



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

2018 Forecast: Some Signs of Weakness and a Return to Normal

Current Portland Metro Trends

- Unemployment: 3.6%
- Job Growth: 2.6%
- Population Growth: 1.2%
- Portland-Salem CPI: 2.1%
- Apartment Construction: Permits for around 10,300 units issued in 2017, or up 41% from 2016.
- Apartment Sales: 192 sale transactions in 2017 vs. 261 in 2016
- Apartment Sales Volume: \$1.70 billion in 2017
- Apartment Values: Up 20% to 25%
- Apartment Income: Up 3% to 5% in 2017
- Apartment Vacancies: 4.9%

This issue of the Barry Apartment Report is based on a recent speech given by Mark D. Barry, MAI and Patrick O. Barry, Certified General Appraiser.

From all indications, 2017 was a good year for the Portland apartment market. As we continue our return to a normal market, we saw increasing vacancies, a slow down in the pace of rental increases, a surge in apartment construction, but strong value increases.

Portland Economy: The local economy continues to shine. The Portland Metro added 27,600 jobs in 2017, exceeding expectations. The industries with the strongest job growth includes construction, professional services, education/health, hospitality, and government. The 2017 figures shows that Portland metro unemployment dropped from 4.3% to 3.6%. Most economists agree that Portland is at full employment.

Apartment Construction: With the implementation of



11/17 Sale—\$231,250 Unit
8 Unit Apartment
3005 SE Morrison Street, Portland

Inclusionary Zoning (IZ) pushing many developers off the sidelines. 2017 was busiest year ever for apartment construction, with only a short period in the early 1970's rivaling current activity. Permits were issued for 10,319 new apartment units in the four county metro area, versus 7,300 in 2016, or a 41% increase. Around 65% of the permits for new units were issued in Multnomah County alone. Clark and Washington County account for 17% and 13% of construction, respectively, while Clackamas County accounts for 5%. Construction activity remains very slow in Clackamas County, while apartment construction in East Multnomah County continues to show some signs of life.



Recently Completed
30 Unit — 30th & K Apartments
3009 NE Killingsworth Street, Portland

The surge in 2017 permits was driven by the February 1, 2017 implementation of IZ. Projects with 20+ units in the City of Portland must include a portion of their units as affordable. Many developers submitted projects just prior to February 1, 2017 to avoid the IZ requirements. Applications for new apartments in the City of Portland declined since IZ was implemented.

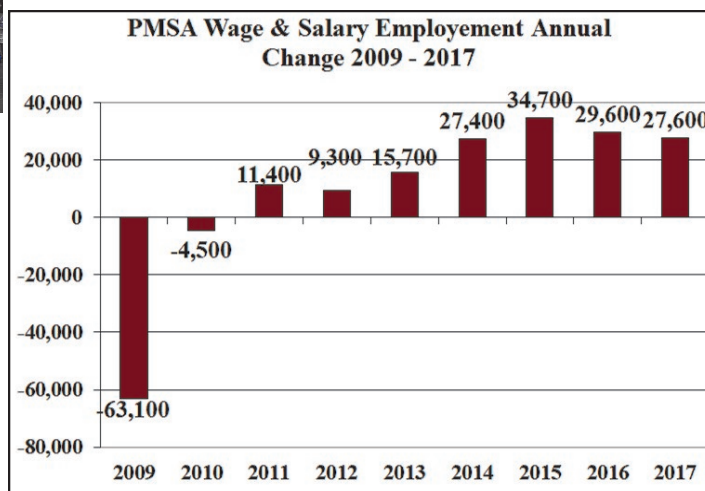
Apartment Vacancies and Rental Rates:

The latest *Multifamily Northwest Apartment Report (MFNW)* shows a 4.9% vacancy factor vs. 4.4% in Fall of 2017. Only 3 of the 20 submarkets showed vacancies below 4%, and vacancies are above 5% in six submarkets. The lowest vacancies were reported the outer areas of Multnomah County, while the highest vacancies were in the close-in urban submarkets. This MFNW Report concludes that turnover rents were flat year over year. CoStar also reports effective rents as flat year over year.

Apartment Expenses: Outside of City of Portland, property taxes were up a manageable 2% to 5% in 2017. However, with the passage of a 2016 school bond, property taxes in the city of Portland increased between 9-10%. In addition, maintenance and repair costs have increased due a booming construction industry luring away quality employees. Most other expenses showed little change from the previous year. However, as vacancies rise, some advertising and tenant retention expenses are making a comeback.



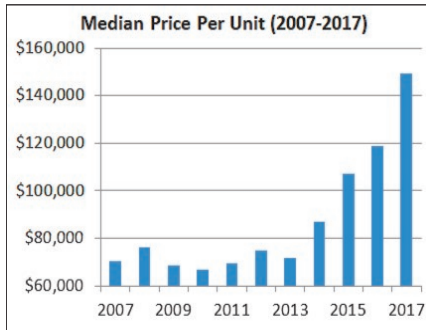
1/18 Sale— \$262,500 Unit
12 Unit East Bank Quarters
686 SE Spokane St, Portland



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Apartment Values: In 2017, apartment values showed little sign of slowing. When considering all sales across the metro area, median values were up 20% to 25%.

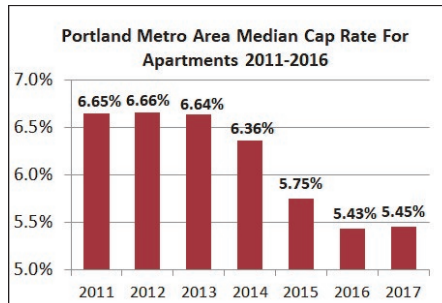


While values have risen across the entire metro area, not all increases have been equal. Clark County continues to show large value gains and vintage urban apartments rebounded from a dip in 2016.

While value increases may vary from submarket to submarket, there are virtually no areas that show flat or decreasing values. The Co-Star figures show a 5.45% median cap rate for 2017, which is flat from 2016. This would suggest little change in values if the net income were flat. However, income and net income have been increasing.

Apartment Sales Volume: If only compared against 2016, then 2017 appears to be a disappointing year. Apartment sales volume from 2017 was 44% below 2016 and the number of transactions were down 27% from 2016. During 2017, there were around 192 transactions, which represented around \$1.70 billion in apartment sales. While sales volume and transactions were off from the previous year, 2017

was the 3rd best year for sales volume and in the top 10 for number of transactions.



Portland remains on the radar of institutional buyers. At the same time, Portland has managed to maintain some of its "cool factor". ULI ranked Portland No. 3 for Overall Real Estate Prospects, Forbes' 2017 list of Best Places for Business and Careers listed Portland at No. 1., and US News & World Report ranked Portland as the 6th best place to live in the US.

FORECAST FOR 2018

With apartment construction boosted by IZ, completions in 2018 and 2019 will likely hit their peak this cycle. The impact of the new units will be seen in the market in the year ahead. Our thoughts are as follows:

Economy: The metro area job growth in 2017 was robust and exceeded expectations from expert forecasts. Transportation, business services, hospitality, education/health and government have shown strong job gains over the past 12 months. For the fifth year in a row, Portland had the highest national percentage of inbound moves according to United Van Lines. The moves to Oregon were driven by jobs (49% of in-bound moves) and proximity to family (24% of in-bound moves).

The most recent State of Oregon employment report forecasts job growth to be around 2.1 percent for 2018 and 2019. If you assumes that employment in the Portland area will grow consistent with the State, the baseline forecast is for around **25,000 new wage and salary**

jobs here in the Portland metropolitan area in 2018, and 25,500 new jobs in 2019. However, with a tightening labor market and low unemployment, personal income growth is expected to increase 5-6% annually in the coming years.

Single Family: The single family housing market showed little slowing in 2017. Forecasts call for increased housing starts in the coming years. As the prime cohort of renters age, a transition to homeownership is likely. The Portland metro homeownership ratio increased since 2016 and will likely continue. **It's important to remember that a 1.0% increase in home ownership means 9,000 fewer households are renting!**

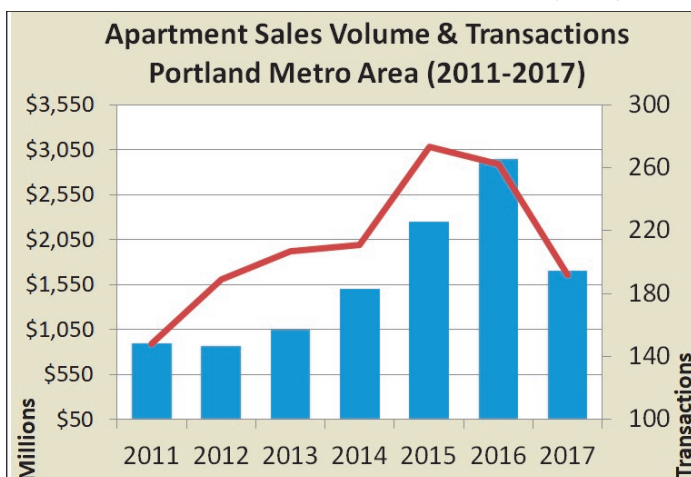
Apartment Construction: With a push from IZ, apartment permits issued surged in 2017, and represents **Portland Metro's busiest year ever**. The City of Portland reports that there are 1-2 years supply of pre-IZ apartments in the pipeline. Given the quantity of pre-IZ apartments that remain, **we expect there will be permits for 12,000 to 18,000 new units in 2018 and 2019**. Information through February 2018, shows 1,550 permits issued, which is 9,300 annualized. Most of the permits will be issued for projects with pre-IZ entitlements. Since the implementation of inclusionary zoning in Portland on February 1, 2017, applications for new projects plummeted. Twelve months after the IZ implementation, applications have been submitted for around 1,000 new apartment units in buildings with 20+ units.

After the pre-IZ projects have been exhausted, there is uncertainty as to whether a new batch of IZ compliant projects will continue to fill the pipeline. However, as supply has outpaced demand in recent years, a slowdown in permit applications may help the absorption of recently completed units.

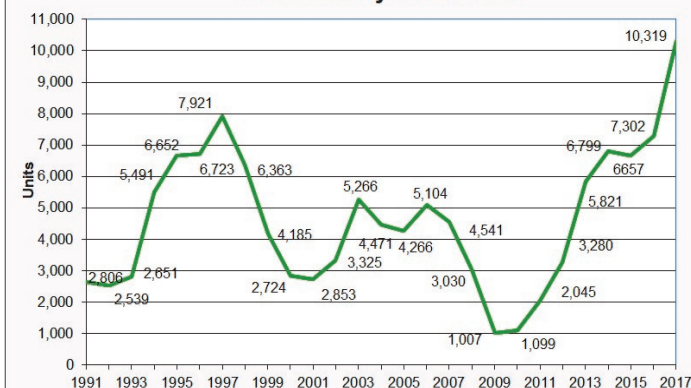
Rising labor costs are a real concern and some projects are no longer penciling out. A



3/18 Sale—\$112,963 Unit
27 Unit Griffin Court Apartments
15301-15353 SE Division St, Portland



Apartment Permits 1991 - 2017 Four County Metro Area



Source: US Census Bureau Building Permits Database

developer recently reported that between 2014 and 2018, the budgeted cost for labor and materials increased from \$156 to \$220 per Sq. Ft. for similar projects.

Due to rising land costs, increased regulation and costs in Portland, and rising vacancies in the urban area, **we expect to see more suburban apartment construction.** In the coming years This will include East Multnomah County, Washington County, and Clark County.

Apartment Vacancies and Rental

Income: In recent years, high vacancies were limited to areas seeing the most construction. Now, increased vacancies are being experienced across the metro area. Expect a further increase in vacancy rates, especially urban units, where construction has been most active. Most surveys agree that vacancies rates are currently between 4% and 5%, depending on how new units are accounted for.

Permits were issued for over 10,000 units in 2017, and historical Portland metro area demand is around 4,500 to 5,500 units. The current new supply is outpacing demand. The current levels of supply are



11/17 Sale- \$161,184/Unit
76 Unit Hallwood Apartments
7535 SW Hall Blvd, Beaverton

chipping away at any shortage of units that may remain, and pushing some submarkets towards a renters market.

We expect vacancies to approach 5.5% by the end of 2018.

Localized vacancies will continue in areas with above average construction and high end rents. A continued period of increased vacancies will eventually lead to more reasonably

priced units, though this transition does not occur overnight.

Concessions will continue to be prevalent until full occupancy is achieved at new units. Concessions will also continue their spread to seasoned units, especially units that compete with the lower end of the range for new apartments.

We expected 2018 to be another year of transition to a market more in balance, especially in the urban core. Many owners and managers seem content with re-renting a unit at a similar rate, assuming it was at market. We expect apartment income will be up by 1% to 4%. **By the end of 2018, we expect the market to be in balance across the metro area, with some submarkets seeing a shift in power to the renters, especially at the high end.**

Apartment Values: Apartment values showed an another strong increase in 2017. With a strong economy, there is continued optimism for 2018. Given the rate of value increases in recent years coupled with increased vacancies, modest rent increases, and increasing interest rates, we expect slower value overall increases. Through early April 2018, there have been 53 sales and values are flat compared to 2017.

The Federal Reserve raised interest rates three times during 2017. Experts are expecting three increases in 2018 given the strong fundamentals in the US economy. **We expect increasing interest rates will result in a flattening out of apartment values in 2018.**

Apartment Sales Volume: In 2017, Portland saw continued interest from institutional buyers, which accounted for over 65% of the sales volume, but only 10% of the transactions. Portland continues to have

superior yields compared to other west coast cities. **In 2018, we expect to see \$1.80 billion to \$2.20 billion in apartment sales, and 175 to 225 apartment sale transactions.** Additional regulation and the continued possibility of rent control in the City of Portland, has done little to deter investors. Unless rent control is enacted, we expect continued investor interest.

Risks: Since 2014, the Portland apartment market has faced some hurdles, though the overall adverse impact has been limited. Despite the limited impact, some risk remains.

Risks—Currently Occurring

- Interest rates are increasing
- Apartment construction is at record levels and completions should peak in 2018 & 2019
- Increasing home ownership and home construction
- Some tenant protections have been made permanent
- A shift in the political climate & political power
- Aging cohort of prime renters that will slowly move toward home ownership
- Rapidly rising construction costs
- Shortage of affordable housing

Risks—Potential

- Slowdown in local population growth
- Slowdown in local job growth
- Rent Control
- Macroeconomic events (recession, oil, trade wars, China)
- Portland losing its “cool” factor
- Overall capitalization rate increases
- Continued increase in expenses

CONCLUSION: 2017 was yet another very strong year for the Portland apartment market. Apartment values hit record highs, vacancies were reasonable, though approached long term averages, and rents increased. However, there are some clear indications that risks remain.

During 2018, we expect continued increases in interest rates, increases in apartment vacancies up to 5.5%, a slowdown in rental increases, and flattening income. Up to this point, these indicators have had a minimal, if any impact on value. In 2018 **apartment values are expected to stabilize as we return to a more normal market.**

The Barry Apartment Report

Patrick O. Barry & Mark D. Barry, MAI
Barry & Associates

Apartment Appraisal Specialists
1535 SW Clifton Street, Second Floor
Portland, Oregon 97201
503-243-2925 (Mark)
971-275-5345 (Patrick)
mb@barryapartmentreport.com
pb@barryapartmentreport.com
www.barryapartmentreport.com



Mark D. Barry & Patrick O. Barry

Turn Back the Clock . . .



Portland Metro Construction Activity 1960-1982

Year	Houses	Duplexes	Low-Rise	High-Rise	Total	Non-housing	All perm.
1960	4,551	220	1,106	376	6,253	1706	
1961	5,130	290	763	53	6,236	1104	
1962	4,611	260	1,129	404	6,404	1713	
1963	4,339	346	2,425	294	7,404	3005	
1964	4,738	320	2,688	566	8,312	3574	
1965	4,791	450	2,429	537	8,207	3416	
1966	4,227	397	2,779	274	7,677	3450	
1967	5,183	684	4,156	-	10,023	4840	
1968	5,701	966	5,779	300	12,746	7045	
1969	5,338	782	5,504	-	11,624	6256	
1970	5,496	734	3,716	697	10,625	5168	
1971	7,735	1,165	7,794	314	17,008	9173	
1972	8,998	1,330	8,336	283	18,947	9449	
1973	7,494	928	5,079	-	13,501	6047	
1974	5,122	652	2,507	-	9,281	4159	
1975	7,204	638	1,938	152	9,922	2718	
1976	10,188	1,072	4,247	-	15,507	5519	
1977	12,348	1,986	5,606	-	19,940	7596	
1978	11,752	1,504	6,003	-	19,259	7577	
1979	7,590	988	5,205	-	13,783	6133	
1980	5,746	648	2,316	-	8,710	2944	
1981	3,709	154	1,930	-	5,793	2054	
1982	2,287	-	1,268	-	3,555	1114	
Construction Cost Per Unit As Shown in Building Permits							
1967	\$17,000	\$ 8,330	\$ 8,080	\$			
1968	18,280	9,010	8,430	12,000			
1969	19,000	10,230	9,450				
1970	18,960	10,220	8,610	13,840			
1971	20,370	11,160	9,430	20,380			
1972	21,190	11,730	10,170	42,400			
1973	23,850	12,280	10,250				
1974	26,700	13,800	12,130				
1975	30,640	16,300	12,640	15,780			
1976	33,390	17,720	13,960				
1977	37,320	31,350	15,340				
1978	41,600	26,340	18,620				
1979	49,715	31,997	22,790				
1980	52,040		36,910				
1981	58,695		31,450				
1982	65,195		33,485				

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1970 & 1971

- Portland busiest years for apartment construction
- An average of 9,610 apartment permits/year
- Average reported cost - \$20,780/Unit

1981 & 1982

- Some of the Portland's slowest years for apartment construction
- An average of 1,676 apartment permits/year
- Average reported cost - \$61,945/Unit



10/2017 Sale—\$108,333 Unit
9 Unit Kimberly Ann Apartments
202 Pearl Street, Oregon City

We have transitioned most of our market updates to electronic only. We send 2-3 emails a year with updates on the Portland apartment market. You can subscribe or unsubscribe on our website.

www.BarryApartmentReport.com