

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

2009 Forecast - Recession To Impact Portland Apartment Market

Current Portland Metro Trends

- Unemployment: 6.9%
- Job Growth: -1.1%
- Population Growth: 1.3%
- Portland CPI: 3.9%
- Apartment Construction: Slow
- Apartment Sales: Sales volume down 40% from 2007, a record year
- Apartment Values: up around 2% in 2008, but a decline in the second half
- Turnover Apartment Rents: Up 4% to 8%, but income up 2% to 6% in 2008
- Apartment Vacancies: 4.0%



This issue of the Barry Apartment Report is based on recent forecast type speeches given by Mark D. Barry to the Metro Multi Family Housing Association (MMHA), the Oregon/SW Washington CCIM Chapter, the HFO Investors Roundtable, The Rental Housing Association, and the Tivor Title Commercial Breakfast

On New Years Eve, I made a stiff drink, sat down in my living room, and raised my glass to say, **Thank God It's Over!** We made it through the setbacks of 1974-75, that terrible recession in the early 1980's, the stock market crash of 1987, and the dot com bust and slowdown after 9/11/01. But 2008, particularly the second half, was as tough as I have ever seen it. Any one of the seismic or category five hurricane type events of 2008 would have been remarkable on its own. However, the fact that they all occurred in the same year means that we are part of a once in a lifetime phenomenon that will not only change our financial landscape, but which is having a

major impact on the investment real estate market. So what happen here in 2008?

Portland Economy: The Portland economy peaked in March 2008. Since then, we have lost 15,500 jobs. Our current unemployment rate is 6.9% vs. 5.0% a year ago. These job losses have been broad based, and spread through all major sectors, with the exception of health care and education. 76,000 Portland area residents are now unemployed and looking for work, up 23,000 from a year ago.

Apartment Construction: 2008 saw continued slow construction, particularly in Clark and Clackamas county. The figures for 2008



should show permits for around 3,300 new multifamily units. About 80% of the activity is in Multnomah County. The three Trammel Crow

Residential projects with 850 total units as well as subsidized apartments account for around half of this construction.



Single Family Market: A year ago, Portland was considered one of the best single family markets in the nation. Median home prices jumped 72% from 2000 to 2006, while income had increased just 10%. While this market is holding up better than most other metro areas, 2008 was a tough year. Single family home prices are down 10.1% from a year ago, though well below the decline of 18.0% from the Case Shiller Home Price Index of 20 metro areas. Closed sales in Portland are down 32% in 2008. The December 2007 auction of 240 homes by Buena Vista Custom Homes was the first sign of a major problem. Since then, some of our largest single family builders, including Legend Homes, Pacific Lifestyle Homes and Renaissance Homes have sought bankruptcy protection. Based on the current level of depressed sales, these is 15 months of inventory. In 2008, permits were issued for 3,800 new homes.

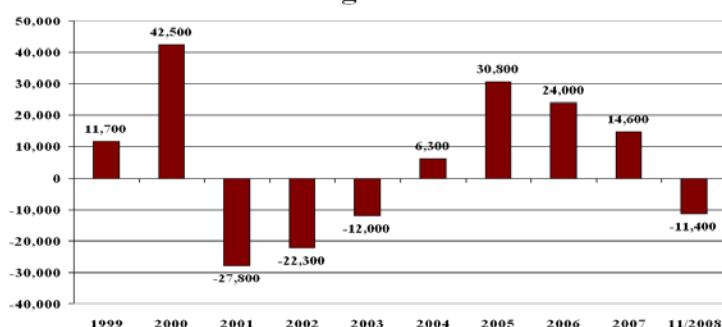
9/08 Sale- \$104,878/Unit
43 unit Wescott Court Apts.
1517 NE 8th Avenue

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PMSA Wage & Salary Employment Annual Change 1999 - YTD 2008

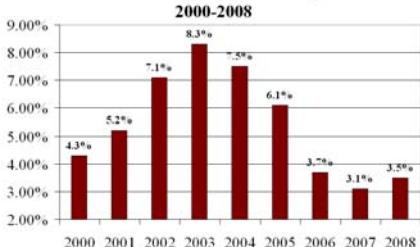


Apartment Vacancies and Rental Rates

Rates: Apartment vacancies were reported at 3.6% in the Fall 2008 MMHA Apartment Report. However, with a rapidly deteriorating economy, apartment vacancies are now felt to be closer to 4.0% to 4.5%. The apartment market has been close to a

model of stability compared with the single family or condo market. Turnover rents were up in the 4% to 8% range, while 2008 income at most apartments was up between 2% to 6%. In my opin-

**Portland Area Apartment Vacancy Rates
2000-2008**

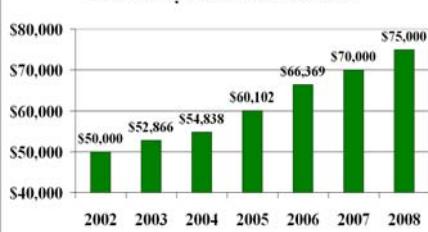


ion, **the biggest reason for a healthy apartment market in both Portland and across the nation is due to the decline in the rate of home ownership.** Home ownership rates in Oregon hovered around 63% to 65% since the mid 1980's until the recent housing bubble, when it peaked at 69%. The most recent data shows that 65% of Oregon households are now home owners. Thus, **around 6% of the people who owned homes a few years ago are now renters.**

Apartment Expenses: Most operating expenses were fairly stable in 2008. Property taxes in most municipalities were flat after some horrendous increases in 2007. Insurance costs were stable, and a soft economy has resulted in only modest payroll cost increases. However, utility costs continue to see double digit increases, including 11% for water and sewer, 14% for electric, 14% for natural gas, and 10% for garbage. Advertising costs are way down due to lower apartment vacancies, and free sites such as *Craig's List*.

Apartment Values: The median price per unit in 2008 is clearly higher than seen in 2007. This is due to firm values

**Median Per Unit Sales Price
Four County Metro Area 2002-2008**



4/08 Sale- \$84,615/Unit
52 unit Silver Bells Apartments
12933-12941 SE Foster Road

in the first half of 2008. However, the average price per unit for apartments of \$10 million and over showed a 2.0% decline from 2007 to 2008. In addition, the financial crisis in the US accelerated in the second half of 2008. It is interesting to note that **the per unit and per Sq. Ft. value indicators are down about 10% in the second half of 2008 vs. the first half of the year.** In addition, cap rates increased by ten basis points in the second half of the year.

Apartment Sales Volume: 2008 was slow year in the local apartment brokerage community. As one broker described it, **"Buyers are on strike and sellers are in denial."** While there were 249 sale transactions of five units and over in 2007, there were 65% as many such sales in 2008. Many buyers are looking for dis-



tressed deals, but the problem is that there isn't enough distress out there! Buyers are seeing the problems in the economy and other sectors of the real estate market, and are expecting lower values. Very few sellers are highly motivated due to favorable occupancy and recent increases in income. Despite a relatively slow year for apartment sales, the level of apartment sales activity in 2008 looks

pretty good in comparison with the very slow year for sales in the retail, office, and industrial sectors.

FORECAST FOR 2009

So where is our apartment market going in 2009? My forecast is as follows:

Economy: Over the last twelve months, the number of unemployed in the US increased by 2.8 million to 10.1 million persons. November 2008 was a particularly tough month, with a loss of 533,000 jobs, or the worst month since December 1974. Goldman Sachs and Citigroup are forecasting a loss of 4.1 to 4.3 million jobs nationwide from the December 2007 peak to the late 2009 or early 2010 trough. State of Oregon Economist Tom Potiowsky expects job losses of 1.5% in Oregon in 2009, with a weak turnaround in 2010. If this rate of job loss is applied to Portland, **this would result in a loss of another 15,000 jobs in 2009.** On a positive note, the FedEx distribution center in Troutdale, the Solarworld production plant in Hillsboro, and Vestas Wind Technology expanding their headquarters, could add 3,500 jobs by 2010. However, we will be losing 900 jobs with the closing of the Freightliner Swan Island truck plant. And a prominent analyst is forecasting that Intel will need to trim their US work force by 6% to 10%.

Single Family Market: There is not a lot of optimism for the single family market in the US or Portland for 2009. Wells Fargo's economist has identified Portland as the seventh most overvalued metro area in the country, and **is forecasting a decline of 11.9% in 2009. Fortune Magazine recently forecast a 14.8% decline for 2009, and another 4.8% decline in 2010.**

Condominium Market: The condo construction market and condo conversion market has come to a complete and total



halt in the face of an estimated 2.5 to 3.5 years of inventory based on slower sales activity. It would not surprise me to see a few projects go into receivership in 2009.

Apartment Construction: The competition for medium to high density sites from row house and condo developers is now non-existent, and the housing construction decline has pushed down prices for labor and materials. With a low apartment vacancy and increases in rents in recent years, some developers are looking at apartment development. However, a weak economy, conservative lending practices, and an aversion to risk should result in 2009 being another slow year for apartment construction. *I expect to see 2,500 to 3,500 new apartment units in 2009.*

Apartment Vacancies and Rental Income: Continuation of a tough single fam-



ily market in 2009 will help the apartment market. Offsetting this trend is the fact that around 3,000 units from the "shadow inventory" of homes, condos, and row-houses are now rentals, with more expected to come in 2009. In addition, a much tougher economy in 2009 will force some tenants to double up or move back home. Apartment vacancies crept up in late 2008, and this trend is expected to continue in 2009. A challenging economic environment is expected to make tenants more price sensitive. *I expect we will see an overall apartment vacancy factor of 5.5% to 6.0% a year from now, with a 0% to 2% increase in income.* The close-in urban market will remain in balance, with the higher vacancies concentrated in more expensive units and the more outlying suburban areas, particularly Clark County.

Apartment Values: 2008 was a year in which every major asset class—stocks, real estate, commodities, and even bonds—

suffered significant double digit percentage losses. There has been a re-pricing of risk among virtually all asset classes. Some investors have gotten into liquidity problems and were forced to sell illiquid assets to raise cash. Information provided by REIS shows a 17% decline in apartment values nationwide from the peak in the third quarter of 2007. Due to such strong investor and tenant demand, I expect that values of B and C type apartments in the urban area of Portland will remain stable in 2009. Class A suburban apartments and more outlying larger suburban apartments could face additional pressure on holding their values in 2009 for those who need to sell. If one assumes rent increases of 0% to 2%, a 5% to 6% vacancy rate, a 2% to 4% increase in expenses and a 25 to 50 basis point increase in cap rates, *this would result in a loss in value of around 5% to 10%.* If the credit market remains tough, and the economy continues to deteriorate, this is a possible scenario.

Apartment Financing: The days of 75% to 80% LTV, low debt service coverage ratios, and underwriting on pro forma are now over. Buyers and lenders are scrutinizing all of the details on each transaction. Apartment owners and brokers are bemoaning the uncertainty with the new Washington Mutual/JP Morgan, and what will happen to what was Portland's largest apartment lender. In 2009, 65% will be considered a good LTV. Apartment lenders will not be basing their pricing on the low yield Treasuries. *Expect to see higher interest rates and tougher terms in 2009.*

2008 also saw the bankruptcy of DBSI, a leader in tenant-in-common (TIC) real estate transactions. Some 8,500 investors, including many Portlanders, were involved with 240 commercial properties valued at \$2.4 billion in 30 states. Also, the collapse of Land America 1031 Exchange has left 400 investors with \$400 million in deposits wondering if they will get their money back, and if they do, if it will arrive in time to complete the 1031 exchanges 180-day deadline. Summit 1031 Exchange has also gone into bankruptcy. Uncertainty about the future will result in a reduction in risk taking by individuals, lenders, and institutional investors.

CONCLUSION

In conclusion, what happens with the national

economy and the Obama administration's success in dealing with the financial crisis will impact all real estate markets in 2009. *I expect a very tough economy in 2009, with some light at the end of the tunnel late in the year, but no real recovery until 2010.* The apartment market is better positioned to hold its own in 2009 than other commercial real estate markets. However, *apartment vacancies are expected to increase in 2009 and the re-pricing of risk could impact apartment values here in Portland in 2009.*

"I wouldn't be surprised to see double digit unemployment in Oregon in 2009" said Oregon State University economist Patrick Emerson. "I think the entire of 2009 could be characterized by a painfully severe recession in Oregon and the United States."

"It's going to be a painful next year, but the forecast over the next five years is really healthy," said Tim Priest, CEO of Greenlight Greater Portland in their economic forecast for Portland. "We could bounce back really fast, and we're doing better than the other cities that we studied."

"Wall Street's flu came home to Portland's asset values," said Kirk Taylor of CB Richard Ellis in his IREM Multi-family Forecast for 2009. "Forecasted cap rates represent asset devaluation of 10% to 25% from 2007's intoxicating high values."

"The challenge is in finding ways to increase rents while the tenant pool becomes increasingly impacted by joblessness, bankruptcies, and poor credit." Carmen Vallarma, President of the Management Group in Vancouver.

The Barry Apartment Report

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Cycle Oregon—September 2008

Turn Back the Clock . . .



***1919** – Blaming a great part of the Spanish influenza condition on unheated apartments, Mayor Baker introduces an ordinance to require Portland apartment owners to provide minimum heating standards. The Association of Apartment House Building Owners and Managers opposes the heating ordinance, and questions its legality. *Oregon Journal* – January 23, 1919.

***1929** - “A meeting of more than 100 apartment owners was held to facilitate an association of apartment house owners. ‘The purpose was to place the apartment house owners on a strictly business basis, and for interchange of information between members,’ said G. W. Moyer, who became chairman”. *Oregon Journal* – March 1, 1929

***1946** – “Before executing the sale of an apartment building, the owner or agent must apply to the Bureau of Buildings for a certificate of multiple dwelling occupancy stating such occupancy is or is not

in conformity with the city ordinances. The premises will be investigated by the building bureau before a certificate of occupancy is issued.” *Oregon Journal* – August 25, 1946

***1981** - “The Metropolitan Human Rights Commission and the Multifamily Housing Council, which represents apartment owners in the Portland area, signed a four year agreement Tuesday designed



5/08 Sale- \$85,000/Unit
10 unit McKenzie Townhomes
9850 SW McKenzie Street, Tigard

to make more housing available to families with children. The agreement does not include a blanket pledge of non-discrimination against families, but the parties agreed to participate in programs designed to ensure families receive adequate information about housing where children are allowed.” *Oregonian* – September 16, 1981.

***1984** - GSL Properties from Albuquerque, NM purchased the 48 unit Eaton Village Apartments at 2500 SE 157th Ave. from Jim Brayson for \$1.2 million. This is their first Portland area investment.

***1991** - “A survey by Portland apartment brokers Dean McGregor and Mike Millette determined there is a 15.9% vacancy rate for metro area apartments built since 1987, up from 9.8% last fall.” *The Business Journal* – April 22, 1991.