10 Sale- \$69,455 Unit
11 unit Apartment
7625 SW Garden Home Road



PMSA Wage & Salary Employment Annual Change 2004 - 2010



5.0%. Apartment vacancies have declined despite a weak economy. This is due to a lack of any new supply, some natural growth, a decline in the proportion of homeowners, and population and job growth among the 20 to 34 year old Echo Boomers, who are most likely to rent. Income at most

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apartments is basically flat. **Apartment income has held up well in light of the economy.**

Apartment Expenses: The rapid acceleration of expenses in recent years is truly amazing. Keep in mind that Portland CPI was 0.1% last year, and 1.6% this year. But property taxes in Portland are up around 4.5% percent per year over the last four years, while utility cost increases have gone up around 8% to 10% per year. With a flat income, and expenses up around 10% in two years, net income is down by 5% to 8%.

Apartment Values: A flat income, some increases in expenses, and higher cap rates have impacted apartment values in the US and the Portland area in recent years. Cap rates showed a noticeable increase in the second half of 2009 in comparison with the first half. Our analysis shows an overall decline in apartment values of 15% to 25% from the peak in late 2007 and early 2008. However, overall apartment values have firmed up and been stable in YTD 2010, which I attribute to such low interest rates. Co Star figures show a 7.39% median cap rate for the second half of 2009, and a 6.75% median cap rate for 2010. Thus, cap rates have come down about 65 basis points.



Apartment Sales Volume: In looking back, we can now see that 2005 to 2008 was the golden era for apartment brokers, with an average of almost



11/10 Sale- \$65,800 Unit
15 unit Hart Ridge Apartments
16595 SW Hart Road, Beaverton

\$900 million in apartment sales volume per year, and an average of 225 apartment sale transactions per year. Our apartment sales volume was around \$285 million in 2009, with 81 sales. However, a very strong fourth quarter in 2010 resulted in around \$525 million in apartment sales volume in 2010, with just over 100 sales. While apartment sale activity in 2009 and 2010 was well below the peak years, the good news is that there was a noticeable improvement in 2010. Sales volume was up by around 85%, and the number of transactions up by around 25% in comparison with 2009.

FORECAST FOR 2011

So where is our apartment market going in 2011? Some thoughts are as follows:

Economy: The recovery is limping along as we start the first quarter of the new year. 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 **15,000 new wage and salary jobs here in the Portland metropolitan area in 2011, and 25,000 new jobs in 2012**, but that employment will not reach pre-recession levels until 2015.

Apartment Construction: Some developers are sniffing around the urban area, 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. However, it is a very tough financing environment for new apartments. In 2009 and 2010, 20 banks in Oregon and Washington have failed. In light of residential and commercial real estate accounting for the biggest problem area with failed banks, I don't think we are go-

ing to see much apartment construction in 2011. Most apartment lenders head the other way when they see a developer. There will be some well-capitalized private developers who want to have their product in place for when the economy turns, but they will need to provide 40% to 60% of the costs, and sign with recourse. There also will be some government sponsored urban projects. **I expect we will see permits for 1,500 new units in 2011**, with most of the construction activity in Multnomah County. While this is way below the trend line of the last 40 years, we will see double the apartment construction in 2011 that we saw in 2010. I expect that half of this apartment construction will have public sponsorship or participation.



9/10 Sale- \$45,217/Unit
23 unit Hunters Highland Apartments
855 SE Hogan Road, Gresham

Apartment Vacancies and Rental Income: The first part of 2011 will be a time to concentrate on keeping tenants happy, holding on to what you have, burning off concessions, bringing those tenants with below market rents up to market, and testing some new rent levels on turnover. In light of the unemployment rate being north of 13% in Clark County, and north of 10.5% in the Oregon counties of the metro area, I do not feel landlords are going to try to be aggressive on rents due to the fear of pushing their tenants out the door, and the high costs of turnover. **Apartment vacancies should remain in the range of 3.5% to 4.5%.** But income will remain flat in the first half of 2011. Looking beyond mid 2011, apartment income should rebound quickly once the economy turns around due to the pent up demand from Echo Boomers in the 20 to 34 year old age group living at home and doubling up. **There will be a shortage of apartments and a spike in rents in 2012 and 2013 in conjunction with a better economy.**

Apartment Values: Apartment values stabilized in 2010. I expect that apartment

values will remain stable in 2011 due to low interest rates, low vacancies, stable apartment income, and anticipation of better times in the second half of 2011 and 2012. When the economy improves, everyone expects apartment income to increase. The real concern is that interest rates will also increase, with a corresponding increase in cap rates. Expect to see typical cap rates of 6.25% to 7.50% for B and C suburban apartments, and about 50 to 75 basis points lower in the urban area.

Apartment Sales Volume: In 2009 and the first half of 2010, we saw the lowest level of apartment sales activity over the last decade. The next two years will be a better environment for apartment sales. In addition, the lending environment should improve as money center banks continue to strengthen their balance sheets. We like to think that **in 2011 and 2012 we will be well on our way to seeing \$600 to \$800 million in apartment sales, and 150 to 200 apartment sale transactions.**

Risks: The risks facing the apartment market include an increase in interest rates, which usually translates into higher cap



11/10 Sale- \$73,333/Unit
30 unit Plymouth Apartments
1230 NW 21st Avenue, Portland

rates, and thus lower values. Other risks include a double dip recession, a continuing decline in housing values in conjunction with low interest rates that could make single family home more affordable in comparison with apartments, and an out of the blue random event.

CONCLUSION We were shocked to the core in 2008 and 2009. Nobody expects a sharp rebound in the economy, though the October and November employment reports were encouraging. Unresolved problems with huge deficits, high unemployment, consumer debt, and two wars are too

much to overcome in the short term. In addition, residential and commercial real estate construction is not going to lead the economy back to health as has happened after other economic downturns. We expect the economy to be lackluster in the first part of 2011, with some limited signs of recovery in the second half of 2011, but no real recovery until 2012 and 2013.



7/10 Sale- \$56,250/Unit
16 unit Brookside Village Apartments
2123 NE Kane Drive, Gresham

Apartment construction will remain slow, which will help in maintaining low apartment vacancies. We expect apartment income will be flat up until mid 2011, but much stronger in the second half of 2011 and 2012. Close-in and in-fill apartments are clearly favored over fringe suburban apartments.

The economy has hit bottom, and is starting to improve. However, **apartments are the favored asset class among investors, and Portland has one of the healthiest apartment markets in the nation. This will continue in 2011.** To sum it all up, I expect that the apartment market will be stable but flat in the short term, but much stronger in 2012 and 2013 in conjunction with a better economy.



7/10 Sale- \$71,607/Unit
28 unit Reedville Meadows Apartments
2855 SW 209th Avenue, Aloha

HEARD ON THE STREET

“The recovery is in place, but the feel good part of the recovery isn’t going to come until mid 2011 at the earliest.” Tom Potiowsky, Oregon state government chief economist.

“Remember that all investors should fear the consequences of mindless US deficit spending as far as the mantis eye can see. Higher inflation, a weaker dollar, and eventual loss of America’s AAA sovereign credit ratings are the primary consequences.” Bill Gross, PIMCO in his January 2011 Investment Outlook.

“If you want to hit the market, you need to come out of the ground now.” Tom DiChiara, on his 179 unit Savier Flats Apartments proposed for 2244 NW Savier Street.

“Main Street—the homeowners, small businesses—did not get bailed out. They are still in deep, deep trouble. Most Americans don’t feel this recession is over.” Charles Reich, Clinton Labor Secretary.

“We continue to drink from a fire hose in terms of humility.” Jordan Schnitzer, Harsch Investments.

“We all knew that there would be a housing hangover from the expiration of the tax credit. But this takes your breath away.” Mike Larson, Weiss Research.

“This is a function of Opus and the bank trying to take advantage of a red hot market right now, “ said Tom Parsons of Opus Northwest, after the 220 unit Ladd Tower went on the market. “When a building like this goes for sale, there will be 50 offers.”

“If I were a 29 year old kid moving to Portland, this is where I would live. This is the very epicenter of where the creative class lives.” Jim Winkler, after his purchase of the Mississippi Lofts at 4216 N. Mississippi Avenue.

“Was this a pleasant time to be in the real estate industry? No. Was I scared? Yes. Anybody who says they weren’t is fooling themselves.” Jordan Schnitzer, Harsch Investments.

The Barry Apartment Report

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Turn Back the Clock . . .



***1905-** The building located on the corner of NW 26th and Vaughn Street is the last standing from the centennial celebration of the Lewis and Clark expedition in 1905. It was once a grand hotel and is now an apartment complex. Some of the residents over the years have reported seeing apparitions late at night. The Fairmount Apartments made the list of Oregon's Haunted Hotspots.



12/10 Sale- \$84,375/Unit
96 unit Markana Apartments
8585 SW Canyon Lane, Portland

***1907-** In 1907, Boyd McNaughton, future president of First National Bank cited the "fever of speculation" as creating "a riot" in Portland. From 1900-1910, Multnomah County's property assessments increased over 500%.

***1932-** In his article about Portland apartments, Claude Bristol writes: "Most kitchens have no room to turn around in, nor do they have windows; the entrances to the buildings are often deceiving as to their luxuriousness; and too much racket is going on in and around the buildings."

***1960-** Robert D. Randall and his wife Marcia purchase a duplex at 18680-18682 SW Shaw Street in Aloha, Oregon. They paid \$8,500, with \$1,000 down, and lived in one side and rented out the other. From that humble beginning, Mr. Randall went on to build over 25,000 apartment units.



11/10 Sale- 54,545/Unit
11 unit Fern Hill Apartments
2325 SE 174th Avenue, Portland

***2005-** "Build it and they will come. Actually, don't even break ground and they will come. If the Portland real estate market is hot, the Portland condo market is on fire. The demand for lofts and condos in Portland continues to amaze. The John Ross started taking reservations by appointment last Saturday. 220 of 286 units are sold!" *Portland Loft and Condo Update.*