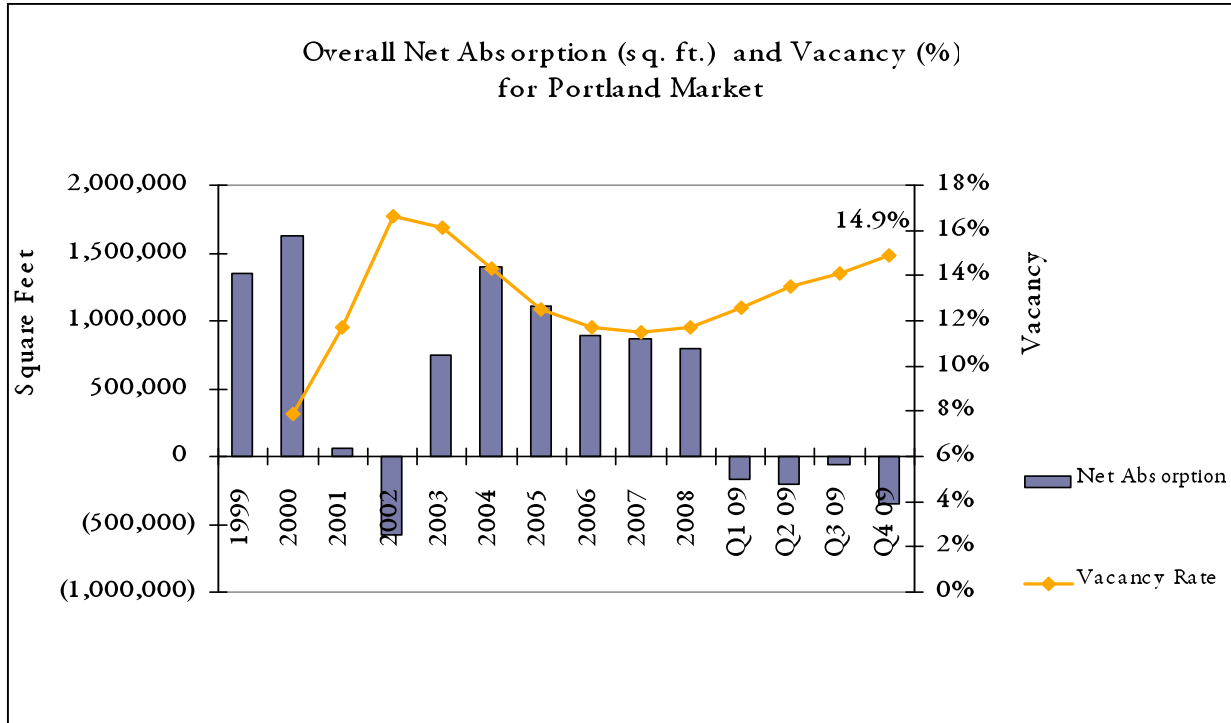


# Office Market Analysis

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## Portland Office Market

The office market continued to decline during the fourth quarter to end the year with a median vacancy rate of 16.1% and a negative net absorption of 23,362 square feet during the quarter. Grubb & Ellis believe that because real estate is a lagging indicator, the job losses during the summer months are now being reflected by reduced demand in the metropolitan area office market. The seasonally adjusted unemployment rate for December was 11.0% in Oregon. The Portland metropolitan area's seasonally adjusted unemployment rate was 10.7% in December, showing improvement from the previous two months. An estimated 123,365 residents were unemployed in the metropolitan area, which is 26,727 more than during December, 2008. Monthly job losses have averaged about 2,900 jobs over the last seven months, but have not been as severe as the 6,300 monthly jobs lost during the recession's height in late 2008 and early 2009. In other positive economic news, the University of Oregon's Index of Economic Indicators rose 0.6% in October to a score of 85. This is one signal that the state could be on its way to recovering from the recession.



Source: Grubb & Ellis Office Quarterly Report - Fourth Quarter 2009

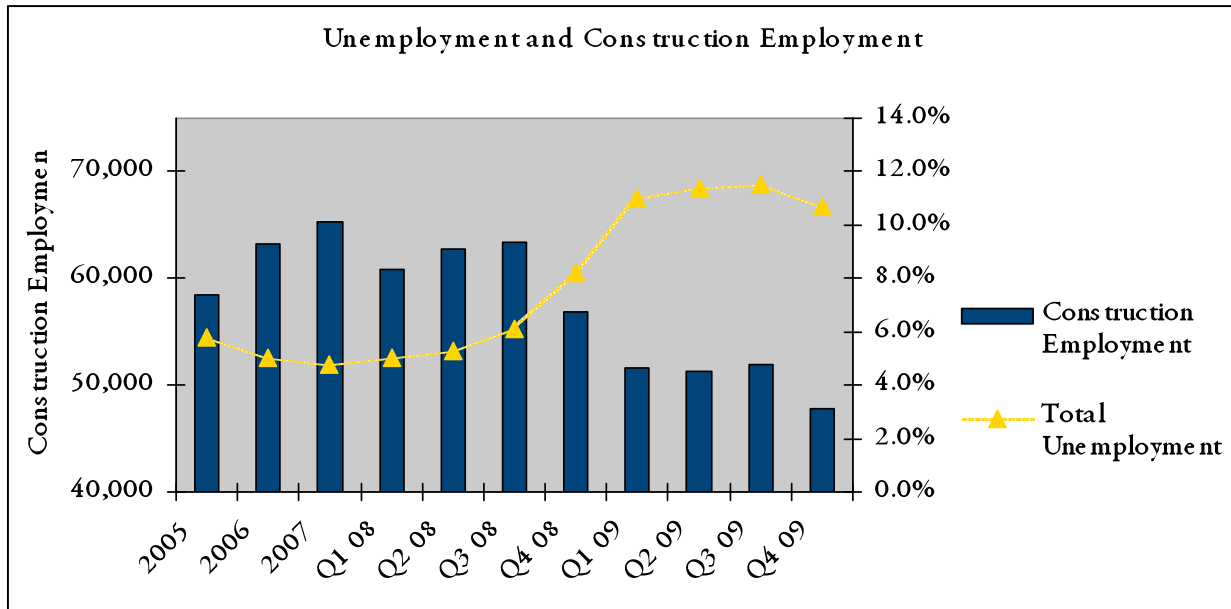
**Net absorption has decreased while overall vacancy rates continue to increase**

<b>OFFICE Q4-09</b>	<b>CB Richard Ellis</b>	<b>Cushman &amp; Wakefield</b>	<b>Grubb &amp; Ellis</b>	<b>Norris, Beggs &amp; Simpson</b>	<b>Median</b>
<b>Market-Wide Vacancy</b>	<b>15.6%</b>	<b>16.6%</b>	<b>14.9%</b>	<b>17.5%</b>	<b>16.1%</b>
Previous Quarter	15.4%	15.9%	14.1%	17.1%	<b>15.7%</b>
Fourth Quarter 2008	10.5%	12.6%	11.7%	12.9%	<b>12.2%</b>
Fourth Quarter 2007	10.8%	11.7%	11.5%	12.8%	<b>11.6%</b>
<b>CBD and Downtown Vacancy</b>	<b>10.3%</b>	<b>12.1%</b>	<b>10.4%</b>	<b>11.8%</b>	<b>11.1%</b>
Previous Quarter	10.0%	11.7%	9.8%	11.1%	<b>10.6%</b>
Fourth Quarter 2008	6.6%	8.7%	5.1%	9.3%	<b>7.6%</b>
Fourth Quarter 2007	8.0%	9.4%	8.2%	10.1%	<b>8.8%</b>
<b>CBD Class A Vacancy</b>	<b>7.7%</b>	<b>7.8%</b>	<b>7.3%</b>	<b>7.2%</b>	<b>7.5%</b>
Previous Quarter	6.3%	9.0%	6.2%	6.7%	<b>6.5%</b>
Fourth Quarter 2008	3.8%	6.4%	5.1%	5.4%	<b>5.3%</b>
Fourth Quarter 2007	4.9%	4.9%	5.3%	5.5%	<b>5.1%</b>
<b>CBD Class A Asking Rents</b>	<b>27.47</b>	<b>\$25.61</b>	<b>\$25.54</b>	<b>N/A</b>	<b>\$25.61</b>
Previous Quarter	N/A	\$25.79	\$25.86	N/A	<b>\$25.83</b>
Fourth Quarter 2008	\$26.63	\$27.07	\$26.80	N/A	<b>\$26.80</b>
Fourth Quarter 2007	\$24.68	\$25.79	\$25.57	\$24.22	<b>\$25.13</b>
<b>Suburban Vacancy</b>	<b>20.3%</b>	<b>21.0%</b>	<b>18.5%</b>	<b>20.5%</b>	<b>20.4%</b>
Previous Quarter	20.3%	19.9%	17.4%	20.2%	<b>20.1%</b>
Fourth Quarter 2008	14.1%	16.3%	15.2%	16.2%	<b>15.7%</b>
Fourth Quarter 2007	13.4%	13.9%	14.8%	14.5%	<b>14.2%</b>
<b>Suburban Class A Vacancy</b>	<b>N/A</b>	<b>22.8%</b>	<b>21.1%</b>	<b>23.1%</b>	<b>22.8%</b>
Previous Quarter	N/A	22.6%	20.6%	22.6%	<b>22.6%</b>
Fourth Quarter 2008	N/A	16.3%	15.2%	17.0%	<b>16.3%</b>
Fourth Quarter 2007	N/A	14.4%	14.6%	N/A	<b>14.5%</b>
<b>Suburban Class A Asking Rents</b>	<b>N/A</b>	<b>\$23.44</b>	<b>\$23.40</b>	<b>N/A</b>	<b>\$23.42</b>
Previous Quarter	N/A	\$24.04	\$23.84	N/A	<b>\$23.94</b>
Fourth Quarter 2008	N/A	\$24.48	\$23.69	N/A	<b>\$24.09</b>
Fourth Quarter 2007	N/A	\$24.38	\$24.25	N/A	<b>\$24.32</b>

Source: CB Richard Ellis, Cushman & Wakefield, Grubb & Ellis, Norris, Beggs & Simpson Quarterly Reports and Statistical Reports - Fourth Quarter 2009.

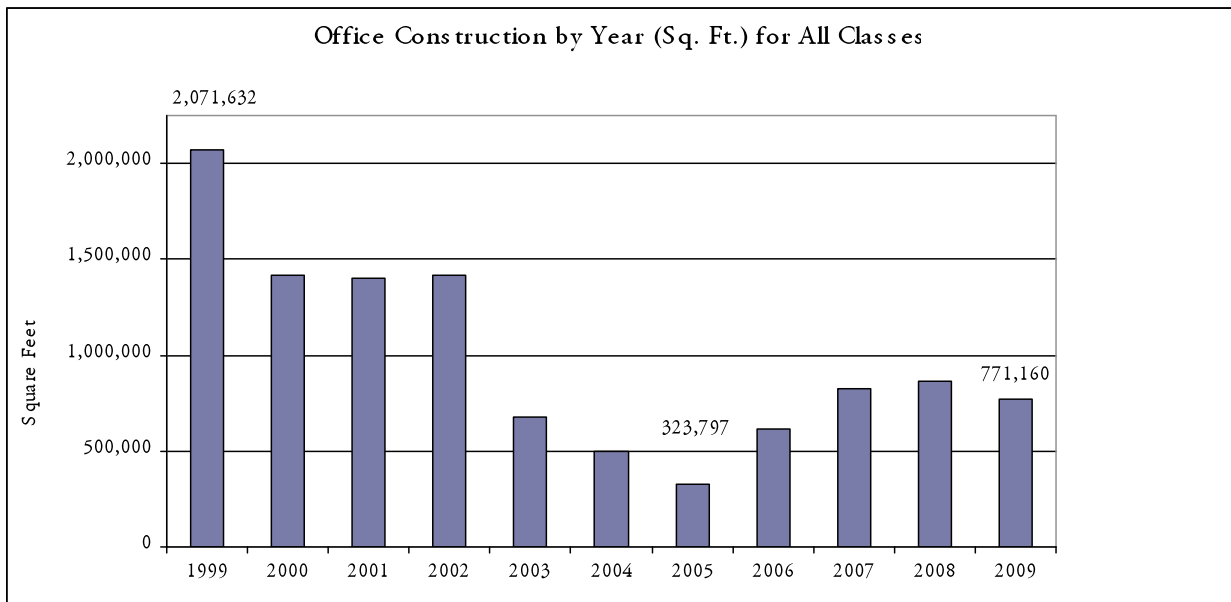
As one sees in this summary chart, the CBD class A vacancy rate of 7.5% remains substantially lower than the overall CBD vacancy rate which is now up to 11.1%. The suburban class A market, on the other hand, continues to have higher vacancy rates than the overall suburban market. Both the CBD

and the suburban submarkets have seen declines in rent during 2009, likely in response to increased vacancy rates in nearly every submarket.



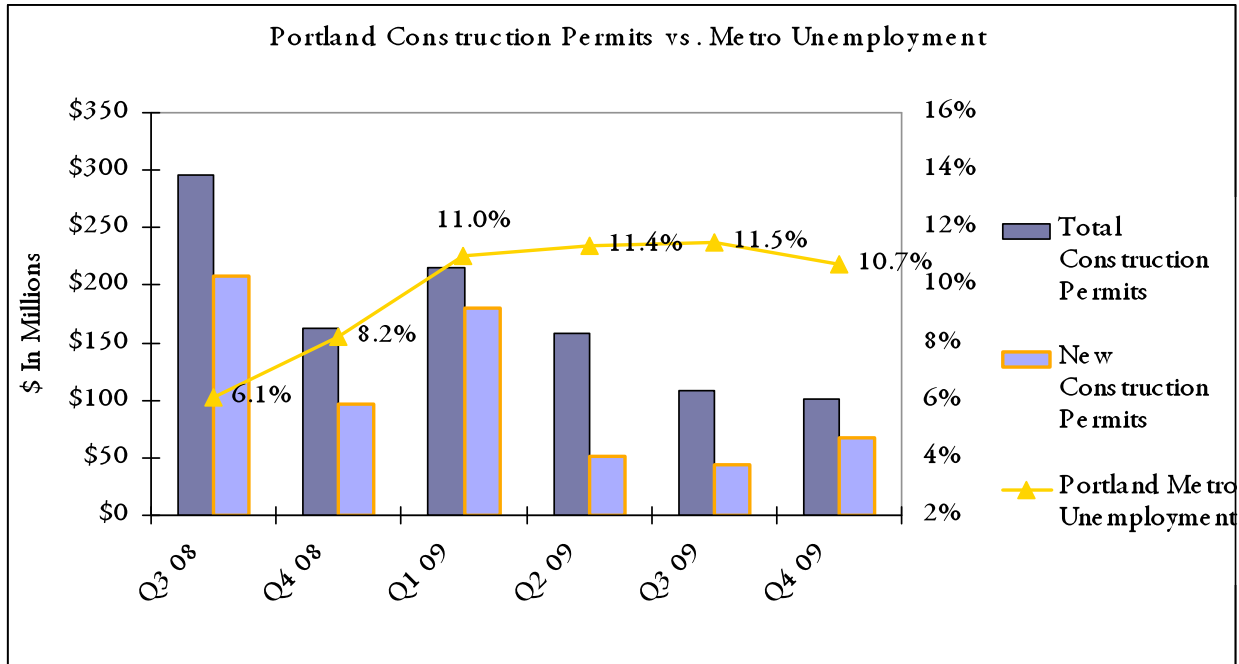
Source: Oregon Employment Department

**Metropolitan area unemployment and construction employment fall.**



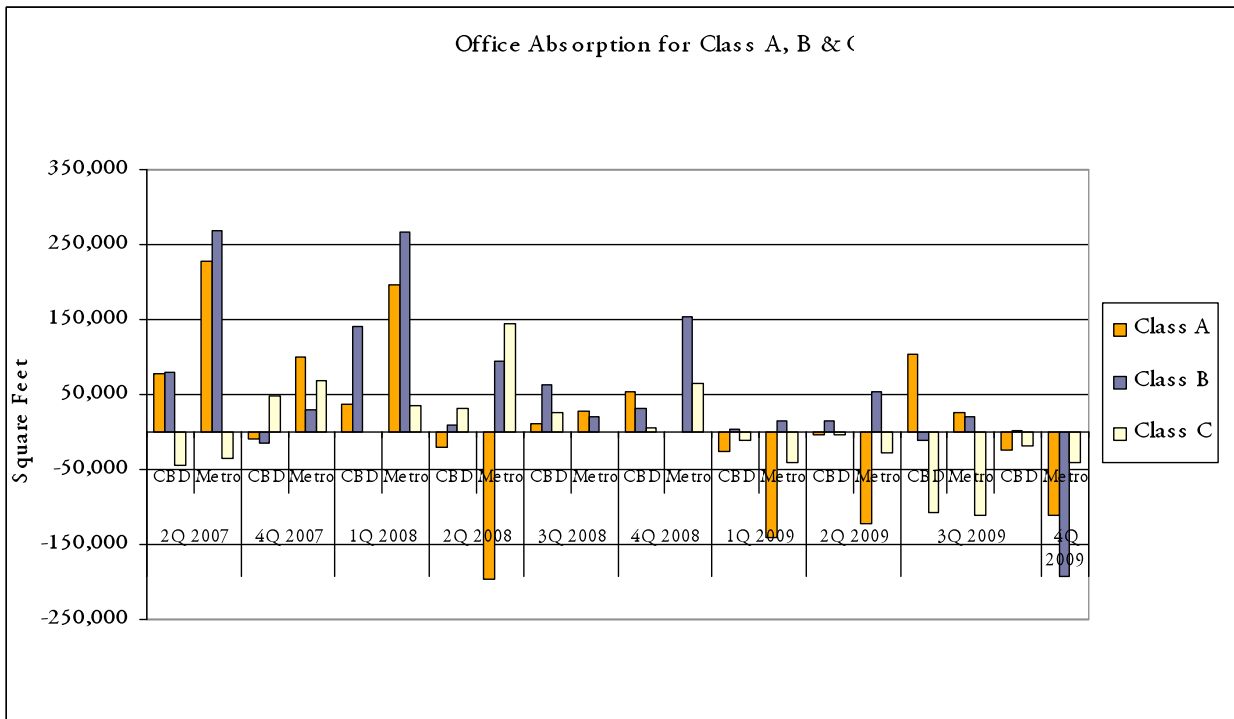
Source: Grubb & Ellis Office Quarterly Report - Fourth Quarter 2009

**Reduced office construction in 2009**



Source: Portland Bureau of Development Services, Oregon Employment Department

**New commercial construction permits increase while total permits remain flat.**



Source: Grubb & Ellis Office Quarterly Report - Fourth Quarter 2009

**Negative net absorption across building classes except CBD Class B**

New commercial construction permits in Portland increased \$23.6 million to \$67.8 million during the 4<sup>th</sup> quarter of 2009, while total construction permits remained at a relatively flat \$100.6 million. However, both are down from the previous year when permitting was at \$96.2 million and \$163 million respectively.

### **CBD Trends**

CBD class A vacancy finished 2009 with a 7.3% vacancy rate which is an increase from the 6.2% vacancy rate posted during the third quarter, according to Grubb & Ellis. One of the largest commercial real estate transactions in Portland history, and the largest office transaction of 2009, was completed at the end of December when American Pacific International Capital purchased the office portion of KOIN Center. American Pacific International Capital (APIC) is a Portland investment firm, but purchasing 19 floors of the 30-floor building is its first acquisition in this region. The KOIN Center is Portland's ninth largest office building with 415,425 total square feet.

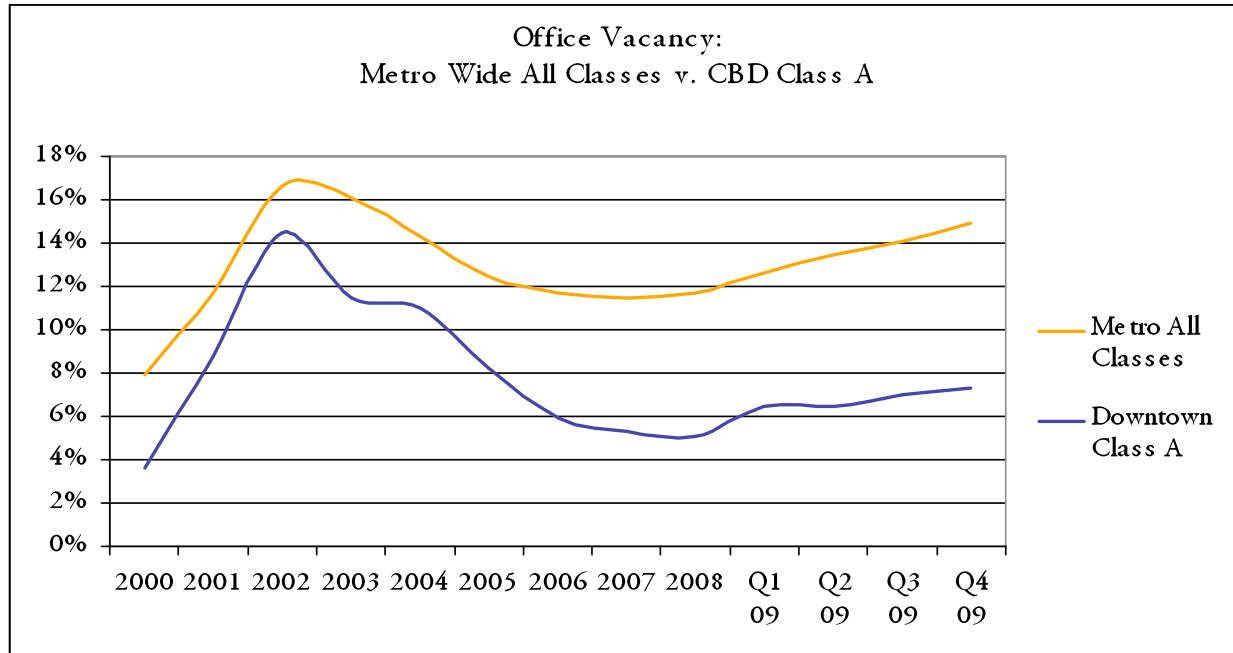


The terms of the deal have not been revealed, but the Oregonian reported that the sale price was between \$50 and \$60 million<sup>1</sup>. This is approximately half of the \$107 million that the California Public Employees Pension System (CalPERS) paid for the same property in 2007, and less than the \$70 million loan which encumbered it. After CalPERS defaulted on the loan, the mortgage provider, New York Life Insurance Inc., sued to take control of the building and completed the recent transaction with APIC through a short sale. Based on estimates of current lease revenue, APIC should produce approximately a 9% return on investment.

The KOIN Center office sale gives some indication about comparable building values in an office market with very little activity. An article in the Wall Street Journal<sup>2</sup> explains the recent plight of the KOIN Center. Calpers and CommonWealth Partners LLC were joint owners of the office portion of the building and decided to walk away from their investment. The troubles were due to insufficient cash flow caused by a higher than expected vacancy rate. The last straw may have come when the law firm Ater Wynne LLP vacated 50,000 SF in the building, relocating to the Lovejoy Building, a mixed-use complex in the Pearl District that also houses a new Safeway and rental apartments. After that significant loss, the building gained two substantial tenants, ECONorthwest and Willis of Oregon, but it was not enough to make up for the loss of Ater Wynne. APIC has offices in Portland's World Trade Center but its business activities have taken place primarily in China. APIC is involved in multiple businesses that range from hotels, condominiums and retail space to palm and soybean oil production.

<sup>1</sup> "Portland investment firm buys KOIN Center", The Oregonian, December 29, 2009

<sup>2</sup> "Calpers takes another property hit", Wall Street Journal, August 19, 2009.



Source: Grubb & Ellis Office Quarterly Report - Fourth Quarter 2009

**Metropolitan area and CBD class A vacancy rates continue to increase.**



In another major office transaction, One Main Place, the 20-story office tower located at 101 SW Main Street, is being sold to KBS Realty Advisors. The Portland Business Journal reports that the deal is valued at \$57 million, or \$182 per square foot.<sup>3</sup> This is five million dollars more than the previous deal, which fell through last summer, involving an unrelated buyer. KBS is a Newport Beach, CA real estate investment and management firm that acquires income-producing properties on behalf of two private real estate investment trusts and other investors. Since its formation in 1992, KBS has closed approximately \$16.4 billion in real estate deals and become an active investor in the Northwest. One Main Place has 313,133 SF of leasable space and opened in 1982. The building is currently 96.1% leased, which is a substantial change from the near 25% vacancy rate which One Main Place posted in 2007.<sup>4</sup>

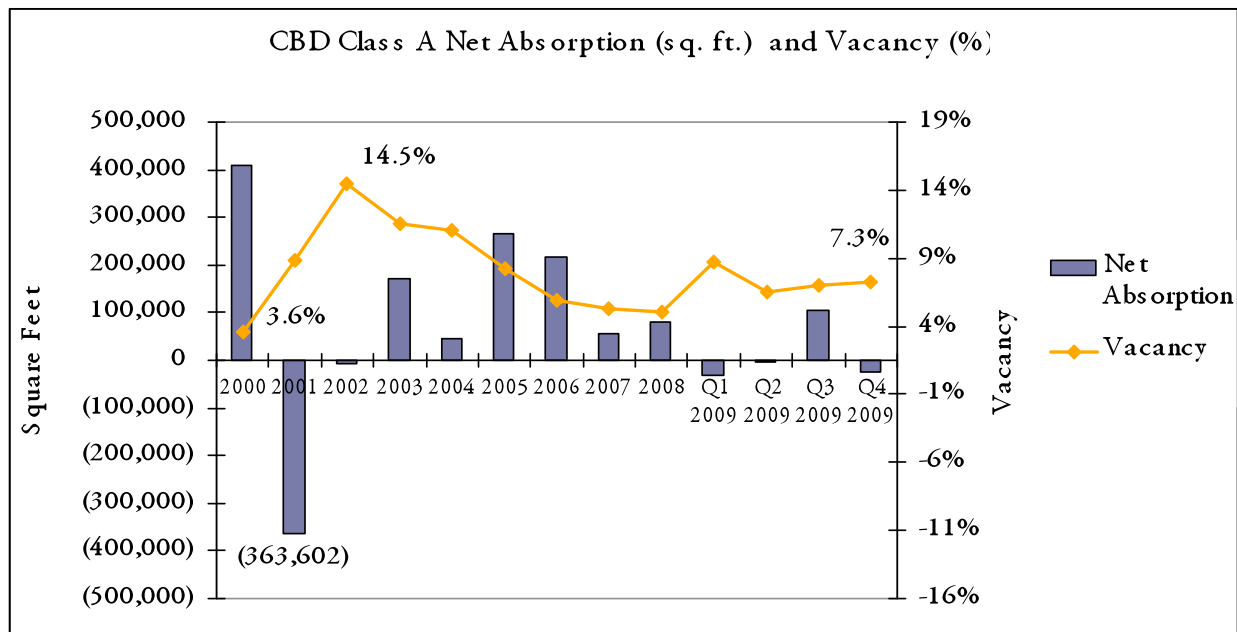
The CBD is struggling through the slowest commercial real estate market in decades as buyers and sellers sit on the sidelines. The Portland Business Journal<sup>5</sup> reported that, in November 2009, the KOIN Center was the only class A office building for sale downtown, although One Main Place must have been in negotiation.

<sup>3</sup> "One Main Place to sell for \$57 million", Portland Business Journal, January 22, 2010

<sup>4</sup> "One Main Place to sell for \$57 million", Portland Business Journal, January 22, 2010

<sup>5</sup> "Slow sales slam office market", Portland Business Journal, October 30, 2009

The short list of other commercial real estate offered for sale during the same period included smaller buildings suffering from high vacancy rates. Illustrating this trend is the Police Headquarters Building that is only one-third occupied. The name is deceiving because the building is not the headquarters for the police bureau. The 50,500 square foot property, which was constructed in 1912, is currently listed for \$5.75 million, or approximately \$114 per square foot. The motivated seller has reduced the price four times during the several months it has been on the market and is reported to be willing to carry the loan.



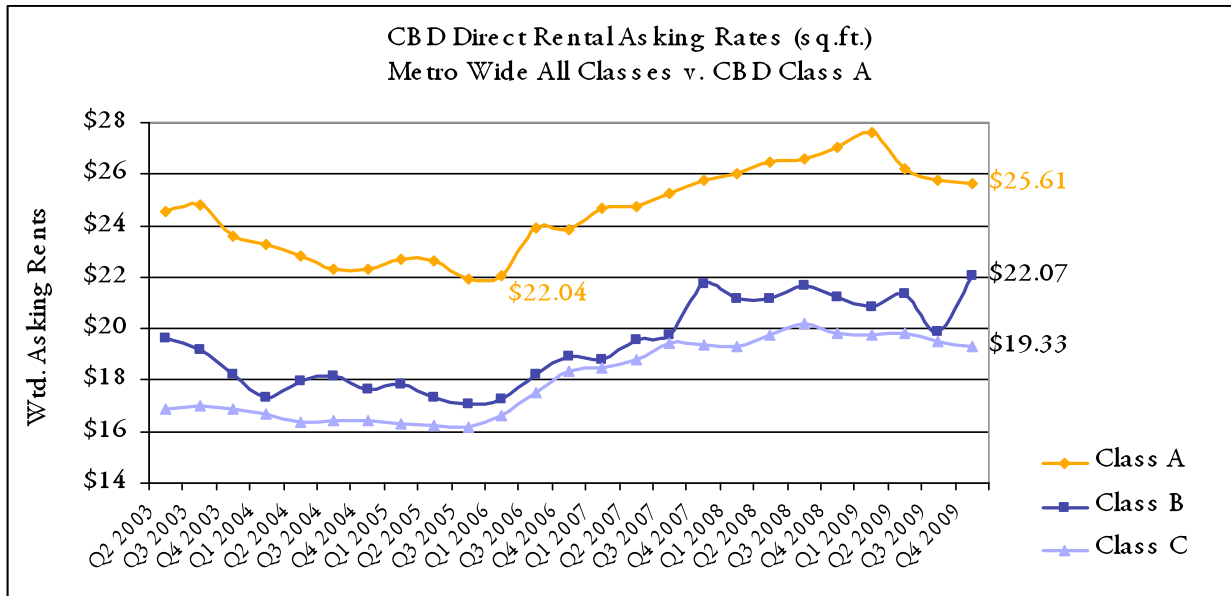
Source: Grubb & Ellis Office Quarterly Report - Fourth Quarter 2009

The federal government should be a major driver for office absorption in 2010 because the U.S. General Services Administration (GSA) needs space for about 1,200 workers during the \$133 million renovation of the Edith Green-Wendell Wyatt Federal Building on SW Third Avenue<sup>6</sup>. The project begins this year and is funded by the American Recovery and Reinvestment Act (ARRA), otherwise referred to as the stimulus act.

The GSA currently occupies about two million square feet of space in the Portland area and is shopping for an additional 300,000 square feet of class A office space, which it needs by the third quarter of 2010, according to Grubb & Ellis.<sup>7</sup>

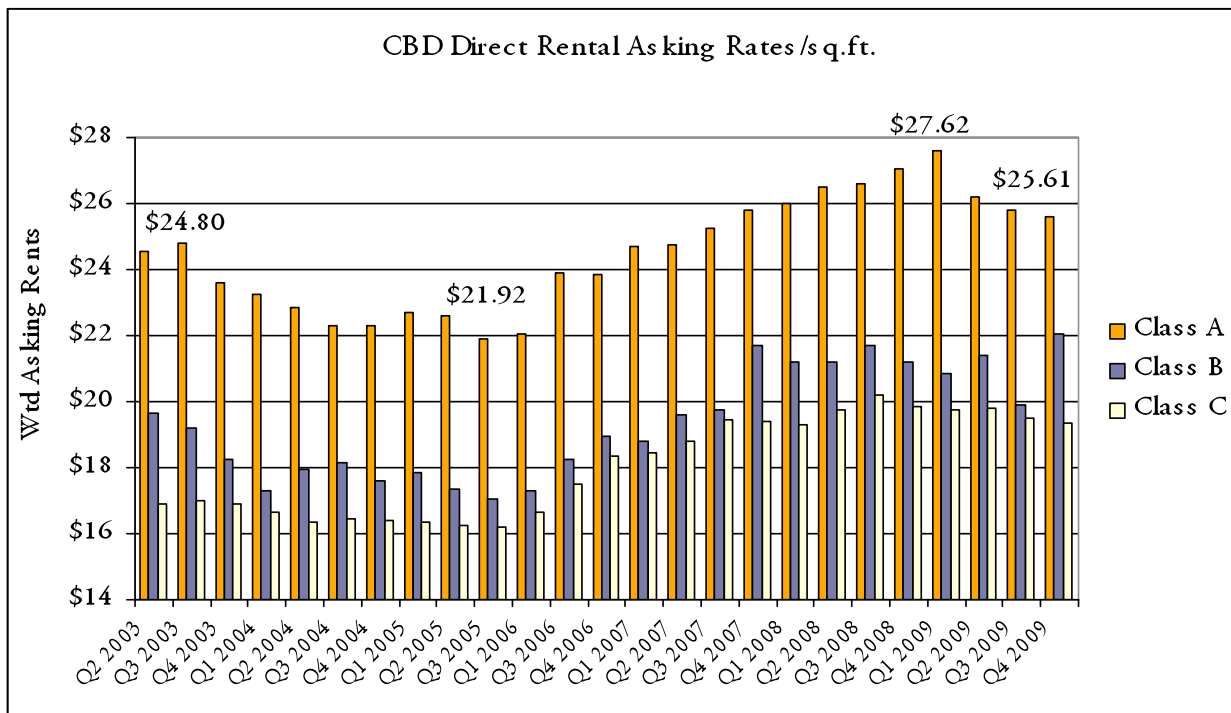
<sup>6</sup> "Empty office blues", Portland Business Journal, December 4, 2009

<sup>7</sup> "2010 Forecast Report", Grubb & Ellis, January 4, 2010

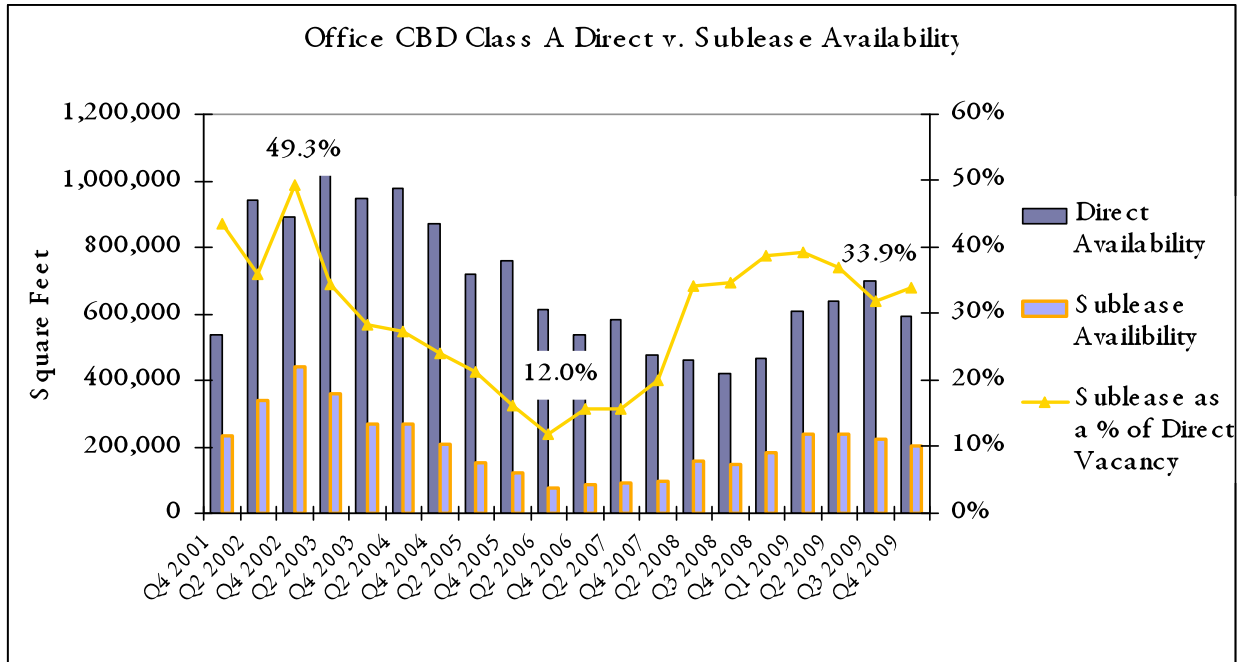


Source: Cushman & Wakefield Overall Office Summary - Fourth Quarter 2009

**Class B asking rents jump approximately \$2.00 per square foot.**



Source: Cushman & Wakefield Overall Office Summary - Fourth Quarter 2009



Source: Cushman & Wakefield Overall Office Summary - Fourth Quarter 2009

**Direct availability declines for the first time in five quarters.**

### Suburban Trends

Vacancy in the suburbs continues to increase, rising to a median rate of 20.4% as shown in the brokerage report summary. CBRE notes that the suburban submarkets have not seen vacancy rates this high since the end of 2001. Average asking rents are down quarter over quarter as well.

According to Grubb & Ellis, the Tualatin/ Wilsonville submarket still has the highest vacancy rate, but the amount of vacant space is only a third of the amount of vacant space found in the sixth ranked Washington Square/ Kruse Way submarket.

The Cascade Park submarket had the largest increase in vacancy rate, going from 16.9% in the third quarter to 23.4% in the fourth quarter of 2009. The only submarkets which experienced declines in vacancy rates were the Columbia Corridor, Hazel Dell/Salmon Creek, and St. Johns/Central Vancouver which had declines of 0.1%, 0.1% and 0.6% respectively.

Fenton Properties, Inc purchased a portfolio of eight properties at AmberGlen Business Center in December. This REO sale was for \$27 million, or \$48.30 per square foot.<sup>8</sup>

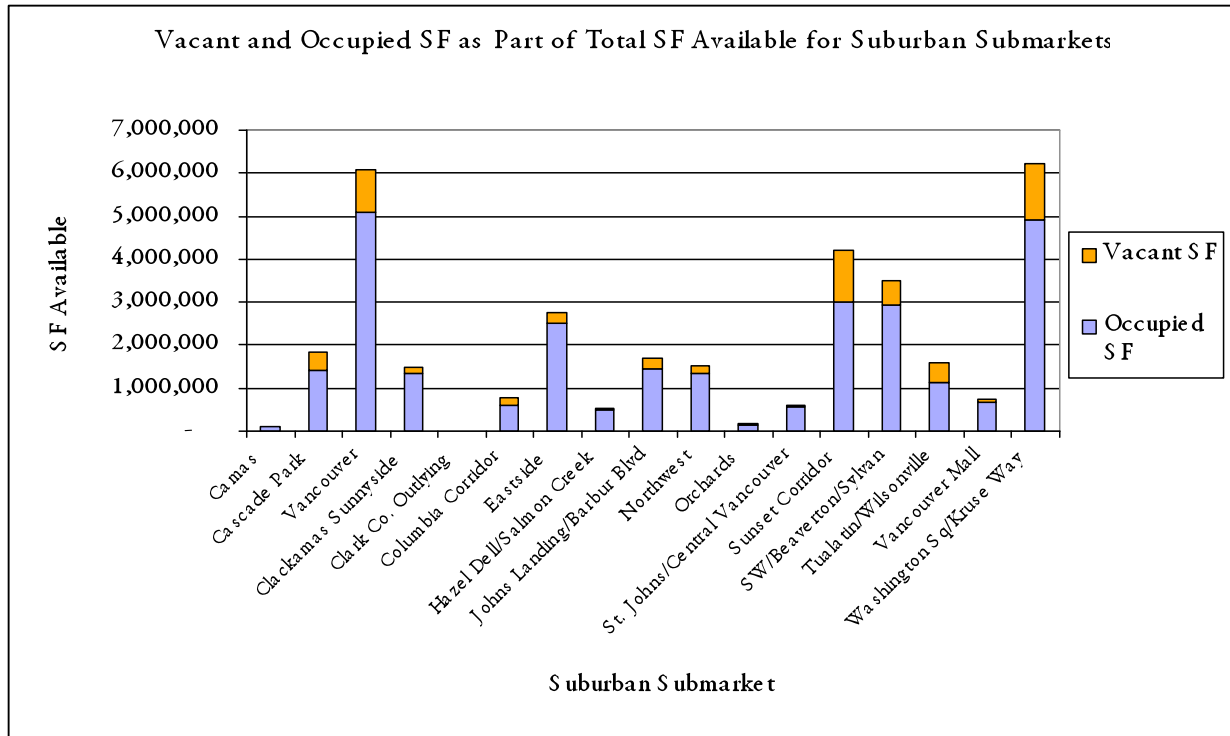
<sup>8</sup> "Market View", CB Richard Ellis, Fourth Quarter 2009

<b>Suburban Office Markets Ranked By Highest Percentage of Vacancy</b>		
<b>Submarket</b>	<b>Rank</b>	<b>Vacancy Rate</b>
Tualatin/Wilsonville	1	28.3 %
Sunset Corridor	2	28.0 %
Camas	3	25.0 %
Cascade Park	4	23.4 %
Columbia Corridor	5	23.0 %
Washington Sq/Kruse Way	6	21.1 %
Orchards	7	20.3%
SW/Beaverton/Sylvan	8	16.5 %
Vancouver	9	16.3 %
Johns Landing/Barbur Blvd	10	15.1 %
Clark Co. Outlying	11	14.1%
Northwest	12	10.9 %
Vancouver Mall	13	10.8 %
Clackamas Sunnyside	14	10.7 %
St. Johns/Central Vancouver	15	10.2 %
Eastside	16	8.6 %
Hazel Dell/Salmon Creek	17	6.1 %

<b>Total Vacancy for Select Suburban Submarkets</b>							
<b>Submarket</b>	<b>Current</b>						
	<b>Market Size (Sq. Ft.)</b>	<b>3Q 08 Vacancy</b>	<b>4Q 08 Vacancy</b>	<b>1Q 09 Vacancy</b>	<b>2Q 09 Vacancy</b>	<b>3Q 09 Vacancy</b>	<b>4Q 09 Vacancy</b>
Washington Square/ Kruse Way	19,235,450	13.5%	14.7%	16.3%	19.6%	20.6%	21.1%
Sunset Corridor	3,509,988	22.3%	22.3%	25.3%	25.6%	27.4%	28.0%
Beaverton	1,600,875	16.9%	15.4%	16.5%	16.8%	15.8%	16.5%
Eastside	522,016	8.2%	8.2%	7.6%	7.4%	7.4%	8.6%
Johns Landing/Barber Blvd.	1,509,931	14.2%	13.1%	13.9%	14.5%	14.8%	15.1%
Tualatin/Wilsonville	759,284	28.7%	27.3%	26.1%	26.9%	27.9%	28.3%

Source: Grubb & Ellis, Co., Office Quarterly Report, Fourth Quarter 2009 Statistics

The overall metropolitan area market continues to have negative net absorption for the third straight quarter, but according to CB Richard Ellis, the suburban submarkets are back in the black with a positive net absorption of 31,223 SF. Nine out of the fifteen suburban office submarkets posted positive absorption figures for the fourth quarter.



Source: Grubb & Ellis Office 4<sup>th</sup> Quarter Report –2009

**Major Lease Transactions Q3 2009**

Lessee	Property	Submarket	Size (SF)
Transcore (renewal)	Creekside Four	Central 217	38,065
M&T Real Estate, Inc	4949 Meadows	Lake Oswego	22,482
The Portland Dermatology Clinic	Machine Works	Northwest	19,482
HQ Global Workplaces (renewal)	4800 Meadows	Lake Oswego	19,306
McCormick & Schmicks	Machine Works	Northwest	19,250
Barran Liebman, LLP (renewal)	ODS Tower	Portland	18,324
Bluestone & Hockley	9320 SW Barbur Blvd.	Barbur Blvd.	14,704

Source: CB Richard Ellis, Norris, Beggs & Simpson Office Report - Fourth Quarter 2