



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

2019 Mid Year Update: Stable Fundamentals, butSome Slowdown

Current Portland Metro Trends

- **Unemployment:** 3.8%
- **Job Growth:** 2.6%
- **Population Growth:** 0.9%, or 42nd out of 100 US metro areas
- **Portland-Salem CPI:** 3.3%
- **Apartment Construction:** Permits for around 7,500 units issued in 2018, or down 27% from 2017.
- **Apartment Sales:** Just 90 sales through June 2019 vs. 230 sales in 2018
- **Apartment Sales Volume:** \$750 million through June 2019 vs. \$2.3 billion in 2018.
- **Apartment Values:** Stable and firm, except for new units,
- **Apartment Income:** Up 1% to 3% in YTD 2019
- **Apartment Vacancies:** 5.0%

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.

YTD 2019 has seen some shift and transition in the Portland area apartment market. Vacancies have crept up, rents are flattening out, and permits are down. Despite declining interest rates and solid job growth, **apartment sales volume is way off, and the political climate in the city of Portland appears to be impacting investor interest.**

Portland Economy: Most economists agree that Portland is at full employment. **as the economy reaches a record expansion of ten years since the Great Recession** The Portland Metro added 20,600 jobs in 2018. This was the slowest year of growth since 2013. However, year over year job growth as of May 2019 is 30,000. Unemployment is 3.8%.



3/2019 Sale—\$240,000 Unit
30 Unit 30th & K Apartments
3011 NE Killingsworth St, Portland

Apartment Construction:

After a surge in permits prior to the implementation of Inclusionary Zoning (IZ), permits dropped significantly in 2018. Permits were issued for approximately 7,500 units. This is down 26 percent from 2018, but it was one of the top 10 busiest years ever for Portland Metro apartment construction. The current cycle of apartment construction rivals previous peaks seen in the early 1970's and late 1990's.

Around 70% of the permits for new units were issued in Multnomah County alone. Clark County saw 16% of total units, while Washington and Clackamas County account for 8% and 7% of construction, respectively.

The location of apartment construction during this current cycle represents a major shift from past cycles. From 1990 to 2006, 39 percent of all construction occurred in Multnomah County. However since 2007, this figure is closer to 60 percent.

There has been an obvious decline in permit applications since the implementation of IZ, and the number of affordable units produced under IZ has lagged behind expectations. The City of Portland is reportedly considering changes to this policy.

Apartment Vacancies and Rental Rates:

The Spring 2019 **Multifamily Northwest Apartment Report (MFNW)** shows a 5.0% vacancy factor vs. 4.4% in Fall of 2018. Just four of the 20 submarkets covered showed vacancies below 4%, and vacancies are above 5% in six submarkets. The highest vacancies are in the areas of highest construction. Inner/Central SE Portland, Downtown, and NW Portland, show vacancies of 5.4%, 6.4%, and 7.9%, respectively.

Apartment Expenses:

Most expenses remained in check. Property taxes were up a manageable 3% to 4%. In addition, maintenance and repair costs have increased due to a shortage of labor and strong growth in the construction industry. Some managers/owners with a large geographic footprint are playing with the idea of "self-showing" units, which is done with a combination of lockboxes and pre-registering online. However, as vacancies rise, some advertising and tenant retention expenses are making a comeback. **And administrative costs are expected to increase based on increased regulations.**

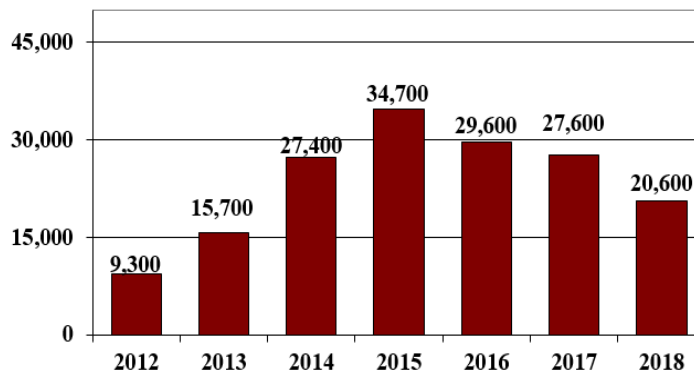
Apartment Values:

Apartment investors in Portland have been the biggest winners in the economic expansion, **with values doubling in the last eight years.** However, if one takes all of the metro area apartment sales



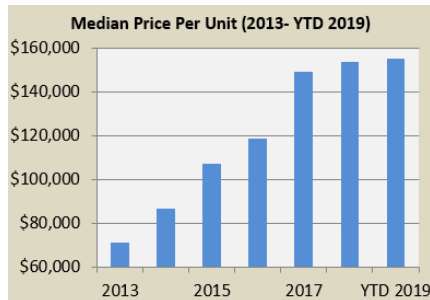
11/18 Sale— \$163,889 Unit
18 Unit Apartment
1684 8th Ave, West Linn

PMSA Wage & Salary Employment Annual Change 2012 - 2018

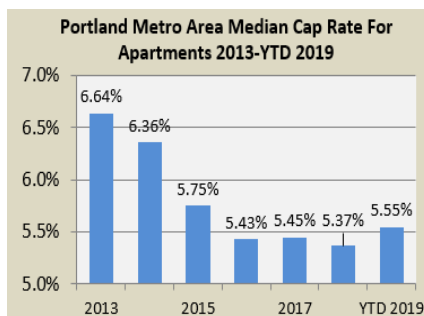


Inside this issue:

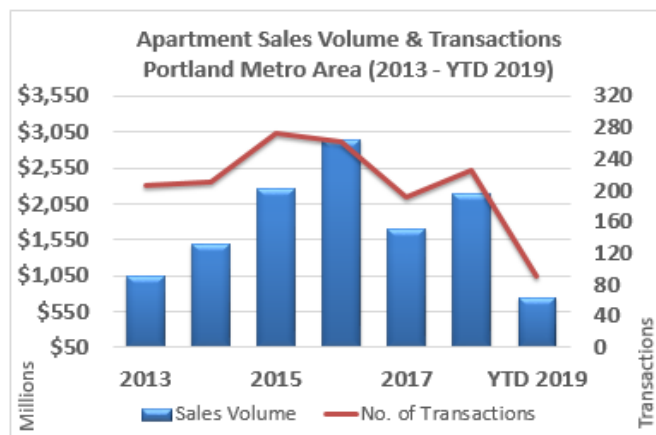
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for the last 18 months, the median price per Sq. Ft. has declined by around 4.5% for YTD 2019 vs. 2018. **This is felt to be due to fewer sales of newer apartments, and some softening of values for newer units.** While apartment values appear to be flattening out, values vary widely among different market segments. The sales market for new apartments has softened in 2019 despite substantial increases in construction costs. The sales price per unit for newer apart-



ments built since 2010 is **down around 8.5% in 2019 vs. 2018.** While value trends may vary from submarket to submarket, **there are virtually no other market segments that have shown a decline in values.** The CoStar figures show a 5.37% median cap rate for 2018, vs. 5.55% for YTD 2019. NFN and Trion Properties have been the biggest sellers for YTD 2019.



The threshold to enter the market has seen substantial increases in recent years. **There have been just two YTD 2019 sales at less than \$100,000 per unit.**

| Transactions Below \$100,000/Unit | |
|-----------------------------------|-----|
| 2014 | 104 |
| 2015 | 113 |
| 2016 | 77 |
| 2017 | 19 |
| 2018 | 14 |
| YTD 2019 | 2 |

Apartment Sales Volume: Sales volume is down significantly for YTD 2019. There were around 230 sales transactions for \$2.3 billion 2018 vs. just 90 sales for \$750 million through June 2019. While apartment sales volume has held steady in the suburban counties, **the city of Portland has seen apartment sales volume fall by around 35% to 40%.**

Portland has been on the radar of institutional buyers. In 2018 there were 45 sales exceeding \$10M+. However, there were just 16 such sales for YTD 2019.

2019 UPDATE & FORECAST

Our thoughts are as follows:

Economy: Economists are forecasting slower job growth in the years ahead. The most recent State of Oregon employment report forecasts job growth to be 2.1 percent for 2019 and 1.7 percent in 2020. 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 2019, and 21,000 new jobs in 2020.** However, with a tightening labor market and low unemployment, personal income growth is expected to increase around 5% annually in the coming years.

Single Family: The single family housing market picked up steam in 2018. Forecasts call for increased housing starts through at least 2022. As the prime cohort of renters age, a transition to homeownership is likely. The Portland metro homeownership

ratio has increased since 2016 and will likely continue. **A 1.0% increase in the home ownership ratio means 9,000 fewer households are potential renters.**

Apartment Construction: Coming off 2017 and 2018, which were two of the five busiest years ever for apartment construction, a drop in construction in 2019 wouldn't be a big surprise. Pre-IZ projects still remain, though they are few and far between. Based on the YTD 2019 permits, we are on track for around 8,700 units in 2019. Portland may experience a boost from the tax advantaged Opportunity Zones, which exist in prime Portland locations. **We expect there will be permits for 14,000 to 18,000 new units in 2019 and 2020.**

The City of Portland recently reported that the IZ program is under-producing affordable units and some changes to the IZ program may be under consideration. Given the rising construction costs, flattening rents, softening of values for new apartments, some relief to the IZ program requirements would be a change welcomed by developers.

While the region as a whole may be underbuilding housing, there is concern about overbuilding of apartments in the short term. The rate of population growth is slowing. Our population growth in conjunction with employment growth has been the major driver filling these new units.

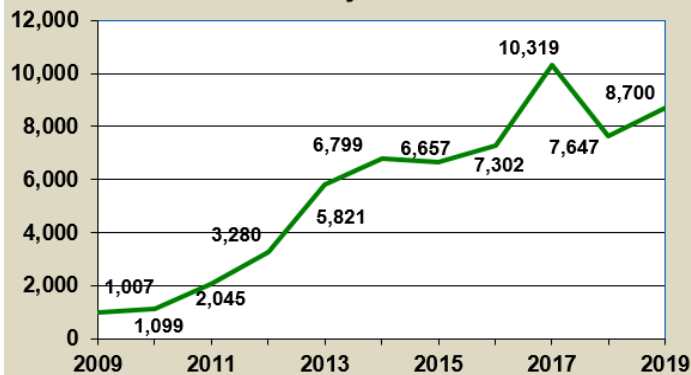
Additional suburban construction is expected as regulation and fees in Portland have increased. In the coming years, **we see a larger share of apartment construction shifting to the suburbs.**

Apartment Vacancies and Rental Income: Despite all the new construction across the metro, vacancies have remained within normal ranges. Vacancies have increased moderately in 2018 and YTD



11/2018 Sale—\$132,500 Unit
24 Unit Franklin Apartments
5575 SW Franklin Ave, Beaverton

**Apartment Permits 2008 - YTD 2019 Annualized
Four County Metro Area**



2019. We expect a further increase in vacancy rates, as 2019 will likely represent peak completions of new units. Most surveys show that vacancies rates are currently between 4.5% and 5.5%, depending on how new units are accounted for. Permits were issued for over 7,300 units in 2018, and historical Portland metro area demand is around 4,500 to 6,500 units. The current new supply is outpacing demand. **We expect vacancies to approach 5.25% to 5.50% by the end of 2019 and in early 2020.** Localized vacancies will continue in areas with high rates of construction.

A continued period of increased vacancies will eventually lead to more reasonably priced units. **The lower priced units at the upper end will create downward pressure throughout the market. This is particularly true for studio units, which have the highest vacancies.** Concessions will continue to be the norm on recently completed units, upgraded vintage units, and units that become vacant over the winter. We expect modest rent increases and most increases focused on B & C grade apartments. We expect apartment income will be up by 1% to 3%. By the end

of 2019, we expect a more balanced market with tenants having a better negotiating position, especially in new buildings. **By the end of 2019, we expect some submarkets will see a shift in power to the renters, especially at the high end.**

Apartment Values:

Apartment values have flattened out YTD 2019. There appears to be some forces that are

chipping away at values, that if considered by themselves, wouldn't be a major concern. But when considered as a whole, values for new units have slipped. This is felt to be due to modest increases in vacancies, slower rent growth, increasing labor costs, and increases in taxes. However, the recent decline in interest rates have been an offsetting factor.

The sales for YTD 2019, are showing stable to moderately increasing values for pre 2000 built units in the suburban counties and the city of Portland. Values are showing slight declines in new units. There appears to be a gap between buyer and seller expectations.

Apartment Sales Volume:

Institutional buyers have played a big part in our market. There were 45 sales surpassing \$10M in 2018, but just 16 for YTD 2019. While Portland may have superior yields compared to other west coast cities, **increased regulation is giving some buyers second thoughts.** Through June 2019 Portland has seen 85 sales transactions for around \$750M. We anticipate these figures increasing the second half of 2019, **with sales volume in 2019 reaching \$1.75 to \$2.0B and 175 to 225 apartment sale transactions.**

Politics: Rent control across the state of Oregon and other regulatory rules (primarily Portland) have made some investors look to the suburban counties, and other markets. Rent control has had a minimal impact on well-operated apartments. However, long term owners with rents well below market will likely see a discount when they go to sell. **The major concerns are whether the State of Oregon will start adjusting the dials of rent control if the rental market remains tight and how the stigma of rent control will impact investment/development.**

Risks:

Risks—Currently Occurring

- Apartment completions will peak in 2019 and permits remain high
- Increasing home ownership and home construction
- Rent control. For now, the stigma hurts more than the actual policy
- A shift in the political climate with a strong us vs. them mentality with tenants and property owners
- Aging cohort of prime renters that will slowly move toward home ownership
- Rapidly rising construction costs and lower returns due to IZ
- Shortage of affordable housing
- Slowing job and population growth

Risks—Potential

- If rent growth does not slow, rent control could be tightened (lower rent caps, lower exemption period for new construction, harsher penalty for evictions, etc.)
- Macroeconomic events (oil, trade wars, China, Middle East)
- Portland losing its "cool" factor
- Overall capitalization rate increases
- Continued increase in expenses?
- Inverted yield curve, and after ten years of expansion.....a recession in 2020?

CONCLUSION: 2018 was a strong year for the Portland apartment market, and we are seeing decent fundamentals in YTD 2019. Apartment values hit record highs in 2018, occupancy levels were stable, and rents showed modest increases. However, there are some clear signs that the market is flattening out, with some decline in values at newer units.

In the balance of 2019 and in early 2020, we expect some increases in apartment vacancies up to 5.5%, a slowdown in rental increases, flattening income, and uncertainty on how to deal with all of the new regulations. Up to this point, these indicators have had no apparent adverse impact on values except for newer units. In the balance of 2019 and into early 2020, the Portland apartment market **is expected to remain stable, as we return to a more normal market.**



3/19 Sale- \$141,933/Unit
15 Unit Anchor Apartments
15340-15368 SE Stark Street, Portland

The Barry Apartment Report

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Mark D. Barry & Patrick O. Barry

Turn Back the Clock . . .



Portland Condominium Conversions

| CONDOMINIUMS | | | |
|--------------------------|----------------------|--------------|----------------|
| | Conversions Units | New Units | Total Units |
| Multnomah County | | | |
| 1977 | 153 | 37 | 190 |
| 1978 | 278 | 533 | 811 |
| 1979 | 826 | 846 | 1672 |
| 1980 | 381 | 523 | 904 |
| 1981 | 288 | 271 | 559 |
| 1982 | 54 | 169 | 223 |
| 1983 | 16 | 155 | 160 |
| 1984 | 0 | 75 | 75 |
| 1985 | 26 | 450 | 476 |
| Washington County | | | |
| 1977 | 0 | 20 | 20 |
| 1978 | 16 | 618 | 634 |
| 1979 | 591 | 842 | 1443 |
| 1980 | 433 | 200 | 633 |
| 1981 | 252 | 283 | 535 |
| 1982 | 259 | 101 | 360 |
| 1983 | 58 | 18 | 76 |
| 1984 | 0 | 168 | 168 |
| 1985 | 0 | 55 | 55 |
| Clackamas County | | | |
| 1977 | 0 | 0 | 0 |
| 1978 | 75 | 49 | 124 |
| 1979 | 79 | 697 | 776 |
| 1980 | 171 | 167 | 338 |
| 1981 | 15 | 418 | 433 |
| 1982 | 5 | 95 | 100 |
| 1983 | 0 | 15 | 15 |
| 1984 | 0 | 50 | 50 |
| 1985 | 0 | 0 | 0 |
| Totals for State | | | |
| 1983 | 187 | 568 | 755 |
| 1984 | 3 | 501 | 504 |
| 1985 | 44 | 697 | 741 |

Condominiums

The first wave of condominium conversions begins in the mid-1970's. Between 1977 and 1982, nearly 3,900 apartment units were converted to condominiums. By 1982-1983, the market had dried up, and was dead.

Some of these condominium conversions remain today, though many ended up returning to rentals or as broken condominiums with fractured ownership that remains.

The conversion market would not return again in the mid 2000's. While some conversions were successful, many were not and the final results were similar to the 1980's.



6/19 Sale—\$175,574 Unit
 61 Unit Icon Apartments
 14620 SW Farmington Rd, Beaverton

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