Johnson Economics

Market Analysis for Office Space in Milwaukie, Oregon

Prepared for the City of Milwaukie,
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JOHNSON ECONOMICS, LLC
621 SW Alder St, Suite 605
Portland, Oregon 97205

I. INTRODUCTION

JOHNSON ECONOMICS was retained by THE CITY OF MILWAUKIE to evaluate the market potential for new office space development in Milwaukie. The study evaluates the potential for different office products and identifies the subareas within the city that are best positioned to attract these types of development. The main objective of the study is to provide inputs to the City's planning process considering viable development programs and locations.

The main components of this study are:

- Evaluation of economic trends pertaining to local office space demand;
- Analysis of regional and local office market trends;
- Survey of the competitive environment, including a survey of existing and anticipated future supply;
- Market depth analysis;
- Submarket/district evaluation; with identification of viable development forms and achievable pricing

II. EXECUTIVE SUMMARY

EMPLOYMENT TRENDS

The Portland Metro Area has seen strong job growth throughout the current economic expansion, growing at rates nearly twice the national level. The growth has shown signs of moderation over the past year, in part due to reduced availability of labor. The region is currently adding 35,000 jobs per year, for a robust 3.1% annual growth rate.

Clackamas County was slower to recover from the 2008 recession than the region, due to weakness in important suburban industries like homebuilding and retail. However, the county has added jobs at a higher rate than the remainder of the region since 2014, peaking at 7,200 jobs per year (+5.0) in late 2015. Currently, the growth is 3,000 jobs or 1.9% per year.

In aggregate, industries that primarily occupy office space are currently growing at 2.6% per year in Clackamas County, while industrial sectors are growing at 1.9%, and retail/hospitality sectors are growing at 0.9%. Professional and business services are the engine of growth in the office segment, currently adding 1,100 jobs per year (+5.5%). This is also the industry that is projected to see the strongest growth over the next ten years, both in terms of number of jobs and percentagewise growth rate.

Within the market area (PMA) defined for the Milwaukie office market (covering the region south of Foster Road, between the Willamette River and 82nd Avenue/I-205), the most recent employment estimates indicate annual growth of around 1,050 jobs (2.2%, 2015). Retail and manufacturing are the largest contributors of new jobs over the 2010-2015 period. However, the most rapidly growing industries over this period are financial activities (+48%, 400 jobs) and professional/business services (+32%, 600 jobs). In the sectors that occupy non-medical office space, the growth over this period was dominated by small firms (1-4 employees), while the healthcare sector saw stronger growth among larger firms.

OFFICE MARKET TRENDS

The Portland Metro office market has been among the strongest in the nation over the past years, with low vacancy rates and rapid rent growth. The vacancy rate peaked at 11.8% in mid-2010, and currently sits at 7.1%. Lease rates have risen 5.3% per year on average over the past five years, with a 4.5% increase over the past 12 months, and currently average $25.09.

The Portland Metro market has absorbed 7.3 million square feet of space since the bottom in mid-2010, while 4.3 million square feet of new space has been delivered. The regional development pipeline currently totals 4.0 million square feet of space in projects with submitted land use applications, representing an inventory increase of 4.0% over a three-year period – well within the market's absorption potential.

Market conditions in the PMA have been tighter than in the remainder of the region over the past ten years, with vacancy peaking at 8.2% in 2011 and remaining below 5.0% since 2012. The current rate is 2.0%, which is unusually low, both historically and geographically. Asking rates in this market are somewhat unreliable indicators of market conditions, as they are based on a few vacant spaces of varying quality – mostly older and smaller spaces. However, the observed rent growth trajectory over the past four years, averaging 6.0% per year, is on par with regional growth.

Historical absorption of office space in the PMA has been held back by a lack of available supply in recent years, and is not a good indicator of the market's absorption potential. Total new supply delivered so far in this current construction cycle is only 95,000 square feet, which has been absorbed quickly upon delivery. The greatest amount of new supply was delivered in 3Q16, totaling 44,000 square feet. Net absorption for that quarter was 56,000 square feet. At the current market vacancy rate, the market needs an additional 90,000 square feet of space to facilitate a 5% vacancy rate, and 220,000 to reach a 10% rate.

COMPETITIVE MARKET SURVEY

JOHNSON ECONOMICS surveyed 11 office properties for this analysis, including six located outside the defined PMA. The projects represent a wide range of formats, including new construction creative space, traditional professional space, medical office space, semi-industrial flex space; and renovated creative/industrial space. In total, the properties represent 690,000 square feet of space. Annual, per-square-foot asking rates range from a low of $14.40 NNN for semi-industrial flex space to $34.00 NNN for well-positioned, new construction creative space. Stabilized properties have occupancy rates ranging from 85% to 100%.

Only two projects totaling 37,000 square feet are currently in the pipeline within the PMA. 27,000 square feet of the new supply is medical space oriented toward the I-205 corridor population, while 10,000 square feet is professional/medical space oriented toward the Gladstone population.

MID-TERM MARKET DEMAND

Based on current employment trends in the typical office industries, we project a net increase in office space demand within the PMA of 300,000 to 680,000 square feet over the coming five years. Our baseline estimate is 490,000 square feet, or roughly 100,000 square feet per year. With only 37,000 square feet of space in the supply pipeline, we expect increasing market pressure in the PMA, with continued rapid rent growth and low vacancy rates. We expect the demand to be strongest for spaces with less than 1,000 square feet and more than 5,000 square feet.

SUBAREA EVALUATION

JOHNSON ECONOMICS evaluated the market potential for new office space in five subareas within Milwaukie based on current market conditions and projected demand. The five subareas are Downtown; the area between Downtown and Highway 224; the Highway 224 corridor; the North Milwaukie Industrial Area; and the Murphy/McFarland sites.

We regard Downtown and the Highway 224 Corridor to represent the strongest potential for new development over the near term, given the profile of current market growth and estimated achievable pricing. These areas represent good access and visibility, and have amenities in place that appeal to office users. Downtown has the potential to attract population-serving as well as region/national users, while the 224 corridor is best positioned toward the latter.

Achievable lease rates in Downtown are estimated to $24-26 NNN, assuming occupancy today and tenant improvement allowances of $50 per square foot, with small suites leasing for up to $27 NNN. Assuming 3.5% annual rent escalation, we would expect $26-28 NNN to be achievable for space with occupancy in late 2019. Strong sites in the Highway 224 corridor are estimated to achieve pricing representing a discount of $1.00 to Downtown rates.

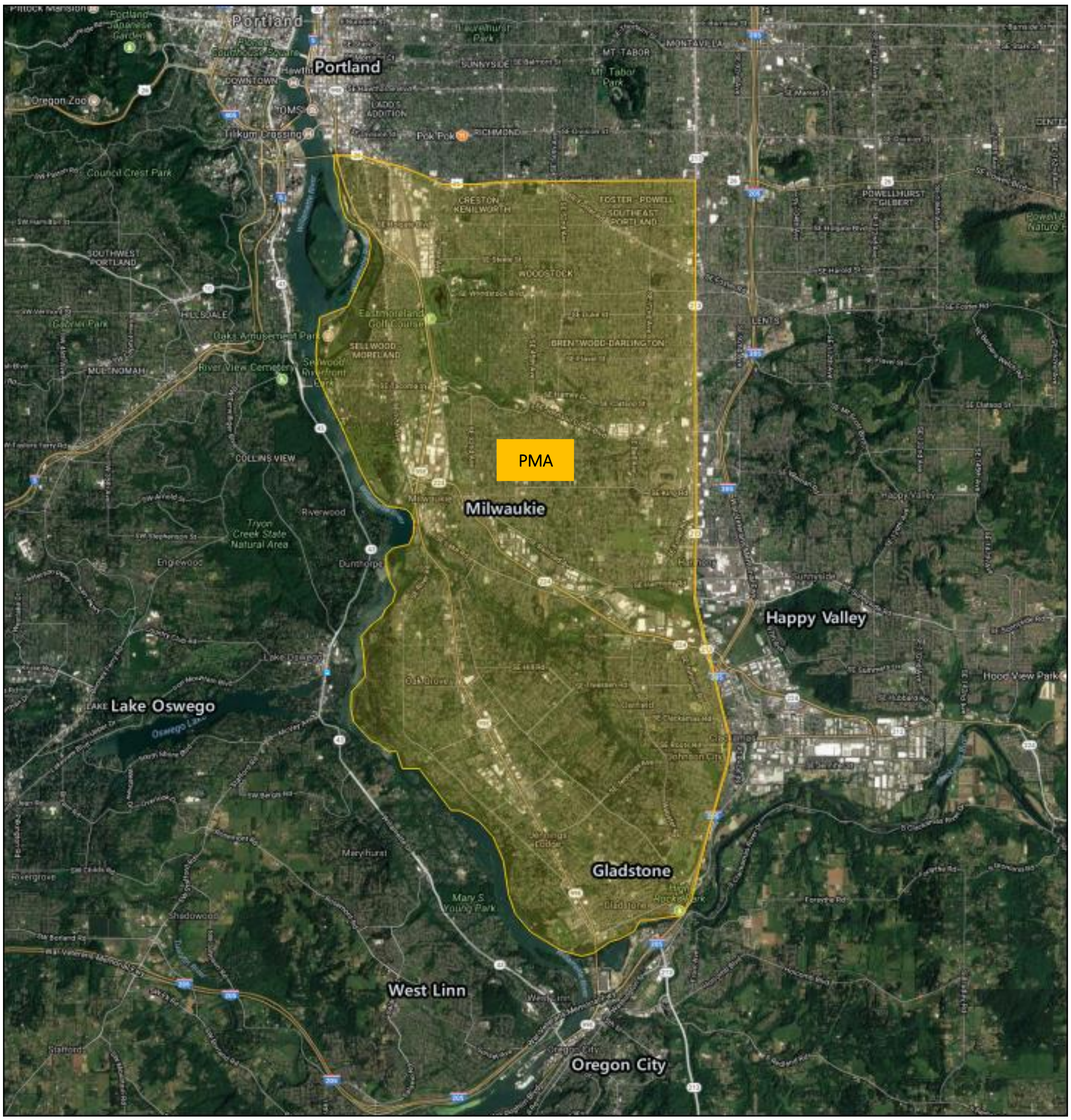
The area west of Downtown and the Murphy/McFarland sites have some potential for population-serving space, but suffer from limited visibility. Challenges to development in the North Milwaukie Industrial Area (NMIA) include lacking amenities, a dated industrial environment, fragmented ownership, and relatively strong economics for existing uses – though it represents a low-cost alternative to Portland in terms of land prices. A large office campus with its own on-site amenities may be possible in the future, as developers are expected to follow Millennials who establish families and migrate to affordable single-family areas around Central Portland.

III. Market Area

Market Area Definition

The primary market area (PMA) is the geographic region from which the subject development is expected to draw much of its market support, and within which the subject is anticipated to compete with similar projects on a comparable basis. For this analysis, we define the PMA as the region located east of the Willamette River, west of 82nd Avenue and I-205, north of the Clackamas River, and south of Foster Road. In the context of office space, we regard this market to be distinct from the I-205 corridor, which attracts office users reliant on freeway access. We also regard the market to be distinct from areas to the north and the west, which represent more affluent demographics.

FIGURE 3.1: PRIMARY MARKET AREA

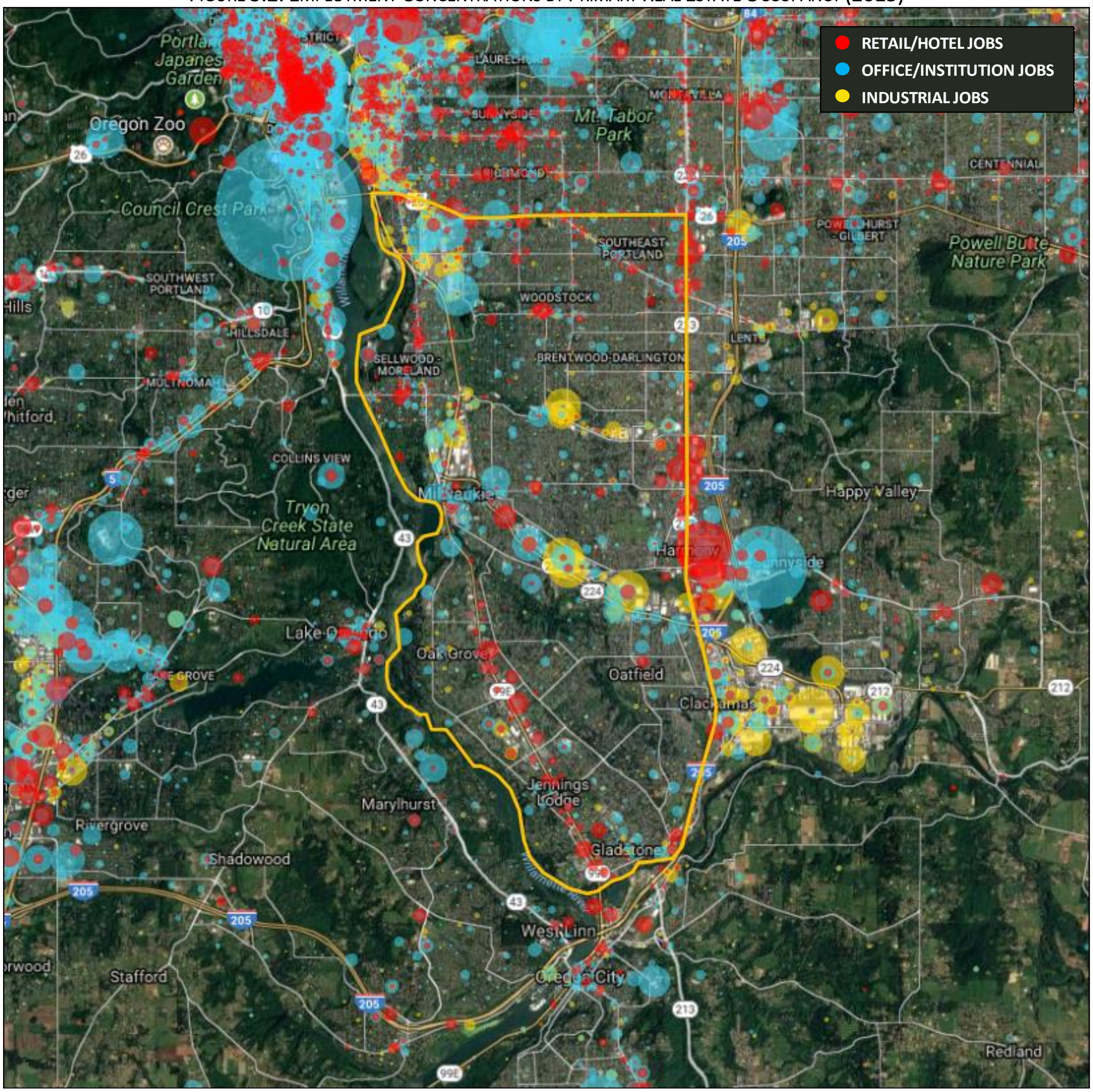


SOURCE: Google Maps, Johnson Economics

EMPLOYMENT CONCENTRATIONS

As of 2015, the PMA was home to roughly 50,000 primary jobs.[1] Of these, approximately 13,000 were located in the Highway 224 corridor (including Downtown Milwaukie), and 5,000 were in the Highway 99 corridor. The latter is dominated by retail jobs, while the Highway 224 corridor is dominated by office and industrial jobs. Another 5,000 primary jobs are in Sellwood-Moreland, and 7,000 jobs are located around the Brooklyn Rail Yard. The largest employment concentrations just outside the PMA are Clackamas (27,000 primary jobs, including Town Center and Industrial Area), the Central Eastside (18,000 primary jobs), and Gateway/Mall-205 (8,000 primary jobs).

FIGURE 3.2: EMPLOYMENT CONCENTRATIONS BY PRIMARY REAL ESTATE OCCUPANCY (2015)



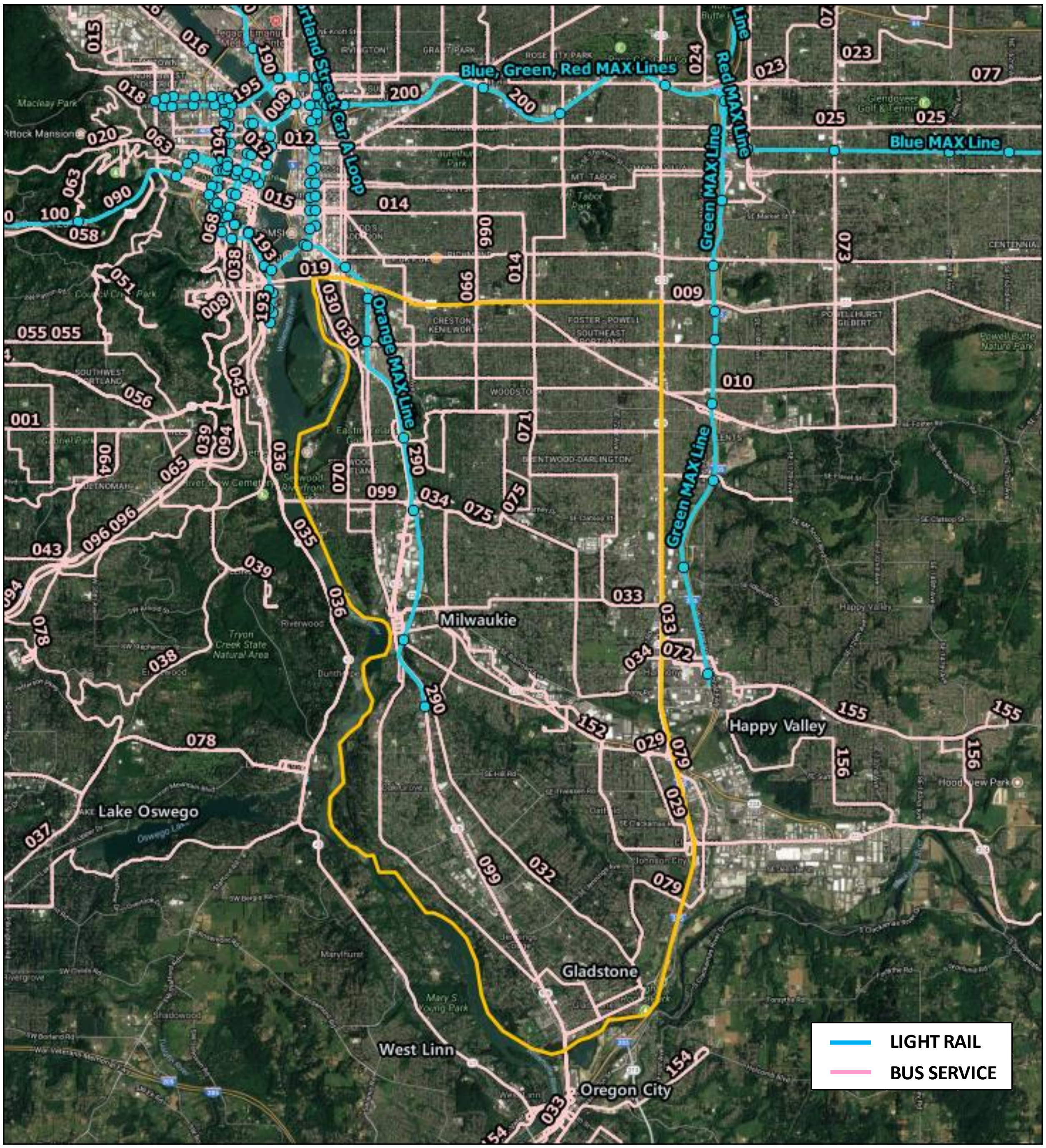
SOURCE: U.S. Census Bureau, Google Maps, JOHNSON ECONOMICS

[1] Primary jobs represent the highest paying job for each employed worker, and does not include supplementary jobs.

PUBLIC TRANSIT

Access to public transit varies across the PMA, with the northwest portion providing the best connectivity to outside commercial and residential concentrations via the MAX Orange Line (light rail). Throughout most of the day, this line provides service between Central Portland and Milwaukie every 15 minutes. Just to the east of the PMA, the MAX Green Line provides equally frequent service between Clackamas, Gateway, and Central Portland along the I-205 freeway. An extensive bus network covers the remainder of the PMA, with connections to MAX stations as well to smaller towns in the southern portion of the Metro Area.

FIGURE 3.3: PUBLIC TRANSIT



SOURCE: Metro, Google Maps, JOHNSON ECONOMICS

IV. EMPLOYMENT TRENDS

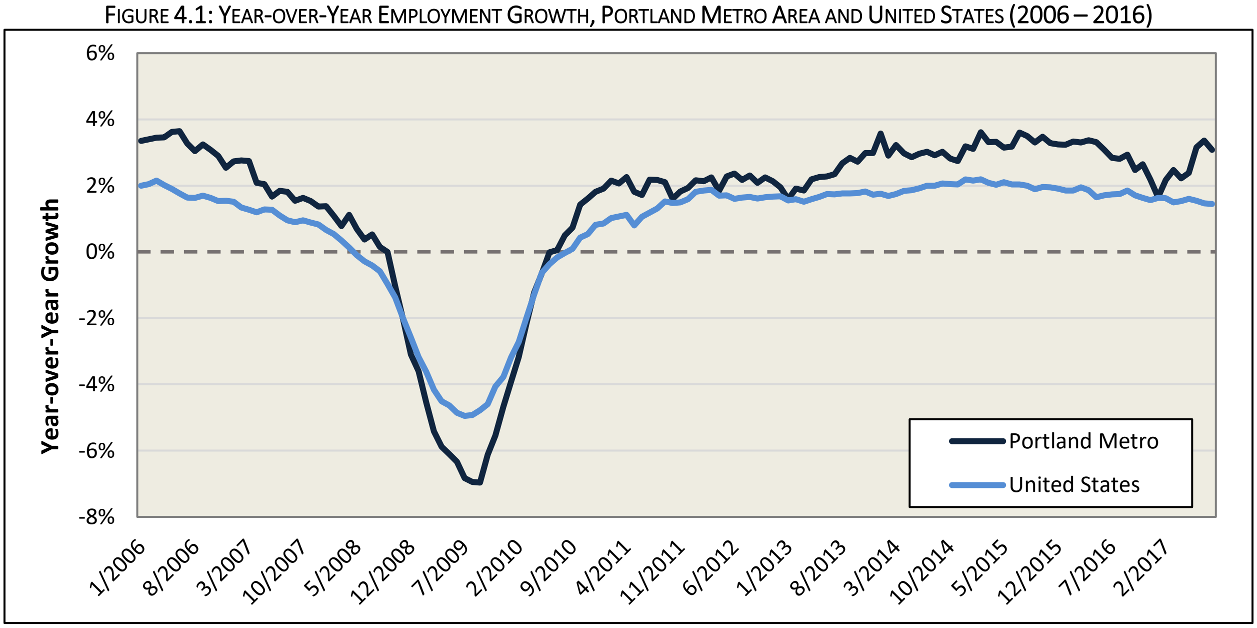
REGIONAL TRENDS

EMPLOYMENT

The four-county Portland Metro Area is currently adding 35,000 new jobs per year. This represents a year-over-year growth rate of 3.1% - more than twice the national rate of 1.5%. The region has outperformed the remainder of the nation during much of this recovery, largely due to a thriving tech sector and strong in-migration, with the professional and business services industry being the single most important growth driver.

The growth seemed to moderate earlier year, likely due to a lack of available labor. The deceleration began to take effect as the unemployment rate dipped below 5.0%, affecting virtually all industries (healthcare being a notable exception). The unemployment rate has since fallen to 4.0% - well below the "natural rate" of 4.7-5.8%, which according to the Federal Reserve characterizes a healthy economy. A tight labor market reduces access to labor directly, and secondarily limits the growth in consumption, which in turn reduces the need for new hiring. The strong growth has resumed in recent months, perhaps reflecting an increase in available labor due to new graduates and summer migration.

FIGURE 4.1: YEAR-OVER-YEAR EMPLOYMENT GROWTH, PORTLAND METRO AREA AND UNITED STATES (2006 – 2016)

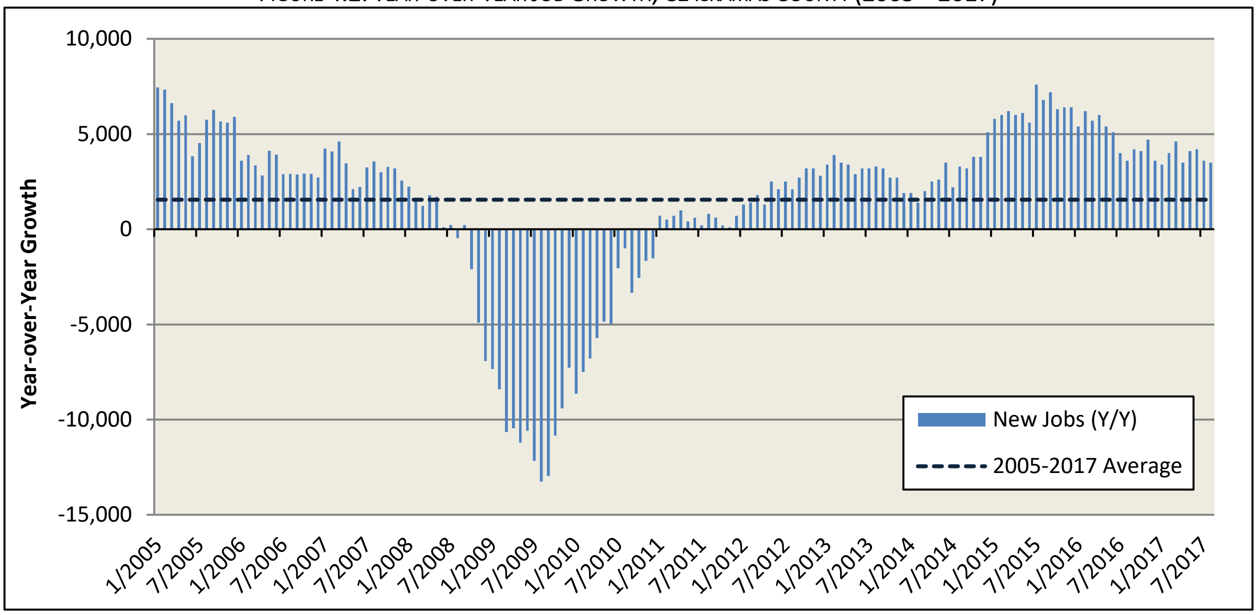


SOURCE: Oregon Employment Department, JOHNSON ECONOMICS

CLACKAMAS COUNTY

The rate of job growth in Clackamas County has generally been somewhat lower than the regional rate over the past ten years, and more in line with national growth. This reflects that the county has seen less benefit from growth in tech/software and apparel sectors than Multnomah and Washington counties, and captured fewer headquarter relocations than Clark County, which has an advantage in terms of the Washington State tax structure. However, after the suburban economic recovery began to take hold in 2014 – driven largely by retail and construction – Clackamas County has exhibited growth above the regional rate. On average, the county has created 3,300 new jobs per year during this recovery (since 2010), and 4,800 per year since 2015. The average annual growth since 2005 is 1,600 jobs per year. The growth reached a high in mid-2015, at 7,200 new jobs (+5.0%) per year, but has normalized over the past two years. As of September 2017, the growth rate was 3,000 jobs or 1.9% per year.

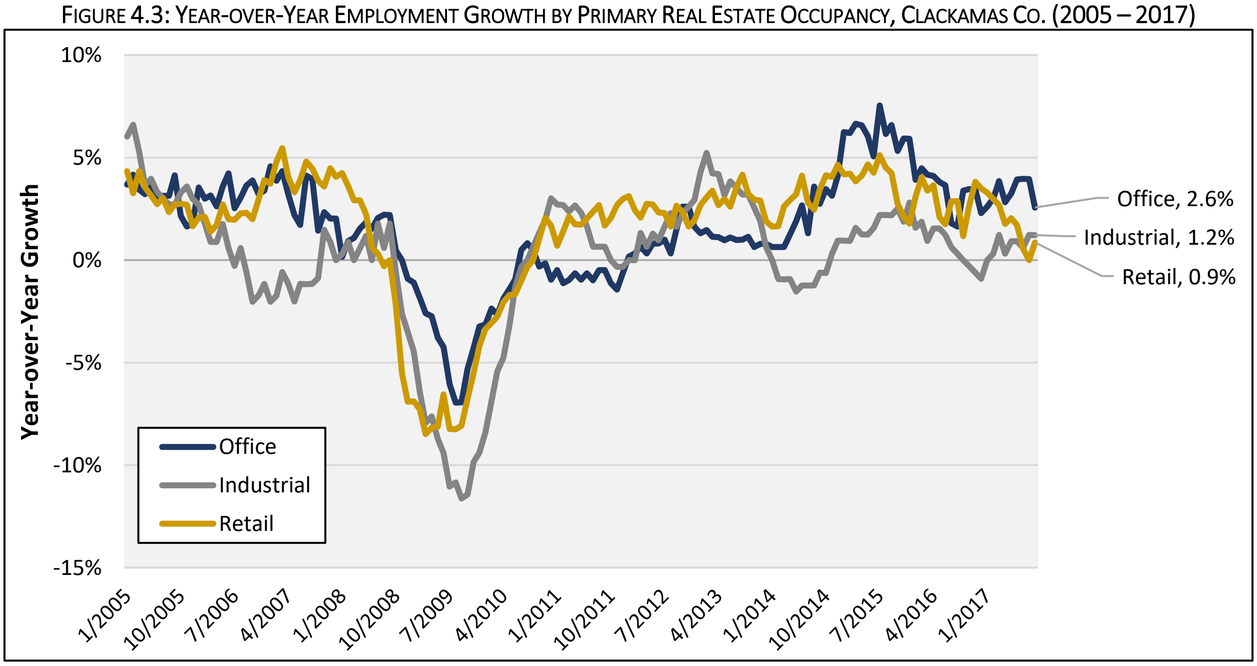
FIGURE 4.2: YEAR-OVER-YEAR JOB GROWTH, CLACKAMAS COUNTY (2005 – 2017)



SOURCE: Oregon Employment Department, JOHNSON ECONOMICS

The current employment growth in Clackamas County is weighted to industries that utilize office space as their primary real estate occupancy. These include information, finance, professional/business services, health/education, and public administration. Together, these industries currently represent annual growth of 2.6% (1,800 jobs), after peaking at 7.5% in the fall of 2015. Job growth in industrial sectors, excluding construction, is currently 1.2% (400 jobs), while retail sectors are growing at 0.9% (300 jobs). While the employment picture indicates moderating demand for commercial real estate relative to 2015 levels, the recent strong job growth has not yet been met with a commensurate increase in space supply, suggesting that there might be some unmet demand in Clackamas County.

FIGURE 4.3: YEAR-OVER-YEAR EMPLOYMENT GROWTH BY PRIMARY REAL ESTATE OCCUPANCY, CLACKAMAS CO. (2005 – 2017)

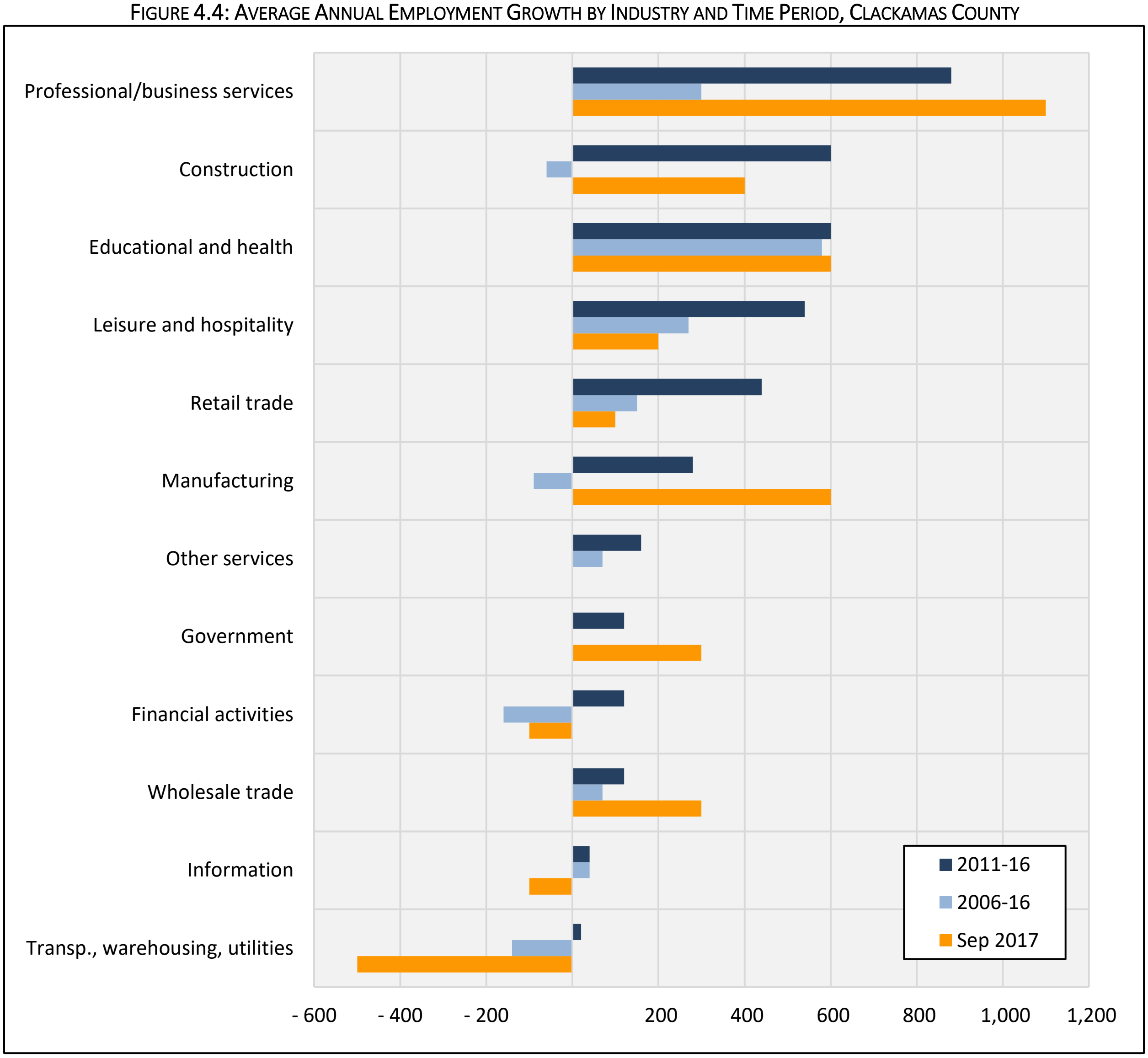


SOURCE: Oregon Employment Department, JOHNSON ECONOMICS

The professional/business services industry has been the single most important driver of job growth in Clackamas County during the current recovery, generating nearly 900 jobs per year on average. This is also the industry that currently generates the highest number of new jobs. Much of the current demand for office space in the region can be attributed to growth in this industry. As of September 2017, this industry added 1,100 jobs over the past 12 months (+5.5%), after creating 1,700 jobs in 2015 and 1,000 in 2016.

Other industries that are significant in the context of office space demand include information, financial activities, education/health, and government. The information industry, which has been characterized by growth among software publishers offset by declines in print media, has grown very modestly in this recovery, and lost 100 jobs (-4.8%) over the past year. The financial sector has seen limited growth during the recovery due to consolidation and a shift to online platforms, and has also lost 100 jobs (-1.1%) over the past year. Education and health has seen steady growth at around 600 jobs per year (+2.7%), and is the second largest contributor of new jobs in the county. The government sector has generated 300 jobs over the past year (+1/8%), after being flat over the 2006-16 period.

FIGURE 4.4: AVERAGE ANNUAL EMPLOYMENT GROWTH BY INDUSTRY AND TIME PERIOD, CLACKAMAS COUNTY



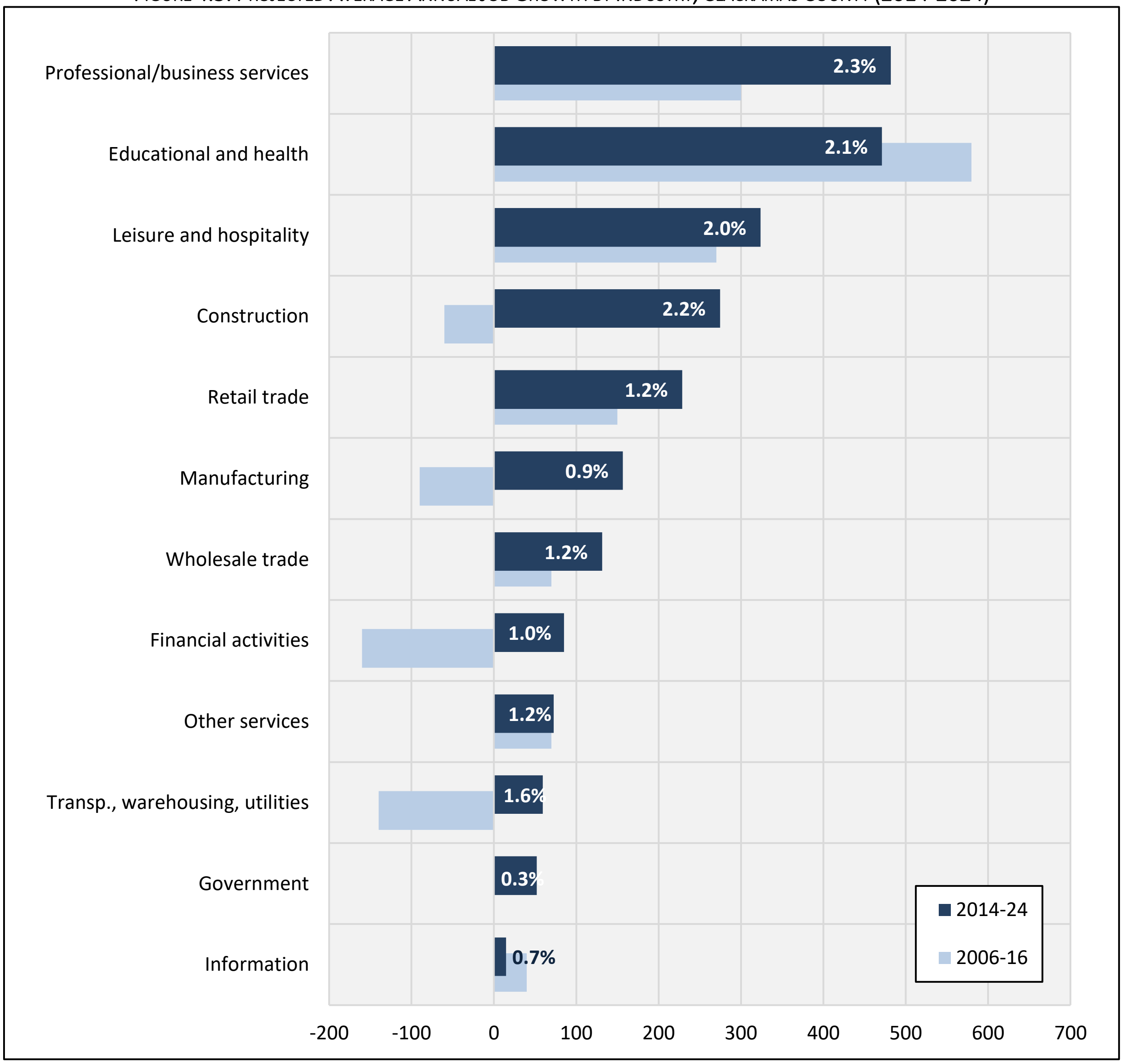
SOURCE: Oregon Employment Department, JOHNSON ECONOMICS

CLACKAMAS COUNTY PROJECTIONS

The Oregon Employment Department produces 10-year employment forecasts by industry for Clackamas County. The most recent forecast covers the 2014-2024 period. In the following chart, we apply the annual growth rates assumed in this forecast to September 2017 employment levels. This provides an indication of the number of new jobs anticipated annually in these industries in coming years. For comparison, the chart also includes average annual job growth over the past ten years.

The professional/business services industry is expected to generate the greatest number of new jobs as well as the greatest percentagewise growth over the 2014 to 2024 period, expanding by around 500 jobs per year. Growth at this level would represent a moderation from the current recovery (~900 jobs per year), but an increase from the past ten years (~300/year). Education and health is projected to exhibit nearly the same growth. Only moderate growth is anticipated in the other sectors that occupy office space.

FIGURE 4.5: PROJECTED AVERAGE ANNUAL JOB GROWTH BY INDUSTRY, CLACKAMAS COUNTY (2014-2024)



SOURCE: Oregon Employment Department, JOHNSON ECONOMICS

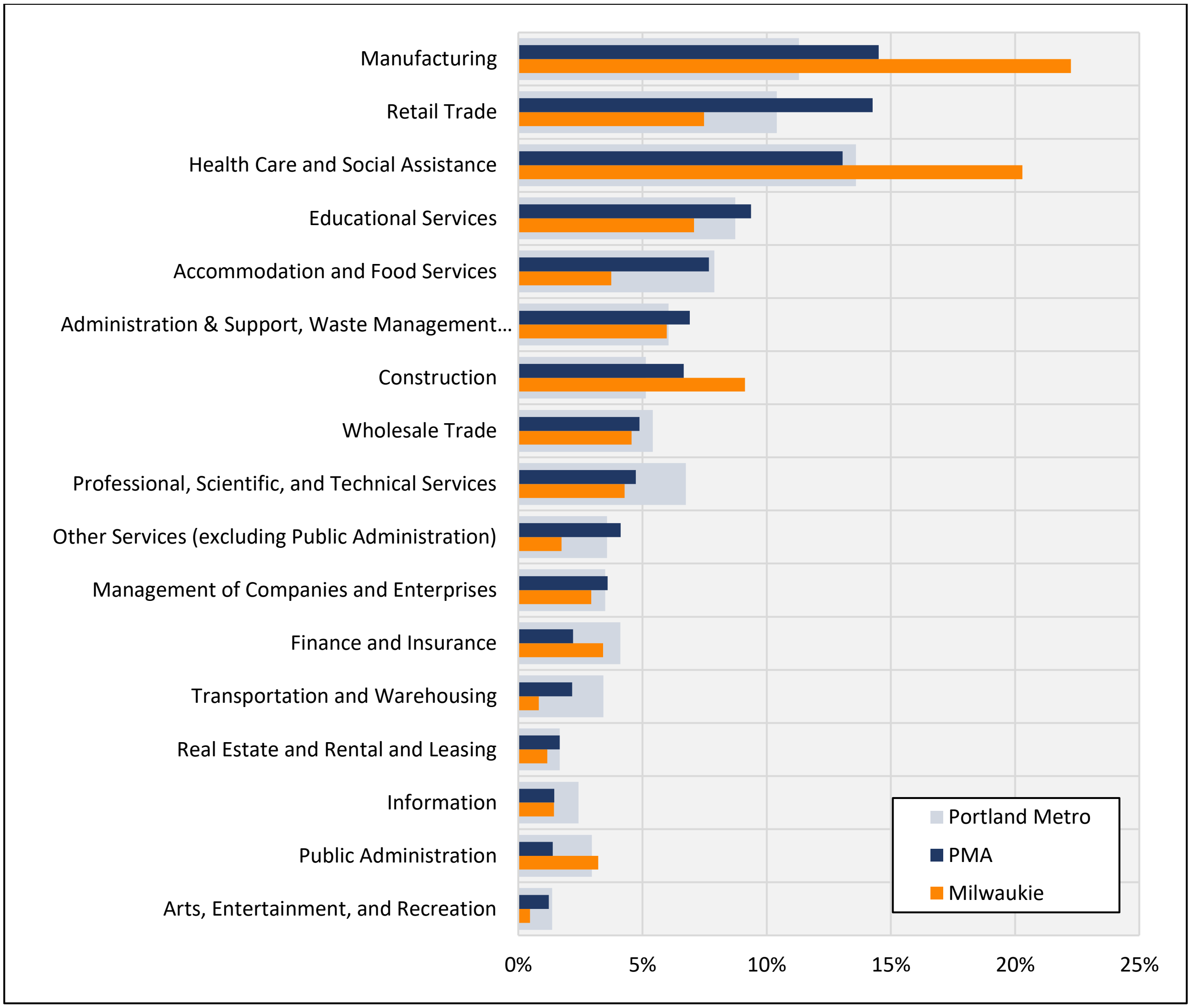
THE PMA

EMPLOYMENT PROFILE

As of 2015, the PMA had a total of 52,000 primary jobs[2], which represents 5% of metro-wide employment. Milwaukie accounts for 25% of all primary jobs in the PMA. The PMA is characterized by large manufacturing and retail sectors. Manufacturing represents 15% of total PMA primary employment (22% in Milwaukie), compared to 11% regionally. Retail accounts for 14% (7% in Milwaukie), compared to 10% regionally.

Apart from healthcare and education, industries that utilize office space are relatively small in the PMA. Professional services, which make up 7% of regional primary employment, represent only 5% of PMA employment (4% in Milwaukie). And financial activities, which account for 4% of metro-wide employment, represent only 2% of PMA employment (3% in Milwaukie). However, healthcare accounts for the same share as in the Metro Area, 14%, though it represents 20% of all primary employment in Milwaukie.

FIGURE 4.6: EMPLOYMENT DISTRIBUTION BY INDUSTRY (2015)



SOURCE: Oregon Employment Department, JOHNSON ECONOMICS

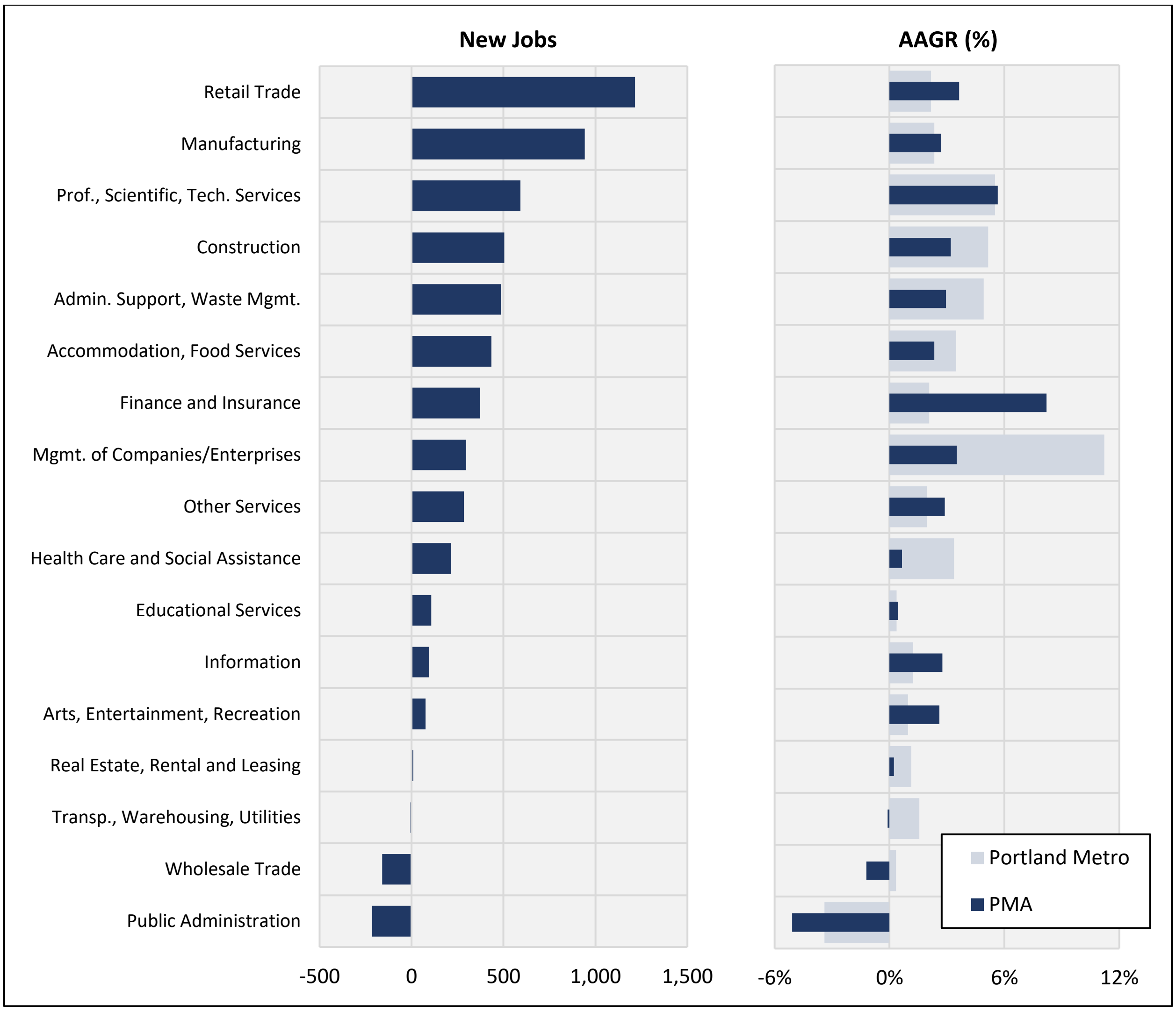
2 Primary jobs represent the highest paying jobs for each employed worker, and does not include supplementary jobs.

EMPLOYMENT GROWTH

Between 2010 and 2015, the PMA added roughly 5,300 primary jobs, or around 1,050 jobs per year on average. This represents an annual growth rate of 2.2%, which is somewhat lower than in the Portland Metro Areae (2.6%). The weaker growth is reflective of the economic recovery taking hold later in suburban areas than in Central Portland. Roughly half of the job growth in the PMA during this period took place in a single year, between 2014 and 2015 (+ 2,800 jobs; 5.7%). Milwaukie saw weaker growth over the period, adding only 200 jobs. This represents 0.3% average annual growth. However, the city added nearly 700 jobs between 2014 and 2015 (+5.4%).

The two largest industries in the PMA are responsible for much of the growth since 2010. The retail sector added 1,200 jobs (+20%), while manufacturing added 900 jobs (+14%). Among industries utilizing office space, the greatest contribution came from professional services, which generated 600 jobs over the period (+32%). Financial activities represented the strongest relative growth over the period (+48%), adding 400 jobs to a 2010 base of 800 jobs. Public administration lost 200 jobs over the period (-23%).

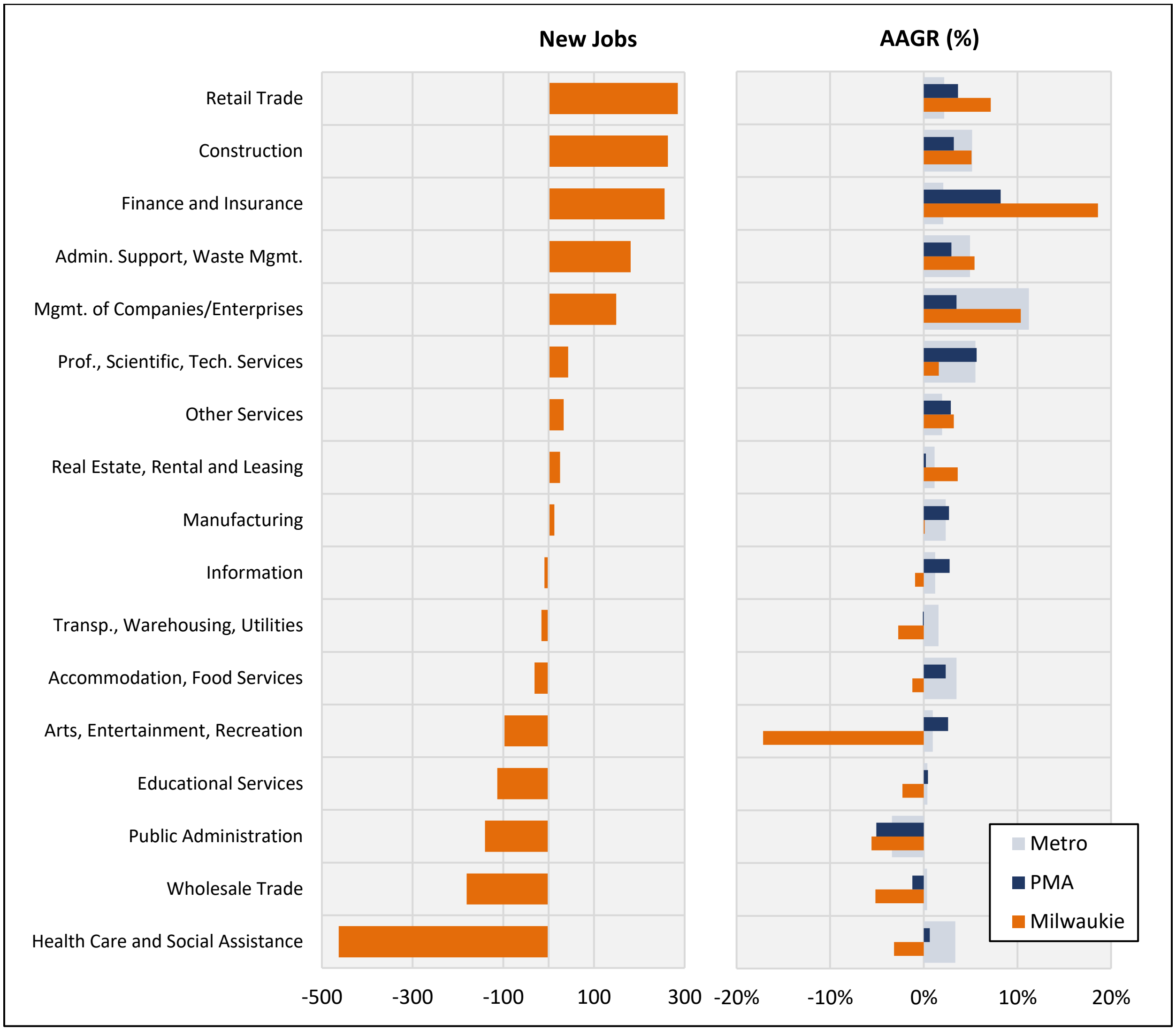
FIGURE 4.7: EMPLOYMENT GROWTH, PMA (2010-2015)



SOURCE: Oregon Employment Department, JOHNSON ECONOMICS

In Milwaukie, the main contributors to job growth over the 2010-2015 period were retail (+285 primary jobs; 41%), construction (+263 jobs; 28%), and finance/insurance (+256 jobs; 135%). Management (headquarter) jobs and administrative services also saw healthy growth, together generating 330 jobs (+40%). According to the data, there was a steep loss of jobs in healthcare and social services (-463 jobs; -15%). However, this appears to reflect a geographic reclassification. According to the state economist covering Clackamas County, there was an actual gain in healthcare employment in Milwaukie over this period.

FIGURE 4.8: EMPLOYMENT GROWTH, MILWAUKIE (2010-2015)



SOURCE: Oregon Employment Department, JOHNSON ECONOMICS

EMPLOYMENT GROWTH BY FIRM SIZE

The PMA is dominated by small firms. Establishments with fewer than five employees represent 56% of all establishments in this area, after increasing by more than 200 units over the 2010-15 period. However, the greatest relative growth took place among the largest firms, with a 50% increase in firms with more than 500 employees. Mid-size firms also saw relatively strong expansion, especially those with 50-99 employees (+16%).

Among the industries that occupy standard (non-medical) office space within the PMA, recent growth has almost exclusively taken place among firms with fewer than five employees. Over the 2010-15 period, 65 new establishments (+9%) were created in this category on a net basis. At the same time, there was a net decline of 9 firms (-3%) with 5 to 49 employees. Of the six firms that disappeared from the 20-49 category, four were in the information industry (likely print media), and two were in the administrative services sector. Among large-scale firms, there was an increase of two units in the 500-999 category, offset by a similar decline in the 250-499 category, reflecting that two administrative services firms grew their employee count above the 500-employee threshold.

In terms of office space needs in non-medical sectors, small firms differ from larger firms by more often leasing space in multi-tenant buildings, and relying more on building amenities and off-site amenities than amenities within their own. Small firms are generally less likely to lease creative space than larger firms, as population-serving firms – which make up a large share of the small firms, especially in the suburbs – tend to need more square footage per worker than larger firms, and therefore do not benefit to the same extent from the more efficient floor plans in creative buildings. Small firms are also less likely to lease space in newly constructed buildings, as they generally have less creditworthiness and sign shorter leases than larger firms, and thus are less likely to meet financing requirements for new projects. However, coworking firms with good credit sometimes act as middlemen in new buildings, leasing larger blocks of space and breaking it up to smaller tenants. This is predominantly an urban phenomenon, though there is an increasing number of suburban examples nationally.

In the healthcare sector, the increase in establishments is more even across size categories. The strongest increase is observed in the 100-249 category (+63%), followed by the 10-19 category (+30%) and the 1-4 category (+20%). According to industry experts, recent regulatory changes have made it more difficult for practitioners of traditional medicine to operate as individuals, something that has caused a consolidation into larger multi-practitioner clinics. This might be the reason behind the relatively strong growth seen in the 10-19 and 100-249 categories. As most tenants in specialized medical office buildings represent traditional medicine, this trend suggests that demand for medical office space is dominated by large users. Growth among the smallest establishments might be driven more by alternative practitioners, who tend to lease suites in professional service or retail buildings.

FIGURE 4.9: JOB GROWTH BY ESTABLISHMENT SIZE, PMA (2010-2015)

ALL INDUSTRIES	1-4	5-9	10-19	20-49	50-99	100-249	250-499	500-999	1000+	Total
2010	2,068	748	524	306	83	42	11	1	3	3,786
2015	2,277	780	521	344	96	47	11	4	2	4,082
Change	209	32	-3	38	13	5	0	3	-1	296

NON-MEDICAL OFFICE SECTORS	1-4	5-9	10-19	20-49	50-99	100-249	250-499	500-999	1000+	Total
2010	725	150	90	51	20	9	5	0	0	1,050
2015	790	147	89	45	21	9	3	2	0	1,106
Change	65	-3	-1	-6	1	0	-2	2	0	56

HEALTHCARE & SOCIAL SERVICES	1-4	5-9	10-19	20-49	50-99	100-249	250-499	500-999	1000+	Total
2010	205	100	67	42	15	8	3	1	0	441
2015	246	99	87	41	17	13	3	1	0	507
Change	41	-1	20	-1	2	5	0	0	0	66

SOURCE: Oregon Employment Department, JOHNSON ECONOMICS

Data on firm size is not publicly available for the City of Milwaukie. However, data is available on the zip code level, and we will in the following rely on data for zip code 97222, which roughly corresponds to the city geography. Based on this dataset, Milwaukie has a slightly smaller concentration of small firms (1-4 employees) than the remainder of the PMA, and has seen relatively stronger growth among mid-size and large firms. However, among the industries that occupy standard (non-medical) office space, Milwaukie exhibits similar patterns as the PMA, with growth concentrated among the smallest firms. Over the 2010-15 period, there was a net increase of two non-medical office establishments with more than 100 employees, both within the administrative services industry. In the healthcare sector, the growth is primarily taking place among mid-size firms, especially in the 10-19 and 50-99 categories.

FIGURE 4.10: JOB GROWTH BY ESTABLISHMENT SIZE, ZIP CODE 97222 (2010-2015)

ALL INDUSTRIES	1-4	5-9	10-19	20-49	50-99	100-249	250-499	500-999	1000+	Total
2010	476	189	142	92	28	18	6	1	1	953
2015	487	173	132	85	36	21	8	3	0	945
Change	11	-16	-10	-7	8	3	2	2	-1	-8

NON-MEDICAL OFFICE SECTORS	1-4	5-9	10-19	20-49	50-99	100-249	250-499	500-999	1000+	Total
2010	167	37	32	24	8	4	1	0	0	273
2015	178	31	35	20	8	5	1	1	0	279
Change	11	-6	3	-4	0	1	0	1	0	6

HEALTHCARE & SOCIAL SERVICES	1-4	5-9	10-19	20-49	50-99	100-249	250-499	500-999	1000+	Total
2010	56	31	17	9	5	5	2	1	0	126
2015	59	28	20	9	7	6	2	1	0	132
Change	3	-3	3	0	2	1	0	0	0	6

SOURCE: Oregon Employment Department, JOHNSON ECONOMICS

V. Office Market Trends

Portland Metro Trends

The Great Recession left a large amount of vacant space in the nation's office market, and parts of the nation are still working through the oversupply. One reason for the relatively muted recovery in the office market is the increasing use of home-offices and telecommuting. This trend was facilitated by technology advances, but catalyzed by cost-cutting measures prompted by the downturn. The trend has lost momentum in recent years, as many firms have found face-to-face collaboration to be crucial to innovation. Another factor is the shift to more open and flexible office space, which requires less space per worker. This has not only caused a decline in the amount of office space leased per new job, but also in many cases caused existing office space of the traditional format to remain vacant while newly renovated warehouse space has been absorbed for office use.

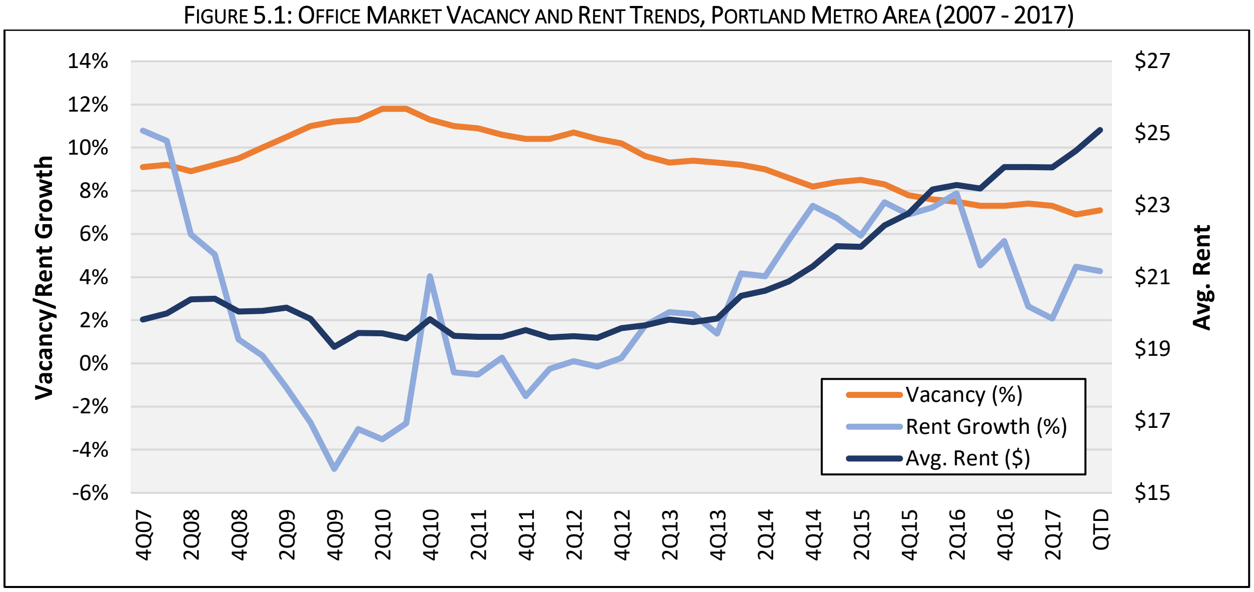
Tech-heavy West Coast cities, including Portland, have seen relatively strong job growth and, consequently, more rapid improvement in the office market than most other parts of the nation. Central markets have performed the best, while suburban markets have experienced a slower recovery. This bifurcation is largely driven by employers positioning themselves to attract Millennials, who typically prefer to live and work in well-amenitized, urban environments before they have children. The post-recession growth in software-related occupations – disproportionately filled by young workers – has contributed to this shift, as has the wave of Millennials graduating from college over the past five years. The first speculative office buildings to be built since the downturn have therefore been urban projects. However, we are beginning to see stronger demand growth in the suburban markets, as the suburban economic recovery is gaining momentum.

Rent and Occupancy Trends

While vacancy rates in many of the nation's office markets exceeded 15.0% during the downturn, the Portland Metro Area peaked at 11.8% in mid-2010. The vacancy rate has fallen gradually since, and reached 6.9% in 3Q17. As of early November, the rate is 7.1%.

Average lease rates bottomed at $19.06 per square foot in late 2009, and remained near that level through most of 2012. Since then, the rate has climbed to $25.09, which represents a 23% increase from the pre-recession high and a 30% increase since late 2012. The average annual increase over the past five years is 5.3%, and 2.4% over the past ten years. Over the past year, the average rent level has increased 4.5%.

Figure 5.1: Office Market Vacancy and Rent Trends, Portland Metro Area (2007 - 2017)



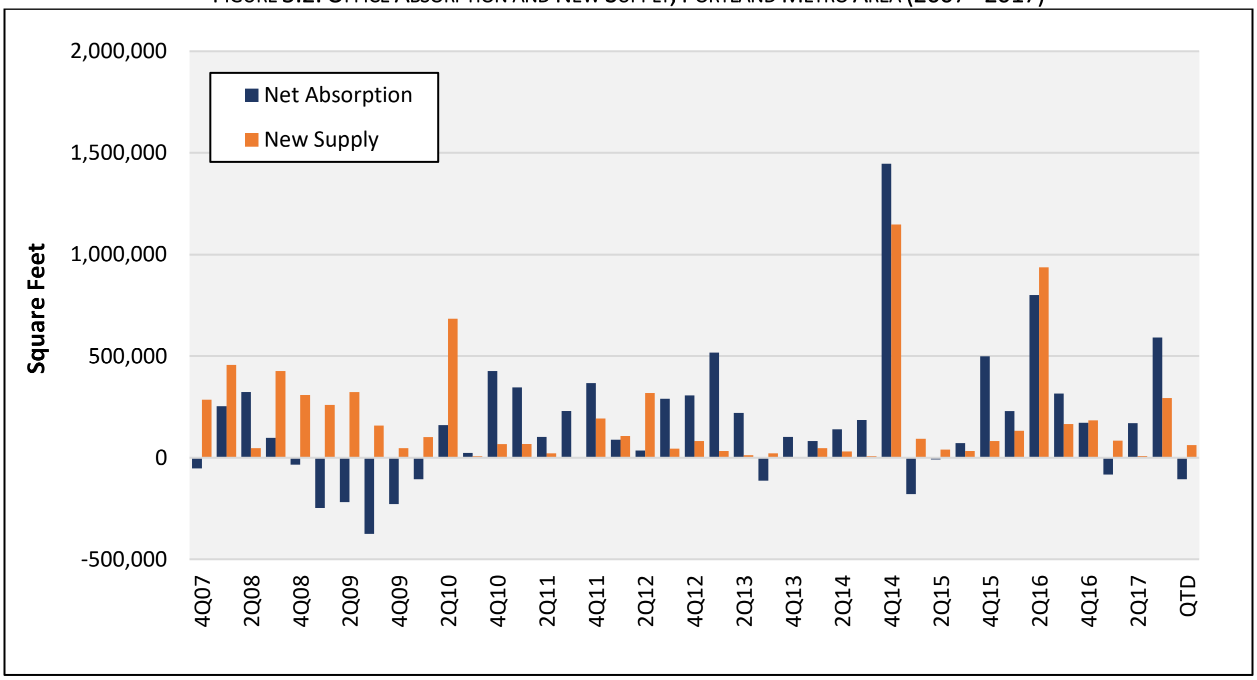
SOURCE: *CoStar, Johnson Economics*

ABSORPTION

The decline in vacancy and associated rent increases is a function of new demand outpacing new supply. This relationship is illustrated by the following chart, which shows how net absorption vastly outpaced new deliveries over the past seven years, especially over the 2010-2015 period. The chart also illustrates how the absorption slowed in 2014, as the market tightened and the amount of available space dwindled. However, the new supply delivered in 4Q14 and later has facilitated increased absorption since, though it still appears that the absorption is held back by inadequate new supply.

The Portland Metro office market has absorbed 7.3 million square feet of space (net) since the market bottom in mid-2010, while only 4.3 million square feet of new space has been delivered. At the current vacancy rate, the market needs an additional 3.0 million square feet to accommodate existing users in a 10%-vacancy market (often regarded to represent a balanced market), and 1.0 million square feet to facilitate an 8% market. In addition to the space currently leased by existing users, there is likely some pent-up demand for expansion space among existing users, as well as demand from new users waiting to enter the market.

FIGURE 5.2: OFFICE ABSORPTION AND NEW SUPPLY, PORTLAND METRO AREA (2007 - 2017)



SOURCE: CoStar, JOHNSON ECONOMICS

DEVELOPMENT PIPELINE

Developers began to respond to the increased demand in late 2013, and some of these projects are now completed. The pipeline has increased since, and we currently track 53 projects with submitted land use applications in the Portland Metro Area, for a total of 4.0 million square feet of office space. These figures include owner-user and pre-leased buildings. In addition, we track 20 projects (2.3 million sf.) of a more tentative character that have been discussed with planning staff in pre-application meetings. Most of the pipeline projects are in Central Portland.

In aggregate, projects with submitted land use applications represent an inventory increase of 4.0%, delivered over a three-year period. With the pre-application projects included, the inventory increase is 6.4% over a longer time horizon. Considering current employment growth and pent-up demand, and assuming no major demand disruption, we would expect a pipeline of this magnitude to be absorbed in a timely manner, with limited impact on the PMA market.

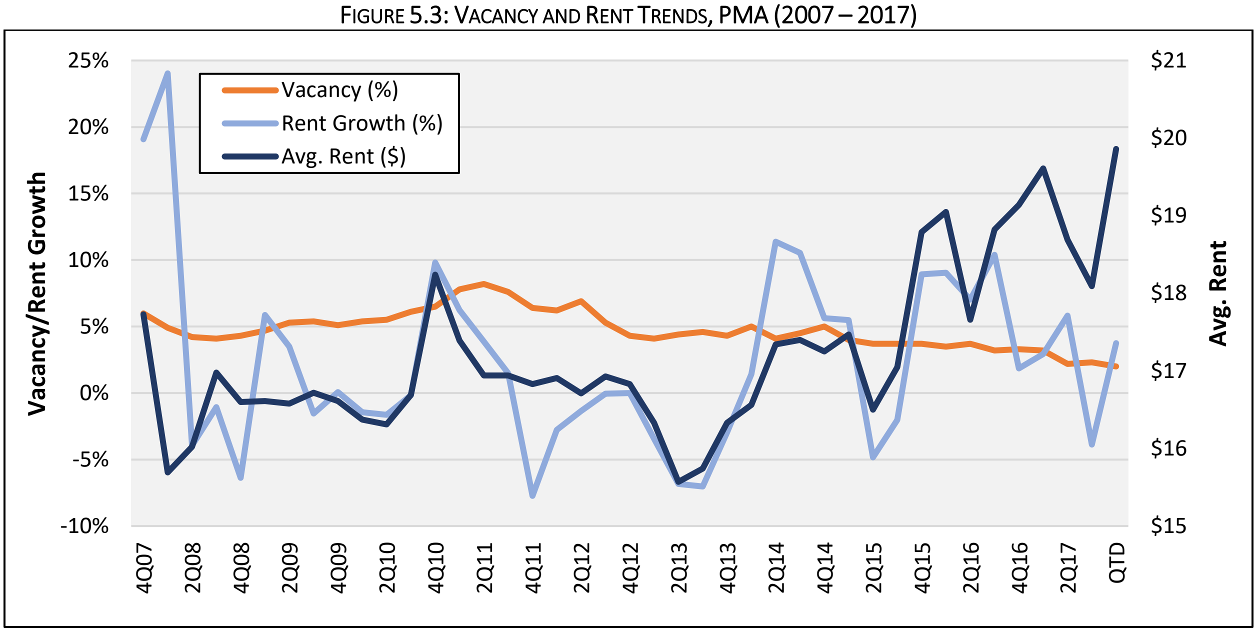
PMA Trends

Rent and Occupancy Trends

As mentioned, fundamental office market trends in suburban markets have generally underperformed central areas in the current economic expansion, though with strengthening momentum over the most recent years. Over the past four years, average asking rates in the PMA have increased 26.1%, or 6.0% per year on average – on par with regional rent growth.

Judging by vacancy rates, the PMA has been a stronger market than the remainder of the region over the past years, peaking at a relatively low 8.2% rate in mid-2011 and remaining below 5.0% since late 2012. The current vacancy rate sits at 2.0%, which is unusually low – both in a historical and geographic context. The low vacancy rates make the rent estimates somewhat unreliable as trend indicators, as rent averages are calculated from asking rates at available spaces – highly dependent on the quality of the few spaces available in the market. In other words, the PMA market is clearly undersupplied, and is likely to see strong rent growth at existing properties without a considerably supply increase.

FIGURE 5.3: VACANCY AND RENT TRENDS, PMA (2007 – 2017)



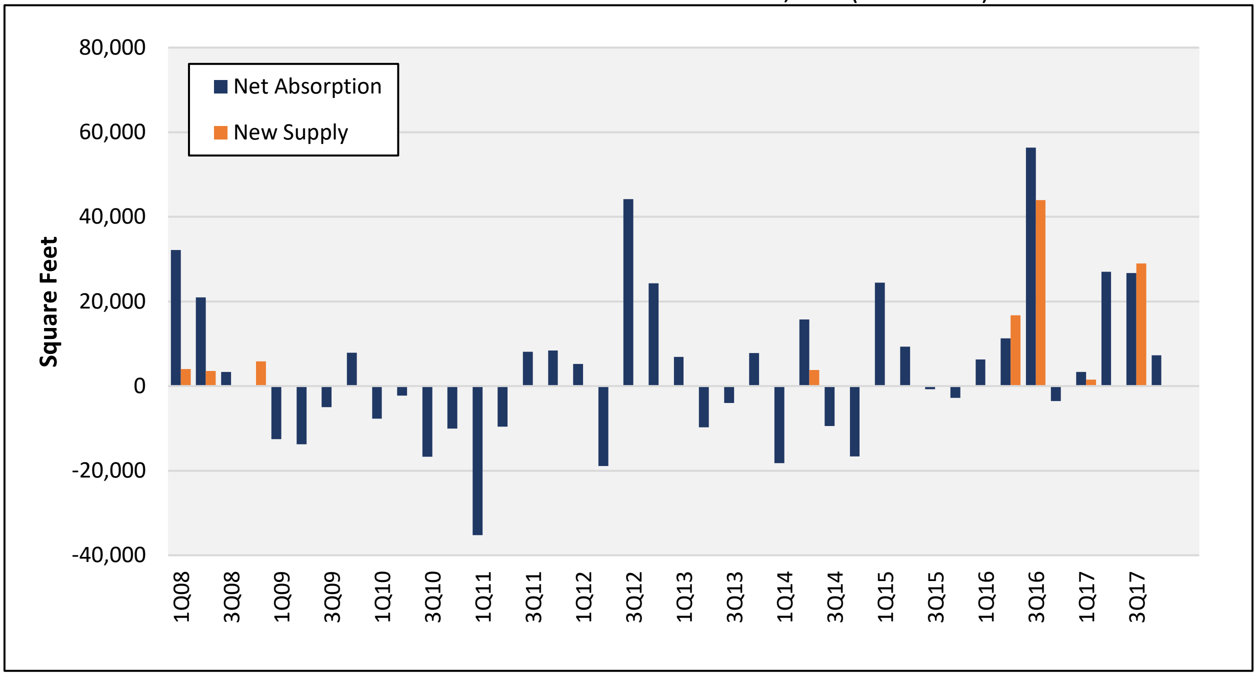
SOURCE: *CoStar, Johnson Economics*

Available space in the PMA is primarily small suites in multi-tenant buildings. In terms of vintage, the spaces reflect the office stock, but is weighted to older buildings, averaging 1985 as construction year. This suggests that newer spaces are in particularly high demand. The 18 spaces that are currently available range from 425 to 5,600 square feet in size, with an average of 2,600. These include three spaces with less than 1,000 square feet; six with 1-2,000 square feet; six with 2-4,000 square feet; and three with 4-6,000 square feet. Without any space that can accommodate a user larger than 6,000 square feet, the PMA is unlikely to attract new firms with more than 25 employees.

Absorption

As in the wider Metro Area, net absorption within the PMA has outpaced new supply by a wide margin in recent years. Since vacancy peaked in mid-2011, the market has absorbed 210,000 square feet, while only 95,000 square feet of new space has been delivered. With the market's low vacancy rates, net absorption has likely been held back by a lack of available space. The following chart indicates that new space delivered over the past two years was absorbed quickly. Assuming no new users in the market, and no expansion among existing users, the market needs an additional 90,000 square feet of space to facilitate a 5% vacancy rate, and 220,000 to reach a 10% rate. Given the prolonged shortage of space in this market, we would expect there to be considerable pent-up demand for additional space among existing users looking to expand and potential new users looking to locate within the PMA.

FIGURE 5.4: OFFICE MARKET VACANCY AND RENT TRENDS, PMA (2007 - 2017)



SOURCE: *CoStar, JOHNSON ECONOMICS*

<u>DEVELOPMENT PIPELINE</u>

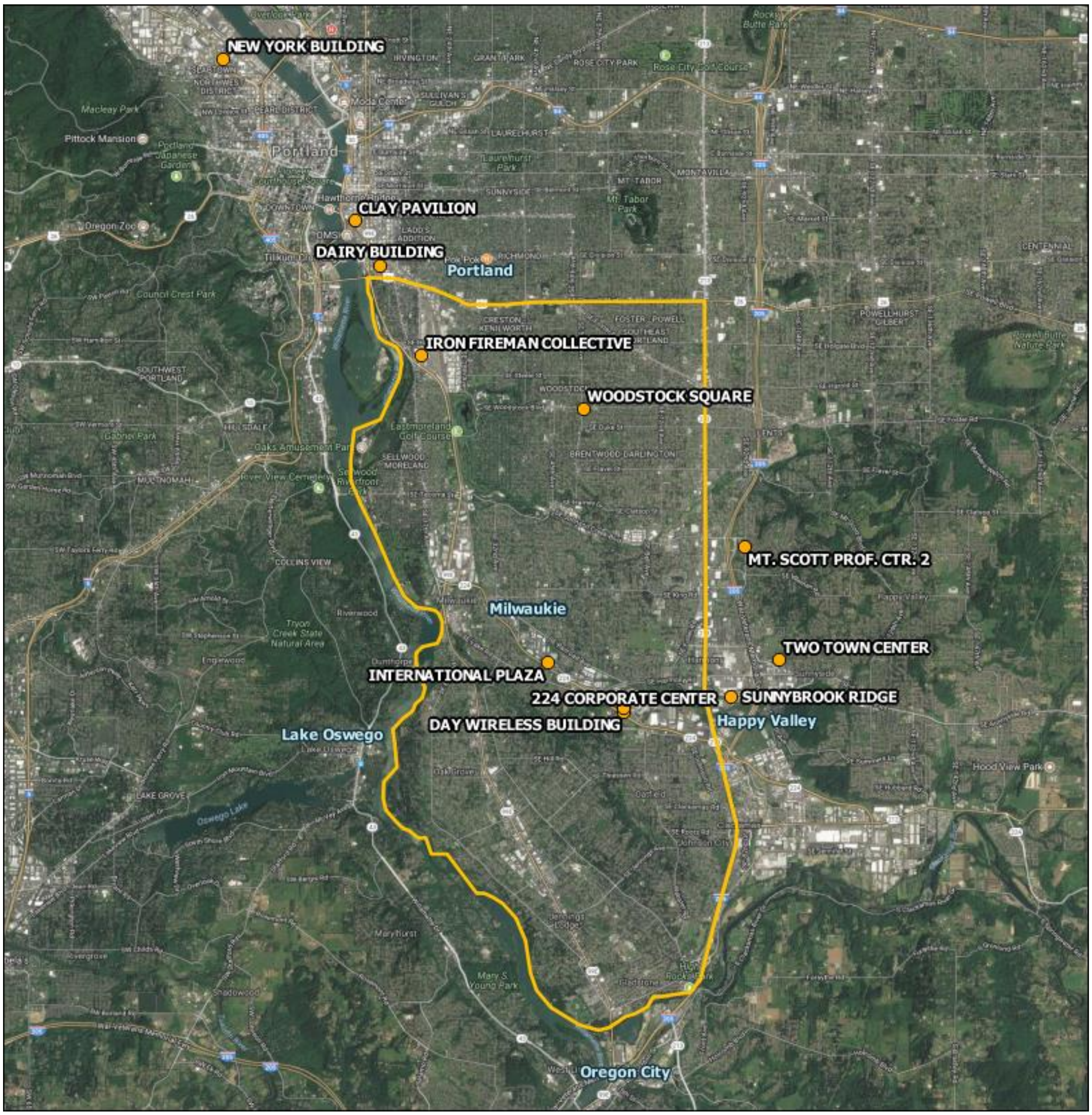
Despite the recent rent growth and current low vacancy rates, there is so far little new development of office space within the PMA. JOHNSON ECONOMICS is aware of only two projects in the pipeline currently. Together, these represent 37,000 square feet of space, of which 27,000 square feet is medical space oriented toward the I-205 corridor population, and 10,000 square feet is professional/medical space oriented toward the Gladstone population. Neither of the projects have begun construction. The projects are presented in more detail at the end of the Office Market Survey.

VI. OFFICE MARKET SURVEY

COMPETITIVE SURVEY

JOHNSON ECONOMICS conducted a survey of 11 office properties for this analysis. Five of these are located within the defined PMA – including three in the Highway 224 corridor – and six are located outside the PMA. The sample represents a wide range of office formats, including new creative space, traditional professional space, medical office space, semi-industrial flex space; and renovated creative/industrial space. The projects target users of different size, from small professional service firms to large single-tenant users. Three of the surveyed projects were built around the turn of the millennium; one was built in the mid-2000s; five were completed within the past three years; one is under construction; and one is proposed. Profiles of the properties are included over the following pages.

FIGURE 6.1: MAP OF SURVEYED PROPERTIES



SOURCE: Google Earth, JOHNSON ECONOMICS

FIGURE 6.2: PROFILE OF SURVEYED COMPARABLES

INTERNATIONAL PLAZA

4560 SE International Way, Milwaukie, Oregon

Developer:	JBH Company
Architect:	Studio 3 Architecture
Owner:	Menashe Properties
Broker:	Kevin VandenBrink (Macadam Forbes)
Occupied:	100%
Asking Rate/SF/Yr:	**$23.00 FS (2016)**

International Plaza is a two-story complex from the early 2000s. It is located along International Way, with good visibility from Highway 224. The building is a quadratic structure with a central courtyard. The property features 243 surface parking spaces. The largest tenant is Marquis Companies, an operator of senior care facilities. The most recent availability (2016) was offered at $23 full service.

PROJECT CHARACTERISTICS

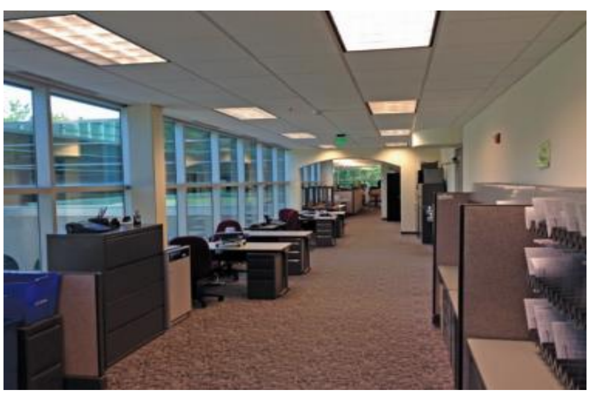
Year built:	2003
Year renovated:	-
Class/type:	B/Suburban
Rentable SF:	60,632
Stories:	2
Construction:	Steel
Parking type/#:	Surface, 4/1,000
Parking charge:	-

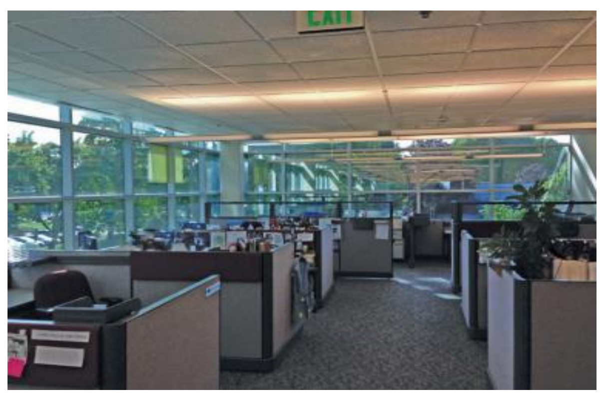
AMENITIES

Central courtyard
Conference facilities
9-foot ceilings
Large windows
Elevator

TENANTS

Marquis Companies (27,000 SF)
Tonkin (14,000 SF)
Conscious Healthcare (5,900 SF)
Marquis Senior Care (1,400 SF)





224 CORPORATE CENTER

6400 SE Lake Road, Portland, Oregon

Developer:	JBH Company
Architect:	Unknown
Owner:	Randall Investment Group
Broker:	Mark Carnese (Cushman & Wakefield)
Occupied:	97%
Asking Rate/SF/Yr:	**$25.00 FS**

224 Corporate Center is a large office complex from 2002, offering a central three-story glass atrium and on-site coffee shop and deli. There is 500 surface parking spaces on the property. The building enjoys strong visibility from Highway 224. One 3,900-square-foot space currently available at $25 FS asking rate, which is $2 higher than the 2016 rate.

PROJECT CHARACTERISTICS

Year built:	2002
Year renovated:	-
Class/type:	A/Suburban
Rentable SF:	125,000
Stories:	4
Construction:	Masonry
Parking type/#:	Surface, 4/1,000
Parking charge:	-

AMENITIES

Glass atrium
Conference facilities
Coffee shop and deli
Water features and landscaping
Locker rooms and showers

TENANTS

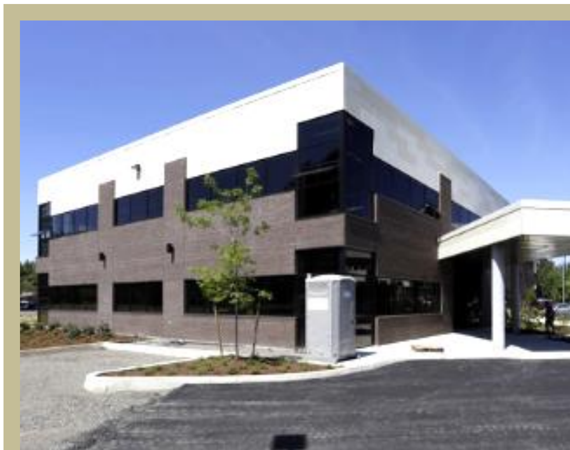
Argo Select (16,900 SF)
The Fish (8,900 SF)
Cornerstone Clinical (6,900 SF)
Fitzwater Meyer LLP (6,400 SF)
Providence Health (5,900 SF)





DAY WIRELESS BUILDING

6430 SE Lake Road, Portland, Oregon



Developer:	Day Management Corp
Architect:	Mackenzie
Owner:	Day Management Corp
Broker:	Irfan Tahir (Colliers International)
Leased:	100%
Asking Rate/SF/Yr:	**$24.00 NNN**

Office/warehouse/showroom building initiated on a speculative basis by Day Wireless Systems, which are located nearby. It was offered for lease in late 2016, and leased in May 2017 to Stanley Black & Decker, which is using it as global headquarters for its Infrastructure division, selling construction equipment. Completed September 2017. Offered for medical use at $5 PSF premium. TI allowances: $50/SF.

PROJECT CHARACTERISTICS

Year built:	2017
Year renovated:	-
Class/type:	B/Flex-Suburban
Rentable SF:	16,465
Stories:	2
Construction:	Concrete
Parking type/#:	Surface, 3.4/1,000
Parking charge:	-

AMENITIES

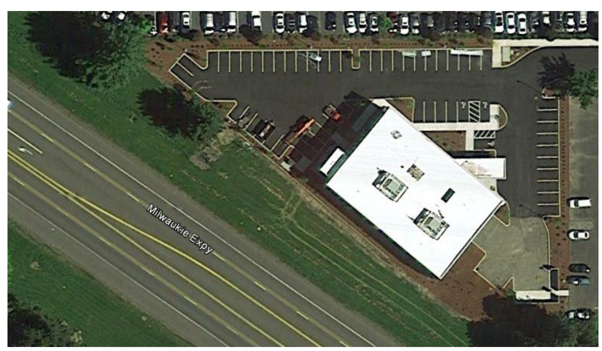
Elevator

Covered entrance

Grade-level loading

TENANTS

Stanley Black and Decker



SUNNYBROOK RIDGE M.O.B.

8730 SE Sunnybrook Boulevard, Clackamas, Oregon

Developer:	MAJ Development
Architect:	Unkown
Owner:	Doug Bean and Assoc.
Broker:	Kevin VandenBrink (Macadam Forbes)
Leased:	0%
Asking Rate/SF/Yr:	**$25.00 NNN**

Proposed medical office building with land use approval waiting for pre-lease commitments. The project will be similar to the adjacent office building, which was built in 2007 and last leased at $23.50 FS (asking) in early 2016. The proposal has a low parking ratio (1.4/1k SF; 39 surface spaces), but is adjacent to a four-story parking garage with 220 spaces. Will provide a total 4/1k ratio. Advertised since mid-2015.

PROJECT CHARACTERISTICS

Year built:	Proposed
Year renovated:	-
Class/type:	A/Medical
Rentable SF:	27,248
Stories:	3
Construction:	Concrete
Parking type/#:	Surface, 1.4/1,000
Parking charge:	-

AMENITIES

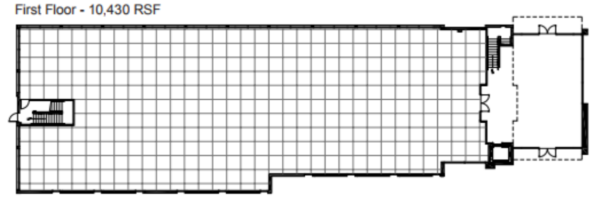
Top-floor deck

Adjacent to 24 Hour Fitness

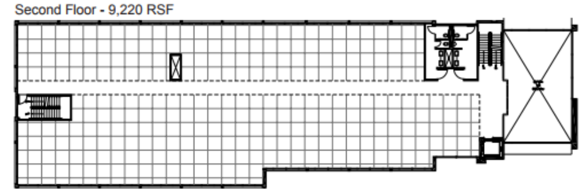
Near Clackamas Town Center

TENANTS

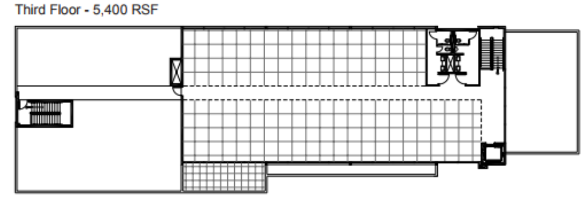
First Floor - 10,430 RSF



Second Floor - 9,220 RSF



Third Floor - 5,400 RSF



TWO TOWN CENTER

10135 SE Sunnyside Road, Clackamas, Oregon

Developer:	Unknown
Architect:	Unknown
Owner:	Hawaii Twenty-O
Broker:	Doug Bean (Doug Bean Assoc.)
Occupied:	100%
Asking Rate/SF/Yr:	**$27-28 FS**

The most recent of four Town Center buildings (1989-1997) located behind retail on Sunnyside Road. The buildings are one to four stories and offer varying amenity levels. Asking rates are $25-28 FS, with building two in the upper end, despite limited amenities. A 1,700-square-foot suite recently leased at $27-28 FS asking rate. In aggregate, the four buildings offer 203,000 SF and are 96% occupied.

PROJECT CHARACTERISTICS

Year built:	1997
Year renovated:	-
Class/type:	B/Suburban
Rentable SF:	36,456
Stories:	2
Construction:	Masonry
Parking type/#:	Surface, 3.5/1,000
Parking charge:	-

AMENITIES

Lobby
Elevator

TENANTS

Premiere Property Group (15,000 SF)
Chicago Title Company (11,000 SF)
Householder Group (5,200 SF)
Northwest Mortgage Group (5,200 SF)
Beemer Smith Munro (2,700 SF)

MT. SCOTT PROFESSIONAL CENTER 2

9300 SE 91st Avenue, Portland, Oregon

Developer:	MD Partners
Architect:	CIDA
Owner:	MB Real Estate
Broker:	Brian Norton (KW Commercial)
Occupied:	85%
Asking Rate/SF/Yr:	**$30.00 FS**

The second of two medical office buildings at the 92nd Ave/ Johnson Creek Blvd intersection. The buildings have good freeway access and visibility. The first building was completed in 2002 and totals 41,000 square feet, with 2.4 parking spaces per 1,000 SF. It is 83% occupied and has an asking rate of $29 FS. Together, the two buildings total 93,500 square feet, of which 14,600 is vacant (84% occupied).

PROJECT CHARACTERISTICS

Year built:	2008
Year renovated:	-
Class/type:	A/Medical
Rentable SF:	52,486
Stories:	4
Construction:	Concrete
Parking type/#:	Suface, 2.3/1,000
Parking charge:	-

AMENITIES

Lead lining
Medical grade electricity/plumbing
Multi-zone HVAC
Covered entrance

TENANTS

East Portland Surgery Ctr (12,900 SF)
Adventist Health (2,700 SF)
Creekside Family Practice (2,700 SF)
Kellog MD Brain & Spine (2,700 SF)
Mt. Scott Diagnostic Imaging (2,700 SF)

WOODSTOCK SQUARE

6030 SE 52nd Avenue, Portland, Oregon

Developer:	Skoro Construction
Architect:	Unknown
Owner:	Skoro Family Trust
Broker:	Jorie Girod (Berkshire Hathaway)
Occupied:	68%
Asking Rate/SF/Yr:	**$26.00 NNN**

Woodstock Square is a two-story retail/office building located at the corner of Woodstock Boulevard and 52nd Avenue, an intersection with an average daily traffic volume of nearly 30,000. The project targets smaller neighborhood-serving tenants, with suites in the 500-2,000 SF range. It was completed in May 2016. Roughly 5,000 square feet (one-third of the space) remains vacant.

PROJECT CHARACTERISTICS

Year built:	2016
Year renovated:	-
Class/type:	B/Mixed Use
Rentable SF:	14,776
Stories:	2
Construction:	Timber
Parking type/#:	Surface, 1.3/1,000
Parking charge:	-

AMENITIES

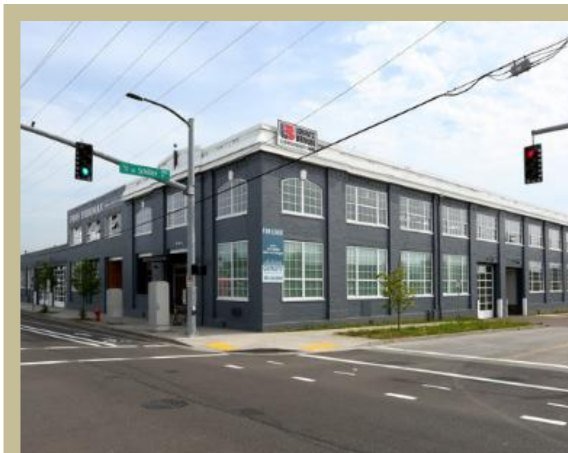
9-foot ceilings
Elevator
Balcony

TENANTS

Edward Jones (financial advisor)
Metro PCS (cell phones/service)
NVS Glassworks (head shop)
Ate-Oh-Ate (restaurant)

IRON FIREMAN COLLECTIVE

4784 SE 17th Avenue, Portland, Oregon



Developer:	ScanlanKemperBard
Architect:	Mackenzie
Owner:	WHI Real Estate Partners
Broker:	Scott Maclean (Colliers International)
Leased:	8%
Asking Rate/SF/Yr:	**$16.80 NNN**

Former Peco Manufacturing building near the Brooklyn Rail Yard renovated to provide industrial/office flex space for maker tenants. The building, which is 200 x 550 ft., offers 19 spaces ranging in size from 1,000 to 15,000 sf., averaging 6,100 sf. It includes 32,000 sf. of 2nd floor space, and 59 surface parking spaces. The building opened in June 2017, and has so far leased five smaller spaces.

PROJECT CHARACTERISTICS

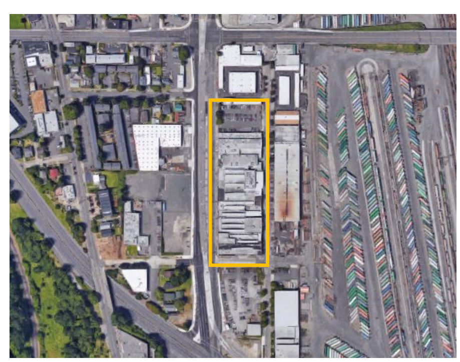
Year built:	1925
Year renovated:	2017
Class/type:	B/Creative
Rentable SF:	144,000
Stories:	1-2
Construction:	Masonry
Parking type/#:	Surface, 0.4/1,000
Parking charge:	-

AMENITIES

Grade and dock high loading doors
480 volt 3-phase power
Sectional glass roll-up doors
Skylights
Concrete and wood flooring
A/C (2nd floor)

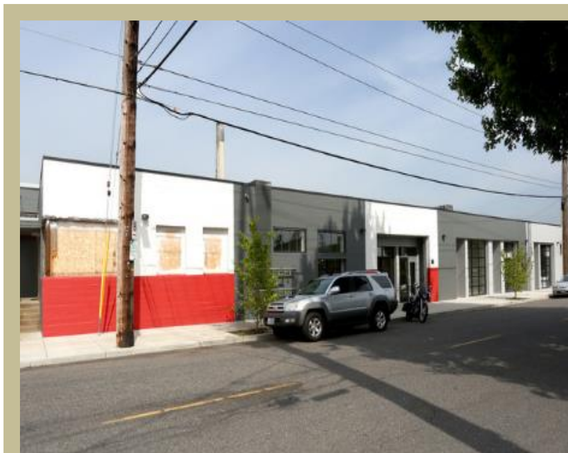
TENANTS

Ruse Brewing
Brooklyn Tweed
Automation Resource Group



THE DAIRY BUILDING

2715 SE 8th Avenue, Portland, Oregon



Developer:	Intrinsic/Lindquist Development
Architect:	Ankrom Moisan
Owner:	Intrinsic Ventures
Broker:	Carter Beyl (Colliers International)
Leased:	43%
Asking Rate/SF/Yr:	**$24-27 NNN**

Converted manufacturing building located south of Division Street in the south end of the Central Eastside in Portland. Tenant spaces range from 500 to 6,900 sf., averaging 1,600 sf., with mezzanines available in some suites. A central common area provides gathering space, kitchen, and conference rooms. 160 parking spaces are available on secured lot. The building opened June 2017.

PROJECT CHARACTERISTICS

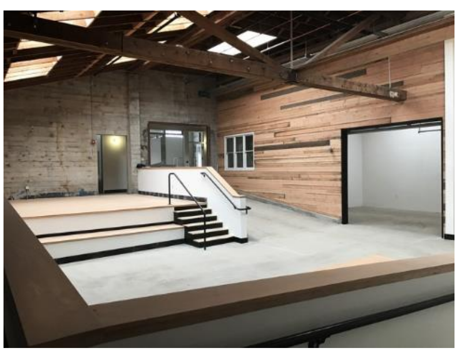
Year built:	1937
Year renovated:	2017
Class/type:	B/Creative
Building SF:	46,500
Stories:	1
Construction:	Masonry
Parking type/#:	Surface, 3.4/1,000
Parking charge:	-

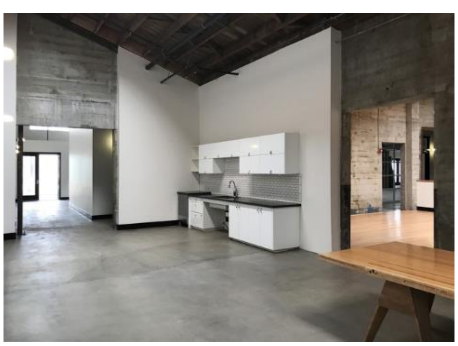
AMENITIES

- Up to 24' clear height
- Loading dock, sectional roll-up doors
- "Amphitheater" gathering area
- Common kitchen and bathrooms
- Phone rooms
- Conference rooms
- Mezzanines available
- Secure surface parking

TENANTS

- Vagabond Brewery
- Frank Creative (marketing)
- OBR Architecture
- Photo to Canvas (printing)





CLAY PAVILION

120 SE Clay Street, Portland, Oregon

Developer:	Killian Pacific
Architect:	Ankrom Moisan
Owner:	Killian Pacific
Broker:	Mark Friel (Apex Real Estate)
Leased:	57%
Asking Rate/SF/Yr:	**$33-34 NNN**

LEED certified three-story building with ground-floor retail, underground parking, and large rooftop deck. The floors offer high ceilings (14-17') and open floor plans. Majority leased by Simple Bank, who also leased the adjacent Clay Creative ($28.50/SF in 2015). Simple is planning for 3-400 workers in the building (125-165 SF/emp.). 25,000 SF of ground-floor office space available. Opening early 2018.

PROJECT CHARACTERISTICS

Year built:	2018 (U.C.)
Year renovated:	-
Class/type:	A/Creative
Building SF:	75,000
Stories:	3
Construction:	Timber
Parking type/#:	U.G., 1.1/1,000
Parking charge:	N/A

AMENITIES

Eco-roof deck (12,000 SF)
Lobby atrium
Raised floor HVAC system
Exposed glulam beams
14-foot ceilings
Huddle/phone/conference rooms
Locker rooms, showers
Bike storage

TENANTS

Simple Bank

THE NEW YORK

2104 NW York Street, Portland, Oregon

Developer:	Rosan Inc.
Architect:	DiLoreto Architecture
Owner:	Rosan Inc.
Broker:	Todd Collins (Macadam Forbes)
Occupancy:	96%
Asking Rate/SF/Yr:	**$14.40-16.80 NNN**

Multi-story industrial building in NW Portland, developed by partners from Andersen Construction, with five floors of shell space over ground-floor parking. The space is leased in 26' by 45' blocks (1,170 SF), offered at $14.40 NNN for <2,500 SF and $16.80 for 5,000+ SF. Completed late 2014. Leased 3,200 SF per month on average thru 2016. Three 1,170-SF spaces remain unleased. Rates have remained the same through lease-up.

PROJECT CHARACTERISTICS

Year built:	2014
Class/type:	A Industrial
Total rentable SF:	87,500
Rentable industrial SF:	87,500
Stories:	6
Construction:	Steel
Parking type:	Gr.fl./surface
Parking spaces/ratio:	1.46/1,000

AMENITIES

One grade door to freight elevator
12-foot clear height
Secured entry
Cable/internet
Bike storage
Showers

TENANTS

Amazon (35,000 SF)
Fiction
Canary Marketing
Love Bottle
Pearl Gallery & Framing
Kristal Passy Photography

SOURCE: Brokers, developers, CoStar, LoopNet, media articles, Johnson Economics

Summary of Survey Observations

Creative/Industrial Office Space

During the current construction cycle, new office development has primarily been concentrated in Central Portland, almost exclusively representing a “creative space” format, either in new structures or renovated warehouse buildings. Whereas traditional space typically includes 9-foot drop tile ceilings, finished sheet rock walls, carpet flooring, and individual offices, creative space is characterized by open floor plates, high ceilings, exposed beams and ductwork, and concrete or wood floors. Tenants occupying creative space typically furnish their offices with open desks rather than cubicles, and tend to provide a wider variety of smaller areas for socialization (lounge areas, game rooms), team work (“huddle rooms”), and phone-based work (“phone booths”). Firms relying on millennial workers tend to prefer this type of space.

Clay Pavilion, located in Portland’s Central Eastside, represents a ground-up, multi-story project of the creative format. Because of the cost of constructing this type of space from the ground up, these projects are usually built in well-amenitized urban areas that can capture high lease rates – as is the case of the Clay Pavilion site. In the Portland Metro Area, there are no examples of this type of space east or south of the Central Eastside. When completed, Clay Pavilion will be the ninth ground-up creative office building in the Central Eastside. It was initiated upon securing a pre-lease commitment from Simple Bank for the majority of the space. It is currently asking $33-34 per square foot (NNN).

The **Dairy Building** is a representative of a warehouse-to-office conversion, which is the original creative space format. These projects are less costly than ground-up projects, and are thus feasible in less well amenitized areas with lower achievable pricing. Consequently, such projects tend to precede ground-up office development in former industrial areas (so also in the Central Eastside). As these projects increase the employment density in an area, they generate support for new amenities and create a more vital urban atmosphere, causing an increase in achievable pricing also for ground-up projects. The Dairy Building is a pioneer in the industrial area south of Division Street, which is a portion of the Central Eastside which is until now has not participated in the district’s redevelopment and amenity expansion. However, the recently completed OMSI/SE Water MAX/Streetcar station has connected this area to other parts of Central Portland, and thus reduced its isolation. Reflecting its location and achievable pricing, the Dairy Building has a stronger industrial profile than Clay Pavilion and is oriented more toward maker tenants with loading needs. It has leased 20,000 square feet (43%) since opening June 2017, at an asking rate of $24-27 NNN.

The **Iron Fireman Collective** is even more pioneering than the Dairy Building, with its location in the Brooklyn Rail Yard. Like the Dairy Building, the project likely would not have been realized had it not been for the opening of the Milwaukie MAX line, which has a station just north of the project. The project is also within walking distance of a small cluster of amenities along McLoughlin Boulevard, including a fitness center, coffee/donut shop, restaurant, taproom, and bar. The Iron Fireman Collective has an even stronger industrial profile than the Dairy Building, and is more appropriately classified as flex/maker space than office space, with an asking rate of $16.80 NNN. Since opening in June 2017, it has leased five spaces – most of them relatively small – totaling 12,000 square feet (8%). The larger and deeper spaces have been difficult to lease, illustrating the challenge of converting large industrial buildings.

The **New York Building** has a similar flex/maker orientation, though it is a ground-up, multi-story project. Its location is more similar to the Dairy Building, in an industrial area adjacent to but somewhat isolated from a rapidly redeveloping mixed-use area. However, the lack of transit service reduces its connectivity and thus its achievable lease rates. The project has a plain design, and represents a construction form that is considerably less costly than Clay Pavilion or other true office projects. Thus, it can be feasible despite moderate achievable pricing. (It has been asking $14-17 NNN all through lease-up). Its appeal to creative firms is limited, as it lacks the “authenticity” of an older warehouse structure. The project was somewhat slow to lease up, averaging 3,200 square feet per month over a three-year period. It has been greatly helped by Amazon, which has leased 40% of the space.

Population-Serving Office Space

Population-service office users are dependent on access and exposure to potential customers and clients, and tend to prefer highly visible locations near larger residential areas. In the previous decade, office buildings of this format were typically built around suburban retail centers or near retail nodes on arterial corridors. As online shopping since then has eaten into the demand for brick-and-mortar retail space, many service firms have been able to find space with good visibility and affordable lease rates in retail buildings. Thus, there has been limited demand for new office buildings of the service format. **Woodstock Square** is one of a few new buildings of this format in the Portland Metro Area in recent years, counting on increased demand for services as the Southeast Portland population gentrifies. Only one of the four tenants in the building so far is an office user (Edward Jones). A year-and-a-half after opening, two-thirds of the building is so far leased, at an asking rate of $26 NNN.

Class A Professional Space

Very little new suburban class A office space has been built in the Portland Metro Area (or nationwide) since the 2008 recession. More than anything, this reflects the shift in demand toward urban creative space, as office firms have positioned themselves to attract millennial workers. Though per-square-foot lease rates are higher for urban creative space, this is often offset by a reduction in required square footage, as the open floor plates allow for higher employment density. As creative space has developed into a recognized office subcategory, attracting increasing demand also from traditional users, suburban class A buildings are increasingly perceived as something of the past. The most recent downturn contributed to this tainted image, as it caused large amounts of suburban class A space to sit vacant for long periods of time, earning a reputation as something failed and undesirable.

The few class A suburban office projects that have been developed in the Portland Metro Area since the downturn have been owner-user or single-tenant build-to-suit projects. These have been located near amenity hubs, and within short commutes of residential areas attractive to young families. Speculative multi-tenant projects have been virtually non-existent, reflecting inadequate achievable pricing and difficulty in securing pre-lease commitments.

The survey sample includes several suburban class A buildings. **224 Corporate Center** and **International Plaza** were both built in the early 2000s and are located along Highway 224. These projects have very high occupancy rates (97% and 100%, respectively), indicating that demand for this type of space is strong. However, the lease rates are relatively low, at $24-25 full service (approx. $19-20 NNN). It is therefore uncertain whether tenants like these can support the construction of a new building in this area. **Two Town Center** is a similar but slightly older project (built 1997) that also sports full occupancy now. It is located near the Clackamas Town Center, on the east side of the I-205, and captures a premium for its access and nearby amenities ($27-28 full service).

The **Day Wireless Building**, which is located adjacent to 224 Corporate Center, represents a somewhat different format, combining flex/R&D and traditional class A features. It was initiated on a speculative basis, and leased to Stanley Black & Decker during construction at $24 NNN. The company is using the building as headquarters for its Infrastructure division, which sells construction equipment.

Medical Office Space

Medical space has been the strongest office subcategory in suburban markets over the past ten years, reflecting steadily increasing demand for medical services due to the aging population. Medical office buildings are like traditional office buildings but usually include more extensive plumbing and higher-capacity electric and HVAC systems. Some buildings also include larger elevators and lead-lined walls for x-ray. The premium charged for the medical space depends on the extent of these additional features. Buildings with extensive medical features tend to be located near hospitals, while buildings with less extensive features are more like traditional population-serving buildings, and tend to be in commercial areas that offer visibility and access to the resident population.

Our survey included two medical office buildings. **Mt. Scott Professional Center 2**, built 2008, is located off Johnson Creek Boulevard, east of I-205, and represents medical space with extensive medical features. It benefits from strong freeway access and proximity to Kaiser Sunnyside Medical Center. The building is 85% occupied, at an asking rate of

$30 full service. The slightly older building 1 (adjacent) is 83% occupied, at $29 full service. Sunnybrook Ridge is a proposed medical office building just south of Clackamas Town Center, representing less extensive medical space. It has been offered for pre-lease at $25 NNN since mid-2015, without securing any leases so far. The two projects indicate somewhat limited demand for medical space in this area currently.

OCCUPANCY AND LEASE RATES

The following table summarizes observed pricing and occupancy at the surveyed properties. The table includes estimates of average NNN-equivalent lease rates in the current market and in late 2019, assuming annual lease rate escalation of 3.5%. New projects offer tenant improvement allowances around $50 per square foot.

FIGURE 6.3: SUMMARY OF OCCUPANCY AND LEASE RATES

		YEAR	TOTAL	%	LEASE EXAMPLE						NNN EQUIVALENT*	
PROJECT	ADDRESS	BUILT	OFFICE SF	LEASED	SF	DATE	LOW		HIGH	TYPE	2017	2019
International Way	4560 SE Int'l Way	2003	60,600	100%	14,300	2016	$23.00	-	$23.00	FS	$19.00	$20.50
224 Corporate Ctr.	6400 SE Lake Rd	2002	125,000	97%	3,900	Avail.	$25.00	-	$25.00	FS	$20.00	$21.50
Day Wireless Bldg.	6430 SE Lake Rd	2017	16,500	100%	16,500	05-2017	$24.00	-	$24.00	NNN	$24.00	$26.00
Sunnybrook Ridge	8730 SE Sunnybrook	Prop.	27,200	0%	27,200	Future	$25.00	-	$25.00	NNN	$25.00	$27.00
Town Center Two	10135 SE Sunnyside	1997	36,500	100%	1,700	10-2017	$27.00	-	$28.00	FS	$22.50	$24.00
Mt. Scott Prof. 2	9300 SE 91st Ave	2008	52,500	85%	7,600	Avail.	$30.00	-	$30.00	FS	$25.00	$27.00
Woodstock Square	6030 SE 52nd Ave	2016	14,800	68%	4,700	Avail.	$26.00	-	$26.00	NNN	$26.00	$28.00
Iron Fireman C.	4784 SE 17th Ave	1925 ('17)	144,000	8%	132,500	Avail.	$16.80	-	$16.80	NNN	$16.80	$18.00
Dairy Building	2715 SE 8th Ave	1937 ('17)	46,500	43%	26,500	Avail.	$24.00	-	$27.00	NNN	$25.50	$27.50
Clay Pavilion	120 SE Clay St	2018 (UC)	75,000	57%	25,000	Avail.	$33.00	-	$34.00	NNN	$33.50	$36.00
New York Building	2104 NW York St	2014	87,500	96%	3,500	Avail.	$14.40	-	$16.80	NNN	$15.60	$16.50
Total/Average			686,100	65%							$22.99	$24.73

* Assumes operating costs of $5 per square foot at full-service properties. 2019 estimates assume 3.5% annual lease rate increase.

SOURCE: JOHNSON ECONOMICS

PARKING

The surveyed properties offer parking ratios ranging from 0.4 to 4.0 spaces per 1,000 square feet of rentable office space (see table next page). The highest ratios are found at the largest suburban class A properties, reflecting that these offer limited transit access and target users with relatively high employment densities. Projects targeting service tenants, including medical service providers, represent lower parking ratios – down to 1.3 at Woodstock Square. These projects tend to be located along transit lines, and lease more space per employee, both of which are factors that reduce the parking need per 1,000 square feet. Woodstock Square also benefits from nearby street parking.

Creative office projects tend to have higher employment densities, but also tend to be more centrally located, providing good transit and bike access, as well as access to off-site parking. These projects also tend to house relatively young workers, who are less likely to commute by car. This is the case with creative projects on the Central Eastside in Portland, where parking ratios range from 0.0 to 1.5 per 1,000 square feet. Among the surveyed properties in this category, the Iron Fireman Collective has the lowest ratio at 0.4, reflecting its location near a MAX station and that it caters to maker/flex tenants with lower employment densities. Clay Pavilion, built to meet the requirements of Simple Bank's customer service division, with up to 8 workers per 1,000 square feet, has a parking ratio of 1.1, though with the possibility of sharing parking spaces with the adjacent Clay Creative (1.4 ratio), which is leased by the same tenant. The Dairy Building has an unusually high parking ratio (3.4) for a converted industrial building, which is simply a function the property having a large paved lot adjacent to the building.

The New York Building has a parking ratio (1.5/1,000 SF) that is close to the norm for small-bay warehouse projects (~2.0/1,000 SF). With somewhat limited transit access, the developer is likely counting on some bike commuters (on-site bike storage and showers) and employment densities typical of maker/warehouse tenants.

FIGURE 6.4: SUMMARY OF PARKING RATIOS

PROJECT	ADDRESS	CLASS/TYPE	YEAR BUILT	TOTAL OFFICE SF	PARKING TYPE	PARKING (/1,000 SF)
International Way	4560 SE Int'l Way	Suburban Class A	2003	60,600	Surface	4.0
224 Corporate Ctr.	6400 SE Lake Rd	Suburban Class A	2002	125,000	Surface	4.0
Day Wireless Bldg.	6430 SE Lake Rd	Suburban Class B/Flex	2017	16,500	Surface	3.4
Sunnybrook Ridge	8730 SE Sunnybrook	Suburban Class A/Medical	Prop.	27,200	Surface (+Structured)	1.4 (4.0)
Town Center Two	10135 SE Sunnyside	Suburban Class B	1997	36,500	Surface	3.5
Mt. Scott Prof. 2	9300 SE 91st Ave	Suburban Class A/Medical	2008	52,500	Surface	2.3
Woodstock Square	6030 SE 52nd Ave	Suburban Service	2016	14,800	Surface	1.3
Iron Fireman C.	4784 SE 17th Ave	Creative/Industrial Conversion	1925 ('17)	144,000	Surface	0.4
Dairy Building	2715 SE 8th Ave	Creative/Industrial Conversion	1937 ('17)	46,500	Surface	3.4
Clay Pavilion	120 SE Clay St	New Class A/Creative	2018 (UC)	75,000	Underground	1.1
New York Building	2104 NW York St	Multi-Story Industrial/Flex	2014	87,500	Gr.floor, Surface	1.5

SOURCE: JOHNSON ECONOMICS

PIPELINE SUPPLY

JOHNSON ECONOMICS has identified two projects with a total of 37,000 square feet of office space in the development pipeline within the defined PMA. One of these is Sunnybrook Ridge MOB, which was profiled in the preceding survey. As a medical building, it is primarily oriented toward the I-205 corridor population, and is not likely to represent direct competition with new projects in Milwaukie. The project has been granted land use approval, but is not likely to begin construction until it has secured pre-lease commitments for a significant share of its space.

The second project in the pipeline is a 10,000-square-foot professional/medical service building located east in Gladstone, at the intersection of Oatfield Road and 82nd Drive. It will be oriented toward the Gladstone population, and will not impact the supply-demand balance in Milwaukie. The project is in design review.

FIGURE 6.5: OFFICE SPACE DEVELOPMENT PIPELINE, PMA

PROJECT	ADDRESS	JURISDICTION	DEVELOPER	STORIES	ENTITLEMENT	DELIVERY	SF
Sunnybrook Ridge MOB	8730 SE Sunnybrook Blvd	Clackamas	MAJ Development	3	LU Approval	2019+	27,200
Clarendon Project	735 E Clarendon St	Gladstone	Mark Meek	2	LU Application	2018+	10,000
TOTAL							***37,200***

SOURCE: JOHNSON ECONOMICS

In addition to these two projects, we are aware of a pre-application conference for a smaller dental office at the intersection of 73rd Avenue and Foster Road in Portland. It is uncertain at this point whether this project will be realized.

VII. Market Depth Analysis

Demand Growth (2017-2022)

Johnson Economics makes projections for future office space demand by applying industry-specific rates for office space utilization to anticipated job growth in each industry. We operate with a high and low assumption for job growth, based on historical growth over the 2010-15 period and county-wide projections for the 2014-24 period (developed by the Oregon Employment Department, OED). The high-growth scenario assumes the highest of the historical and projected rates in each industry, while the low-growth scenario assumes the lowest. The only departure from this approach is for public administration, which experienced relatively steep job cuts over the 2010-15 period, something that we do not expect over the coming years. The low-growth assumption for this industry is therefore set to -0.5% per year, rather than the -5.1% rate observed over the 2010-15 period.

Note that the OED projections are conservative in nature, and have generally underestimated the job growth in recent years. We also regard historical rates from the 2010-15 period to be fairly conservative for the PMA, as this was a period of moderate growth within this geography.

Figure 7.1: Assumed Annual Employment Growth Rates, PMA (2017 – 2022)

Growth Assumptions		Historical & Projected Growth (AAGR)		Model Assumptions (AAGR)	
NAICS	Employment Sector	A) OED Projections, Clackamas Co., 2017-2022	B) Historical growth, PMA, 2010-2015	Low Assumption, 2017-2022	High Assumption, 2017-2022
51	Information	0.7%	2.8%	0.7%	2.8%
52-53	Financial Activities	1.0%	4.3%	1.0%	4.3%
54-56	Professional & Business	2.3%	3.9%	2.3%	3.9%
61	Education	1.8%	0.4%	0.4%	1.8%
62	Health Services	2.1%	0.6%	0.6%	2.1%
81	Other Services	1.2%	2.9%	1.2%	2.9%
92	Public Administration	0.3%	-5.1%	-0.5%	0.3%

SOURCE: Oregon Employment Department, U.S. Census Bureau, Johnson Economics

The assumed growth rates are applied to 2017 employment. Because estimates of 2017 employment is only available on the county level, and the most recent estimates for the PMA are from 2015, we apply county-wide growth over the 2015-17 period to 2015 PMA estimates in order to estimate 2017 employment in the PMA.

Based on the assumed growth rates and the typical share of office jobs within each industry (sourced from Urban Land Institute), we project between 1,200 and 2,600 new office jobs within the PMA over the next five years. The estimates indicate that new demand for office space will come primarily from professional/business service firms, which are projected to generate 940-1,650 new jobs over the period.

Figure 7.2: Projected Growth in Office Employment, PMA (2017 – 2022)

Office Space-Utilizing Demand		Base Year	2017	2022 Projection		*Office*	Office Space Employment			'17-'22 Change	
NAICS	Employment Sector	2015	Est.[1]	Low	High	*Share*[2]	2017	2022 Lo	2022 Hi	Low	High
51	Information	755	755	784	865	*90%*	680	705	778	26	99
52-53	Financial Activities	2,010	1,966	2,062	2,429	*90%*	1,769	1,855	2,186	86	416
54-56	Professional & Business	7,924	8,754	9,800	10,590	*90%*	7,878	8,820	9,531	941	1,653
61	Education	4,874	5,219	5,337	5,696	*10%*	522	534	570	12	48
62	Health Services	6,796	7,277	7,515	8,078	*40%*	2,911	3,006	3,231	95	321
81	Other Services	2,147	2,295	2,433	2,645	*27%*	620	657	714	37	94
92	Public Administration	721	756	737	767	*35%*	265	258	269	-7	4
TOTAL		***25,227***	***27,021***	***28,667***	***31,070***		***14,644***	***15,835***	***17,279***	***1,191***	***2,635***

1 2015-17 county-wide growth rates applied to 2015 estimates.
2 Share of office space-utilizing employment (Urban Land Institute), converted to NAICS categories by Johnson Economics

SOURCE: U.S. Census Bureau, Urban Land Institute, Johnson Economics

New office employment is converted to office space demand assuming an average of 175-250 square feet per employee, depending on industry. These assumptions are based on recent employment density analyses conducted by JOHNSON ECONOMICS. The resulting estimates of new space demand incorporate a vacancy assumption of 10 percent. In the low-growth scenario, total new demand over the coming five years is estimated to roughly 300,000 square feet, while the high-growth scenario indicates demand for 680,000 square feet. The mid-point of the two estimates is 490,000 square feet, or roughly 100,000 square feet per year.

FIGURE 7.3: PROJECTED GROWTH IN OFFICE SPACE DEMAND, PMA (2017 – 2022)

Office Space-Utilizing Demand		'17-'22 New Office Jobs		*Avg. Space*	New Office Space Need, '17-'22		
NAICS	**Employment Sector**	**Low**	**High**	***Per Job***	**Low**	**High**	**Mid**
51	Information	26	99	*175*	5,017	19,247	12,132
52-53	Financial Activities	86	416	*250*	23,961	115,690	69,825
54-56	Professional & Business	941	1,653	*225*	235,371	413,163	324,267
61	Education	12	48	*250*	3,285	13,252	8,268
62	Health Services	95	321	*250*	26,415	89,035	57,725
81	Other Services	37	94	*250*	10,345	26,240	18,292
92	Government	-7	4	*250*	-1,819	1,116	-351
	TOTAL	***1,191***	***2,635***		***302,574***	***677,743***	***490,158***

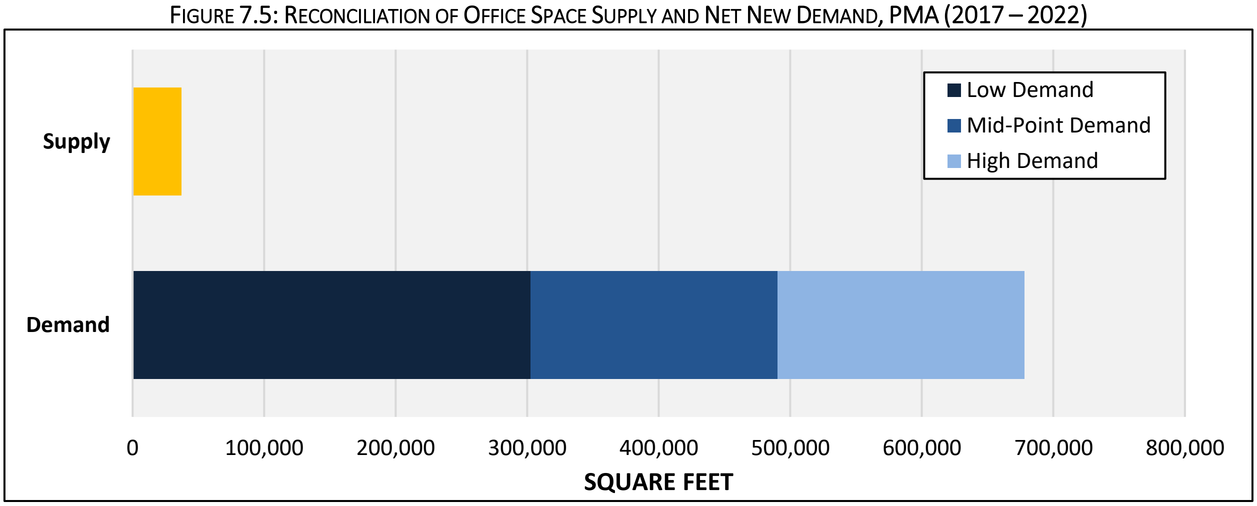
SOURCE: JOHNSON ECONOMICS

RECONCILIATION OF SUPPLY AND DEMAND

The demand estimates displayed above represent new employment growth, and do not consider existing pent-up demand in the PMA. As indicated earlier in this report, at the current vacancy rate of 2.0%, the market needs an additional 90,000 square feet of space to facilitate a 5% vacancy rate, and 220,000 to reach a 10% rate.

A comparison of estimated demand growth to the current office pipeline suggests that the PMA will continue to remain undersupplied over the coming years. The pipeline totals less than 40,000 square feet of space, which represents 7.3 months of absorption in the low-growth scenario, 3.3 months in the high-growth scenario, and 4.5 months with the mid-point demand estimate. Without additional space delivered over the forecast horizon, the increasing demand pressure is likely to cause accelerated rent growth in the PMA, while vacancy rates are likely to remain very low.

FIGURE 7.5: RECONCILIATION OF OFFICE SPACE SUPPLY AND NET NEW DEMAND, PMA (2017 – 2022)



SOURCE: JOHNSON ECONOMICS

DEMAND BY SPACE SIZE AND TYPE

The distribution of the new demand across size categories can be estimated based on the current (2015) distribution of office sector firms by size (number of employees). An alternative approach, which better captures current trends, is to base the estimates on the change in jobs by firm size category between 2010 and 2015. In the following, we use both approaches, as well as the average of the two, applied to mid-point demand estimates. The estimates assume metro-wide, industry-specific averages for employees per firm within each firm size category, and use the per-employee square footages assumed in the preceding analysis. The estimates indicate that most of the demand will be for spaces larger than 5,000 square feet, but with a concentration of demand also for spaces smaller than 1,000 SF.

FIGURE 7.4: PROJECTED GROWTH IN OFFICE SPACE DEMAND BY SQUARE FOOTAGE, PMA, MID-POINT DEMAND (2017 – 2022)

Size Distribution	Size Category (SF)						
	< 1k	1-2k	2-5k	5-10k	10-20k	20-50k	50k +
2015 Employment	63,000	29,000	42,000	74,000	49,000	75,000	159,000
2010-15 Growth	57,000	-20,000	-183,000	133,000	41,000	161,000	301,000
Average	60,000	4,000	-70,000	103,000	45,000	118,000	230,000

SOURCE: JOHNSON ECONOMICS

In terms of types of space that will be in demand, we expect a large share of the demand for the smallest spaces to come from population-serving users, dominated by financial and professional services firms. Medical providers are expected to account for only a small share of this demand (7-11% in the above analysis). These small service firms will likely prefer space in 1-2-story, multi-tenant buildings with high visibility and good access. In most cases, we believe 1-2 parking spaces per 1,000 square feet will be adequate for these users, though certain users that generate high customer/client traffic might prefer higher ratios.

We expect a minor share of the demand for smaller spaces to come from firms that do not directly serve the local population, including software/design contractors and technical services providers. These are less corned with visibility, and often do not need space for client visits. They are more likely to lease space in renovated creative buildings and potentially in co-working spaces in newer structures, though we have not yet seen examples of this in suburban parts of the Portland Metro Area. Based on the above analysis, we expect this demand to total 10,000-20,000 square feet over the next five years. However, demand for co-working space will also likely come from tele/virtual commuters working for larger firms.

Demand for spaces between 5,000 and 50,000 square feet is expected to be dominated by regional professional/administrative services firms and management establishments (36-66% of the demand). We expect most of these to prefer traditional space, though some will likely prefer more open creative space. The analysis also indicates that local education entities will contribute to demand (2% according to the 2015 distribution; 46% according to 2010-15 growth). The education segment is concentrated in the 5,000-10,000 square feet category, and will likely prefer traditional space. Parking needs associated with these users is typically in the 3-5/1,000 range in suburban areas without good transit access. In Downtown Milwaukie, we would expect a ratio around 1-2/1,000 to be adequate near the MAX station, while we expect sites in the north end to need close to 3/1,000.

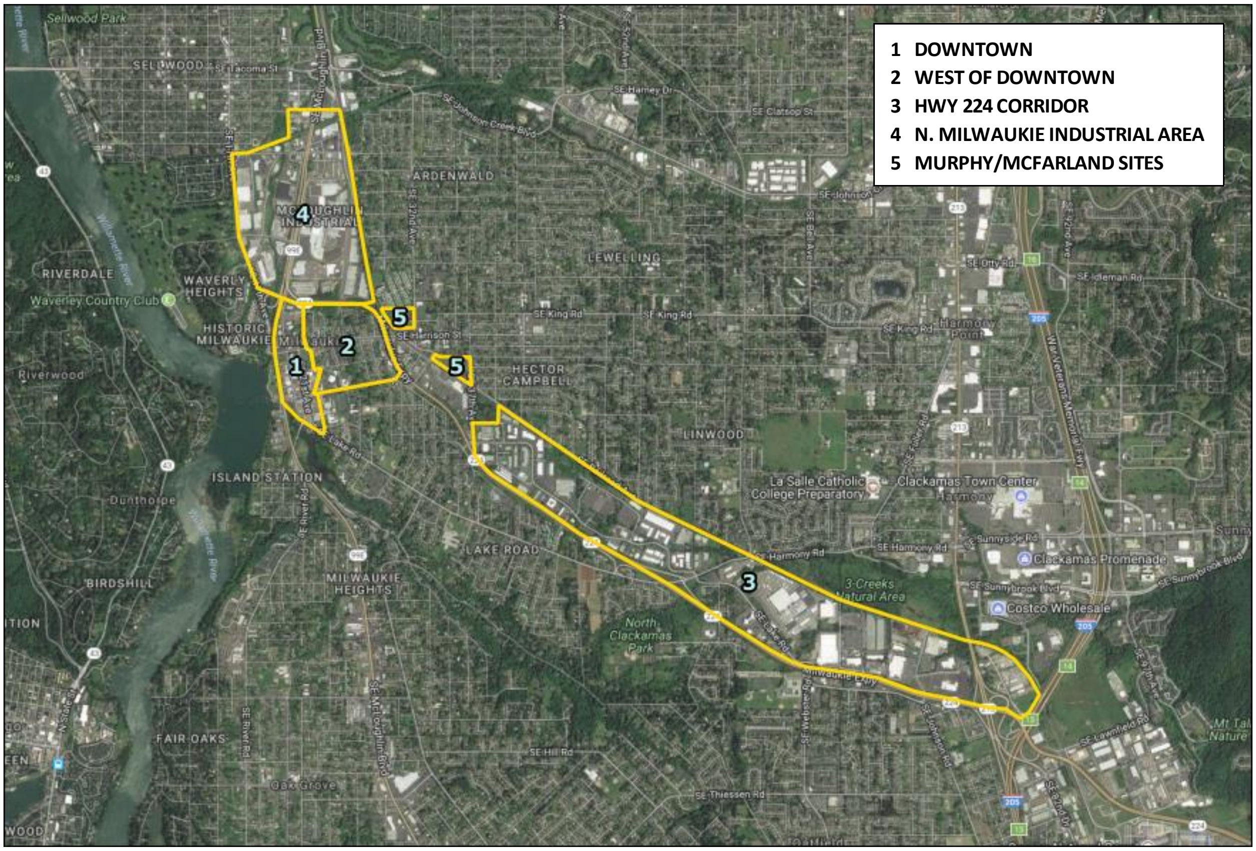
The demand for medical space in the 5,000-50,000 category is estimated to roughly 40,000 square feet. Growth in recent years suggests that one to two new users in the 20,000-40,000-square-foot range are the most likely scenarios, in line with nationwide consolidation trends in this industry. We expect parking ratios in the 2-3/1,000 range to be adequate for these users.

The analysis indicates a need for an additional 1-3 blocks with more than 100,000 square feet in the PMA over the next five years. Users of this scale often locate on single-user campuses. Though these have been rare in the current construction cycle, there are examples in Clark County of this type of development in recent years, both of the traditional and creative format (e.g., Fisher Investments and Banfield Pet Hospital HQ). These have suburban locations without good transit connections, and have parking ratios in the 3-6/1,000 range.

VIII. Subarea Evaluation

Johnson Economics evaluated the market potential for new office space in five subareas within Milwaukie based on our analysis of current market conditions and our projections for future space demand. The five subareas are Downtown, the area between Downtown and Highway 224, the Highway 224 corridor, the North Milwaukie Industrial Area, and the Murphy/McFarland sites.

Figure 8.1: Evaluated Subareas



SOURCE: Johnson Economics

The subareas that in our opinion are best positioned to attract new office development over the near term are Downtown and the Highway 224 Corridor. These areas have existing amenities attractive to office users, good access and visibility, and an established professional environment. These are features that appeal to professional/business service firms, which are projected to generate most of the new demand for office space in the coming years.

Downtown

Downtown has the potential for ground-up development of creative space as well as traditional class A space. The former has largely been limited to Central Portland, but there are recent examples also in smaller Downtown areas in our region.[3] In Portland, the trend is that this type of development is spreading beyond core central areas.[4] Given its proximity and transit connections to Portland, Milwaukie represents the next logical extension of current development patterns. Downtown also has the potential for creative space in converted or renovated structures.

3 E.g., the Hudson in Vancouver (101 E 6th St), Milwaukie Way in Sellwood (6637 SE Milwaukie Ave), Dakine Building in Hood River (603 Portway Ave).

4 E.g., Albina Yard in North Portland (4713 N Albina Ave), Hoodworks in John's Landing (5615 SW Hood Ave), and the Geode in SE Portland (2502 SE Division St).

FIGURE 8.2: RECENT CREATIVE OFFICE PROJECTS OUTSIDE CENTRAL PORTLAND

SOURCE: JOHNSON ECONOMICS

Downtown has the potential to attract population-serving as well as regional/national users, providing both exposure to the local population and access to a large labor pool via the MAX line, McLoughlin Blvd, and Highway 224. This dual appeal is already reflected in the current Downtown office market. The appeal to larger users is likely to increase in the future, as the large millennial cohort move into the family stage and relocate from Central Portland to surrounding areas with affordable single-family housing. We would expect parking needs to be around 3 spaces per 1,000 square feet for larger users in the north end of Downtown and 1-2/1,000 near the MAX station. 1-2/1,000 might also be adequate for smaller service tenants in the north end. We would expect Downtown to represent absorption capacity for 50,000-150,000 square feet over the coming five years, taking into account current pent-up demand.

We estimate that quality office projects in Downtown can achieve annual per-square-foot pricing in the $24-27 NNN range in the current market, with the upper end representing pricing for small service-user suites. This estimate is informed by previous analyses conducted by JOHNSON ECONOMICS, which have found that new creative space in Downtown areas tends to achieve triple-net rates roughly 10% over full-service rates in 2000s-vintage buildings. We would expect the latter to achieve full-service rates in the $22.00-24.50 range in Downtown Milwaukie today, based on observations from our competitive survey. Assuming annual rent escalation of 3.5% over the next two years, and applying the premium for new space, we would expect a Downtown office project with delivery in late 2019 to lease at around $26-29 NNN. For a large project oriented toward regional users, we would assume $26-28 NNN. The rates assume tenant improvement allowances of $50 per square foot.

WEST OF DOWNTOWN

The area between Downtown and Highway 224 represents weaker appeal to office users than Downtown, as it offers more limited visibility (except along Hwy 224), access to amenities, and professional environment. The most likely office development along east-west streets is small-scale projects of the population-serving format. However, we do not expect achievable pricing (estimated to $19-21 NNN in today's market) to be adequate for new construction projects in the near future. There are few vacant or underutilized sites along these streets, and a continuation of the existing use likely represents stronger economics than demolition and new construction, in most cases.

On sites along Highway 224, both population-serving and regional office projects are possible, though we expect achievable lease rates to be slightly below Downtown rates. In the current market, we expect $24-26 NNN to be achievable for service suites, and $23-25 to be achievable for a class A building with creative features targeting regional/national users. However, there are few sites that can accommodate this type of development along Highway 224 in this subarea, and existing uses may represent stronger economics than redevelopment.

HIGHWAY 224 CORRIDOR

The Highway 224 Corridor represents relatively strong appeal to large, regional office users, as it provides good access to the Southeast Metro labor pool. The area west of Harmony Road (Milwaukie Business-Industrial area) has the advantage of offering an established professional environment with tenant-oriented amenities, though parking constraints is an issue currently. The eastern portion offers stronger freeway access, but also represents a less attractive industrial environment, and more limited access to amenities.

Based on our competitive survey, the 224 Corridor is undersupplied in terms of office space, and thus represents potential for new development. Within the Milwaukie Business-Industrial area, there are few sites that are vacant or that represent strong redevelopment potential, and new office space supply is more likely to come from office expansions in existing flex buildings (at the expense of warehouse space) rather than new ground-up construction. The investments already made in office buildouts tend to prevent expansion of warehouse space in these buildings. And as these flex buildings represent an affordable alternative to new shell construction, the conversion of space tends to go in one direction, from warehouse space to office space. Over time, these flex parks therefore become office parks. This is a trend observed in other markets, for instance in Beaverton. In Milwaukie, this dynamic is most recently exemplified by a 5,500-square-foot office expansion at Audatex (4211 SE International Way). Large warehouse buildings with deep spaces, which are more difficult to convert to office space, may represent redevelopment potential, though the current pressure in the local warehouse market ensures strong profitability for most of these buildings currently. Limited parking capacity also reduces the potential for additional office space.

For a mid-size Class A project, we estimate current achievable pricing to be in the $23-25 range, NNN, in this subarea. Smaller buildings targeting population-serving firms may be feasible in the west end of the submarket, near the Milwaukie Marketplace, provided the sites have direct access and visibility from Highway 224. Sites close to the I-205 also represent some future potential for a large single-user campus with its own on-site amenities. Such projects are rare in the current market, as large white-collar employers gravitate to urban areas to woo Millennials. However, we expect this trend to see at least a partial reversion in the future, as the Millennials become parents and migrate to suburban areas. At that point, we expect suburban campus projects to be viable in this area, at rates comparable to mid-size class A rates.

NORTH MILWAUKIE INDUSTRIAL AREA

Potential for office development in the North Milwaukie Industrial Area (NMIA) is limited by its lack of amenities and its industrial environment. It does, however, offer good visibility along McLoughlin Boulevard and good regional access via McLoughlin Boulevard and the Milwaukie MAX line. It therefor represents some potential as a lower-cost alternative to Portland. A large office campus with its own on-site amenities might be a future possibility in this subarea, as in the east end of the Highway 224 corridor. Mid-size multi-tenant projects are less likely, as these are more dependent on an existing amenity base. A master planned development with concurrent retail/restaurant and office buildout is unlikely given multiple ownership and strong economics for current industrial uses.

The NMIA has some potential for warehouse-to-office conversion in the north end, near the MAX station. However, users attracted to this type of space tend to be relatively small, and the somewhat weak absorption to-date at the Iron Fireman Collective in the Brooklyn Rail Yard suggests limited market potential for large-building conversions. Moreover, the NMIA is at a disadvantage to the Iron Fireman Collective in terms of access to amenities and connection to urban areas. We therefore regard the market potential for this type of development to be very limited currently.

A commercial cluster with amenities like grocery store, lunch options, coffee shop, and fitness center would enhance the potential for new-construction or renovated multi-tenant projects in the NMIA. More pedestrian-friendly infrastructure and streetscape, with better linkages between the MAX station, the Springwater Trail, and areas south of the Springwater Trail would also enhance the redevelopment potential.

MURPHY/MCFARLAND SITES

The potential for office development at the Murphy and McFarland sites is limited primarily by a lack of visibility, though the rail line running along the two sites also represents a barrier and a nuisance. The sites have relatively good access to commercial amenities, but do not represent a walkable environment. We therefore regard the sites to have weak appeal to larger office users concerned with attracting labor. We regard the potential to be stronger vis-à-vis service users, as the proximity to the Milwaukie Marketplace allows for combined shopping/service visits. Medical users might also be attracted to the Murphy site due its proximity to the Providence Milwaukie Hospital.

We estimate current achievable lease rates at the Murphy and McFarland sites to be in the $19-21 range, NNN. A grocery store at the Milwaukie Marketplace will draw additional traffic to the area, which will likely increase achievable pricing for population-serving space at these sites.

FIGURE 8.3: SUBAREA EVALUATION

SUBAREA		COMPETITIVE STRENGTH	MOST LIKELY DEVELOPMENT	ACHIEVABLE PRICING (2017)
DOWNTOWN		**Strengths & Weaknesses** + Access to amenities + Access to light rail (south) + Access to Portland & SE Metro labor + Historic Downtown environment - Lack of freeway access - Limited parking Appeal to small firms serving local pop./businesses and to small/mid-size firms with larger service areas, seeking access to labor.	**Multi-tenant prof. service building** - 2 stories, 5-20k sf., 0.5-2.5k sf. suites - On sites with good access/visibility - 1-2 parking spaces per 1,000 sf. **Urban, mid-size class A/creative building** - 3-5 stories, 20-50k sf., 2k+ suites - 1-3 parking spaces per 1,000 sf. **Renovated creative space** - Renovation/converison of existing structures. Parking: 1-2/1,000 sf.	**Multi-tenant prof. service building** - Just below achievable retail rates - On par with Woodstock Square - $25-27 NNN **Urban, mid-size class A/creative building** - 10% prem. to 2000s vintage FS rates - $24-26 NNN **Renovated creative space** - Depending on standard, size/depth, and renovations: $20-27 NNN
WEST OF DOWNTOWN		**Strengths & Weaknesses** + Proximity to Downtown + Exposure to Hwy 224/Downtn. traffic - Limited traffic volume (except 224) - Lack of amenities - Lack of professional environment Some appeal to local service firms, though traffic exposure is limited off Hwy 224. Sites along Hwy 224 are best positioned, and can also attract larger firms with wider service areas.	**Multi-tenant prof. service building** - 2 stories, 5-20k sf., 0.5-2.5k sf. suites - On sites with good access/visibility - 1-2 parking spaces per 1,000 sf. **Mid-size class A building (along 224)** - 3-5 stories, 20-50k sf. - 3-5 parking spaces per 1,000 sf.	**Professional service building** - Rates dependent on exposure - $19-21 NNN along east-west roads - $24-26 NNN along Hwy 224 **Mid-size class A building (along 224)** - $23-25 NNN along Hwy 224
HWY 224 CORRIDOR		**Strengths & Weaknesses** + Access/visibility from Hwy 224. + Access from I-205 and SE Metro. + Office-oritened amenities (west) - Dated flex environment (west) - Industrial environment (east) Appeal to mid-size regional firms seeking access to SE Metro labor pool (Business-Industrial area). Potential for future large-user campus with own on-site amenities (east).	**Multi-tenant prof. service building** - 2 stories, 5-20k sf., 0.5-2.5k sf. suites - On sites with good access/visibility **Mid-size class A building** - 3-5 stories, 20-50k sf. - 3-5 parking spaces per 1,000 sf. **Large single-user campus (future, east)** - 3-5 stories, 100k+ sf. - 3-5 parking spaces per 1,000 sf. - Owner-user or build-to-suit	**Professional service building (west)** - Just below achievable retail rates - $24-26 NNN near M. Marketplace **Mid-size class A building** - NNN on par w/2000s FS rates - Near Sunnybrook Ridge rate - $23-25 NNN, dep. on access/visibility **Large single-user campus (future, east)** - Future rates comparable to rates for mid-size class A (currently $23-25)
N. MILWAUKIE INDUSTRIAL		**Strengths & Weaknesses** + Access to light rail (north) + Proximity to Portland + McLoughlin access/visibility - Industrial environment - Lack of amenities - Lack of freeway access Some appeal to large campus users with own on-site amenities. Possible future play oriented toward Millennial workers living in SE Metro.	**Large single-user campus (future)** - 3-5 stories, 100k+ sf. - 3-5 parking spaces per 1,000 sf. - Owner-user or build-to-suit - Most likely along McLoughlin Blvd.	**Large single-user campus (future)** - Future rates along McLoughlin Blvd comparable to rates in the Hwy 224 Corridor (currently $23-25 NNN)
MURPHY/MCFARLAND SITES		**Strengths & Weaknesses** + Access from Hwy 224 + Some exposure to residential traffic + Access to amenities - Limited visibility - Along active rail line Some potential for professional service project, with tenants targeting local population/businesses.	**Multi-tenant prof. service building** - 2 stories, 5-20k sf., 0.5-2.5k sf. suites - 1-2 parking spaces per 1,000 sf.	**Multi-tenant prof. service building** - Below M. Marketplace rates - $19-21 NNN

SOURCE: JOHNSON ECONOMICS