

2012 REPORT & FORECAST

Portland Metro

By: Thomas Marcus

1231 NW Hoyt #201
Portland, Or 97209
Ph: 503.224.6743
Fax: 503.224.7933
Thomas@tfn-ire.com

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It's a great time to be a part of the apartment market. Currently, apartments are experiencing exceptional value appreciation and rental growth. This is especially true here in the Portland area which has been ranked in the top ten metro areas with the lowest vacancy rate by Reis in its fourth quarter 2011 report.

What is going to happen over the next year?

Apartment values may well be at historic highs.

Here's why:

1.) **The Recession**- The move away from home ownership is tied primarily to the foreclosure crisis. Clearly we are seeing the pitfalls of this now. Over the past five years, millions of people have lost homes in foreclosures and now have bad credit ratings. Because they can't meet the tighter lending standards for new mortgages, they won't be able to buy houses for years - if ever.

Moreover, the Unemployment Rate for many U.S. cities hit double digits - Oregon peaked at 11.5% in July of 2009. The weak job market and slow wage growth are making it harder for Americans to come up with down payments or qualify for loans, forcing many to vacate their homes and move into apartments.

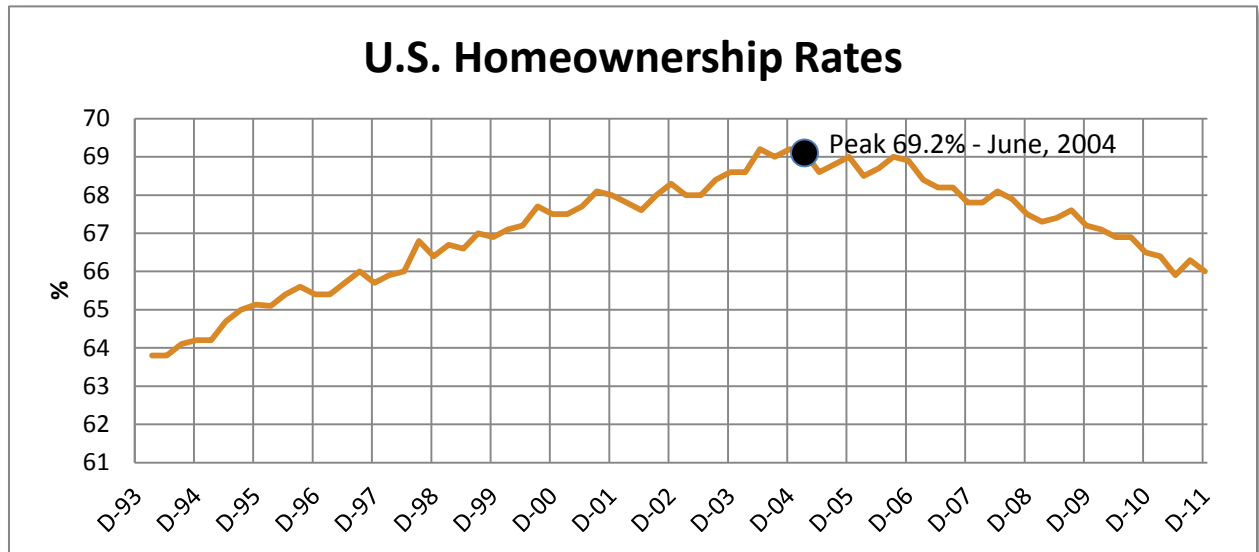
2.) **Change of thinking** - Owning a large home in the suburbs was a sensible plan in the past because energy was cheap. People could afford to air condition lots of space with high ceilings and fill their gasoline tanks for long commutes. Fifteen years ago, gas cost about \$1.20 a gallon. Today, the price averages around three times that.

With energy prices rising, the total cost of maintaining the suburban lifestyle has increased. Instead of buying gas for long commutes, many people look to cut costs by renting an apartment closer to their workplaces. In addition, many renters want to be within walking distance of shopping and dining. Renting also improves worker

Portland Area Highlights:

- Low Vacancy
- Historically low interest rates
- Strong rent growth
- Limited available supply for the short term

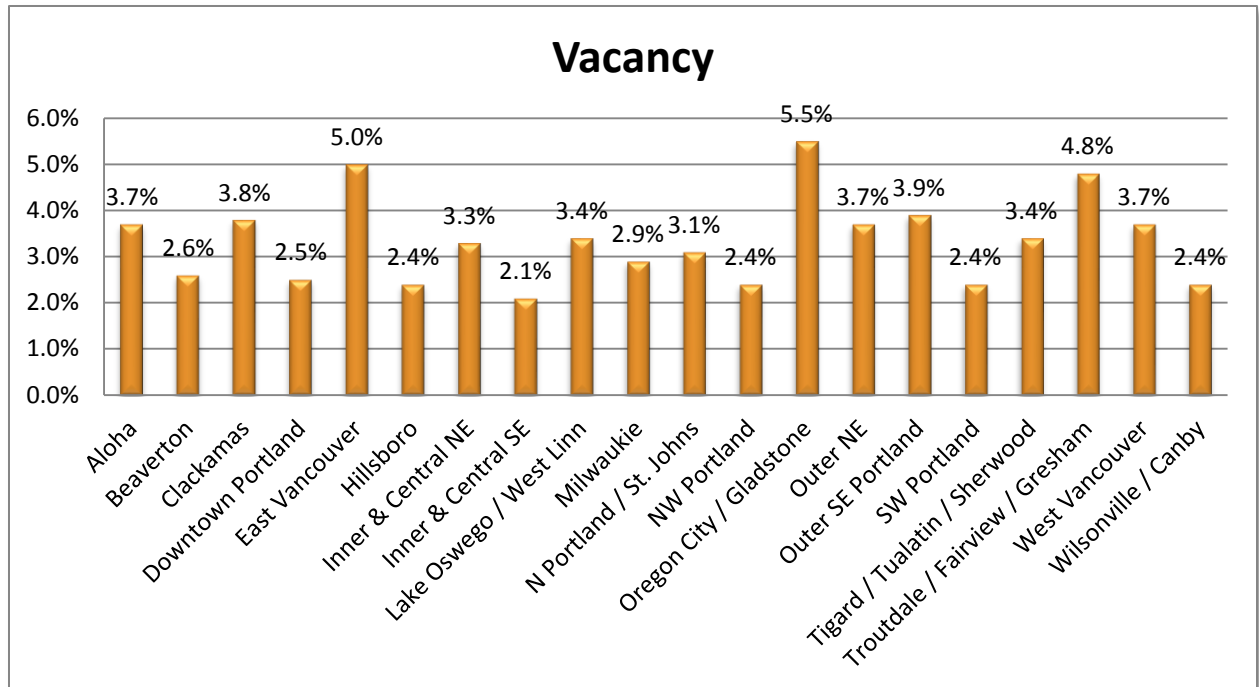
mobility. If someone owns a home, they may not be able to sell in time to pursue new job opportunities in other parts of the country.



Source: U.S. Census Bureau

This shift toward renting is reflected in the Census Bureau's home ownership statistics. The ownership rate jumped to a record 69.2 percent by 2004. After the housing crisis began in 2007, home ownership rates started dropping. As of the fourth quarter of 2011, the rate is 66.0 percent - the lowest level since June, 1998.

3.) **Increased demand / limited supply** – The Portland apartment market has seen an upturn in demand, yet there is a lack of current supply available. According to the Fall 2011 Metro Multifamily Housing Association Report, in 2011 the Portland Metro area had only 1,500 new units built compared to the ten year average of 4,000, with even fewer being built in 2010. A combination of constrained supply and demand growth means one thing – an upsurge in occupancy.

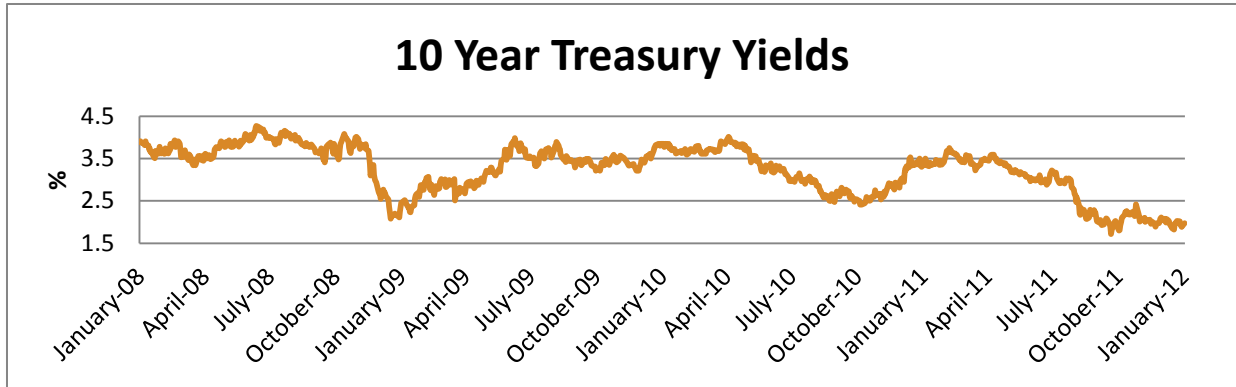


Source: 2011 MMHA Fall Report

In addition, the tri-county area has the Urban Growth Boundary to control urban sprawl by mandating that the area inside the boundary be used for higher density urban development and the area outside be used for lower density, which limits development.

4.) **Other commercial assets became too risky** – The slumping economy weighed heavily on office, industrial, and retail properties. High unemployment, reduction in consumer demand as well as spending all took their toll on these commercial assets with declining occupancy and shrinking rents. In turn, investors saw a drop in cash flow as well as a rise in perceived risk in holding these properties which caused prices to drop substantially. As a result, they focused on more attractive, stable assets – apartments.

5.) **Record low interest rates** – The Federal Reserve has made its priority to spur the economy by keeping the cost of lending artificially low by reducing the Federal Funds Rate.



Source: www.treasury.gov

In August, 2011 and then again in January, 2012 the Federal Reserve indicated plans to keep "exceptionally low" interest rates in place to prop up the recovery. The latest is the Central Bank expects to keep the Federal Funds Rate near historic lows until late 2014. The expressed time horizon is an unusual move because the Fed typically will not signal its policies this far in advance. What this means? Interest rates will continue to stay low.

6.) Little salvation for savers – Yields for savings accounts and CD's are pegged to the return on U.S. Treasuries. Given that they are at historic lows, so too are the yields on savings accounts, CD's as well as corporate bonds. Investors respond by looking for relatively safe assets with reliable returns - apartments meet their criteria.

7.) Volatile Stock Market -



Source: Yahoo Finance

In 2011, the S&P 500 ranged anywhere from 1,074.77 - 1,370.58 in 2011, a difference of 27.5% from the low to high. Investors can make money relatively quickly or watch the money disappear in an instant. U.S. political squabble over the debt limit? Crisis in the Eurozone? Remember 2008? More so, the calendar year ended flat, with the S&P 500 starting at 1257.64 and ending at 1257.60.

8.) Irresistible financing for multifamily – Apartments are investment assets; however, they can fall under Fannie Mae / Freddie Mac / HUD financing requirements because they are residential. Also, given the increase in demand, other institutions (banks, life companies, etc.) have strongly returned to multifamily financing. Therefore, interest rates are much lower and loan-to-value ratios (LTV) are much higher when compared to other commercial assets, so more product can be bought for lower debt service by investors.

What's on the Horizon?

The Portland apartment market is strong. The expectation is for this trend to continue. Vacancy is incredibly low at 2.7% in the Portland Metro area according to the REIS 4Q2011 Report, and rental rates have climbed 8% over the past year.

The combination of rising demand, lack of available supply and low borrowing rates have compressed capitalization rates and will continue to do so until interest rates increase and new product becomes available in the market.

Buyers are starting to realize the strength in the Portland apartment market. With the positive attention, transaction volume is expected to increase over the next year. **In addition to the optimism, there is added pressure from changes with the tax code which should influence investors to restructure their holdings, further increasing activity.** Investors who are seeking to depart the market may be encouraged to do so before the potential increases in the capital gains tax while investors looking to take advantage of historically low interest rates will be waiting to buy.

Please give me a call if you would like more information regarding the multifamily market, are looking to purchase or want a **free value estimate for your property.**



Thomas Marcus has been involved with commercial real estate since graduating Oregon State in 2007. After spending two years in appraisal as an analyst and consultant, he currently focuses directly on multifamily projects in the Portland Metro and surrounding area. He has worked on a number of projects during the acquisition, marketing and disposition phases and has helped successfully close over \$45,000,000 worth of apartment transactions.

