

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

## 2010 Forecast - High Unemployment Clouds Economic Recovery

### Current Portland Metro Trends

- Unemployment: 11.6%
- Job Growth: -5.2%
- Population Growth: 1.5%
- Portland CPI: -1.0%
- Apartment Construction: Dead; at record low levels
- Apartment Sales: Sales volume down 67% from 2008
- Apartment Values: down around 15% to 18% from the peak in early 2008
- Turnover Apartment Rents: Flat; income showing a slight decline at many properties
- Apartment Vacancies: 5.9%

*This issue of the Barry Apartment Report is based on five recent forecast type speeches given by Mark D. Barry, MAI, Apartment Appraisal Specialist, with research and professional contribution from Phillip E. Barry, Apartment Real Estate Broker.*

2009 will go down as one of the toughest years for the Portland economy since the early 1980's, with only the Great Depression causing noticeably more pain. While we all know how tough the second half of 2008 was, there was little to prepare us for the turbulent waters and gale forces winds which impacted the Portland economy and commercial real estate in 2009. So just what happened here in 2009?

**Portland Economy:** The big surprise of 2009 was just how weak the Portland economy was. Over the twelve months ending in October 2009, we have lost 53,200 wage and salary jobs, or over 5% our employment base. In addition, our unemployment rate rose from 6.8% in October 2008 to 11.6% in October 2009.

**Apartment Construction:** 2009 will go down as the slowest year for apartment construction since 1983, when permits were issued for just 793 apartment units. The final figures should show permits for around 850 new multifamily units in 2009 vs. an average of around 4,000 units per year for the previous ten years.

**Single Family Market:** Two years ago, Portland was considered one of the best single family markets in the country. However, home values slipped by 8.5% in 2008, and another 9.8% in 2009. We are down 20% from the peak in August 2007. We currently have around 8.5 months of supply based on current home sales, and the

range of 5% to 10% in 2010 due to lay offs, mortgage defaults, and expiration of the \$8,000 tax credit on 6/30/10. In 2009, there will be permits for approximately 2,800 new homes.



### Apartment Vacancies and Rental Rates

**Rates:** Apartment vacancies were reported at 5.9% in the Fall 2009 MMHA Apartment Report, but were up to 6.9% by year end according to the recent Norris and Stevens apartment vacancy report. While apartment vacancies are clearly on the rise, our apartment vacancy rate is well below the national average of 7.8%. Apartment vacancies are creeping up primarily due to such a tough economy. Studios and three bedroom units are showing the lowest vacancy rates, while one bedroom and two

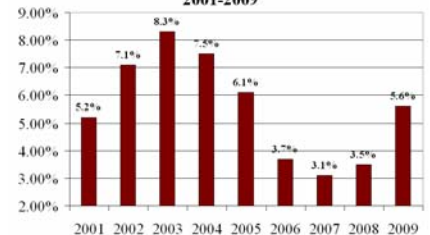


median price of a home is \$239,000. IHS Global Insight, Wells Fargo, and Fortune Magazine are all forecasting a decline in Portland housing values in the

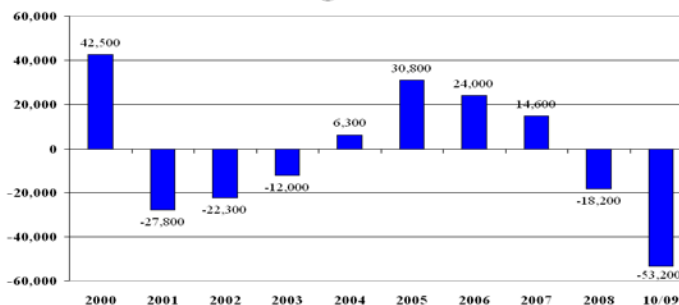


9/09 Sale- \$72,727/Unit  
33 unit Hillcrest Apartments  
3315-3532 SW 11th Avenue

Portland Area Apartment Vacancy Rates 2001-2009



PMSA Wage & Salary Employment Annual Change 2000 - YTD 2009



bedroom townhouse units are showing the highest vacancy rates. North Portland and downtown Portland are showing the lowest vacancy rates. However, apartment vacancy rates of over 6% are being seen in NE Portland, SW Portland, outer SE Portland, Gresham, Clackamas

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and Hillsboro. East Vancouver, Aloha, and Lake Oswego/West Linn are all showing apartment vacancy rates of over 8%.

**Apartment Expenses:** Voter approved bond measures for libraries, parks, the zoo, and the local community college contributed to higher property taxes for the 2009-2010 tax year. While the tax rates vary by municipality, most apartments are facing a 6% to 7% increase in property taxes. Utility costs continue to rise, with overall increases of around 8% in 2009. In addition, turnover costs are on the rise, and we are seeing a slight increase in advertising and marketing costs.

**Apartment Values:** Apartment values had been steadily climbing for a decade, with the median price per unit up an average of 6% per year since 2000. However, this changed in 2009. Apartment values have been adversely impacted by higher vacancies, lower effective gross income, increased expenses, and increases in cap rates. The median cap rate increased from 6.1% in 2008



to 6.8% in 2009. However, cap rates showed a noticeable increase in the second half of 2009 in comparison with the first half. Our analysis shows a decline in value of 15% to 18% from the peak in early 2008. These declines appear more pronounced for newer larger complexes and more outlying suburban communities, and less pronounced in the urban area and close-in area just outside of the urban core.

**Apartment Sales Volume:** 2009 was a major challenge for even the best of apartment brokers in the local market. When the final figures are in, we should see about 85 apartment sales for around \$300 million vs. an average of



12/09 Sale- \$57,143/Unit  
14 unit Brandi Lee Apartments  
6729-6731 SE Powell Blvd.

215 sales per year and \$991 million in sales volume per year from 2006 to 2008. The 2009 transactions are down by 65% from 2007, with the sales volume



down by 73%. In 2009, there were just nine apartment sales of over \$5.0 million vs. an average of 26 such sales per year from 2001 to 2008. Many sellers are unrealistic on values, and many buyers seem to be bottom feeders.

**Condominium Market:** In 2009, we saw continued conversion to rentals of urban projects designed and built as condominiums. The downtown and urban area will see over 3,100 newer luxury rental units



from mid 2008 to late 2010, with at least 500 more units from the shadow supply

of row houses and condominiums. This has resulted in effective rents 15% to 30% below pro forma. This oversupply and bubble of inventory has put pressure on higher end rentals going for \$1,200 and over per month in the urban area.

### FORECAST FOR 2009

So where is our apartment market going in 2010? My forecast is as follows:

**Economy:** I keep watching the monthly employment reports for signs of a recovery, but it is very clear that we are not there yet. The November 2009 figures show that Oregon lost 4,600 jobs. Red Capital Research is forecasting a loss of another 4,100 jobs in the Portland metro area in 2010, with 15,000 new jobs in 2011. Greenlight Portland and Wells Fargo are more optimistic for 2010, and are forecasting 1,200 to 3,000 new jobs. The Oregon Office of Economic Analysis expects that the job losses will stop in early 2010, with stabilization and some recovery in the later part of 2010, but that employment will not reach pre-recession levels until 2013. Many consider this to be overly optimistic in light of the recent job reports.

**Condominium Market:** This is a market characterized by pain, distress, slow sales, declining values, many foreclosures on individual units, and workouts and some foreclosures on major projects. This market is so tough that **Portland will not see a major new condominium project in at least five years, and in all likelihood, significantly longer.**

**Apartment Construction:** 2010 will be another very slow year for apartment construction due to a weak economy, difficulty in attaining financing, and higher apartment vacancies. There will be some government sponsored urban projects, and a few contrarian developers want to get ready for the expected economic recovery in 2011 and



2012. However, if you are an apartment developer, 2010 will be a good year to work on your golf game, or find another line of work such as an asset manager or work-out specialist. **I expect we will see permits for 1,000 to 1,500 units in 2010.**

**Apartment Vacancies and Rental Income:** 2010 will be a year to concentrate on keeping your tenants happy, and holding on to what you have. With continued weakness in the economy, I expect apartment vacancies to trend upward. REIS and CBRE Torto Wheaton are forecasting an apartment vacancy rate of 7.0% to 7.5% by late 2010. Looking beyond 2010, apartment vacancies should rebound quickly due to pent up demand from young adult 20-something's getting tired of living with their parents, very slow apartment construction, and a better economy. There will



be a shortage of apartments by 2012. **I expect we will see an overall apartment vacancy factor of 7.0% to 7.5% a year from now, with a flat income in 2010.** 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:** I make a point of following every sale of every apartment, and do some analysis. The majority of the sales since July 2009 have shown pressure on values, with continued lower value indicators and higher current cap rates. Even with the higher cap rates, we are below the trend line of cap rates seen prior to 2004. I expect that **there will be continued pressure on apartment values in 2010.** Expect to see typical cap rates of 7.25% to 8.50% for suburban properties, and 6.25% to 7.50% for more urban properties.

**Apartment Sales Volume:** 2009 saw the lowest level of apartment sales activity over the last few decades. With just 85 sales for \$300 million in 2009, we have nowhere to go but up. **2010 will be a far better year for apartment sales.** This will be due to many owners getting better educated on values, some capitulation on the part of sellers, motivated sellers who need the funds, seller motivated by possible increases in capital gains,



12/09 Sale- \$183,616/Unit  
354 unit Cyan Apartments  
1720 SW Fourth Avenue

and buyers who sense that we are close to a bottom. Some underwater and disappointed investors will be forced to make some hard decisions, and their hand will be forced by cash calls due to lower net income and an inability to re-finance their current debt.

## CONCLUSION

It is too early to be even guardedly optimistic about employment. The recent job figures show that the rate of job losses is slowing, but no real light at the end of the tunnel. While there are noticeable signs of an improved economy, commercial real estate is usually slow to recover. I expect the first half of 2010 to be rocky, with some limited signs of recovery of jobs in the second half of the year, but no visible recovery until 2011. Apartment construction will be very slow, with flat income, a slight increase in apartment vacancies, and some pressure on apartment values. We should hit bottom by mid year, with an anemic recovery in the second half of 2010, which will build a base for a stronger recovery in 2011 and 2012.

*"Here's what I am worried about. Portland is a nice city. But I'm worried that we're creating a city that is good for 20% of the population—the creative class—and throws the other 80% under the bus." Tim Duy, Economics Professor, University of Oregon*

*"Unfortunately, my crystal ball tells me that 2010 is going to be another ugly year in commercial real estate as the fundamentals to turn this market around are not yet in place," said Doug Marshall of Marshall Commercial Funding. "Hang in there. It is not over yet."*

*"For new development to underwrite in most markets today, rental rates must increase 25% to 40%," said Clyde Holland of Holland Partner Group at the recent IREM Forecast Breakfast. "We believe that Oregon and Washington will return to peak employment long before the nation as a whole."*

*"Multifamily is the sector to watch in 2010 as investors seek strong, stable assets with growth potential." 2010 Multifamily Forecast Survey by Jones Lang LaSalle.*

*"We saw a downturn coming before the recession. We just didn't see how deep it would be and how large an impact it would have across the country. I don't think I'm the only one surprised by the depth and breadth of this downturn." Mark Edlen, Gerding Edlen Development Company.*

*"Apartment owners will need to brave a downturn for the next 24 months to get to the light at the end of the tunnel in 2012. Our advice in the short term is not to leave the crash helmet out of site." Cliff Hockley, President of Bluestone & Hockley Real Estate Services.*

# The Barry Apartment Report

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**Mark D. Barry, MAI & Phillip Barry, Apartment Broker, backpacking the Timberline Trail**

## Turn Back the Clock . . .



**\*1946-** 500 members of Portland Property Owners Union announce that they will follow the lead of Seattle landlords in not renting their units until the Office of Price Administration rent regulations are abolished. The Oregon Apartment House Association, controlling 12,000 apartments in Portland, is considering joining.

**\*1948-** The Housing Authority of Portland assures Vanport City residents that they are safe and secure from any flooding. Eight hours later, a wall of water falls on Vanport, leaving 18,700 persons homeless. Vanport City was the largest public housing project ever built in the United States.

**\*1948-** Rev. Richard Steiner of the 1st Unitarian Church and Kenneth Kraemer, the Housing Chairman of the American Veterans Committee, have called for the resignation of Herbert Dahlke, Chairman

of the Housing Authority of Portland. Their concern is that the housing authority, dominated by apartment house owners and real estate agents, has been urging removal of rent controls.

**\*1960-** Portland Real Estate School opens. Joe Weston, the 22 year old owner, uses the proceeds from the business to build his real estate investment portfolio.



10/09 Sale- \$92,500/Unit  
10 unit Weidler Place Apartments  
2624-2644 NE Weidler Street

**\*1963-** Architects Blair and Zaik have won an architectural award for their design of the Iron House Apartments in Lake Oswego. These apartments have set the pace for low cost apartments that have high style.

**\*1983-** The 120 unit Cherry Blossom Estates Apartments is sold by Stan Culver for \$3.5 million, or \$29,166 per unit. The price per unit is one of the highest seen in East Multnomah County.

**1985-** Syndicators dominate the local apartment purchase market. These include Lindsay Enterprises, Mara Limited Partnership, VMS National, Brevick-Whyte, SimmCo Properties, Butterfield Properties, Noram Properties, and Mayfield Investments.