

PORTLAND METRO APARTMENT CONSTRUCTION UPDATE

By Patrick O. Barry and Mark D. Barry, MAI

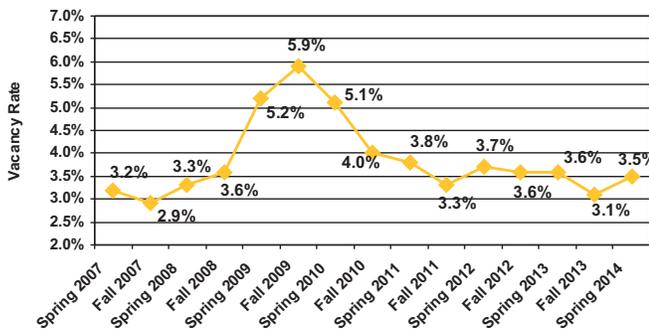
In 2009, we were in the depths of the Great Recession, and new apartment construction came to a screeching halt. But at the same time, demand for apartments in Portland was growing. Developers took note, and we are now in the midst of an apartment construction boom. This article analyzes where we are in the current construction cycle, and the expected impact on apartment vacancies. In order to gauge where we stand today, we visited every site with apartments recently completed, under construction, or proposed.

A Brief History

How did our apartment vacancy rates drop so low in recent years? In the not so distant past, during Fall 2009, Multifamily NW reported a 5.9% vacancy rate for the Portland Metro area. Around this same time, the economy started its nosedive. Unemployment jumped, home foreclosures spiked, and any type of construction financing, commercial or residential, was difficult if not impossible.

However, Portland remained a popular destination and our population grew by around 75,000 from 2009 to 2012. These people needed a place to live, along with the scores of those that lost their homes to foreclosure or unemployment. All of these factors combined would have a positive effect on apartments, and set the stage for our current apartment construction boom.

Portland Metro Vacancy Rates (Multifamily NW)



Supply and Demand: 2009-2012

Given the recent single-family crash, many were not eager to become homeowners and demand for apartments was on the rise. Using conservative estimates, we will assume an average household size of 2.40 persons, and a home ownership rate of around 65 percent. Using these assumptions, growth of 75,000 people translates in to demand for roughly apartment 11,000 units. And this figure does not account for demand from those who left the single-family market and entered the rental market, or demolition.

While there was demand for at least 11,000 new units from 2009 to 2012, permits were issued for 7,400 new units in the Portland Metro area. Thus, the Portland Metro area was short by at least 3,600 new units over this time period. By Fall 2013, vacancy rates had dropped to just over 3.0%.

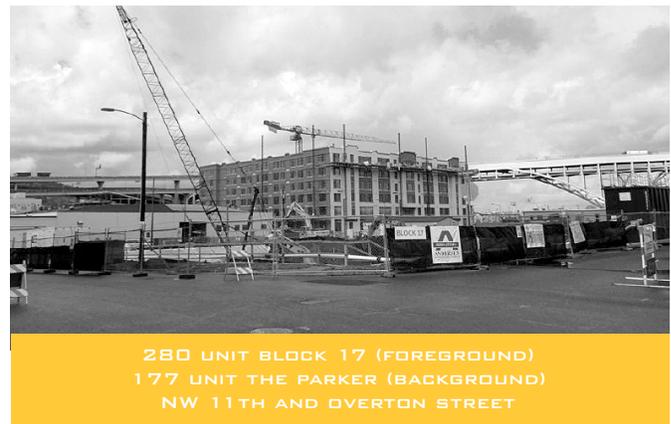
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Inventory and Vacancy

Based on information provided by the 2010 US Census and with adjustment for apartment permits in more recent years, the Portland Metro area has around 270,000 multi-family units. Using the 3.5% apartment vacancy rate from the Spring 2014 Multifamily NW report, we have around 9,500 vacant units. If one assumes that a market in balance will show a 5.0% vacancy rate, then there is a current shortage of 4,000 units.

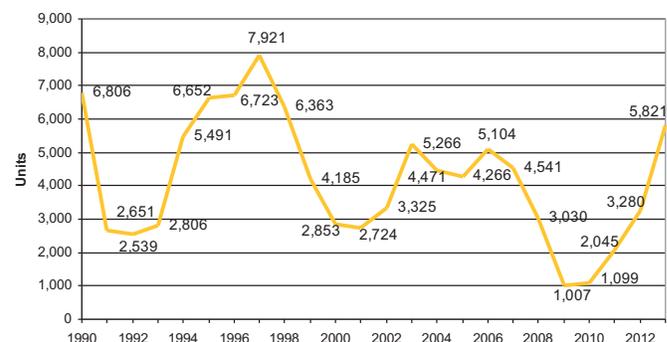
Historical Apartment Permits

There is no denying that the apartment construction market is hot right now. During 2013, permits were issued for 5,800 new units in the Metro area. This is the most active year for apartment construction since the late 1990s. This is a drastic reversal from 2009, when permits were issued for just 1,000 units. Through February 2014, permits have been issued for 866 units across the Metro Area.



While construction is hot right now, it's worth taking a look at a few long-term trends to gain some perspective. From 1990 to 2007, the Portland Metro area averaged permits for just over 4,700 new units per year. When you look at 2008 through 2012, we averaged permits for just under 2,100 units, less than half of our average from the previous 17 years. Specific information on the permit history for the four County metro area from 1990 through 2013 is summarized as follows:

**Apartment Permits 1990 - 2013
Four County Metro Area**



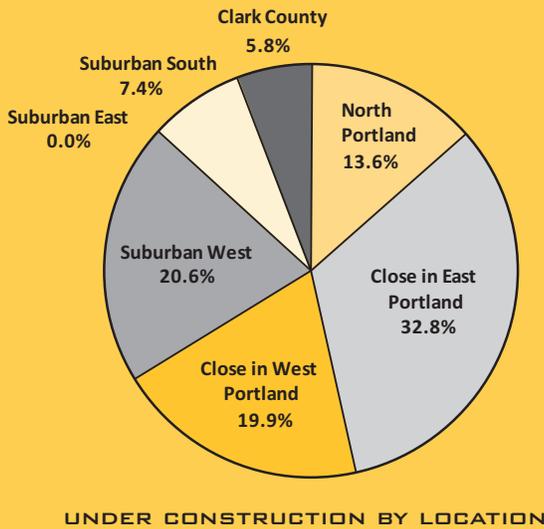
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New Apartment Construction

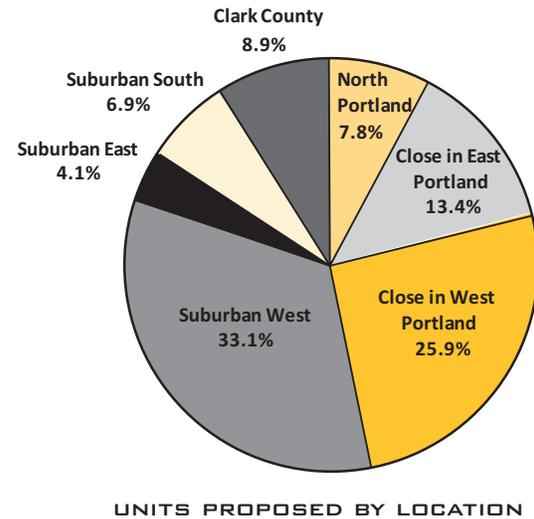
It's no secret; the Portland Metro apartment construction cycle is in full stride and is picking up steam. This current construction cycle has not only attracted local and regional developers, but also many national developers. The 2014 ULI Emerging Trends recently ranked Portland 11th among 50 metro areas for real estate investment. While the commercial and single-family construction markets remain sluggish, developers have flocked towards apartments. For the first time on record, permits for apartments outpaced permits for single-family homes.

Permits were issued for 5,821 new apartment units in 2013. This is 2,500 more permits than was issued in 2012. Our figures show that at least 75 projects with 6,850 new units were completed over the last 18 months. Some of these projects have already stabilized, while others remain in lease up.

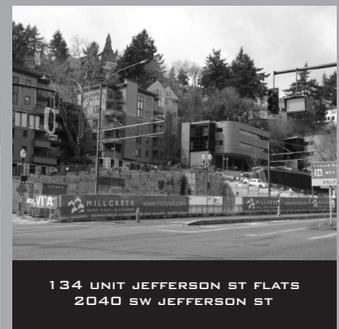
Our research shows an additional 6,500 units currently under construction across 56 projects. Over 65% of these projects are in the urban area. Most of these projects will be complete by the second half of 2014 or during 2015. The number of units under construction is slightly higher than what our research showed from Spring 2013, as new larger projects have replaced completed projects.



When we look at the number of proposed units, we have seen a drastic increase from one year ago, as the economic recovery has continued. Twelve months ago, in Spring 2013, we were tracking 7,500 proposed units across 60 projects. Our most recent figures show nearly 14,000 proposed units across 125 projects. That is an 87% increase over 12 months. A vast majority of these projects were identified from activity on the public records through permit applications or requests for design assistance. This typically means that a significant amount of money has already been spent on acquiring land, developing drawings, commissioning market studies, and other pre-construction related costs. Most of the projects taken to this level will get built. Developers are racing to get their project out of the ground before lenders start to question the extent of demand for all the new units. However, it's inevitable, that the plug will be pulled on some of these projects, but other new projects not yet announced or still in the planning stage are likely to emerge.



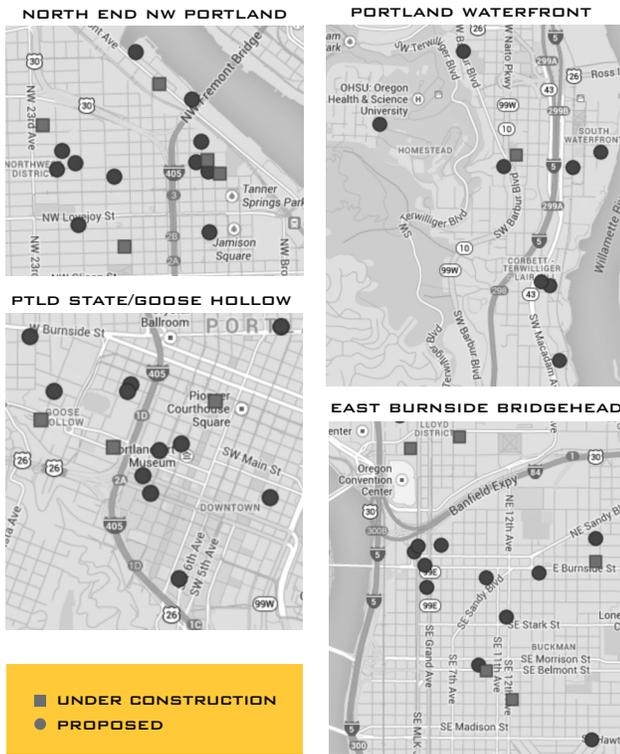
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Specific Submarkets and Building Trends

The new construction is by no means evenly distributed across the Portland Metro area. A few select areas have seen a disproportionately large number of units under construction and proposed. This includes the north end of Northwest Portland, the area surrounding Portland State/Goose Hollow, near the South Waterfront and the East Burnside Bridgehead.



While the selected areas above show high activity, many areas have seen very few units since 2008. This includes most of Clackamas County, east Multnomah County, and some pockets of Washington County including Tigard and East Beaverton.

As more projects are announced, the size of the projects appears to be scaling up. There are currently 13 buildings with over 100 units under construction in the urban area. However, there are an additional 26 proposed urban buildings with over 100 units. This could lead to longer lease up periods as a large number of units are delivered in a short period of time. Many developers have bet heavily on specific unit types, which may or may not be accepted by the market. When consumers have more choices for apartments, less desirable unit types can fall out of favor.

New Units and Impact On Apartment Vacancy Rates

Metro is forecasting that from 2010 to 2035, the population of the Multnomah, Washington, Clackamas and Clark County will grow by 781,152. This averages roughly 31,000 people per year. Using similar assumptions on household size and home ownership rate, this translates into demand for around 4,500 units per year, very close to our historical average for permits. There is also felt to be some pent up demand from those who found roommates, or moved in with friends and family during the recession. Pent up demand is difficult to quantify, but some demand exists.

In 2014 and 2015, we expect completion of around 12,000 to 14,000 new apartment units. This figure includes the units currently under construction and as well as proposed units.

Based on the figures discussed in this article, new units in the coming years will exceed current demand. However, to reach a market in balance, vacancies around 5%, we need an additional 4,000 units in excess of current demand. We expect the new units during 2014 and 2015 to bring the Portland apartment market to a more balanced state. We expect apartment vacancies to gradually increase in 2014, and be at 4.5% to 5.25% by late 2015. This will result in a shift from a landlords market to a market more in balance over the next 18 to 24 months.

Additional Risks

As with every real estate cycle, there are some considerable risks as we move along the curve. Risks specific to our current cycle include:

- An increase in the home ownership rate. As the single-family market continues to improve, a strong increase in the home ownership rate would dampen demand for apartments.
- Oversupply. If all the proposed units are delivered in a short period of time, some projects will experience slow absorption and higher vacancies.
- Increasing rents and the Portland Economy. Many of the new units are aiming for the very top of the rental market in Portland. We reviewed a few advertised rents for various unit types. We found new some studios around \$1,200, one-bedrooms up to \$1,900 and two-bedrooms up to \$2,500. If up to a third of one's income could be spent on housing, what incomes levels are these developers targeting? Given the rents listed above, household incomes should range from \$43,000 for a studio, up to \$90,000 for a two-bedroom unit. Does Portland have the economy to support these income levels, at the number of units to be delivered? And at what point does the renter paying \$1,500 to \$2,500 per month decide they'd rather own a home?

Conclusions

Based on the current level of units under construction and proposed, the majority of the Portland metro area apartment market will not become saturated, and will not result in an overbuilt market in the short term. However, some neighborhoods will experience slow absorption, higher vacancies, and possible concessions or rent reductions until there is sufficient time for the new units to be absorbed. The primary neighborhoods of concern are the urban areas with large numbers of units expected to be delivered in a short period of time. Older, established apartments in these neighborhoods should be less affected, due to substantially lower rents. ■

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